S&P Dow Jones Indices

A Division of S&P Global

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 is designed to represent 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 concentration risk, no company can account for more than 10% of the index weight at each rebalance.

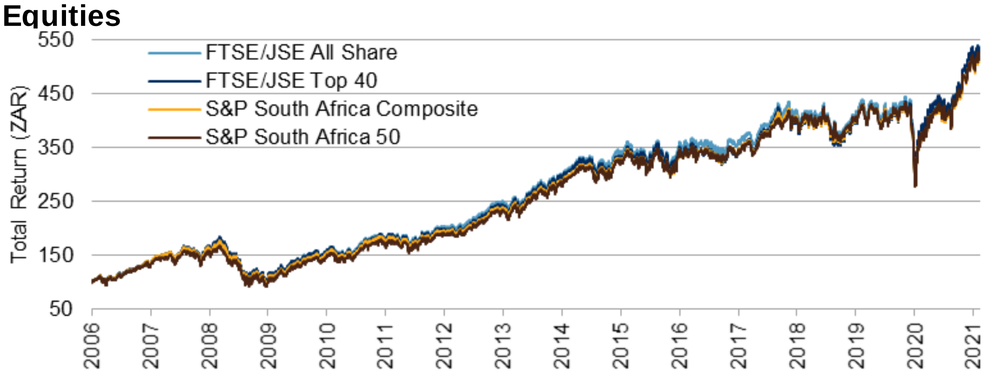
In comparison with the often-used FTSE/JSE Top 40, the S&P South Africa 50 provides broader coverage and greater diversification, which contribute to its historically lower volatility and higher risk-adjusted returns.

EFFECTIVE CORE REPRESENTATION

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 captured the return profile of the broader market.

Exhibit 1: S&P South Africa 50 – An Efficient Measure of South African Equities



Source: S&P Dow Jones Indices LLC. Data from March 17, 2006, to April 30, 2021. 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

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

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 1.9% 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.

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 94% of the float-adjusted market cap of the FTSE/JSE All Share, while the FTSE/JSE Top 40 accounts for a lesser 88%.

CAPPING TO MITIGATE SINGLE-STOCK RISK

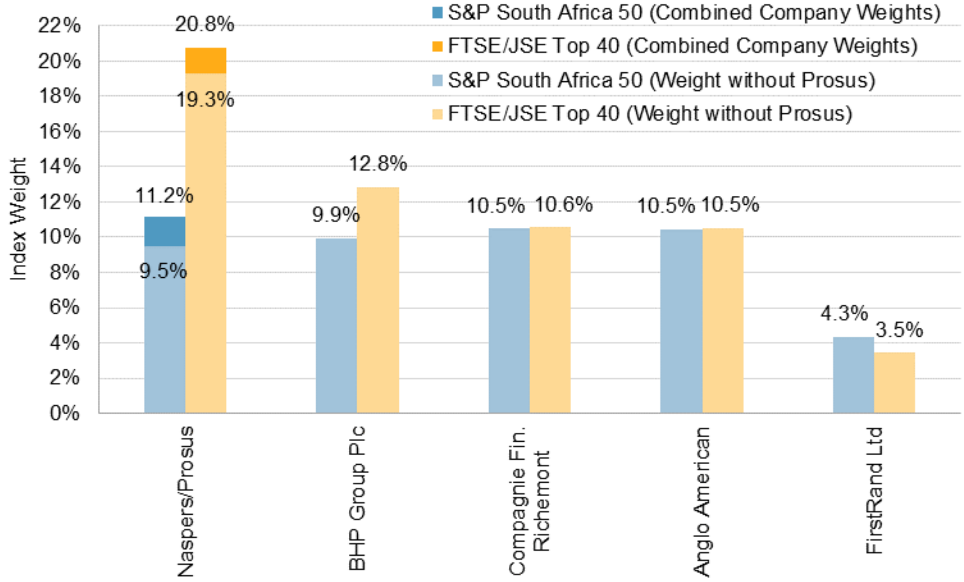
Investing in stocks can be risky. However, investing in a single stock tends to be far riskier than investing in a diversified basket of stocks, since performance is more prone to be driven by factors beyond macroeconomic forces.

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).

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

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



Source: S&P Dow Jones Indices LLC, FTSE. Data as of April 30, 2021. Chart is provided for illustrative purposes.

