Market

Dynamics

January 2009

OLD MUTUAL
Investment Group

Performance through Focus

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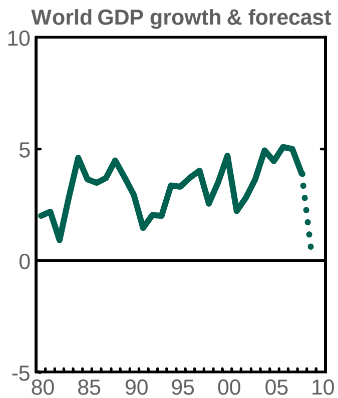
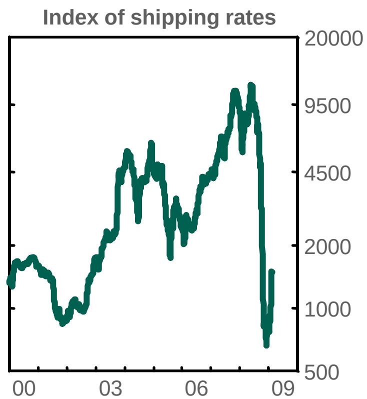
World Economic Overview and Outlook

World growth outlook poor, but some signs of stabilisation?



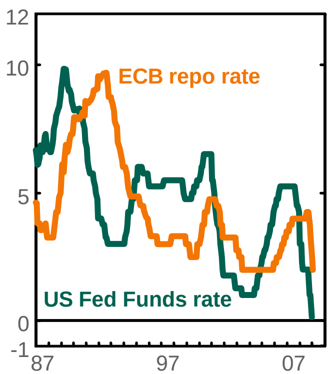


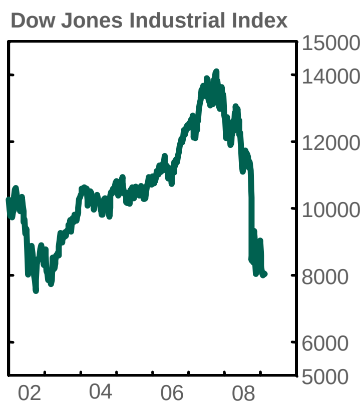
Source: OMIGSA (Iris)

- During the past month there was no let-up in the stream of very weak, and sometimes plain scary, macroeconomic numbers around the world. The global downturn has spread via a sudden slump in consumer demand, postponement or scrapping of private expansion plans, a sharp contraction in global trade and the sharply lower commodity prices (hitting commodity producing countries hard).
- Growth forecasts for 2009 have been slashed sharply, as is evidenced by the IMF cutting its own forecasts from a little over 2% as recently as November 2008 to only 0.5% now. Moreover, risks remain skewed to the downside in the short term.
- Nevertheless, despite an ongoing stream of poor economic data, there have also been a few signs that the pace of decline has started to slow. In particular, a strong rise in the closely watched Baltic Dry Freight Shipping Rate suggests that demand for shipping, closely correlated with global economic activity, may have started to recover.

***OMIGSA view:** World growth slump continues, but the pace of deceleration may soon start to slow.*

Central banks cutting aggressively, but markets remain concerned





Source: OMIGSA (Iris)

- The combination of slumping growth and sharply lower commodity prices has raised the spectre of deflation, a condition that global policy makers fear, as it can be very hard to escape.
- In order to prevent such an outcome, policymakers are pulling out all the stops to stimulate economic activity. As a result, the past month saw further rate cuts and yet more fiscal packages announced around the world.
- Looking further out, we still expect conditions to stabilise towards mid-year, with a moderate recovery taking hold during the latter part of 2009. The combination of aggressive policy stimuli and lower commodity prices will be the key recovery drivers. Perhaps, and hopefully, the recent rise in global shipping rates is an early indication that the worst may be behind us, even though things will remain very difficult for an extended period.

