Market Dynamics

April 2009

OLD MUTUAL
Investment Group

Performance through Focus

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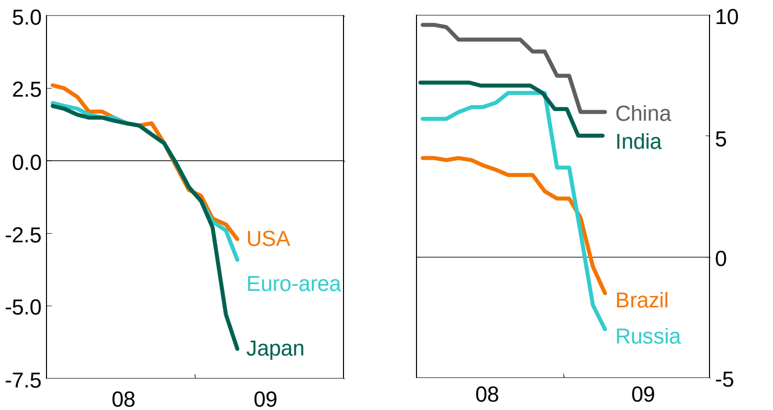
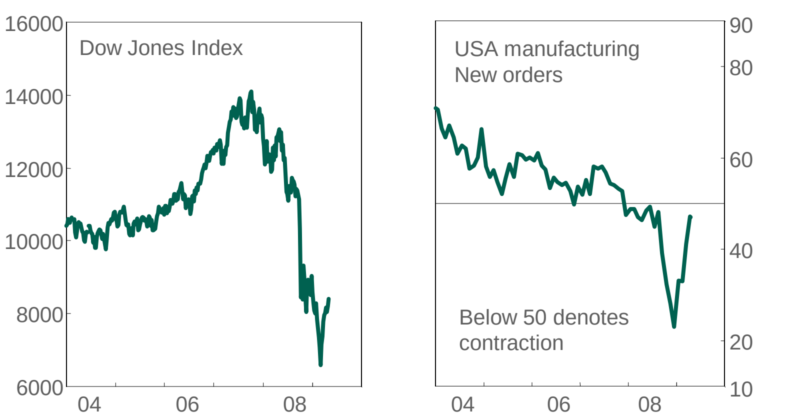
World Economic Overview and Outlook

GDP growth forecasts for 2009



Source: OMIGSA (Iris)

Markets rally on hopes of economic stabilisation



Source: OMIGSA (Iris)

- The past month saw the release of yet more very weak macroeconomic numbers, and growth forecasts for 2009 and 2010 were slashed further. The International Monetary Fund (IMF) cut its global growth forecast for 2009 to -1.3% from +0.5%, while its 2010 forecasts were lowered from 3.0% to 1.9%. Private sector analysts generally have notably more negative predictions than the IMF.
- The global downturn continues to be driven by a broad-based slump in consumer demand, postponements or scrapping of private expansion plans, a sharp contraction in global trade, and steeply lower commodity prices (hitting commodity producing countries hard).
- With the outlook for the global economy grim, policy settings remain extremely expansionary as policy makers continue to pull out all the stops in order to stabilise global economic conditions. As the month drew to a close, renewed panic set in over the potential negative impact on the world economy, should the outbreak of swine flu in Mexico turn into a global pandemic.

OMIGSA view: *The world growth slump continues, but the pace of deceleration should start to slow towards mid-year.*

- April saw some good news too, with some signs that the speed of the global downturn is slowing. As a result, the global equity rally, that started early in March, was sustained through April on growing hopes that the policy measures are starting to have some effect, and that a moderate recovery will take hold towards the end of 2009 or early next year.
- Recent data, pointing towards some stability beginning to set in, is supportive of our long-held view that conditions will begin to improve gradually later in 2009. However, investors should guard against over-optimism in the short term as there are still considerable downside risks and the recovery, when it eventually arrives, is likely to be slow and uneven.

