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This issue in brief

Money Market Funds: The missing link in the South African Unit Trust Industry?

Since 1993, the possibility of establishing money market funds (MMFS) in South Africa has received considerable attention. The Financial Services Board (FSB) established a study group to investigate the establishment of this type of unit trust. It met for the first time in September 1993 and the final report and recommendations were completed at the end of August 1994. This paper discusses the characteristics of money market funds, their international development, the possible effect of money market funds on the money supply and monetary control, and possible opportunities for unit trust management companies in South Africa.

The paper concludes that the establishment of money market funds in South Africa will create numerous advantages and opportunities for unit trust management companies. There are few problems, if any, which could constitute any obstacle preventing the official go-ahead from being given to an industry which is eagerly awaiting and preparing to launch this new product line.

Market timing and share returns

The relationships between business cycle peaks and troughs and turning points in two value indices based on the JSE All Share Index and Industrial Index are examined. It is shown that *ex post* and *ex ante* estimates of cyclical peaks and troughs based on share value indices lead the business cycle in an inconsistent way. However, timing strategies, based on forecasting the business cycle and switching between equities and treasury bills or equities and bonds around cyclical turning points have produced better than average returns.

Inflation and Price-earnings ratios

This paper studies the effect of inflation on price-earnings ratios. The analysis shows that price-earnings ratios could be expected to decline with increased inflation. This effect is more marked for firms employing short-lived assets than for firms employing assets with a longer life. Under high inflation investors should therefore expect lower price-earnings ratios from firms employing short-lived assets. They should expect price-earnings ratios to decline with increasing inflation. International investors should expect lower price-earnings ratios in economies with high inflation.

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Inhoud

Liberalising foreign trade: The interaction between the real & monetary sectors

The most important element in the external relations of less developed countries (LDCs) is the interaction between foreign trade and the domestic economy. The theoretical issues at stake have been reviewed by Krueger (1984). During recent years this particular aspect has become an important element in the debate regarding the opening up of LDCs and the emergence of the newly industrialising countries. The debate is closely related to the major policy options of import substitution and export promotion, also known as inward- versus outward-looking development options. It would appear that Adam Smith's approach in these matters can be a powerful analytical tool in explaining the issues regarding trade liberalisation. Trade liberalisation is a process which has serious implications for the interaction between the real and monetary sectors of an economy. A closer analysis of these issues appears to be helpful in understanding trade liberalisation and implementing the opening up of an economy to international trade successfully.

Earnings changes: A random walk? Some South African evidence

The article examines the concept of earnings changes as a random walk for industrial companies listed on the Johannesburg Stock Exchange. The results overwhelmingly support the hypothesis of higgledy piggledy growth using three different test procedures. There is some suggestion that investors can, on the average, identify companies with the highest growth potential.

Investment Basics: XXXI. Sustainable Growth Models

Many firms state their financial objectives in terms of a growth target for a parameter such as earnings per share. Research on the sources firms use to raise new capital has shown that there is a reluctance to raise new equity capital (Ross, Westerfield and Jaffe, 1993, p409), and yet without the injection of new equity capital there are limits to growth for the firm. The rate at which a firm can grow, without resorting to external equity finance or altering its present financial structure, is consequently a parameter of great interest to management.

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Die Beleggings-ontleders Tydskrif

Een-en-veertigste uitgawe – Winter 1995

Finance Minister, Chris Liebenberg, and his Reserve Bank adviser, Dr Chris Stals, are to be congratulated for the initiative they took on 10 March 1995 in abolishing the financial rand. Although circumstances changed to make it a logical and appropriate thing to do at the time, it was bound, still, to be a difficult decision. What may seem right at a given moment, may not prove to be right when circumstances change, which of course they are bound to do. Messrs Liebenberg and Stals must have known when they decided on the finrand's abolition that this time it would have to be for ever. There could be no rushing back to it reinstatement were exogenous factors to change in a way that might once again trigger a flight of capital from South Africa. In 1983, the finrand had been abolished by the then P W Botha government, but it was hastily brought back in September 1985 after the disaster of the Rubicon speech the previous month and the financial sanctions and the flight of capital that followed.

