

Market Dynamics

June 2009



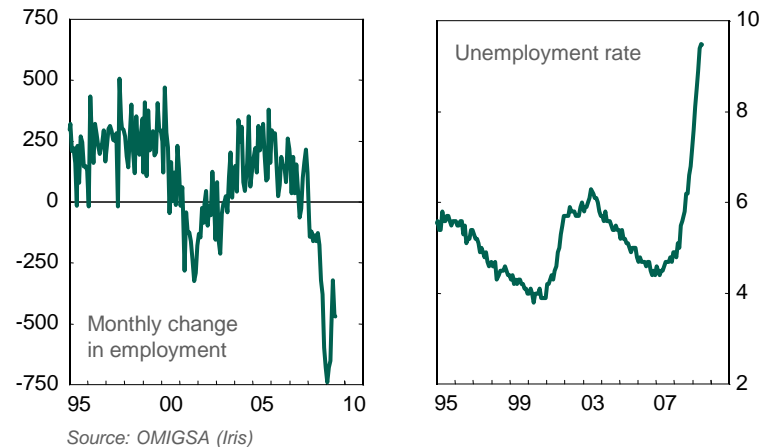
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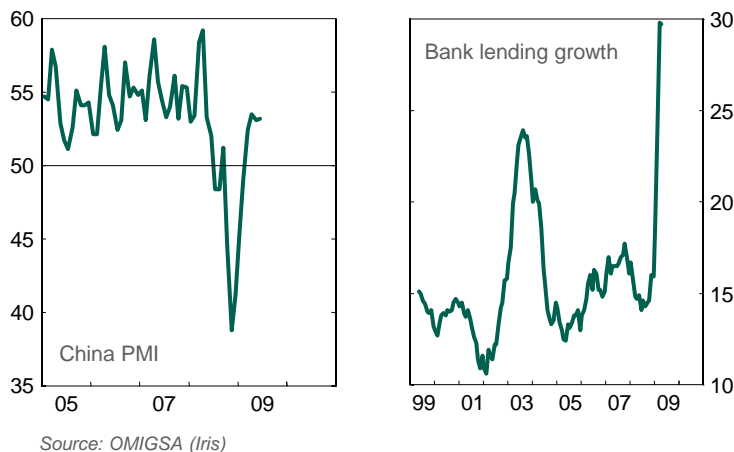


World Economic Overview and Outlook

USA employment



China PMI & bank lending growth



- ▲ The global stabilisation signs that emerged in late April and May continued during June. Thus confidence continued to improve that the global slump may be over.
- ▲ However, data remains very volatile and there are no clear recovery signs yet.
- ▲ In the US, the latest round of employment data surprised on the downside, with 100 000 more jobs lost during June than expected by analysts. This kept alive the worry that the US consumer – already under severe financial pressure – might take some time before starting to spend again.
- ▲ Apart from worries about the US consumer, there are also concerns about other areas such as the Euro-area and Japan, where most data remains very weak. Lingering concerns about fading stimulus measures or the premature resumption of interest rate hikes – resulting in a relapse in economic activity – are also overhanging financial markets.
- ▲ China is the one area where there are clear recovery signs. The Purchasing Managers Indices (PMI's) have rebounded sharply and are now clearly in recovery mode. Bank lending and money supply growth are also extremely buoyant and indicative of a recovery.
- ▲ Despite the lack of clear recovery signs over a broad front, the stabilisation signs and the realisation that the worst is over have led to growth forecasts being upgraded markedly over the past two months.
- ▲ Policy remains extremely expansionary virtually everywhere, and is likely to remain so for an extended period of time. One of the regional presidents of the Federal Reserve Board, Janet Yellen, said that the federal funds rate may remain at zero for several years.

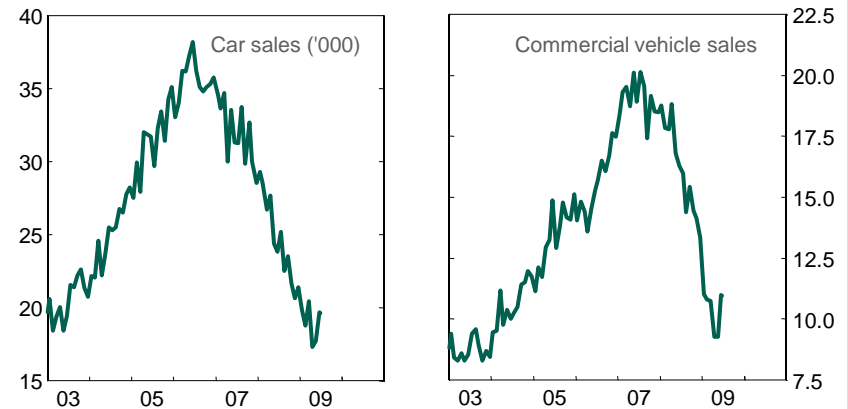
OMIGSA view: *Investors should guard against over-optimism in the short term, as there are still considerable downside risks and the recovery, when it eventually arrives, is likely to be slow and uneven.*

