

The Investment Analysts Journal

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Inhoud

This issue in brief

Business investment decisions under inflation: Some South African evidence

Is money illusion a factor which affects the performance of the real economy? This is a question likely to provoke disagreement between different schools of thought regarding market efficiency and the rationality of expectations. In this article by Robert Reeve, Senior Lecturer in the Department of Accountancy at the University of Natal, Durban, the results of a study concerned with the effect of inflation on investment in South Africa are reported and evaluated. The study is based on a similar study undertaken in the UK by Carsberg and Hope during the early 1970s and a comparison of the results of each is made. Mr Reeve's findings support the contention that investment appraisal practices in the Republic are biased towards underinvestment in inflationary times.

Analysing the yield curve: A new approach

The yield curve has an entrenched place in the analysis of fixed income security returns. However, its nature and value as an investment tool are not often properly understood. If the curve reflects the outlook of investors of future yields rather than the comparative supply functions of stocks with different terms to maturity, the nature of the expectations concerned have still to be appreciated. Stanley Diller, in a very comprehensive paper, argues that real world investors are more concerned with the near-term future than with the medium or long-term future when making their comparisons. This goes a long way to explaining why yield curves differ as between sectors and how tax considerations affect fixed income evaluation.

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Review of the gold sales policy of the United States Treasury (1978-9)

As the largest single holder of gold bullion, the US Treasury is, clearly, in a special position to influence the gold price if this is, indeed, possible and its intention. For this reason, if for no other, the review of the US gold sales policy during the 1978-9 period, by Professor Roger Gidlow of the Department of Business Economics at the University of the Witwatersrand, is important. Professor Gidlow starts with an examination of the reasons for the gold sales and then proceeds to examine their impact on the gold price and the monetary status of the metal. Interestingly, he draws attention to the fact that while the gold sales had the short-run effect of weakening the gold price, their longer-run effect was to accelerate the trend towards reserve diversification out of the dollar. This is one of the reasons for his concluding that a change in Treasury policy could materialise in the near-term.

An illustrative method for valuing annuities

Annuities have an important place in both the theory and practice of finance. In this technical article from the Graduate School of Business in Melbourne, expressions are derived for the valuation of the four main types of annuities, namely, ordinary annuities, annuities due, deferred annuities and perpetuities. In addition, a graphical method for calculating the value of an annuity, that is easy to use, is presented in the form of a nomogram. This illustrates what happens to the value of an annuity when it is subject to changes in the values of input parameters.

The use of comprehensive cash flow analysis as a basis for risk measurement and determination of debit capacity.

In his last Investment Basics article (see IAJ April 1981) Mr A C Valsamakis discussed the 'return of investment' concept showing how it could be used as a tool in financial management. In this article he develops his theme further to include an investigation of the matter of gearing and its specific effect on both return and risk. Particular emphasis is placed on cash flow evaluation and its importance to the survival of the firm.

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It has never been a policy of this Journal to express an opinion about the future course of stock-market share prices or even about that of the general economy, either in editorials or in the columns of our contributors. Prognostications, both financial and economic, have a habit of quickly becoming outdated and are a sure road to academic irrelevance. Certainly, they diminish the durability of analysis and research, and durability is a quality upon which we, of the Journal, place a high value in the selection of our content. Nevertheless, we take this opportunity to express our interest in the fact that the JSE Actuaries Industrial Index has, within the last few weeks, reached a new high almost simultaneously with the publication by the South African Reserve Bank of a seasonally adjusted per annum estimate for the deficit on the current account of the balance of payments of approximately R3 000 m for the first six months of the year. No observer of money and capital markets in South Africa can be unmoved by such an apparent contradiction, especially having regard to the fact that, in the past, industrial share prices and the BoP deficit have tended to move in an inverse relationship.

Money and capital markets are not always right in terms of ex post assessment; but as barometers of expectations, they need to be taken seriously, especially when there exists a fair accumulation of evidence as to their efficiency. In present circumstances the rise in share prices is telling us something. The important thing to decide is "what?" Our guess is that it has at least something to do with the renewed fall in short-term interest rates, with the recent recovery in the gold price, with the still strong flow of good profits results, with the fact that dividend and earnings yields never did decline to unreasonable levels during the erstwhile economic upswing, and with the weight of new institutional funds seeking investment while scrip has remained essentially in short supply.