One of the factors which contributed to making the finrand's abolition easier was an extraordinary weakening of the dollar on world foreign exchange markets. Thus the rand has been able to remain firm against the dollar even though it has declined significantly against other major currencies. On a weighted average basis, the rand has declined by more than 6,5 per cent since the end of last year. This decline is not a bad thing and will contribute to shifting production towards exports rather than imports, which is what is now required. Import growth is strong enough and is being driven by a cyclical upswing of some power. Hence, the already substantial deterioration of the current account of the balance of payments. Fortunately, the inflow of capital has been large enough to more than compensate for that deterioration so the country's gold and foreign exchange reserves have actually increased substantially, and on a net basis also.

Two things could now pose a threat to the rand-dollar exchange rate. These are, firstly, the possibility of a turn-around in the exchange performance of the dollar itself and, secondly, the possibility that political events in South Africa might take a turn for the worse. At some point the dollar is bound to recover. Already it has reached a clearly oversold position against the Deutschmark and the yen. When it recovers, the rand most likely will find the going tough although, dragged up by the dollar, it might recover some lost ground against third currencies. An adverse turn of political events in South Africa can never be ruled out, Minister Buthelezi constantly reminds us of this but there also exists the possibility of a maverick event of the Sharpeville or assassination kind. Whatever the case, were it to happen, the rand would have to be left to itself to serve the purposes of checking an outflow of funds. And that is how it should be. Exchange rate volatility, though adding to the risk of foreign investment in one way, contributes to stability in others.

These, however, are only possibilities – the kinds of hazard with which market participants continuously have to contend. There is now good reason to argue that the present institutional framework in South Africa is sufficiently robust to deal with whatever shocks they may deliver. After all the violence the country has been through, including the assassination of Chris Hani, it has demonstrated its resilience. This is why, despite such hazards, it is necessary to begin to consider the next step in the removal of exchange control.

There are a number of reasons why the complete abolition of exchange control, including its scrapping in respect of residents, is desirable. These fall into two categories, those relating to the distortions it causes to the economy, and those relating to matters of human freedom. They are, of course, linked but it serves a useful purpose to make the distinction for analytical purposes. Exchange control has had a hugely distorting impact on the South African economy. The protection it has afforded local industry through its discouragement of foreign investment, and the im-

Die Minister van Finansies, Chris Liebenberg, en sy Reserwebankadviseur, dr Chris Stals, behoort gelukkigens te word met hul inisiatiewe van 10 Maart 1995 met die opheffing van die finansiële rand. Alhoewel dit onder veranderde omstandighede die logiese en toepaslike besluit was op daardie tydstip, was dit niemin nie maklik nie. Wat reg mag lyk op 'n gegewe oomblik, mag bewys verkeerd te wees wanneer omstandighede verander, wat stellig natuurlik kan gebeur. Die here Liebenberg en Stals moes geweet het dat dit hierdie keer finaal sou wees toe hulle besluit het om die finrand op te hef. Daar sou nie teruggekeer kon word na 'n herinstelling daarvan indien eksogene faktore so sou verander dat dit weereens 'n uitvloeï van kapitaal uit Suid-Afrika sou ontketen nie. Die PW Botha-regering het die finrand in 1983 opgehef, maar dit is spoedig in September 1985 heringestel na die katastrofiese Rubicon toespraak van die vorige maand, en die finansiële sanksies en kapitaalvlug wat daarop gevolg het.