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

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Local Economic Overview and Outlook

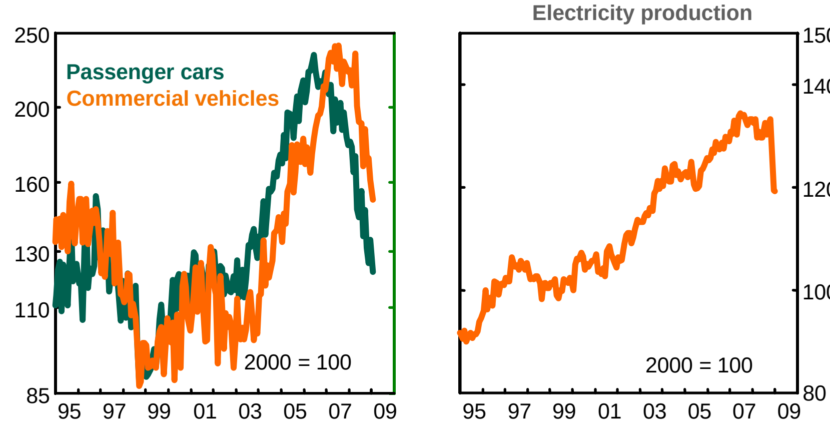
- The slowdown in the local economy continues. Available data for the fourth quarter of 2008 suggests that the economy stalled, or may even have contracted. Severe weakness was evident in key indicators such as manufacturing production, passenger and commercial car sales and electricity production.
- Prospects for 2009 are not very promising. While lower interest rates and petrol prices, as well as still-robust public sector infrastructure activity, will support the local economy, exports are likely to be hard hit by the global slump and there is already mounting evidence that capital projects in the private sector are being postponed or scrapped.
- The outlook for consumers is a little more rosy. Lower interest rates, sharply lower petrol prices and a general slowdown in inflation will lend support to consumption as the year progresses. The biggest risk is that the downturn in the broader economy will cause widespread lay-offs, as has already started to occur in some industries.

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

- News on the real economy remained negative early in 2009, but there are some welcome developments on the financial side of the economy.
- Inflation fell further, with CPIX easing to 10.3% in December, down from its peak of 13.6% in August. With CPIX being replaced by the new re-weighted and rebased CPI inflation measure, another fall to below 8% is on the cards in January. We expect CPI to be back into the target range by mid-year.
- More good news is the 27% downward revision by SARS of SA's trade deficit in 2008. While the current account deficit numbers for the first three quarters of 2008 will remain unchanged, the fourth quarter deficit should be notably smaller than the original trade numbers suggested.
- The Reserve Bank cut rates by 100 basis points (bps) early in February, following on the 50bps December cut. We expect rates to be cut by a further cumulative 200bps during 2009.

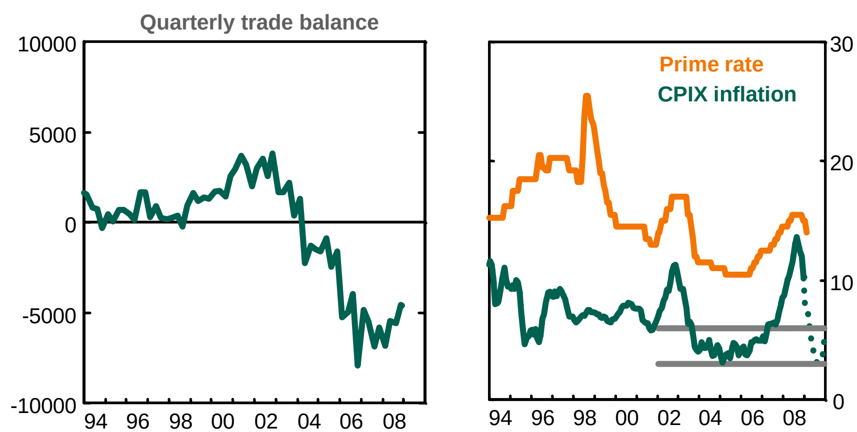
***OMIGSA view:** The downcycle in local interest rates is under way and rates should decline a further 200bps in 2009.*

Broad-based economic slowdown



Source: OMIGSA (Iris)

Inflation peaks, lower rand oil price improves outlook



Source: OMIGSA (Iris)

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Equity Sector Overview and Outlook

Resources

- The Resources Index outperformed the FTSE/JSE All Share Index in January due to a strong performance from gold stocks, which were seen as a safe haven among the global turmoil.
- Non-gold resources stocks performed poorly, as economic data confirmed that the credit crisis has caused global growth to slow sharply. This, in turn, caused a steep correction in commodity prices and related resource stocks.
- 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 under the current conditions.
- Despite the uncertainty regarding global growth, there are still some larger and/or higher quality resources companies whose prices we consider to be in value territory.

