S&P Dow Jones Indices

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Index Education

# The S&P South Africa 50: Bringing Efficiency and Diversification to the South African Market


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## INTRODUCTION

The S&P South Africa 50 represents the South African equity market by selecting 50 of the largest companies listed on the Johannesburg Stock Exchange, including both South African and foreign-domiciled firms. To reduce risk from large exposures, no company can account for more than 10% of the index weight at each rebalance.

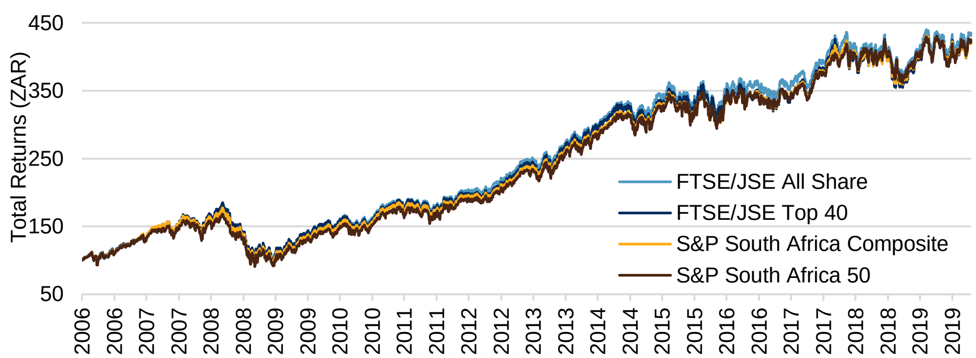
In comparison with the often used FTSE/JSE Top 40, the S&P South Africa 50 provides broader coverage and greater diversification, which contribute to its historically lower volatility and higher risk-adjusted returns.

## EFFECTIVE CORE EXPOSURE

Accessing the target market through a limited number of stocks is a hallmark of efficient investable indices. The S&P South Africa 50 addresses the need for an efficient index for product tracking that remains representative of the characteristics of the broad market S&P South Africa Composite.

Exhibit 1 illustrates the historical returns of the S&P South Africa 50 against the backdrop of S&P South Africa Composite and the FTSE/JSE indices, which attempt to reflect a similar target universe. The S&P South Africa 50 effectively captures the return profile of the broader market.

**Exhibit 1: S&P South Africa 50 – Efficient Exposure to South African Equities**




Source: S&P Dow Jones Indices LLC. Data from March 17, 2006, to Dec. 31, 2019. Index performance based on total return in ZAR. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

## TIGHT TRACKING ERROR DEMONSTRATES CLOSE REPRESENTATION

The tight tracking of the indices and comparable history illustrate the ability of the S&P South Africa 50 to efficiently replicate the return profile of the broader South African equity market. Since its inception,[1] the S&P South Africa 50 has delivered a relatively low tracking error of 1.8% per year against the broad market FTSE/JSE All Share, while the FTSE/JSE Top 40 posted a somewhat higher 2.0% tracking error against the same benchmark.

*Accessing the target market through a limited number of stocks is a hallmark of efficient investable indices.*

The inclusion of 10 additional stocks in the S&P South Africa 50 has contributed to its ability to represent the broad market. The index covers over 90% of the float-adjusted market cap of the FTSE/JSE All Share, while the FTSE/JSE Top 40 accounts for merely 84%.

## CAPPING TO MITIGATE SINGLE-STOCK RISK

Investing in stocks can be risky. However, investing in a single stock tends to be far riskier than investing in a diversified basket of stocks, since performance is more prone to be driven by factors beyond macroeconomic forces.

*The typical broad diversification of well-built indices has, in part, led to their wide adoption and popularity.*

Over the past several years, the impressive growth of Naspers has resulted in the company becoming a considerable weight within South African indices. While Prosus was spun off as a separate company in September 2019, Naspers retains a majority ownership stake in Prosus, leaving the fortunes of the two companies—along with their connection to Tencent—aligned to some extent. As a result, understanding the combined exposure of the two companies may be useful, as large concentrated weights have a greater ability to affect the performance of a market index (see Exhibit 2).

While the FTSE/JSE Top 40 historically suffered from much larger concentration issues, the index continues to have outsized concentration compared to the S&P South Africa 50. The result is that the top three stocks in the S&P South Africa 50 compose roughly 30% of the index, while the same three stocks make up over 36% of the FTSE/JSE Top 40.

