

Market Dynamics

May 2011

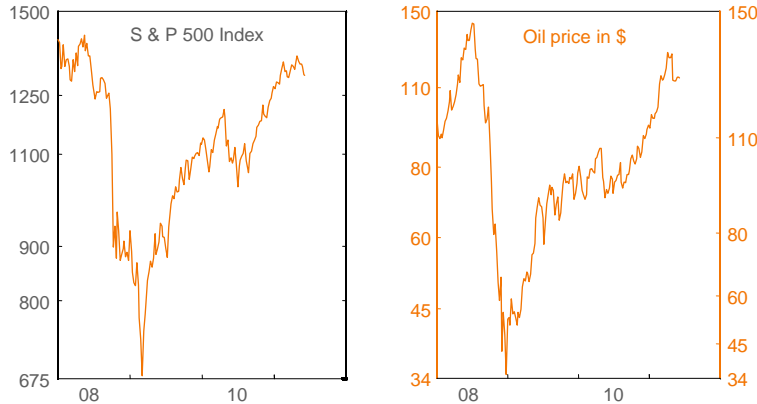


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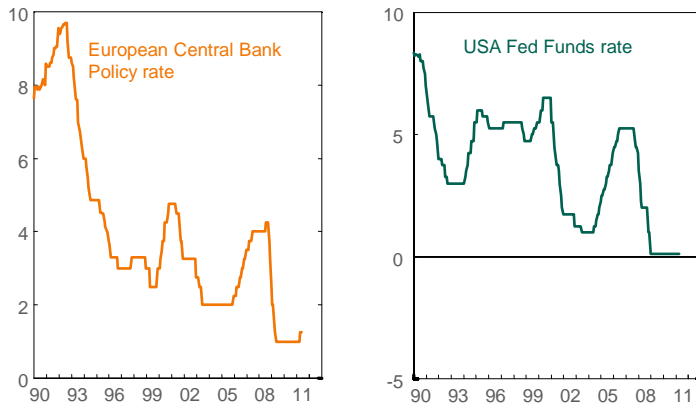
World Economic Overview and Outlook

Worries hit markets



Source: OMIGSA (Iris)

Interest rates rising outside of the USA



Source: OMIGSA (Iris)

- ▲ The month of May saw a continuation and intensification of the concerns that plagued global investors in April. These included: the economic implications of the disaster in Japan; sustained high oil prices; rising inflation in many countries; further policy tightening by a number of central banks; a flare-up in concerns over Greece's fiscal position; another warning to US lawmakers (this time by Moody's, following on a similar warning by Standard & Poor's earlier) to get the US's fiscal house in order or face an unprecedented sovereign debt rating downgrade; downgrades to 2011 growth forecasts for a number of countries; and growing fears of a sharper slowdown in China as still-rising inflation pressures may force aggressive further policy tightening over the remainder of 2011.
- ▲ Whereas in April global equity markets largely ignored the worsening macro-economic data flow (instead focusing on solid earnings reports out of the USA) and rallied solidly, May saw a pretty strong reversal as global macro worries finally took their toll on markets. Contrary to the sell-off in equities, bonds rallied, with the US 10-year yield, for example, falling to just above 3.0% by month-end, from a recent high of around 3.70% in February.
- ▲ Global macro data flow has indeed deteriorated considerably in recent weeks, and a clear growth slowdown is now in place in many countries, with data out of the USA and China causing most concern (partly also because of the sheer importance of both countries to the world economy). As an example of the deteriorating macro conditions, the US GDP growth forecast for 2011, which was as high as 3.3% still in March, has subsequently been cut back to just over 2.5%. The real uncertainty on investors' minds is whether the current growth momentum loss is yet another temporary slowdown or the start of a more extended cyclical downturn. We favour the former.
- ▲ Meanwhile, global inflation concerns still remain very much alive, despite having eased over the past month as growth slowed and commodity prices eased. As a result, the global tightening cycle will continue, although it may also pause in the months to come.

