

Market Dynamics

July 2011

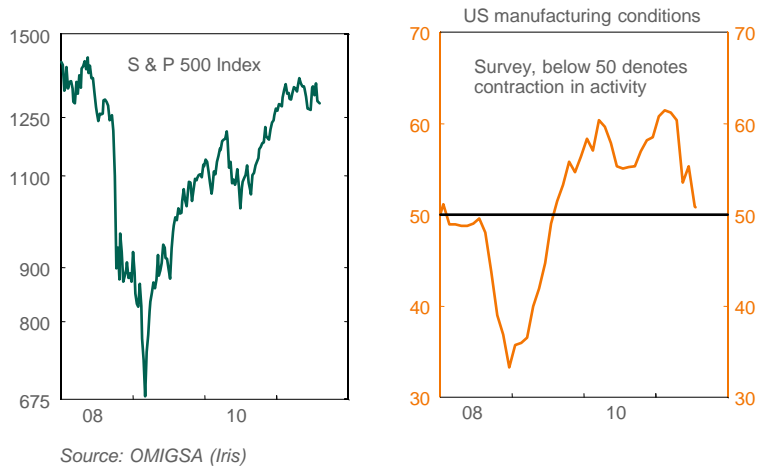


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World Economic Overview and Outlook

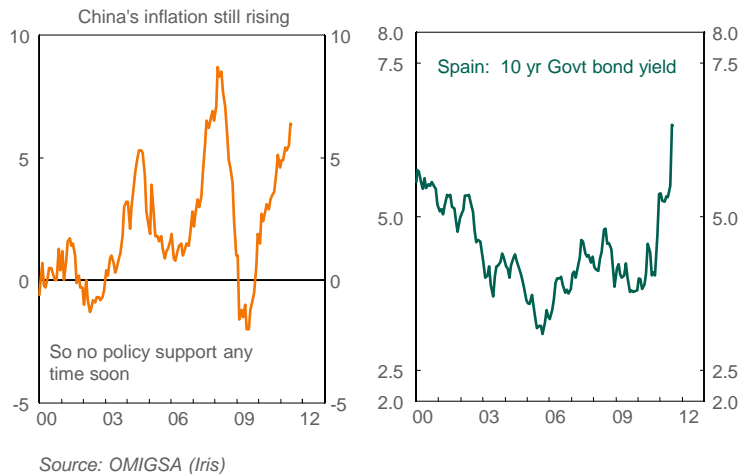
Worries hit markets



▲ July was a month full of worries for global financial markets. While the fiscal troubles in the European Union and the US took centre stage, growing signs of a considerable loss of momentum in the global economic recovery and fears over policy tightening in the emerging world, China and India in particular, added to the worries. As a result, global equity markets, which rallied strongly towards the end of June, sold off again in July. As the traditional safe haven, the gold price surged to yet new all-time highs.

▲ European officials, reacting to mounting panic in financial markets, eventually came up with a package that should avoid a Greek default in the foreseeable future. While markets initially reacted with relief, concerns soon turned to the fiscal situation in much larger Italy and Spain. Continued increases in 10-year government bond yields of both countries (see graph) reflected the mounting concerns over medium-term fiscal prospects for both countries. In the US, following building frustrations over lawmakers' bickering over reaching an agreement to raise the \$14.3trn debt ceiling, a last-minute deal was reached. Yet, the agreement falls short of what is needed to stabilise, let alone lower, US government debt as a percentage of GDP over the next decade. Concern over the US fiscal situation will consequently continue to cast a cloud over financial markets for a long time to come.

Worries are global



▲ To add to mounting fiscal worries, global growth lost further momentum over the past month. Against this background, looming fiscal tightening in the US and Europe, as well as further monetary tightening in China to counter still-rising inflation pressures, raised concerns that the current soft patch will turn into an outright downturn in the months to come.

▲ While the risks to the global economy have undeniably increased considerably over the past few months, we remain of the opinion that a full-blown global downturn is unlikely. Yet, it is very likely that growth will remain soggy for a few months to come, causing concerns over the sustainability of the elevated level of company profits globally. As a result, markets may well remain very volatile in coming months as investors wait for the current clouds of uncertainty to fade.

OMIGSA Economic Research Unit view: After a soft patch in global growth during the second quarter, we expect growth to rebound during the second half of 2011. Substantial risks remain – including fiscal policy tightening globally – so we cannot expect more than moderate growth going forward.



