

Market Dynamics

August 2009



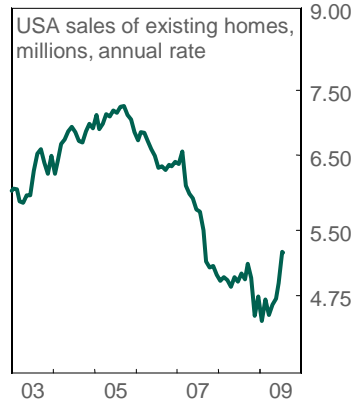
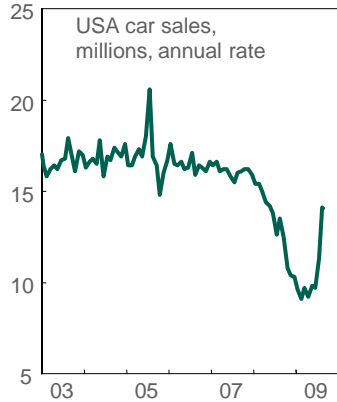
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World Economic Overview and Outlook

Global recovery indicators



Source: OMIGSA (Iris)

Global recovery indicators



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- ▲ The global stabilisation signs that have been emerging since April have gradually been transformed into outright economic recovery over the past few months. The upturn, which was first evident in Asia, has spread over a fairly broad front over the past few months and overall global growth is likely to be fairly solid during the third quarter.
- ▲ While the strength of the recent economic upturn has surprised most analysts, there are still considerable concerns over the sustainability of the recovery. The key concerns revolve around the eventual fading of stimulus measures, weak labour markets around the world and ongoing debt de-leveraging by highly indebted households in many parts of the world.
- ▲ We share these medium-term concerns. As a result, and given the limited risk of any meaningful rise in global inflation over the next twelve to eighteen months, economic policy settings will remain expansionary until such time as policy makers are confident that the risk of a serious growth relapse has faded.
- ▲ Despite the stronger economic data over the past month and growing confidence that the world has already entered an economic recovery, global equity markets rose only moderately in August. This should not be too surprising, given the very strong rally since early March and ongoing concerns over medium-term economic prospects.

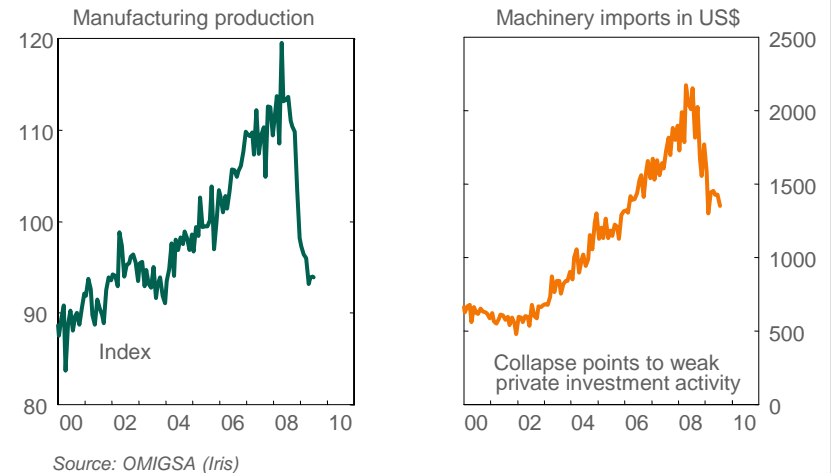
OMIGSA Economic Research Unit view: *While short-term prospects continue to brighten, there are still many obstacles and risks that cloud medium-term prospects.*

