Fundamentals

November 2010

The quarterly news magazine of Old Mutual Investment Group (South Africa)

- Consumers reap benefits of emerging markets boom
- Fundamental indexing under the spotlight
- Old Mutual Property Investments opens shopping mall in India

Performance through Focus

OLD MUTUAL
Investment Group

Tim Cumming

Interim CEO, Old Mutual Investment Group (SA) (OMIGSA)

In this last edition of Fundamentals for 2010, as usual, we lead with an economic update, this time from our senior economist Johann Els. He looks at why, as South African consumers, we have a lot to be grateful for in the current economic environment, as well as what's making SA such an attractive investment destination for foreign investors.

This is followed by Craig Chambers', MD of our index-tracker boutique Dibanisa Fund Managers, review of the three-year-old RAFI® Index, which has successfully outperformed other standard equity indices. He shows how the RAFI®'s fundamental weightings in certain shares can pinpoint which shares look attractive, and which could be overvalued — a really interesting read.

Toros Equity head Peter Linley provides his outlook on the market and cautions that investors' fear levels could be as volatile as current markets. This can result in irrational investor behaviour, which could have costly implications for investment returns. He tells us where he sees value in the equity market and advises clients to invest as he does — with a focus on the long term.

Within OMIGSA there are a number of exciting developments that we feature in this edition of Fundamentals:

- Our property boutique opened their first shopping mall in Aurangabad, India. Through Old Mutual's Triangle Real Estate India Fund investors can share in the rapidly expanding organised retail market in India. The Fund plans to open another two malls in India within the next couple of years.
- We have entered an exciting new phase in the evolution of our multi-boutique structure, as two of our Old Mutual-branded boutiques have taken on their own identities.
- Futuregrowth Asset Management has recently won two industry awards for the role it plays, through loan financing, in supporting housing developments and other community projects.

My tenure as interim CEO at OMIGSA is coming to an end, as Diane Radley's appointment takes full effect from 1 January 2011. It's been an honour and a privilege to have been back in the captain's seat in OMIGSA and I wish Di and the entire OMIGSA team continued success.

Should you require additional information, please contact us (contact details below).

November 2010

Insights

Inside OMIGSA

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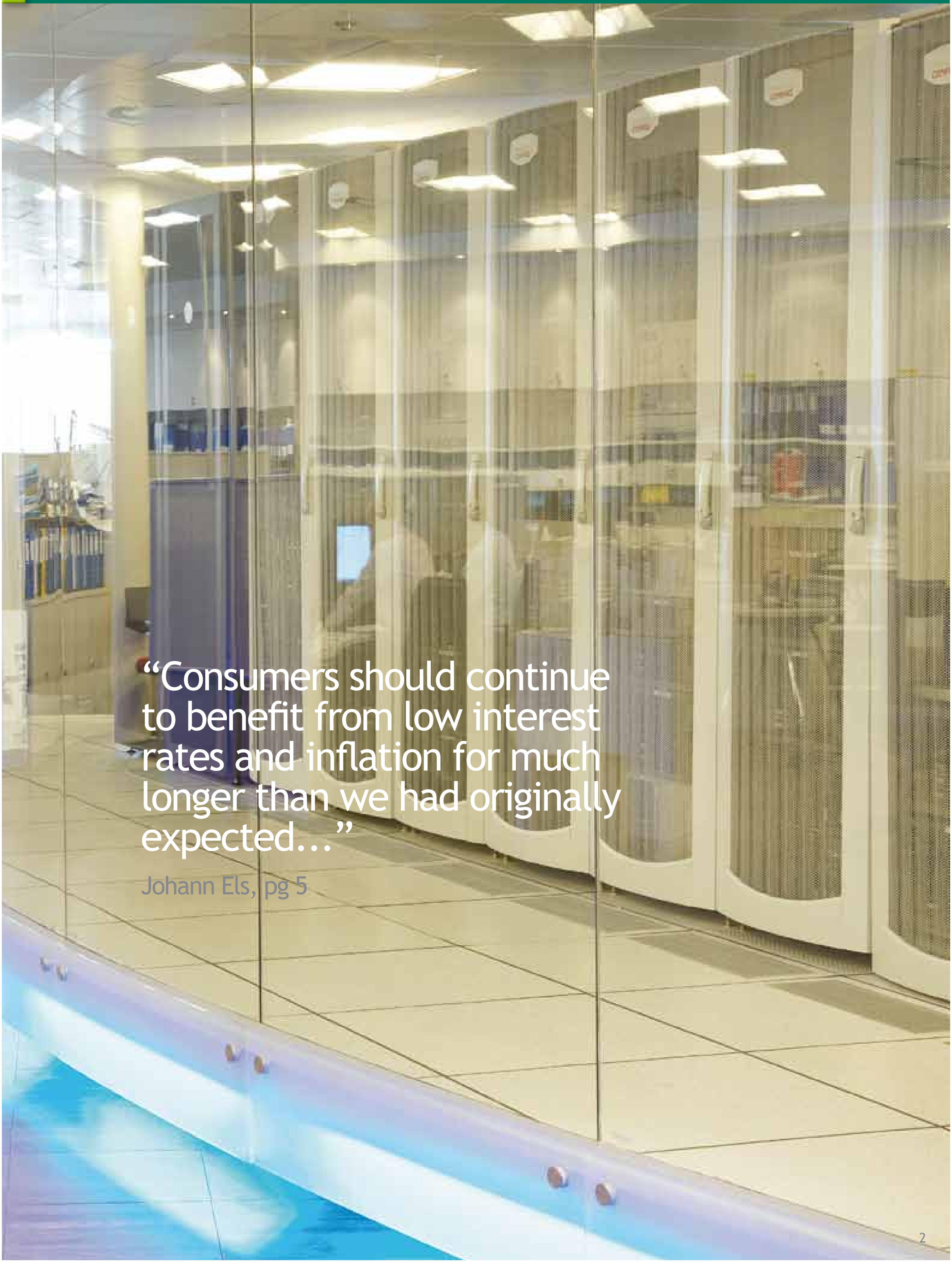
Insights



"Consumers should continue to benefit from low interest rates and inflation for much longer than we had originally expected..."

Johann Els, pg 5

SA consumers reap the benefits of the emerging markets boom

Johann Els
Senior economist at Old Mutual Investment Group SA (OMIGSA)

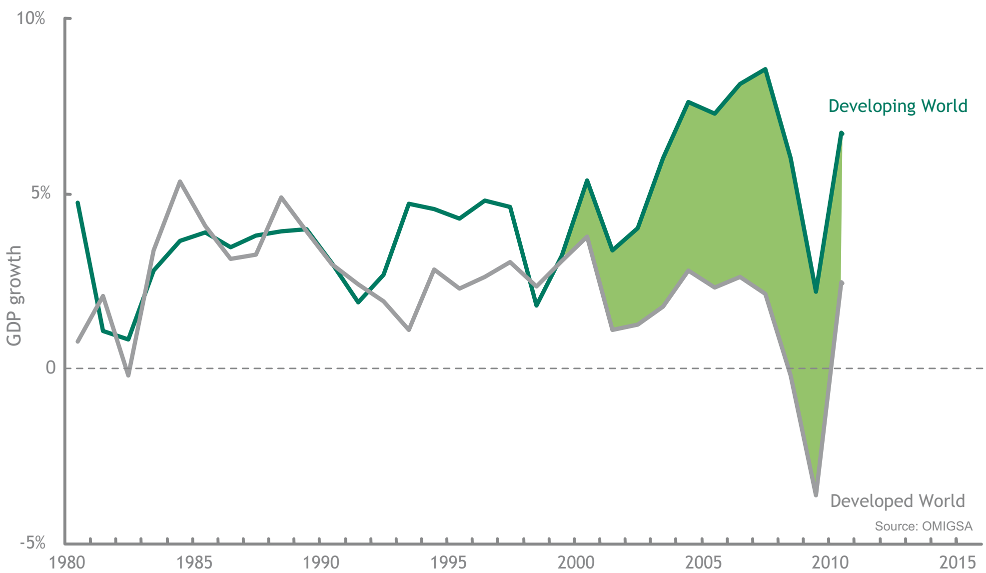
Although recent news headlines have highlighted the negative impact of the strong rand on our economy, the current global environment of easy money and low price pressures, along with the economic troubles in many developed countries, is proving to be surprisingly positive for most South African consumers, who are benefiting from exceptionally low interest rates and inflation. And the good news for SA is that these conditions are likely to continue through 2011 and even 2012, barring unforeseen shocks.

