Market Dynamics

March 2008

OLD MUTUAL
Investment Group

Performance through Focus

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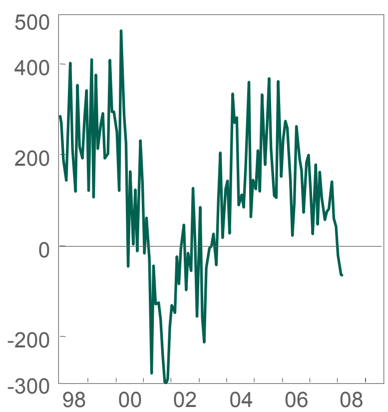
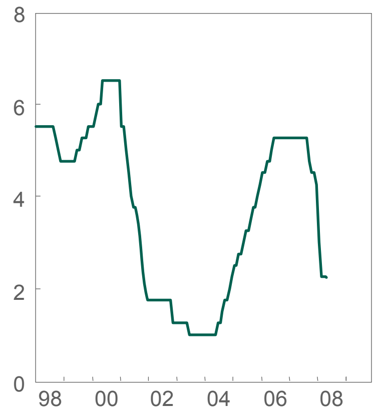
World Economic Overview and Outlook

US economy weakens and Fed cuts rates

Consumer confidence index



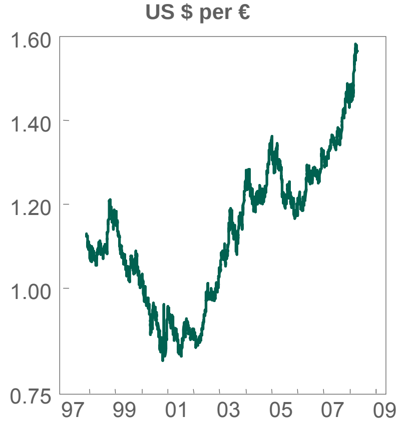
Federal funds rate



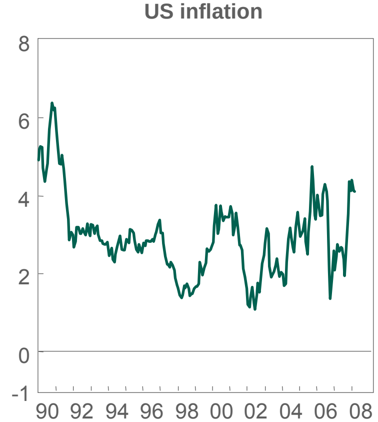
Source: OMIGSA (Iris)

Dollar weakens, US inflation rises

US $ per €



US inflation



Source: OMIGSA (Iris)

- The latest US data suggests that the economy may already be in recession, even though it will take months before it is either confirmed or denied by the authorities. Elsewhere around the world, growth is generally also still slowing, albeit not as severely as in the US.
- Despite the global slowdown, inflation remains a global concern as inflation rates have risen notably across a broad range of countries recently. Higher oil, food and metals prices remain the key driving forces behind higher inflation. As a result, a number of countries have, despite slowing growth, raised interest rates over the past month or so and some are expected to do so again in coming months.
- In contrast, with US growth still slowing, the Federal Reserve is expected to lower interest rates again at its end-April meeting. A combination of sharply lower interest rates, a stimulatory fiscal package and weak dollar should help stabilise the US economy by mid-year, followed by a moderate recovery during the second half of 2008.

***OMIGSA view:** The US economy appears to be in recession. However, it is expected to be relatively short and shallow, as policy makers are pursuing aggressive policy stimulation.*

- Slowing growth and lower interest rates caused the dollar to weaken to new all-time lows against the euro during March. This lent support to commodity prices, with precious metals and energy also surging to all-time highs.
- With growth slowing, inflation rising, more bad news on losses stemming from the sub-prime crisis and ongoing concerns over the health of global credit markets, financial markets have remained extremely volatile over the past month.
- This volatility is expected to continue for a while longer, as uncertainty remains over the outlook for corporate profit growth and the health of the global financial system in general.
- On a more positive note, a number of institutions have recently announced major recapitalisation plans and global central banks have aggressively added liquidity to the global financial system.