Local Economic Overview and Outlook

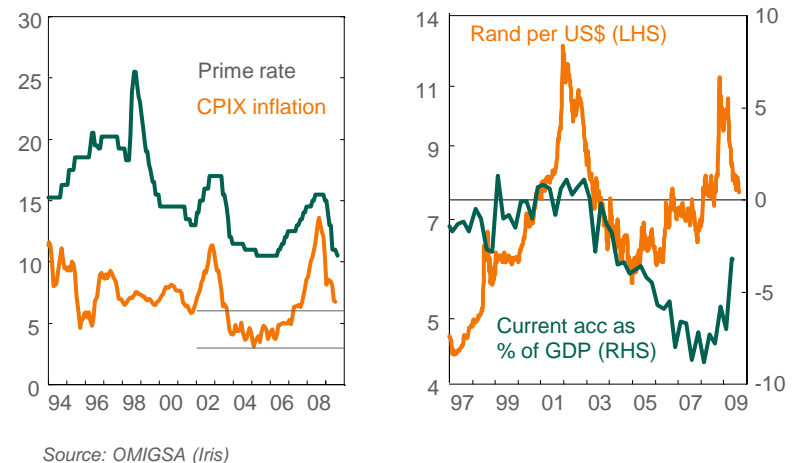
- ▲ Gross Domestic Product (GDP) numbers confirmed the widely held view that the local economy remained in recession in the second quarter, but that the pace of the decline in total output has slowed. GDP contracted at an annualised 3% in Q2 2009, compared with over 6% in Q1.
- ▲ Near-term prospects are still poor. While we still expect some improvement during the second half of the year, a decent recovery is only expected in 2010. Of particular concern is the stressed financial position of consumers, despite lower interest rates and fairly high wage settlements. High debt levels, job losses and the continued erosion of buying power by administered price increases remain the key culprits.
- ▲ On a more positive note, inflation prospects have improved and the foreign trade balance recorded its third successive monthly surplus in July. Still-weak domestic demand, the strong rand, a levelling out of the oil price and a notable deceleration in food inflation have raised hopes that inflation will continue to ease in the months to come. However, there are still some medium-term inflation concerns that the Reserve Bank will take into account in monetary policy decisions. These include still-high wage settlements, rapid escalations in administered prices and still-high inflation expectations.
- ▲ The improvement in the trade balance in recent months, together with a decline in net services payments abroad, has caused the deficit on the current account to narrow from 7% of GDP in Q1 to a little over 3% in Q2. This, and a growing risk appetite among foreign investors, lent strong support to the rand, which firmed to well below R8/\$ by the end August.
- ▲ The South African Reserve Bank (SARB) surprised the markets with an unexpected 50 basis point rate cut in August. While the scope for further cuts is now very limited, it is still too early to say with certainty that we have finally reached the bottom of the rate cycle.

OMIGSA Economic Research Unit view: *The local economy remains depressed and will recover only slowly during the second half of the year. This keeps open the possibility of a further lowering of local interest rates.*

SA economy still very weak



Inflation eases, rates cut; Rand firm on better current account



Equity Sector Overview and Outlook

Resources

- ▲ The basic materials sector delivered strong gains during the month, driven by strong performance from the non-mining sector (forest products/paper and industrial metals/steel).
- ▲ The strong performance was based on evidence of an earlier-than-expected recovery in China and India, with signs of stabilisation in the G7.
- ▲ 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 steel/paper.

Investment Research view: *The diversified miners are protected by their exposure to a variety of commodities and currencies in their portfolios, as 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, despite the recent strong share price performance. While short-term conditions are tough for some non-mining resources companies, valuations are very attractive.*

Small Companies

- ▲ During July 2009, the Small Cap Index gained 6.6%, compared to the 2.9% increase posted by the FTSE/JSE Top 40 Index. The outperformance of shares at the smaller end of the market is reflective of the returning risk appetite among investors.
- ▲ Many companies reporting results for the period ending June 2009 have released their numbers. Broadly speaking, these results show that trading conditions are tough. Turnover numbers have not been that badly hit, but margins are under pressure, particularly in companies with a high fixed cost base or that were slow to adapt to the change. Most prospect statements remain very cautious.
- ▲ Going forward we believe that the decreased interest rates will ultimately be very good for small caps relative to the larger companies. This is because of their higher debt levels as well as their ability to grow faster by being able to take on more debt.
- ▲ The risk appetite of investors appears to be picking up as the global momentum starts to improve, and this is likely to increase the size of funds flowing into the small and mid-cap space.

Investment Research view: *The average price:earnings (p:e) ratio at which small caps trade compared with large caps has narrowed again to a 10% discount. This is more in line with the longer-term norm and we would be more comfortable with this level. Lower interest rates will favour the relative performance of small over large caps.*

Equity Sector Overview and Outlook (cont.)