As we all know, governments and individuals in developed economies in Europe, the US and UK are tightening their belts in order to repay the excessive debt built up both before, and as a result of, the financial crisis. Coming on top of the slow and uneven recovery from the global recession, the developed world is facing several years of slower-than-average economic growth. This, in turn, is forcing central banks to keep interest rates extremely low, until growth is decisively established and strong enough to create new jobs at a healthy rate.

Meanwhile, emerging economies have recovered much more quickly than their developed counterparts and are set to expand at a much faster pace going forward, offering higher interest rates and more attractive potential returns for investors.

The consequences of this “two-speed” economic environment, with deflationary forces at work around the globe, have been significant for South Africa.

DEVELOPING WORLD BOOMS: GDP GROWTH



It has sparked a huge search for yield, with a wave of funds being invested into emerging market bonds and equities that has driven many emerging market currencies, the rand included, much stronger. And although our recovery has been slower than that in some other emerging economies, our growth has still picked up, we have been able to cut interest rates to a 30-year low (to 9.5%), and inflation (at 3.2% p.a. in September) is at its lowest rate in five years.

Food inflation has also dropped from 18% in May 2008 to near 0%.

Bond repayments on R500 000 have dropped from around R6 700 a month in August 2008 to around R4 600 in September 2010.

200 litres of petrol that cost about R2 100 in August 2008 now costs R1 600.

These conditions have been very favourable for South African consumers, who have helped to lead the recovery. Those who were able to hold on to their jobs have seen their real disposable incomes rise significantly due to lower inflation and improving income growth. At the same time, households are paying far less interest on their mortgage bonds and other outstanding debts: those with a bond of R500 000 would have paid around R6 700 per month in repayments in August 2008; this would have fallen to around R4 600 in September 2010. Food inflation has also dropped dramatically, from 18% in May 2008 to near 0% currently, and the lower petrol price has also offered some relief: those buying 200 litres of petrol per month would have paid about R2 100 in August 2008, but two years later were only spending about R1 600 for the same volume.

Even the much-feared administered price inflation, which includes electricity tariffs and municipal rates, has been falling – from 14.5% at the beginning of the year to 8.3% currently. And the stronger rand has helped push inflation for consumer goods like cars, appliances and furniture into negative territory.

South African investments look attractive on a relative basis

South African financial markets have also benefited. As part of the emerging markets boom, foreign investors are pouring into our bond and equity markets in search of higher yields. They are less worried about the risk these days, as our own government debt/GDP ratio was only 22.2% in 2009, which looks highly responsible and creditworthy compared to 71.5% in the US, 62.3% in the UK, and 115.8% in Italy (see table below).

SOUTH AFRICA IS AN ATTRACTIVE DESTINATION FOR INVESTORS

	10-yr Government Bonds	CPI (latest)	Real yield	Government debt as % of GDP 2009
South Africa	**7.94**	**3.2**	**4.4**	**22.2**
Italy	3.72	1.6	2.1	115.8
Japan	0.84	-0.9	1.7	217.4
Brazil	6.16	4.7	1.7	60.0
United States	2.40	1.1	1.3	71.5
France	2.58	1.6	1.2	78.2
Canada	2.86	1.7	1.2	52.2
Germany	2.22	1.3	0.9	73.9
Britain	3.00	3.1	-0.1	62.3
China	3.02	3.5	-0.5	16.9
India	8.23	9.9	-1.7	58.0
Russia	5.26	7.0	-1.7	6.3

Source: OMIGSA

Continued ...

The downside of the current global conditions

The downside is primarily two-fold: the strong rand's impact on our competitiveness and job creation. Although the strong rand is acting as a strong deflationary influence (having gained 10% against the US dollar in the quarter to end September) its strength is certainly detrimental for our exporters, particularly in the agriculture, manufacturing and mining sectors. Our miners are unable to take advantage of much higher commodity prices – for example, the gold price has risen by 21% in dollar terms so far this year, but in rand terms it is only up 13%.

Other emerging markets like Brazil, and commodity-producing countries like Australia, are experiencing similar currency appreciations (see graph below), with their exporters cutting costs to stay competitive. And while South African exporters are also attempting to stay competitive, they are finding it much more difficult to reduce costs – for various reasons.

Although there are no definitive studies, it is fairly widely believed that our input costs are higher than those of many other emerging markets, so our exporters are going to have to redouble their efforts to find cost savings to remain competitive in the current global environment, where some countries are racing down the cost curve to stay ahead of their neighbours. This implies that job creation will remain slow – in SA and around the world – and we do expect this recovery to be particularly difficult for employment from a historical perspective.

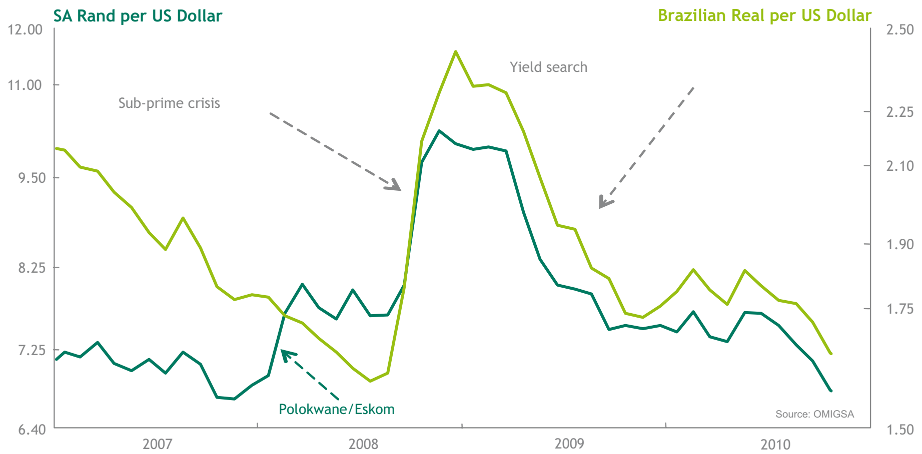
There is no easy solution for curbing the rand's strength. Significant Reserve Bank intervention is very costly, and has been proven time and again worldwide to be ineffective against global market forces. We agree with recent remarks by Finance Minister Pravin Gordhan that SA cannot go it alone, given that the structural problems behind the appreciation of emerging market currencies are global in nature. The G20 would need to come up with an agreed framework to address the problem of overvalued currencies, but we also don't expect that to happen, given the US intent to maintain an easy monetary policy.

