

Market Dynamics

October 2011

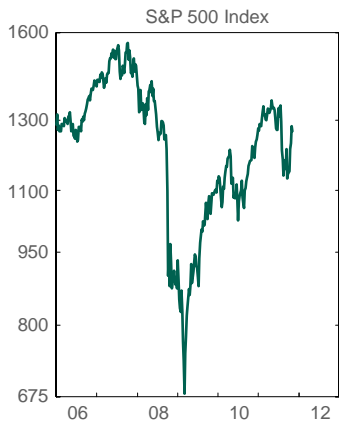


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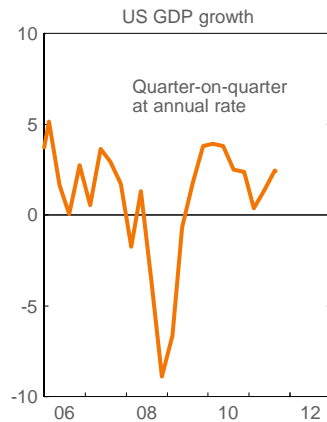
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World Economic Overview and Outlook

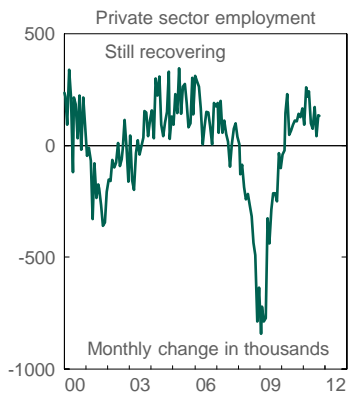
Big rally on EU debt plan & good USA data



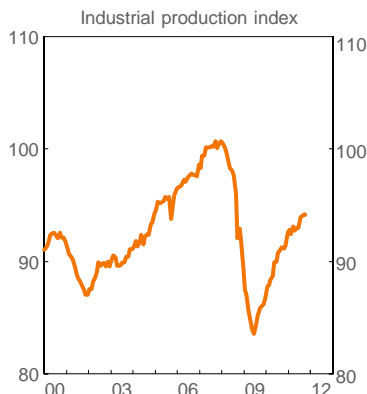
Source: OMIGSA (Iris)



USA data surprises on the upside



Source: OMIGSA (Iris)



- ▲ Following a severe sell-off in global equity markets in September, October saw a scorching rally, with most markets far offsetting the previous month's losses. Three factors played a key role in the rally. First, European Union (EU) policy makers finally came up with a plan to contain the EU sovereign debt crisis; second, incoming macro-economic data surprised mostly on the upside, damping fears of another full-blown global downturn; and third, US company earnings reports for the third quarter surprised firmly on the upside.
- ▲ The EU plan to deal with the immediate Greek crisis and also designed to deal with possible similar troubles in other EU countries, was received with great relief by financial markets. While the finer details of the plan were not yet available at the time of writing, markets appeared to give EU policy makers the benefit of the doubt, implying that this attempt to deal with the crisis has far greater credibility than previous efforts.
- ▲ Yet, while the initial market reaction was positive, the problem will not disappear as a key issue any time soon. Painful fiscal tightening and pedestrian economic growth still lie ahead for many EU countries for an extended period, and are likely to cause more bouts of extreme volatility. Nevertheless, for the first time since the crisis broke more than a year ago, there appears to be some light at the end of the tunnel.
- ▲ US economic data surprised mostly to the upside over the past few months and this was reflected in the third quarter GDP rising at an annualised rate of 2.5%. Solid demand growth of 3.5% annualised was not fully met by production gains, causing inventory investment to slow sharply. Inventory building may well add firmly to the fourth quarter production in the US. The latest data moderated fears that the US economy is on the verge of another full-blown downturn.
- ▲ By the end of the month, the US third quarter corporate earnings reporting season was just over halfway complete, and results were generally very good, despite some high-profile disappointments. The available results suggest that companies have weathered the storm well and are generally financially sound.

OMIGSA Economic Research Unit view: A more credible EU debt plan, good macro-economic data out of the USA and solid third quarter earnings reports by US companies suggest that the worst of the panic in recent months may be over. Nevertheless, the world still faces considerable challenges and market volatility will remain high for some time to come.



OLD MUTUAL

Investment Group

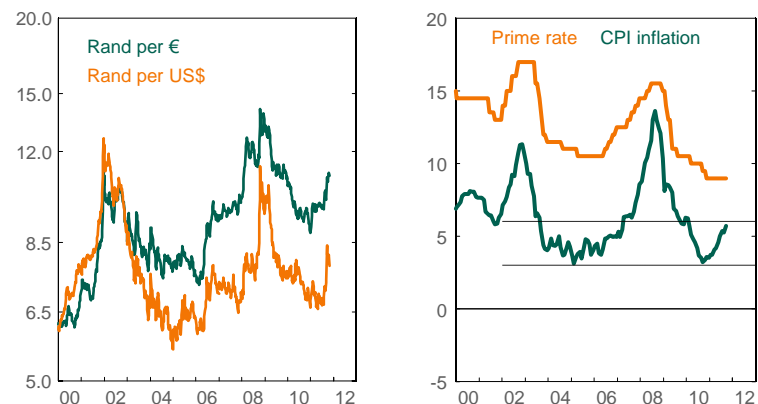
Equity
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Local Economic Overview and Outlook