OLD MUTUAL

Investment Group

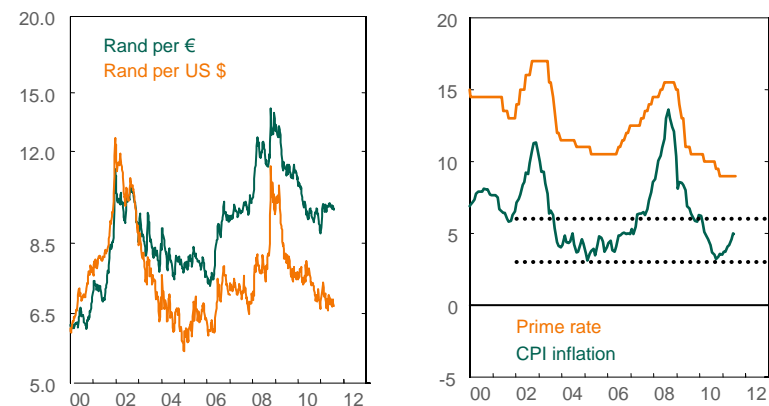
Equity
Research

Local Economic Overview and Outlook

- ▲ Following a strong first-quarter growth performance of almost 5% (at an annual rate), the latest high-frequency indicators suggest growth lost considerable momentum again in the second quarter. The slowdown was evident in both production- and demand-side indicators, such as manufacturing production, retail and car sales and building plans passed. Nevertheless, we don't think this marks the start of a renewed economic downturn, as the second quarter of the year is typically negatively affected by a host of public holidays. This year an extended school holiday likely distorted the picture further.
- ▲ Nevertheless, with growth slowing and global conditions deteriorating, the local growth outlook has undeniably deteriorated. This was acknowledged by the South Africa Reserve Bank (SARB) at the latest meeting of the Monetary Policy Committee. As a result, expectations of the start of the up-cycle in local interest rates have softened considerably over the past month. Most analysts that were expecting the first hike in September or November have started to push that forecast out to early 2012. Money market rates have reacted in a similar fashion.
- ▲ Inflation rose to 5.0% in June. This is up from a cyclical bottom of 3.2% in September 2010. The primary drivers of the rise are still food and energy prices, as well as municipal rates and charges. The still-strong rand continues to be a powerful brake on inflation. Nevertheless, we expect inflation to rise to about 6% by year-end and to start to ease gradually during the course of 2012. This forecast assumes no significant weakening of the rand and/or a sharp further rise in the oil price.
- ▲ The SA economy's inability to create jobs during the recovery so far was once again highlighted by a further rise in the unemployment rate to 25.4% in the second quarter. The current spate of strike activity, together with still very high wage demands by labour unions, will further harm SA's international competitiveness and ability to create jobs.

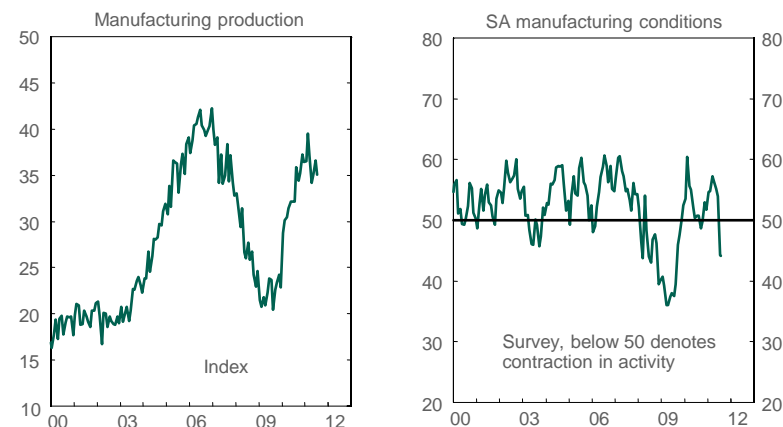
OMIGSA Economic Research Unit view: *The local recovery remains on track. However, weakness in a number of areas still stands in the way of a faster recovery. Inflation is on a moderate uptrend and interest rates are expected to start rising somewhere between the fourth quarter of 2011 and the first quarter of 2012.*

Rand firm, inflation on moderate uptrend



Source: OMIGSA (Iris)

