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DIVERSIFICATION USING EMERGING EQUITY MARKETS

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2011-06-07
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ABSTRACT

Research indicates that international portfolio diversification results in risk reduction and/or improved rates of return across both developed and emerging markets. However, these diversification benefits with developed markets are now lower than they have ever been. The purpose of this project report has been to investigate the benefits that could have been derived, from a South African perspective, through international diversification, over the period 1976 to 2003.

The project report examined the mean returns and standard deviations, as well as inter-country correlation coefficients, in respect of the equity markets of 27 countries. Efficient ex-post international portfolios were developed using the Markowitz mean-variance approach. Ex-ante investment strategies were also examined using a naïve "buy-the-market- approach.

The main findings of the project report were:

- South African investors would have benefited historically from international portfolio diversification. However, the benefits of international portfolio diversification have been diminishing over the last decade since the research of Patrick (1996).
- The increased importance of emerging equity markets for international portfolio diversification was evidenced when comparing the Patrick (1996) research to the extended period (1976 to 2003).
- The importance of the investment horizon was evident as it was shown that different efficient international portfolios could result from the use of monthly as opposed to annual returns.
- The impact of currency movements on the returns of foreign equity markets had increased when compared to the previous study by Patrick (1996).

DECLARATION

I, Craig Steven Paterson, declare that this project report is my own, unaided work. It is submitted in partial fulfillment of the requirements for the degree of Master of Business Administration in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

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Craig Steven Paterson
28 November 2005

ACKNOWLEDGEMENTS

I wish to express my sincere thanks to:

- Mr Frank Durand, my supervisor, for his time, insight and direction in the preparation of this project report;

- Mr Ian Patrick for kindly allowing me to utilize the work from his Research Report.

- Mr Neil Jacobsohn for his assistance in the acquisition of the MSCI and IFC international stock market data.

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