***OMIGSA view:** Global financial markets will remain volatile for some time to come due to lingering concerns over the health of the global financial system and worries over corporate profit growth as economic activity slows.*

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Local Economic Overview and Outlook

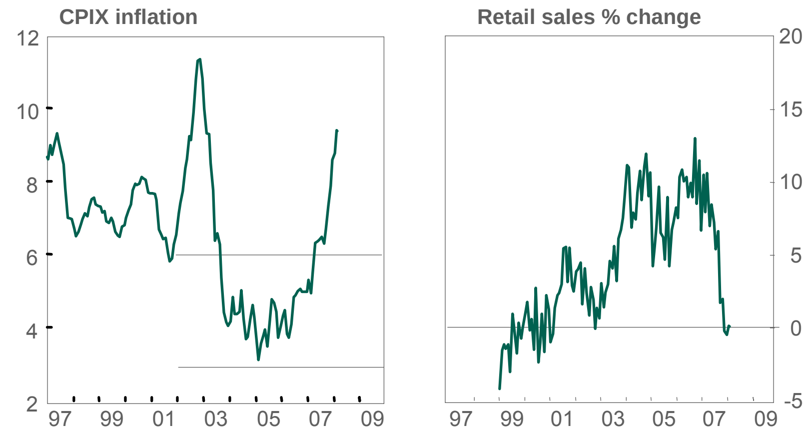
- Following the slump in domestic confidence during January and February over the electricity crisis, a sharp fall in the rand and uncertainty over future economic policies, the past month saw a number of further unwelcome developments. These included a further sharp weakening of the rand, more bad inflation numbers, signs of a more severe slowdown in local economic activity than was generally expected and Eskom's shock announcement that it will be seeking a massive increase in electricity tariffs.
- The adverse developments on the inflation front has prompted the Reserve Bank to raise rates again at its April meeting.
- With inflation risks remaining to the upside, rates will remain elevated for an extended period of time.

***OMIGSA view:** With inflation risks still high, local interest rates will remain elevated for an extended period of time.*

- As signs mounted that economic activity, and consumer spending in particular, is slowing sharply, pessimism around the economic outlook for 2008 and beyond deepened further. While the downside risks to the performance of the economy cannot be ignored or denied we still believe that these fears are exaggerated at this stage.
- While the electricity shortages and past two years of policy tightening will undoubtedly cause growth to ease notably this year from about 5% a year recorded for the past four years, to between 3.5% and 4% this year, we do not agree with some analysts' views that the economy is heading for a slump.
- Importantly, government's infrastructure drive will gather considerable further momentum over the next three years and the weaker rand will provide a big boost to industry, mining, agriculture and tourism.
- So while a cyclical slowdown is clearly underway, fears of a severe slowdown locally seem unjustified.
- However, we do expect a considerable slowdown in consumer spending. Consumption is already slowing sharply, as reflected in weak car and retail sales, and these will probably remain depressed for the remainder of the year, as high fuel and food prices and sustained high interest rates take their toll.

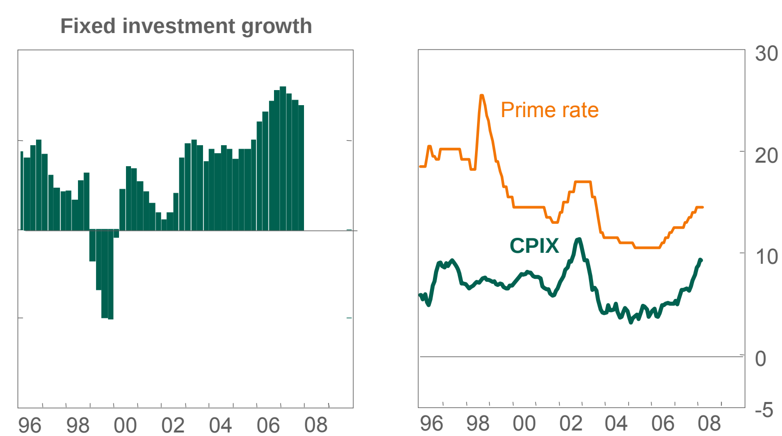
***OMIGSA view**: Growth will slow this year, but fears of a severe downturn locally are exaggerated. Government's infrastructure drive will gain momentum and a weaker rand will lend strong support to key sectors.*

Inflation surges and consumer spending growth stalls



Source: OMIGSA (Iris)

Investment growth strong, will rates rise again?



