

Market Dynamics

December 2011



OLD MUTUAL

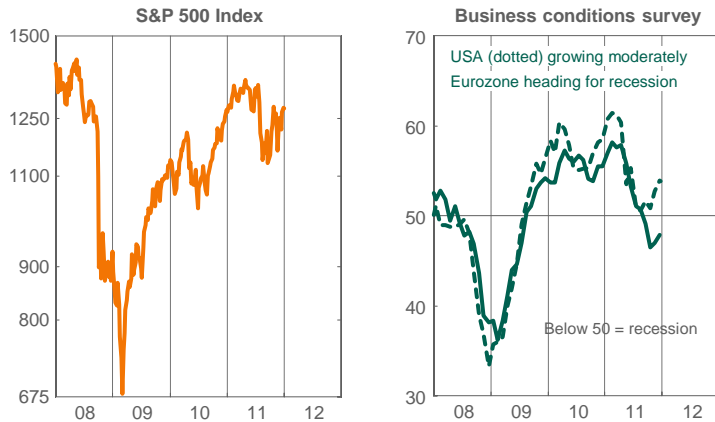
Investment Group

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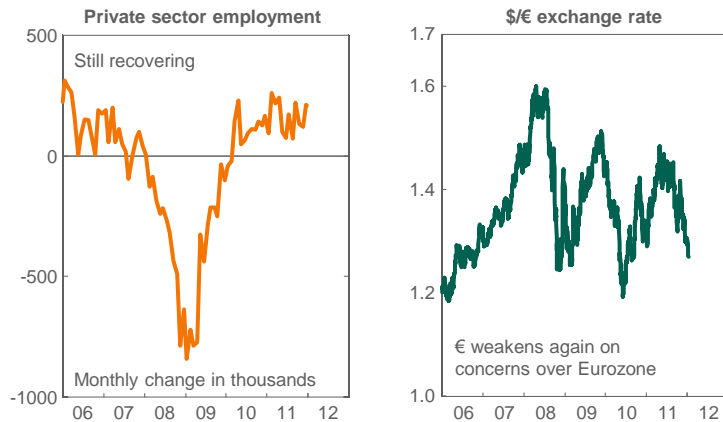
World Economic Overview and Outlook

Markets remain worried over debt and growth



Source: OMIGSA (Iris)

USA data surprises on the upside



Source: OMIGSA (Iris)

- ▲ Global financial markets remained very volatile in December. Nevertheless, the US S&P 500 Index ended December 0.9% higher over the month.
- ▲ Compared to the end of December 2010, the index was virtually unchanged. In comparison, the US 10-year Government Bond yield declined from 3.3% at the end of 2010 to below 2% by the end of 2011, yielding a 10% total return over the year. Another solid performer in 2011 was gold, with the gold price ending 2011 at US\$1 560, some 10% up on the end of 2010. But, despite being up quite sharply on the year, gold was well below the peak of around US\$1 900 reached early in September by year end.
- ▲ The relative performance of asset classes over the past year to a large extent reflected macroeconomic developments. The deepening Eurozone government debt crisis and slowing global growth kept investors wary of risk assets such as equities. Yet, good earnings growth and very-expansive central bank policies prevented worse equity market performances in 2011. Investors' preference for 'safe' assets, especially US government bonds, and hedges against a possible global financial calamity, such as gold, essentially drove the good performance of these asset classes in 2011.
- ▲ Looking into 2012, the macroeconomic environment remains very uncertain. While progress is being made, the Eurozone crisis has not been solved and panic could easily flare up again. Moreover, the Eurozone faces tough economic conditions in 2012 and has likely already entered recession. How long and severe this recession will be and how it will impact the rest of the world remains pretty uncertain. Uncertainty also surrounds the ability of US lawmakers to come up with a credible plan to contain US government debt. In addition, the slowdown in China is being watched with some concern by investors, as China has been a key driver of global growth in recent years.
- ▲ Despite all the concerns, we remain of the opinion that the world will avoid a renewed slump, that the Eurozone crisis will not degenerate into yet another global financial meltdown, and that US policymakers will eventually come up with a more credible budget plan. Add to this view sustained very-expansive policies by central banks, and 2012 could be a better year for risk assets. But, much could still go wrong.

