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LISTED EQUITY INVESTING

FAIRTREE
ASISA FOUNDATION

Retirement funds

Invest directly in equities on a stock exchange

Own portfolio
making use of a registered broker

Exchange-traded fund (ETF)
Listed investment products that track the performance of a group or "basket" of shares, bonds or commodities

South Africa's major stock exchanges are the JSE, A2X and ZARX.

Stock exchange

Capital is raised through an initial public offering (IPO) to investors whereby they can apply to buy shares. These IPOs need to be backed by third parties with security (e.g. bank).

While holding the shares, shareholders can receive dividends, depending on the company's policy regarding how much is paid out and how often.

While holding the shares, shareholders (or their proxies) can vote on certain company matters at the company's annual general meeting.

Shareholders can elect to sell their shares to other investors on the stock exchange in order to lock in capital growth or prevent potential losses.

If public companies delist from stock exchanges, shareholders will keep their shares. With mergers or acquisitions, shares may be swapped for shares in the other/new company.

Public companies, that meet listing requirements, can list on stock exchanges. Investors can then buy shares, but will expect dividend payments in exchange for the capital provided.

Stock exchanges are typically regulated. In South Africa, our exchanges are regulated by the Financial Markets Act 2021, the JSE Rules and Directives and the Financial Intelligence Centre Act 2001.

Registered brokers are used for most trading of shares on a stock exchange. They take a fee when selling or buying shares on behalf of a client.

Pool investments with other investors in a Collective Investment Scheme (CIS)

Retirement funds often invest through equity driven funds where money is pooled to buy, hold and sell shares in companies.

Regulation 28 of the Pension Funds Act:

The underlying portfolios of Regulation 28-compliant unit trusts are limited to exposures of 75% in equities. Retirement funds may also invest up to 10% of their assets directly into unlisted equities.

Types of listed equity funds

A variety of local and global funds that include listed equities are available to investors. Retirement funds can invest in some of these funds. These funds vary in terms of their mandates (what they can invest in) and strategies (how they aim to achieve risk-adjusted returns).

Mandates can cover:
- Geographies (countries, regions or global)
- Industries
- Assets (equity only or a combination of equity and debt)
- Size (large caps, mid- or small-caps or a combination)

Strategies can include:
- **Growth investing** (seek investments that have strong future earning potential)
- **Value investing** (invest in stocks that do not fully reflect their intrinsic value, i.e. are undervalued)
- **Index tracking** (passive strategy that attempts to mimic the performance of a market index by investing in a group of securities)
- **Momentum investing** (purchasing securities that are rising and selling securities that are performing poorly)

Investment managers

- Appointed to manage funds on behalf of investors under a specific mandate.
- In return for managing a fund, they charge a % of assets under management (AUM). This will vary, depending on whether the fund is actively or passively managed.
- Functions of an investment manager include determining the goals and strategies for the fund, and making decisions to try and increase the value of the fund.
- In South Africa, investment managers of listed equity funds need to be licensed financial service providers (FSPs) under the FAIS Act.

The risks to equity investors include:

- Returns received (through dividends and capital gains when shares are sold) are lower than the return expected by the investor
- There are no buyers for the shares (more prevalent with smaller companies or companies in distress)
- Permanent loss of capital due to company going out of business.

Actively managed funds

Overview:
- A manager/management team makes decisions about how to invest the fund's money
- Requires regular buying and selling of shares in an effort to outperform a specific benchmark or index

Management fees:
Varies between funds, often using a combination of management fees based on AUM (between 1% and 2%) and a 15% share in returns above a base return rate.

Passively managed funds

Overview
- A fund which simply follows a market index
- Passive management replicates a specific benchmark or index in order to match its performance

Management fees:
Typically charged as a % of assets under management (AUM). However, a number of long-only and multi-asset equity funds adopt a combination of a base fee on AUM and incentive-based fees.