Financials

- ▲ The FTSE/JSE Financial Index marginally outperformed the FTSE/JSE Shareholder Weighted All Share Index (SWIX) during August. The SWIX ended the month 4.1% up while the Financial Index gained 4.7%.
- ▲ Within the financial sector, strong performance came from the banking sector, which was up 7.1% during the month, while the life sector lagged and only managed to advance 0.8%. The banking sector was buoyed by the second quarter's Gross Domestic Product (GDP) numbers that came in stronger than expected, raising hopes that the worst of the recession is over.
- ▲ We expect the operational environment for financial sector companies to remain tough in 2009, with loan impairment ratios for banks and policy termination rates for life companies remaining above trend.
- ▲ Although recent interest rate cuts should bring some relief to the sector, this is only expected in the medium term due to their lagged effect. Continued weakness in the economy, as well as a consequent increase in unemployment, poses the highest risk to the sector's recovery.
- ▲ Although impairment ratios for banks are still trending up, the rate of decline has slowed, and we believe earnings will surprise in the medium term as the ratios begin to recover.

Investment Research view: Financial stocks are facing a tougher operating environment, but this has been more than discounted in current prices. Valuations are looking attractive, and are still below historic averages.

Industrials

- ▲ Industrials had a strong run in August, up 4.0% compared to the 3.2% rise in the FTSE/JSE All Share Index.
- ▲ Within the sector there was a clear preference for cyclical shares, particularly extremely cyclical shares that had been sold down in previous months.
- ▲ Shares like Steinhoff, Naspers, Richemont and most of the construction sector delivered more than 10% in the month, fuelled by news of the world economic turnaround.
- ▲ The laggards were the retailers (food, clothing and durable retail) and some of the defensive industries like pharmaceuticals and hospitals. With the rand strength, most of the rand hedge shares were also not favoured in the month.
- ▲ The sector continues to look expensive, as prices factor in a full recovery globally and locally.
- ▲ While we don't question that a recovery is currently under way, we question the health of the world economy post all the stimulus measures and its ability to grow without continued stimulus.
- ▲ Many companies' share prices are factoring in extremely high returns, sometimes higher than were experienced in the heyday, prior to the financial crisis a year ago.

Investment Research view: The sector is now starting to look expensive, although we would consider some of the more defensive shares again as they have pulled back.

Equity Sector Overview and Outlook (cont.)

Property

- ▲ The listed property sector has been quite a defensive year for the 12 months to August 2009. The listed property index has produced a pre-tax total return of 14% for the 12 months to August to August while equities produced a negative 4% and bonds 12%.
- ▲ For the month of August, the sector produced a pre-tax total return of 2.2%, equities 0.8% and bonds 1.8%. The sector therefore outperformed both bonds and equities for the month of August and year to August.
- ▲ In our view, the listed property sector is fairly valued and offers defensive cash flows, albeit with lower growth over the next two years (7%-8%) than in the previous two (12%-14%).
- ▲ Property expenses (especially higher electricity, rates and taxes) are putting pressure on tenants' ability to afford space.
- ▲ While vacancies are 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.

Investment Research view: *Market rentals have largely peaked and tenant arrears have increased. The sector is fairly valued and offers defensive cash flows with growth of 7%-8% over the next two years.*

Fixed Interest Overview and Outlook

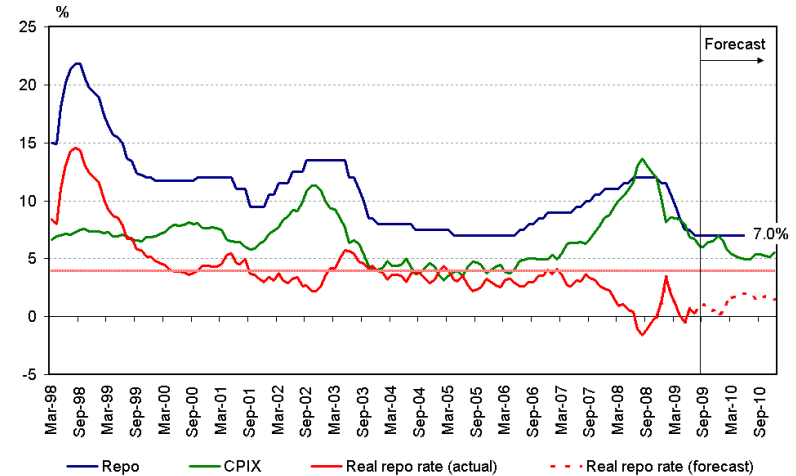
- ▲ Short-dated money market rates moved lower in reaction to the 50 basis point (bp) repo rate reduction at the beginning of the month. The yield of the R203 (maturity 2017) traded in a band of 9.0% to 8.6%, before closing the month at 8.7% or 15bps lower compared to the previous month's close. The yield curve slope steepened as the short end adjusted in tandem with the rate cut.
- ▲ Other supportive factors included: local data releases, which generally served as confirmation of the decision to lower official interest rates; a stable to marginally strong rand; lower global bond yields; and a continued improvement in global risk appetite.
- ▲ The recent rally forced yields to the lower end of our target range – the government bond market now offers limited value, particularly against the background of high net new issuance. We maintain a healthy appetite for corporate and other non-government debt, still offered at attractive spreads over RSA government debt.

