

Market Dynamics

December 2009

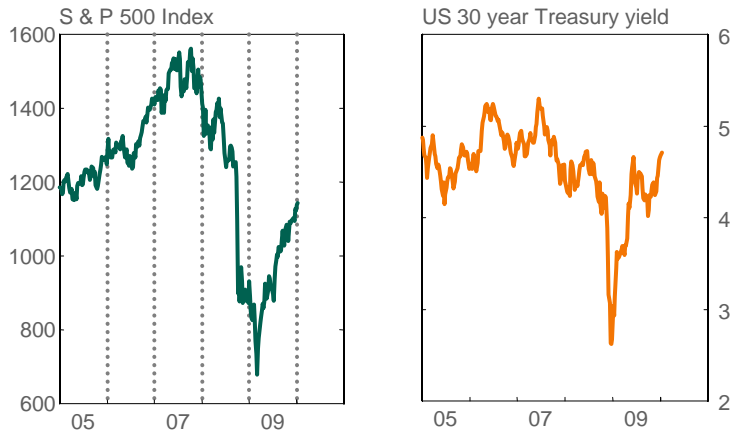


Contents

▲ Economic Overview and Outlook	1-2
▲ Equity Sector Overview and Outlook	3-5
▲ Fixed Interest Overview and Outlook	6
▲ Economic Indicators	7
▲ Market Indicators	8
▲ Contact Details	9
▲ Regulatory Information	10

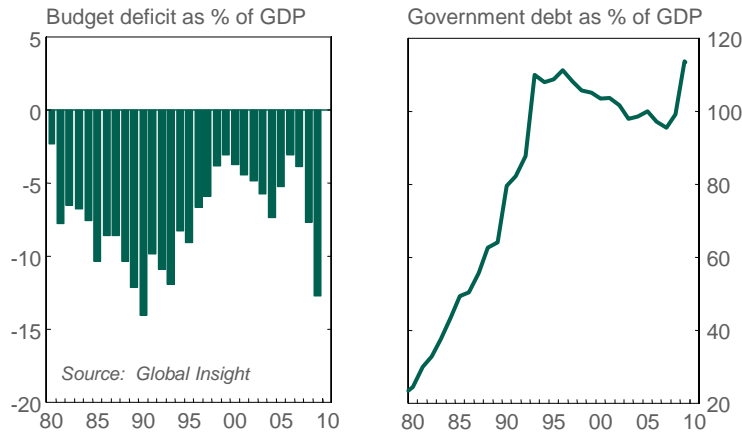
World Economic Overview and Outlook

US markets reflect economic recovery confidence



Source: OMIGSA (Iris)

Greek troubles



Source: OMIGSA (Iris)

- ▲ The global recovery remains on track. Data released across the globe over the past month continue to point to a broadening of the global upturn, with more countries returning to positive growth during the third quarter and early data for the fourth quarter pointing to a further acceleration in activity.
- ▲ Growing optimism about prospects for the world economy in 2010 resulted in a further rise in equity prices around the world during the month of December. At the same time, bond yields rose as investors' attention started to focus on the timing and extent of the tightening of monetary policy by the major central banks during the course of 2010. Growing concerns over the fiscal health of many countries also weighed on global bond markets.
- ▲ Indeed, just like the woes of Dubai World reminded investors that all is not yet well in the world economy, worries flared over the past month about the fiscal position of many countries. While the situation in Greece got most media attention, many countries around the world face similar fiscal problems as tax revenues slumped during the recession and spending rose in an attempt to support economies. As a result, many countries will be forced to raise taxes and curb spending as soon as their economies are on a firmer footing. This will have a constraining impact on the economic recovery over the medium term.
- ▲ Even though recent data have painted a fairly rosy picture for the world economy, concerns over the sustainability of the global recovery have not disappeared completely. Global central banks share these concerns and will therefore tread with caution when they consider the timing and speed of the inevitable phase of policy tightening.

