

From 2011 to 2012: what has changed; what has not; and what does it all mean for SA investors?

January 2012

PETER BROOKE

Boutique Head,
Macro Strategy Investments

www.omigsa.com/msi



OLD MUTUAL

Investment Group

Macro Strategy
Investments

What did we say last time?

- | | | | |
|-------------------------|---|------------------------|---|
| ◀ Big government | ✓ | ▶ Good earnings --- | ✓ |
| ◀ Low-return | ✓ | --- bad equity returns | ✗ |
| ◀ Quest for yield | ✓ | ▶ Avoid offshore bonds | ✗ |
| ◀ Weak rand - diversify | ✓ | | |

What happened in 2011

- ▲ Politics and natural disasters kill the recovery
 - Middle East politics = higher oil price
 - European politics = banking crisis
 - US politics = loss of confidence
 - Japanese tsunami, Australian & Thai floods = supply shocks
- ▲ Lower growth, higher risk, decreased confidence = risk off
 - Bonds > equities
 - Developed > emerging
 - Defensives > cyclicals

Asset class returns

For 12 Months to 31.12.11

	Rand returns (%)	US dollar returns (%)
<u>SA returns</u>		
FTSE/SWIX	4.3	-15.0
SA Listed-property	8.9	-11.1
SA bonds	8.8	-11.3
SA cash	5.8	-13.7
<u>International returns</u>		
MSCI All Country World	14.2	-6.9
Emerging Market	0.3	-18.2
Bonds	31.4	7.2
Cash	23.8	0.2



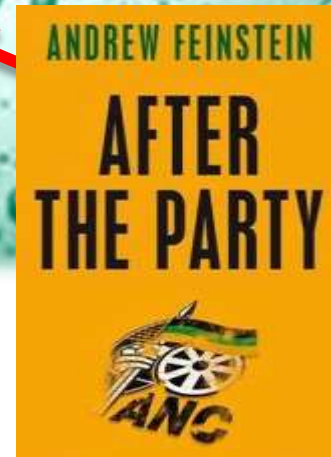
OLD MUTUAL
Investment Group

Macro Strategy
Investments

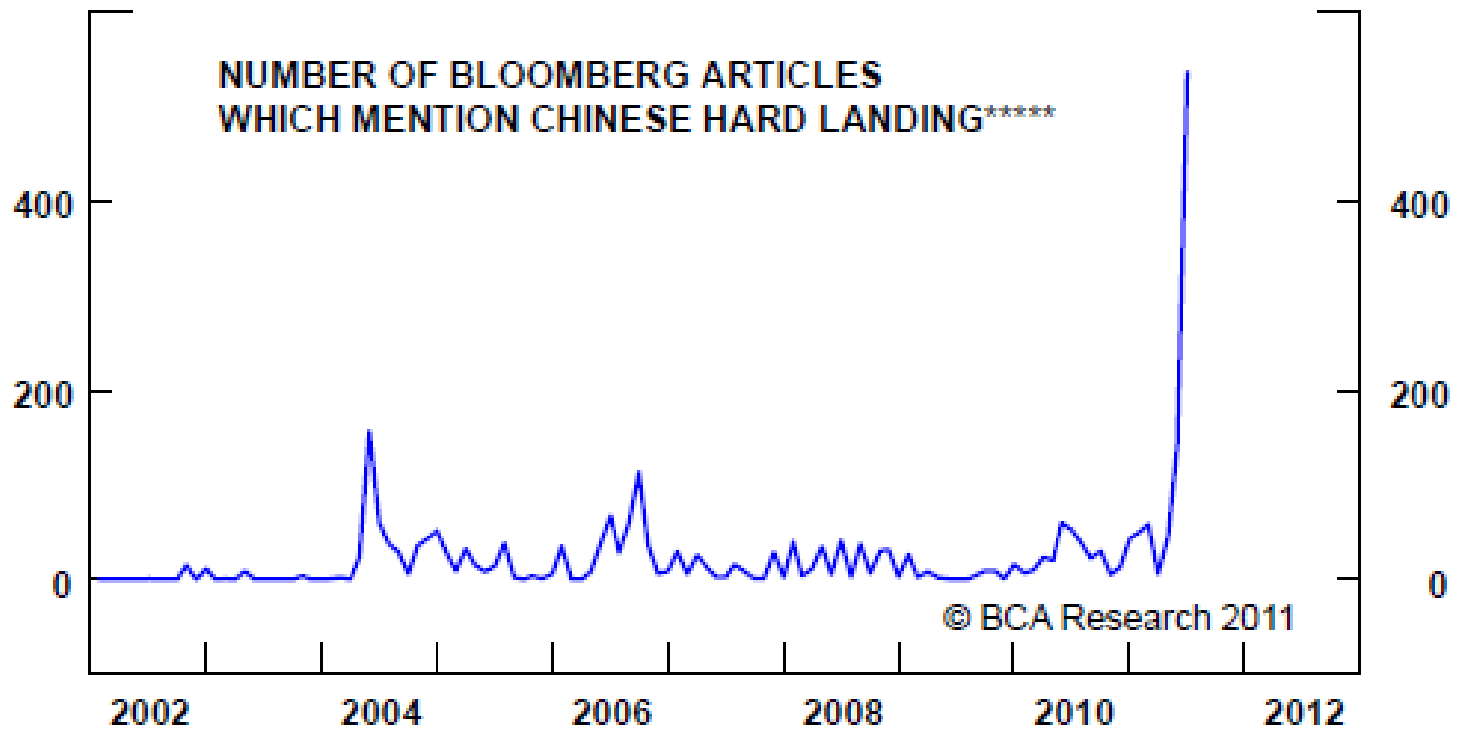
What will happen in 2012?

