By Johan Fourie

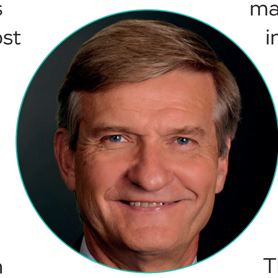
MARKETS

The future of the stock market

We need to expose more companies to a larger audience of investors for the democratisation of wealth.

In 2018, Hank Bessembinder, professor of business at Arizona State University, published a paper in the *Journal of Financial Economics* with the rather nonsensical question: Do stocks outperform Treasury bills? It seems nonsensical because, from 1926 to 2016, the approximately 25 300 companies listed on US stock exchanges, created $35tr in net wealth for its shareholders, in other words, $35tr more than what investors would have earned on US Treasury bills. But here's the catch: All that net wealth was created by the top 1 092 companies, or 4% of the total, which means the remaining 96% of listed companies "collectively generated lifetime dollar gains that matched gains on one-month Treasury bills".

One might easily conclude from this research that it is vitally important to pick the right stocks. But that is almost certainly the wrong conclusion. Bessembinder explains: "The results presented here reinforce the importance of portfolio diversification. Not only does diversification reduce the variance of portfolio returns, but also non-diversified stock portfolios are subject to the risk that they will fail to include the relatively few stocks that, ex post, generate large cumulative return."



Hank Bessembinder
Professor of business at Arizona State University

This is precisely why public capital markets have been such vital tools for the democratisation of wealth. Imagine if those 1 092 companies had remained in private hands. The massive gains would have accrued to the lucky few founders and early investors, leading to extreme inequality. Yet, this is exactly what many fear may be happening today. The technological revolution of the last three decades has changed the nature and scale of start-ups. Many firms in the tech space, for example, do not have the capital requirements of the brick-and-mortar companies of yesteryear, allowing them to remain private for longer, and raising concerns about rising inequality and exclusion.

I asked Dr Leila Fourie, CEO of the JSE, what the stock exchange can do to counteract these changes and bring more firms to a larger audience of investors.

Dr Leila Fourie
CEO of the JSE

"There are two components to this. The first is to have global corporations list in the South African market. In order to attract international companies with favourable growth prospects – tech focused or other – the SA market must be attractive to foreign issuers. Our capital markets are both deep and liquid, making it a favourable destination for issuers wanting to raise capital in Africa. Some of our local companies also offer exposure to high-growth industries. Naspers* is an example of a SA-listed stock with exposure to one of Asia's fastest growing tech stocks. One of many initiatives aimed at driving listings is our recently approved standard listings, which are LSE-listed companies that are subject to less stringent listings requirements.

"The second approach is to have local high-growth companies list on the JSE. In order to provide local investors with a wide range of investment opportunities, there needs to be a strong pipeline of local businesses maturing to the Initial Public Offering (IPO) phase. Current macroeconomic challenges and the cyclicality between debt and equity mean that IPOs have been low across the globe." But this is not just a cyclical trend. Over the last two decades, the number of firms listed on the JSE has declined substantially. The good news is that plans are being made to reverse this decline. "We are not resting on our laurels. Indeed, the JSE is exploring avenues to support small and medium enterprises (SMEs) in SA, while also reviewing the listings requirements for small and mid-cap listings," says Fourie.

Democratising wealth does not only mean adding more listed firms. It also involves attracting more investors to the market. What about the benefits and challenges of retail investing, a trend that has accelerated rapidly since the arrival of Covid-19? "The JSE recognises the growing retail investor market and their need for a healthy, trustworthy and thriving ecosystem that allows them seamless access to the financial markets. We agree that it has been difficult in the past for individuals to invest directly on the stock market – the JSE's value chain has been better geared for institutional investors. This is something we are determined to address, not in competition with our members, but rather together with the rest of the financial market ecosystem. Each party in this value chain plays a valuable role, and we believe that together we can increase access for current retail investors and grow the market in totality."

Another approach to deepen the capital market is to entice international investors to SA. Are there any specific plans to do this? "The JSE'S collaboration with China Investment Information Services is an exciting first step in our Asian growth journey. Investors in Asia, with an interest in SA, will require reliable access to JSE market data as a precursor to any trading activity. With JSE market data now available, we can start to turn our attention to how we build interest in the JSE as a trading destination."

Bessembinder's research has not been replicated for historic JSE-listed companies, but there is little reason to suspect that the results will differ hugely. Although the JSE has traditionally yielded higher returns than most other equity markets, it seems probable that a small set of companies have been responsible for most of its net wealth creation.

Yet this trend, too, may be changing. As more companies – notably the more successful ones – list on multiple exchanges, and new technologies allow retail investors access to the most valuable companies, one can expect the democratisation of wealth to expand. But this will only happen if public capital markets, like the JSE, remain attractive intermediaries matching those with capital to those in need of it. ■

editorial@finweek.co.za

* finweek *is a publication of Media24, a subsidiary of Naspers.*

Johan Fourie is professor of economics at Stellenbosch University.

Photos: Supplied | www.wpcarey.asu.edu