OMIGSA view: *2009 will be a year of two halves: a deep slump during the first half, followed by stabilisation, and possibly even a moderate recovery in the second.*

Local Economic Overview and Outlook

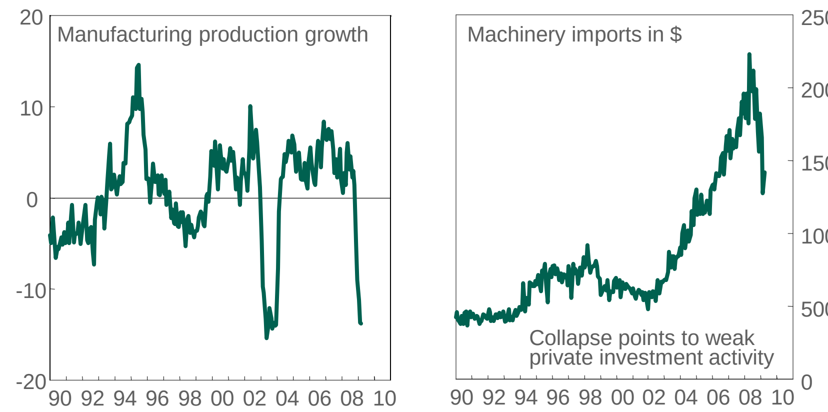
- Following an almost 2.0% contraction in Gross Domestic Product (GDP) in the fourth quarter of 2008, available data for the first quarter of 2009 looks even worse. Considerable weakness remains in key sectors such as mining, manufacturing and electricity production.
- Additionally, sharply lower commercial vehicle sales, machinery imports and non-residential building plans passed, indicate that the corporate sector is now aggressively curtailing expenditure. As a result, based on the available data – mostly for January and February – GDP could contract at an even faster pace in the first quarter of 2009.
- This extremely weak data has resulted in growth forecasts for the full year being slashed further, with a contraction of about 0.5% now roughly the consensus opinion, against previous forecasts of about 2.0% GDP growth for 2009 as recently as January this year.

***OMIGSA view:** Local 2009 growth prospects are poor due to the global slump and intensifying local demand weakness.*

- The outlook for consumers is a little more rosy. Lower interest rates, lower petrol prices, a general slowdown in inflation and sizeable tax cuts will lend support to consumption as the year progresses. The biggest risk is that the downturn in the broader economy will cause widespread layoffs, as has already started to occur in some industries.
- With the economy slowing sharply, and promising prospects for a further deceleration in inflation in the months to come, interest rates were cut by a further 100 basis points (bps) in April.
- The rand strengthened from well over R10/$ (early March) to around R8.50 by the end of April. The firmer rand, if sustained, will have a positive impact on the inflation outlook, but it is not doing the badly struggling key manufacturing and mining sectors any favours. A further firming of the local currency may indeed aggravate the local downturn and deal a severe blow to any prospects for recovery in the second half of the year.

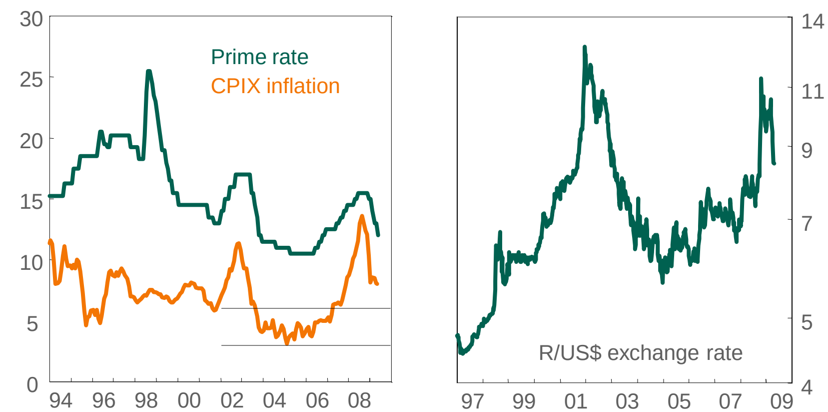
***OMIGSA view:** The strengthening rand is a double-edged sword: It will improve the inflation outlook, but may aggravate the downturn in the economy as the mining and manufacturing sectors will be hard hit.*

Real economy very weak



Source: OMIGSA (Iris)