- ▲ The world economy will struggle
- ▲ Europe will lurch from crisis to crisis
- ▲ Chinese house prices will fall
- ▲ American politicians will focus on politics
- ▲ ... unfortunately so will the ANC
- ▲ Earnings growth will slow and disappoint analyst expectations

Risks pre-dominate



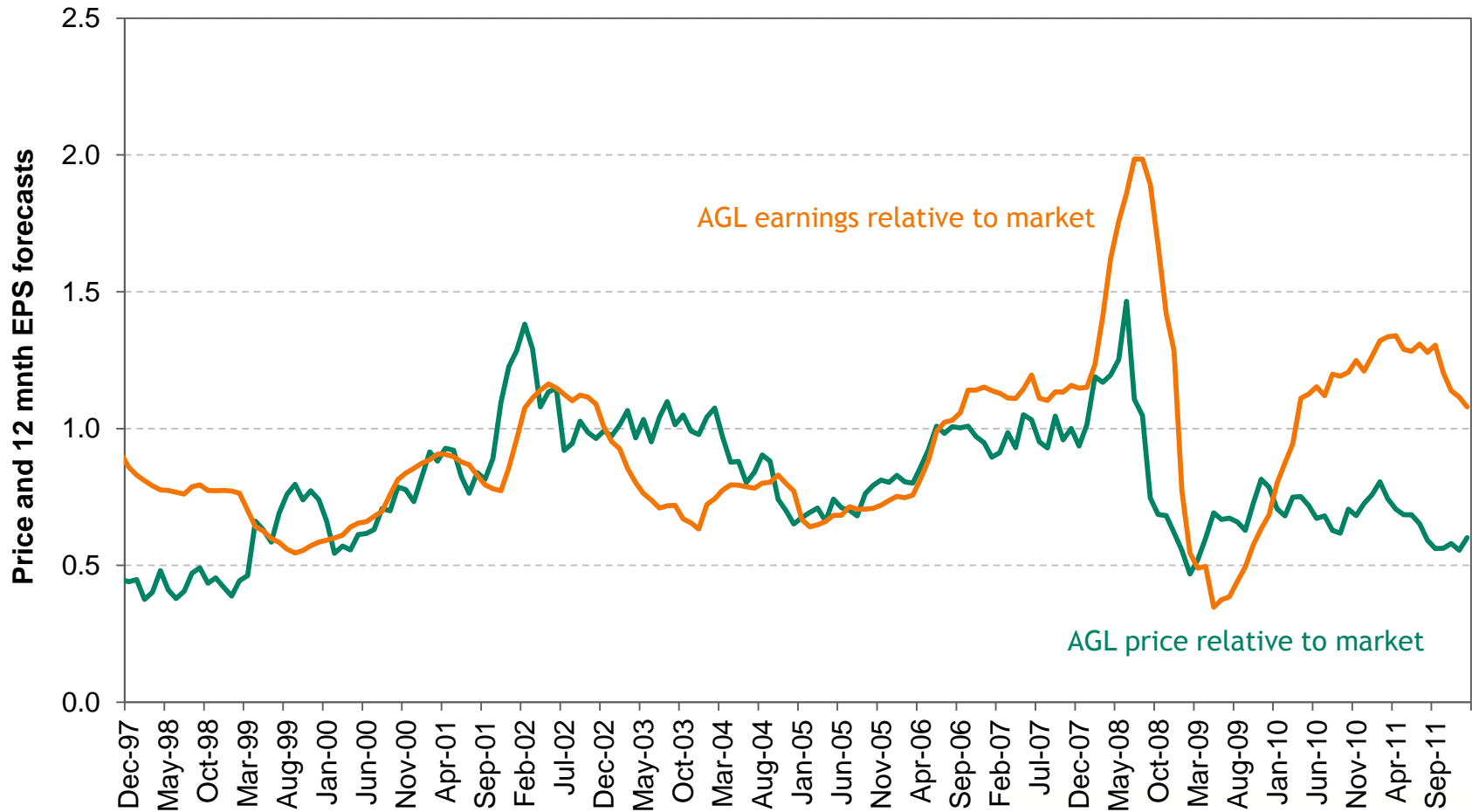
Concerned consensus



... but this will not be a surprise

- ▲ Consensus growth forecasts have halved to 1.2%
- ▲ European banks fell 32% last year
- ▲ The Chinese market fell 18% in 2011 and the copper price is down 22%
- ▲ The American election is on 6 November
- ▲ Earnings expectations have fallen for 34 consecutive weeks

