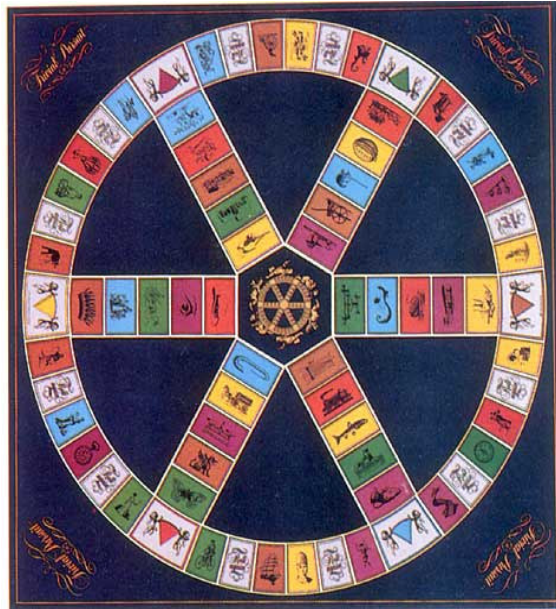


# INVESTMENT TRIVIA



**Foreign Portfolio Flows and Equity Returns**

**By Daniel R Wessels**

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**DRW INVESTMENT RESEARCH**

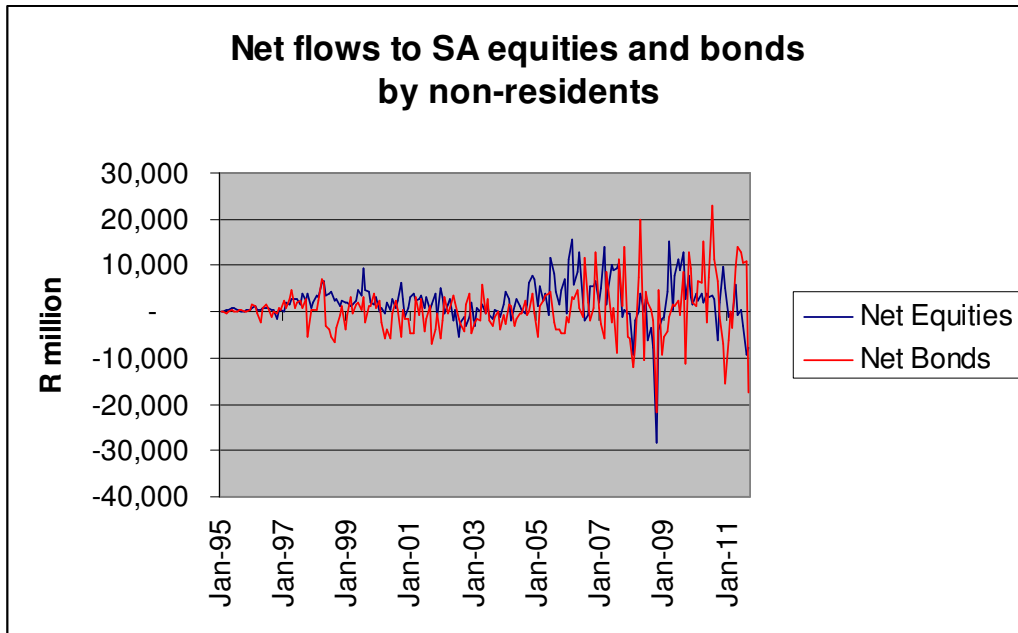
## **Part 6:**

### **The Relationship between Net Purchases of Equities by Non-residents and FTSE JSE Returns**

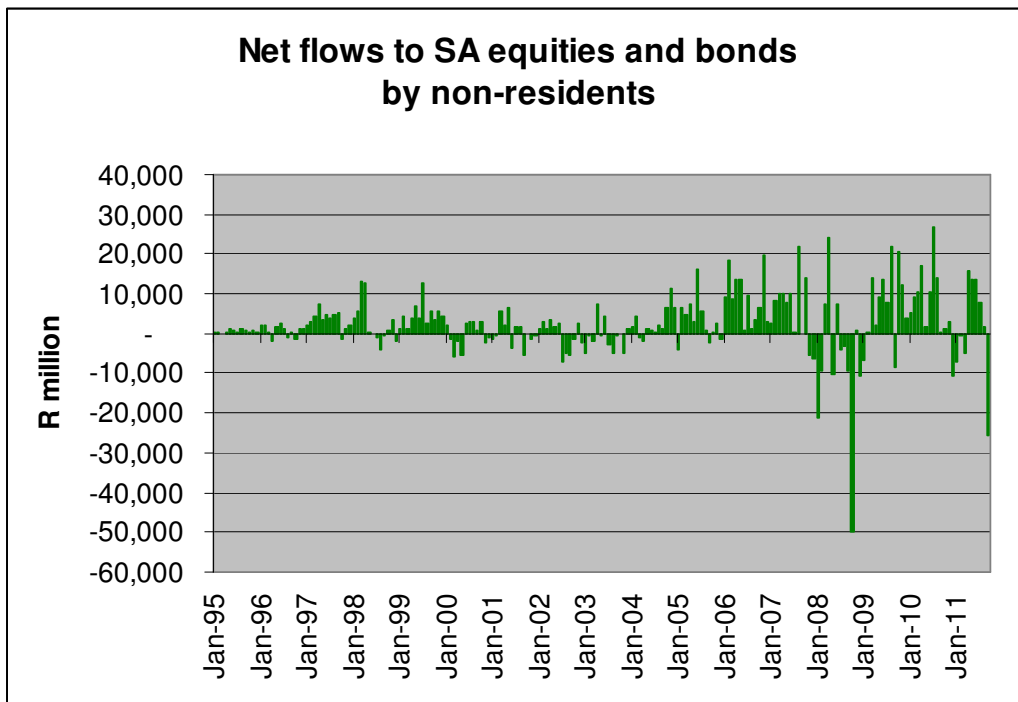
*Data:*

- The monthly net purchases of South African equities and bonds by non-residents (foreign portfolio flows) from January 1995 to September 2011.
- The closing values of the FTSE JSE All Share Index (ALSI) at month-end from June 1995 to September 2011.