SA recovery stalls, too



Source: OMIGSA (Iris)



Equity Sector Overview and Outlook

Resources

- ▲ The basic materials sector produced a return of -4.0% for the month of July, underperforming the FTSE/JSE All Share Index (ALSI)'s return of -2.0%.
- ▲ The mining houses and platinum sectors experienced a poor month, with platinum the worst with a return of -7.3% for the month. The usual reasons for underperformance continued to exist: a strong rand, uncertainty over wage negotiations and threats of nationalisation were compounded by the threat of a US debt default which was only resolved at month-end.
- ▲ Developed world debt problems continued to dominate the market, with the focus switching from Greece and other "PIIGS" to the US. The uncertainty appeared to impact more on share prices than on actual metal prices, with the platinum price actually increasing during the month. The global uncertainty is likely to remain, with developing market robustness offset by the ongoing hangover in the developed world from previous profligacy.
- ▲ Closer to home, South African unions across the board appear to be taking a more militant stance to the current set of wage negotiations, with the call for strike action no longer appearing as a last resort. Although margins have recovered in most of the industry, wage increases at a multiple of the local inflation rate will dampen prospects. However, as this appears a global phenomenon rather than a peculiarly South African occurrence, relative competitiveness probably won't suffer too badly. Nationalisation remains a relevant topic, with the industry seemingly unwilling to enter the debate and leaving the running to the African National Congress Youth League.

Equity Research view: *The diversified miners valuations remain relatively more compelling than the single commodity plays, and their geographic diversification also provides some degree of comfort in the current circumstances. The more pure plays (platinum, gold) suffer from their higher exposure to a strong currency and a fraught industrial relations arena.*

Small Companies

- ▲ The small cap and mid-cap indices returned 0.0% and 0.3%, respectively, for the month ended 31 July 2011, while the FTSE/JSE Top 40 Index returned -2.4%.
- ▲ The outperformance of shares at the small/mid-cap level was a function of underperforming large cap mining stocks.
- ▲ The market performance has turned negative for the year so far. Ongoing debt issues continue to create global uncertainty. Sovereign debt issues in the US and Europe continue to knock investor sentiment.
- ▲ Most of the uncertainty surrounds the developed world and not the developing world. Emerging markets have slowed but are still expected to show robust growth over the next few years. Quantitative easing policies might be re-introduced, for the third time, to get the US onto a firmer growth path. The European debt issues remain and Greece is still a basket case. Sovereign debt issues in Ireland, Spain, Portugal and Italy continue to capture news headlines.
- ▲ With global growth under question, markets will remain nervous, and investors' cash will remain on the sidelines.

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



Equity Sector Overview and Outlook (cont.)

Financials

- ▲ The FTSE/JSE Financial Index ended down 1.6% for the month. This was in line with the performance of the FTSE/JSE Shareholder Weighted All Share Index (SWIX).
- ▲ Within financials, the Banking Index was down 3%, while the life assurance sector lost 1.5%, and general financials were down 0.9%.
- ▲ The insurance sector was boosted by a strong performance from Liberty Holdings, while Nedbank was a poor performer within the banking sector, giving up some of its recent gains.
- ▲ For the balance of 2011, we expect the banks to continue their focus on costs as revenue growth remains subdued. Capital levels will also be a focus area, with potential for increased dividends.
- ▲ Life companies should continue to show an improving trend in lapse-experience and recurring-premium sales, due to improving real household incomes. Cost management will also become an issue in a sector with limited growth prospects.

Equity Research view: We expect the financial services sector to benefit from the recovering economy, which should begin to lift operating results in 2011. We believe some counters in the sector still present value, with ratings below historic averages.

Industrials

- ▲ The Industrial Index managed to end the month of July flat, compared with the FTSE/JSE All Share Index (ALSI) which fell 2%. For the year-to-date, the Industrial Index is up 3.5%, which is 5% better off than the ALSI.
- ▲ The star performers in July were Kumba Iron Ore (+5%) which reported strong results off the back of record iron ore prices (offset by the strong rand to a degree) and British America Tobacco (+5%), which has remained in favour throughout this year. The retail sector also enjoyed a strong run in July. Investors focused on the strong dividend yielders, with Mr Price up 8% and Woolworths up 6%. The cotton price dropped 36% in July, which should help boost the clothing retailers' margins in the coming year.
- ▲ The building and construction sector continued to slump. The government has put a moratorium on new projects and is now delaying payments to contractors. All this is happening at a time when the industry is being investigated by the competition authorities. The share prices of Murray & Roberts, PPC, Group Five and Aveng are all down in excess of 15% year-to-date.