Een van die faktore wat bygedra het om die opheffing van die finrand te vergemaklik, was 'n buitengewone verswakking van die dollar op die wêreld se buitelandse valutamarkte. Die rand kon homself daarom teen die dollar handhaaf, al het dit beduidend teenoor die ander belangrike geldeenhede gedevalueer. Op basis van 'n geweegde gemiddelde het die rand met meer as 6,5 persent sedert die einde van verlede jaar gedevalueer. Hierdie afname is lank nie sleg nie, en sal bydra tot 'n verskuiwing van produksie van invoere na uitvoere, iets wat tans nodig is. Invoergroei is sterk genoeg, en word ondersteun deur 'n sterk sikliese opswaai, vandaar die reeds substansiële afname in die lopende rekening van die betalingsbalans. Die invloed van kapitaal was gelukkig groot genoeg om meer as te kompenseer vir hierdie afname, sodat die land se goud- en buitelandse valuta inderwaarde substansiëel toegeneem het, ook op 'n netto basis.

Twee dinge kan moontlik 'n bedreiging vir die rand-dollarwisselkoers inhou. Eerstens die moontlikheid van 'n ommeswaai in die wisselprestasie van die dollar self, en tweedens die moontlikheid dat politieke gebeure in Suid-Afrika 'n ongunstige wending kan neem. Die dollar sal stellig op 'n sekere stadium herstel. Dit het reeds 'n oorverkoopte posisie teenoor die Deutschmark en die jen ingeneem. Wanneer die rand herstel, sal dit heelwaarskynlik opdraande kry, alhoewel dit met behulp van die dollar verlore veld teen ander geldeenhede mag herwin. 'n Ongunstige ommeswaai in politieke gebeure in Suid-Afrika kan nooit buite rekening gelaat word nie. Minister Buthelezi herinner ons voortdurend hieraan, maar daar bestaan ook die moontlikheid van onvoorspelbare gebeure, soos Sharpeville of sluipmoorde. In alle geval, sou dit gebeur, sal die rand aan homself oorgelaat wees om die uitvloeï van fondse te reguleer. Dit is ook hoe dit behoort te wees. Alhoewel valutakoers volatilititeit enersyds bydra tot die riskantheid van buitelandse beleggings, dra dit andersyds by tot die stabiliteit.

Dit is egter bloot moontlikhede – die tipe risiko's waaraan markdeelnemers deurlopend blootgestel is. Daar is tans genoegsame rede om te beweer dat die huidige institutionele raamwerk in Suid-Afrika robuust genoeg is om enige moontlike skokke te hanteer. Na al die geweld in die land, insluitende die sluipmoord op Chris Hani, is hierdie weerbaarheid bewys. Ten spyte van hierdie risiko's is dit egter nodig om die volgende stap, naamlik die opheffing van valutabeheer, te oorweeg.

Daar is verskeie redes waarom die totale opheffing van valutabeheer, ook wat betref inwoners, wenslik is. Twee kategorieë kan onderskei word, naamlik dié wat verband hou met verwringsings in die ekonomie en dié wat verband hou met die vryheid van die mens. Daar is natuurlik 'n verband tussen die twee, maar dit dien 'n bruikbare doel om vir analitiese doeleindes 'n onderskeid te maak. Valutabeheer het tot 'n groot mate 'n verwrigende impak op die Suid-Afrikaanse ekonomie gehad. Die beskerming wat dit plaaslike nywerhede gebied het deur buitelandse investering te ontmoedig, en die behoud van plaaslike investering wat dit afge-

prisonment of local investment it has enforced, have been the principal reasons for the emergence of what has come to be called the hot house economy. This is an economy of high costs and low productivity that would not pay its way in an open world system. It has been perpetuated because successive South African governments, once the system was entrenched, were too fearful of what the consequences for employment and profits would be were it to be removed. The matter of human freedom speaks for itself. It requires no elaboration in the journal of a society dedicated to the cause and to the openness and transparency which are essential if financial markets are to fulfill their social function.