OMIGSA Economic Research Unit view: *Global growth fears are rising on weaker incoming macro data and fears over considerable fiscal tightening around the world. However, we remain confident that the expansion will not be derailed and that the momentum loss currently underway will prove to be temporary.*



OLD MUTUAL

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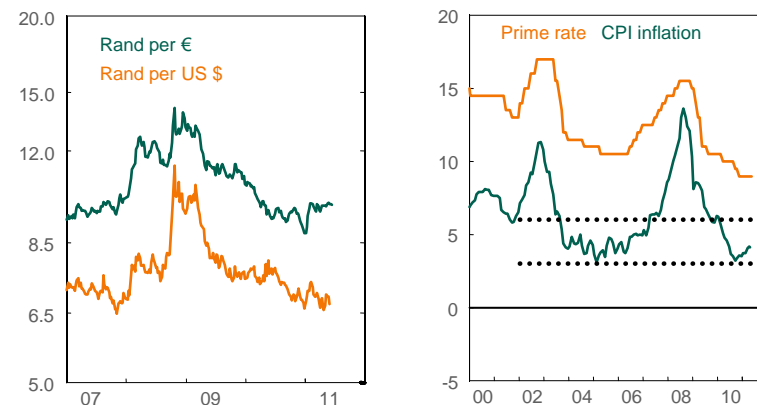
Equity
Research

Local Economic Overview and Outlook

- ▲ Global macro-economic concerns barely affected the rand in May. While the rand weakened against the US dollar, it moved basically sideways against most of the other major global currencies. Reasonably good economic news out of South Africa, together with still-firm precious metal prices and relatively high bond yields in a global context, continued to attract inflows into the local bond market, supporting the rand.
- ▲ Our view that the local recovery remains on track was borne out by the release of strong GDP data for the first quarter, which came in at a seasonally adjusted annualised rate of 4.8%, beating consensus estimates of a 4.2% gain. Encouragingly, manufacturing output showed the strongest gains, and all other sectors, bar agriculture and construction, recorded solid quarterly gains. Agricultural output contracted in the first quarter, but this followed on strong gains in 2010. Disappointingly, construction activity is yet to show any signs of recovery. This is a clear sign that government infrastructure activity, which slowed sharply after the Soccer World Cup, is yet to regain momentum. Nevertheless, our long-held view that growth for 2011 will be 3.5% - 4.0% remains on track.
- ▲ Inflation is now in a cyclical rising phase. After bottoming at 3.2% in September 2010, inflation drifted up to 4.2% by April 2011, driven primarily by food and energy prices. While the cyclical rise in inflation was widely anticipated, it has so far been slower than expected, despite the unexpectedly strong rise in global oil prices. Fortunately, the strong rand continues to act as a pretty powerful brake on inflation in a broader context.
- ▲ This still implies that a relatively stable rand over the remainder of 2011 is key to inflation prospects for the year. As we expect the rand to remain relatively well behaved during the remainder of the year, we don't expect inflation pressures to build to such an extent as to cause the South African Reserve Bank (SARB) to tighten policy unexpectedly aggressively or much earlier than currently forecast.

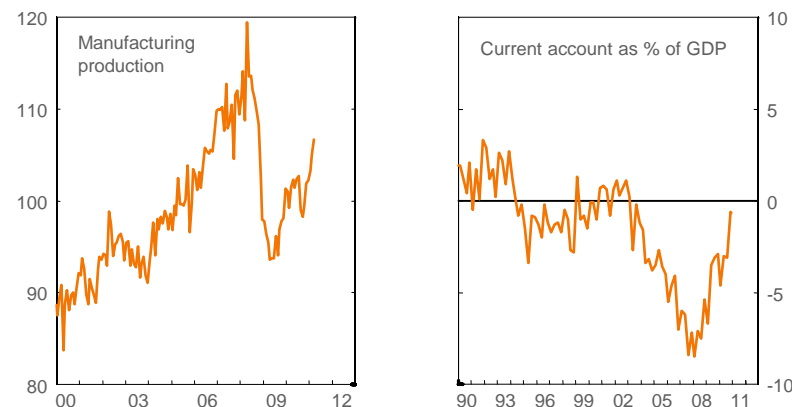
OMIGSA Economic Research Unit view: *The local recovery remains on track, with the latest data surprising on the upside. However, weakness in a number of areas still stands in the way of a faster recovery. Inflation is on a moderate up-trend and interest rates are expected to start to rise somewhere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