Investment Research view: *The diversified miners are protected by their exposure to a variety of commodities and currencies in their portfolios; they typically have the best assets that 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. Fundamentals and relative valuations are improving for some non-mining resources companies.*

Small Companies

- There is a lot of global uncertainty at present, which has caused a sell-off in many securities. SA small caps are no exception, exacerbated by some suspected forced selling by local and international players. In this environment, small caps tend to underperform relative to the FTSE/JSE All Share Index. Therefore it is not surprising to see that small caps returned -31.2% in 2008 versus the FTSE/JSE Top 40 Index return of -23.6%.
- For January 2009, the Small Cap Index lost -1.4%, compared to the -4.7% decline posted by the Top 40 Index.
- We are constantly seeing downward revisions to forecasts, and trading updates are confirming the economic slowdown.
- The prospect of decreasing interest rates in 2009 should be good for small caps, as many companies are reliant on the health of the SA consumer for their well being. The Reserve Bank has just cut the repo rate by 100 basis points to 10.5%.
- The waning appetite for additional risk among some funds is likely to increase small cap volatility, but this can provide us with good buying opportunities in the year ahead.

Investment Research view: *The average price:earnings (p:e) ratio at which small caps trade compared with large caps has narrowed to about a 10% discount. From that level it is unlikely that small caps will re-rate (upwards) relative to the Financial & Industrial Index.*

Equity Sector Overview and Outlook (cont.)

Financials

- The Financial Index was down 7.0% in the month, underperforming the SWIX All Share Index, which was down 4.7% during the month.
- However, within the financial sector, the banking index was down 11.65%, while the life sector delivered a flat performance during the month.
- We are in a downward phase in the interest rate cycle, which will be positive for the financial sector operationally.
- However, this will be countered by a slowdown in GDP growth and potentially an increase in unemployment.
- 2009 will be a tough year operationally for the companies, but we believe that the share prices already reflect this.
- On an absolute basis, we believe that the financial sector is looking very attractive and is underpinned by a high dividend yield.

Investment Research 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

- January heralded in a bad start for the year, and we continued to see industrials down, in line with the overall market, by over 6%.
- Bad news abounds, locally and abroad, on the economic and the company earnings fronts.
- In January a particularly hard-hit part of the sector was construction, as scepticism mounts as to the sustainability of the earnings and the stability of the announced order books. The dichotomy of this sector lies in the fact that some of the earnings are extremely cyclical, while another portion is very defensive as it is supported by the government infrastructural drive that is unlikely to be reversed.
- Richemont was also badly hit when their trading update indicated a sharp downturn in the global appetite for luxury goods.
- Defensive shares such as British American Tobacco (BAT) and South African Breweries (SAB) have held their own, as has the entire healthcare sector.
- Within the healthcare sector, Aspen's performance was particularly strong in the month, up 26% as speculation mounts about its cautionary announcement.
- Credit retailers have held up in the hope of rapid interest rate cuts in the early months of this year.

Investment Research view: *A defensive stance is still warranted, although the pricing of some defensive shares make them less desirable. Pricing in some of the more cyclical shares has now become quite compelling, but we would not change our defensive stance just yet, as we still expect quite a bit of strain on the economy.*

Equity Sector Overview and Outlook (cont.)

Property

- Listed property kicked off 2009 with a better-than-FTSE/JSE All Share Index (-4.7%) return of -1.1%. The sector has held up well compared with general equities, underpinned by expectations of lower interest rates and stable income flows.
- At the beginning of 2008 distribution growth was anticipated to slow from 12% to around 10%, but as at June and September growth was still running at 12%, and indications are that the final quarter of 2008 may prove to be stronger than expected.
- The market will be watching for signs of deterioration in property fundamentals – namely vacancies, arrears, reversionary rental growth and cost-to-income ratios. While some weakness in these factors is expected, the lower interest rate environment will ease the interest rate burden and reduce the dilutionary effect of capital expenditure. Overall, distribution growth is forecast to slow to around 9% in 2009 – still above expected inflation.
- Investors in the sector could reasonably expect to receive an income yield in the region of 9%, with potential for capital growth in the region of 8%-10%. The primary risk resides at the macro level - should South Africa be hit by a wave of risk aversion, currency weakness and bond market jitters, capital returns would be under threat.

