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The world stage and our business in 2011

The last year has been a wild ride on the global markets, leaving many investors reeling in its wake. In this newsletter we look at some of the stand-out events of the year – many of which caused extreme volatility in our markets. This further reinforces the importance of taking a long-term view when investing.

FTSE/JSE ALL SHARE INDEX (ALSI) FROM 31 DECEMBER 2010 TO 30 NOVEMBER 2011



JANUARY	<ul style="list-style-type: none"> ▼ Pro-democracy unrest erupts in Egypt, oil price surges.
FEBRUARY	<ul style="list-style-type: none"> ▼ Christchurch, New Zealand, hit by a massive earthquake.
MARCH	<ul style="list-style-type: none"> ▼ Japan devastated by a lethal earthquake-tsunami combination; fears of a meltdown at the Fukushima nuclear power plant. ▼ Libyan uprising gains momentum and US and European military enters the fray.
APRIL	<ul style="list-style-type: none"> ▼ US Democrats and Republicans lock horns. ▼ Japan escalates its nuclear crisis to the levels of Chernobyl as it continues to experience severe aftershocks.
MAY	<ul style="list-style-type: none"> ➤ Al' Qaeda strongman, Osama bin Laden, is captured and shot dead in Pakistan. ▼ Renewed concerns over Greece's fiscal position. ▼ Local inflation drifts up, driven primarily by food and energy prices.
JUNE	<ul style="list-style-type: none"> ▼ Sovereign debt fears continue to stalk markets: Greek bailout plans stall; Moody's puts Italy on review for a downgrade. ▲ Oil prices plummet as International Energy Agency announces a 60 million barrel oil sale from strategic reserves. ➤ The US Federal Reserve's QE2 (quantitative easing round 2) ends.
JULY	<ul style="list-style-type: none"> ▲ Greece gets its second bailout package to the tune of €109 million. ➤ Norway is rocked by right-wing terror attacks. ▼ At home, strike season is in full swing. ▼ China hikes interest rates for the fifth time in nine months.
AUGUST	<ul style="list-style-type: none"> ▼ Uncertainty around the future of the Eurozone and risk aversion result in market sell-off. ▼ The UK descends into violence as rioters and looters take to the streets. ▲ Gold price hits a US\$1 890 all-time high. ▲ The US Federal Open Market Committee (FOMC) announces that interest rates will be fixed at 0.25% to mid-2013. ▼ Down to the wire, US Congress breaks deadlock and raises the debt ceiling; S&P downgrades US credit rating from AAA to AA+. ▲ The European Central Bank starts buying Spanish and Italian debt.
SEPTEMBER	<ul style="list-style-type: none"> ▼ Global flight of capital away from risk assets due to continued uncertainty – emerging markets hard-hit. ▲ Rand weakens significantly against US dollar. ➤ Occupy Wall Street, and anti-capitalist, anti-establishment gains national and global traction.
OCTOBER	<ul style="list-style-type: none"> ▲ Equity markets rally due to upbeat macroeconomic data; good earnings reports out of the US. ▼ Greek Prime Minister Papandreou announces a public vote on the austerity measures, catalysing turmoil. ➤ Gaddafi is killed and Libya starts the slow process of transition towards democracy.
NOVEMBER	<ul style="list-style-type: none"> ▲ Papandreou steps down, followed by Italy's Berlusconi. ➤ Julius Malema is suspended from the ANC for five years. ▼ German bond auction "flops". ▼ Moody's downgrades Portugal to junk status. ▲ On 30 November, the FTSE/JSE All Share Index spiked by 3.7% on the back of decisive action by major central banks.

MSI's 2011 business highlights

Two key appointments

Diversity of skills is key to the success of our business model, and this year we made two important appointments, both of which enhance the quality of our team and our delivery to our clients.



May:

Melanie Vollenhoven, Distribution Support Specialist

Melanie brings her diverse experience in the financial services distribution arena to support our endeavours to offer seamless client service. Among other things, Melanie manages all our client databases; coordinates

client interactions and events; and assists with reports, communication material and responses to client queries.

She has significantly improved our capacity to serve our clients optimally.



November:

Arthur Karas, Senior Portfolio Manager: Equity

Prior to accepting our offer, Arthur was the Chief Investment Officer at Hermes Asset Management for six years, where he was responsible for, among other tasks, the investment process and strategy, equity research and portfolio management. On his watch the company launched two unit trusts, won several segregated institutional mandates and in that time picked up an S&P award for best small unit trust company.

Arthur will focus primarily on equity selection, along with Alida Jordaan and Warren van der Westhuizen. His input will add further insights to our "best investment view" equity portfolio.

Increased offshore allowance

In December 2010, the South African Reserve Bank relaxed its foreign exchange control limits, increasing allowable offshore exposure from 20% to 25%, plus a further 5% may be invested in Africa. Regulation 28 of the Pension Funds Act was amended to reflect this increase, and to update the asset class exposure guidelines, which now make formal provision for the inclusion of hedge funds and derivatives in retirement portfolios.