Equity Research view: The industrial sector is not offering much value as a whole based on our valuation. There are certain companies, however, which are offering some reasonable value.



Equity Sector Overview and Outlook (cont.)

Property

- ▲ In July the FTSE/JSE SA Listed Property Index (SAPY) provided a 1.6% total return, in line with the All Bond Index (1.5%). Property prices tracked the slight decline in bond yields. The FTSE/JSE All Share Index lost 2%, but the general retailer sector, which is often similar to property, was strong (+2.7%).
- ▲ In July, as in previous down-markets, the sector's defensiveness was evident, with listed property prices oblivious to equity market weakness. The sector may get a boost from equity investors looking for shelter. At some stage continued equity weakness must flow through to put pressure on listed property prices, if this is reflective of a deteriorating economic environment.
- ▲ In the new month, two new property companies should list. Results season also begins and we will get an indication of conditions in the still-challenging environment.

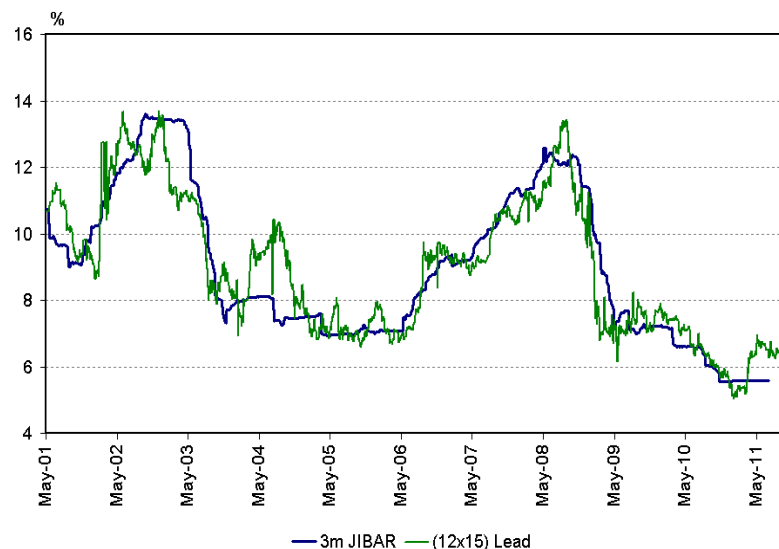
Equity Research view: *The sector offers a one-year forward yield of 8.4%, exceeding the 10-year bond yield, and distribution growth approximating inflation. Downside operational risk has declined and funding conditions are easier. Commercial building plans passed have fallen, which will facilitate rental increases in the recovery. Vacancies are plateauing. A genuine recovery in property conditions may take longer than many anticipate, with higher electricity and rate costs constraining net rental growth, and over-rentals possibly developing in time (a key concern). The direct commercial property market remains resilient. On a long-term secular view, property is attractive as existing rents are below feasibility rentals for developments but building costs have softened.*



Fixed Interest Overview and Outlook

- ▲ The local market benefited from persistent non-resident buying of local bonds (R9.5bn during July), the decision by the South African Reserve Bank (SARB) to leave the repo rate unchanged, weak May retail sales data and a strong rand. This combination overpowered the fact that June Consumer Price Index (CPI) and Producer Price Index (PPI) data confirmed the rising inflation trend, with annual increases of 5% and 7.4%, respectively. The latest European financial support package and the eleventh-hour raising of the US debt ceiling to avoid default, managed to contain global risk aversion in the short term.
- ▲ An eventful month caused the 10-year RSA government bond to trade in a wide range of 8.3% to 8.5%, before ending the month 16 basis points stronger at 8.3%. It turned out to be a good month for interest-rate bulls as the All Bond Index rendered 1.5%, beating both the JSE Inflation-linked Bond Index (+0.9%) and cash (+0.4%).
- ▲ The investment view remains for inflation and interest rates to rise in months ahead, with the usual bouts of volatility. Recent strong buying of South African bonds by non-residents is reminiscent of the rush-to-accumulate during the third quarter of 2010, which was followed by hefty selling for four consecutive months.
- ▲ As a result, we continue to favour a sizeable holding of cash, variable-rate and inflation-linked bonds, combined with a lower fixed-rate bond holding and a lower modified duration. The current steepness of the yield-curve slope and the expectation of monetary-policy tightening in the months ahead, favour an underweight position in short-dated bonds.