1. Net purchases of shares and bonds by non-residents

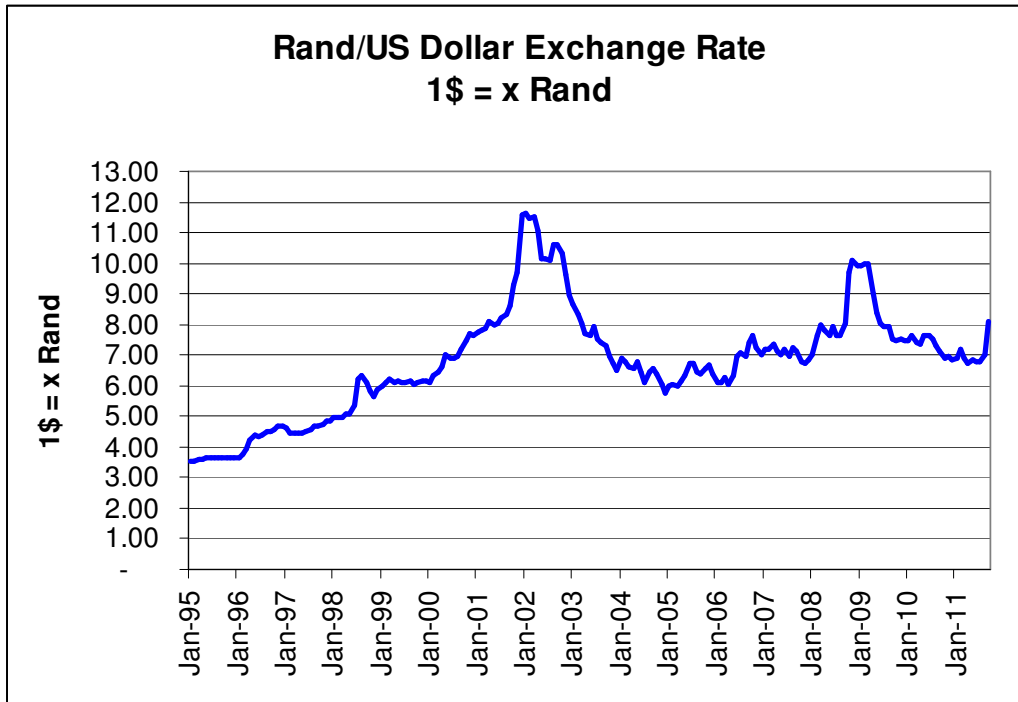


Source: SA Reserve Bank, DRW Investment Research

