Dear fellow IAS member

One of the benefits of being a member of our 50-year old professional body is the complementary access members have to the Investment Analysts Journal (IAJ). The IAJ, the first issue of which was dated November 1972, publishes significant new research in finance and investments with a suitable balance between the theoretical and the empirical. Papers submitted cover the related disciplines of finance, investment, accountancy, and economics. A substantial commitment is made by the IAS with respect to the funding, supervision, and guardianship of the Journal to ensure its continuing success and it is published in three volumes annually. In addition, the IAS has sponsored a special South African Finance Association conference edition. The IAS is proud of its flagship contribution to the body of knowledge in our profession.

The Journal is going from strength to strength under the direction of Editor-in-Chief, Professor Christo Auret at Wits University, ably assisted by Professor Robert Vivian, Professor Doojin Ryu, Professor Adam Zaremba, and Liezel du Plooy, IAJ Editorial Assistant, all of whom put in a great deal of hard work and dedication. We as the Board are deeply grateful for their services.

The IAJ is privileged to have eminent Editorial Board Members who give selflessly of their time in the pursuit of research excellence in our field. As of December 2018, there are fourteen Editorial Board Members from five countries. The IAS is also cognisant of the fact that a double-blind review system can only be effective if there is an active community of appropriately qualified, selected, and willing reviewers. We are therefore appreciative of the importance of such people in helping make the IAJ recognised as an international Journal of standing.

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The growing circulation of the IAJ is underscored by the Clarivate Impact Factors being achieved, a listing with the Chartered Association of Business Schools Journal Quality Guide, the number of submissions received from around the world, and that only a few manuscripts received are considered exceptional enough to be finally published. On average, only 10% to 15% of manuscripts received make the cut for final publication, underscoring the rigor applied.

As an example of the excellence we strive for at the IAJ, I attach to this email the full winning article for the 2017 IAJ prize, jointly authored by Professor Chih-Hsiang Chang and Associate Professor Chien-Feng Huang. The article is entitled "The disposition effect, price performance and fundamentals of IPOs: Evidence from Taiwan" which was published in Vol. 46, Issue 4, pages 263 – 278. The work of the authors is a valuable addition to the science of human behaviour and the role this plays in influencing investment decisions.

Please also click here to view the full winning article for the 2017 IAJ prize, an example of the excellence we strive for at the IAJ.

I have also attached below for your interest abstracts from several published articles.

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These articles are of inestimable value for continuing professional development and career progression, whilst apprising members of the latest thinking in our profession. The next issue of the IAJ (Vol. 48, Issue 1) is scheduled to be published on 22 February. I shall be updating you all regularly on articles that are published.

Mark N Ingham, Director (and on behalf of the Board of Directors)

Investment Analysts Society of South Africa NPC: Registration number 2014/014810/08

Celebrating 50 years of serving the investment industry

Timing information, SEC enforcement intensity and illegal insider trading

Han-Ching Huang

ABSTRACT

This paper explores the difference between illegal insider trading around scheduled and unscheduled corporate announcements. Moreover, this paper also examines whether the underlying option has impacted on trading patterns of illegal insider trading around corporate announcements. I find that the negative relationship between price run-ups and measures of SEC effort before unscheduled announcements is stronger than before scheduled announcements. Keeping other variables, the same, the relationship is stronger for stocks without traded options than for stocks with options listed. The results between illegal insider volume and measures of SEC effort are similar to those between price run-ups and measures of SEC effort. The abnormal returns and illegal insider volume do not decrease by category of defendant in the proposed order, which does not support the information hierarchy hypothesis.

The inflation-hedging ability of individual shares: Evidence from the Johannesburg Stock Exchange (JSE)

Johannes Hendrik van Rooyen & Daniel Lee Jones

ABSTRACT

The erosion of purchasing power due to inflation is a source of concern for investors who invest in stocks over long investment horizons.

This study examines the inflation-hedging abilities of stocks for South Africa over three different investment periods for both individual stock and for different sectors based on their inflation betas.

The results indicate that inflation-hedging betas did not produce conclusive evidence of hedging benefits. A 12-month rolling regression of three long-term portfolios with high, close to zero and low betas revealed that the zero-beta portfolio yielded the best average geometric real return over the 2004 to 2015 period. Measuring the inflation-hedging benefits of individual stocks and sector portfolios based on performance measures such as real return, reliability and risk-adjusted return was more conclusive. The results also suggest that some sectors such as technology, consumer staples and healthcare sectors exhibited better inflation-hedging possibilities than other sectors during unstable inflationary conditions.

The investment return puzzle on the Johannesburg Stock Exchange

Pravin Semnarayan, Michael Ward, & Chris Muller

ABSTRACT

Firms that invest into positive net present value projects should outperform firms that do not invest. Surprisingly, several studies on United States data have found a negative relationship between capital investment and subsequent shareholder return. There are conflicting explanations for this negative relationship. The present study also confirmed a significant negative relationship between capital investment and subsequent shareholder returns in the South African developing market conditions. Over the period from 1992 to 2017, shares on the Johannesburg Stock Exchange with lower investment rates consistently outperformed shares with higher investment rates, exhibiting similar behaviour to the US. We find that the negative investment return is significantly associated to the firm's book-to-market value consistent to the rational-based q-theory of investment with real options explanation.

Is investor sentiment a relevant factor in determining asset prices?