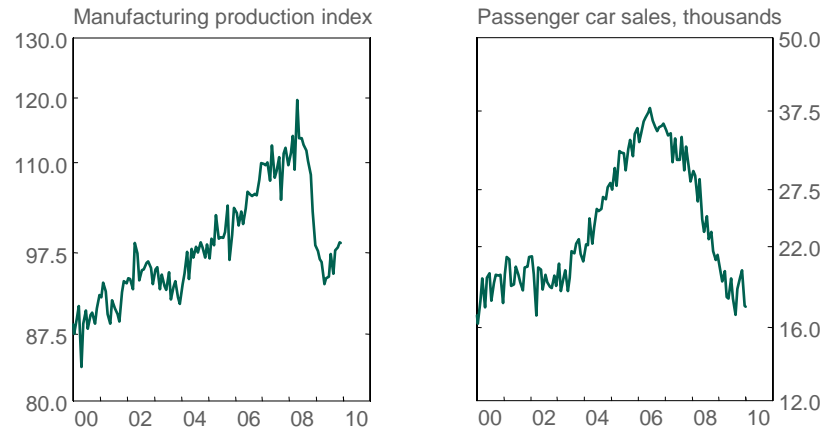
OMIGSA Economic Research Unit view: *While short-term prospects continue to brighten, there are still many obstacles and risks that cloud medium-term prospects for the world economy.*

Local Economic Overview and Outlook

- ▲ Data released towards the end of 2009 suggest that the recovery in the economy that started in the third quarter continued in the fourth, but still at a very sluggish pace. While a moderate recovery in exports, a slower pace of inventory depletion and ongoing growth in public sector spending are lending welcome support to the production side of the economy, private demand remains worryingly weak. Retail and vehicle sales remain very depressed, with no sign of any convincing recovery. Aggressive job-shedding by companies has been the key driver of weakness in aggregate household consumption. Spending on capital equipment by private companies remains equally depressed as profits remain under severe downward pressure and demand prospects are not rosy.
- ▲ The weakness in private demand may continue in the opening months of 2010, but we expect a recovery to set in towards the middle of the year. The Soccer World Cup will provide a welcome additional impetus to the economy. As a result, we think there is a reasonably good chance that the economy may be growing fairly solidly by the middle of 2010.
- ▲ In the meantime the rand has remained very firm as a steady stream of foreign capital continued to flow into local financial assets.
- ▲ The strong rand, weak domestic demand and easing food inflation have caused the overall pace of price increases of consumer goods to slow notably to 5.8% in November. We expect inflation to remain just inside the target range for most of 2010. A better inflation performance will likely be prevented by another large electricity price hike, the lagged impact of sizeable wage hikes in 2009 and still rapidly rising administered prices in general (education costs, municipal charges, etc).
- ▲ While interest rates have probably reached a bottom and will likely remain at these levels for some time, there is an outside chance of another cut if the economy remains weak and inflation surprises on the positive side.

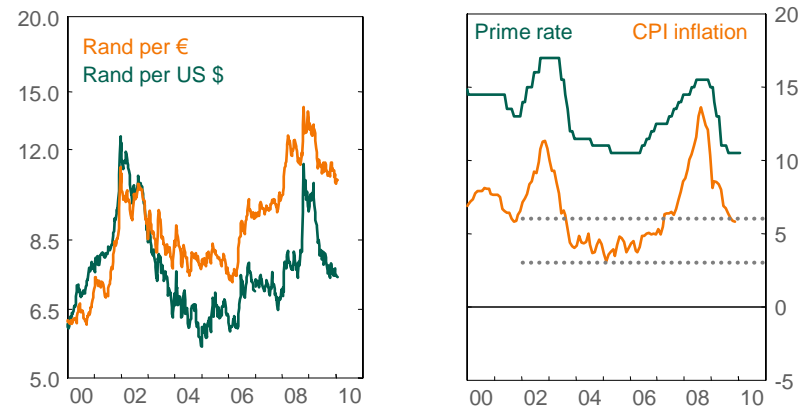
OMIGSA Economic Research Unit view: *The local economy is back in positive growth territory, but the recovery will likely be modest – especially from the side of consumer spending. This keeps open the possibility of a further lowering of local interest rates.*

Unbalanced economic recovery



Source: OMIGSA (Iris)