Inflation and rates decline; rand firms



Source: OMIGSA (Iris)

Equity Sector Overview and Outlook

Resources

- The basic materials sector delivered negative returns (-2.0%) in April, while the gold and oil/gas sectors delivered -20.7% and -5.0% respectively.
- This was due to profit taking in the gold sector after talk that the International Monetary Fund (IMF), the third largest holder, was considering selling some of its gold holdings, and on rising petroleum stockpiles.
- Global uncertainty regarding economic growth remains high. As a result, it would be prudent to avoid higher-cost, lower-quality resources companies or exploration/junior companies that will not receive funding in the current conditions.
- We expect most non-gold mining companies to post substantially lower profits than their last set of record results, with pressure on earnings during 2009 due to materially lower commodity prices and/or volumes.
- Despite the uncertainty regarding global growth, there is substantial value in certain shares and/or sectors – even on (lower) normalised earnings, such as ArcelorMittal.

OMIGSA view: *The diversified miners are protected by their exposure to a variety of commodities and currencies in their portfolios. This is because they typically have the best assets and tend to remain profitable even in commodity downturns, unlike some of the pure and smaller miners. Mining valuations remain compelling, given the recent weak share price performance. While short-term conditions are tough for some non-mining resources companies, valuations are very compelling.*

Small Companies

- April 2009 saw positive returns in the mid- and small cap sectors of 8.1% and 5.5% respectively. This is on the back of a very volatile start to the year. Global uncertainty from the credit squeeze persists, which causes diverse views on market direction and asset valuations.
- We are constantly seeing downward revisions to forecasts, and company results are confirming the economic slowdown. Another feature coming from the recent reporting season is the extent to which layoffs are increasing. This must surely impact on consumers, particularly at the lower end.
- Decreasing interest rates should be good for small caps, as many companies are reliant on the health of the South African (SA) consumer for their wellbeing.
- The waning appetite for additional risk among some funds is likely to increase small cap volatility, but this may provide us with good buying opportunities in the months ahead.

OMIGSA view: *The average price:earnings (p:e) ratio at which small caps trade compared with large caps has widened to about a 20% discount. Unless renewed optimism comes back into the market, we expect this discount to persist.*

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Equity Sector Overview and Outlook (cont.)

Financials

- The financial sector continued to consolidate gains from the previous month, with the index up 5.1% in April. This translated into an outperformance of 2.7% against the FTSE/JSE All Share Weighted Index (SWIX) that returned 2.4%.
- The banking sector was up 5.1% in the month, while the life insurance sector was up 7.1% – mainly lifted by Old Mutual which advanced 19.7%, making it the best performer in the sector.
- Recent interest rate cuts, with more cuts expected in coming months, will benefit the sector although relief on earnings will only be seen in the medium term.
- However, the slowdown in Gross Domestic Product (GDP) growth and a possible increase in unemployment pose a headwind to the performance of the sector.
- The operational environment for financial sector companies is expected to remain tough in 2009, but we believe that share prices already reflect much of this.
- We believe that the financial sector is still looking attractive on a long-term view and is underpinned by a high dividend yield.
- However, we would expect some consolidation over the near term after the strong rally, and given that the sector no longer looks very attractive compared to its global peers.

OMIGSA view: *Financial stocks are facing a tougher operating environment, but this has been discounted in current prices. Valuations are looking attractive, especially dividend yields.*

Industrials

- The industrial sector made up the previous months' losses against the FTSE/JSE All Share Index (ALSI) in April, ending the month up 5.4%.
- The sectors that are generally regarded as more cyclical were better performers across the board, with construction standing out, and retail holding its own.
- Aveng was the star performer, up 26% in the month, but all construction shares were strong on the back of further interest rate cuts.
- Retail performance was not quite as stellar, but nevertheless held up with a stable performance. The consumer should be slowly emerging out of the woods as we approach the second half of 2009. This is due to the 350 basis point (bp) drop in interest rates, which has resulted in more than R2 000 monthly savings on a household with an R800 000 bond.
- Traditionally defensive shares such as Tiger Brands and British American Tobacco (BAT) lost some ground during the month.
- The momentum has swung away from defensive towards recovery shares, as some indicators seem to show that the world economy is at the point of turning the corner and monetary policy is starting to make its mark.