Local Economic Overview and Outlook

- ▲ Real economic data remains very weak. After the shocking 6.4% annualised contraction in Gross Domestic Product (GDP) during the first quarter, we expect another negative growth number in the second quarter of this year.
- ▲ SA has lagged the global business cycle somewhat. Local stabilisation signs only emerged – very tentatively – over the last few weeks.
- ▲ Although data is still very weak and volatile, car sales and commercial vehicle sales have shown signs of stabilisation. Similarly, the manufacturing PMI and electricity production data also improved in the latest round.
- ▲ One worrying aspect of the weak economy is the sharp impact on tax revenue collected. Pravin Gordhan, the Minister of Finance, revealed Treasury fears that revenue could potentially show a shortfall of up to R60bn in the current fiscal year. This would lift the budget deficit to closer to 6%-7% of GDP compared to the February budget of 3.8%.
- ▲ In addition to this, the Minister's comments that 2.5% to 3.5% growth is the best that can be expected over the next few years raised concerns over medium-term growth prospects.
- ▲ Near-term prospects are still poor. We do not expect any meaningful improvement during the second half of the year, as the economy will continue to face strong headwinds. A decent recovery is only expected in 2010.
- ▲ Inflation data remains sticky and looks unlikely to get inside the target range of 3% to 6% any time this year. Nevertheless, we expect the gradual downtrend to continue, and we could see a low for the year just above 6% some time in the third quarter.
- ▲ Substantial cost-push pressures – emanating from electricity price hikes, big increases in municipal charges and high wage settlements – mean that the medium-term prospects for inflation are not rosy.

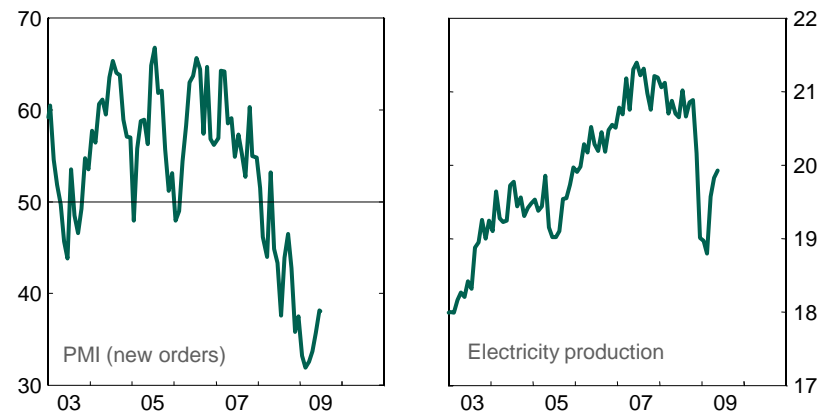
OMIGSA view: *Despite the weak economy, the actual and potential future inflation trajectory – as well as the extent of recent cuts – led to the Reserve Bank not cutting rates at the June meeting. Substantial improvement in inflation drivers and a very weak economy could see more cuts, but for now we are on hold.*

SA stabilisation signs



Source: OMIGSA (Iris)

SA stabilisation signs



Source: OMIGSA (Iris)

Equity Sector Overview and Outlook

Resources

- ▲ The basic materials sector delivered a return of 4.1% for the second quarter versus the FTSE/JSE All Share Index's (ALSI) 8.6%, with the gold and oil/gas sectors underperforming. Industrial metals (steel) and forestry/paper were the outperformers.
- ▲ 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 Arcelor Mittal.

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 June 2009, the Small Cap Index gained 2.6%, compared to the 3.8% decline posted by the FTSE/JSE Top 40 Index.
- ▲ Market commentators appear to be getting more concerned about the sustainability of the economic recovery, while global markets indicate that we are past the worst of the crisis. As mentioned before, we continue to focus on individual company valuations and the prospects for each one of these companies.
- ▲ The current trading statements being issued by companies as a whole are painting a fairly negative picture on the last six months' trading environment. However, this was largely expected and the key now is how much of a recovery will the next six months deliver. The interest rate declines should start to impact on the SA economy in the next six months and this will be positive for small and mid-caps.
- ▲ Within the universe of shares this fund can play in is the Alt-X Index. This index returned -61% in the last year, while small caps have decreased by 11%. Resources are now being dedicated to re-assessing some of these companies now that they should start to return to normalised earnings and price/earnings multiples.
- ▲ 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.*

Equity Sector Overview and Outlook (cont.)

