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Soapbox

Author: Fabian de Beer | 17 November 2014 00:33

The changing nature of the JSE

SA economic growth's become a less important driver of the JSE's fortunes.

The FTSE-JSE All-Share Index (ALSI) has reached all-time highs over recent years despite negative news, ratings downgrades and a weakening rand. Business and consumer confidence have largely remained weak and the recent labour strikes have been particularly lengthy and damaging to the economy with the result that growth prospects have been revised downwards by many economists, as well as leading global financial institutions.

Given the weak and unexciting economic growth environment, how is it possible that the local bourse could continue marching upwards and register all-time highs? After all, generally investors expect economic growth to be a key driver of markets.

The answer lies largely in the changing nature of the JSE, influenced by changes in the investor base, market composition and company earnings sources. For example, post-1994, a number of major local companies have been allowed to dual-list thereby enabling access to foreign investor capital markets and many local companies have increasingly spread their interests beyond the borders of the domestic economy, irrespective of whether they are dual-listed or not. There have also been some inward and African company listings on the JSE.

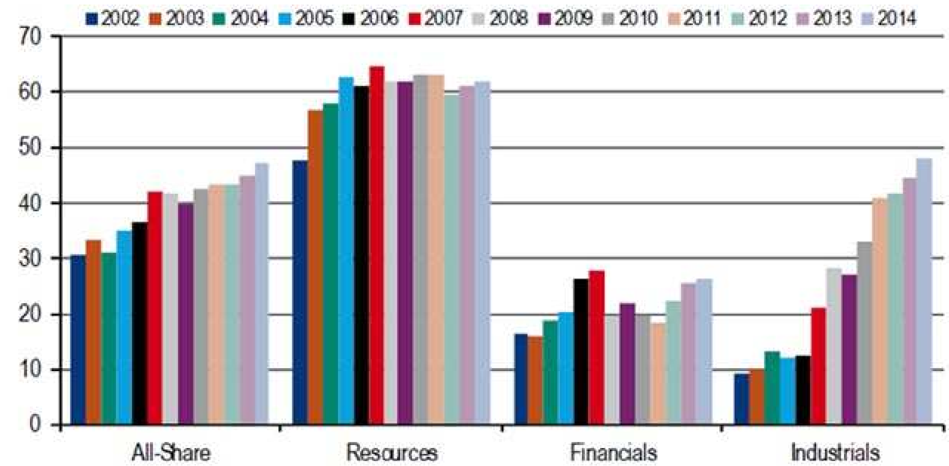
The globalisation of South African companies means that some company earnings are now derived from beyond our borders. This trend is likely to persist as successful local companies continue to explore growth opportunities offshore. The take-over by Woolworths of David Jones in Australia is a case in point. It is estimated that roughly 55% of FTSE-JSE earnings are now derived offshore. While estimates may differ among different sources, the figure remains significant.

The ALSI is highly concentrated and remains dominated by a few major capitalisation stocks, with the top seven stocks making up about 60% of the top 40. Many of these top counters tend to be dual-listed and/or derive their earnings from multiple geographic regions around the world. This has provided local investors with some foreign earnings exposure and thus more rand hedge opportunities compared to the past. This enables greater portfolio management flexibility and positioning. These developments are in any case a global phenomenon as companies search for new markets and growth opportunities.

Another contributor to transforming our stock market has been the increased appetite by foreign investors for emerging market growth prospects and thus for investment in companies exposed to such opportunities. This has created an important foreign investor component to African and especially South African markets. South Africa's free float adjusted equity foreign ownership (including dual-listed shares) is now approaching 50% compared to 30% in 2004, as shown in the graph below. This has disposed our stock market to greater offshore exposure and interest.

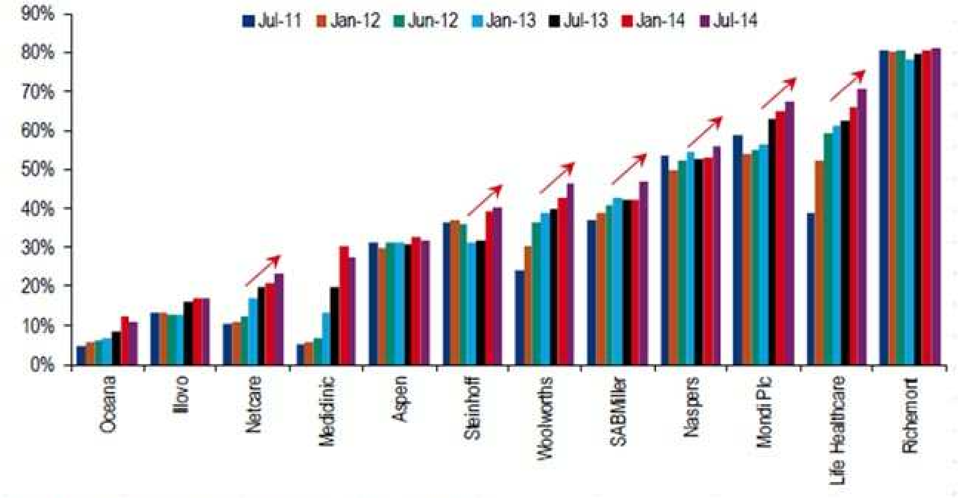
The implication is that South African economic growth, albeit a key factor given the context noted above, has become far less important as a driver of our local stock market's fortunes. Obviously global monetary policy stimulus packages have, in general, amplified the decoupling between the performance of equity markets and the underlying economies. Therefore foreign investor participation and the developments that have transformed and influenced the nature of our stock market have increasingly played a significant part in the fortunes of the FTSE-JSE ALSI.

South Africa free float foreign ownership including dual-listeds



Source: BofA Merrill Lynch South Africa Strategy, STRATE (01 Jul 2014)

Non-resource ZAR hedges, high non-SA revenue and growth stocks continue to gain



Source: BofA Merrill Lynch South Africa Strategy, STRATE (01 Jul 2014)

The chart above illustrates that non-resource ZAR hedges (Mondi, Naspers, SABMiller), high non-SA revenue (Steinhoff, Woolworths) and growth stocks (Life Healthcare, Netcare) have remained in demand, given the lacklustre domestic growth. Furthermore, they provide non-resource rand hedge properties.

Top 10 stocks/sectors by foreign ownership

Stocks				Sectors			
	Jan-14	Jul-14	Δ (ppt)		Jan-14	Jul-14	Δ (ppt)
BHP Billiton	82%	84%	2	Luxury	80%	81%	1
Richemont	80%	81%	1	General Mining	73%	74%	1
Massmart	76%	74%	-1	Gold	68%	70%	2
AngloGold	70%	73%	3	Media	53%	56%	3
Life Healthcare	66%	71%	5	Telecoms	54%	53%	-1
Gold Fields	69%	67%	-1	Paper	51%	51%	0
Mondi Plc	65%	67%	2	General retailers	49%	50%	1
Truworths	61%	66%	4	Food and drug retailers	50%	50%	0
Capital & Counties	59%	63%	4	General Finance	43%	50%	6
Tiger Brands	63%	62%	-1	Transport	46%	48%	2

Source: BofA Merrill Lynch South Africa Strategy, STRATE (01 Jul 2014).

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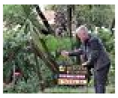
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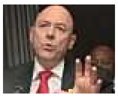
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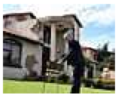
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