Source: OMIGSA (Iris)

Equity Sector Overview and Outlook

Resources

- Commodity prices rallied across the board in March due to supply disruptions, a weaker dollar and inflation concerns.
- Further production problems or strike action may cause commodity prices to move even higher temporarily.
- We expect most non-gold companies to continue posting record results.
- SA mining companies in particular will achieve even higher levels of profitability than their peers due to the currency advantage.
- With record cash flows, company balance sheets are strong, supporting mergers and acquisitions, organic growth and returns to shareholders.
- However, cost pressures are on the rise again; for example wage demands are increasing and producer currencies are strengthening.
- The global macro-economic outlook continues to signal slower growth for 2008, which should put a dampener on some commodity prices going forward. This is likely to be offset somewhat by strong growth and infrastructure spending in the emerging markets. So while some commodity prices may come off, there are others we believe will perform quite well.

OMIGSA 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. However, mining valuations are relatively less compelling, given the recent strong share price performance. Fundamentals and relative valuations are improving for some non-mining resource companies.*

Small Companies

- It is typical that during periods of uncertainty and negative returns, investors will seek out more certainty and therefore move to shares of higher perceived quality and liquidity.
- The sharp decline in markets at the start of 2008 signals the end of a long period of very strong returns delivered by the small-cap sector. We believe that this will result in a slowdown in all corporate activity, specifically new listings, private equity takeovers and black economic empowerment (BEE) deals. Most of the companies that have reported or released trading statements are showing some slowing in earnings and the prospects statements are taking on a more bearish tone for the year ahead. Most companies highlight high interest rates, the state of the consumer, the electricity cuts, the National Credit Act and skills shortages as key concerns going forward.
- Small-caps have built substantially stronger balance sheets compared with three years ago and special dividends and share buy-backs are becoming more prevalent. Organic growth and growth by acquisition are features of many of the companies in which we are invested.
- 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.

OMIGSA view: *The average price:earnings (P/E) relative at which small-caps trade compared with large-caps has increased to about a 33% discount. This seems to be an extreme level and we would expect to see a narrowing of this large discount. Mid-cap shares are currently trading at a 14% discount to the large-cap P/E.*

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Equity Sector Overview and Outlook (cont.)

Financials

- The financial sector returned negative 12.8% for the first quarter of 2008, which was below the negative 0.3% return of the SWIX.
- The financial sector was hurt by:
  - Negative sentiment due to the deepening of the global credit crisis that culminated in the demise of Bear Sterns during the quarter.
  - Significant weakening of the rand during the quarter, which will have a negative impact on inflation and increases the risks for further interest rate hikes during 2008.
- We believe that 2008 will be a more challenging year for banks and expect the rate of their earnings growth to slow, but this has been more than discounted into their current share prices.
- The insurance sector had another poor quarter, underperforming the SWIX. We still believe that there are structural headwinds facing the sector, but valuations are starting to look attractive on a selective basis.

***OMIGSA view:** Banking sector shares remain attractive on valuation grounds and hence we still see value. Life companies continue to face headwinds and will face low sales. However, we see value on a selective basis.*

Industrials

- 2008 has proved to be a tough year so far for the industrial sector, down 6% in the first quarter, with hardly a share being spared in the sell-down.
- In general, the sector has fallen out of favour with foreign investors, leaving only local investors now bottom-fishing for bargains.
- More support has been evident in the construction sector than in other industrials due to the substantial amount of guaranteed revenue coming to them through the infrastructure drive. The premium to the other industrials continues to expand.
- Well diversified shares and defensive shares like Bidvest and Remgro have provided a bit of protection in the past months, and the rand hedges have proven to be the safest place to be given the rand's weakness.
- Telecoms are also proving to be a safehaven, as consumers are not expected to cut down on communication expenditure significantly. We prefer MTN, which is geographically well-diversified.
- Even the food retailers generally considered defensive – have taken a knock, and while projections for food inflation remain high, the earnings of these shares should be well protected.

***OMIGSA view:** We retain a defensive view on industrials and would avoid large exposure to cyclical shares as the cycle seems to be longer than originally thought. We also have a preference for internationally diversified companies. There are, however, some compelling valuations where we are prepared to bide our time.*

Equity Sector Overview and Outlook (cont.)