Continued gradual recovery ahead

Looking ahead, we expect the exceptionally low interest rates around the world to support a continued gradual recovery – both globally and in SA – as investment recovers and consumers repay their debt. SA consumers should continue to benefit from low interest rates and inflation for much longer than we had originally expected – currently we see interest rates remaining steady and only starting to rise at the end of 2011, and then only gradually. Inflation is also likely to remain within the Reserve Bank's 3%-6% CPI target range for the next two years, assuming no global shocks.

Consumers would be wise to take advantage of this and try to pay down their debt more quickly, and save and invest more for the future. While investments linked to interest rates like money market funds are not attractive in these conditions, growth assets like equities are likely to offer the best returns over the medium-to longer-term.

RAND: NOW BEHAVING LIKE A TYPICAL EMERGING MARKET CURRENCY



Fundamental Index investing proves its value to investors

Craig Chambers
MD of Dibanisa Fund Managers

October marked the third anniversary of the launch of the FTSE/JSE RAFI® 40 Index (Research Affiliates Fundamental Index) in South Africa, during which time it has outperformed 75% of all domestic general equity funds – proving that it can be a common-sense option for investors looking for equity exposure.

A fund we manage that tracks this index, the Old Mutual RAFI® 40 Tracker Fund, is currently ranked 11th out of 71 general equity funds for the three years to 31 October 2010, providing a cumulative total return of 11.72% compared to the 2.7% total return from the average domestic general equity fund over the same period.

At the same time, on an annualised basis, it has returned 3.77% per year for the three years to 31 October 2010, versus 0.76% per year for the average general equity fund, during a period that encompassed the global financial crisis.

These are significantly higher returns for investors than those of the average general equity fund, in both bull and bear market conditions. This highlights the wisdom behind the fundamental methodology used, which invested in undervalued companies during the market crash of 2009 and resulted in superior returns during the recovery. The lower fees of our index tracking fund, which are typically half those of conventional unit trusts, have also added to the outperformance.

RAFI® companies representative of the SA economy

The RAFI® 40 Index is based on the fundamental indexation concept that relies on four fundamental company measures – cash flow, book equity value, total sales and gross dividends – instead of market capitalisation, to determine company weightings in the index. The methodology involves taking an average of each of these financial measures over a five-year period, with of book value being as at review date. The best performing companies are picked to create a portfolio of 40 shares that is largely representative of the South African economy. The strategy is biased towards value investing, because it recognises strong company performance regardless of that company's share price. By contrast, market-cap indices have a tendency to overweight stocks that are overvalued and underweight stocks that are undervalued.

A RAFI® Index uses four fundamental measures – cash flow, book equity value, total sales and gross dividends – instead of market capitalisation, to determine company weightings in the index.

One of the obvious advantages of the RAFI® 40 Index is that it avoids market sentiment by not using share price as a basis for calculating the index. Share prices can – and do – get caught up in sentiment and ignore fundamentals at times, adding to volatility. In fact, investor sentiment is increasingly driving financial market behaviour – we have seen this earlier in the year, with investors developing a herd mentality into defensive stocks like retailers. One of the reasons the Old Mutual RAFI® 40 Tracker Fund has outperformed is because the methodology avoids this behaviour.

Continued ...

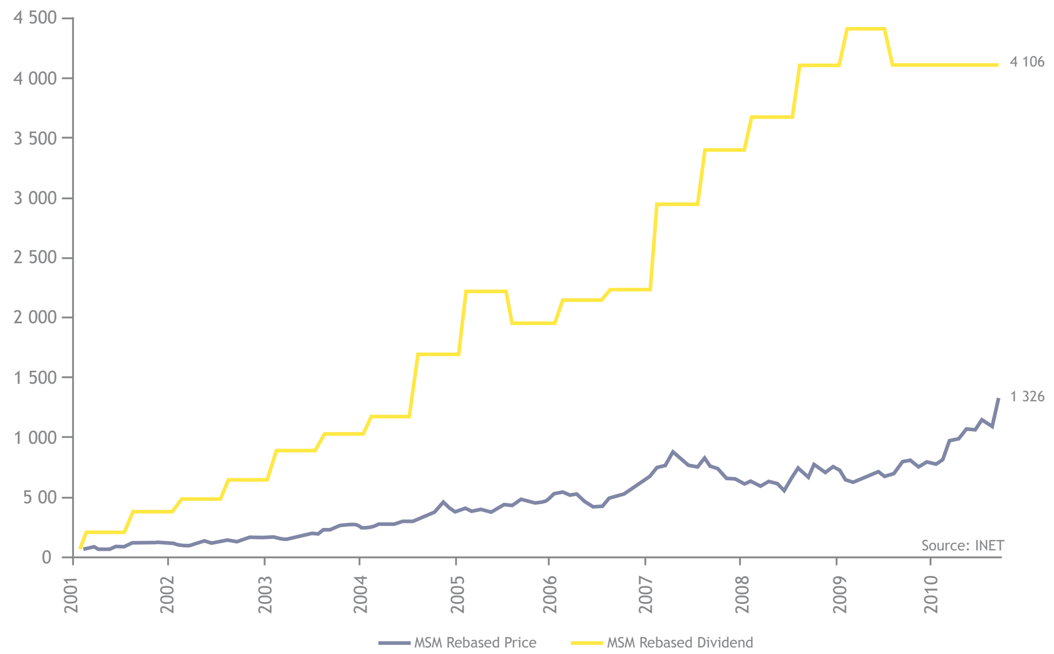
The table lists some of the positions held by the Old Mutual RAFI® 40 Tracker Fund that have contributed to its top-quartile performance over the past three years.

Stock	FTSE/JSE RAFI® 40		FTSE/JSE All Share Index		Peer Group Mean*	
	Weight	Rank	Weight	Rank	Weight	Rank
BHP Billiton	9.92%	1	12.24%	1	4.48%	4
Anglo American	9.65%	2	9.27%	2	3.64%	6
Old Mutual	6.96%	3	2.14%	12	2.29%	12
Sasol	6.07%	4	4.86%	5	8.20%	1
SABMiller	5.94%	5	6.82%	3	3.49%	7
Standard Bank	5.89%	6	4.28%	7	5.45%	2
MTN Group	4.93%	7	5.68%	4	5.16%	3
Bidvest	2.21%	13	1.26%	18	2.56%	9
Massmart	1.31%	25	0.72%	29	0.29	69
AngloGold Ashanti	1.26%	27	2.85%	9	2.03%	13
Shoprite	1.21%	28	1.31%	16	0.15%	84

Sources: FTSE/JSE and Riscura

*Holdings are derived from the Riscura Large Manager Watch Survey and are used to represent active managers.

MASSMART
PRICE VERSUS DIVIDEND GROWTH



Bidvest - overweight vs the average manager

Since 2002, the growth in Bidvest's dividend has outstripped that of its share price. As a result, the fund has had an overweight position in Bidvest relative to the average manager. In 2008 there was a sharp drop in its dividend payment as a result of the financial crisis, but as the fundamental methodology uses the five-year average dividend levels, it ignored this drop and remained invested in the share. This made the fund perfectly positioned to capture Bidvest's exceptional share price gains of 77% since early 2009.

Massmart – overweight vs the average manager

Although the share prices of many retail stocks have become overvalued in recent months due largely to foreign investor enthusiasm, the fund has been overweight Massmart over the three-year period versus the average general equity fund manager, due largely to the high rate of growth of its dividends outstripping share price growth. RAFI® recognised the attractiveness of the company's expanding economic footprint by looking at real-world measures like sales and dividends, rather than abstract accounting ratios, with the fund's overweight position yielding positive benefits for investors in the wake of the Walmart bid.

