

The Investment Analysts Journal

Number 36 – Summer 1992/1993

Die Beleggings- ontleders Tydskrif

Nommer 36 – Somer 1992/1993

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This issue in brief

SA Foreign Exchange Risk under Managed Floating: Distributional Aspects

The authors examine exchange rate risk over the decade of managed floating. Distributional tests lead to the rejection of the normal distribution often used to evaluate and control exchange rate risk. Estimation shows that the leptokurtic character of empirical exchange rate distributions are better characterised by the class of non-normal stable Paretian distributions. The major economic implication is the higher probability of the irregular occurrence of larger price changes than is usually allowed for. Improved knowledge of the underlying distribution will allow for more efficient hedging.

Are our portfolio managers ready to invest overseas when exchange control goes?

The results of a questionnaire survey revealed that the majority of portfolio managers in South Africa are aware of the overall investment benefits accruing from investing in foreign securities. However, these same portfolio managers showed a distinct reluctance towards investing in foreign securities. It would seem that portfolio managers in South Africa are functionally fixated with investing on the JSE, and that they are thus inefficient in their role as allocators of investments funds. As a result of this functional fixation, portfolio managers are unlikely to optimise their portfolio returns by pursuing international portfolio diversification when exchange control regulations are partially relaxed or completely abolished.

Equivalent dividends: an extension

The equivalent dividend is a mechanism which can be used to incorporate capital structure changes in the calculation of share returns in computerbased systems without having to change the time-series of price data. This note highlights a number of problems in the calculation of the equivalent dividends for simultaneous or near simultaneous changes in the capital structures, and suggests the correct approach to the calculation. The problems are illustrated with examples of capital structure changes of companies listed on the JSE.

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Stock Market Over-reaction: The South African Evidence

It has been suggested that stock markets over-react and that investors pay too much attention to recent “dramatic” news. If over-reaction does occur and prices overshoot then there should be a subsequent revision in the opposite direction. This paper outlines empirical research into the over-reaction hypothesis on the Johannesburg Stock Exchange using data over the period July 1974 to June 1989 for two hundred and four well traded securities.

The findings provide clear evidence of long run weak-form inefficiencies in the South African stock market over the period investigated. Additionally, while less pronounced than for the American market, there is evidence of both a January effect and an asymmetric excess returns effect for the South African market.

Investment Basics – XXVI Trading Systems

All technical indicators suffer from limitations which makes it impractical to use the buy and sell signals they generate blindly for trading. On the other hand, a knowledge of limitations could enable the analyst to distinguish when the signals produced by some indicator are more likely to be correct.

Further, not all indicators suffer from the same limitations. While one indicator is generating incorrect or ambiguous signals, another indicator may well be more reliable, just because it is not subject to the problems and limitations of the first.

This means that the judicious use of different indicators in combination, should result in improved trading performance.

The procedures which govern the selection and interpretation of indicators, and also the way signals are translated into buy or sell orders, constitute a trading system. A trading system has the advantage of improving discipline, the most important single ingredient of successful trading.

Complex trading systems extend well beyond mere technical analysis, and could well include economic analysis and portfolio theory.

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It would be a nice world if it were possible to abolish all national currencies and for them to be replaced by a common exchange medium that would be used by all people everywhere. Imagine being able to get onto an aeroplane and flying off to Tokyo, Texas or Timbuktu and not having to worry about travellers cheques or making mental calculations of comparative prices when touring abroad. In the common currency, one would know, instantly, what was cheap and what was expensive. Gone too would be all the foreign exchange speculation that has become the bane of the lives not only of central banks but also of ordinary people. How much more efficient the world economy would be and how much economic growth itself would be encouraged. Without exchange risk, trade between countries would expand, and investment flows would increase as well, to the benefit of everybody.

But if this is what would really happen, why is it taking so long for national governments to agree on a new monetary order? Three reasons suggest themselves. First, while there would be advantages to such a world system, there could also be disadvantages. These would be born by weaker nations rather than by stronger ones. In brief, an open world system would pose the threat of a loss of funds by those most desperately in need, and as long as this was the perception, it would be resisted by the governments concerned. South Africa declines to abandon exchange controls, let alone adopt, say, the dollar as its currency, precisely for this reason.

Second, the adoption of a common currency by any group of countries would necessitate a loss of both economic and political sovereignty for the affected individual governments. Gone would be the possibility of exercising any separate monetary policy (raising or lowering interest rates, revaluing or devaluing the currency) for the purpose of protecting a domestic economy or trying to win for a particular country an advantage relative to others in the shared area. Clearly, this second reason is not far removed from the first (mentioned above) although the first would most often apply to underdeveloped or developing countries, while the second would apply most often to more advanced countries.