Property

- The listed property sector returned -10.9% during the first quarter of 2008 compared with 2.9% for the All Share Index. This performance must, however, be considered within the context of a rampant resources sector and weak financial & industrial sector (-7.2%).
- Domestic macro-economic and global factors, rather than property-specific issues, have been the cause of the poor returns. High fuel, food and commodity prices are global phenomena that continue to present significant inflationary risk. SA looks set to enter a sustained period of critical investment by especially the public sector that will add to pricing pressure. Consequently, the cost of capital (debt and equity) is likely to continue to remain at least at current levels for the short to medium term. Listed property prices are expected to remain volatile in this environment for the foreseeable future.
- Low vacancy rates and the increasing difficulty in developing new stock is key to keeping market rentals rising, albeit at an expected slower pace. Increased borrowing costs will pressurise income statements. Overall, we expect distribution growth to slow from 13% year-on-year in 2007 to around 11% in 2008, slowing to 10-11% in 2010 – importantly, still above inflation.

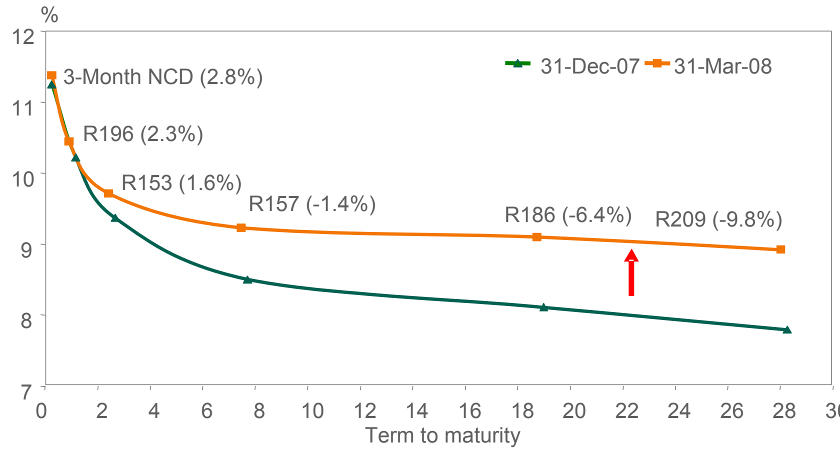
***OMIGSA view:** Listed property offers attractive returns, but capital market risk is elevated. Property offers better risk-adjusted return prospects than cash or bonds over the medium term given defensive above-inflation income growth.*

Fixed Interest Overview and Outlook

- Global risk aversion continued in March due to sub-prime mortgage-related woes, while concerns increased about slower global economic growth, partly reflected by lower US treasury bond yields and widening emerging market bond spreads.
- Locally, the negative news flow gained momentum with the rand weakness and worse-than-expected inflation and monetary data continued to cause bond yields to rise and the yield curve to flatten.
- As a result, cash and short-dated bonds again outperformed long-dated bonds over the period.

***OMIGSA view:** Our long-held view of yield curve normalisation is unfolding. It is debatable whether long-term inflation expectations are anchored in the 3% to 6% target range. This implies that long bond yields have potential to rise further relative to short-dated rates/yields.*

SA yield curve is normalising (returns in brackets)

