

OUR TWO CENTS

October
2024

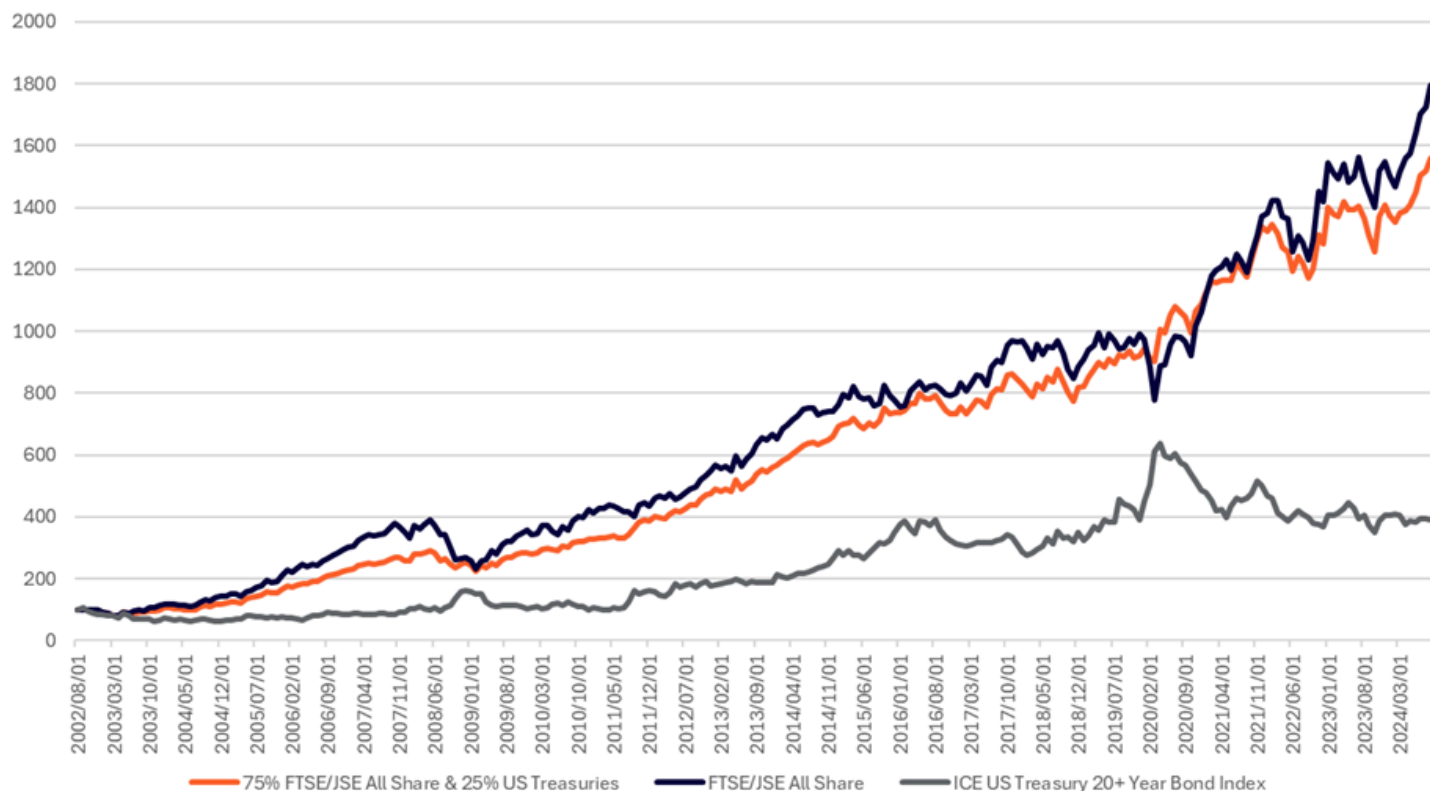


The Protection Potential of US Treasuries

Offshore income is an often overlooked building block in multi asset portfolios, especially since global yields have been low. Ignoring this asset class, however, results in South African investors missing out on the benefits of this asset class beyond simply looking for yield.

Offshore income offers a wide variety of investment opportunities ranging from corporate credit instruments of various credit ratings to bonds issued by specific countries. While it may be tempting to look to global corporate credit for yield, doing so will overlook the powerful risk protection that US treasuries offer to South African investors. Since US treasuries are a safe haven asset class, drawdowns in equity markets are usually offset by US treasuries rallying. These conditions are often accompanied by a strengthening of the US dollar giving South African investors a further boost from Rand depreciation. The effect of this protection is demonstrated in the following chart which shows the performance of the FTSE/JSE All Share Index (ALSI), long dated US government bonds and a portfolio composed of 75% ALSI and 25% US treasuries.

FTSE/JSE All Share & US Treasury Performance



	Return	Volatility	Maximum Drawdown
75% FTSE/JSE All Share & 25% US Treasuries	13.49%	11.97%	-22.40%
FTSE/JSE All Share	14.17%	15.48%	-40.44%
ICE US Treasury 20+ Year Bond Index	6.80%	22.02%	-44.58%

Source: Morningstar Direct

Although both the ALSI and US treasuries are volatile, investors benefit from the negative correlation of -0.18 between the two asset classes. The portfolio has a volatility of 11.97% and maximum drawdown of 22.40% compared to the ALSI which has a volatility and maximum drawdown of 15.48% and 40.44% respectively. Despite the lower return of the portfolio relative to the ALSI, there is a substantial improvement in risk adjusted returns. The Calmar ratio of the portfolio was 0.60, nearly double the Calmar ratio of the ALSI which was 0.35! This shows that the investor is getting substantially more value in the reduced maximum drawdown of the portfolio than what they give up in returns.

Offshore income is a diverse asset class with a lot of potential to add value to a multi asset portfolio. US treasuries are particularly useful to South African investors thanks to the double benefit of both US treasuries and the US dollar rallying with risk off sentiment. The negative correlation between the ALSI and US treasuries provides South African investors with a powerful risk management tool that should not be ignored.



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Michael joined as an investment analyst and has an MPhil (Financial Management Sciences) cum laude specialising in economic psychology and has passed the CFA level 3 exam. Prior to starting at New Road Capital, he worked as assistant lecturer at the University of Pretoria assisting with quantitative investment analysis. He has built and traded on models using CFDs. Outside of work, he enjoys flying motor gliders from Springs airfield as well as sailing his Laser class sailboat.