Third, in order to bring a situation of monetary union about would require a high degree of economic convergence between participating countries at the time the union was instituted. If the needed convergence did not exist, stronger countries would benefit at the expense of weaker ones and all the reasons just mentioned above as problems would come into force. Britain's withdrawal from the European Community's ERM is a demonstration of this. If fixing the pound to the Deutschmark was too much for the country to bear, how much worse would it have been had monetary union in the EC already been instituted? High German interest rates, made necessary because of a merging of the West German and East German economies, would have applied with equal force in Britain itself, driving its economy deeper into recession.

The Maastricht commitment to monetary union by the end of the present decade needs to be re-examined in the light of the tough experience of recent months. Is it reasonable to expect that such an objective can be achieved when the world economy has been subjected to such major structural change (the US's emergence as a net debtor, the collapse of Soviet socialism, the end of the arms race) and the economies of member EC countries are still so far apart? The common sense

Die Beleggingsontleders Tydskrif

Ses-en-dertigste uitgawe – Somer 1992/1993

Dit sou 'n wonderlike wêreld wees indien alle nasionale geldeenhede kon verdwyn en vervang word met 'n gemeenskaplike geldeenheid wat oral deur alle mense gebruik word. Dink daaraan om op 'n vliegtuig na Tokio, Texas of Timbuktu te klim en jou nie hoef te bekommer oor reisigerstjeks nie, of om oorsee te reis sonder die hoofrekenkunde van prysvergelykings. In 'n gemeenskaplike geldeenheid sou jy onmiddellik kon bepaal wat goedkoop en wat duur is. Wisselkoersspekulاسie, wat nie net die straf van sentrale banke, maar ook van gewone mense geword het, sou verdwyn. Hoeveel meer effektief sou die wêreld ekonomie nie wees en hoeveel sou ekonomiese groei nie aangemoedig word nie. Sonder wisselkoersrisiko's sou die handel tussen lande uitbrei en beleggings toeneem, tot voordeel van iedereen.

Maar as dit regtig sou gebeur, waarom neem dit so lank vir regerings om 'n ooreenkoms te bereik aangaande 'n nuwe monetêre orde? Drie redes lê voor die hand. Eerstens, terwyl daar voordele in 'n sodanige wêreldstelsel is, bevat dit ook die nadele. Laasgenoemde sou die swakker lande, eerder dan die sterkeres, toeval. Kortliks, 'n wêreldstelsel sou die bedreiging inhou dat hulle wat fondse die meeste benodig, die beste kans staan om dit te verloor, en terwyl hierdie persepsie geld, sal dit deur die betrokke regerings teengestaan word. Suid-Afrika wys die afskaffing van wisselkoersbeheer, en die aanvaarding van die dollar as nasionale geldeenheid, af juis om hierdie rede.

Tweedens, die aanvaarding van 'n gemeenskaplike geldeenheid deur enige groep lande, sal 'n verlies aan beide ekonomiese en politieke soewereiniteit beteken vir die individuele regerings. Daar sou weggedoen word met die moontlikheid om onafhanklik monetêre beleid te bepaal (die verhoging of verlaging in rentekoerse, die revaluasie of devaluasie van die geldeenheid) ten einde die nasionale ekonomie te beskerm, of 'n relatiewe voordeel bo 'n ander in 'n area van gedeelde belang te bekom. Hierdie tweede rede is duidelik nie verwyder van die eerste (hierbo genoem) nie, maar sal eerder van toepassing wees op ontwikkelde lande, terwyl die eerste meer dikwels van toepassing sal wees op onderontwikkelde of ontwikkelende lande.

Derdens, die skepping van monetêre eenheid sal 'n hoë mate van ekonomiese konvergensie tussen deelnemende lande vereis op dié stadium dat die eenheid daargestel word. Indien sodanige konvergensie nie, bestaan nie sal sterker lande bevoordeel word ten koste van swakkeres en al die voorgaande argumente sal geld. Brittanje se onttrekking uit die EEG se eenheidswisselkoersmeganisme is 'n voorbeeld hiervan. Indien die vaspenning van die pond tot die Deutschmark meer was as waarvoor die land kans gesien het, hoeveel slegter af sou dit gewees het indien monetêre eenheid in die EEG alreeds bestaan het? Hoë Duitse rentekoerse, genoodsaak deur die samesmelting van die Wes-Duitse en Oos-Duitse ekonomieë, sou net so in Brittanje geldig het, wat die ekonomie dieper in 'n resessie sou dryf.