OMIGSA view: *A reasonably defensive stance is still warranted, as sustainability of earnings is still a worry. However, some reasonably priced cyclicals have emerged now that earnings expectations have been pulled back and absorbed by the market.*

Equity Sector Overview and Outlook (cont.)

Property

- The listed property sector recorded a 4.1% total return in April lifting the year-to-date performance to 2.6%, outperforming the year-to-date returns of the All Bond Index (ALBI) and FTSE/ JSE All Share Index (ALSI), that were down -4.2% and -2.7% respectively.
- The listed sector has been remarkably stable in 2009 and reflects our view that the sector is fairly valued but offers defensive cash flows. The sector may underperform equities if risk appetite increases, and is likely to outperform bonds and cash.
- Market rentals have largely peaked and tenant arrears have increased. Access to funding has become tougher and companies have shelved all except already-committed capital expenditure. Property expenses (especially higher electricity, rates and taxes) are putting pressure on tenants' ability to afford space and landlords' operating margins.
- Positively, average listed sector vacancies remained essentially unchanged at around 3.5% as at December 2008 compared with 2007. While expected to rise over the next two years, the slowdown in building completions means that national vacancies are unlikely to rise to the crisis levels of above 12% recorded in 2002, and may top out at 6%-7%. Expiring leases are still below market rentals and continue to provide an uplift to revenue growth.

OMIGSA view: *The sector represents fair value. However, should appetite for risk increase, listed property could underperform rising equities. The sector is expected to outperform cash as interest rates fall, as well as bonds, which have already priced in much of the rate cuts.*

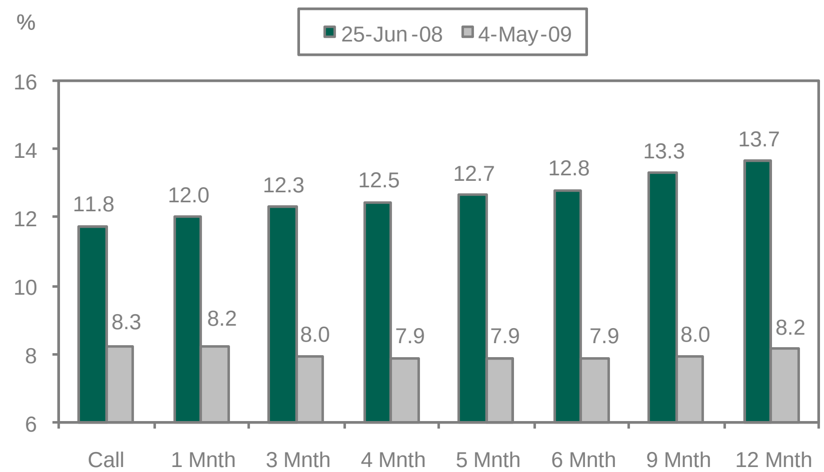
Fixed Interest Overview and Outlook

- More recently, growing anecdotal evidence that a base is starting to form with regard to economic conditions partly contributed to rising developed market bond yields - finally some reaction, given the massive injection of liquidity implemented by authorities worldwide!
- The local bond market traded in a fairly wide range and ended the month marginally stronger following another repo rate cut of 100 basis points (bps) by the South African Reserve Bank (SARB).
- The net effect of the above was a further normalisation of the local yield curve, with money and bond market rates now more evenly balanced.
- The bond market is expensive, but is expected to trade in a trading range of about 150bps, with the risk of higher yields increasing significantly on a 12-month view.

Futuregrowth view: *The South African yield curve has normalised to a large extent since December 2008 as the central bank caught up with the market, and therefore offers limited value. In contrast, non-government debt offers excellent long-term value.*

- Our money market funds maintained an underweight tilt to cash and a high holding of floating rate instruments, while we utilised short-lived market weakness to reduce the underweight tilt to long-dated Negotiable Certificates of Deposit (NCDs).
- In the bond funds we utilised weakness to increase the overweight tilt to the 7-12 year maturity band; this also resulted in a small overweight modified duration tilt.

