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The application of fundamental indexing to the South African equity market for the period 1996 to 2009

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Over the years the norm in the investment industry has been to use market capitalization-weighted indices as benchmarks to measure investment performance. However, market capitalization-weighted indices, such as the FTSE/JSE All Share Index (ALSI), create a natural return drag because of the overweighting of overvalued stocks and vice versa.

On the other hand, fundamental indexing weights stocks based on their economic footprint in the market rather than their market capitalization. The fundamental indexing approach uses four metrics, namely sales, book values, dividends and cash flows to calculate this footprint.

The fundamental index concept delivered very good results when applied to the South African stock market. The South African Fundamental Index outperformed the ALSI by 4,7% p.a. during the period 1996 to 2009. This return was achieved with a risk profile similar to that of the ALSI. This index also had similar turnover rates relative to the ALSI.

When is money likely to be smart? Evidence from mutual fund investors in Taiwan

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Past behavioural research has provided evidence that fund investors have the ability to predict fund performance; this is called the smart money effect. In this study we examine whether the smart money effect exists in the Taiwanese mutual fund market. Specifically, we investigate whether the smart money effect appears across UP and DOWN markets and whether this effect persists over time. Consistent with the literature, we find that the smart money effect exists over our sample period. Moreover, after categorizing the market states as either UP or DOWN markets, our evidence shows a significant smart money effect only following DOWN markets but not following UP markets. According to behavioural theories, bad market states evoke negative affective states in investors, so negatively affected investors may rely less on the use of heuristics and become more careful and logical in their investment decisions. This paper infers that the existence of a smart money effect after DOWN markets occurs because investors in negative emotional states are likely to use more detailed information processing in their decision making.

Monetary policy, structural breaks and JSE returns

R Mangani

This study investigated the effects of monetary policy on JSE portfolios using a GARCH(1,1) framework. Results for the period 1990 - 2009 were compared with those based on four sub-periods. The analysis shows that discount rate changes are important in describing mean returns and return volatilities. The significance of these effects varies during different states of the economy; according to the definition of the market portfolio; and depending on whether or not the asymmetric effects of monetary policy changes are modelled. The effects of positive and negative policy changes are somewhat asymmetric on the JSE.

Pricing of single stock futures and dividend risk

B Swart and A Venter

Pricing of single stock futures and dividend risk

In this paper we consider the fair pricing of single stock futures (SSFs) and the effect of dividend risk on the dividend compensation component in the pricing formulas. SSF valuation is subject to the pricing of *discrete* cash dividends (not percentages or dividend yields) in the underlying stock. Discrete cash dividends present modelling challenges which are not present when dividends are in the form of yields or percentages. Problems are created for market-makers and investors when the actual cash dividend is different from that predicted by analysts and used for pricing. We propose a new model for the fair price of a single stock futures contract which addresses dividend uncertainty.