

The Investment Analysts Journal

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Die Beleggings- Navorsers Tydskrif

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Inhoud

This issue in brief

Inflation and unemployment: The root causes of the capitalist dilemma

There was a time during the immediate post-war period when any rise in domestic inflation (above say the 2-3 per cent level), could be countered successfully by restrictive monetary and/or fiscal policies. That time, however, sadly has passed, and we find ourselves today in a new situation in most Western industrialised countries in which both inflation and unemployment move up together. Previously, an increase in unemployment, brought about by policies of deflation, had a fairly immediate and favourable effect on the level of inflation. Now rising inflation threatens to drag unemployment up even higher with still greater unemployment the only way seemingly to some relief from the price spiral process. Why have we got into this situation and is it something that can be corrected without a radical transformation of capitalism as we know it? This is the question to which Mr Jammine addresses himself from the vantage point of London although he does attach some concluding thoughts about inflation in South Africa.

The random walk model and the behaviour of gold prices: A note

The rise in the gold price to \$850 an ounce in January 1980 and its subsequent "correction" to levels more understated but still by historical standards high, have kept the metal at the centre of investment attention both in South Africa and abroad. While much has been said about the unpredictability of the gold price, the numbers of those who claim some special knowledge as to where it is going still abound, and there are few concerned with financial markets who do not have a 'gut' feel as to what the investment response should be to changes in it as and when these occur. The question arises, however, as to whether the free market for gold is not an efficient market in the sense so often applied to discussions of the behaviour of stock exchanges. The paper by Mr J. P. Botha sets out to test empirically whether or not the gold price follows a random walk and comes to a conclusion that investment analysts, dedicated to objective investigation, should not ignore.

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An analysis of the behaviour of market prices during rights issues

The trouble with rights issues is that they tamper with per share data and, thus, affect their historical consistency. This is not always realised by the lay investor and may even be ignored by the professional investor when undertaking an evaluation. It is, therefore, important to study the behaviour of share prices during the period of rights issues for it is only through such study that meaningful conclusions about the efficiency or otherwise of stock markets can be reached.

This paper by Messrs I. J. Lambrechts and F. J. Mostert fills an important gap in our local research even if it comes to conclusions that are a little discouraging.

An empirical comparison of the performance of different stock market indices

This is another useful technical paper by three authors familiar to readers of The Investment Analysts Journal. It examines the performance of the JSE in terms of five different stock market indices and comes up with some interesting results. The paper comes to the surprising conclusion that the method of computation of an index can be a more important source of variation in it than is the actual sample of securities chosen as constituents.

Interest rates, yield curves and the valuation of ordinary shares

When the prospects for the growth of earnings per share improve, investors are often tempted to ignore the very important role played by interest rates and interest rate changes in the equity valuation process. This brief article in our Investment Basics series serves as a warning against doing this. This article examines the fundamental connection between interest rates and estimated present values, and also the importance of distinguishing between short-term and long-term interest rates in determining appropriate rates of discount.

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Die Beleggingsnavorsers Tydskrif

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In the Investment Basics section of this issue of the Investment Analysis Journal, we carry an article which discusses the connection between interest rates and ordinary share valuation. It is appropriate that we do so, for the conclusion might have been reached by some in South Africa that the connection had become irrelevant given the recent behaviour of share prices on the local stock exchange. Of course, factors other than interest rates have always to be taken into account when evaluating equities and these factors can exercise a very powerful influence on share prices, but, at the end of the day, the opportunity costs of equity investment cannot be ignored. Disregarding such cost leads to errors and, ultimately, to market correction and disappointment.

The investment situation in South Africa at the present time is unusual on two important respects. First, the increase that has taken place in the price of gold has been so large compared with a year ago, as to totally transform the underlying economic situation. Through skilful management, the authorities have drained much of the resultant liquidity out of the system, but whereas a year ago the balance of payments still exercised a measure of restraint on government growth policies, this is no longer the case. On the contrary, the authorities have now resorted to various means to prevent the balance of payments exercising too encouraging an influence on portfolio investment sentiment.

Second, interest rates in South Africa, largely because of what has been happening to the balance of payments, have fallen excessively, both compared with overseas interest rates and compared with domestic rates of inflation. As long as this persists it must be favourable to industrial companies and it should, therefore, not be surprising that corporate profits are now increasing aggressively. But there is something inherently unstable about what is presently happening. It cannot carry on without ultimately running the risk of worsening inflation, and all that that implies for the purchasing power of currency in a country where large numbers of people continue to live close to, if not below, subsistence levels or continue to depend for their sustenance on relatively fixed incomes.

