

# The Investment Analysts Journal

Number 12 August 1978

# Die Beleggings- Navorsers Tydskrif

Nommer 12 Augustus 1978

## Die Beleggings-Navorsers Tydskrif

Nommer 12 Augustus 1978

## Inhoud

---

### This issue in brief

#### Factors affecting dividend policy

**P. J. C. Seneque**

Although most lay investors take it for granted that the payment of dividends affects the market value of securities, this view has come in for a great deal of academic criticism in recent years. Two schools of thought on the subject have emerged, the one arguing that dividends are important in that they represent an aspect of investment return possessing a lower order of risk than do capital gains; the other that it is really capital gains, or their prospect, that motivate the purchase of equity securities. Prof Seneque's article looks at the nature of dividends against the background of the objectives of modern corporate enterprises and examines this controversy in detail. Although he does not resolve it, he concludes that empirical evidence provides some support for the notion of a positive dividend policy.

#### Strategic considerations for investment decision-making

**G. S. Andrews**

Corporate strategy is a comparatively new area of the science of financial management and one probably neglected by most investment analysts, and yet without a knowledge of the strategic objectives of a firm it is not possible properly to evaluate its performance. In his article, Mr Andrews draws attention not only to the fallacies which underly the traditional approaches of bankers and investors to the problems of evaluation but explains what is meant by strategy and how a knowledge of it can be used in practice. In doing so he places particular emphasis on the relationship between the firm and its environment and on the need for planning and anticipation on the part of management, regarding environmental change, in contrast to the need, purely, for adaptation.

#### Investment decisions in an inflationary economy

**Tamir Agmon**

The existence of high rates of inflation in most world economies today is a cause of many difficulties for businessmen for it affects their day-to-day decisions of management as well as their real investment in new productive capacity. Prof Agmon is particularly well qualified to discuss the matter of inflation and corporate performance for he is a senior lecturer at the Tel Aviv Business School and Israel is a country which has suffered in a unique way from an excessive and protracted increase in its price level. Prof Agmon's article deals with the responsibility of governments for inflation, its real effects on business decisions, the role of fiscal policy in an inflationary environment and the solutions open to financial management in adapting to it.

Factors affecting dividend policy <i>Prof P. J. C. Seneque</i> .....	8
Strategic considerations for investment decision-making <i>G. S. Andrews</i> .....	19
Investment decisions in an inflationary economy <i>Prof Tamir Agmon</i> .....	24
Thin trading and tests for stock market efficiency <i>Dr P. J. Strebel</i> .....	29
An econometric approach to exchange rate forecasting <i>A. D. Cohen</i> .....	32
Investment basics — III <i>W. T. Floquet</i> .....	38

---

### **Thin trading and tests for stock market efficiency**

**P. J. Strebel**

In their reply to Dr Strebel's assertion that the efficient market hypothesis could at best be regarded as a half truth as far as the JSE was concerned (see issues Nos. 10 and 11 of this journal), Messrs Gilbertson and Roux had some sharply critical things to say of the methodology and logic of Strebel's approach to technical issues. This article is Dr Strebel's rejoinder. Without ignoring the complexities of the subject or academic properties, Dr Strebel hits back in kind. His argument is persuasive and should be of interest even to non-mathematical readers.

### **An econometric approach to exchange rate forecasting**

**A. D. Cohen**

This article by Mr A. D. Cohen describes an econometric model for the forecasting of exchange rate changes. With the recent decline in the exchange value of the dollar, attention has focused again on the position of the rand. Will this remain linked to the dollar or is the time approaching when the link will have to be broken? Mr Cohen does not answer these questions but he does suggest a way in which others can come to grips with them.

### **Investment basics — III**

**W. T. Floquet**

This is the third article in our series entitled 'Investment Basics'. Its subject is the calculation of earnings per share and the value of the P/E ratio as an investment tool. Mr Floquet knows his subject well and his treatment of it should be helpful to seasoned analysts as well as beginners.

---

# The Investment Analysts Journal

# Die Beleggingsnavorsers Tydskrif

---

Twelfth issue

August 1978

Revolutions are difficult to classify generically. Some relate to violent change in the structure of society; some to change in the ideas of men which is no less profound in its disruption of an established order. Some are effected quickly, the new overtaking the old, as it were, overnight; some work their way out only slowly, their change not always perceptible to those immediately affected by them. The revolution currently taking place in the world of finance is one essentially of the last mentioned kinds. It is a revolution of ideas and it is slow working but it is no less a revolution for being so, and when it has run its inexorable course, the transformation in thinking will be no less complete and dramatic.

The change in thinking to which reference is made here is that which started in 1952 with the publication of Harry Markowitz's now famous article in the *Journal of Finance* entitled "Portfolio Selection". For those familiar with what has been happening in recent years in the theory of finance, with the emergence to widespread use in the United States and other advanced market economies of beta coefficients and the application of systematic as opposed to purely intuitive procedures in portfolio management, it may seem incredible that it is now twenty-six years since Markowitz's article first appeared. But it is and that is a fact to wonder at no less than the fact that for a great number of practising investment analysts in South Africa and elsewhere, the works of Markowitz and his disciples still remain obscure to this day.

There was, of course, a reason why Markowitz's 1952 article and even his book of the same name which appeared in 1959 made only a small initial impact. Both treated their subject mathematically and both were concerned with explaining a highly complex system. It was not until William F. Sharpe, Professor of Finance at the Stanford Business School, published his book on portfolio theory and capital markets, that Markowitz's ideas were sufficiently simplified to be adaptable for use with the aid of modern digital computers. Of course, there has also been a great advance in computer technology and today that technology is available to a greatly expanded number of users at substantially reduced cost.