OMIGSA Economic Research Unit view: *The outlook for 2012 remains very uncertain and macro risks remain high. Yet, we believe that a global slump will be avoided, the Eurozone crisis will not degenerate into another financial meltdown and that central banks will sustain very expansive policies.*



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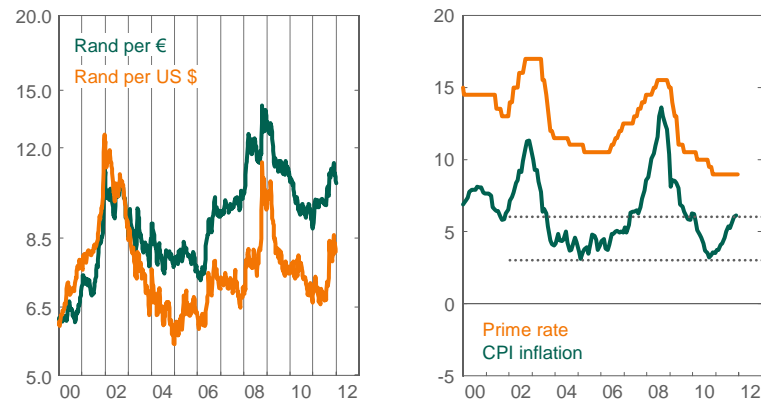
Equity
Research

Local Economic Overview and Outlook

- ▲ 2011 was a mixed year for South Africa on the macro-economic front. On the positive side the economy grew by about 3%, driven by an estimated 4.5% increase in consumption, fixed investment and job creation turned moderately positive and interest rates remained flat. On the negative side inflation broke through the 6% upper band of the inflation target range, the deficit on the current account widened quite sharply, the rand weakened considerably and government's projections for the budget deficit over the next few years were raised yet again.
- ▲ As is the case globally, prospects for SA are also uncertain looking into 2012. Three factors in particular will have a key impact on the local economy: the outcome of the Eurozone debt crisis, global growth and local inflation pressures. Bad outcomes globally will affect SA negatively via foreign trade (volumes and prices) and capital flows, while unexpected upward pressure on local inflation could trigger concerns over monetary policy tightening.
- ▲ Our base case view for 2012 is that, while global conditions will not be very favourable, worst case outcomes will also not unfold. On local inflation, we expect a peak between 6% and 7%, drifting lower later in the year. Should this base case scenario indeed be correct, SA should not be hit by negative external or internal economic shocks. But, at the same time, conditions will generally remain relatively difficult, making for yet another year of very subdued economic growth and very limited job creation. On the positive side it may well imply that interest rates will remain on hold for much, if not all, of 2012, especially if inflation eases later in 2012 as we currently expect.
- ▲ Looking further into the future, we maintain our long held view that economic growth locally will remain structurally capped at around 3% in the absence of considerable structural economic reforms.

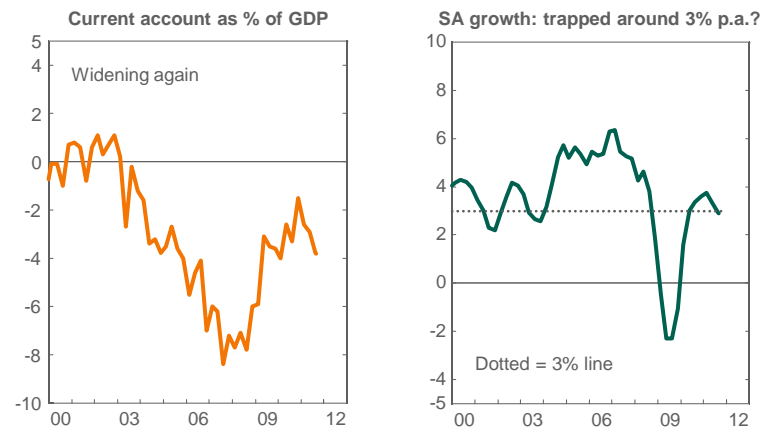
OMIGSA Economic Research Unit view: 2012 will be another year of subdued economic growth and limited job creation. Longer term, local growth will remain capped at around 3% in the absence of much needed structural economic reforms.