Rand firms, inflation on moderate uptrend



Source: OMIGSA (Iris)

SA recovery on track, current account deficit small



Source: OMIGSA (Iris)



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Equity Sector Overview and Outlook

Resources

- ▲ The basic materials sector produced a return of -2.4% for May 2011, underperforming the FTSE/JSE All Share Index (ALSI)'s -0.8% return.
- ▲ Even in the negative environment, some of the sectors still performed strongly, with positive returns from the chemicals and paper sectors. The largest laggards were the coal mining, platinum and gold sectors.
- ▲ Although the immediate catalyst for a downturn is not obvious, there remain risks associated with a slowdown in China, or continuing problems with the high debt levels in Europe. With commodity prices generally still around record highs, we believe that it's not the time to take aggressive bets, and generally the Old Mutual Mining & Resources Fund is still positioned defensively.
- ▲ While the very strong rand has dampened the short-term outlook for some shares and the performance of the fund, it is also an ideal time to increase our offshore exposure to further optimise the risk-adjusted return of the fund.

Equity 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. Diversified miners' valuations are relatively more compelling than smaller or single commodity plays. Non-mining resources companies' valuations are relatively attractive, too.*

Small Companies

- ▲ The small cap and mid-cap indices returned -0.2% and 0.4%, respectively, for the month ended 31 May 2011, while the FTSE/JSE Top 40 Index returned -1%. The outperformance of shares at the mid-cap level was probably a function of the better performing retail shares, as large resources stocks were weaker.
- ▲ The market performance has been fairly pedestrian for the year so far. Most of the uncertainty is stemming from the slower economic growth outlook. Emerging markets are showing slower numbers and inflation is picking up substantially in these areas. The success of the quantitative easing policies is increasingly being questioned, and the belief in austerity packages is starting to wane. The European debt restructurings, exits from the Eurozone and the survival of the euro are still big question marks. Sovereign debt default remains one of the biggest issues for investors currently, and the yields on some government bonds are indicating a very real possibility of defaults occurring. Markets continue to be nervous given the socio-political events unfolding in the Middle East and the potential for debt default in the Eurozone.
- ▲ Economic growth forecasts are being revised down and sovereign debt concerns are a constant threat to investor confidence.

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 flat for the month, marginally ahead of the FTSE/JSE Shareholder Weighted All Share Index (SWIX), which was down 0.8%. Within financials, the Banking Index was flat, the life assurance sector was down 1.2%, while general financials added 2.4%.
- ▲ The insurance sector was dragged down by Old Mutual, which gave up most of last month's gains following an unspectacular first quarter operational update. However, losses in the sector were partially offset by a strong performance from Discovery after it launched a short-term Insurance business, with the news being positively received by the market. The share gained close to 4% in the month.
- ▲ Within banks and general financials, strong performance came mainly from Nedbank, which was up 2%, as well as Investec, which gained 7% in the month. However, these gains were offset by poor performance from other counters, notably African Bank which reported disappointing growth in earnings at their interims.
- ▲ For the balance of 2011, we expect the banks to continue the focus on costs as revenue growth remains subdued. Credit losses will continue to recover and potential interest rate hikes could provide some earnings support. Capital levels will also be a focus area with a 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

- ▲ May proved to be a lacklustre month for both the Industrial Index, which advanced 0.7%, and the total market, which declined by 0.8%.
- ▲ The companies with offshore exposure were the better performers during the month, helped by further weakness, particularly versus the pound. Richemont advanced 5%, helped by the release of some strong results and the news that the impact of the earthquake on the Japanese consumer was not as severe as had been expected. Historically, the Japanese are the biggest consumers of luxury goods, although the Chinese have succeeded them. British American Tobacco (BAT) increased 7% in the month. The one heavy weight industrial stock to come under some pressure was Kumba Iron Ore, which fell 3% in May.
- ▲ Investors continue to be wary of local consumer shares. Despite Mr Price and The Foschini Group reporting strong earnings growth, both shares lost ground in May. Investors seem worried that the consumer companies will begin to struggle once interest rates start to rise sometime later this year, or early next year.
- ▲ Tiger Brands' six-month earnings to March did decline slightly, but not as dramatically as expected. Their milling and baking business was negatively impacted by lower bread prices after the Competition Commission forced Pioneer to drop prices as part of its price-fixing fine. Many of Tiger Brands' other operations, like personal care and snacks, struggled against competitively priced imports. June could be a soft month for the retailers as the euphoric Soccer World Cup spending last year will be in the base.