Financials

- ▲ The FTSE/JSE Financial Index returned a strong 12.3% for the quarter ended 30 June 2009. It outperformed the broader market as the FTSE/JSE Shareholder Weighted All Share Index (SWIX) gained 9.7% during the quarter.
- ▲ The banking sector was up 13.8% in the quarter, while the life insurance sector gained a spectacular 21.5%, mainly lifted by Old Mutual, which gained 44.7% during the quarter. The stock is up over 100% since it reached its lows in mid-March, as concerns over the global economy and Old Mutual's US credit exposure have eased.
- ▲ The operational environment for financial sector companies is expected to remain tough in 2009. The sector will benefit from the recent interest rate cuts, although relief on earnings will only be seen in the medium term, as there is a lag before one sees a benefit on the bad debt line. Slowdown in GDP growth and a possible increase in unemployment pose a headwind to the performance of the sector.
- ▲ We believe that the market will look through these poor earnings.
- ▲ On an absolute basis, we believe that the financial sector is looking attractive, and is still trading below its long-term average.

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

Industrials

- ▲ Industrials have been the stellar performer in the second quarter of 2009, up 14% versus the overall market (up 8.6%). Still, they only made up for the losses of the first quarter, showing a 3.6% return for the half year to June.
- ▲ The evidence of the world stabilising started appearing in the quarter in the form of commodity prices recovering sharply, global trade recovering and financial stability being established.
- ▲ The spectacular performers for the quarter were mostly those sectors that had been sold down the most in the previous quarters, especially the very cyclical construction sector.
- ▲ Other sectors that performed well were retail, on the back of some good interest rate cuts, and shares such as Steinhoff, the healthcare sector and Naspers (that has proved more resilient to an economic downturn than expected)
- ▲ A significant underperformer was PPC, which was pricing in unreasonable cement demands.
- ▲ Currently the sector is not showing much upside.

Investment Research view: *We maintain a relatively defensive stance as the next few months will probably remain very volatile. The sector as a whole is fairly priced, with only pockets of value available.*

Equity Sector Overview and Outlook (cont.)

Property

- ▲ The listed property sector has been range bound so far this year, recording an unexciting negative 3% total return to June, outperforming the All Bond Index's (ALBI) negative 6%, but underperforming the FTSE/JSE All Share Index's (ALSI) 6% as "bombed-out" equities staged some recovery.
- ▲ The sector's performance relative to equities will be largely determined by investors' appetite for risk.
- ▲ 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 years (12%-14%).
- ▲ Market rentals have largely peaked and tenant arrears have increased. Property expenses (especially higher electricity, rates and taxes) are putting pressure on tenants' ability to afford space and landlords' operating margins.
- ▲ 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: *Property is, however, more likely to outperform cash and bonds, as the sector's forward income yield of 10% is some 2% above that of cash, and still offers income growth.*

Fixed Interest Overview and Outlook

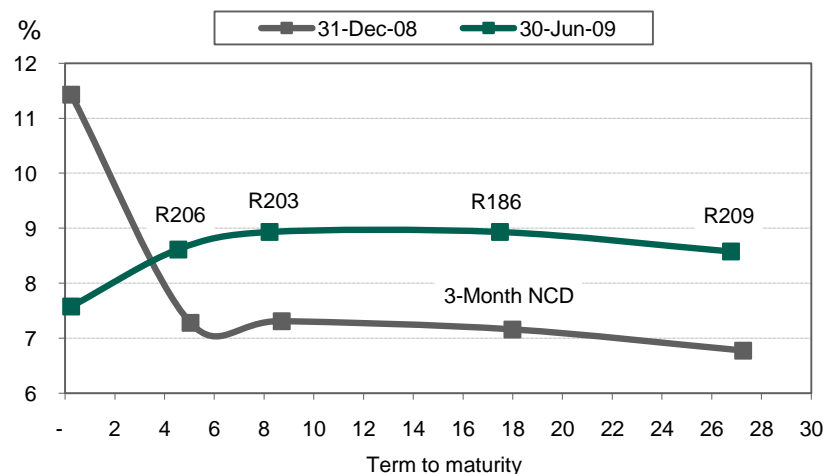
- ▲ The local bond market continued to weaken in tandem with global markets. This was despite a continued improvement in global risk appetite, lower-than-expected year-on-year increases in Producer Price Inflation (PPI) and private credit extension, and a strong rand. A slower than expected decline in Consumer Price Inflation (CPI) and the decision by the South African Reserve Bank (SARB) to keep the repo rate unchanged played in the hands of bears.
- ▲ The net effect of steady short-term interest rates and rising long-bond yields was a further steepening of the yield curve.
- ▲ The bond market is expected to trade in a range of about 100 basis points in the medium term, and is marginally better priced relative to low money market rates.