The trouble is that interest rates are not really being allowed to do their job properly. They really are low in South Africa because exchange control continues to protect local money and capital markets from quantitatively serious fund withdrawals. Would the commercial rand be trading at a premium to the dollar in a world in which exchange control did not exist? The current discount to the dollar of the financial rand must provide the answer to that question. And if local long-term gilt rates are clearly below the running and

Vyftiende uitgawe

Mei 1980

In die afdeling in hierdie uitgawe van Die Beleggingsnavorsers Tydskrif wat handel oor beleggingsgrondbeginsels bied ons 'n artikel waarin die verband tussen rentekoerse en die waardering van gewone aandele bespreek word. Dis 'n baie paslike bespreking, want sommige Suid-Afrikaners het dalk tot die slotsom gekom dat die verband nie meer van toepassing is nie, as die gedrag van aandeelpryse op die binnelandse effektebeurs in ag geneem word. Ander faktore as rentekoerse moet natuurlik altyd by die evaluering van gewone aandele in rekening gebring word en dié faktore kan 'n baie sterk invloed op aandeelpryse uitoefen, maar op die ou end kan die alternatiewe koste van gewone aandelebelegging nie veronagsaam word nie. As dié koste nie in ag geneem word nie, lei dit tot foute en, uiteindelik, tot markkorreksie en teleurstelling.

Die beleggingsituasie in Suid-Afrika is tans in twee belangrike opsigte ongewoon. In die eerste plek was die styging in die goudprys so groot in vergelyking met 'n jaar gelede dat dit die onderliggende ekonomiese situasie geheel en al laat verander het. Deur middel van deskundige bestuur het die owerheid heelwat van die gevolglike likwiditeit uit die stelsel verwyder, maar waar die betalingsbalans 'n jaar gelede nog 'n mate van beperking op regeringsgroei-beleidspele uitgeoefen het, is dit nie meer die geval nie. Inteeendeel, die owerheid het hom nou tot verskeie maniere gewend om te verhoed dat die betalingsbalans 'n te bemoedigende invloed op portefeuljebeleggings sentiment uitoefen.

In die tweede plek het rentekoerse in Suid-Afrika, grootliks as gevolg van wat met die betalingsbalans aan die gebeur was, buitensporig gedaal, vergeleke met oorsese rentekoerse sowel as die binnelandse inflasiekoerse. So lank as wat dit voortduur, moet dit gunstig wees vir nywerheidsmaatskappye en dit behoort dus nie verbasend te wees dat maatskappywinste nou teen 'n aggressiewe tempo toeneem nie. Maar daar is iets inherent onstabiel omtrent die huidige verwickelinge. Dit kan nie so voortgaan sonder om uiteindelik die risiko te loop van inflasie wat al hoe erger word en alles wat dit inhou vir die koopkrag van valuta in 'n land waar groot getalle mense steeds naby of selfs onder bestaanspele leef of steeds op betreklik vaste inkomstes vir hulle lewensonderhoud staat maak nie.

Die probleem is dat rentekoerse nie in werklikheid toegelaat word om hulle werk behoorlik te verrig nie. Hulle is werklik laag in Suid-Afrika omdat deviesebeheer steeds binnelandse geld- en kapitaalmarkte teen fondsonttrekkings van ernstige hoeveelhede beskerm. Sou die kommersiële rand teen in premier teenoor die dollar verhandel word in 'n wêreld waar deviesebeheer nie bestaan nie? Die huidige diskonto van die finansiële

prospective rate of inflation, which many would argue is the case, can it be expected that this will continue to be the case indefinitely? What investor worth his salt knowingly opts for a return which he calculates must ultimately be negative in real terms? We are forced to the conclusion that institutions and individuals who buy government stock on current yields do so either because they have to, or because they believe that they have superior insights and/or analytical prowess and, thus, will be able to get out before the inevitable crash comes.

Either way, the situation is not a healthy one and this is something equity investors must take into account in their decision making.

The Editor

rand teenoor die dollar moet die antwoord op dié vraag verstrek. En as binnelandse langtermyn- prima koerse duidelik laer is as die lopende en toekomstige inflasiekoers, soos baie mense sal beweer, kan daar verwag word dat dit vir 'n onbepaalde tyd die geval sal wees? Watter belegger wat enigsins bedrewe is, sal willens en wetens 'n opbrengs kies wat volgens sy berekenings uiteindelik negatief moet wees in reële terme? Ons word tot die gevolgtrekking gedwing dat instellings en individue wat staatseffekte op huidige opbrengste koop, doen dit òf omdat hulle moet òf omdat hulle meen dat hulle oor besondere insigte en/of ontledingsvaardigheid beskik en dus die onvermydelike ineenstorting betryds sal kan vryspring.

Hoe dit ook al sy, dit is nie 'n gesonde situasie nie en dit is iets wat ekwiteitsbeleggers in ag moet neem wanneer hulle beslissings neem.

Die Redakteur