What is really interesting about these present developments in the fields of corporate finance and portfolio selection is not that they started in the academic ivory tower and have only slowly descended into the market place; it is that they have been linked to a great deal of empirical research and substantiation. It is not, as has often been the case with economic theory, that hypotheses have been developed which have relied purely on deductive reasoning for their authority. The theory of portfolio selection and capital markets is empirically supported, and for this reason, if for no other, it is theory which practitioners ignore at their cost.

Twaalfde uitgawe

Augustus 1978

Dit is moeilik om rewolusies generies te klassifiseer. Sommiges hou verband met hewige veranderings in die sosiale struktuur; ander met veranderings in die idees van mense, wat nie minder diepgaande is in die ontwrigting van 'n gevestigde orde nie. Sommiges word blitsvinnig ten uitvoer gebring, en die nuwe oorweldig die oue as 't ware oornag; ander speel hulle stadig uit, en die verandering wat daardeur teweeggebring word, is nie altyd waarneembaar deur diegene wat onmiddellik daardeur geraak word nie. Die rewolusie wat tans in die wêreld van finansies aan die gang is, is een wat in wese tot laasgenoemde soort behoort. Dit is 'n rewolusie van idees en die werking daarvan is stadig, maar is daarom nie minder 'n rewolusie nie, en wanneer dit sy onverbiddelelike gang gegaan het, sal die metamorfose van denke nie minder volledig en dramaties wees nie.

Die verandering in denke waarna hier verwys word, is die verandering wat in 1952 met die verskyning van Harry Markowitz se nou beroemde artikel in die *Journal of Finance* onder die titel "Portfolio Selection" begin het. Vir diegene wat vertrou is met wat die afgelope jare aan die gebeur is in die teorie van finansies, met die verskynsel van die uitgebreide gebruik in die Verenigde State en ander moderne markeconomieë van betakoëffisiënte en die toepassing van sistematiese, gestel teenoor suiwer intuïtiewe, prosedures in portefeuljebestuur, lyk dit miskien ongelooflik dat dit nou ses en twintig jaar is sedert die verskyning van Markowitz se artikel. Maar dit is nietemin 'n feit, en 'n feit wat net so vasstaan as dat die werke van Markowitz en sy volgelinge vir 'n groot aantal praktiserende beleggingsnavorsers in Suid-Afrika en elders tot op hede onbekend bly.

Daar was natuurlik 'n rede waarom Markowitz se artikel van 1952 en selfs sy boek met dieselfde titel wat in 1959 verskyn het aanvanklik slegs beperkte ingang gevind het. In albei is die onderwerp wiskundig behandel en was die skrywer gemoeid met die verduideliking van 'n uiters komplekse stelsel. Dit was eers toe William F. Sharpe, professor in Finansiële by die Stanford Business School, sy boek oor portefeuljeteorie en kapitaalmarkte die lig laat sien het, dat Markowitz se idees voldoende vereenvoudig is om aangepas te kan word vir gebruik met behulp van moderne syferrekenaars. Daar is natuurlik ook heelwat vordering gemaak met rekenaartegnologie en vandag is dié tegnologie teen aansienlik verlaagde koste tot beskikking van 'n heelwat uitgebreide getal gebruikers.

Wat werklik interessant is omtrent dié huidige ontwikkelings op die gebiede van maatskappyfinansies en portefeuljeseleksie, is nie dat dit in die akademiese ivoortoring ontstaan het en slegs stadig na die vlak van die mark afgedaal het nie; dit is dat dit gepaard gegaan het met 'n groot mate van empiriese navorsing en bevestiging. Dit is nie, soos al so dikwels die geval was

---

At the moment, the financial transformation in South Africa is still very much in its formative stages. Its arena is the universities, one or two leading companies and the columns of this journal: most executives concerned with corporate finance and professionals concerned with investment management remain largely unaware about it. But as more and more graduates emerge from the business schools and business colleges and assume positions of responsibility in commerce, industry and our financial institutions, the ideas that are already widely accepted and used overseas will take deeper root here too. When that happens, the probability is that the gap that presently divides protagonists and opponents of the efficient market hypothesis will be narrowed because one of the effects of a wider application of the principles involved will be to improve the efficiency of the market place.

THE EDITOR

met ekonomiese teorie, dat hipoteses ontwikkel is wat vir hulle geldigheid uitsluitend op deduktiewe redenering staatgemaak het nie. Die teorie van portefeuljeselektering en kapitaalmarkte word empiries gesteun en om dié rede, al is dit om geen ander nie, is dit 'n teorie wat praktisyns tot hulle eie nadeel verontagsaam.

Op die oomblik verkeer die finansiële metamorfose in Suid-Afrika in 'n groot mate nog in die vormingsstadiums. Die strydperk waar dit afspeel is die universiteite, een of twee toonaangewende maatskappye en die rubrieke van hierdie tydskrif; die meeste mense in uitvoerende posisies wat betrokke is by maatskappy-finansies en professionele mense wat betrokke is by beleggingsbestuur bly grootliks onbewus daarvan. Maar namate al hoe meer gegraduateerdes deur besigheidskole en besigheidskolleges opgelewer word en verantwoordelike poste in die handel, nywerheid en ons finansiële instellings vul, sal die idees wat in die buiteland reeds alom aanvaar en toegepas word, hier ook dieper wortel skiet. Wanneer dit gebeur, is dit waarskynlik dat die gaping wat tans die voor- en teëstanders van die hipotese van doeltreffende markte skei, vernou sal word omdat een van die uitwerkings van 'n algemener toepassing van die betrokke beginsels sal wees om die doeltreffendheid van die mark te verbeter.

DIE REDAKTEUR