Backed by rigorous statistical optimisation techniques, using data over a 40-year period, we took the opportunity to further diversify offshore, taking advantage of the prevailing rand strength. Our investments have benefited from this position as the rand has subsequently weakened.

Improvement in global portfolio returns

Last year we completed a significant restructure of our global equity portfolios. A year later, it is pleasing to note the improvement in performance and we look forward to this being an ongoing trend.

Portfolio	1-year performance rankings
Global Balanced	3/9
Opportunities Equity	8/22
Multi-Style Equity	5/22
Global Bond	1/7
Global Money Market	1/3

Source: Alexander Forbes International Survey August 2011

Old Mutual Real Income Fund

This low-risk unit trust has proved extremely popular with investors as it hit R1bn assets under management in January and, just nine months later, reached R2bn. This fund offers volatility protection, while aiming to deliver a growing income and inflation protection through a maximum exposure to 25% equity.

This bears testimony to the growing awareness of investors that, in times of low interest rates and inflationary pressure, an actively managed conservative fund is a more compelling strategy than a pure money market investment.

Offshore exposure does not increase risk

We successfully balloted investors in the fund to extend its mandate to include offshore exposure. As the portfolio manager, I would like to reassure investors that this in no way compromises the fund's objective of delivering a growing income. In fact, it is actually a powerful tool that I can use to better achieve this objective.

Twin benefits of offshore exposure

I will be using the fund's ability to invest offshore to take advantage of opportunities to generate additional income for investors and to further protect the fund from rising inflation.

- A primary source of inflation is rand weakness (a weak rand = more expensive imported goods). Offshore exposure will respond favourably in rand terms when inflationary pressures emerge.
- The offshore component also provides me with a broader opportunity set when seeking income. For example, I can invest in foreign convertible bonds which have the potential to deliver income plus some potential capital growth.

It is worth noting that I do not intend to make a predetermined allocation to a portfolio of offshore assets. Rather, any individual foreign asset held in this fund will be considered specifically in relation to the objectives of the fund.

Performance

To end October 2011, the fund is a top-quartile performer and has delivered handsomely for investors over the medium term.

	3 years		5 years (since inception 2006)	
	Returns	Rank*	Returns	Rank*
Old Mutual Real Income Fund	12.0%	4/53	9.5%	3/32
CPI	4.9%		6.8%	

* Against Asset Allocation - Prudential - Low Equity peer group.

Source: Morningstar

Market Commentary

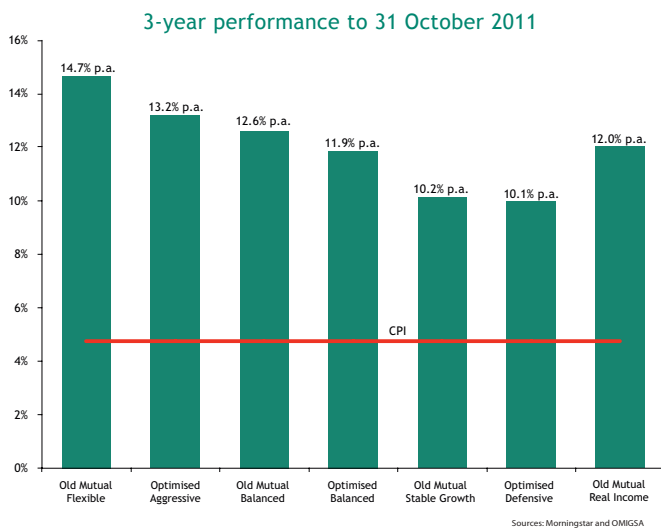
Global equity markets rebounded strongly in October. This was on the back of better than expected US economic data and relief that the Eurozone countries had agreed to a plan of action to recapitalise their banks and to write down 50% of Greek debt. The MSCI World Index gained 10.4% on a total return basis in US dollars.

Locally, the FTSE/JSE Shareholder Weighted All Share Index (SWIX) gained 7.7%, the All Bond Index (ALBI) gained 2.8%, the listed property sector was up 2.6%, the Inflation-linked Bond Index declined by 0.1%, and cash returned 0.5%. Commodity prices also recovered from the sell-off in the previous quarter, as the US dollar gave back some gains in October. Gains in equity markets were pared towards the close of the month as doubts resurfaced about the effectiveness of the announced plans.

Fund performance and commentary

Old Mutual Flexible Fund and Optimised Aggressive Fund

The funds enjoyed a much better month as rising equity markets boosted total returns. They captured 80% of the equity market rally as they had increased total equity exposure during the previous quarter. The purchase of Richemont shares, on the advice of our equity specialist Alida Jordaan, was particularly helpful, as the share rallied an extraordinary 27% in the month. We would remind investors, due to the high degree of volatility in markets, to stick to their long-term savings plans, as the timing of returns will be very lumpy.