Equity Research view: The industrial sector does not appear to have much upside as a whole. However, many shares in the sector remain relatively defensive, with strong balance sheets and dividend yields.



Equity Sector Overview and Outlook (cont.)

Property

- ▲ Listed property recovered from weakness early in the month to manage a 0.1% return for May. While this was above the FTSE/JSE All Share Index's -0.8% and general retailers' -2.7%, it was disappointing. This is because the All Bond Index provided a 1.4% return as bond yields fell while property yields increased. Since higher yields reflect lower prices, this has reversed some of the pricing gains relative to bonds the sector has enjoyed this quarter.
- ▲ Redefine, Fountainhead and Vukile reported results during the month. Fountainhead and Redefine showed poor distribution growth because of company-specific factors which did not reflect comparable net property income growth. Vukile surprised with a 9% increase in distributions. While its core performance was good, this headline growth was flattered by lumpy non-annuity income.
- ▲ The Old Mutual SA Quoted Property unit trust fund supported the new listing in May of an entrepreneurial BEE managed property fund.

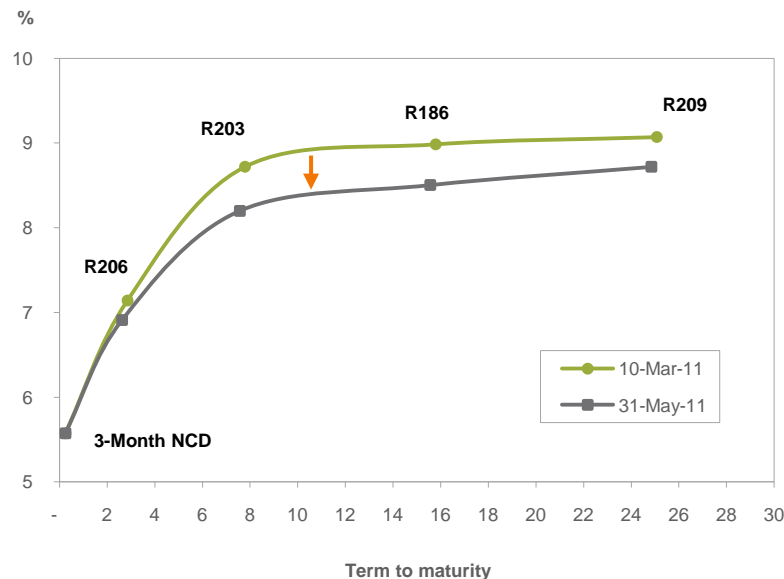
Equity Research view: *The sector offers a one-year forward yield of 8.5%, slightly above the 10-year bond yield, and distribution growth around inflation. Downside operational risk has declined and funding conditions are easier. Commercial building plans passed have fallen materially, which will facilitate rental increases in the recovery. 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). Large capital raisings may constrain prices. The direct commercial property market remains resilient. On a long-term secular view, property is attractive as existing rents are below feasibility rentals for new developments.*



Fixed Interest Overview and Outlook

- Lower bond yields in advanced market economies, a sharp decline in crude oil prices, better-than-expected local inflation data, the decision by the South African Reserve Bank (SARB) to keep the repo rate at a multi-decade low and large net purchases of local bonds by non-residents (R13.8bn) were the main supporting factors during May 2011. As a result, local bond yields continued to drift lower. In the process, the yield of the RSA 10-year government bond declined by 15 basis points, to close at 8.3%. The real yield of inflation-linked bonds also decreased during the month, as the demand for protection against possible higher inflation outstripped supply. As a result, the inflation-linked bond index rendered a strong return of 1.9%, followed by 1.4% from the All Bond Index (for fixed-rate bonds). Both handsomely outperformed cash, which only delivered 0.4%.
- Recent market events did not change our core investment view and, therefore, our broadly defensive investment strategy. Markets do not move in a straight line and the recent pull-back in bond yields was anticipated. Although inflation has behaved relatively well until now, partly due to the lagged effect of the rand's strength, the medium-term outlook remains a concern from an interest rate point of view. It therefore follows that the central bank will be required to start the policy-tightening cycle later this year – as a repo rate at its lowest level since 1974 is unsustainable against this background.
- A sizeable holding of cash, variable-rate bonds and inflation-linked bonds are preferred over fixed-rate bonds. The current steepness of the yield-curve slope and the expectation of monetary policy tightening in the month ahead, favour a reduction of short- and medium-dated bonds.