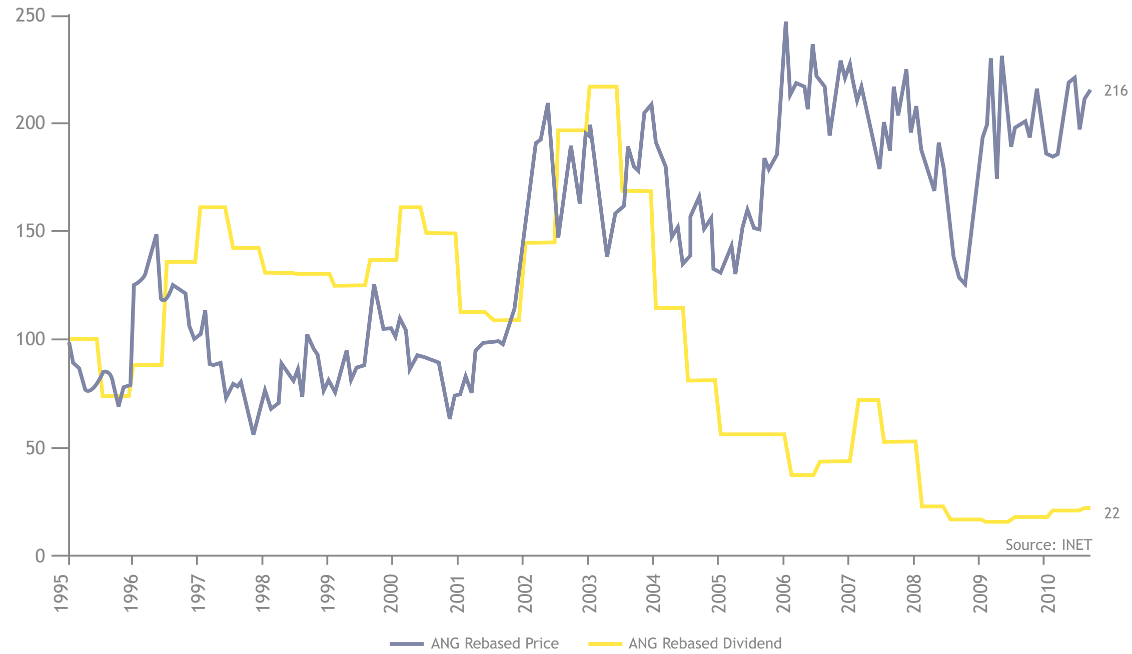
MTN - underweight vs the average manager

The fund has been, and remains, underweight in MTN — a classic growth company — because its share price has been factoring in as-yet-unrealised growth in its fundamentals. The fundamental methodology generally invests less in a company whose valuation (or price) has run ahead of its economic footprint, following more of a value approach to investing. Investing in growth stocks can be more risky, as that future growth is never guaranteed. The fund's underweight position in MTN helped to limit the impact of MTN's less impressive growth in share price performance since the financial crisis recovery in early 2009.

AngloGold Ashanti - underweight vs the average manager

The fund is currently underweight in AngloGold Ashanti versus the average general equity fund manager, as dictated by the four measures of the company's long-term economic footprint. This shows the defensive nature of the RAFI® methodology as it avoids trying to time the highly volatile short-term moves in the company's share price. This is one stock foreign investors have piled into this year, in search of higher returns in line with the "emerging markets" growth story, but fundamental measures are pointing to it being overvalued.

ANGLOGOLD ASHANTI
PRICE VERSUS DIVIDEND GROWTH



OMIGPI fund opens first shopping mall in India

Ben Kodisang
Managing director of Old Mutual Investment Group Property Investments (OMIGPI)

The Triangle Real Estate India Fund, a US$120 million venture by Old Mutual Investment Group Property Investments (OMIGPI) and ICS Realty, has opened the doors of its first Indian investment, the Prozone Aurangabad Mall.

This US$75 million shopping centre is a milestone in OMIGPI's decade-long association with India. In 1999 ICS was founded to introduce international groups to India. In 2005 our initial links with ICS were cemented in a joint venture, Pioneer Property Zone. This joint venture, where we contribute skills from our experiences in retail developments and ICS facilitates access to clients, enables developers in India to get a structured approach towards building and managing shopping centres. Having gained an appreciation of the opportunities in the Indian market, we established the Mauritius-based **Triangle Real Estate India Fund** in 2008.

Triangle India Fund targets growth through partnerships in retail-biased property in India.

The Prozone Aurangabad Mall was also a realisation of an opportunity to address the under-representation of organised retail in smaller "tier 2" cities like Aurangabad.

There is fast-growing market demand in these "tier 2" cities and I believe they offer good value and long-term growth prospects. While we, as investors, and our stakeholders, are set to benefit from the fast-growing consumer market in India, we also recognise the benefits associated with the mall for the development of the Aurangabad community. These include upgraded roads, world-class shopping, entertainment and banqueting facilities and a market-place for smaller local traders.

Prozone Aurangabad Mall, located in a prime residential neighbourhood in one of the fastest growing and industrialising cities in India, has 74 320m^2 of space and more than 150 retail stores selling top local and international brands, a five-screen cinema complex, a large family entertainment centre, 3 000 parking bays and a market trading area to promote local entrepreneurs. The centre is anchored by key national retailers, including Shopper's Stop, Tata's Star India Bazaar, Croma and Westside, and select Pantaloon formats.

There are also plans to build an office complex above the centre. A business class hotel will be constructed to complement the precinct.

The mall is three kilometres from the city's international airport and a 15-minute drive from the city centre. It has a primary catchment area of 1 million middle- to high-income consumers within a radius of 7-10 kms (or 25 minutes' drive), while its secondary catchment area comprises about 1.65 million middle- to high-income consumers within a radius of 50-100 kms (30-90 minutes' drive).

Aurangabad is the administrative headquarters of the Marathwada region. It ranks as the seventh-most popular tourist destination in India, attracting some 1.5 million tourists a year to see the famous Ajanta and Ellora caves.

Following the success of this partnership, the Triangle India Fund and its partners have investments in two other fast-growing cities in India — Coimbatore and Nagpur.

In two years' time, these two cities should see the opening of mixed-use developments covering over 70 000m^2 of retail space, together with office, hospitality and residential components.

About Triangle India Real Estate Fund LLC

The Triangle India Real Estate Fund was promoted by Old Mutual Investment Group Property Investments (OMIGPI) and its joint venture partner, ICS Realty, in 2008 as an opportunistic closed-end development fund focused on retail shopping centres. The Fund has a commitment of US$120 million and its first investment in Prozone is valued at around US$70 million. The Fund is listed on the Mauritian Stock Exchange, with Old Mutual Life Assurance Company SA as its primary investor. The targeted return is 20% over an eight-year term. It aims to capitalise on the rapidly expanding Indian retail market and its exceptional economic growth rate.

About Provogue and Prozone

Founded in 1997 and listed on the Mumbai and National Stock Exchanges, Provogue is one of India's top retail brands with 126 stores and 110 "shop-in-shops" across the country. Its property subsidiary, Prozone, a joint venture with UK listed Capital Shopping Centre plc (formerly Liberty International plc), focuses on developing retail infrastructure including shopping centres. It is the developer of the Prozone Aurangabad Mall. To find out more, visit www.prozone.co.in.

Cautious optimism for the global and local economies

Peter Linley
Head of Toros Equity

While the world and South African economies will face unusually high risks and challenges over the next few years, the likelihood is that both will continue the uneven but positive recoveries now underway as businesses, investors and consumers gradually leave behind the fear that has dominated the environment in the past two years.