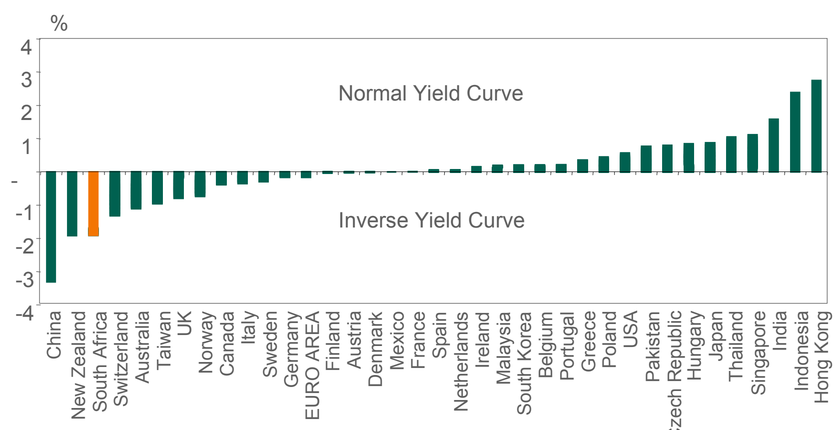


Source: I-net, OMIGSA

- Relative to the nominal bonds and CPI-linkers, the money market still offers best value on a risk-adjusted basis, hence the large holding within the Balanced and Enhanced Income Funds.
- Within the money market building block, we will continue to accumulate 12-month NCD's above 12%, as well as floating rate notes at better spreads.
- Within the bond building block, we will maintain an underweight duration tilt, but we will be looking for tactical trading opportunities given the yield retracement of late.
- We will maintain the underweight position in the 12+ year maturity band given rising inflation uncertainty and rising net issuance of long-dated debt.

***OMIGSA view:** South Africa still has one of the most inverted yield curves in the world. This makes little sense given rising medium- to long-term inflation uncertainty.*

SA yield curve still one of most inverted in the world



Source: Bloomberg, OMIGSA

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Economic Indicators to March 2008

	Latest Data		Previous Year
Exchange Rates:			
Rand/US$	March-08	8.12	7.25
Rand/UK Pound	March-08	16.13	14.22
Rand/Euro	March-08	12.85	9.59
Rand/Aus$	March-08	7.41	5.84
Interest Rates:			
Prime Overdraft	March-08	14.50%	12.50%
3-month NCD rate	March-08	11.30%	9.10%
R157 Long Bond Yield	March-08	9.23%	7.84%
Inflation:			
CPI (y-o-y)	February-08	9.8%	5.7%
CPIX (y-o-y)	February-08	9.4%	4.9%
National Accounts:			
GDP Growth (y-o-y)	December-07	4.9%	5.8%
GDP Growth (q-o-q, annualised)	December-07	5.3%	6.0%
HCE Growth (y-o-y) (Household Consumption Expenditure)	December-07	5.1%	9.1%
GFCF Growth (y-o-y) (Gross Fixed Capital Formation)	December-07	13.8%	15.5%
Balance of Payments:			
Trade Balance (cumulative 12month)	February-08	-$10.36	-$9.49
Current Account (% of GDP)	December-07	-7.5%	-7.8%
Capital Account (% of GDP)	December-07	10.3%	9.3%
Forex Reserves (incl. gold)	February-08	$34.18	$26.73
Other:			
Manufacturing Production (y-o-y) (seasonally adjusted)	January-08	1.5%	6.2%

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Market Indicators to March 2008

	1 Month (%)	Calendar Year (%)	Quarter (%)	12 Months (%)	3 Yrs (%)	5 Yrs (%)
Equity						
All Share Index	-3.0	2.9	2.9	11.1	34.0	34.7
Shareholders Weighted Index	-3.4	-0.4	-0.4	6.3	31.9	-
All Share/Resources 50%	-3.0	-1.2	-1.2	5.7	30.4	34.2
Top 40 Index	-2.9	5.1	5.1	14.0	34.7	34.6
Resources Index	-3.3	17.6	17.6	31.9	47.5	35.9
Financial Index	-6.6	-12.8	-12.8	-16.3	17.6	27.8
Industrial Index	-0.9	-6.4	-6.4	3.0	28.4	36.8
Mid-cap Index	-4.5	-10.8	-10.8	-7.8	27.9	33.4
Small-cap Index	-3.7	-10.2	-10.2	2.5	35.9	44.0
Interest-Bearing						
ALBI BEASSA	-0.5	-1.9	-1.9	0.6	6.2	9.2
STEFI	0.9	2.6	2.6	10.0	8.3	8.7
Cash	0.8	2.6	2.6	9.9	7.8	7.8
Property						
SA Quoted Property Index	-4.0	-10.9	-10.9	-2.6	27.2	-
International						
MSCI World Index (R)	3.7	8.3	8.3	9.0	20.4	17.3
MSCI World Index ($)	-0.9	-9.0	-9.0	-2.8	10.2	16.5
JPM International Bond (R)	7.9	30.3	30.3	34.4	17.2	8.7
US 1-month LIBOR (R)	5.0	20.3	20.3	18.0	14.4	4.1
Inflation (Estimated)						
CPI	1.3	2.7	2.7	10.2	6.5	4.6
CPIX	1.2	2.9	2.9	9.6	6.3	5.4

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Regulatory Information

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