Rand firm, inflation just inside target range



Source: OMIGSA (Iris)

Equity Sector Overview and Outlook

Resources

- ▲ The year 2009 turned out to be just as volatile as 2008, with the first half of 2009 turning into panic from the fear that prevailed in the second half of 2008.
- ▲ We expect most 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.
- ▲ The market has correctly “looked through” these unrepresentative results and towards continued evidence of an earlier and stronger-than-expected recovery in China and India, with signs of stabilisation in the G7.
- ▲ Despite the debate regarding global growth, there is substantial value in certain shares and/or sectors – such as non-mining resources.
- ▲ Looking ahead, we find similarities between H1 2010 and H1 2008, with more challenging investment conditions - especially the increased risk associated with high commodity and share prices.

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 are not as compelling, due to the recent strong share price performance. While short-term conditions are tough for some non-mining resources companies, valuations are relatively attractive.*

Small Companies

- ▲ During December 2009 the Small Cap and Mid-Cap indices returned 5.0% and 4.3% respectively, while the FTSE/JSE Top 40 Index returned 2.7%.
- ▲ The reporting season finally came to an end in December 2009 and we look forward to 2010 with “cautious optimism”. The stronger rand, lower volumes and deflationary pricing will impact on companies in the year ahead.
- ▲ Margins will remain under pressure as additional electricity costs and lower volumes materialise.
- ▲ The Christmas trading period appears to be a little softer than 2008 so far, as discretionary spending remains subdued.
- ▲ Interest rates should remain low and in line with global norms, but we are now expecting a hike towards the end of next year.
- ▲ Prospect statements should start to reflect a better operating environment towards the end of the year. The recovery in 2010 will be a slow one.

Investment Research view: *The average price/earnings (p/e) ratio at which small caps trade compared with large caps remains greater than last month's 10% discount. This has started to increase over the last three months.*

Equity Sector Overview and Outlook (cont.)

Financials

- ▲ The FTSE/JSE Financial Index gained 6.5% for the three months ended 31 December 2009. It underperformed the FTSE/JSE Shareholder Weighted All Share Index (SWIX), which ended the quarter 9.0% up.
- ▲ Within financials, the banking sector underperformed with a return of 7.2%. In contrast, the life sector increased 9.7%. Nedbank and African Bank provided the most drag on the banking index, while strong performances from Sanlam and Old Mutual during the quarter boosted the life sector index.
- ▲ The financial sector continues to benefit from an improved local economic environment following positive GDP growth for the third quarter of 2009.
- ▲ We expect the operational environment for financial sector companies to remain tough, with loan impairment ratios for banks and policy termination rates for life companies remaining above trend.
- ▲ However, we expect an operational recovery to commence sometime in 2010, supported by a stabilising economy and improved household incomes.

Investment Research view: Financial stocks are facing a tougher operating environment that is only expected to improve later in 2010. However, this has been more than discounted in current prices. Valuations are looking attractive, and are still below historic averages.

Industrials

- ▲ Although a volatile quarter, the Industrial sector ended up strongly, up 8.5%, but still underperformed the FTSE/JSE All Share Index (ALSI) that was up 11.4%.
- ▲ The rand hedges performed well ahead of the rest, with SAB and Steinhoff outshining the pack. Perhaps in anticipation of a weakening rand. Healthcare also had excellent performance with all shares up at least 10% and Netcare up and impressive 33% in the three months.
- ▲ The food manufacturers performed well after proving that they could hold and even increase margins in 2009. This may be more challenging looking forward with electricity tariff increases impacting their cost base, and deflation (or at least less inflation) limiting their revenues in the year ahead. All this while the competition commission is showing a strong interest in investigating the entire food supply chain.
- ▲ Telecoms had a difficult quarter, weathering the news that interconnect tariffs will be limited over time; as did construction shares, mainly on the back of bad news about delayed Eskom construction expenditure.
- ▲ Retailers performances were extremely varied, with uncertainty about how the consumer was recovering, if at all. Overall, the defensive food retailers performed better than the cyclical retailers.

Investment Research view: Industrials as a whole are fairly valued, although we still find pockets of value in some shares.