The South African yield curve has flattened by 50 basis points since the peak in market rates in early March 2011



Sources: JSE, Futuregrowth

Futuregrowth view:

Current market strength offers an opportunity to reduce the holding of short- and medium-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 is contributing to a slightly improved outlook for inflation-linked bonds, despite low real yields.

Economic Indicators to 31 May 2011

	Latest Data		Previous Year
Exchange Rates:			
Rand/US\$	May-11	6.80	7.66
Rand/UK Pound	May-11	11.18	11.12
Rand/Euro	May-11	9.81	9.43
Rand/Aus\$	May-11	7.27	6.49
Interest Rates:			
Prime Overdraft	May-11	9.00%	10.00%
3-month NCD rate	May-11	5.50%	6.55%
R157 Long Bond Yield	May-11	7.53%	8.04%
Inflation:			
CPI (y-o-y)	April-11	4.2%	4.8%
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)	December-10	5.2%	-0.4%
GFCF Growth (y-o-y) (Gross Fixed Capital Formation)	December-10	0.2%	-9.9%
Balance of Payments:			
Trade Balance (cumulative 12month)	April-11	\$2.12	-\$1.25
Current Account (% of GDP)	December-10	-0.6%	-2.9%
Capital Account (% of GDP)	December-10	0.2%	3.5%
Forex Reserves (incl. gold)	April-11	\$49.70	\$42.17
Other:			
Manufacturing Production (y-o-y) (seasonally adjusted)	March-11	4.4%	6.7%

Source: OMIGSA

Market Indicators to 31 May 2011

	1 Month (%)	Quarter (%)	Calendar Year (%)	12 Months (%)	3 Yrs (%)	5 Yrs (%)
Equity						
All Share Index	-0.8	2.0	2.6	23.2	3.6	12.6
Shareholders Weighted Index	-0.8	3.6	2.2	22.2	5.7	13.1
All Share/Resources 50%	-0.3	3.7	3.2	24.2	6.6	13.2
Top 40 Index	-1.0	1.8	3.3	24.2	1.9	12.2
RAFI® 40 Index	-0.9	1.7	3.6	23.1	8.3	13.9
RAFI® All Share Index	-0.9	1.3	2.5	23.2	7.7	13.1
Resources Index	-2.8	-4.6	-0.0	19.5	-6.1	10.3
Financial Index	0.4	6.1	4.0	15.9	11.5	7.8
Industrial Index	0.7	7.0	4.5	30.5	12.7	17.6
Mid-cap Index	0.4	3.5	-1.3	17.8	18.0	15.6
Small-cap Index	-0.2	1.6	-3.0	16.2	8.1	12.1
Interest-Bearing						
ALBI BEASSA	1.4	4.2	2.1	11.4	12.7	8.0
STeFI	0.5	1.4	2.4	6.3	8.5	8.8
Cash	0.4	1.2	2.0	5.3	7.5	8.2
Property						
SA Quoted Property Index	0.1	7.3	1.6	20.3	22.3	15.2
International						
MSCI World Index (R)	1.6	-0.3	10.7	14.3	-4.8	3.6
MSCI World Index (\$)	-2.0	1.3	7.3	28.7	-1.2	3.2
JPM International Bond (R)	3.7	1.8	7.0	-0.3	2.6	7.8
US 1-month LIBOR (R)	3.7	-1.6	3.3	-11.0	-2.6	3.1
Inflation (Estimated)						
CPI	0.3	1.7	2.9	4.3	5.6	7.1

Source: OMIGSA

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Regulatory Information

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