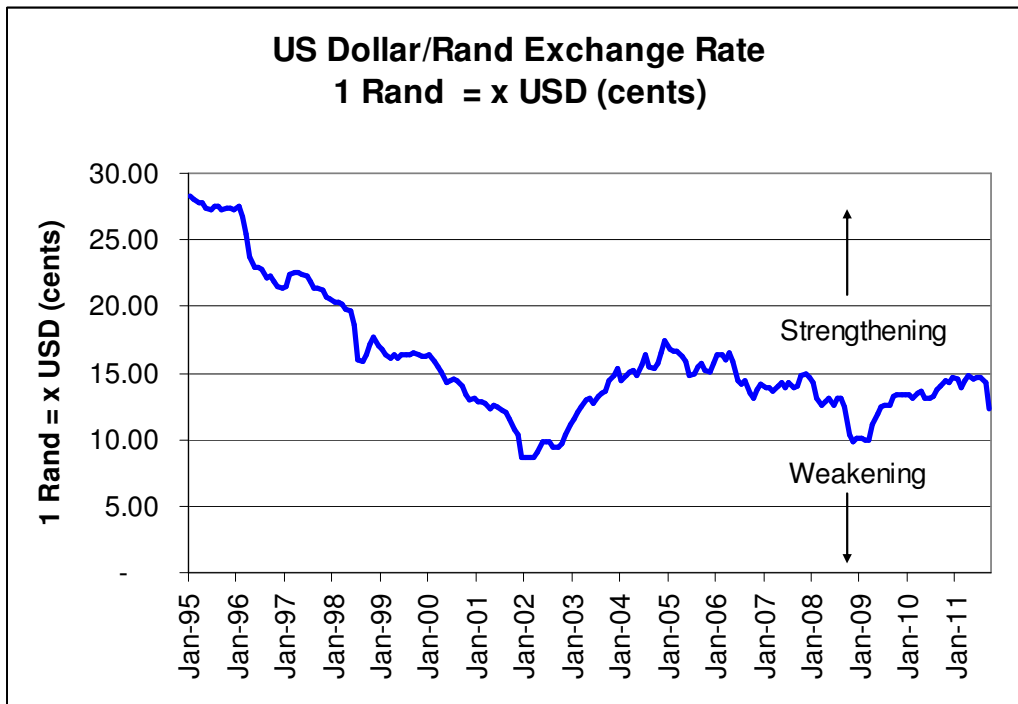


Source: SA Reserve Bank, DRW Investment Research

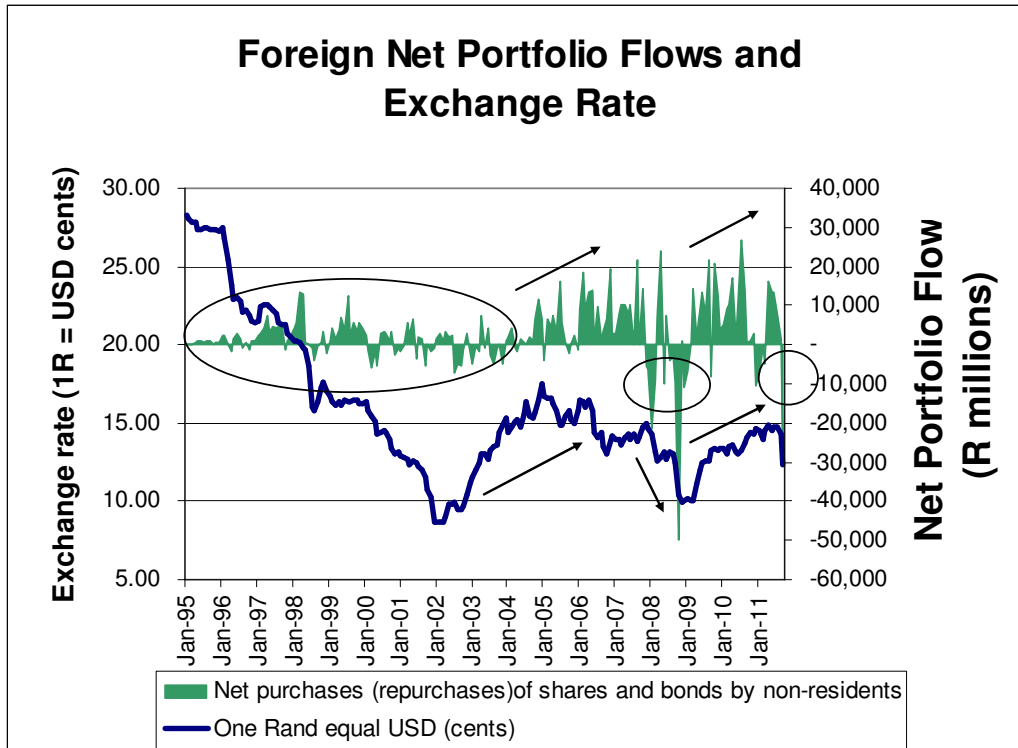
## 2. Foreign Portfolio Flows and R/USD Exchange Rate