Anglos price and earning per share forecast relative to market



Source: MSI

Silver linings

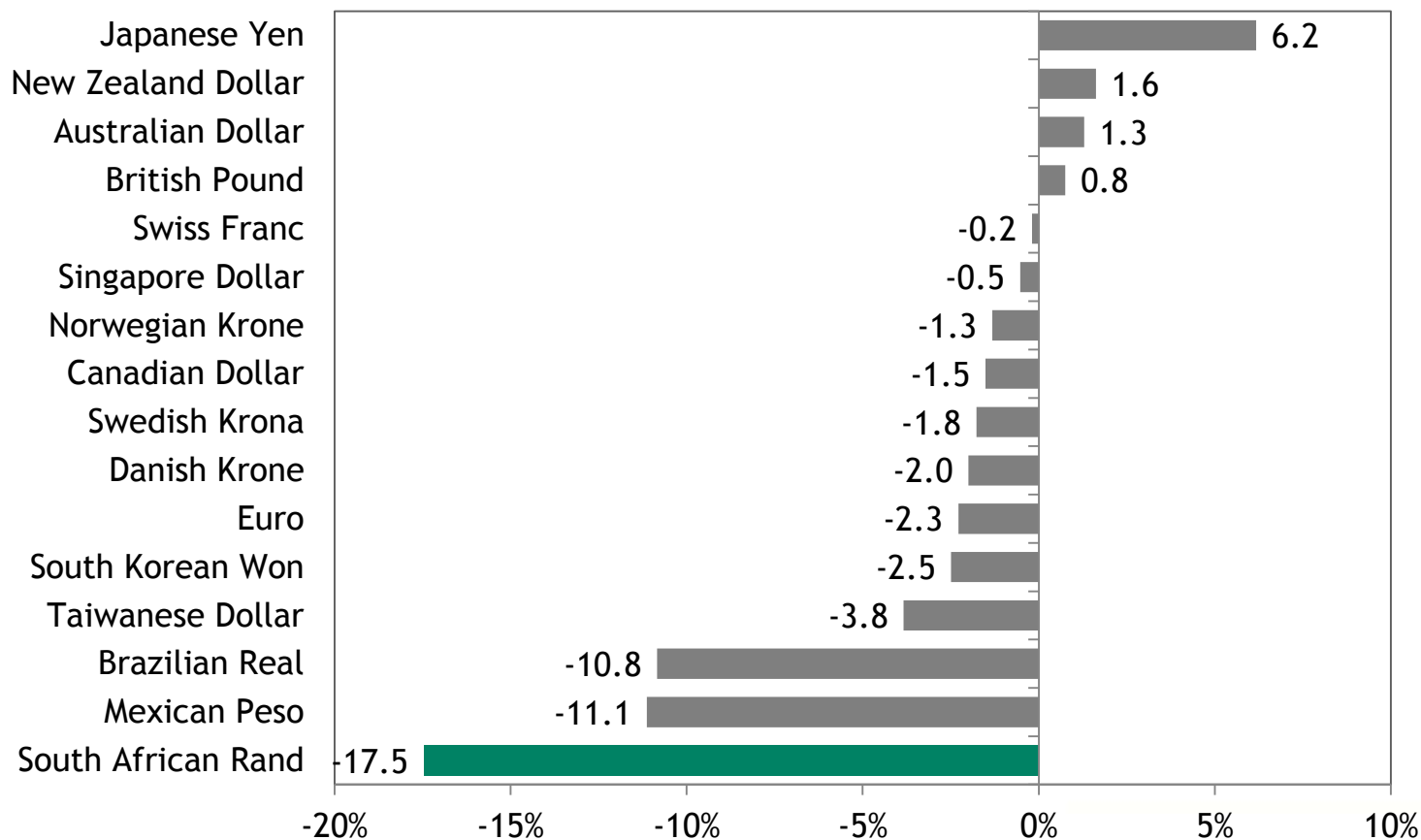
- ▲ Emerging markets will loosen monetary policy
- ▲ China will cut Reserve Ratio Requirements (RRR)
- ▲ Europe will cut rates
- ▲ The ECB will support the banking sector through the LTRO
- ▲ The American housing market shows some life

What does this mean for asset allocation?

- ▲ Rand
- ▲ Rates
- ▲ Equity
- ▲ Global emerging markets

Weak rand in 2011

Rand was the weakest major currency in the world



Source: Bloomberg 31.12.10 to 31.12.11

Rand in 2012

- ▲ Moved back to fair value

- ▲ Countervailing themes

 - Positive**

 - Quest for yield / carry trade
 - Emerging markets

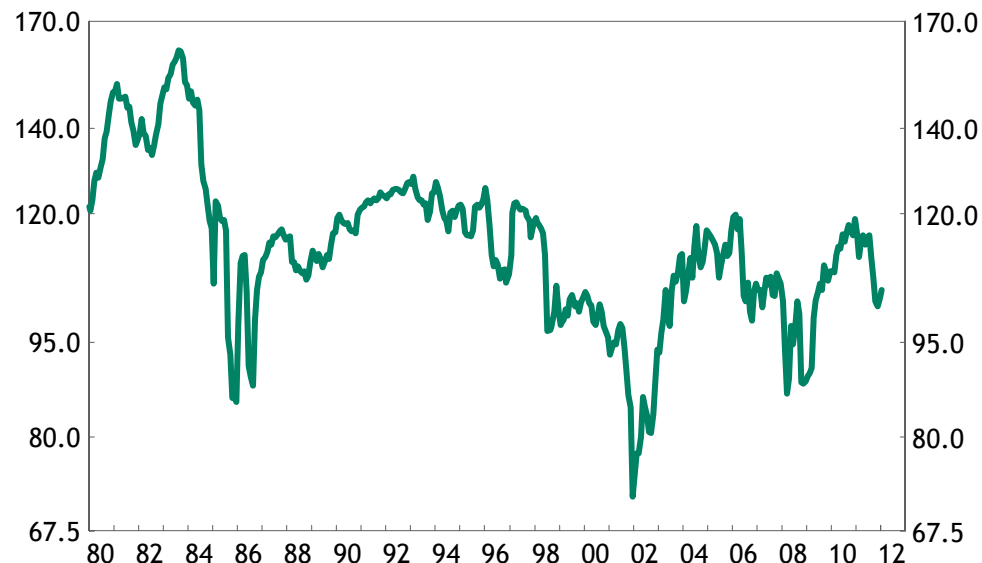
 - Negative**

 - Hot money / risk off
 - Terms of trade
 - Uncompetitive

- ▲ Conclusion

 - Rand broadly flat
 - Risk biased towards strength
 - Weak rand no longer a theme