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 medium-dated and longer-dated money market instruments when market rates retraced to higher levels following the decision by the SARB to keep policy unchanged.
- ▲ In the bond funds we are putting less emphasis on the modified duration tilt, and are instead looking to add value by being correctly positioned on the yield curve.

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

Significant yield curve normalisation over the last six months



Sources: OMIGSA & I-Net

- ▲ Given the general level of market rates, we are running underweight tilts to the one- to three-year and 12-year+ maturity bands. This is offset by a significant overweight tilt to bonds in the seven- to 12-year band.
- ▲ The RSA CPI-linked bond holding was kept at zero on valuation concerns, following the sharp decrease of real yields in March and April. We did utilise opportunities to pick up non-government CPI-linked bonds offered at very attractive spreads.
- ▲ We maintain a low listed property holding on a weak economic growth outlook, preferring nominal bonds and preference shares instead, while consistently looking to increase the holding of attractively priced non-government debt.

Economic Indicators to June 2009

	Latest Data		Previous Year
Exchange Rates:			
Rand/US\$	June-09	7.72	7.83
Rand/UK Pound	June-09	12.68	15.61
Rand/Euro	June-09	10.81	12.33
Rand/Aus\$	June-09	6.26	7.53
Interest Rates:			
Prime Overdraft	June-09	11.00%	15.50%
3-month NCD rate	June-09	7.45%	12.30%
R157 Long Bond Yield	June-09	8.47%	10.72%
Inflation:			
CPI (y-o-y)	May-09	8.0%	11.7%
National Accounts:			
GDP Growth (y-o-y)	March-09	-0.8%	3.8%
GDP Growth (q-o-q, annualised)	March-09	-6.4%	1.7%
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)	May-09	-\$5.79	-\$10.87
Current Account (% of GDP)	March-09	-7.0%	-8.8%
Capital Account (% of GDP)	March-09	6.1%	9.1%
Forex Reserves (incl. gold)	May-09	\$34.16	\$34.39
Other:			
Manufacturing Production (y-o-y) (seasonally adjusted)	April-09	-21.6%	11.3%

Market Indicators to June 2009

	1 Month (%)	Quarter (%)	Calendar Year (%)	12 Months (%)	3 Yrs (%)	5 Yrs (%)
Equity						
All Share Index	-3.1	8.6	4.1	-24.9	4.2	20.3
Shareholders Weighted Index	-1.3	9.7	4.7	-17.6	5.9	20.9
All Share/Resources 50%	-1.4	10.3	4.0	-17.8	5.1	19.9
Top 40 Index	-3.8	7.7	3.3	-28.6	3.3	19.8
RAFI® 40 Index	-1.7	13.7	6.7	-14.2	5.4	21.4
RAFI® All Share Index	-2.0	11.8	3.7	-15.4	4.8	21.2
Resources Index	-9.0	2.8	4.4	-43.9	0.6	21.4
Financial Index	4.1	12.3	4.4	3.4	0.1	15.1
Industrial Index	0.7	14.0	3.4	-4.7	10.7	21.7
Mid-cap Index	1.0	14.5	9.4	10.6	11.2	23.2
Small cap Index	1.0	11.6	4.5	-7.0	8.2	23.4

Interest-Bearing						
ALBI BEASSA	-0.2	0.3	-4.9	19.3	7.7	9.3
STeFI	0.8	2.3	5.1	11.3	10.0	8.9
Cash	0.6	2.0	4.5	10.5	9.8	8.3

Property						
SA Quoted Property Index	-1.8	-0.9	-2.3	30.5	15.4	25.6

International						
MSCI World Index (R)	-4.3	-1.7	-10.8	-30.0	-5.0	5.1
MSCI World Index (\$)	-0.4	21.1	6.8	-29.0	-7.5	0.6
JPM International Bond (R)	-3.8	-16.4	-18.1	3.4	10.8	10.9
US 1-month LIBOR (R)	-3.8	-18.6	-15.9	1.0	7.0	8.4

Inflation (Estimated)						
CPI	0.0	2.5	4.6	6.7	8.6	6.7

For more information, please contact:

Western Cape:

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

Mike van Heerden – Senior Executive: Business Development
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: hjansevanrensburg@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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