However, while these reasons may seem plausible, they do not probe far enough below the surface to provide a really adequate explanation. Why have interest rates fallen again? What is behind the increase in the gold price? These are the questions investment analysts need to be asking now if they want to find the answers to the future movements of share prices.

The fall in South African domestic interest rates can be simply explained but not easily understood given the Government's declared objective of reducing the level of inflation in the country and its looming BoP deficit. When off-shore borrowing is made deliberately attractive, as it was during August by manipulation of the forward cover mechanism, and when the rand is devalued by 22% and then kept down despite a recovery in the gold price, the

Agtiende uitgawe

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Dit was nog nooit hierdie Tydskrif se beleid om 'n mening uit te spreek oor die toekomstige verloop van effektemarkaanledepryse of selfs oor die verloop van die ekonomie in die algemeen nie, hetsy in redaksionele artikels of in die rubrieke van ons bydraers. Voorspellings, finansiële sowel as ekonomies, het die manier om baie gou verouderd te raak en is gedoem tot akademiese ontoepaslikheid. Dié voorspellings doen beslis afbreuk aan die bestendigheid van ontleding en navorsing, en bestendigheid is 'n eienskap waaraan ons by die Tydskrif groot waarde heg wanneer dit kom by die selektering van ons inhoud. Nietemin maak ons van dié geleentheid gebruik om ons belangstelling uit te spreek in die feit dat die JE Aktuariële Nywerheidsindeks binne die afgelope paar weke 'n nuwe hoogtepunt bereik het, byna gelyktydig met die verskyning van 'n jaarlikse raming, seisoensinvloede uitgeskakel, vir die tekort op die lopende rekening van die betalingsbalans van ongeveer R3 000 m vir die eerste ses maande van die jaar deur die Suid-Afrikaanse Reserwebank. Geen waarnemer van geld- en kapitaalmarkte in Suid-Afrika kan só 'n duidelike teenstrydigheid miskyk nie, veral met die oog op die feit dat nywerheidsaanledepryse en die betalingsbalans in die verlede geneig het om in 'n omgekeerde verhouding tot mekaar te staan.

Geld- en kapitaalmarkte het nie altyd gelyk wanneer dit kom by 'n skatting ex post nie, maar as barometers van verwagtinge moet hulle ernstig opgeneem word, veral wanneer daar redelike bewyse van hulle doeltreffendheid bestaan. In die huidige omstandighede hou die styging in aanledepryse vir ons 'n boodskap in. Die belangrike vraag is net "wat?" Ons raaiskoot is dat dit minstens iets te doen het met die hernieude daling in korttermynrentekoerse, met die onlangse herstel in die goudprys, met die steeds sterk beweging van goeie winsresultate, met die feit dat dividend- en winsopbrengste gedurende die onlangse ekonomiese opswaai nooit na onredelike peile afgeneem het nie, en met die gewig van nuwe institusionele fondse wat vir belegging beskikbaar is terwyl daar in hoofsaak 'n onvoldoende aanbod van effekte was.

Hoewel dié redes aanvaarbaar mag klink, is hulle nie grondig genoeg om 'n werklik toereikende verduideliking te bied nie. Waarom het rentekoerse weer eens gedaal? Wat het aanleiding gegee tot die styging in die goudprys? Dit is die vrae wat beleggingsnavorsers nou moet stel as hulle die antwoorde op die toekomstige bewegings in aanledepryse wil vind.

Die daling in die Suid-Afrikaanse binnelandse rentekoerse kan maklik verklaar, maar nie so maklik verstaan word nie, gesien die Regering se verklaarde doelstelling om die inflasiepeil in die land en sy opdoemende betalings-

cash flow to the money market must per force be increased. The trouble is that, when that happens, the credibility of anti-inflationary policies must also be brought into question. Such behaviour on the part of the monetary authorities must suggest that policy objectives are different from what they have been declared to be or have changed because the foreign exchange reserves have suddenly become a more important problem than either the problem of excessive money supply growth or the problem of resurgent inflation.