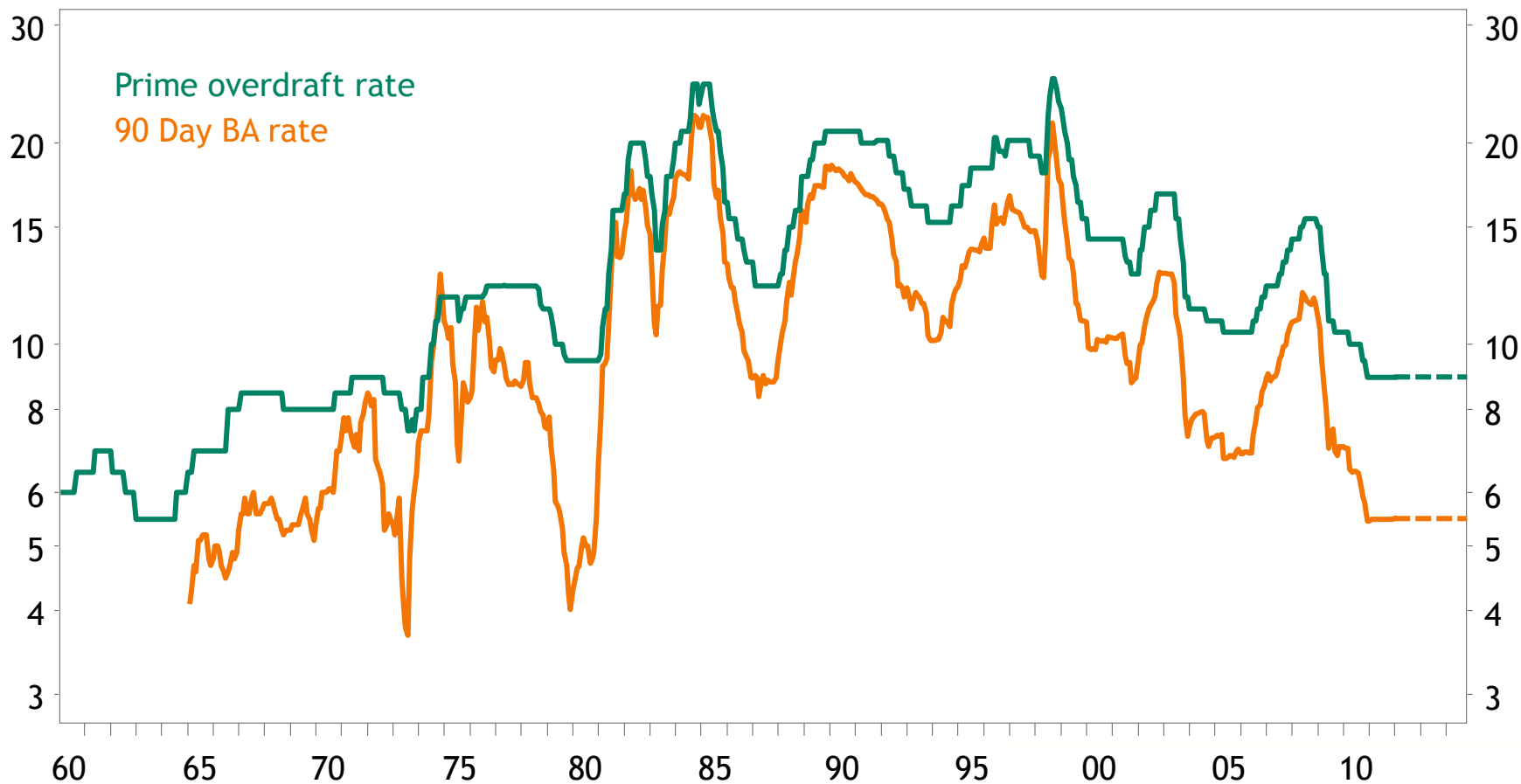
Real trade weighted rand exchange rate



index 2000 = 100

Source: I-Net

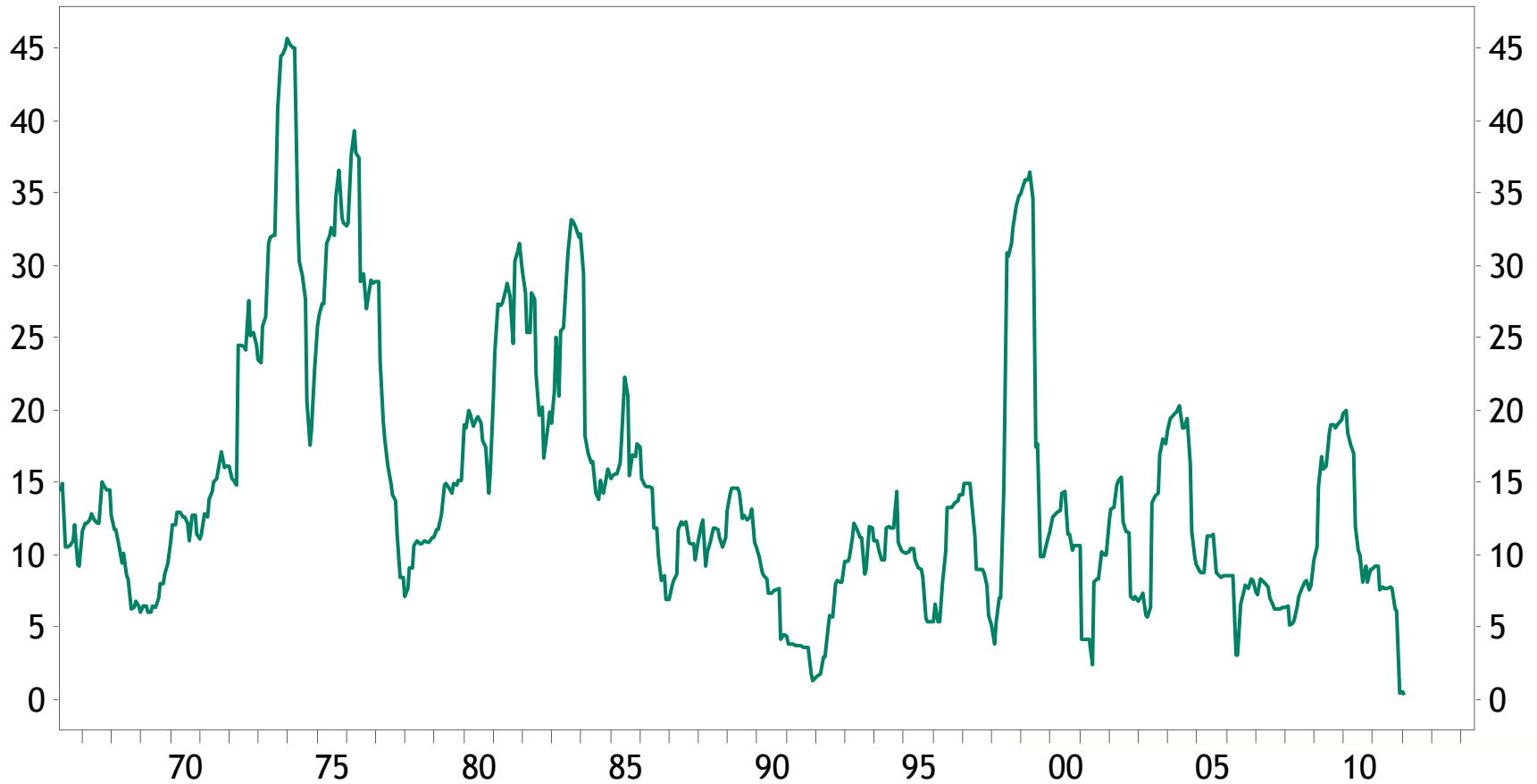
Historic prime and cash yields with forecasts