Rand still soft on global worries, inflation rising



Source: OMIGSA (Iris)

SA economy growing slowly



Source: OMIGSA (Iris)



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Equity Sector Overview and Outlook

Resources

- ▲ For the year as a whole, the basic materials sector fell 8.3%, compared with the ALSI's positive return of 2.6%.
- ▲ A combination of investor fatigue (platinum), global uncertainty (general mining) and profit taking (gold) sapped the share prices until at the end there was a sense of relief that 2011 was finally over.
- ▲ Although base metal prices retreated throughout the year, the underlying demand meant that levels never fell as far as they did in 2008/9.
- ▲ Margins and cash flows at most of the diversified producers remained well above historic levels, even if share prices appeared to be pricing in a complete collapse at various times during the year.
- ▲ Gold was probably the highest profile of the sectors, with gold price almost touching \$1900/oz during the year before retreating at the end.
- ▲ 2012 is shaping up to be another mixed year. Europe continues to stagger around like a punch drunk fighter, but economic data out of the US has been surprisingly encouraging recently. Indications are that the Chinese are happy to look to boost consumption in 2012, while India seems to be slowing down amid bureaucratic and political uncertainty.

Equity Research view: *Commodity prices generally appear to be bouncing around recent lows, but the catalyst to push them higher is unclear. We believe that when the market regains confidence there will be a strong restocking cycle, although we are loath to put a firm date on when that will happen. We continue to believe that now is not the time to take aggressive bets. We continue to favour the larger, higher quality, and/or better priced counters such as Anglo American and BHP Billiton, while the rand weakness has increased the attractiveness of certain South African-based miners.*

Small Companies

- ▲ The small cap and mid-cap indices returned 6.8% and 8.2% respectively for the three months ended 31 December 2011, while the FTSE/JSE Top 40 Index returned 8.4%.
- ▲ The market is swinging wildly on any new piece of economic or political data and is exceptionally short-term focused. The reality is that the world is in a fairly poor state, with very little certainty about how we are going to get out of this mess.
- ▲ Certain regions are better than others, but it is clear that all of us will be affected in some way or another. People have been living beyond their means and it is time for some belt tightening.
- ▲ From a portfolio management point of view, we need to be very clear on the fair values of companies we invest in, because volatility can create some great opportunities. This is particularly true in the under-researched areas such as small and mid-caps. However, a volatile market may mean that it takes longer for value to be realised and patience will be key in the year ahead.
- ▲ Looking forward, we believe 2012 will be more of the same unfortunately. Political posturing, austerity programmes, debt reductions, liquidity issues, unemployment, low growth etc.
- ▲ Ultimately investor confidence will return in the longer term and markets may enter a strong re-rating period. In the short term, however, I am not holding my breath.

Equity Research view: *The average price:earnings (p:e) ratio at which small caps trade compared with large caps is now at a discount.*



Equity Sector Overview and Outlook (cont.)

Financials

- ▲ While the fourth quarter of 2011 ended on a positive note for the local equity market, with the FTSE/JSE Shareholder Weighted All Share Index (SWIX) up 8.3%, December was not a great month and the index started out flat but, as the December holidays approached, it experienced weakness ending the month down 1.4%.
- ▲ The market continued to be weighed down by the European debt crisis. The FTSE/JSE Financial Index outperformed the overall market and was up 1.9% and 8.7% for the month and quarter ending 31 December 2011, respectively.
- ▲ During the December, the life assurance sector rose an impressive 6.4% on the back of Old Mutual's 16.6% performance, which was a boost provided by the disposal of its Nordic operations. The proceeds will be used to pay back debt and the market anticipates a special dividend from the proceeds. Life companies should continue to show an improving trend in lapse-experience and recurring-premium sales, due to improving real household incomes.
- ▲ The FTSE/JSE Banking Index gained 1%. Operationally, we expect the operating environment to remain tough for the banking sector and advances growth to remain subdued, which will necessitate a focus on the cost line.

Equity Research view: We feel that there is scope for dividend covers to reduce further in this low-growth environment. We do, however, recognise that banks are altering their asset mix (to high return and high growth advances), and re-pricing new loans. Both these actions will be supportive of interest margins going forward.

Industrials

- ▲ The FTSE/JSE Industrial Index was down nearly 2% in December, but still managed to report a 9% gain for the year. This compares with the FTSE/JSE All Share Index (ALSI) which squeezed out 2% for 2011. As of December, British American Tobacco (BAT) was included in the JSE indices. Although BAT will be the largest company by market value at around R800bn, its weight in the index is reduced as only 12% of its investors are based in South Africa. The second largest stock is SABMiller at nearly R500bn, followed by MTN at R260bn.
- ▲ The stable interest rate environment (prime was 9% for the whole of 2011) and the easing of cotton prices, resulted in the clothing retailers being the star performers. Woolworths led the way at +45%, but The Foschini Group (+17%) and Mr Price (+20%) also performed well. The other star performer was BAT, which increased 50%. It was aided by the rand that weakened around 20% versus the pound as well as some buying by index trackers following its inclusion in the various FTSE/JSE indices, as mentioned earlier. SABMiller finished the year strongly helped by both the weaker rand and renewed speculation that ABInbev (the world's biggest brewer) was interested in acquiring it.
- ▲ The building and construction sector continued to suffer from the 2010 Soccer World Cup hangover, with all of Murray & Roberts, Aveng, Group 5 and PPC all down in excess of 20% over the course of 2011. Interestingly the order books for the construction companies are now looking more healthy, but it seems that margins are going to be under pressure.