South African NCD market (changes in yield over the last ten months)



Sources: OMIGSA and Bloomberg

- Given the general level of market rates, we are running underweight tilts to the 1-3 and 12+ maturity bands. This is offset by a significant overweight tilt to bonds in the 7-12 year band.
- We are selectively buying non-government debt at very attractive spreads.
- We maintain a low listed property holding on a weak economic growth outlook, preferring nominal bonds and preference shares instead.
- We are cautious on CPI-linked bonds following the sharp recent bull rally, current low levels and a fairly bullish inflation view.

Futuregrowth Asset Management

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Economic Indicators to April 2009

	Latest Data		Previous Year
Exchange Rates:			
Rand/US$	April-09	8.44	7.54
Rand/UK Pound	April-09	12.49	14.99
Rand/Euro	April-09	11.17	11.78
Rand/Aus$	April-09	6.19	7.11
Interest Rates:			
Prime Overdraft	April-09	13.00%	15.00%
3-month NCD rate	April-09	7.95%	11.75%
R157 Long Bond Yield	April-09	8.12%	9.50%
Inflation:			
CPI (y-o-y)	March-09	8.5%	10.6%
National Accounts:			
GDP Growth (y-o-y)	December-08	1.3%	4.8%
GDP Growth (q-o-q, annualised)	December-08	-1.8%	5.4%
HCE Growth (y-o-y) (Household Consumption Expenditure)	December-08	0.1%	4.9%
GFCF Growth (y-o-y) (Gross Fixed Capital Formation)	December-08	6.4%	16.3%
Balance of Payments:			
Trade Balance (cumulative 12month)	March-09	-$7.36	-$10.59
Current Account (% of GDP)	December-08	-5.8%	-7.2%
Capital Account (% of GDP)	December-08	6.6%	10.0%
Forex Reserves (incl. gold)	February-09	$34.02	$34.18
Other:			
Manufacturing Production (y-o-y) (seasonally adjusted)	February-09	-15.0%	3.9%

Market Indicators to April 2009

	1 Month (%)	Quarter (%)	Calendar Year (%)	12 Months (%)	3 Yrs (%)	5 Yrs (%)
Equity						
All Share Index	1.6	1.6	-2.7	-30.3	2.1	18.1
Shareholders Weighted Index	2.4	2.5	-2.3	-26.1	2.5	-
All Share/Resources 50%	2.9	1.8	-3.0	-26.2	1.9	17.9
Top 40 Index	0.6	1.2	-3.5	-33.2	1.8	17.5
RAFI® 40 Index	4.6	2.7	-1.8	-25.0	3.4	18.8
RAFI® All Share Index	4.0	0.5	-3.5	-25.6	2.4	18.8
Resources Index	-3.0	1.2	-1.4	-42.7	2.5	18.3
Financial Index	5.1	5.1	-2.3	-18.1	-4.5	14.2
Industrial Index	5.4	0.3	-4.4	-18.1	5.2	19.7
Mid-cap Index	8.1	5.3	3.3	-5.0	4.7	21.3
Small-cap Index	5.5	0.1	-1.2	-22.5	2.3	21.8
Interest-Bearing						
ALBI BEASSA	0.96	-1.9	-4.2	15.0	6.2	9.7
STeFI	0.8	2.6	3.5	11.7	9.9	8.9
Cash	0.7	2.3	3.3	11.2	9.7	8.2
Property						
SA Quoted Property Index	4.1	3.8	2.6	17.4	9.6	-
International						
MSCI World Index (R)	-0.8	-10.6	-10.0	-31.4	-0.5	3.5
MSCI World Index ($)	11.3	7.6	-1.8	-38.9	-11.0	-0.5
JPM International Bond (R)	-11.0	-17.7	-12.8	13.0	19.8	10.0
US 1-month LIBOR (R)	-10.8	-16.7	-7.9	15.3	16.7	8.0
Inflation (Estimated)						
CPI	1.4	3.7	3.5	8.1	8.7	6.5

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Regulatory Information

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