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

While the FTSE/JSE Top 40 has historically suffered from concentration issues, the index continues to have outsized concentration compared to the S&P South Africa 50. As of April 30, 2021, Naspers and Prosus accounted for nearly 21% of the FTSE/JSE Top 40—almost double their 11.2% weight in the S&P South Africa 50. In addition, the top five stocks in the S&P South Africa 50 compose roughly 45% of the index, while the same five stocks make up nearly 57% of the FTSE/JSE Top 40.

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

COMPARING RETURNS AND RISK

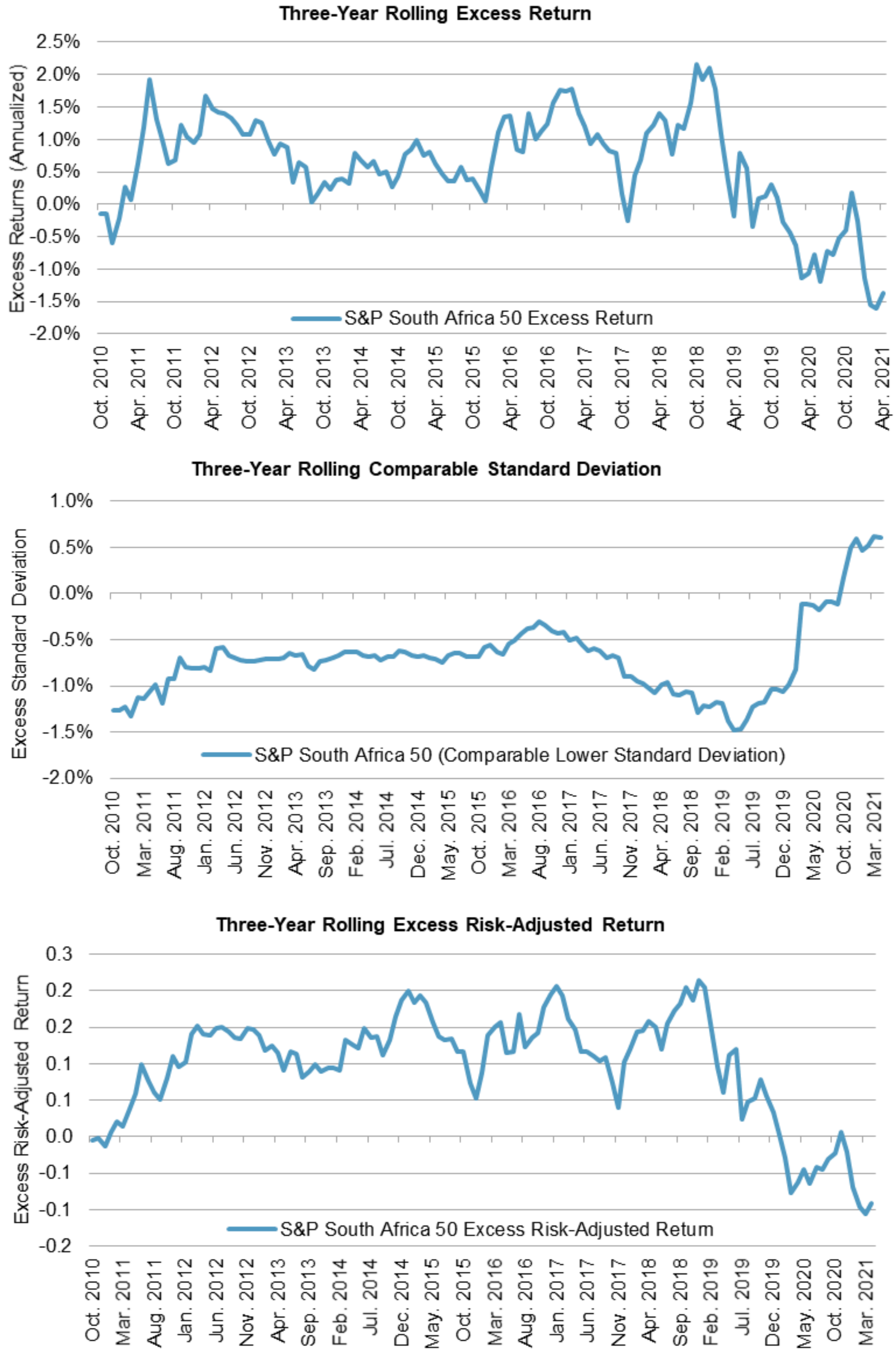
While returns vary in the near term, the S&P South Africa 50 exceeded the risk-adjusted returns of the FTSE/JSE Top 40 over a majority of longer-term periods. To measure the comparable return profiles of the indices, three-year rolling performance is used in Exhibit 3. With the exception of the latest period, higher returns and lower standard deviation largely favored the S&P South Africa 50 on a rolling basis (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).