Equity Research view: Similar to our view last month, prices in the industrial sector continues to be slightly overvalued – particularly the more defensive companies like Shoprite, BAT and Tiger Brands. Pockets offering some value tend to be in the smaller companies and some of the cyclical large caps.



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Equity Sector Overview and Outlook (cont.)

Property

- ▲ Listed property provided an 8.9% total return in 2011, comfortably beating the FTSE/JSE All Share Index (2.6%), but only on par with the All Bond Index (8.8%), and worse than general retailers (19.6%).
- ▲ The return came from income as, in price terms, property barely budged and the sector's historical yield rose marginally. Distributions increased around 5.6% over the year, slightly below the most recent inflation reading of 5.9%. In 2010, distribution growth was over 7%. We expect this to fall to under 5% in 2012 (even adding back Redefine's unbundled Arrowhead distribution).
- ▲ During 2011, nine new relevant counters listed. We expect activity will move from new listings to capital raisings.
- ▲ As evidenced last year, listed property is more defensive than equities, as most earnings are medium-term contracts. Property should outperform in an economic downswing, even if the industry itself is under pressure, but should lag the recovery.

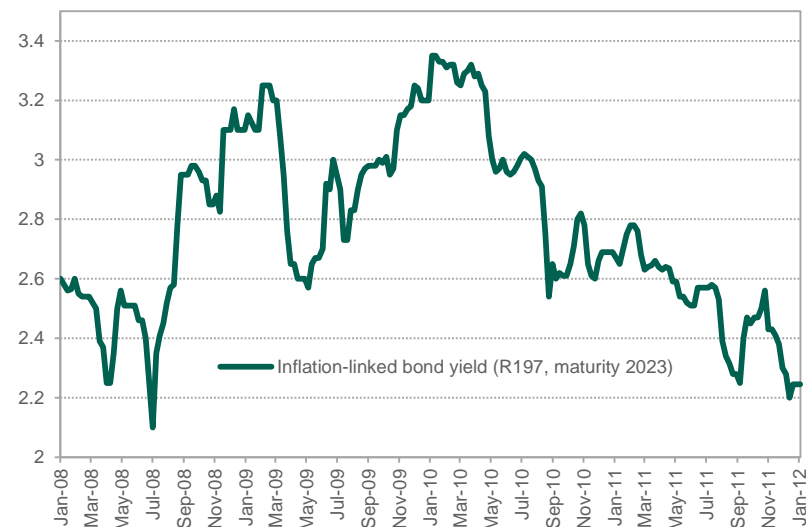
Equity Research view: *The sector offers a one-year forward yield of greater than 8%, which exceeds the 10-year bond yield, with distribution growth below inflation in that period. Downside operational risk has reappeared, but base funding rates have reduced. Vacancies are plateauing, but may still increase in some pockets. A genuine recovery in property conditions may take longer than many anticipate, with higher electricity and rate costs constraining net rental growth, and significant over-rentals possibly developing (our key concern). The direct commercial property market remains resilient, although signs of strain are appearing. On a long-term secular view, property is attractive as existing rents are below feasibility rentals for developments, even with softer building costs.*



Fixed Interest Overview and Outlook

- ▲ Eurozone troubles, global currency volatility and rising local headline CPI were some of the main sentiment drivers during the last quarter of 2011. The yield of the benchmark R208 government bond ranged between 8.3% and 7.8% over this period. Rising inflation and growing concerns about the potential negative impact of broad-based rand depreciation since August 2011 lent strong support to the inflation-linked bond market.
- ▲ This caused the real yield of the benchmark R197 government CPI-linked bond to rally from 2.61% to 2.25%; the lowest level since July 2008. As a result, the official CPI-linked Index returned 4.3% for the three months ending December 2011, followed by the All Bond Index (+3.5%) and the SteFi Money Market Index (+1.4%).
- ▲ It is unlikely that the Eurozone debt debacle will be resolved soon as efforts to date to stabilise the situation simply lack the power to address the complicated solvency issues the peripheral countries are facing. The domino effect of stringent austerity measures and the inability to gain from currency depreciation have already pushed some countries into recessionary territory.
- ▲ Small open economies with strong trading links to the Eurozone, like South Africa, will not escape the might of global sentiment swings – with continued market volatility being unavoidable. The most likely outcome is a combination of below-trend growth, higher inflation, stable short-term interest rates, bond market volatility and continued strong demand for inflation protection.