The likelihood of a 'double-dip' recession is smaller than most people fear. A combination of the significant monetary policy stimulus that governments have in place and the strong motivation to keep interest rates low until economic recovery is truly well-established, plus strong growth from China and other emerging markets, means that we are likely to muddle through in the short term. I believe this scenario will play out despite the fiscal tightening in many developed economies that could constrain growth.

So-called "double-dip" recessions, in which an economy that has managed to recover from a recession soon falls back into negative growth, are very rare occurrences that have historically only been brought about by some policy shock. Rather, it is common for strong economic recoveries to be followed by slowdowns, as we have seen recently around the world. I expect a moderate but sustained expansion for our economy going forward (with GDP growth of around 3.0% p.a. this year and 3.5% p.a. in 2011). Growth will be sustained by continued low inflation and low interest rates. These will eventually encourage more spending and investment on the part of consumers and businesses. In fact, South African consumers have already been picking up their spending – a trend evident in higher car and retail sales, and faster credit extension growth. Although they face higher electricity and other administered prices, consumers are benefiting from rising real disposable incomes from relatively high wage increases, low inflation – especially low food and fuel price rises – and lower debt repayments, all of which help improve individual balance sheets. And luckily, house prices did not crash here as in many other markets, shielding homeowners from further financial worries.

So-called "double-dip" recessions are very rare occurrences that have historically only been brought about by policy shock.

The running rand

One concern is the strength of the rand, which is hurting local manufacturers and exporters, including SA's large resources companies that account for a significant source of jobs. Commodity prices have held up well due to steady demand from emerging markets, but as these are priced in US dollars and the rand has appreciated against the dollar, the benefit to our miners has been offset by the strong rand. With their costs in rand, there is little incentive to grow jobs.

And I expect the rand to remain stronger for a while, barring any unforeseen intervention by the Reserve Bank, as the relatively high local interest rates – and emerging market investments generally – continue to attract foreign investors.

Investor fear can trigger further volatility

Turning to equity markets, I am also cautiously optimistic. Fundamentally, the low-interest environment coupled with an improving economy is positive for equity prices, but investors should remain wary of volatility. Given the shocks to financial markets over the last two years, investors' fear levels can rise rapidly, leading to further volatility (which reflects risk) in prices.

Investors around the world don't have the appetite for much more volatility. This tends to result in irrational investor behaviour, which can have costly implications for investment returns.

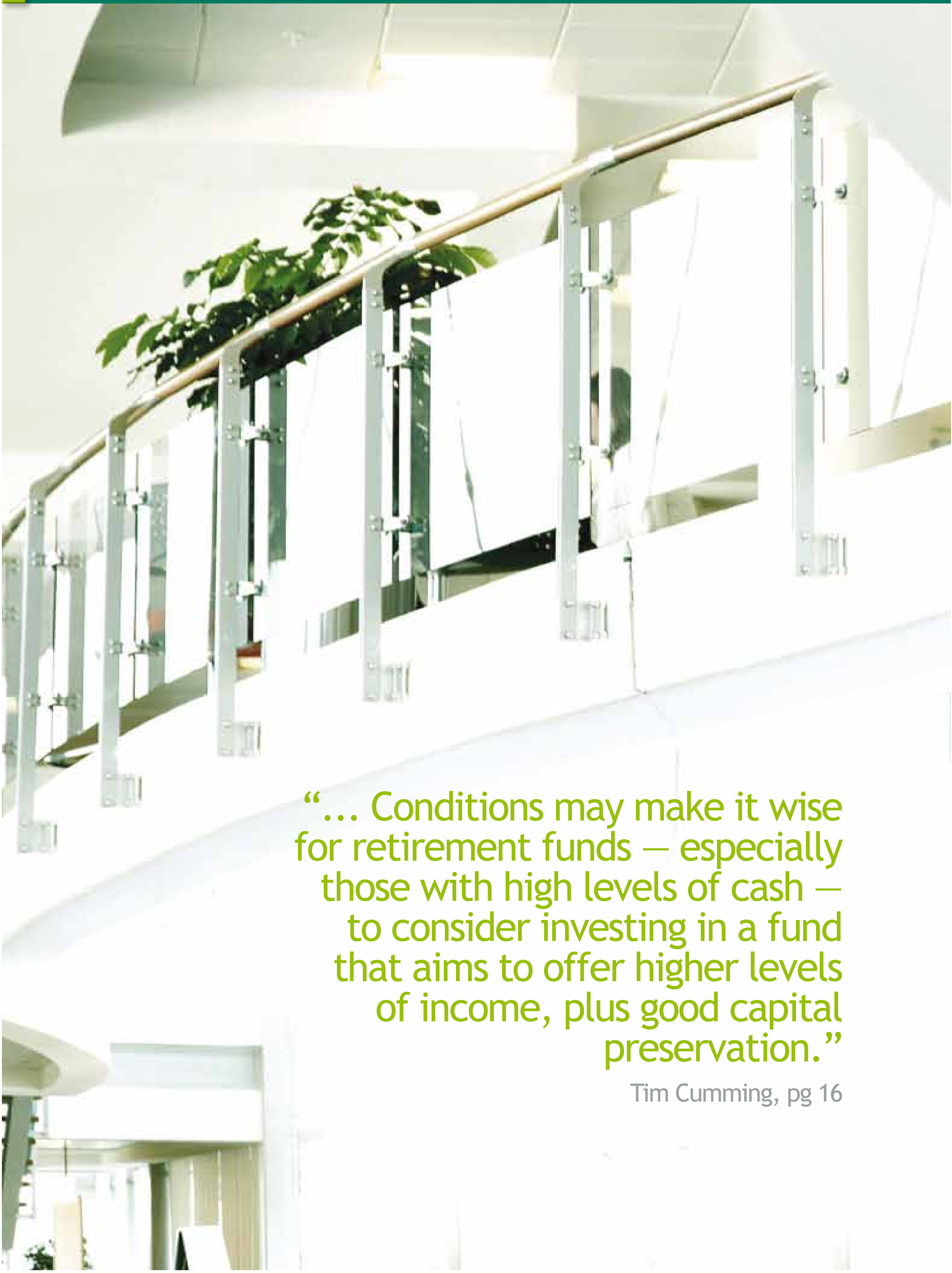
Investor fear has led to a strong demand for quality defensive shares, as well as those with high momentum, such as the food companies and retailers, many of which I believe are now very overvalued. This is not a market where investors are easily rewarded for buying cheap shares. Cheap shares, like Anglo American, are seen to present more risk, but there is a price for everything and the riskier shares currently present more opportunities to perform.

In managing the Old Mutual Investors' Fund, my colleagues and I have stayed true to our belief in a gradual recovery, rather than a double-dip. Consequently, we have focussed on the cheaper, less defensive shares. We have sold down the overpriced retailers which global investors have been chasing for yield and the 'Africa growth' story. We see this as nothing more than a story and valuations can no longer be justified. Many of the global peers of these companies are also overvalued.

We have used opportunities to stick with, and even add to, attractively valued, oversold shares like MTN and Anglo American. As the market has regained some confidence in the last few months, these previously unloved shares have outperformed, boosting the performance of the Old Mutual Investors' Fund. As investors, we cannot afford to be swayed by the enormous short-term swings and 'noise' in the market. Instead, we advise our clients to invest as we do – with a focus on the long term.

Investor fear has led to a strong demand for quality defensive shares, such as the food companies and retailers, many of which I believe are now overvalued.