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

Standard deviation of the S&P South Africa 50 has historically been lower compared to the FTSE/JSE Top 40.

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

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



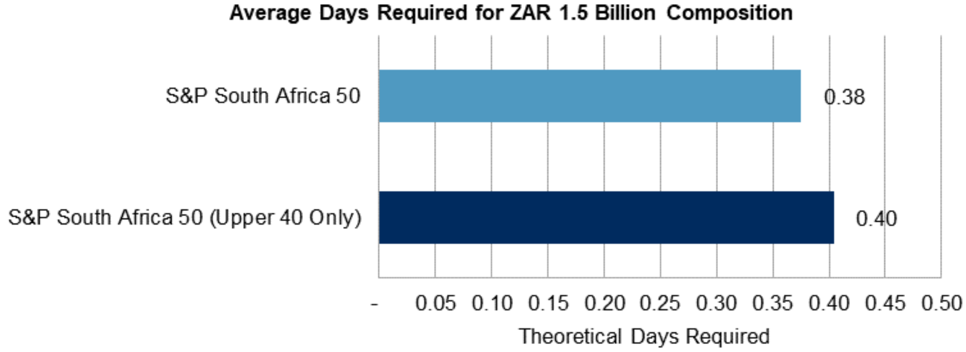
Source: S&P Dow Jones Indices LLC, FactSet. Data from Oct. 29, 2010, to April 30, 2021. Index performance based on total return in ZAR, with standard deviation calculated on a monthly basis. Past performance is no guarantee of future results. Charts are provided for illustrative purposes and reflect 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.

HIGHER STOCK COUNT HAS NOT MATERIALLY DIMINISHED INDEX LIQUIDITY

We analyzed trading days required to achieve a theoretical index composition with a given market value of ZAR 1.5 billion.

To test the liquidity impact of including 10 additional stocks in the S&P South Africa 50 compared with the FTSE/JSE Top 40, we analyzed trading days required to achieve a theoretical index composition with a given market value of ZAR 1.5 billion. In our scenario, we used the average three-month median daily value traded (MDVT) of each stock over the past three years and then reduced each MDVT figure by 75% in order to reflect market availability to form the composition.

Exhibit 4: Improved Liquidity of S&P South Africa 50



Source: S&P Dow Jones Indices LLC, FactSet. Data from as March 28, 2018, to March 31, 2021. Chart is provided for illustrative purposes.

The liquidity profile of the S&P South Africa 50 was slightly better than if the bottom ten were excluded based on the mentioned assumptions.

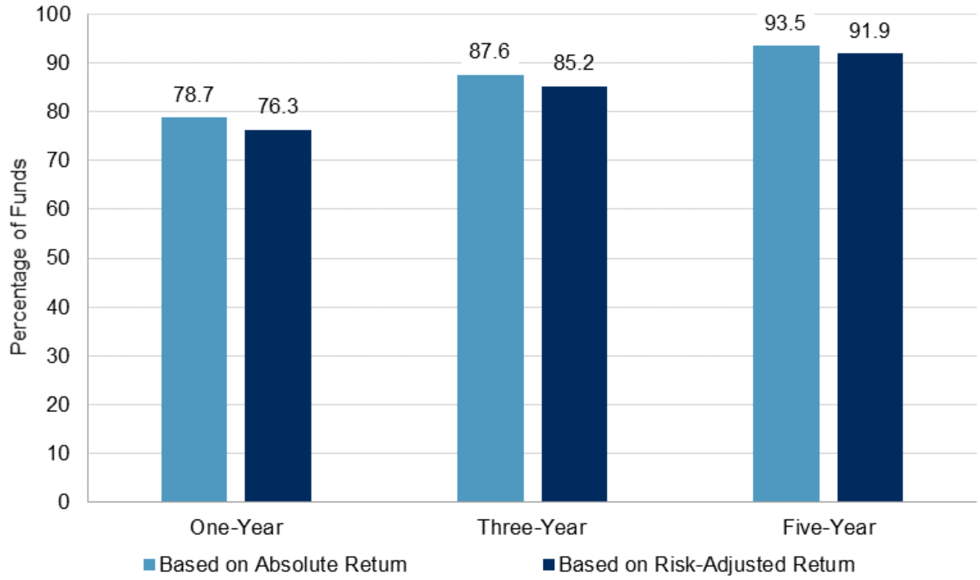
Due to the broader composition of the index and reasonable trading volumes of the bottom 10 constituents, the liquidity profile of the S&P South Africa 50 was slightly better than if the bottom ten were excluded based on the aforementioned assumptions.