Equity Sector Overview and Outlook (cont.)

Property

- ▲ SA Listed Property delivered a total return of 14.1% in 2009 (4% in the fourth quarter), of which 4% was capital appreciation. This was a robust performance considering the rise in bond yields (which depresses property prices) and a falling distribution growth rate.
- ▲ The yield on the RSA 10-year government bond rose 176 basis points in 2009 (22bps in Q4) with the All Bond Index delivering a -1% return (+1% in Q4), with a 10% capital loss. Compared to bonds, property now offers substantially less relative value than it did at the beginning of 2009.
- ▲ The growth rate of listed property distributions in 2009 fell to 7.4% from 11.6% in 2008. This was a sharper deceleration than the market had anticipated. Direct property conditions became tougher, with higher vacancy rates (on par with our expectations), a struggle to let new developments and softness in market net rentals.
- ▲ Sector distributions growth fell to approximately 7.5% in 2009 from double-digit growth in 2008. This could favour property in the event of a pull-back in equities.

Investment Research view: *The sector is appropriately valued and can sustain positive nominal distribution growth, albeit at a slower rate over the medium term. Direct property market newsflow may become more negative (e.g. office vacancy rates are heading for double digits in some markets), higher electricity costs constrain net rental growth and significant new space continues to be released. The optimism implicit in the strength in retailers' share prices is positive for listed property. On a long-term secular view, property remains attractive as existing rents are too far below viability rentals for new developments.*

Fixed Interest Overview and Outlook

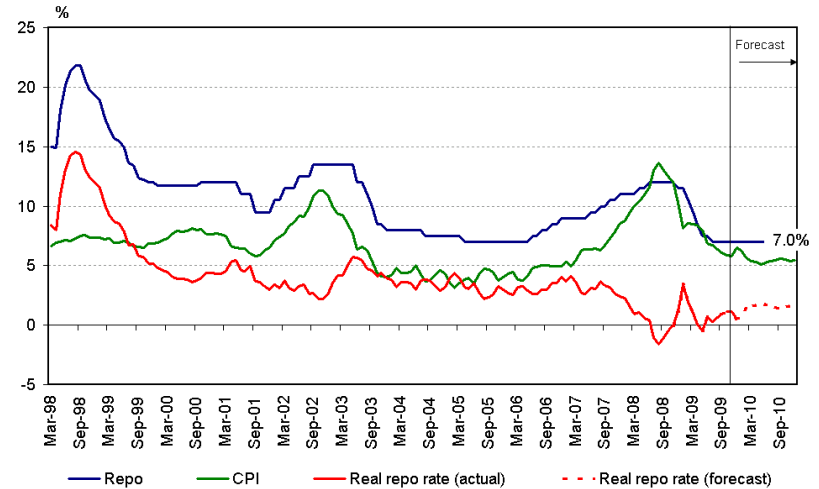
- ▲ The slope of the yield curve flattened during December. As a result, the bond market outperformed cash, with the 12-year+ maturity band rendering the best performance. However, bonds still underperformed cash for the fourth quarter and the 2009 calendar year.
- ▲ A temporary slow down in the pace of net new issuance, marginally better-than-expected CPI and monetary aggregate data and strong foreign demand for emerging market bonds in general and South African bonds, in particular) lent support to the local market during December.
- ▲ We maintain that RSA bond yields should remain somewhat elevated. This is based on our investment view that there remains upside risk to inflation on a 12-18 month horizon, that interest rates have bottomed and that we expect sustainable high levels of net new issuance in months to come. We maintain a healthy appetite for corporate and other non-government debt, which is still offered at attractive spreads over RSA government debt. Market weakness will be utilised as an opportunity to slowly accumulate a holding in CPI-linked bonds.

Futuregrowth view: *A positively-sloped yield curve is expected to remain intact in the light of low, stable short-term interest rates and sustainable high net new issuance of long-term bonds.*

- ▲ Our money market funds combine a neutral-duration tilt with low cash holdings, while we used market weakness to increase our holding of medium-dated and long-dated money market instruments – still favouring floating as opposed to fixed rates, and tempered only by liquidity constraints.
- ▲ In our bond and income funds, we maintain an underweight modified duration.
- ▲ In terms of yield-curve tilts, we are mainly running an underweight position in the 12-year+ maturity band and an overweight tilt to bonds with a term-to-maturity of less than twelve years.