Source: I-Net

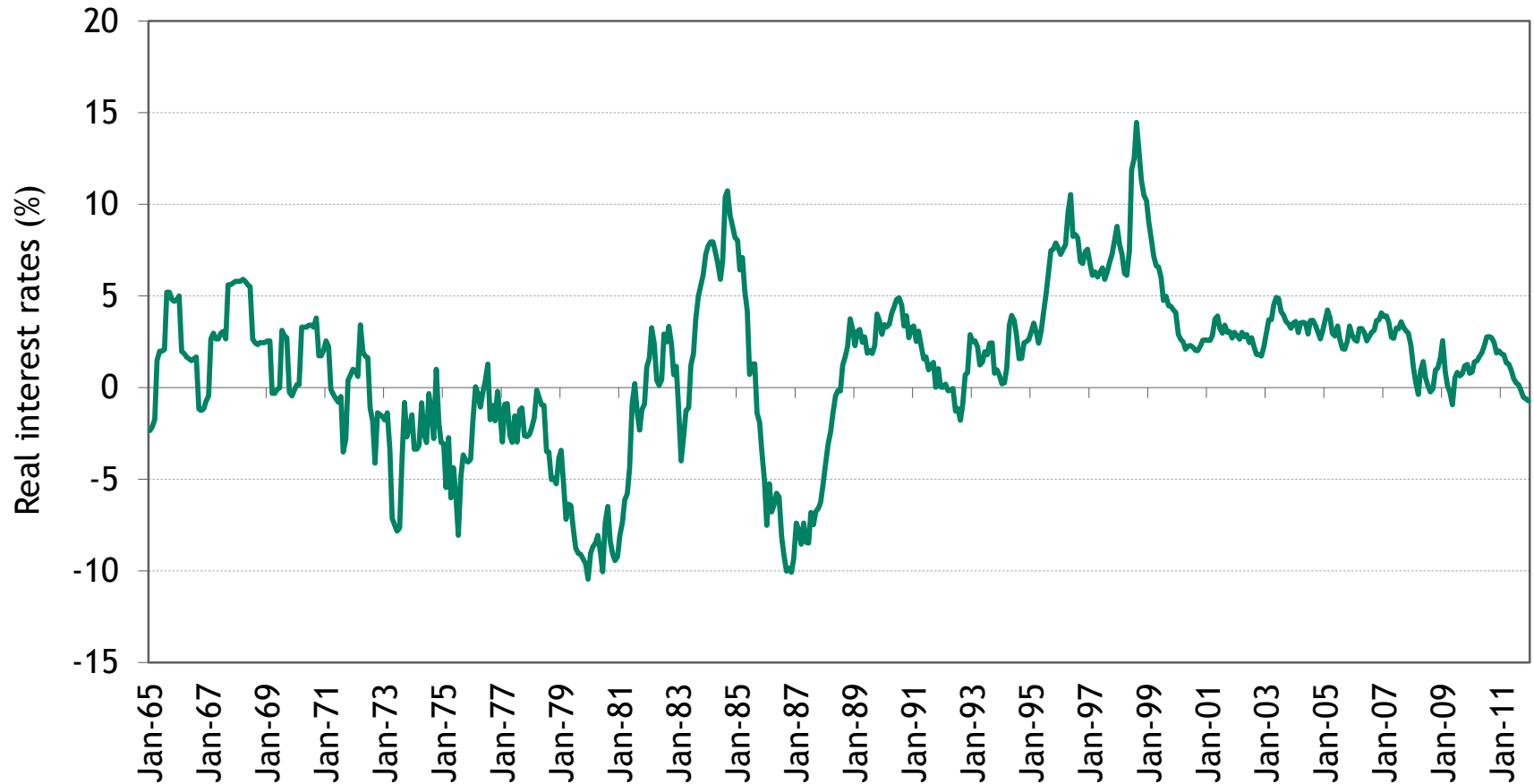
Remarkably stable rates

Interest rate volatility (rolling 12 month)