Core Equity Investments has changed its name to **Toros Equity.** Read more about this exciting development on pages 14 and 15.



"... Conditions may make it wise for retirement funds – especially those with high levels of cash – to consider investing in a fund that aims to offer higher levels of income, plus good capital preservation."

Tim Cumming, pg 16

OMIGSA's boutique structure continues to evolve

Tim Cumming
Interim CEO, Old Mutual Investment Group (SA) (OMIGSA)

It has been nearly four years since Old Mutual Investment Group SA (OMIGSA) established a series of autonomous investment businesses. As part of the pioneering vision of developing these independent businesses, I am delighted that we are now taking the next logical step in our development as two of our boutiques take on their own identities. Select Equity Investments was our first Old Mutual-branded investment boutique to take on its own identity and, as of 1 October 2010, trades under the new name of ELECTUS.

The name ELECTUS – which means "select" in Latin – reflects the care with which boutique heads Neil Brown and Richard Hasson have managed their hand-picked share portfolios. The funds they manage hold only 35 to 40 carefully chosen shares, while they have limited both their asset capacity and number of clients in the pursuit of excess returns and the highest standard of personalised client service. All of these criteria point to the "select" nature of their business and, while not undermining the complexity behind their meticulous stock selection process, ELECTUS seemed an obvious choice of name.

More recently, Core Equity Investments changed its name to Toros Equity. The name Toros was inspired by the 'bull' lithographs of Pablo Picasso in which, through a series of drawings, he strips away the outward layers of the bull until he is left with what he refers to as the "raw essence". This is illustrative of the Toros Equity investment approach as they strip away all that is unnecessary and focus on the absolute essence of equity investment. It is a process that is simultaneously simple and complex.

While the names and branding of these boutiques have changed, clients have not been impacted in any way, as all funds continue to be managed according to their original mandates. Toros Equity and ELECTUS will continue to leverage off OMIGSA's extensive investment research, services and operational infrastructure, particularly the insightful propriety research from our equity research team and economists. At the same time, OMIGSA remains as fully committed as ever to supporting the success of these businesses.

ELECTUS
EQUITY SPECIALISTS

Richard Hasson and Neil Brown
Joint Heads of ELECTUS

Previously called Select Equity Investments, ELECTUS comprises the expert asset management team of Richard Hasson and Neil Brown, who have been with OMIGSA since 2004 and 1997, respectively. The boutique focuses on managing high-conviction, concentrated equity portfolios. They are supported by Russell Bodill in client service and distribution.

ELECTUS had nearly R30 billion in client assets under management as of 31 August 2010. Besides managing several segregated specialist equity mandates for large local and international institutional investors, ELECTUS also manages three retail unit trusts: Old Mutual Top Companies Fund (managed by both Neil and Richard since 2006); Old Mutual Growth Fund (managed by Richard since 2002); and Nedgroup Investments Growth Fund (managed by Neil since 2001).

A Member of the OLD MUTUAL Investment Group

Continued ...

More star performances from our funds

OMIGSA is in the unique position of having the depth of resources and investment expertise that enabled us to successfully adopt a multi-boutique model. It is in times of extreme market volatility and uncertainty that the expertise to achieve consistent, long-term performance is really put to the test. That is why I am delighted that no fewer than 13 of our unit trusts have been awarded top 5-star or 4-star ratings for their performances by Morningstar.

Morningstar rates funds based on risk-adjusted performance using a combination of periods over one, three and five years. This means that they are assessed according to how much investors are rewarded in the form of returns relative to the amount of risk the portfolio manager took in order to deliver those returns. Five stars is the highest rating available. Five-star funds are consistently in the top 10% of their respective peer groups, while four-star funds are consistently in the top 22.5% of their peers (on a risk and return basis).

5-STAR FUNDS

★★★★★	Old Mutual Mining & Resources R
★★★★★	Old Mutual Institutional Money Market
★★★★★	Old Mutual Global Bond Feeder Fund
★★★★★	Old Mutual Financial Services A

4-STAR FUNDS

★★★★	Old Mutual Income
★★★★	Old Mutual Real Income
★★★★	Old Mutual Flexible R
★★★★	Old Mutual High Yield Opportunity
★★★★	Old Mutual Industrial A
★★★★	Old Mutual Global Index FoF
★★★★	SYm|mETRY Fixed Interest FoF
★★★★	SYm|mETRY Balanced FoF A
★★★★	Marriott Dividend Growth R

Source: Morningstar (to end September 2010)

TOROS EQUITY

Peter Linley
Head of Toros Equity

Toros Equity boasts a highly skilled team of Peter Linley, Mila Mafanya and Johan Strydom, with an impressive 56 years' combined investment experience. They focus on constructing well-diversified portfolios aimed at delivering alpha of 2-3% over the long term, which is derived from numerous sources, rather than from a limited number of sources.

In addition to managing several segregated and pooled specialist equity mandates for large institutional investors such as municipalities, parastatals, tertiary institutions and others, Toros Equity also manages one of South Africa's oldest unit trusts, Old Mutual Investors' Fund.

As of 30 September 2010, the boutique had R40 billion in client assets under management.

A Member of the OLD MUTUAL Investment Group

The real thing in retirement

Our economic recovery depends, to some extent, on the recovery of demand from developed countries. One dilemma facing the United States and other developed countries is the large number of retirement funds with insufficient income to meet the required future payments to their members. With interest rates near zero, and income investments earning very low returns, they are having to look to other, more diversified and higher-yielding investments to meet their targeted levels of income. As a result, we have seen the global wave of funds flowing into emerging markets as part of this intensified "search for yield". South African retirement funds need to guard against a similar fate... As a result of the SA Reserve Bank's attempts to revive our economic growth, we have experienced a cumulative 6.0 percentage point interest rate cut (implemented between December 2008 and September 2010).

While our income-oriented funds have performed well relative to their peers, cash investments are now returning less than 7% a year, the lowest level in a decade. At the same time, equity markets are jittery and likely to return less than previously. These conditions may make it wise for retirement funds – especially those with high levels of cash – to consider investing in a fund that aims to offer higher levels of income, plus good capital preservation. Otherwise they could risk funding shortfalls over the longer-term.

The Profile Capital Portfolio may be a solution to consider. Managed by Macro Strategy Investments (MSI), this is a conservative portfolio that aims to offer solid returns over the long term (CPI+3%), while preserving capital over the shorter term. It has a long-term benchmark allocation to equity of 20%, which allows investors to participate in potentially superior long-term returns from equity without taking on excessive risk. The balance is primarily invested in fixed income assets, providing a high degree of income certainty. The fund has the ability to invest internationally, which provides valuable diversification, and has been active in a number of other asset classes such as gold and preference shares. The strategy has worked well as the fund has consistently delivered real returns greater than 3%.

On the retail side, a fund also managed by MSI with a similar mandate is the 4-star rated Old Mutual Real Income Fund. The fund invests across the full range of local assets to generate a high, regular income paid off an ever-increasing capital base, and to offer capital protection – both made possible by an expert combination of more conservative cash and bond holdings, plus some limited equity and/or property exposure.

New beginnings

My tenure as interim CEO at OMIGSA is coming to an end, as Diane Radley's appointment takes full effect from 1 January 2011, despite our having been in a handover process since October. It's been an honour and a privilege to have been back in the captain's seat in OMIGSA during 2010 (after having originally left it in 2004) but it's time for me to move on to new things. I wish Di and the entire OMIGSA team continued success in meeting all our clients' needs and also in keeping the shareholders happy at the same time!

