Now that South Africa has been readmitted to the international community, investment in that country has once again become respectable. Indeed, after many years as a capital exporter, the republic has recently been experiencing a net capital inflow, much of it in the form of portfolio investment in local securities. Further, the recent deregulation of the stockmarket has seen international firms such as Flemings, James Capel and Merrill Lynch set up business in South Africa.

The sanctions campaign, which ended with the election of the Mandela government, had sought to deprive South Africa of export markets and strategic imports, as well as to end direct foreign investment in the republic. Whereas it may be argued that trade sanctions had only a marginal effect, South Africa now has to deal with the legacy of a sharp decline in foreign investment during the sanctions years, and especially after the Soweto uprising of the mid-1970s.

Foreign perceptions of an imminent bloodbath no doubt played a part, but the fact remains that government intervention and pressure from the anti-apartheid lobby greatly raised the cost of having a business presence in South Africa. Thus the 1980s saw a mass exodus of US multinationals in particular, with subsidiary companies being sold to South African interests, often at bargain prices.

In contrast to the problems associated with having a highly visible business interest in South Africa, portfolio investment in equities listed on the Johannesburg Stock Exchange (JSE) offered anonymity through a variety of legal devices. Accordingly, foreign investors continued to take an active interest in South African securities throughout the sanctions years. However, the sanctions campaign was to have an impact on institutional investors, whose holdings were a matter of public record and therefore open to scrutiny. Many such organisations found themselves pressured into selling their South African holdings.

Given South Africa’s pariah status, high rate of inflation and recurrent racial conflict, were JSE-listed equities a good investment during the sanctions years? Further, now that apartheid and sanctions have passed into history, what of the future for South African equities?

INVESTMENT ENVIRONMENT
From an investment viewpoint, a natural starting point for a study of JSE equity returns is 1960, the year of the Sharpeville shootings. The immediate effect of the tragedy was a flight of capital and the introduction of exchange controls. These controls have continued to deprive South African individual and institutional
investors of the opportunity to hold internationally diversified portfolios. The vast sums of money flowing into institutionalised saving have been forced into local investments. Accordingly, the so-called “pressure of funds theory” sees institutional money as having provided the driving force behind JSE equity prices.

For non-residents the exchange control regulations introduced severe restrictions on the repatriation of funds from South Africa, so creating what became known as the “blocked rand”. In 1976 there was some relaxation of controls, and the blocked rand was renamed the “securities rand”. This, in turn, was to become the “financial rand” (Finrand) in 1979.

The creation of the Finrand mechanism meant that the republic had a two-tier exchange rate system: the Finrand and the commercial rand. This remained in operation until March 1995, when greatly improved perceptions of South Africa made a unified rate possible once again.

Finrand were created when foreign investors, described as “non-residents”, sold assets, mainly securities and fixed investments, in South Africa. Technically, Finrand were credit balances on non-resident-owned blocked bank accounts which contained the proceeds of securities sold through the JSE. The demand for the currency came from non-residents wishing to invest in the republic, and from South African emigrants. The investment alternatives to which Finrand could be put were varied from time to time by the South African authorities.

As certain South African securities are quoted on foreign exchanges, such as London and New York, Finrand could be created by purchasing equities abroad and selling in Johannesburg. The effect was to strengthen share prices abroad and weaken them on the JSE. Conversely, non-residents wishing to disinvest from South Africa could purchase shares in Johannesburg and sell abroad, with the result that JSE prices would firm relative to those in other centres. Generally, therefore, there tended to be an inverse relationship between the Finrand and JSE prices, but other factors also affected this relationship.

**RATES OF RETURN**

Table 1 shows the annual nominal rates of return achieved by JSE-listed equities for the 35-year period from 1960 to 1994. Accumulation returns are tabulated for the JSE Actuaries Overall Index, the Financial and Industrial Index and the All Gold Index. The latter two indexes were selected as being representative of the two major groups of equities traded on the JSE. (In addition, there are other sub-indexes of the JSE Actuaries Overall Index.) All three indexes are capitalisation-weighted.

In terms of the market as a whole, Table 1 indicates that negative returns were recorded in only eight of the 35 years reviewed. Financial and industrial shares also suffered negative returns in eight years. The figure for gold shares is higher at 13 years.

Table 2 shows annual rates of inflation in South Africa from 1960 to 1994 as measured by the consumer price index (CPI). A period of relative price stability in the 1960s was followed by a sharp rise in the annual rate of inflation, with a peak of 18.5 per cent in 1985. The rate remains in the region of 10 per cent, well above the OECD average. A high rate of inflation appears to have become a permanent feature of the South African economy and hedging against a further decline in the purchasing power of the currency has been a major investment objective for South Africans.

Explanations for South Africa’s inflationary problem have been many and varied over the years. Opponents of the Nationalist government saw inflation as the inevitable consequence of apartheid. According to this view, wasteful expenditure on separate amenities and administrations, a skills shortage caused by job reservation, restrictions on the movement of black labour and inadequate expenditure on black education were the main forces driving inflation.

Did South African equities provide a hedge against inflation? Table 3 shows the annual real rates of return achieved by JSE-listed equities from 1960 to 1994. These were obtained by deflating the returns shown in Table 1. In addition, compound real returns over various periods are set out in Table 4.