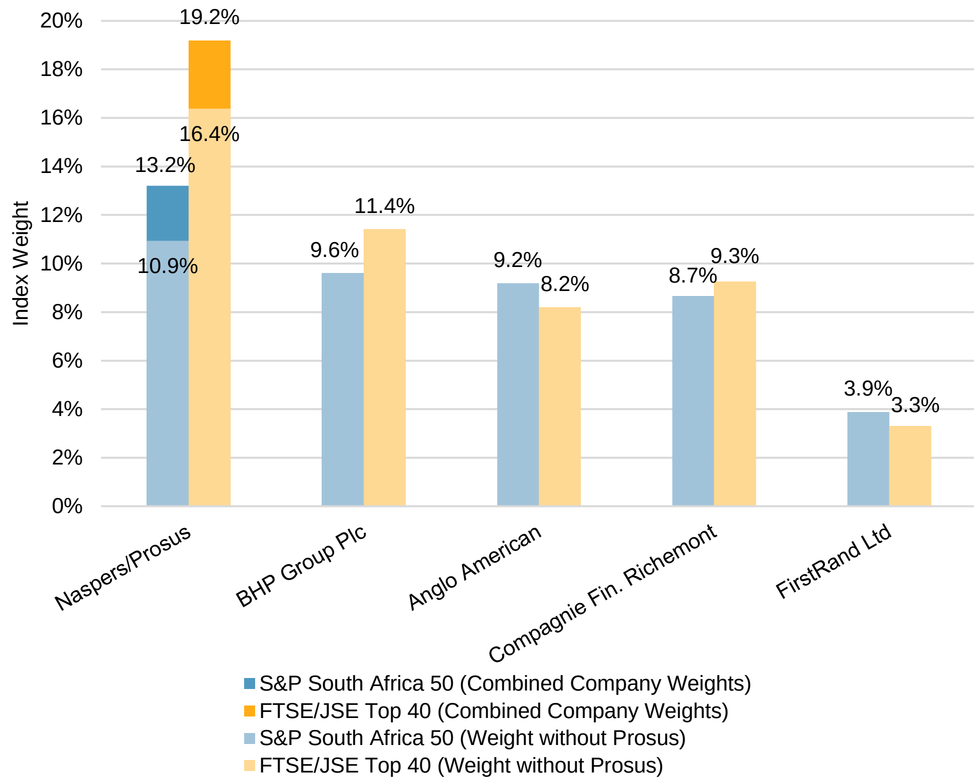
[1] The S&P South Africa 50 was launched on Feb. 6, 2014, and its first value date is Sept. 19, 2008.

*Investing in a single stock tends to be far riskier than investing in a diversified basket of stocks.*

*South Africa's large-cap equity indices provide an interesting case study.*

*The S&P South Africa 50 boasted a dividend yield of 3.6%, highlighting an additional benefit of the reduced single-stock risk.*

**Exhibit 2: Top Company Exposures – S&P South Africa 50 and FTSE/JSE Top 40**




Source: S&P Dow Jones Indices LLC, FTSE. Data as of Dec. 31, 2019. Chart is provided for illustrative purposes.

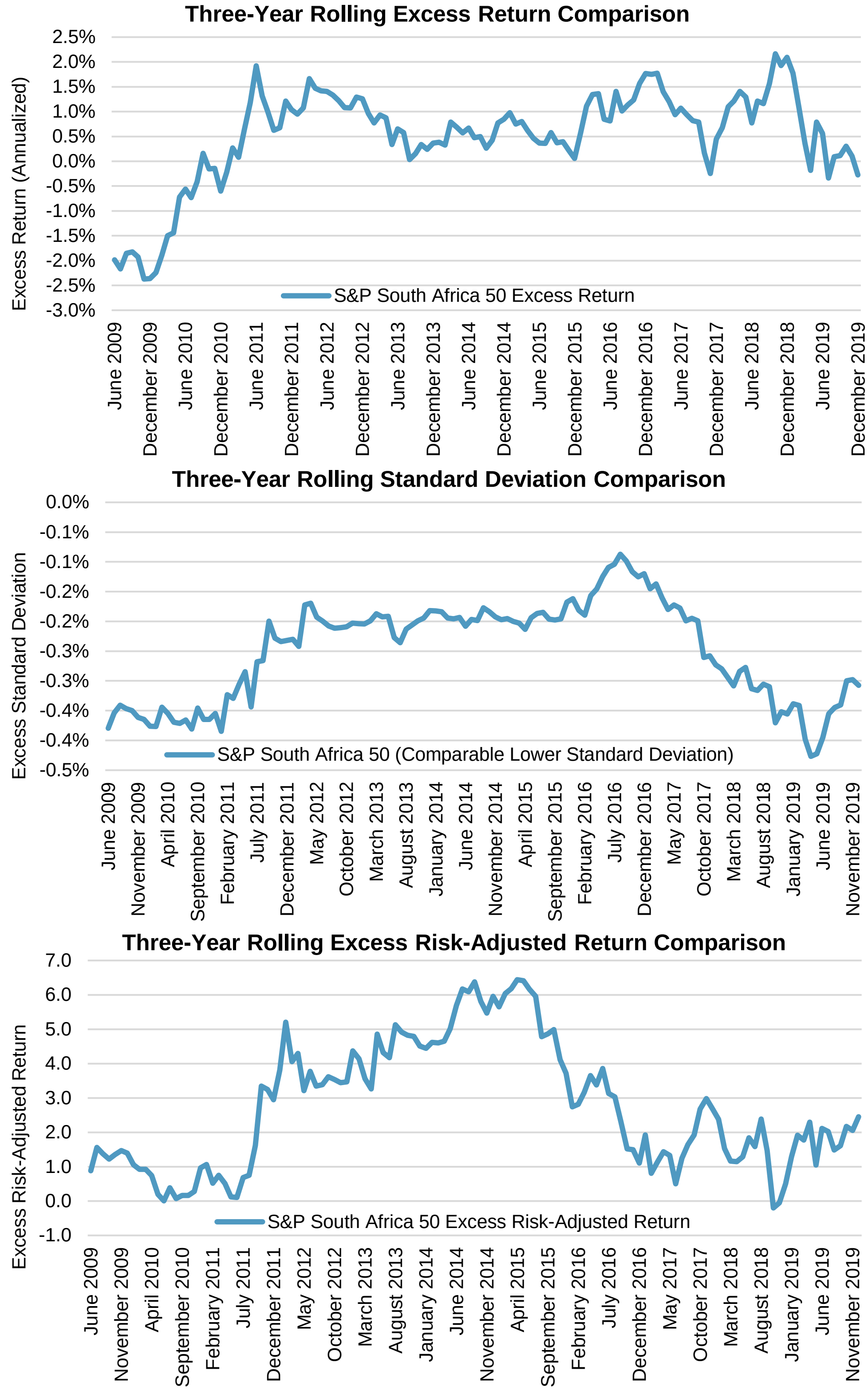
Due in part to the reduced exposure to Naspers and Prosus—which pay few dividends—the S&P South Africa 50 boasted a somewhat larger dividend yield of 3.6% compared to 3.4% for the FTSE/JSE Top 40,[2] highlighting an added benefit of the reduced single-stock exposure.