Die Maastricht verbinten is tot monetêre eenheid teen die einde van die huidige dekade behoort hersien te word in die lig van die moeilike ondervinding van onlangse maande. Is dit redelik om te verwag dat so 'n doelstelling verwesenlik kan word wanneer die wêreld ekonomie onderwerp is aan aansienlike strukturele veranderinge (die VSA se opkoms as 'n netto skuldenaar, die ineenstorting van Sovjet sosialisme, die einde van

answer to this question would seem to be 'No!' At best what looks feasible is a union comprising the currencies of those countries most clearly linked to Germany, but even in their case there are problems as long as the union between West Germany and East Germany remains incomplete. However, the EC governments in their wisdom, or lack thereof, appear still to be committed to a single speed advance towards a common European currency rejecting a multi-speed approach where weaker countries can join as and when they are able. This single speed approach is the solution of the lowest common denominator, or put another way, the forging of a chain the strength of which depends on its weakest link. We would venture to guess that if Mr Delors and his friends remain fixed on the idea of a common moment of union for all, monetary union in the EC will never happen. It would be better then to abandon the idea now. That would be less potentially damaging both to the European and the world economies than continuing to maintain a goal all analysis and good sense suggest is an illusion.

Lest this be taken to be a rejection of the idea of EC monetary union, let us hasten to add that it is not. The long run desirability of such union has been spelled out in the opening paragraph of this editorial. That desirability remains. But union will not be achieved at the wave of a wand from a political or bureaucratic ivory tower. To happen, and to endure, it must make sense on the ground. Governments can help by doing sensible things consistent with market forces, and consistent with the development of a Community central bank that will inspire the required degree of international confidence. The ERM broke precisely because it ignored market forces and what was happening on the ground. It provides a lesson from which there is much still to learn.

THE EDITOR

die wapenresies) en die ekonomieë van ledelande in die Europese gemeenskap nog so ver uiteen is? 'n Redelike antwoord op hierdie vraag skyn te wees "Nee!" Ten beste is daar 'n moontlikheid van 'n gemeenskap wat die geldeenhede omsluit van daardie lande wat Duitsland se belange deel, maar selfs in hierdie geval bestaan daar nog probleme terwyl die vereniging tussen Wes-Duitsland en Oos-Duitsland onafgehandel bly. Regerings in die EEG in hulle wysheid, of gebrek daaraan, steeds skyn verbind te wees tot eenfasige vordering in die rigting van 'n gemeenskaplike Europese geldeenheid, wat 'n meerfasige benadering waardeur swakker lande kan aansluit indien en wanneer hulle kan, uitsluit. Hierdie eenfasige benadering is die oplossing van die kleinste gemene veelvoud, of anders gestel, die smee van 'n ketting waaraan die krag van die swakste skakel afhang. Ons raai dat indien mnr Delors en sy vriende bly vas staan op die idee van een gemeenskaplike unie vir almal, op een enkele tydstep, monetêre eenheid in die EEG nooit bereik sal word nie. Dit sou beter wees om die idee nou te laat vaar. Dit sou minder potensieële skade inhou vir beide die Europese en die wêreld ekonomieë as om 'n doel na te streef wat deur analise en goeie oordeel as 'n illusie uitgewys word.

Indien dit gelees sou word om te beteken dat ons die idee van 'n Europese monetêre eenheid verwerp, laat ons haas om te sê dat dit nie so is nie. Die langtermyn wenslikheid van 'n sodanige eenheid is uitgespel in die openingsparagraaf van hierdie redaksionele kommentaar. Daardie wenslikheid bly behoue. Maar eenheid sal nie behaal word deur die swaai van 'n towerstaf of uit 'n politiese of burokratiese ivoortoring nie. Om tot uitvoering te kom en te oorleef, moet dit op die grondvlak sinvol wees. Regerings kan bydra deur op te tree in ooreenstemming met markkragte en in ooreenstemming met die ontwikkeling van 'n Gemeenskaplike Sentrale Bank wat die nodige mate van internasionale vertroue sal inspireer. Die eenheidswisselkoersmeganisme het misluk omdat dit markkragte en dit wat op grondvlak gebeur, verontagsaam het. Dit bied 'n les waaruit nog heelwat geleer kan word.

DIE REDAKTEUR