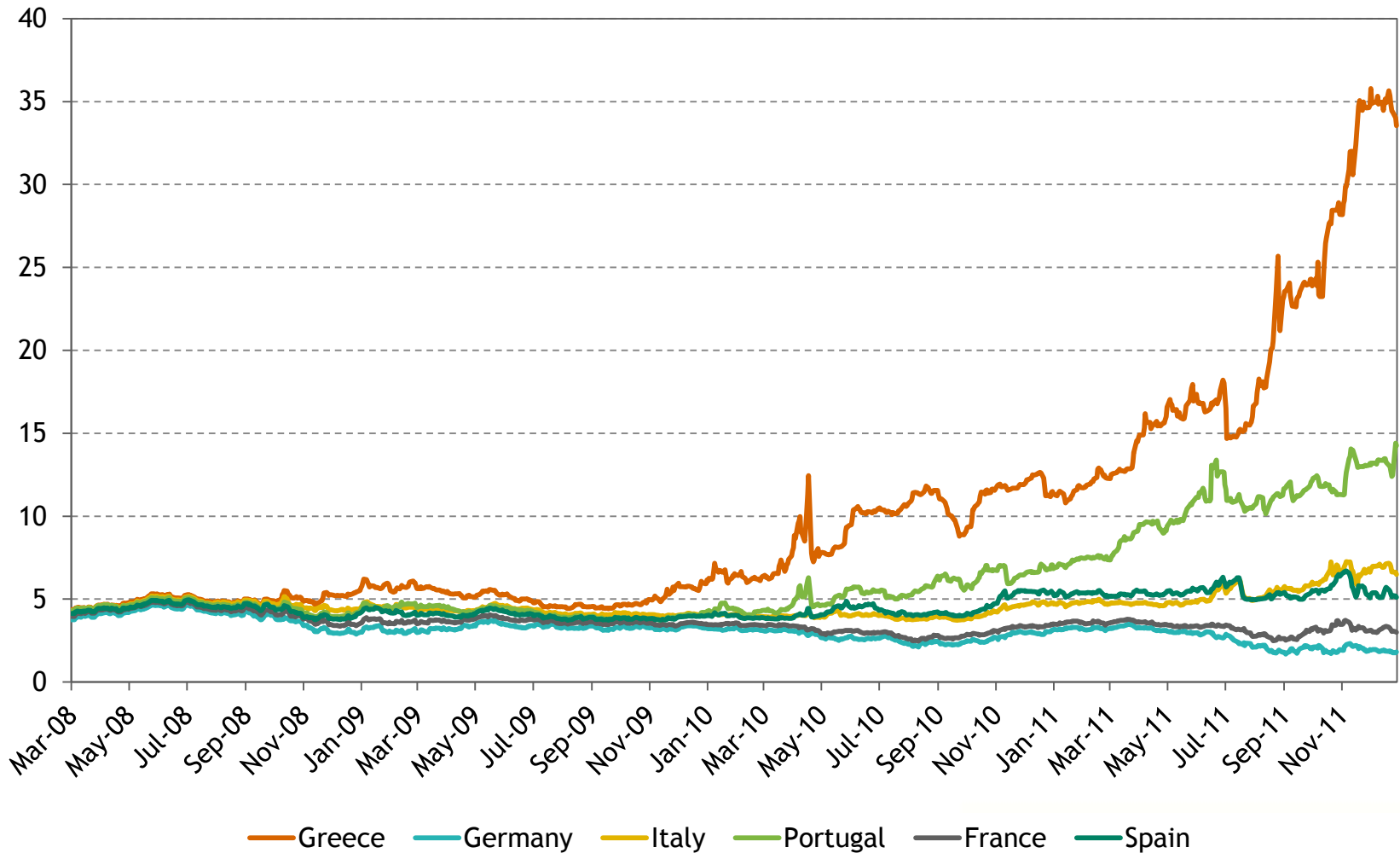
Source: MSI, based on 3mth BA rate

Real rates: cash is trash



Source: MSI

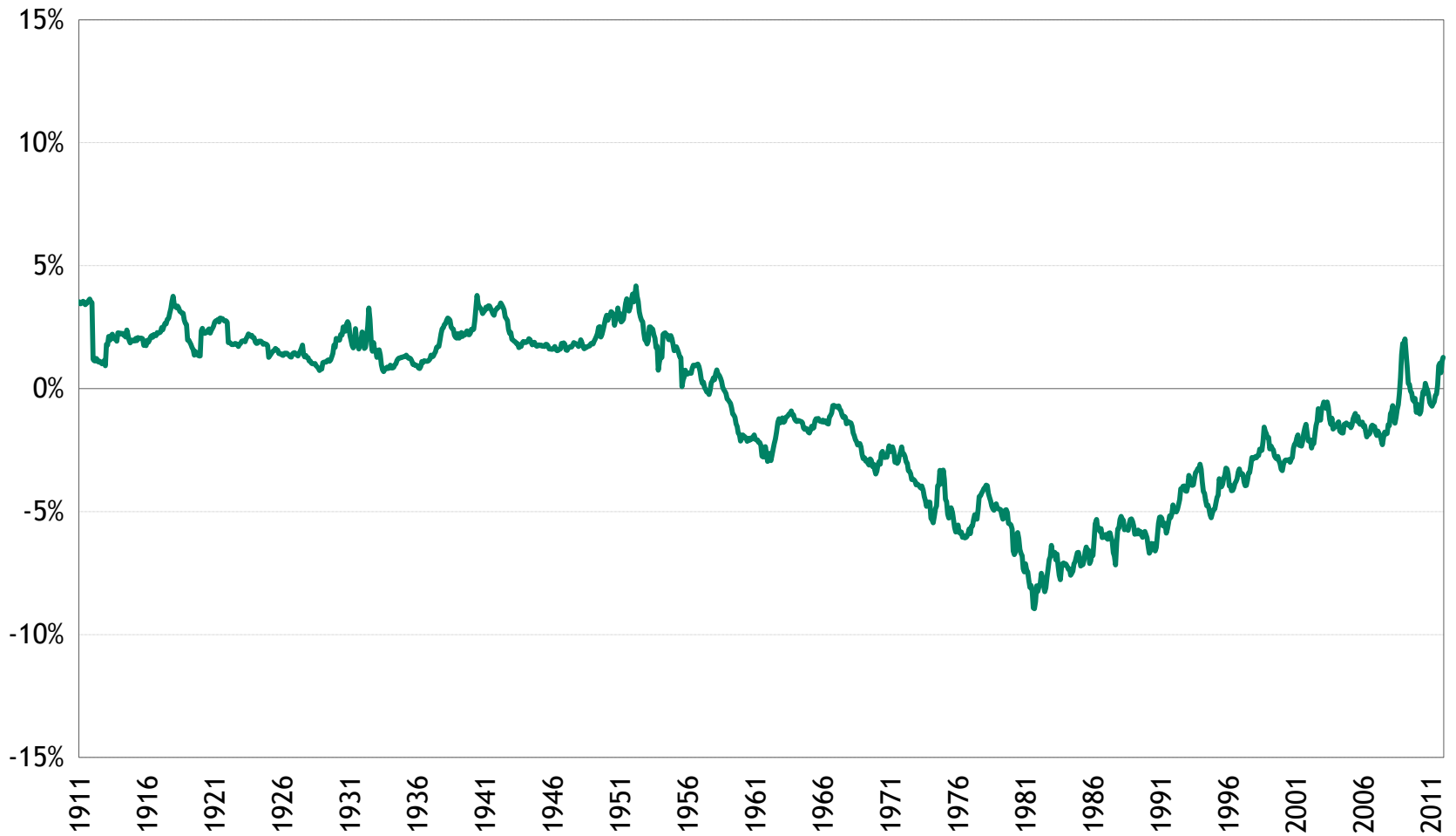
Global bonds: the end of the risk free rate