Source: SA Reserve Bank, DRW Investment Research



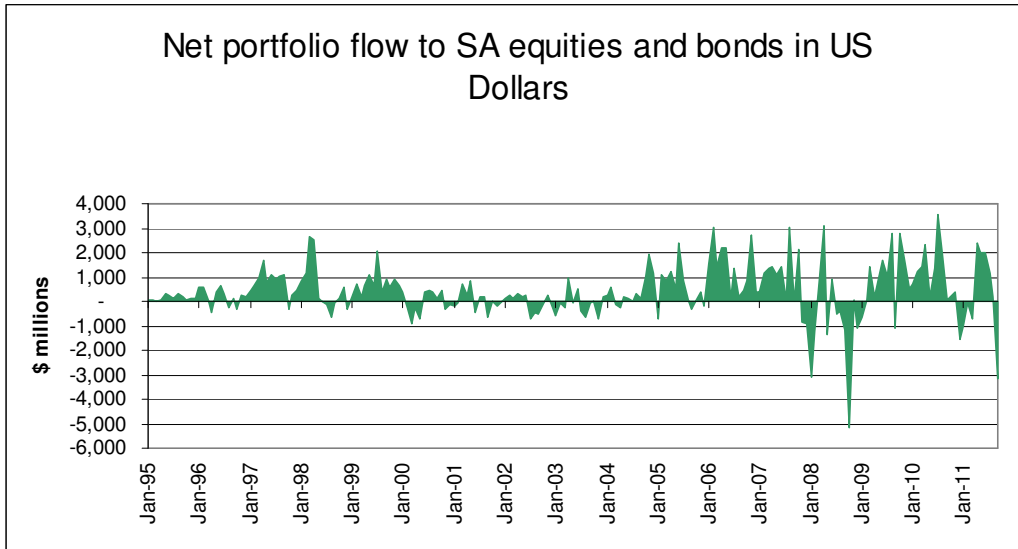
Source: SA Reserve Bank, DRW Investment Research



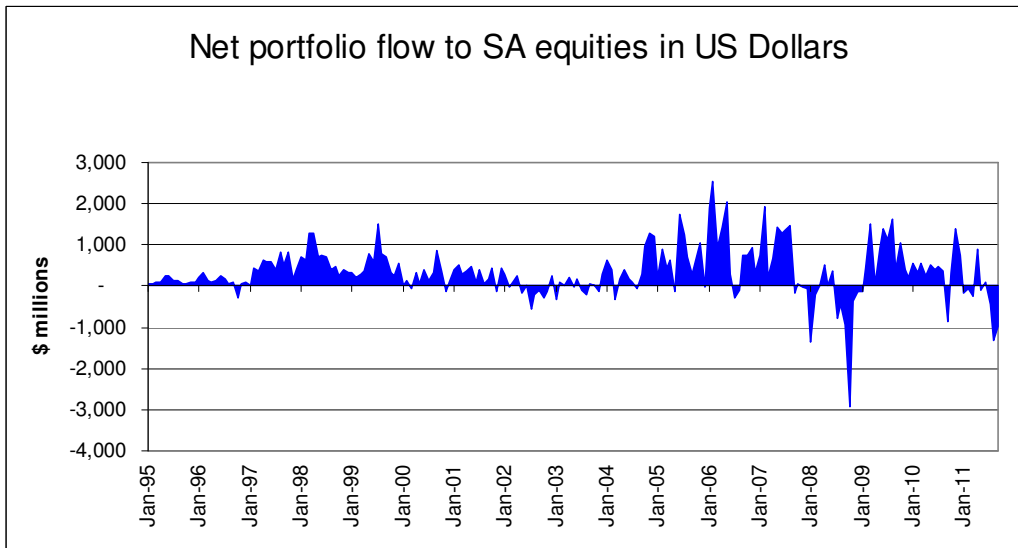
Source: SA Reserve Bank, DRW Investment Research