Demand for inflation protection the strongest since 2008



Sources: I-Net, Futuregrowth

Futuregrowth view:

Our investment view remains defensive, with a focus on short-term capital preservation while carefully considering potential investment opportunities into market weakness, especially with regards to long-dated fixed rate bonds.

Economic Indicators to 31 December 2011

	Latest Data		Previous Year
Exchange Rates:			
Rand/US\$	December-11	8.07	6.62
Rand/UK Pound	December-11	12.53	10.31
Rand/Euro	December-11	10.46	8.84
Rand/Aus\$	December-11	8.24	6.76
Interest Rates:			
Prime Overdraft	December-11	9.00%	9.00%
3-month NCD rate	December-11	5.50%	5.55%
R157 Long Bond Yield	December-11	6.72%	7.31%
Inflation:			
CPI (y-o-y)	November-11	6.1%	3.6%
National Accounts:			
GDP Growth (y-o-y)	September-11	2.9%	3.3%
GDP Growth (q-o-q, annualised)	September-11	1.4%	3.1%
HCE Growth (y-o-y) (Household Consumption Expenditure)	September-11	4.7%	4.7%
GFCF Growth (y-o-y) (Gross Fixed Capital Formation)	September-11	4.9%	0.9%
Balance of Payments:			
Trade Balance (cumulative 12month)	November-11	-\$1.87	\$0.70
Current Account (% of GDP)	September-11	-3.8%	-3.3%
Capital Account (% of GDP)	September-11	4.5%	4.3%
Forex Reserves (incl. gold)	November-11	\$50.94	\$44.45
Other:			
Manufacturing Production (y-o-y) (seasonally adjusted)	October-11	1.8%	1.9%

Source: OMIGSA

Market Indicators to 31 December 2011

	1 month (%)	Quarter (%)	Calendar year (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)
Equity						
All Share Index	-2.5	8.4	2.6	2.6	17.3	8.1
Shareholders Weighted Index	-1.4	8.3	4.2	4.2	17.9	8.6
All Share/Resources 50%	-1.7	8.6	4.8	4.8	18.5	8.7
Top 40 Index	-3.2	8.5	2.2	2.2	16.4	7.5
RAFI® 40 Index	-1.6	9.0	2.9	2.9	18.7	9.9
RAFI® All Share Index	-1.9	8.8	0.9	0.9	17.3	8.9
Resources Index	-5.5	7.3	-6.5	-6.5	12.4	5.6
Financial Index	1.9	8.7	7.4	7.4	17.0	4.0
Industrial Index	-1.7	9.2	9.2	9.2	22.0	12.4
Mid-cap Index	1.3	8.2	4.7	4.7	22.8	12.1
Small-cap Index	3.8	6.8	1.1	1.1	17.4	8.3
Interest-Bearing						
ALBI BEASSA	0.7	3.5	8.8	8.8	7.4	8.6
STeFI	0.5	1.4	5.7	5.7	7.3	8.5
Cash	0.4	1.2	4.9	4.9	6.2	7.9
Property						
SA Quoted Property Index	2.1	3.7	8.9	8.9	17.2	14.3
International						
MSCI World Index (R)	-0.3	8.2	15.9	15.9	6.8	0.9
MSCI World Index (\$)	-0.0	7.7	-5.0	-5.0	11.8	-1.8
MSCI World Emerging Markets (R)	-1.5	4.9	-0.4	-0.4	14.4	
MSCI World Emerging Markets (\$)	-1.2	4.4	-18.4	-18.4	20.1	
JPM International Bond (R)	0.7	0.6	30.8	30.8	0.5	10.6
US 1-month LIBOR (R)	-0.3	0.5	22.3	22.3	-3.9	5.0
Inflation (Estimated)						
CPI	0.3	1.1	6.3	6.3	5.4	6.9

Source: OMIGSA

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Regulatory Information

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