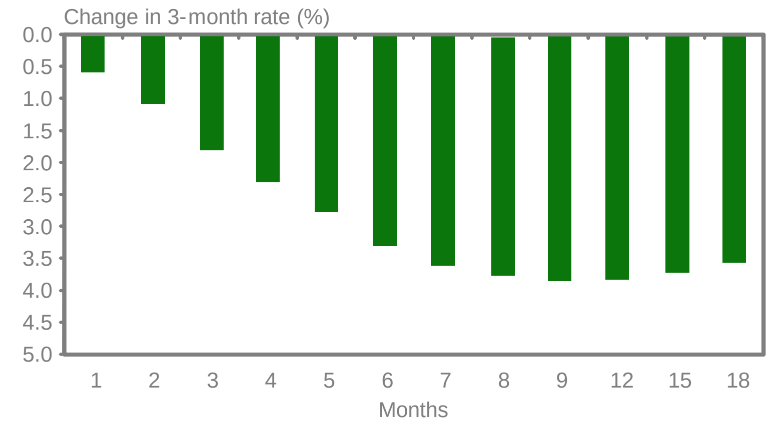
OMIGSA view*: Listed property faces a slowdown in distribution growth, but income growth remains fairly stable when compared with other sectors. A secure income yield of 9% and an income growth of 9% would underpin potentially above inflation returns.*

Fixed Interest Overview and Outlook

- Investor fears about a severe worldwide recession, disinflation and in certain instances even deflation, kept global government bond yields in a tight range as data releases kept surprising on the downside.
- Central banks and governments continued to offer liquidity and other assistance in an effort to stabilise markets and reflate economies.
- The local bond market weakened following a very strong bull rally in December, but some of the losses were offset by interest rate-positive data at month-end.
- Changes to the shape of the yield curve already reflect expectations of aggressive monetary policy easing and significantly higher supply from government and other borrowers.
- The bond market is expensive, but is expected to stay in a relatively tight trading range given the serious risk to global economic growth.

Futuregrowth view: *The forward money market expects the central bank to reduce the repo rate by about another 400 basis points within twelve months.*

Forward money market expects aggressive policy easing

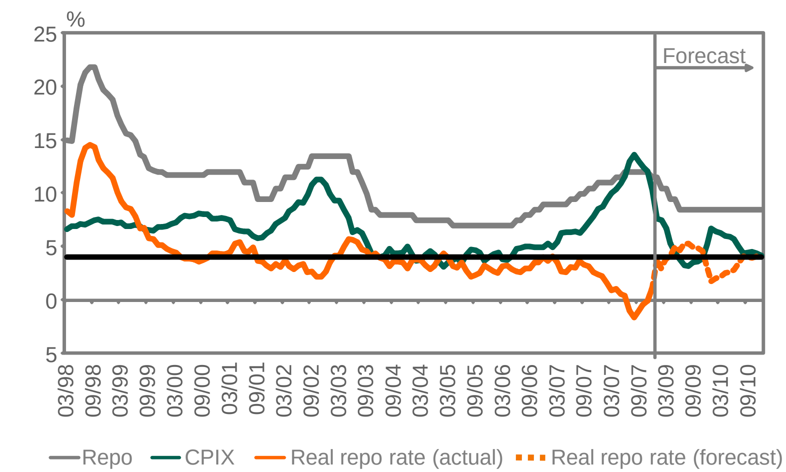


Source: OMIGSA, I-Net

- In our money market funds, we maintained an underweight tilt to cash, added to medium-dated floating rate instruments and slowed the pace of accumulating long-dated fixed-rate Negotiable Certificates of Deposit (NCDs).
- We cautiously created a small overweight modified duration tilt into market weakness for the bond funds, given a bullish inflation and interest rate view.
- Given the general levels of yields, we favour medium-dated bonds as the front and back ends of the bond curve are deemed expensive.
- We maintain a low listed property holding on a weak economic growth outlook, preferring nominal bonds and preference shares instead.
- The CPI-linked bond holding is kept at zero on valuation concerns.