An ENHANCED international equity offering

Urvesh Desai
International Portfolio Manager, Macro Strategy Investments (MSI)

These days, international exposure forms an increasingly important portion of multi-asset class funds. Not only has the government raised the international allocation limit from 15% to 20% of a portfolio, but with the strength of the rand, it has announced that foreign exchange controls will be further relaxed. Importantly, offshore markets offer access to unique industries and areas of growth outside of South Africa, providing investors with valuable diversification of risk.

With this as a backdrop, we have been placing significantly more emphasis on international assets and, over the last 12 months, have undertaken a major review of our international equity offering. We delegate the underlying management of our international asset exposure to a blend of carefully selected top international fund managers, with the aim of exploiting their expertise to generate the best possible risk-adjusted returns. Our allocation to each manager is dependent on our own investment views, while allowing the underlying managers the freedom to select assets within their own portfolios.

The four fund managers responsible for MSI's international asset selection are Acadian, Ashfield, Barrow Hanley and Walter Scott. The first three companies have been managing our international assets for several years, and are within the Old Mutual Asset Management (US) group, while the fourth is newly appointed and is not part of Old Mutual.

Major Changes

Simpler and more focused: This portfolio has moved from a structure diversified by region and style to one with three building blocks – Quantitative Global Equity, Value Global Equity and Growth Global Equity.

Global replaces regional: In an increasingly globalised world, the country of listing for a share (which determines which region the share falls into) is much less important than where the company earns its revenue. By widening the opportunity set to a global scope, we can expect a more optimal portfolio. This is because a manager is able to select the best share in an industry worldwide, as opposed to the best share in his region.

THE NEW INTERNATIONAL EQUITY PORTFOLIO

Benchmark Allocation	Benchmark Index	Mandate	Manager	Manager Track Record	10-yr alpha (p.a.)	Years with OMIGSA	Old Mutual Group
34%	ACWI MSCI	Quant Core	Acadian	24 yrs	3.3%	9 yrs	Yes
33%	ACWI MSCI Value	Global Value	Barrow Hanley	31 yrs	2.5%(2)	9 yrs	Yes
15%(1)	Russell 1000 Growth	US Growth	Ashfield	37 yrs	2.6%	2 yrs	Yes
18%(1)	ACWI ex-US MSCI Growth	Ex-US Growth	Walter Scott	27 yrs	4.3%(3)	0 yrs	No

1. Approximation. Actual BM weights dependent on US and ex-US and ex-US weight within MSCI All Country World Index.
2. Based on Large Cap US Value portfolio. Ex-US portfolio alpha of 3.7% relative to MSCI EAFE Value since inception (August 2006).
3. Based on ex-US portfolio relative to MSCI EAFE index.
Sources: OMIGSA, MSI

MSI International Asset Managers

Global Quant	
ACADIAN	
Founded:	1986
AUM:	$42bn
Ave Experience:	15 yrs
Philosophy:	Market inefficiencies are caused by behavioural errors and can be exploited quantitatively.
Style:	Quantitative

Global Value	
BARROW HANLEY	
Founded:	1979
AUM:	$52bn
Ave Experience:	28 yrs
Philosophy:	Build portfolios with P/E and P/B ratios lower than market dividend yield higher than market.
Style:	Value

Global Growth	
ASHFIELD	
Founded:	1973
AUM:	$3.2bn
Ave Experience:	32 yrs
Philosophy:	Blend of thematic and fundamental bottom-up analysis.
Style:	Growth-based. Risk conscious.

Global Growth	
WALTER SCOTT	
Founded:	1983
AUM:	$3.2bn
Ave Experience:	19 yrs
Philosophy:	Invest in companies with sustainable wealth generation to generate real return.
Style:	Growth-based. Low volatility, high quality.

Emerging markets included: The benchmark for our international equity portfolio will change from the MSCI World Index (which includes only developed countries) to the MSCI All Country World Index (ACWI), which includes emerging market countries (for example, China, Russia, India, Korea, etc.). The reason for this change is two-fold. First, this is in keeping with the principle of giving our managers the broadest possible opportunity set from which to choose their portfolios. Second, emerging economies are fast becoming the engines of growth in the world. Recent data shows that they are responsible for almost half of the world's economic growth. They therefore have an important place in any global equity portfolio.

A more efficient overlay: With our new focus on global mandates, we will now be using exchange-traded funds (ETFs), derivatives and other securities to effect our views. The better liquidity of these instruments makes this process quicker and more efficient.

Appointing a non-Old Mutual manager

Our value proposition for our international equity offering has always been to provide a blend of the best of the Old Mutual Group's asset management capabilities worldwide. By leveraging the group's global resources, we are able to provide a quality international solution, with the additional benefit of manager diversification at a very competitive price.

A comparison with the indicative fee ranges for international assets in the Alexander Forbes Manager Watch Survey of Retirement Fund Investment Managers for the year ended 2009 places us amongst the most competitively priced options in South Africa.

Within the philosophy of using Old Mutual's global resources, however, we have always maintained that, should we not be able to source a suitable and compelling capability within the group, we would look elsewhere. In selecting the best managers to comprise our Global Growth building block, we have done just this, reaffirming another core tenet of our philosophy – the best interests of the client come first.

Our search for an additional manager included managers of ex-US Growth portfolios and Global Growth portfolios. As part of the extensive search process, both Old Mutual Group and external manager research services were utilised. All aspects were analysed, including stability and reputation of the institutions; investment philosophies and processes; research and portfolio management teams; as well as risk and compliance processes. As indicated above, ultimately, MSI selected a blend of Ashfield and Walter Scott, a UK-based investment manager, for the Growth Global Equity building block.

Our International Offering for Institutional Investors

As active asset allocation specialists, we are constantly looking for new investment tools to extract value and drive performance.

MACRO STRATEGY BLENDED PRODUCT			NICHE ASSET CLASSES		
OPPORTUNITIES GLOBAL EQUITY BLEND OF MANAGERS	MULTI-STYLE GLOBAL EQUITY BLEND OF MANAGERS	GLOBAL BOND FUND BLEND OF MANAGERS	GLOBAL CREDIT FUND SINGLE MANAGER	GLOBAL MONEY MARKET FUND SINGLE MANAGER	GLOBAL REIT FUND SINGLE MANAGER
INTERNATIONAL-ONLY BALANCED FUNDS					

SOME THOUGHTS ON CONFLICTS OF INTEREST IN ASSET MANAGEMENT

Tim Cumming
Interim CEO, Old Mutual Investment Group (SA) (OMIGSA)

Fiduciary, trust, and due diligence are words frequently used by professional asset management firms who offer their services to investors. As a precursor to avoiding conflicts of interest, one of the most important things for asset managers to remember is that the assets they manage belong to someone else and have been placed in their hands in "trust".

To address the topic of "conflicts of interest", it's useful to view the related issues from within the framework of "principal and agent". With a few exceptions, the business of asset management is an "agency" business, where the asset manager is mandated to look after the assets of third-party clients (the "principals") in exchange for a fee. The agent will act or make decisions on behalf of the principal because it is understood that the agent has a particular comparative advantage over and above that of the principal – either through proprietary or specialist knowledge and/or because the agent possesses scale or scope advantages.

In looking at this relationship, there can also be further delegation by one agent to another agent. For example, pension fund members are principals for whom the fund trustees are agents, who in turn appoint asset consultants and asset managers (as sub-agents). For the retail investor, the man-in-the-street is the principal, but the agency chain can be a long one starting at the financial adviser, through to other "sales people", to unit trust funds (and its sponsors and trustees) and finally the asset manager at the end of the value chain.