The abolition of the finrand, and hence of exchange control on non-residents, has now removed half the problem. This is a good thing in its own right especially because of what it implies for foreign direct investment. But going only half the way, it still leaves many distortions in place, and it perpetuates unfairness to local industry that remains at a distinct disadvantage compared to foreign industry which is able, now, to operate without restraints upon it.

Let us sketch the picture more completely.

South Africa is a geographical area characterised by a unique mineral endowment. Over the course of the last century that endowment has come to be almost completely exploited. Although the mining sector of the country's economy remains its flywheel, it is now a mature sector the costs of which, in general terms, have become high on any international comparison and which is beginning to experience declining levels of production. Nevertheless, the mining sector is a source of massive cash generation and the handful of large companies which dominate it have the responsibility of managing the cash flow in a manner which is both in their shareholders and the country's best interests. Mining assets are wasting assets that have to be amortised. This means that the controlling mining houses are obliged to direct part of their cash flow into new investments that will provide for a continuity, and even a growth, of income. Because the scope for new mining ventures within the country has declined dramatically, and because exchange control prevents them from widening their involvement in mining abroad (the logical route they should follow given their accumulated capital a knowhow), they are bound to conglomerate within the country investing increasingly in the secondary and tertiary sectors of the economy. This, however, has resulted in much *criticism*. The ANC, indeed, has viewed the conglomeration of the mining houses as a manifestation of monopolistic tendencies which must be checked both if the local consumer is to be protected and if black economic empowerment is to be advanced. It has, therefore, threatened to break up the firms concerned through the application of US-style anti-trust legislation. But that could prove to be problematical. The South African mining groups are not large in a global context. Were they to be broken up, as JCI has already been broken up, their critical mass could be diminished and their global competitiveness adversely affected. This, certainly would not be in South Africa's interest. But worse still, with exchange control now removed as far as foreign companies are concerned, and with its continued enforcement with respect to South African companies, the latter must experience a clear tilting of the playing field against them. They are being required to compete in a new open South African and world economy but are not being allowed to do so, and are even being prejudiced in the exercising of their normal economic functions.

All this the Minister of Finance and the Reserve Bank Governor know. What inhibits them from moving on the abolition of exchange control on residents as they moved on the removal of non-resident controls is a fear of the destabilisation that might cause. Briefly, they assume (probably correctly) that, at the current rand-dollar exchange rate, the disinvestment requirements of residents vastly exceed the availability of the Reserve Bank's gold and foreign exchange holdings and that, therefore, any such move would be severely damaging to the exchange rate. The debate on this must now be opened up. Extensive public discussion can only be to the good particularly as it would help promote a better understanding of the policy problems and also of the position of the mining houses themselves.

THE EDITOR

dwang het, was die hoofredes vir die totstandkoming van wat bekend staan as die kweekhuisekonomie. Dit is 'n ekonomie met hoë koste en lae produktiwiteit wat homself nie sal kan handhaaf in 'n oop-wêreld stelsel nie. Dit is voortgesit omdat opeenvolgende Suid-Afrikaanse regerings bang was, nadat die sisteem reeds ingewortel was, vir die implikasies van werkloosheid en winste, indien dit verwyder sou word. Die kwessie van vryheid van die mens spreek vir sigself. Dit vra geen toelating in 'n tydskrif van 'n vereniging wat toegewyd is aan die saak, en aan die openheid en deursigtigheid wat noodsaaklik is indien finansiële markte hul maatskaplike funksie moet vervul nie.

Die opheffing van die finrand, en daarom valutabeheer op nie-inwoners, het reeds die probleem halfpad opgelos. Op sigself is dit 'n goeie ding, veral weens die implikasies wat dit vir direkte buitelandse beleggings inhou. Deur die pad net 'n ent te loop, bly baie verwrings steeds voortbestaan, en perpetueer dit onregverdigheid teenoor plaaslike nywerhede wat steeds benadeel word in vergeleke met buitelandse nywerhede wat tans sonder beperkinge kan opereer.

