

Benefits of agricultural asset classes in managing investment portfolios

Illustrative case: South African farmlands

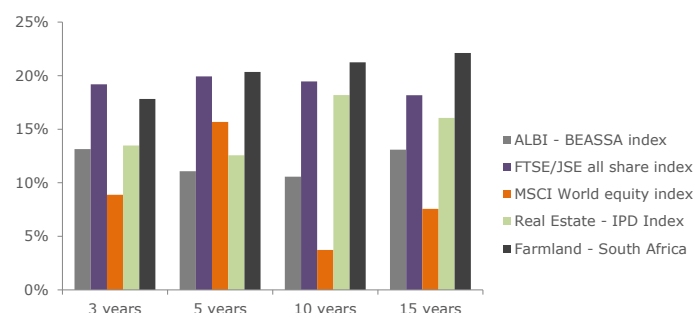
Research: 2013

Amid recent economic turmoil and volatile investment climate, there has been a renewed interest for asset classes with strong capital preservation characteristics, low or negative correlation to stocks and bonds and superior performance in an inflationary environment. Using the case of South African farmland as an example, this document intends to illustrate how the inclusion of farmland assets in a diversified portfolio will provide long-term horizon investors the stability and higher risk adjusted return they are looking for.

South African farmland asset class

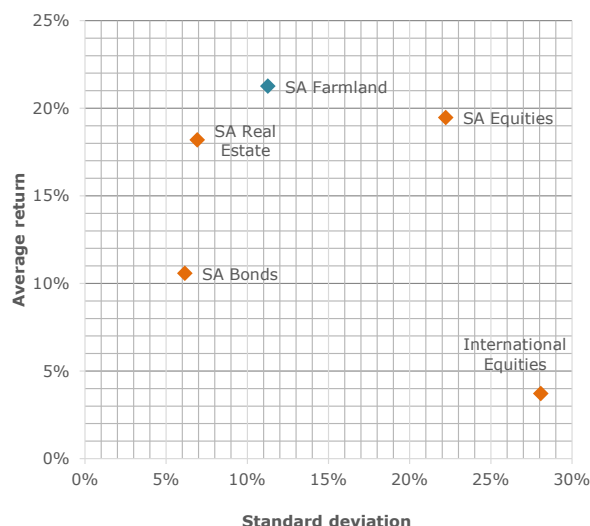
We have used a time series data which covers a period from 1999 to 2013 and for which data on South African farmlands was available. Historical return on South African farmland is based on historical price information for agricultural properties that have been transacted in each year. The return from farmland assets is made of two main components, net rental cash return on property and indirect return on asset or capital gain.

graph 1. Average return asset classes



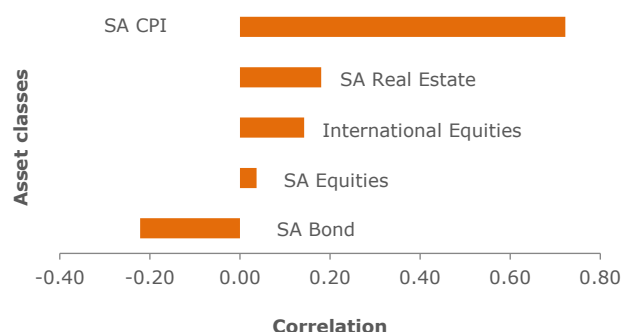
As it can be seen on the graph 1, investments on South African farmland have consistently yielded a higher return in comparison to local and international equity indices (FTSE/JSE and MSCI World), local bond index (ALBI BEASSA) and local real estate (IPD index) over the medium- to long-term.

graph 2. Risk/return profile asset class



Compared to other asset classes, SA farmlands have produced higher returns with moderate volatility. Volatility of farmland investments can be further reduced when assets are leased to an agri-operator, thereby mitigating operational and commodity risks. In general, farmland behaves differently from traditional stock indices and bond markets, providing a natural protection tool against market volatility.

graph 3. Correlation of SA farmland with other assets



Graph 3 demonstrates that SA farmland returns have consistently exhibited negative or low correlation with stock returns (local and international) and high correlation with inflation and therefore investors may use it as an effective hedge in times of higher inflation while offering an opportunity for portfolio diversification.

Portfolio diversification

Investment policy adopted by investors is crucial as it will determine more than 90% of their portfolio performance (1). During that process, they will decide which asset classes will be included in the portfolio (capital allocation) and what would be the respective weight allocated to each asset class (asset allocation).

We have seen that different asset classes are not perfectly correlated, as such, there are high benefits to be obtained from diversification, especially real estate and farmland which have shown increasing performance results over the past decade. This has led investors and fund managers to increasingly reconsider their positions in these assets over the last few years.

To illustrate the impact of including farmland asset in a portfolio, we have constructed five basic portfolios ranging from one-asset portfolio to a multi-asset portfolio.