Old Mutual Balanced Fund and Optimised Balanced Fund

The funds were well positioned for the rally in global markets during October. There have been large swings in the movements of markets, and this once again highlights the benefits of staying invested through the volatility. The funds continue to hold a large percentage of offshore exposure, which is mostly invested in equities. We prefer global equities to local equities, based on relative valuations. While we remain constructive on equities, we added some protection to the funds in recent months in order to deal with the excessive volatility.

Old Mutual Stable Growth Fund and Optimised Defensive Fund

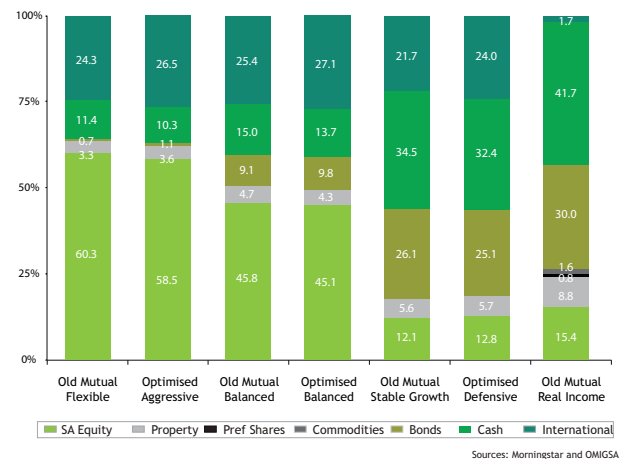
The funds benefited from the rise in global equity markets. During the preceding quarter we had increased equity exposure in the market correction, which moved the funds into overweight positions. However, reflecting their cautious natures, some of this equity was hedged to protect against downside risk. Over the last three years, the funds have both delivered annual returns of over 10%, which is a good result compared to their target of inflation + 4%, which is currently 8.9% p.a.

Old Mutual Real Income Fund

The sharp rally in equity markets was good news for the fund as it holds 17% in shares. These shares are held to produce dividend income, help grow the real value of the fund and protect its spending power. In the current low-interest rate environment it is crucially important to use asset classes like equity and property to generate additional returns.

These asset classes do result in more volatility than a pure income fund but, in the long run, should generate greater returns. Over the course of the last 12 months, the fund generated a return of 7.7%, nearly 2% more than the 5.8% generated by cash. The fund now has approval to invest money internationally in terms of its mandate.

Asset analysis as at 31 October 2011



Performance to 31 October 2011	1 year	3 years (p.a.)	5 years (p.a.)	Description	TER
Old Mutual Flexible Fund	6.8%	14.7%	9.1%	CPI+8% p.a. over rolling 3 years Flexible Category	2.36%*
Optimised Aggressive Fund	8.4%	13.2%	8.5%		
Target	14.0%	12.9%	14.8%		
UT Peer Average	8.6%	12.4%	8.3%	CPI+6% p.a. over rolling 3 years Prudential Variable Equity Category Launched June 2007	2.37%*
Old Mutual Balanced Fund	9.6%	12.6%	8.3%		
Optimised Balanced Fund	8.4%	11.9%	7.8%		
Target	12.0%	10.9%	12.8%	CPI+4% p.a. over rolling 3 years Prudential Low Equity Category	2.20%*
UT Peer Average	7.8%	10.8%	7.9%		
Old Mutual Stable Growth Fund	8.1%	10.2%	N/A		
Optimised Defensive Fund	8.5%	10.1%	8.6%	CPI+3% p.a. over rolling 3 years	1.38%
Target	10.0%	8.9%	10.8%		
UT Peer Average	7.2%	9.3%	7.7%		
Old Mutual Real Income Fund	7.7%	12.0%	9.5%		
Target	9.0%	7.9%	9.8%		
CPI	6.0%	4.9%	6.8%		

*TER as at 30 June 2011

† Three funds currently exceed international limit due to market movements

Sources: Morningstar and OMI/GSA

For more information, visit www.omigsa.com/msi

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Sources: Morningstar and OMIGSA. Unit trusts are generally medium- to long-term investments. Past performance is no indication of future growth. Shorter term fluctuations can occur as your investment moves in line with the markets. Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. Unit trusts can engage in borrowing and scrip lending. The fund's TER reflects the percentage of the average Net Asset Value of the portfolio that was incurred as charges, levies and fees related to the management of the portfolio. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs. A schedule of fees, charges and maximum commissions is available from the company. You may sell your investment at the ruling price of the day (calculated at 15h00 on a forward pricing basis). Certain funds may be capped to be managed in accordance with their mandates. Different classes of units apply to these portfolios and are subject to different fees and charges. Old Mutual is a member of the Association for Savings and Investment SA.

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