Laat ons die situasie meer volledig toelig.

Suid-Afrika is 'n geografiese gebied wat gekenmerk word deur 'n unieke minerale bemaking. Hierdie bemaking is gedurende die afgelope eeu feitlik totaal geëksploiteer. Alhoewel die mynbousector steeds die dryfkrag agter die landse ekonomie is, is dit tans 'n ontwikkelde sektor waarvan die koste, in algemene terme en internasionaal gesproke, baie toegeneem het, en wat besig is om dalende produksievlakke te ervaar. Die mynbousector is nietermin 'n bron van aansienlike kontantgenerering, en die handvol maatskappye wat dit domineer, het die verantwoordelikheid om die kontantvloei sodanig te beheer dat dit tot grootste voordeel van hul aandeelhouders en die land sal wees. Mynboubates is nie-hernieubare bates wat gearmotiseer moet word. Dit beteken dat die mynhuise verplig is om 'n deel van hul kontantvloei in nuwe beleggings te kanaliseer, sodat dit kontinuïteit, en selfs inkomstegroei kan verseker. Aangesien nuwe mynbougeleenthede in die land dramaties afgeneem het, en valutabeheer dit vir hulle onmoontlik maak om hul mynboubelange in die buiteland uit te brei (die logiese weg om te volg, gegee hul geakkumuleerde kapitaal en kundigheid), is hulle eintlik genoodsaak om binne die landsgrense te konglomereer, en om toenemend in die sekondêre en tersiêre sektore van die ekonomie te belê. Dit het egter geweldige kritiek, tot gevolg gehad. Die ANC het inderdaad die konglomerasie van die mynhuise as 'n manifestasie van monopolistiese tendense gesien, wat in toom gehou moet word indien die plaaslike verbruiker beskerm moet word, en indien swart ekonomiese bemagtiging bevorder moet word. Die betrokke firmas het daarom die gevaar geloop om te ontbondel weens die toepassing van die VSA-styl anti-trust wetgewing. Dit mag egter problematies blyk te wees. In 'n globale konteks is die Suid-Afrikaanse mynbou-groepe nie groot nie. Indien hulle sou ontbondel, soos inderdaad die geval met JCI was, kan hul kritiese grootte afneem, en hul globale mededingendheid nadelig geaffekteer word. So iets sou beslis nie in Suid-Afrika se belang wees nie. Veel erger nog, met die opheffing van valutabeheer ten opsigte van buitelandse maatskappye, en met die voortgesette toepassing daarvan op Suid-Afrikaanse maatskappye, moet laasgenoemde noodwendig 'n beslisse swaai van die speelveld teen hulle ervaar. Daar word van hulle verwag om in 'n nuwe, oop Suid-Afrika, sowel as 'n wêreld ekonomie, mee te ding, maar hulle word nie toegelaat om dit te doen nie, en word selfs benadeel in die uitvoering van hul normale ekonomiese funksies.

Die Minister van Finansies en die President van die Reserwebank is volkome bewus hiervan. Wat hulle ontmoedig om aksies te neem wat betref die opheffing van valutabeheer op inwoners, soos wat hulle wel gedoen het met die opheffing van beheer op nie-inwoners, is 'n vrees vir die moontlike destabilisering wat dit tot gevolg kan hê. Kortom, hulle aanvaar (waarskynlik met reg), dat teen die huidige rand-dollar wisselkoers, die disinvesteringseis vir inwoners die beskikbaarheid van Reserwebank goud en buitelandse valutarisewes by verre oorskry, en dat enige stap in hierdie rigting daarom ernstige nadele vir die wisselkoers inhou. Die debat hieroor moet nou geopen word. 'n Grootse openbare bespreking kan net ten goede wees, veral aangesien dit 'n beter begrip vir beleidsprobleme, asook die posisie van die mynhuise sal help bevorder.

DIE REDAKTEUR