The interests of each of these players and the incentives they have can potentially be in conflict with each other.

The challenge in the financial services industry (as in most others where the principal-agent model applies) is to make sure that the respective interests and incentives of each party are well understood and properly managed to ensure proper fulfilment of duties and a fair distribution of risk and rewards for each of the players involved.

Essentially, investors want to attain the best possible investment return within the accepted risk parameters – and to achieve this desired return net of the costs of their agents. Furthermore, the aggregate cost of these agents needs to be kept in reasonable proportion to the total (or excess) return on the assets.

"Reasonable proportion" is a very subjective measure and there is no ready formula or code to suggest what is "just right". However, market mechanisms usually determine these levels. It's normally up to the principal (if not one of their advisory agents) to make their own determination in this regard and thus it's essential that full (and understandable) disclosure of all costs is made to the clients.

Clients (principals) seek to get the "best value for money" and exceed their investment objectives, while agents, on the other hand, seek to maximise the profits of their businesses. This is clearly the fulcrum of conflict between these two sets of interests. Nonetheless, all reputable asset management firms will have clear policies and procedures to ensure that they avoid placing themselves in direct conflict with the interests of their clients. Today, most firms subscribe to and adopt the Institute of Chartered Financial Analysts code of ethics, which provides the ethical foundation to those policies and procedures. These typically cover things like:

- **Personal Account Trading** by managers in the firm (where no securities can be bought or sold by the manager for their personal account until such time as all orders have been totally fulfilled for all clients). This is to ensure that there is no "front running" by the managers to their own benefit. Indeed, some firms put a complete ban on personal investing in individual securities and only allow investment in the company's unit trust funds.

- **Allocation of Trades to Clients** (especially if one or several of the clients are "group" (related) companies). This is to ensure equality of benefit (or pain) across all clients with similar mandates.

- **Gift Policies** (there are strict limits or prohibitions on what you can spend on, or receive from, other service providers). This is so that there can be no undue or improper influence to decisions made around the cost levels or value of services that might be used in managing the clients' assets.

While there are many sensible policies and procedures a professional asset manager can impose to avoid being in conflict with their clients' interests, there are also ways that they can actually align their personal interests with those of their clients – through the mechanism of co-investment.

"OMIGSA's investment managers have a significant proportion of their annual bonus... co-invested in one or several of the funds they manage for their clients."

At Old Mutual Investment Group SA (OMIGSA), with very few exceptions, the boutique investment managers and senior executives have a significant proportion of their annual "variable pay" (bonus) deferred for three years and co-invested during that time in one or several of the main investment funds they actually manage for their clients. If they don't manage specific funds, then their deferred bonus is invested in a mix of OMIGSA client funds. This clearly ensures that any decisions they take for their clients will ultimately affect the outcome for their own investments. They will feel the benefits or pain together.

One of the simple ways I've always used to ensure that we never forget that we are managing other people's money, is to always refer to these assets as "our clients' assets under management" as opposed to "our assets under management".

FUTUREGROWTH WINS AWARDS FOR INFRASTRUCTURE DEVELOPMENT

Paul Semple
Credit Analyst of Futuregrowth Asset Management

Futuregrowth Asset Management, in partnership with NURCHA, has recently won two industry awards. They were joint winners of Mail & Guardian's Investing in the Future Award and an Africa Investor Infrastructure Investment Award.

Futuregrowth and NURCHA announced a R200 million funding partnership earlier this year. We provide loans to NURCHA, a development finance company that provides bridging finance to contractors. These are contractors who are awarded contracts by government to build infrastructure and community facilities. To qualify for a bridging finance loan they must have been awarded a contract in excess of R1 million and require a loan of more than R250 000.

Building a future

Futuregrowth and NURCHA received the "Mail & Guardian Investing in the Future Award for Enterprise Development for 2010". The award was given for our support of developments that create sustainable settlements around the country.

The judges praised the practical nature of the partnership, the tangible results it is producing in rural areas and the way it empowers and supports small contractors who often struggle to raise finances elsewhere.

Infrastructure Deal of the Year

As joint winners of the "2010 Africa Investor Infrastructure Investment Award in the category Social Infrastructure Deal of the Year", Futuregrowth and NURCHA were recognised for their work in housing and community projects.

Africa Investor is a leading international investment research and communications group. This award recognised achievements across the main infrastructure sectors in Africa. The judges looked at the structuring of deals as well as how an infrastructure programme was delivered in terms of Public Private Partnerships innovation, the use of local resources (human and capital), the positive social and economic impact on the local community, the consultation with key stakeholders, the consideration of sustainable development environmental concerns and the promotion of regional integration.

The Africa Investor judges commented on the improving quality of infrastructure investments on the continent and the global competitiveness of African infrastructure as an investable asset class.

A winning partnership

NURCHA was founded in 1994 and operates in the arena of subsidised housing, affordable housing and infrastructural development. Its main aim is to ensure that individual projects are professionally undertaken and successfully completed while ensuring that the contractors make a profit and develop a sustainable path for their businesses.

We have been involved with NURCHA since 1996, as the first private sector funder to partner with NURCHA. The debt funding to NURCHA is made possible through third-party funds that Futuregrowth manages mostly on behalf of investors.

The partnership enables our pension fund clients to invest their money in service delivery… and get returns. The balance between investors' security and returns is a carefully managed relationship. The loan finance will yield a risk-adjusted return in an environment that is specifically structured to constantly manage the credit risk and performance of these loans.

We estimate that this facility could support in excess of R5 billion in total project values over the 66-month duration of the facility.

Market Indicators as at 31 October 2010

	DY %	PE Ratio	1 Month %	12 Months %
FTSE/JSE All Share Index	2.3	17.1	3.6	18.3
FTSE/JSE Resources Index	1.7	19.5	8.5	13.6
FTSE/JSE Industrial Index	2.7	12.8	1.9	24.3
FTSE/JSE Financial Index	3.9	12.2	-2.3	15.9
FTSE/JSE SA Quoted Property Index	7.2	13.8	1.4	29.9
ALBI BEASSA Bond Index			1.0	16.8
STeFI Money Market Index			0.5	7.1
MSCI World Index (R)			3.5	0.7
MSCI World Index ($)			3.8	13.3

Economic Indicators		Latest Data	Previous Year
Exchange Rates			
Rand/US$	October-10	7.0	7.8
Rand/UK Pound	October-10	11.2	12.8
Rand/Euro	October-10	9.7	11.5
Rand/Aus $	October-10	6.9	7.0
Commodity Prices			
Gold Price ($)	October-10	1359.6	1044.9
Gold Price (R)	October-10	9395.7	8049.2
Oil Price ($)	October-10	82.5	74.5
Interest Rates			
Prime Overdraft	October-10	9.5%	10.5%
3-Month NCD Rate	October-10	5.9%	7.2%
R157 Long-bond Yield	October-10	7.0%	8.4%
Inflation			
CPI (y-o-y)	September-10	3.2%	6.1%
Real Economy			
GDP Growth (y-o-y)	June-10	3.0%	-2.5%
HCE Growth (y-o-y)	June-10	2.5%	-3.7%
GFCF Growth (y-o-y)	June-10	-1.6%	4.3%
Manufacturing Production (y-o-y)	August-10	5.4%	-15.5%
Balance of Payments			
Trade Balance (cumulative 12-month)	September-10	-$1.3	-$2.5
Current Account (% of GDP)	June-10	-2.5%	-3.5%
Forex Reserves (incl. gold)	September-10	$43.0	$38.5

Source: OMIGSA

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