- The rand exchange rate followed most of the time a steady decline path versus the US dollar from the mid-1990s and reached its worst exchange rate towards the end of 2001. During those years portfolio inflows oscillated between net portfolio inflow and outflow positions, but often of modest proportions.
- From the mid-2000s continuous foreign portfolio inflows transpired as global investors frantically sought emerging market exposure in search of higher yields, and more specifically access to commodities markets, but this trend temporarily came to an abrupt end with the 2008 financial crisis in full swing (global markets panicked and foreign investors became risk averse).
- The strong foreign net inflows resumed as market fears eventually subsided during 2009 and 2010. However, the growing fears of another fierce global economic recession and insurmountable sovereign debt - especially among peripheral countries in the Eurozone – caused global investors to change their investment outlook once again in 2011 and thereby averting emerging market and currency exposure.
- Notably, the rand exchange rate improved drastically while foreigners invested heavily in the local markets. Likewise, the rand exchange rate deteriorated rapidly when foreign investors pulled out of the local market during times of uncertainty and market volatility.

### 3. Foreign Portfolio Flows in US Dollar



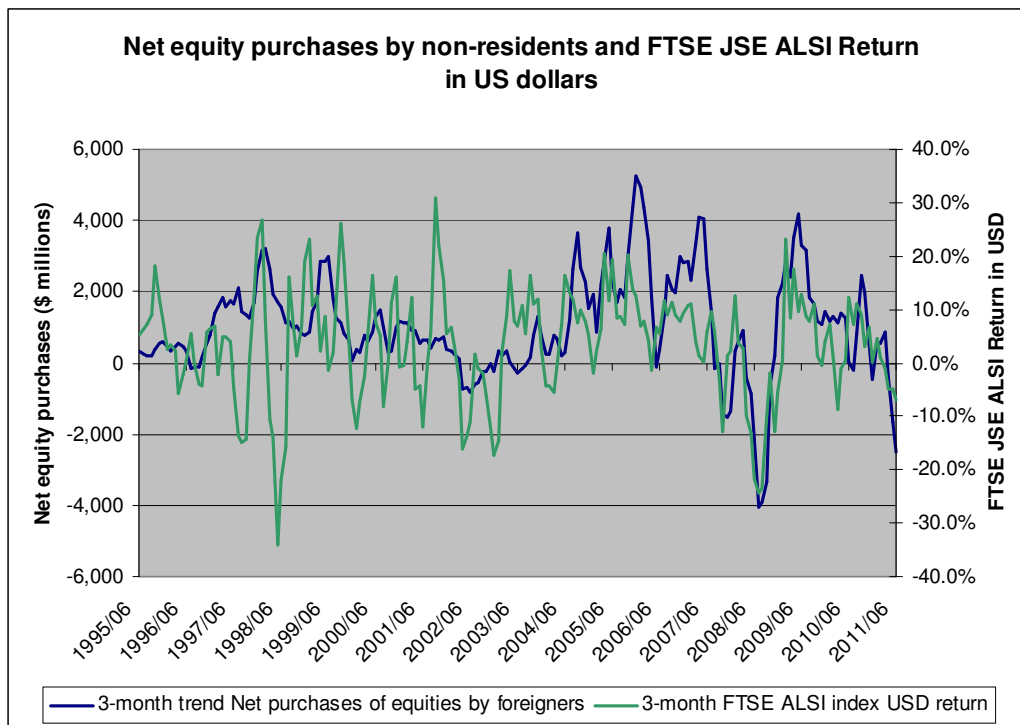
Source: SA Reserve Bank, DRW Investment Research