Futuregrowth view: *The positive slope of the yield curve is expected to remain intact in the light of low short-term interest rates and rising net new issuance of long-term bonds.*

- ▲ Our money market funds maintained an underweight duration tilt and a low cash holding, while we added to our holding of longer-dated money market instruments prior to the repo rate reduction.
- ▲ In the bond funds, we have reduced modified durations into the recent rally and created an underweight tilt against the All Bond Index.
- ▲ Given the general level of market rates, we are running underweight tilts to the one- to three-year and 12-year+ maturity bands, while holding an overweight tilt to bonds in the seven- to 12-year band.

Futuregrowth view: *Money market rates are currently unattractive, while non-government debt offers the promise of superior returns.*

Limited room for further policy easing unless inflation surprises on the downside



Sources: OMIGSA & I-Net

- ▲ The RSA CPI-linked bond market is looking more interesting compared to a few weeks ago, but still not attractive enough to build a large position.
- ▲ We maintain a low listed property holding on a weak economic growth outlook, preferring nominal bonds instead, particularly attractively priced non-government debt. Preference shares have lost a little colour and we have been slowly reducing exposure.

Economic Indicators to August 2009

| | Latest Data | Previous Year | |
|---|-------------|---------------|----------|
| Exchange Rates: | | | |
| Rand/US\$ | August-09 | 7.77 | 7.69 |
| Rand/UK Pound | August-09 | 12.64 | 13.96 |
| Rand/Euro | August-09 | 11.14 | 11.29 |
| Rand/Aus\$ | August-09 | 6.50 | 6.64 |
| Interest Rates: | | | |
| Prime Overdraft | August-09 | 10.50% | 15.50% |
| 3-month NCD rate | August-09 | 6.90% | 12.00% |
| R157 Long Bond Yield | August-09 | 8.18% | 9.16% |
| Inflation: | | | |
| CPI (y-o-y) | July-09 | 6.7% | 13.4% |
| National Accounts: | | | |
| GDP Growth (y-o-y) | June-09 | -2.8% | 4.2% |
| GDP Growth (q-o-q, annualised) | June-09 | -3.0% | 5.0% |
| HCE Growth (y-o-y) (Household Consumption Expenditure) | March-09 | -1.8% | 4.2% |
| GFCF Growth (y-o-y) (Gross Fixed Capital Formation) | March-09 | 4.5% | 13.9% |
| Balance of Payments: | | | |
| Trade Balance (cumulative 12month) | July-09 | -\$3.51 | -\$10.50 |
| Current Account (% of GDP) | March-09 | -7.0% | -8.8% |
| Capital Account (% of GDP) | March-09 | 6.1% | 9.1% |
| Forex Reserves (incl. gold) | July-09 | \$35.20 | \$33.39 |
| Other: | | | |
| Manufacturing Production (y-o-y) (seasonally adjusted) | June-09 | -17.0% | 5.5% |