Futuregrowth view: *In contrast to money market and RSA bonds, non-government debt continues to offer the promise of superior returns.*

Expected real repo rate still close to historical lows, leaving limited scope for further rate cuts



Source: I-Net, OMIGSA

- ▲ The RSA CPI-linked bond market is still re-pricing and, as a result, is looking more attractive. Market weakness is utilised to slowly accumulate holdings, given our more cautious longer-term inflation view.
- ▲ We maintain a low listed property holding based on a weak economic growth outlook, preferring attractively priced non-government debt instead. Preference shares have lost a little colour and we have been slowly reducing exposure, also in favour of corporate debt.

Economic Indicators to December 2009

	Latest Data		Previous Year
Exchange Rates:			
Rand/US\$	December-09	7.40	9.53
Rand/UK Pound	December-09	11.87	13.73
Rand/Euro	December-09	10.50	13.16
Rand/Aus\$	December-09	6.58	6.49
Interest Rates:			
Prime Overdraft	December-09	10.50%	15.00%
3-month NCD rate	December-09	7.15%	11.43%
R157 Long Bond Yield	December-09	8.39%	7.21%
Inflation:			
CPI (y-o-y)	November-09	5.8%	11.8%
National Accounts:			
GDP Growth (y-o-y)	September-09	-2.5%	3.7%
GDP Growth (q-o-q, annualised)	September-09	0.9%	1.3%
HCE Growth (y-o-y)	September-09	-4.1%	1.9%
(Household Consumption Expenditure) GFCF Growth (y-o-y) (Gross Fixed Capital Formation)	September-09	1.2%	13.4%
Balance of Payments:			
Trade Balance (cumulative 12-month)	November-09	-\$2.48	-\$8.34
Current Account (% of GDP)	September-09	-3.2%	-7.5%
Capital Account (% of GDP)	September-09	4.9%	10.0%
Forex Reserves (incl. gold)	November-09	\$39.88	\$32.96
Other:			
Manufacturing Production (y-o-y) (seasonally adjusted)	October-09	-9.3%	-2.7%

Market Indicators to December 2009

	1 Month (%)	Quarter (%)	12 Months (%)	3 Yrs (%)	5 Yrs (%)
Equity					
All Share Index	2.9	11.4	32.1	6.5	20.3
Shareholder Weighted Index	3.9	9.0	29.9	6.3	19.4
All Share/Resources 50%	3.1	10.1	31.3	6.2	19.0
Top 40 Index	2.7	12.5	31.7	6.2	20.1
RAFI® 40 Index	2.4	11.5	37.3	9.5	21.1
RAFI® All Share Index	2.9	12.4	34.7	8.6	20.5
Resources Index	2.5	16.7	35.4	7.8	25.4
Financial Index	2.9	6.5	28.0	-0.9	12.3
Industrial Index	3.4	8.5	30.5	8.9	19.9
Mid-cap Index	4.3	5.6	35.7	9.1	21.1
Small Cap Index	5.0	6.6	28.3	5.8	20.3

Interest-Bearing					
ALBI BEASSA	1.2	1.1	-1.0	6.5	7.1
STeFI	0.6	1.8	9.1	10.0	8.9
Cash	0.5	1.6	7.9	9.6	8.3

Property					
SA Quoted Property Index	1.6	4.1	14.1	11.3	21.6

International					
MSCI World Index (R)	0.9	1.2	4.2	-3.7	8.2
MSCI World Index (\$)	1.8	4.2	30.8	-5.1	2.6
JPM International Bond (R)	-5.9	-4.7	-18.8	9.7	10.4
US 1-month LIBOR (R)	-0.9	-2.7	-19.5	4.9	9.4

Inflation (Estimated)					
CPI	-0.5	-0.7	6.5	8.3	6.9

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Regulatory Information

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