## COMPARING RETURNS AND RISK

While returns vary in the near term, the S&P South Africa 50 exceeded the returns of the FTSE/JSE Top 40 over a majority of longer-term periods. To measure the comparable return profiles of the indices, three-year rolling performance is used in Exhibit 3. With the exception of portions of 2009 and 2010, returns favored the S&P South Africa 50, while standard deviation was lower across the entire period studied (see the first two charts in Exhibit 3). The strong relative returns, combined with consistently lower standard deviation, led to significantly improved risk-adjusted returns over virtually all periods for the S&P South Africa 50 (see the third chart in Exhibit 3).

[2] Dividend yields as of Dec. 31, 2019.

**Exhibit 3: S&P South Africa 50 versus FTSE/JSE Top 40**




Source: S&P Dow Jones Indices LLC, FactSet. Data from June 30, 2019, to Dec. 31, 2019. Index performance based on total return in ZAR, with standard deviation calculated on a monthly basis. Past performance is no guarantee of future results. Charts are provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

*The S&P South Africa 50 exceeded the returns of the FTSE/JSE Top 40 over a majority of longer-term periods.*

*Returns favored the S&P South Africa 50, while standard deviation was lower across the entire period studied.*

*The strong relative returns led to significantly improved risk-adjusted returns for the S&P South Africa 50.*

## CONCLUSION

*The S&P South Africa 50 is designed to be sufficiently broad while serving seamlessly as a basis for investment products.*

The S&P South Africa 50 has consistently outperformed the historical risk/return profile of its competitor index, the FTSE/JSE Top 40, and is ideal for market participants seeking efficient core representation while limiting outsized single-company concentration. It is important that market participants understand how the South African equity opportunity set is represented: the S&P South Africa 50 is designed to be sufficiently broad while serving as an effective basis for investment products—favoring a balance between essential diversity and ease of replication.

# PERFORMANCE DISCLOSURE

The S&P South Africa 50 and The S&P South Africa Composite were launched February 6, 2014. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. However, when creating back-tested history for periods of market anomalies or other periods that do not reflect the general current market environment, index methodology rules may be relaxed to capture a large enough universe of securities to simulate the target market the index is designed to measure or strategy the index is designed to capture. For example, market capitalization and liquidity thresholds may be reduced. Complete index methodology details are available at www.spdji.com. Past performance of the Index is not an indication of future results. Prospective application of the methodology used to construct the Index may not result in performance commensurate with the back-test returns shown.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the Index is set at a fixed value for calculation purposes. The Launch Date designates the date upon which the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its datafeed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

The back-test period does not necessarily correspond to the entire available history of the Index. Please refer to the methodology paper for the Index, available at www.spdji.com for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations.

Another limitation of using back-tested information is that the back-tested calculation is generally prepared with the benefit of hindsight. Back-tested information reflects the application of the index methodology and selection of index constituents in hindsight. No hypothetical record can completely account for the impact of financial risk in actual trading. For example, there are numerous factors related to the equities, fixed income, or commodities markets in general which cannot be, and have not been accounted for in the preparation of the index information set forth, all of which can affect actual performance.

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