Source: SA Reserve Bank, DRW Investment Research

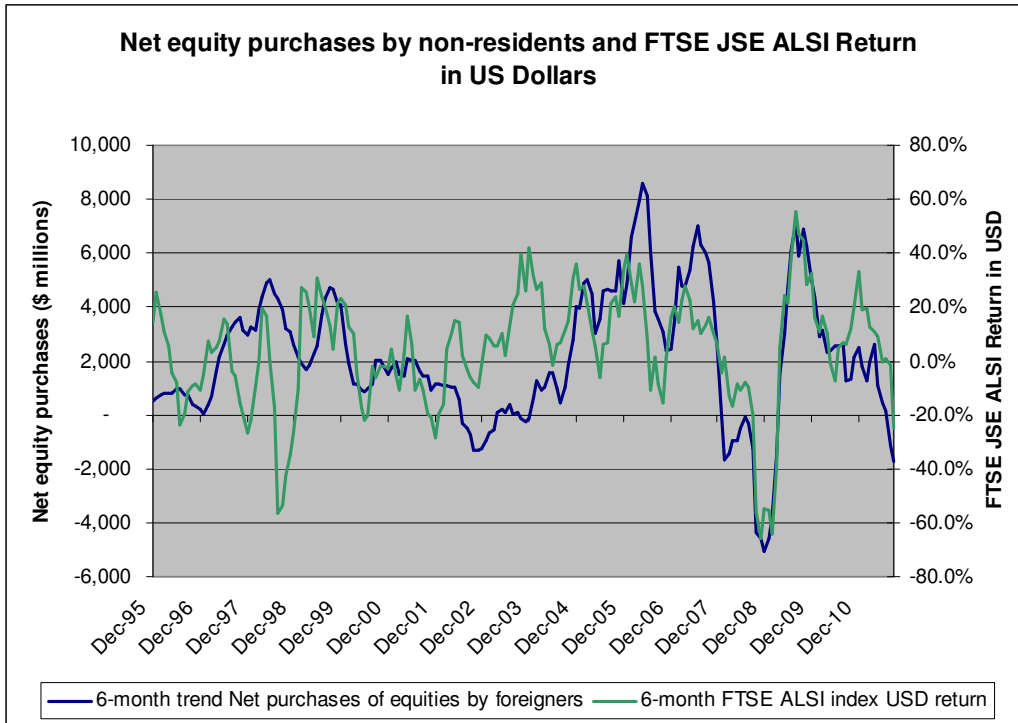
4. Correlations between net purchases of equities by non-residents and FTSE JSE All Share Index Returns in US Dollars