JSE-listed equities generally seem to have performed well during the period reviewed, serving as a good hedge against inflation. Tables 3 and 4 lead to the following observations:

- Over the entire 35-year period, industrial and financial shares outperformed both gold shares and the market (Table 4), earning a high average annual real return of 8.5 per cent. Industrials and financials did best in 1968, earning a real return of 60.7 per cent, and worst in 1970, with a return of -43.1 per cent. For gold shares the corresponding years were 1993 and 1990, with real returns of 154.6 per cent and -46.4 per cent respectively.
- Industrials and financials fared partic-
ularly well in the years before the great market crash of 1969-70, when inflation was low, and again during the economic upswing of the late 1970s and early 1980s when, in sharp contrast, inflation was particularly high. Further, this sector continued to do well throughout the 1980s, even though these were difficult years in terms of foreign disinvestment and internal strife.

- Gold shares appear to have benefited greatly from the world-wide inflation of the 1970s, achieving a 20.1 per cent average real return over the decade. However, the metal has since fallen out of favour, with the returns on gold shares suffering accordingly. Nevertheless, 1993 saw the gold index achieve a return of 15.46 per cent in real terms.

- Risk, as measured by the standard deviation of returns, was significantly higher for gold shares than for either the market as a whole or financial and industrial shares. This statistical outcome may be attributed to the speculative nature of the metal since the end of the fixed-price regime set up under the Bretton Woods agreement.

### INTERNATIONAL COMPARISON

How do the real rates of return achieved by JSE-listed equities compare with those obtained in other markets?

Two international studies are particularly informative. The first, by Ibbotson, Carr and Robinson (1982), compared equity and bond returns for 18 countries from 1960 to 1980, a period which saw the policy of apartheid at its zenith. No African markets were included in the sample. In nominal terms, the study's index of world total equities (in $US) achieved an annual compound return of 9.3 per cent over the 21-year period, but there were considerable differences between countries, the highest being Hong Kong (24.6 per cent) and the lowest Italy (2.4 per cent), with Australia coming in at 9.8 per cent. Over the same period, South African equities, in local currency terms, enjoyed average annual nominal and real returns of 16.7 per cent and 8.7 per cent respectively, figures which put the republic near the top of the international performance scale, without adjusting for currency.

Recent work by Ibbotson and Brinson (1993) compares the returns in 19 developed stockmarkets, including

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Note: These returns are based on movements of the JSE-Actuaries All Shares, Financial and Industrial, and All Gold Indexes. Taxation and transaction costs have been ignored.
Johannesburg, from 1970 to 1990. The authors calculated the returns from the Morgan Stanley Capital International Index but, in the case of South Africa, the FT-Actuaries World Indices were used and only the period from 1980 to 1990 was covered. In domestic currency terms, Hong Kong was the top performer with a compound annual nominal return of 20.7 per cent, the United States, Australia and South Africa achieving rates of 10 per cent, 9.6 per cent and 8.8 per cent respectively.

However, as the figure of 8.8 per cent for South Africa takes into account only the period from 1980 to 1990, this is hardly an appropriate comparison. Accordingly, I have used the JSE-Actuaries Index to calculate the compound annual nominal return over the full 21-year period from 1970 to 1990. This was found to be 19.1 per cent, with a compound annual real return of 5.9 per cent. Again, these figures show the JSE in a favourable light by international standards.

THE FUTURE
What of the prospects for JSE-listed equities? Historical rates of return are, of course, not necessarily indicative of the future, especially when fundamental economic, political and social changes are taking place, as is the case in South Africa today. Nevertheless, the market seems to have taken the transition to black majority rule in its stride, with good returns being recorded both in the run up to the election (1993) and thereafter (1994), while the second half of 1995 saw the market bounce back strongly after a correction earlier in the year.

Several factors support an optimistic view of the JSE, at least in the short run. On the political front, the ANC has abandoned its Marxist rhetoric and embarked on a policy of privatising large sections of the economy now in state hands. Further, the new administration has displayed an unexpected degree of fiscal discipline, and has gone to great lengths to encourage foreign investment by, for example, scrapping the financial rand mechanism, abolishing the 15 per cent tax on non-resident shareholders, and despatching the deputy president, F.W. de Klerk, on a number of promotional trips. In short, the ANC has been at pains to reassure both South African and foreign business that it is a reasonable and responsible middle-of-the-road social democratic party. These efforts have been rewarded by the return of many of those multinationals which fled the country in the dying years of the apartheid regime.

Economic fundamentals also look good. South Africa is the powerhouse of the subcontinent, with transport and trade tentacles throughout the region. Indeed, the republic's geographical position and well developed infrastructure make it attractive to companies wishing to enter the southern African market. The country is also rich in natural resources, and would stand to benefit from any strengthening of commodity prices. With a weak rand,
South African firms are well positioned to recapture markets lost during the sanctions years. Australian business is likely to feel the effects of this competition.

Three economic issues are of particular importance to investors. Although at its lowest level in two decades, inflation remains a threat. In fact, a burgeoning money supply has compelled the Reserve Bank to resist calls to lower interest rates, with the result that South Africa's real rates are among the highest in the world. Clearly, the rand remains vulnerable to further long-run depreciation against other currencies. Second, there is the possibility that exchange control for South African residents may also be ended, a move recently advocated by the IMF. In this event, the diversion of funds from the local market to foreign investment could be considerable. Finally, there is the question of microeconomic reform. South Africa's economic policymakers have indicated their wish to free the republic from the protectionist legacy of apartheid and expose local industry to international competition. However, given the high rate of unemployment, which some estimates put at 45 per cent of the eligible black population, this will require considerable political bravery.

To conclude, the record of the past 36 years shows JSE-listed equities to have offered generally good returns, sanctions notwithstanding.

REFERENCES