Source: Bloomberg

Relative valuation

Dividend yield minus bond yield



Flat average of the US, UK, Japan and Australian yields

Source: MSI

Global Emerging Markets

▲ Emerging markets had a poor 2011

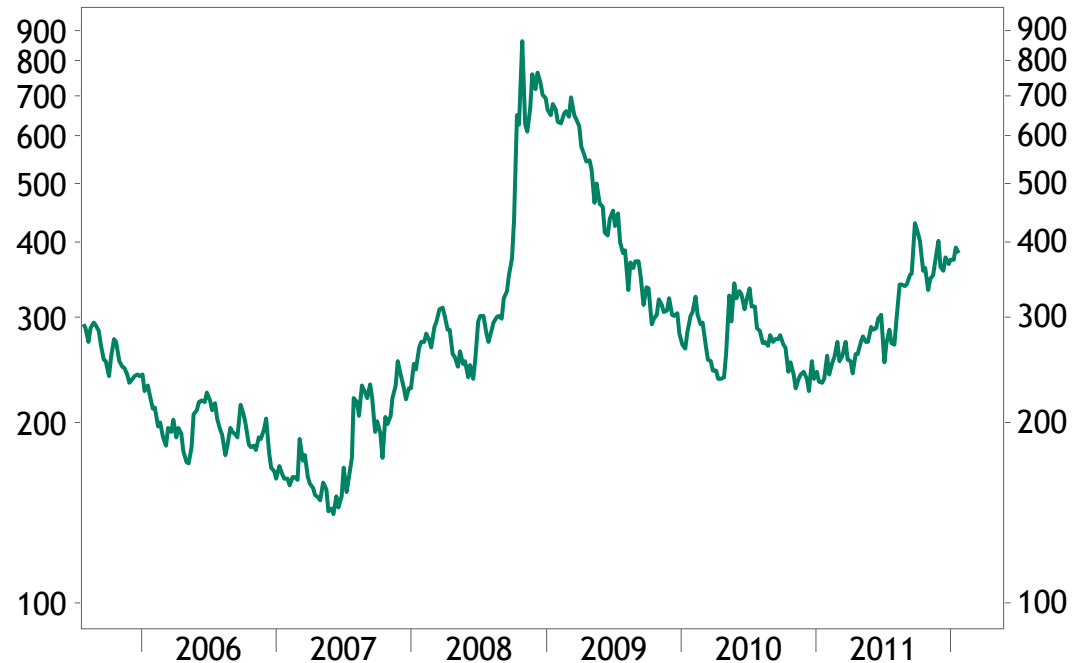
- Risk spreads widened
- Currencies weakened
- Equities underperformed