Sources for graphs: MSCI (International equities); Bloomberg (Local bond and equities); IPD (Real Estate); SA Stat, HSRC and UFF (Farmland)
(1) Brinson, Gary et al. "Determinants of Portfolio Performance." Financial Analysts Journal, Vol. 42, No. 4

table 1. Illustrative portfolios

	portfolio 1	portfolio 2	portfolio 3	portfolio 4	portfolio 5
International Equities	100%	60%	50%	50%	40%
Local Fixed Income	-	40%	40%	30%	30%
Local Equities	-	-	10%	10%	10%
Local Real Estate	-	-	-	10%	10%
Local Farmland	-	-	-	-	10%
Total	100%	100%	100%	100%	100%

Farmland investments bring key benefits to a portfolio through real return strategies (i.e seeking maximum real return, consistent with prudent investment management).

Table 2 shows that positive changes in performance (annualised returns) and risk (annualised standard deviation) are experienced after the spread of investments over several asset classes. A diversified portfolio with 10% of assets allocated to farmland yields a risk adjusted performance of 1.47 (portfolio 5) as opposed to a diversified portfolio excluding farmland assets (portfolio 4) and yielding a risk adjusted performance of 1.30. Last but not least, optimal diversification is crucial in order to increase the returns, regardless of the asset allocation.

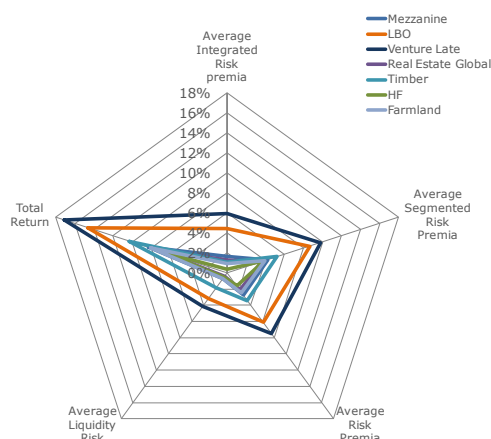
table 2. Expected return of diversified portfolios

	portfolio 1	portfolio 2	portfolio 3	portfolio 4	portfolio 5
Portfolio expected return	7.56%	9.77%	10.83%	11.13%	12.59%
Variance	0.00378	0.00863	0.01103	0.00736	0.00738
Standard deviation	6.146%	9.291%	10.501%	8.579%	8.590%
Risk adjusted performance - return/risk ratio	1.23	1.05	1.03	1.30	1.47

Liquidity considerations

One of the main concerns of investors towards farmland investments is the lack of liquidity and the lock-up period. Findings from our large database on farmland transactions, compiled of farmland transaction sample/data from 1994 to 2008 in South Africa (2) indicates that the South African land market is liquid. In fact, an average of 5.5% of commercial farms are transacted per annum which is about 4.4 million hectares and more than 20% of farms bought in 1995 are resold by 2008. Similar trends were also found in other southern African countries such as Namibia.

graph 4. Liquidity risk alternative investments



Globally, farmland compares favorably to other alternative asset classes such as private equity, hedge funds or infrastructure investments (3) as illustrated in graph 4.

Conclusion

Farmland investments provide an attractive risk-return combination over time due to a strong appreciation of land coupled with competitive income returns. Commodity prices are likely to rise in the future, hence increasing profitability, due to increasing supply deficit and negative supply impacts (for example climate change). We believe that pension funds and private investors should consider farmland as part of an alternative investment allocation.

Old Mutual African Agricultural Fund

The Old Mutual African Agricultural Fund (OMAAF) invests directly in farms that will be developed and managed in partnership with locally-based large-scale agricultural operators. The main objective of the Fund is to enable investors to gain exposure to the attractive African agricultural sector and provide them with strong income return and capital appreciation.

The Fund provides both institutional and private investors with in-class diversification with 60% of its capital allocated in farmland, 30% in agricultural crop commodities and 10% in liquid assets. In terms of geographical diversification, 50% of the Fund's investment will be dedicated to South Africa and 50% in the rest of Africa.

The OMAAF is aimed at investors who are looking for investments which provide long-term financial return combined with positive social impact on the African continent.

In brief: Why should investors consider investing in the Fund?

- Favourable long-term fundamentals.
- Attractive investment opportunities in Africa with low-valued, premium farmland and agribusinesses.
- Considerable in-class diversification opportunities.
- Inflation-beating return potential.
- Low/negative correlation with stocks and bonds.
- Multiple sources of income (lease, capital appreciation & value creation from operating efficiencies).
- Competitive risk-adjusted total return.
- Significant social and development impacts.
- Political Risk mitigated through MIGA.

(2) SA Human Sciences Research Council, SA Deeds Office, SA Stats.

(3) UBS Global Asset Management, "Modeling Illiquidity Premium for Alternative Investments". 2008

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Important notice

Old Mutual African Agricultural Fund (Luxembourg) ("the Fund") has been incorporated for an unlimited period under the laws of the Grand Duchy of Luxembourg as a "societe d'investissement a capital variable (SICAV) under the form of a "societe anonyme" on 31 May 2012 organised under Part II of the Law of 2010.

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More detailed information on the risks and investment strategy can be found in the Prospectus of the Fund.



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