But is it right to separate the balance of payments problem from the inflation problem in our present policy formulation? It is right to believe that by taking the easy option and avoiding an end-August money crunch, a cash problem of inadequate foreign exchange reserves can be solved with any degree of permanence? We think not. On the contrary, we would strongly argue that by causing short-term money market trading rates in South Africa to fall again, to levels significantly below either comparable interest rates overseas or local inflation, and by devaluing the rand, the BoP problem will actually be made worse. The logic behind this kind of argument has to do with the fact that neither the demand for our exports nor the total demand for our imports are price elastic. Export demand will only really recover when growth in the economies of the major industrial countries recovers. Import demand will only really be discouraged when local business expectations of domestic volume sales and inflation are reduced. There are, too, imports in the pipeline that cannot be headed off by any kind of exchange manipulation. The devaluation of the rand, thus, merely means that we will be sacrificing more scarce foreign exchange per rand when paying for them than will be necessary.

There is no escape from the problem of excess money creation and inflation. It has to be tackled at its roots, not papered over with measures which are evidently expedient but of questionable longer-term value. A still further recovery in the gold price could let us off the short-term cash flow hook we now find ourselves on, but is that something upon which we should rely in our domestic monetary management?

The editor

balanstekort te verlaag. Wanneer buitelandse lenings doelbewus aantreklik gemaak word, soos in Augustus die geval was deur middel van die manipulasie van die termyndekkingsmeganisme, en wanneer die rand met 22% gedevalueer word en dan laag gehou word ten spyte van 'n herstel in die goudprys, moet die kontantvloei na die geldmark noodgedwonge toeneem. Die probleem is dat, wanneer dit gebeur, die geloofwaardigheid van 'n anti-inflasionistiese beleid ook bevaagteken moet word. Dié optrede van die kant van die monetêre owerheid kan net daarop dui dat beleidsdoelstellings nie is wat hulle wil voorgee om te wees nie of dat hulle verander het omdat die buitelandse valuta reserwes skielik 'n belangriker probleem as of die probleem van oormatige geldvoorraadgroei of die probleem van hernieuwe inflasie geword het.

Maar is dit reg om die betalingsbalansprobleem van die inflasieprobleem in ons huidige beleidsformulering te skei? Is dit reg om te glo dat deur die maklike uitweg te kies en 'n geldskaarste aan die einde van Augustus te vermy, 'n kontantprobleem van ontoereikende buitelandse valuta reserwes met enigsins blywende gevolge opgelos kan word? Ons dink nie so nie. Inteendeel, ons voer sterk aan dat deur te veroorsaak dat korttermyngeldmarkhandelskoerse in Suid-Afrika weer daal na peile wat heelwat laer is as of vergelykbare rentekoerse oorsee of plaaslike inflasie, en deur die rand te devalueer, die betalingsbalansprobleem in werklikheid vererger sal word. Die logika wat onderliggend is aan dié soort betoog hou verband met die feit dat nóg die vraag na ons uitvoere nóg die totale vraag na ons invoere pryselasties is. Die uitvoervraag sal eers werklik herstel wanneer groei in die ekonomieë van die groot nywerheidslande herstel. Die invoervraag sal eers werklik ontmoedig word wanneer plaaslike besigheidsverwagtinge van groot binnelandse verkope en inflasie verminder word. Daar is ook invoere wat reeds aan die gang is wat hoegenaamd nie deur enige manipulasie van die buitelandse valuta reserwes gestuit kan word nie. Die devaluasie van die rand beteken dus eenvoudig dat ons meer skaars buitelandse valuta per rand sal moet prysgee wanneer ons daarvoor betaal as wat nodig sal wees.

Die probleem van die skepping van oortollige geld en inflasie kan eenvoudig nie ontduik word nie. Daar moet tot die kern van die probleem deurgedring word en dit moenie omseil word met maatreëls wat klaarblyklik doelmatig, maar van twyfelagtige langtermynwaarde is nie. 'n Nog verdere herstel in die goudprys kan ons red uit die korttermynkontantvloeiopenarie waarin ons ons tans bevind, maar kan ons dit bekostig om daarop staat te maak wanneer dit kom by ons binnelandse monetêre bestuur?

Die redakteur