▲ Markets de-rated sharply

- Forward p:e 9.4x (11.7x)
- 20% discount to history
- 13% discount to developed

▲ Cutting rates

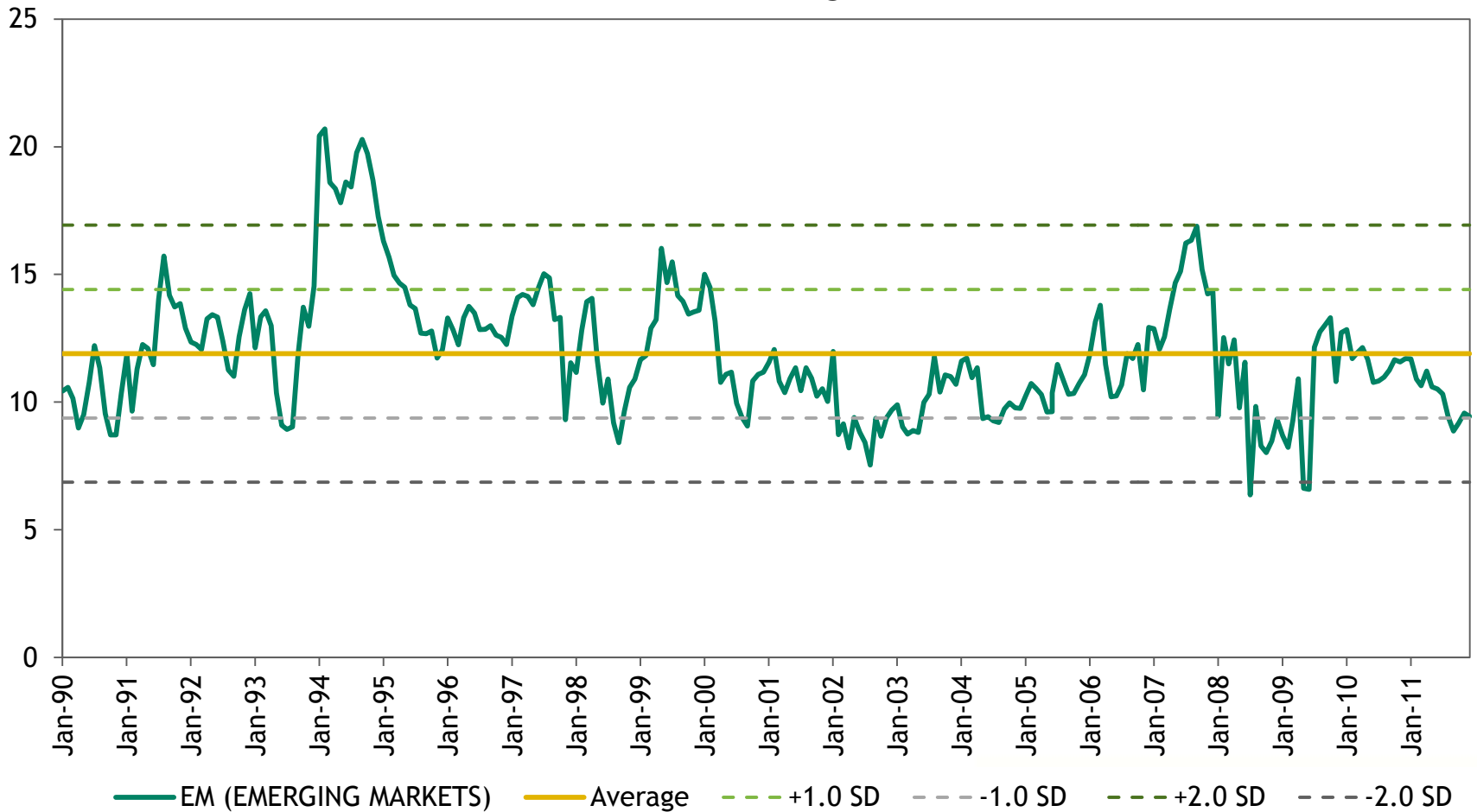
Emerging market bond spreads



Source: I-Net

Global Emerging Market valuations

Price earnings ratio



Source: MSI

Long-term asset allocation view

	Real return	View	Comment
SA		N	Limited further support from rand
Equity	6.5%	N+	In line with long-term returns; biased to upside
Property	5.5%	N	Good yield offset by negative reversion risk
Bonds	2.5%	N+	Attractive carry vs cash and improving tactical outlook
Cash	1.0%	—	Lower rates for longer mean lower returns
International*		N	Diversification is valuable
Equity	6.5%	+	Preferred risk-adjusted asset class
Bonds	-1.0%	—	Expensive, with a growing risk of capital loss
Cash	-1.0%	—	Cash is still unattractive

NB: These are long-term, real returns expected over the next five years, as at 11 January 2012

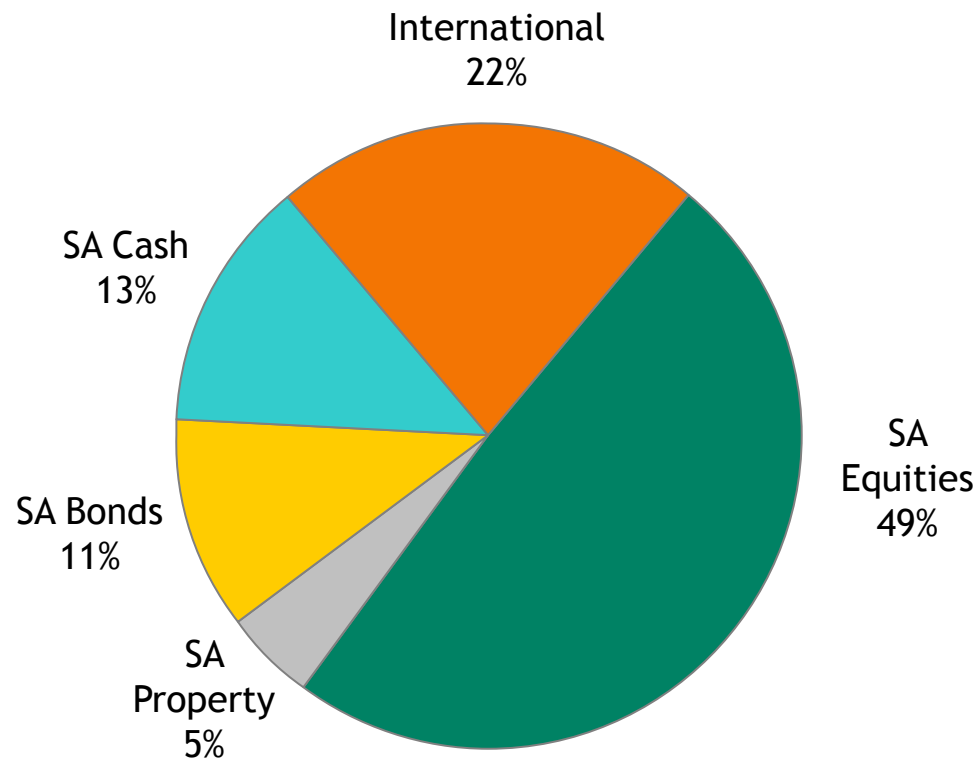
* The international return expectations above are in US Dollar terms; any rand depreciation will add to returns in rands.

Conclusion

- ▲ Themes are largely unchanged
 - Big government, cash is trash, low-return world, quest for yield
- ▲ Equity valuations are improved
 - Equities are cheaper and bonds more expensive
 - Local cash now negative
- ▲ Risks still abound
 - Europe, China, United States, Middle East
- ▲ Extreme pessimism is good news
 - Some silver linings on horizon
 - Equities better than bonds
- ▲ GEM back on the radar

Old Mutual Balanced Fund

Asset Allocation as at 31.12.11



Source: OMIGSA

Regulatory Information

Old Mutual Investment Group (South Africa) (Pty) Limited

Physical Address: Mutualpark, Jan Smuts Drive, Pinelands, 7405

Telephone number: +27 21 509 5022

Old Mutual Investment Group (South Africa) (Pty) Limited is a licensed financial services provider, FSP 604, approved by the Registrar of Financial Services Providers (www.fsb.co.za) to provide intermediary services and advice in terms of the Financial Advisory and Intermediary Services Act 37 of 2002. Old Mutual Investment Group is a wholly owned subsidiary of Old Mutual (South Africa) Limited. Reg No 1993/003023/07.

The investment portfolios may be market-linked or policy based. Investors' rights and obligations are set out in the relevant contracts. Market fluctuations and changes in rates of exchange or taxation may have an effect on the value, price or income of investments. Since the performance of financial markets fluctuates, an investor may not get back the full amount invested. Past performance is not necessarily a guide to future investment performance.

Personal trading by staff is restricted to ensure that there is no conflict of interest. All directors and those staff who are likely to have access to price sensitive and unpublished information in relation to the Old Mutual Group are further restricted in their dealings in Old Mutual shares.

All employees of Old Mutual Investment Group are remunerated with salaries and standard short-term and long-term incentives. No commission or incentives are paid by Old Mutual Investment Group to any persons. All inter-group transactions are done on an arms lengths basis.

In respect of pooled, life wrapped products, the underlying assets are owned by Old Mutual Life Assurance Company (South Africa) Limited who may elect to exercise any votes on these underlying assets independently of Old Mutual Investment Group.

In respect of these products, no fees or charges will be deducted if the policy is terminated within the first 30 days. Returns on these products depend on the performance of the underlying assets.

Old Mutual Investment Group has comprehensive crime and professional indemnity insurance. For more detail, as well as for information on how to contact us and on how to access information please visit www.omigsa.com.