The forward rate market has become less bearish on interest rates



Sources: Bloomberg, Futuregrowth

Futuregrowth view:

Recent market strength offered an opportunity to reduce the holding of short-dated fixed-rate bonds in anticipation of future monetary-policy tightening. Corporate debt spreads keep tightening, forcing investors to become more price sensitive. Expectations of a more bearish medium-term inflation outcome are contributing to a slightly improved outlook for inflation-linked bonds, offsetting low real yields.

Economic Indicators to 31 July 2011

	Latest Data		Previous Year
Exchange Rates:			
Rand/US\$	July-11	6.69	7.29
Rand/UK Pound	July-11	10.98	11.41
Rand/Euro	July-11	9.47	9.51
Rand/Aus\$	July-11	7.36	6.58
Interest Rates:			
Prime Overdraft	July-11	9.00%	10.00%
3-month NCD rate	July-11	5.50%	6.55%
R157 Long Bond Yield	July-11	7.33%	7.58%
Inflation:			
CPI (y-o-y)	June-11	5.0%	4.2%
National Accounts:			
GDP Growth (y-o-y)	March-11	3.7%	1.4%
GDP Growth (q-o-q, annualised)	March-11	4.8%	4.8%
HCE Growth (y-o-y) (Household Consumption Expenditure)	March-11	5.0%	2.3%
GFCF Growth (y-o-y) (Gross Fixed Capital Formation)	March-11	1.7%	-8.0%
Balance of Payments:			
Trade Balance (cumulative 12month)	June-11	\$1.98	-\$1.18
Current Account (% of GDP)	March-11	-3.1%	-4.4%
Capital Account (% of GDP)	March-11	7.8%	8.0%
Forex Reserves (incl. gold)	June-11	\$50.28	\$42.29
Other:			
Manufacturing Production (y-o-y) (seasonally adjusted)	May-11	0.6%	8.4%

Source: OMIGSA

Market Indicators to 31 July 2011

	1 Month (%)	Quarter (%)	Calendar Year (%)	12 Months (%)	3 Yrs (%)	5 Yrs (%)
Equity						
All Share Index	-2.0	-4.7	-1.5	13.1	7.0	11.3
Shareholders Weighted Index	-1.5	-3.8	-0.9	13.1	8.9	12.3
All Share/Resources 50%	-1.4	-3.4	0.0	14.0	9.6	12.2
Top 40 Index	-2.4	-5.7	-1.6	13.2	5.3	10.6
RAFI® 40 Index	-2.5	-5.5	-1.3	11.7	10.6	12.4
RAFI® All Share Index	-2.5	-5.2	-1.9	12.0	10.1	11.9
Resources Index	-4.5	-10.1	-7.5	9.0	-2.2	7.6
Financial Index	-1.6	-3.2	0.4	4.5	9.7	7.3
Industrial Index	0.1	-0.3	3.5	21.3	16.6	17.3
Mid-cap Index	0.3	0.7	-1.0	11.3	19.5	16.7
Small-cap Index	-0.0	-0.4	-3.1	15.4	11.3	12.9
Interest-Bearing						
ALBI BEASSA	1.5	3.1	3.8	8.5	10.9	9.0
STeFI	0.5	1.4	3.3	6.1	8.2	8.7
Cash	0.4	1.2	2.8	5.1	7.2	8.1
Property						
SA Quoted Property Index	1.6	2.9	4.4	14.7	20.4	19.8
International						
MSCI World Index (R)	-2.8	-3.4	5.2	9.5	-1.6	1.7
MSCI World Index (\$)	-1.8	-5.2	3.7	19.2	1.3	2.4
JPM International Bond (R)	1.3	4.5	7.9	0.2	4.2	7.3
US 1-month LIBOR (R)	-1.0	1.9	1.6	-7.9	-1.9	1.9
Inflation (Estimated)						
CPI	0.7	1.6	4.3	5.1	5.2	7.1

Source: OMIGSA

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Regulatory Information

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