Kamini Solanki & Yudhvir Seetharam

ABSTRACT

The APT framework allows for a multitude of risk factors to be priced into asset returns, implying that it can be used to model returns using either macroeconomic or microeconomic factors. As such, the APT allows for non-traditional factors, such as investor sentiment, to be included. A macroeconomic APT framework was developed for nine countries using the variables outlined by Chen, Roll, and Ross (1986) and investor sentiment was measured by the FEARS index (Da, Engelberg, & Gao, 2015). Regression testing was used to determine whether FEARS is a statistically significant explanatory variable in the APT model for each country. The results show that investor sentiment is a statistically significant explanatory variable for market returns in five out of the nine countries examined. These results add to the existing APT literature as they show that investor sentiment has a significant explanatory role in explaining asset prices and their associated returns.

Institutional investment management: An investor's perspective on the relation between turnover and performance

Diego Víctor de Mingo-López, & Juan Carlos Matallín-Sáez

ABSTRACT

The main aim of this study is to analyse the relationship between turnover and performance in institutional investment management. For a sample of US equity mutual funds during the period January 1999–December 2014, we show that high-turnover funds do not beat low-turnover funds, since their performances are no different, or even significantly lower. Moreover, we show that investing in past high-turnover mutual funds provides investors with significantly worse results than investing in previously low-turnover funds. Investors aiming to enhance their risk-adjusted returns should therefore consider the turnover ratio level in their fund investment decisions.

Did informed order flow move to multilateral trading facilities? Evidence for some Eurozone countries

Paulo Pereira da Silva

ABSTRACT

This paper investigates the effects of the fragmentation of European stock markets after MiFID application in 2007. Specifically, we discuss whether the process of fragmentation elicited a flight of informed trading from the primary stock exchanges to the incoming multilateral trading facilities (MTFs). Our sample covers 438 stocks traded on six important markets of the Eurozone and the period ranging from 2010 to 2015. Our findings demonstrate that, on average, primary exchanges still drive the process of price formation. However, MTF platforms have been gradually expanding their influence over the price discovery process of some of the stocks so that for a non-negligible minority of them, MTFs already lead the price discovery.

International transmission of risk factor movements: The case of developed markets

Hyung-Suk Choi, Doojin Ryu & Heejin Yang

ABSTRACT

Under the Carhart four-factor system, this study examines the international transmission mechanism among country-specific risk factors by focusing on the cross-border transmission of factor innovation. We find that international stock markets are interrelated with respect to market, size, value and momentum factors, and developed countries play different roles in each factor system. Moreover, the United States (US) plays a dominant role in the market factor system, with US innovations in terms of size and momentum factors being significantly transmitted to other markets, whereas its influence on the value factor seems marginal. The United Kingdom is found to be the most influential market in the size factor system. Finally, Japanese value factor innovations better explain Hong Kong variance than US value factor innovations. Our results indicate that international exposure to risk factors can be exploited to implement effective hedging strategies and manage globally diversified portfolio risks.

Less pain, more gain: Volatility-adjusted residual momentum in international equity markets

Adam Zaremba, Mehmet Umutlu, & Alina Maydybura

ABSTRACT

We offer a new type of momentum strategy — the volatility-adjusted residual momentum (VARMOM) — which is based on average past residuals scaled with their volatility. We demonstrate its application for international asset allocation within 51 country indexes and 888 industry portfolios from developed and emerging markets. The VARMOM trading strategy notably outperforms and subsumes a standard momentum strategy, delivering Sharpe ratios that are two to three times higher. The VARMOM is particularly strong across portfolios characterised by high limits to arbitrage and following bull markets, supporting the behavioural explanation of momentum. The results are robust to alternative portfolio construction methods as well as the inclusion of trading costs and control variables. They are also valid for several subperiods and subsamples.

The winner takes it all: Outperformance drives subsequent flows in South African Unit Trust Funds

Jennifer Arendse, Chris Muller & Michael Ward

ABSTRACT

The relationship between unit trust (mutual fund) performance and subsequent investment flows into and out of funds has been the focus of many international studies. Emerging markets, which are characterised by higher risk, weaker institutions, volatile economies and fewer participants, provide an attractive opportunity to examine the flow-performance problem in the context of higher arbitrage costs.

This study builds on the findings in the literature of the flow-performance relationship and aims to examine in more detail, and to quantify, the inflow into funds which outperform. The flow-performance relationship is important for investment businesses to understand because of the significant implications this has on the profitability of funds.

The research applies a portfolio time-series methodology to Morningstar's South African fund data, using a buy-and-hold analysis. Two-unit trust categories are tested, namely General Equity and Multi-asset High Equity funds, and within each category, single manager funds and fund of funds are tested separately.

Funds are ranked by their past performance over an optimised 14-month look-back period and assigned into quintiles. Net flows into each fund in the subsequent quarter are then determined, and the process rolled over on a quarterly basis from 2000 to 2015. We find convincing evidence from an emerging market perspective that equity funds need to perform in the top quintile to attract funds and observe that relative performance to peers is more important to investors than performance relative to other benchmarks. One additional inference is that the South African unit trust industry is set to face consolidation.

In search of conclusive evidence on the trade-off and pecking order theories of capital structure: Evidence from the Johannesburg Stock Exchange

Chimwemwe Chipeta & David McClelland

ABSTRACT

This paper tests the validity of the trade-off and pecking order theories of capital structure for non-financial firms listed on the Johannesburg Stock Exchange. Firstly, we find that the pecking order model is superior than the partial adjustment regressions at rejecting random financing behaviour. Secondly, tests on real data show that partial adjustment regressions confirm (reject) target adjustment behaviour for off (on) target firms. However, when falsely generated random financing gaps are used, the GMM model records a higher error rate compared to the Censored Tobit Regressions. Lastly, we propose alternative tests of both theories, and show that the pecking order theory works well, except under conditions where firms with reported financial deficits are at the bottom of the pecking order.