Monthly	0.25
3-month trend	0.43
6-month trend	0.45
12-month trend	0.39

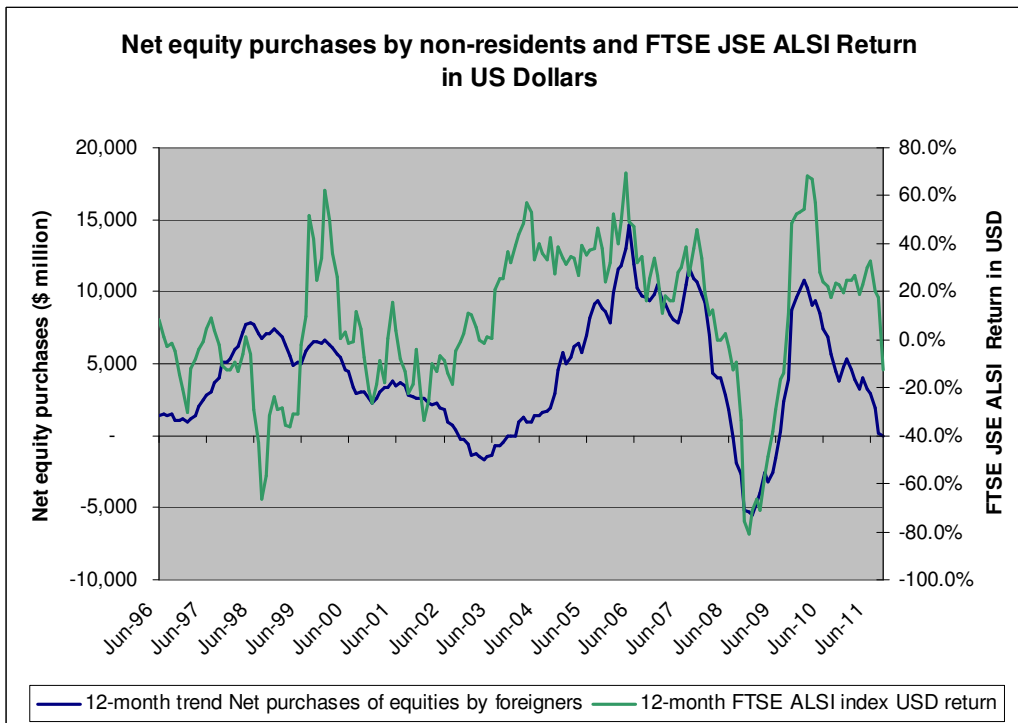


Source: DRW Investment Research





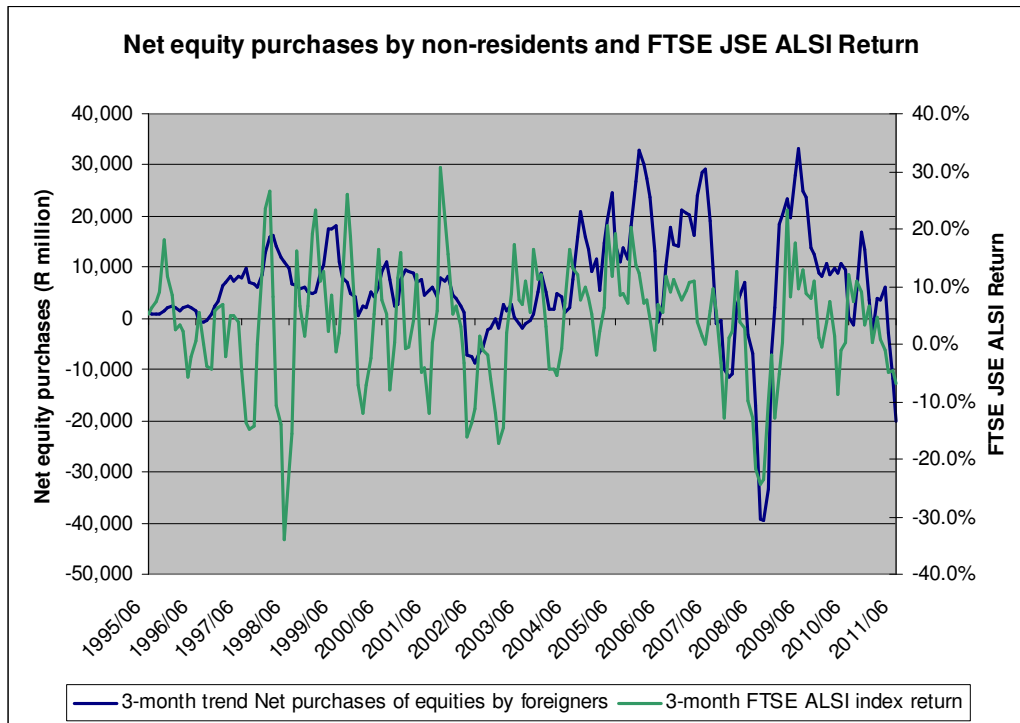
Source: DRW Investment Research



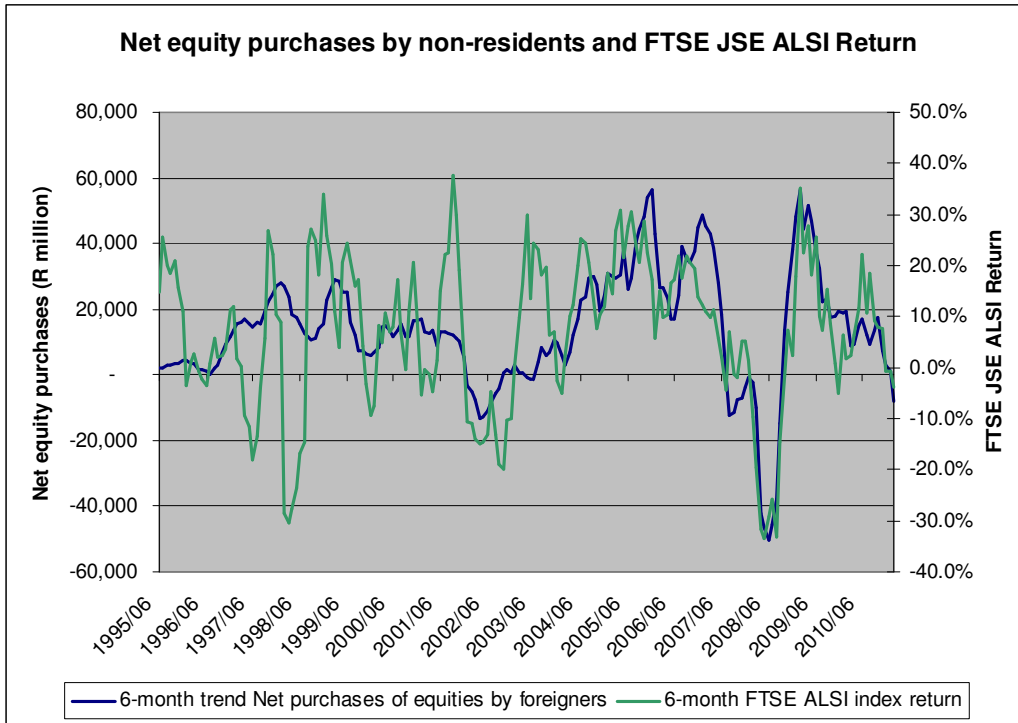
Source: DRW Investment Research

5. Correlations between net equity purchases by non-residents and FTSE JSE All Share Index Return in ZAR

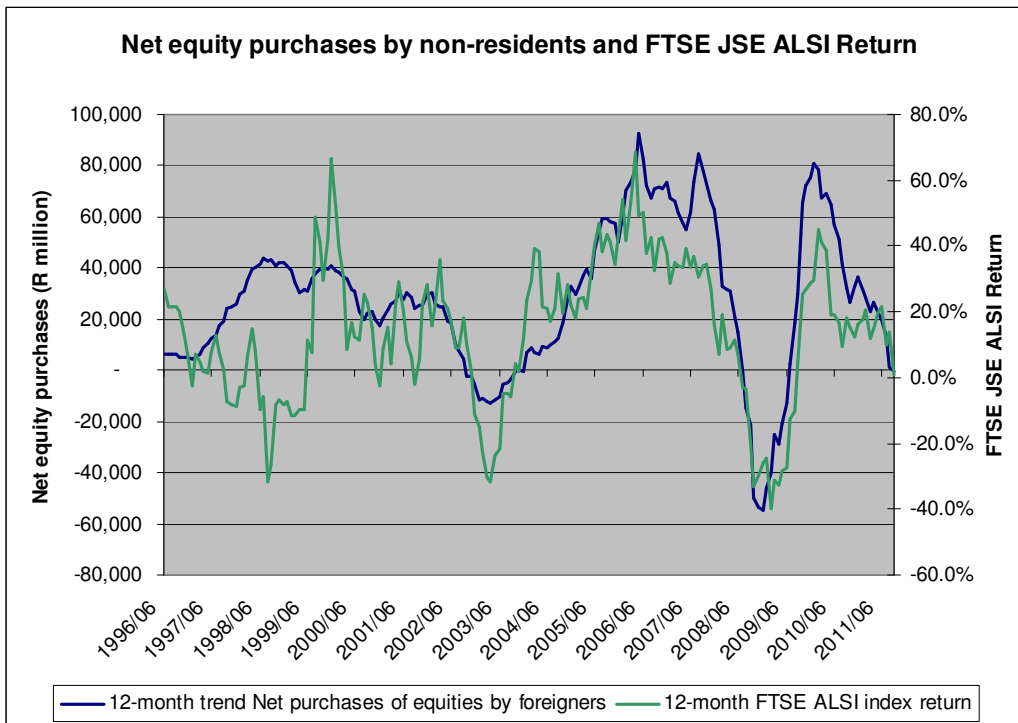
Monthly	0.22
3-month trend	0.37
6-month trend	0.49
12-month trend	0.54



Source: DRW Investment Research



Source: DRW Investment Research



Source: DRW Investment Research

- No significant correlation was identified between foreign equity investing and local market returns when measured on a monthly basis. However, a significant positive relationship was found between the cumulative foreign net portfolio flows and equity returns over shorter term intervals, both in US dollar and rand terms. In this respect it was found that the most significant correlation existed between the cumulative three- and six-month net equity flow and local equity market returns measured in US dollar, and the cumulative six- and twelve-month net equity flows and equity market returns in local currency.
- The cumulative buying or selling of local equities by foreign investors over short-term intervals may have a profound effect on the performance of local markets. For example, if the cumulative trend of equity purchases by foreigners over, say, the past 6 months were negative, it is likely that equity performances were disappointing over the same period, both in rand and US dollar terms.
- It is not certain, however, whether foreign portfolio inflows cause local markets to perform better or whether local market performance attracts more foreign investment flows. In all likelihood, it is probably a combination of both phenomena at play. For example, it is quite plausible that strong local market performance will lure global investors to the market, which in itself will bolster market prices and rand exchange rates, that in turn makes local market returns even more attractive to foreign investors. Therefore, the existence of a positive feedback loop may have a strong influence on foreign investors' behaviour. Obviously, the same situation, but in reverse will hold when foreign investors are selling off their holdings.



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