Futuregrowth view: *The interest rate market is expensive, but could be stuck to a low and tight trading range given the macroeconomic background.*

Weak economic backdrop suggests a 300bp repo rate reduction



Source: OMIGSA, I-Net

Futuregrowth Asset Management

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Economic Indicators to January 2009

	Latest Data		Previous Year
Exchange Rates:			
Rand/US$	January-09	10.18	7.49
Rand/UK Pound	January-09	14.89	14.88
Rand/Euro	January-09	13.14	11.10
Rand/Aus$	January-09	6.49	6.63
Rand/Brazilian Real	January-09	4.41	4.25
Commodity Prices:			
Gold Price ($)	January-09	928.9	925.3
Gold Price (R)	January-09	9,289.9	6,838.2
Oil Price ($)	January-09	43.9	92.9
Interest Rates:			
Prime Overdraft	January-09	15.00%	14.50%
BA Rate	January-09	10.64%	10.98%
R157 Long-bond Yield	January-09	7.42%	8.73%
Inflation:			
CPI (y-o-y)	December-08	9.5%	9.0%
CPIX (y-o-y)	December-08	10.3%	8.6%
Real Economy			
GDP Growth (y-o-y)	September-08	3.0%	5.0%
HCE Growth (y-o-y)	September-08	1.8%	6.1%
(Household Consumption Expenditure)			
GFCF Growth (y-o-y)	September-08	11.0%	16.5%
(Gross Fixed Capital Formation)			
Manufacturing Production (y-o-y)	November-08	-4.6%	4.4%
(seasonally adjusted)			
		m-o-m	y-o-y
Car Sales	November-08	6.7%	-25.0%
(seasonally adjusted)			
Balance of Payments:			
Trade Balance (cumulative 12month)	December-08	-$10.9	-$9.8
Current Account (% of GDP)	September-08	-7.9%	-8.7%
Forex Reserves (incl. gold)	December-08	$32.1	$32.7
Foreign interest:		**Month**	**12 Months**
Net Foreign Flows - Equities	January-09	R-3.81bn	R-48.83bn
Net Foreign Flows - Bonds	January-09	R-5.36bn	R-34.29bn

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Market Indicators to January 2009

	1 Month (%)	Calendar Year (%)	Quarter (%)	12 Months (%)	3 Yrs (%)	5 Yrs (%)
Equity						
All Share Index	-4.3	-4.3	-1.6	-22.1	4.2	16.9
Shareholders Weighted Index	-4.7	-4.7	-1.0	-19.7	4.0	-
All Share/Resources 50%	-4.7	-4.7	-2.5	-19.0	3.8	17.3
Top 40 Index	-4.7	-4.7	-2.6	-23.9	3.9	16.3
RAFI® 40 Index	-4.4	-4.4	-1.0	-18.1	4.4	18.0
RAFI® All Share Index	-4.0	-4.0	-0.3	-17.4	4.3	18.7
Resources Index	-2.6	-2.6	2.2	-32.4	5.1	15.1
Financial Index	-7.0	-7.0	-4.2	-21.3	-3.8	13.7
Industrial Index	-4.6	-4.6	-4.4	-8.6	7.6	20.4
Mid Cap Index	-1.9	-1.9	5.2	-6.8	6.3	20.1
Small Cap Index	-1.4	-1.4	1.9	-22.9	6.3	23.8
Interest-Bearing						
ALBI BEASSA	-2.4	-2.4	9.2	14.8	7.5	10.1
STeFI	0.9	0.9	2.9	11.8	9.6	8.8
Cash	0.9	0.9	2.8	11.6	9.4	8.1
Property						
SA Quoted Property Index	-1.1	-1.1	14.8	6.3	12.9	-
International						
MSCI World Index (R)	0.7	0.7	-8.6	-19.8	4.9	5.3
MSCI World Index ($)	-8.7	-8.7	-11.8	-41.0	-11.7	-2.1
JPM International Bond (R)	6.0	6.0	10.7	41.1	27.9	13.3
US 1-month LIBOR (R)	10.6	10.6	4.2	41.0	24.3	11.7
Inflation (Estimated)						
CPI	-0.9	-0.9	-2.0	7.3	7.5	5.9
CPIX	-1.3	-1.3	-2.0	7.6	7.2	5.9

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