COMPARING ACTIVE MANAGER SUCCESS VERSUS PASSIVE BENCHMARKS

S&P Dow Jones Indices has been the de facto scorekeeper of the ongoing active versus passive debate since the first publication of the S&P Indices Versus Active (SPIVA) U.S. Scorecard in 2002. The SPIVA South Africa Year-End 2020 Scorecard measures the performance of actively managed South African equity and fixed income funds denominated in South African rand (ZAR) against their respective benchmark indices over one-, three-, and five-year investment horizons.

Over 78% of South African Equity funds underperformed the S&P South Africa 50 over the one-year period.

Exhibit 5: Actively Managed Funds Outperformed by the S&P South Africa 50



Source: S&P Dow Jones Indices LLC, Morningstar. Data as of Dec. 31, 2020. Outperformance is based on equal-weighted fund counts. Index performance based on total return in ZAR. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Over 78% of South African Equity funds underperformed the S&P South Africa 50 over the one-year period ending Dec. 31, 2020. Over the five-year horizon, the percentage of funds that underperformed the S&P South Africa 50 increased to 94%. Even on a risk-adjusted basis, the overwhelming majority of active funds had lower risk-adjusted returns than the benchmark during each period reviewed.

CONCLUSION

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

Over the long term, the S&P South Africa 50 outperformed the historical risk/return profile of the FTSE/JSE Top 40, and may be 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/BACK-TESTED DATA

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.spglobal.com/spdji. Past performance of the Index is not an indication of future results. Back-tested performance reflects application of an index methodology and selection of index constituents with the benefit of hindsight and knowledge of factors that may have positively affected its performance, cannot account for all financial risk that may affect results and may be considered to reflect survivor/look ahead bias. Actual returns may differ significantly from, and be lower than, back-tested returns. Past performance is not an indication or guarantee of future results. Please refer to the methodology for the Index 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. Back-tested performance is for use with institutions only; not for use with retail investors.

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 to a fixed value for calculation purposes. The Launch Date designates the date when 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 data feed 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.

Typically, when S&P DJI creates back-tested index data, S&P DJI uses actual historical constituent-level data (e.g., historical price, market capitalization, and corporate action data) in its calculations. As ESG investing is still in early stages of development, certain datapoints used to calculate S&P DJI's ESG indices may not be available for the entire desired period of back-tested history. The same data availability issue could be true for other indices as well. In cases when actual data is not available for all relevant historical periods, S&P DJI may employ a process of using "Backward Data Assumption" (or pulling back) of ESG data for the calculation of back-tested historical performance. "Backward Data Assumption" is a process that applies the earliest actual live data point available for an index constituent company to all prior historical instances in the index performance. For example, Backward Data Assumption inherently assumes that companies currently not involved in a specific business activity (also known as "product involvement") were never involved historically and similarly also assumes that companies currently involved in a specific business activity were involved historically too. The Backward Data Assumption allows the hypothetical back-test to be extended over more historical years than would be feasible using only actual data. For more information on "Backward Data Assumption" please refer to the FAQ. The methodology and factsheets of any index that employs backward assumption in the back-tested history will explicitly state so. The methodology will include an Appendix with a table setting forth the specific data points and relevant time period for which backward projected data was used.

Index returns shown do not represent the results of actual trading of investable assets/securities. S&P Dow Jones Indices maintains the index and calculates the index levels and performance shown or discussed but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the Index or investment funds that are intended to track the performance of the Index. The imposition of these fees and charges would cause actual and back-tested performance of the securities/fund to be lower than the Index performance shown. As a simple example, if an index returned 10% on a US $100,000 investment for a 12-month period (or US $10,000) and an actual asset-based fee of 1.5% was imposed at the end of the period on the investment plus accrued interest (or US $1,650), the net return would be 8.35% (or US $8,350) for the year. Over a three-year period, an annual 1.5% fee taken at year end with an assumed 10% return per year would result in a cumulative gross return of 33.10%, a total fee of US $5,375, and a cumulative net return of 27.2% (or US $27,200).

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