Market Indicators to August 2009

| | 1 Month (%) | Quarter (%) | Calendar Year (%) | 12 Months (%) | 3 Yrs (%) | 5 Yrs (%) |
|------------------------------|----------------|----------------|----------------------|------------------|--------------|--------------|
| Equity (FTSE/JSE) | | | | | | |
| All Share Index | 3.2 | 10.2 | 18.3 | -6.8 | 7.4 | 20.8 |
| Shareholders Weighted Index | 4.1 | 11.9 | 18.8 | -2.7 | 9.0 | 21.8 |
| All Share/Resources 50% | 3.6 | 12.6 | 18.7 | -2.6 | 8.2 | 20.9 |
| Top 40 Index | 2.9 | 9.3 | 17.3 | -9.5 | 6.5 | 20.1 |
| RAFI® 40 Index | 3.6 | 13.9 | 23.6 | 3.0 | 9.9 | 22.6 |
| RAFI® All Share Index | 3.1 | 13.1 | 19.7 | 0.0 | 8.8 | 22.4 |
| Resources Index | 1.8 | 1.7 | 16.7 | -20.6 | 4.2 | 19.9 |
| Financial Index | 4.7 | 20.1 | 20.5 | 4.2 | 3.1 | 17.0 |
| Industrial Index | 4.0 | 15.5 | 18.7 | 5.8 | 13.1 | 23.6 |
| Mid-cap Index | 4.4 | 15.4 | 25.0 | 14.6 | 13.3 | 25.3 |
| Small-cap Index | 6.6 | 14.4 | 18.3 | 0.6 | 10.0 | 25.0 |
| Interest-Bearing | | | | | | |
| ALBI BEASSA | 1.6 | 2.6 | -2.1 | 11.7 | 8.5 | 8.7 |
| STeFI | 0.7 | 2.1 | 6.5 | 10.7 | 10.1 | 8.9 |
| Cash | 0.5 | 1.7 | 5.7 | 9.7 | 9.7 | 8.3 |
| Property | | | | | | |
| SA Quoted Property Index | 1.9 | 7.9 | 7.4 | 12.7 | 15.0 | 26.1 |
| International | | | | | | |
| MSCI World Index (R) | 3.5 | 9.1 | 1.7 | -15.5 | -2.2 | 7.0 |
| MSCI World Index (\$) | 4.2 | 12.6 | 20.7 | -16.6 | -4.7 | 3.7 |
| JPM International Bond (R) | 1.3 | 0.5 | -14.4 | 11.9 | 11.4 | 9.9 |
| US 1-month LIBOR (R) | -0.6 | -2.8 | -15.0 | 3.2 | 6.7 | 7.1 |
| Inflation (Estimated) | | | | | | |
| CPI | 0.2 | 2.3 | 7.1 | 6.1 | 8.8 | 7.1 |

For more information, please contact: _____

Western Cape:

Old Mutual Investment Group, 3rd Floor, West Campus, Mutualpark, Pinelands 7405

Mike van Heerden – Senior Executive: Distribution

Tel: +27 21 509 5082

Cell: +27 82 450 4483

E-mail: mvheerden@omigsa.com

Nirdev Desai – Investment Marketing & Sales Executive: Retail

Tel: +27 21 504 6305

Cell: +27 82 419 4770

E-mail: ndesai@omigsa.com

Paul Glendining – Investment Marketing & Sales Executive: Retail

Tel: +27 21 504 7690

Cell: +27 82 414 3412

E-mail: pglendining@omigsa.com

Gauteng:

Old Mutual Square, Umnotho Building, 3rd Floor, OMIGSA office, 93 Grayston Drive, Sandton 2196

Mario Schoeman – Investment Marketing & Sales Executive: Fund of Funds

Tel: +27 11 217 1411

Cell: +27 83 269 8999

E-mail: mschoeman@omigsa.com

Wynand Gouws – Head: Retail Channel Management

Tel: +27 11 217 1664

Cell: +27 82 450 7386

E-mail: wgouws@omigsa.com

Taz Victor – Manager: Retail Distribution

Tel: +27 11 217 1002

Cell: +27 82 460 1495

E-mail: tvictor@omigsa.com

Sean du Buisson – Investment Marketing & Sales Executive: Retail

Tel: +27 11 217 1003

Cell: +27 82 926 6955

E-mail: sdubuisson@omigsa.com

Durban:

Viewz @ Westway, Office 3B, 11 The Boulevard, Westway Park 3611

Imtiaz Shaik – Investment Marketing & Sales Executive: Retail

Tel: +27 31 275 8305

Cell: +27 83 292 7860

E-mail: ishaik@oldmutual.com

Bloemfontein:

PHG Building, 196 Nelson Mandela Drive, Bloemfontein 9300

Des Bothma – Investment Marketing & Sales Executive: Retail

Tel: +27 51 505 2950

Cell: +27 82 410 2666

E-mail: dbothma@omigsa.com

Pretoria:

1st Floor, Glen Manor Office Park, Frikkie de Beer Street, Menlyn 0042

Hennie van Rensburg – Investment Marketing & Sales Executive: Retail

Tel: +27 12 369 7220

Cell: +27 83 286 2405

E-mail: hjansevanrensborg@omigsa.com

Eastern Cape:

3rd Floor, Old Mutual Place, Cnr Cape Rd & Langenhoven Dr, Greenacres, PE 6000

Colin Archibald – Investment Marketing & Sales Executive: Retail

Tel: +27 41 502 4906

Cell: +27 82 804 1746

E-mail: carchibald@omigsa.com

Regulatory Information

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

Physical address: Mutualpark, Jan Smuts Drive, Pinelands 7405

Telephone number: +27 21 509 5022

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