- ▲ Concerns over prospects for the SA economy also lifted a bit over the past month. Incoming economic data pointed to some acceleration in activity from the depressed second quarter levels, while fading fears about the immediate prospects for the world economy also added to a less gloomy view of the local situation.
- ▲ On the local data front, a number of indicators such as manufacturing and mining production, as well as auto, retail and cement sales, all portrayed signs of recovery from the depressed levels earlier in the year. Nevertheless, third quarter GDP growth will likely still be slow, given the weakness in the early part of the quarter. We expected annualised growth of about 2% in the quarter, but if the recent trend in the high frequency data is sustained, the fourth quarter of 2011 should see a further acceleration. Growth for the full year is still expected to be a little over 3%, with roughly similar prospects for 2012.
- ▲ A key feature of the local recovery remains the slow growth in credit extension by banks. This is likely to continue due to consumers still being focused on lowering their debt/income ratio, while local companies are generally cash-flush and not yet in an expansion mode.
- ▲ Government's Medium Term Budget Policy Statement was tabled over the past month. It contained no major surprises or shocks, even though the projected deficits for the next few years were revised upwards. While markets reacted positively to the fiscal plans, it is crucial that government indeed adheres to the deficit cutting plans over the next few years in order to prevent a fiscal crisis here. Controlling current government spending now becomes the key focus.
- ▲ With the economy still growing slowly, interest rates are set to remain on hold well into 2012, despite the weaker rand and an uptrend in inflation.

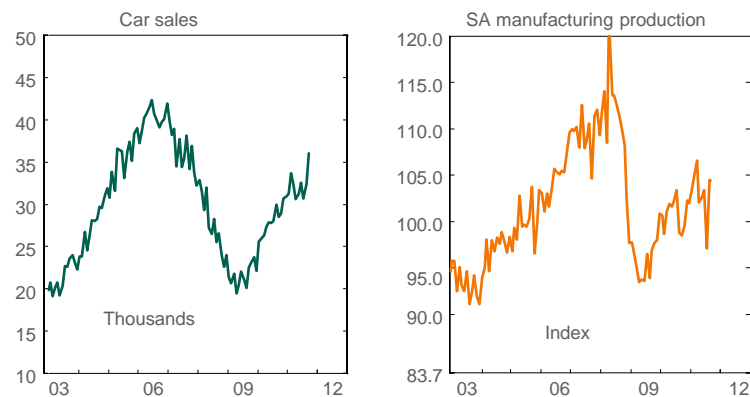
OMIGSA Economic Research Unit view: *The local recovery remains on track, and incoming data points to a moderate acceleration in activity in the third quarter. Growth for the full year is still expected to be around 3.3%. Interest rates are likely to remain on hold until deep into 2012.*

Rand weak on global worries, inflation rising



Source: OMIGSA (Iris)

Better real economy data in SA too



Source: OMIGSA (Iris)



Equity Sector Overview and Outlook

Resources

- ▲ The basic materials sector produced a return of 10.9% for the month of October 2011, outperforming the FTSE/JSE All Share Index (ALSI)'s return of 9.4%.
- ▲ On the back of (transitory) better sentiment about the possibilities of a solution to the Euro concerns, the mining sector (mainly the large mining houses) posted a strong recovery of 11.2% for the month. This follows a period where the shares have been under pressure and, although largely driven by the better sentiment, probably also came as a result of them being oversold in the previous two months. Industrial metals (steel) and oil & gas also delivered strong performances. For once, the gold sector was a relative laggard with a return of 7.9% for the month, underperforming the overall sector although in line with the return from the platinum sector. Those sectors with large exposure to Europe (predominately the paper sector) were still under pressure as improved sentiment failed to overcome the fact that demand in Europe is likely to fall in the near term.
- ▲ Commodity prices have all come off from mid-year highs and although the market fundamentals still appear to be reasonable, there is an increasing fragility to these fundamentals. At the very least some consumers – notably the hard-pressed steel mills – are taking advantage to force through pricing adjustments for raw materials. However, prices for most commodities are still above marginal cost levels and producers are still operating with comfortable margins. We believe that when the market calms down and confidence is regained, there will be a strong restocking cycle.

Equity Research view: *With the de-rating of the mining houses, the majority are now trading on ratings not seen since the dark days of 2008/2009, despite the fact that balance sheets have been significantly strengthened. We continue to favour the larger, higher quality, and/or better priced counters such as Anglo American and BHP Billiton, while the rand weakness has increased the attractiveness of certain of the SA-based miners.*

Small Companies

- ▲ The small cap and mid-cap indices returned 1.9% and 4.8%, respectively, for the month ending 31 October 2011, while the FTSE/JSE Top 40 Index returned 10.3%.
- ▲ The market is still focused on global growth, because growth is the only way countries can remove themselves from the shackles of their current debt structures. Global growth concerns, given excessive debt levels, are also making investors nervous. If growth does not materialise, how will countries resolve their current issues? This lack of investor confidence and belief in future growth makes the markets very volatile. Using a leveraged special purpose vehicle to deal with the Eurozone issues should be very concerning to any investor. Is this the only viable option left to the Eurozone? The Eurozone debt and political issues seem far more difficult to sort out and this area is dominating the news flow completely. Ultimately, some kind of Greek default would be appropriate and the ongoing German support is critical to sorting out most of the Eurozone problems. It also appears unlikely that the Chinese will be saving the Europeans from themselves anytime soon.
- ▲ Emerging markets have slowed, but are still expected to show robust growth over the next few years. China, in particular, appears to be slowing the growth rate, but ongoing demand for commodities will continue.

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



Equity Sector Overview and Outlook (cont.)

Financials

- ▲ The FTSE/JSE Financial Index had a strong month, gaining 5.8%. However, it underperformed the FTSE/JSE Shareholder Weighted All Share Index (SWIX), which was up 7.7% during the month.
- ▲ Within financials, the Banking Index gained 5.4%, while the life assurance sector gained 7.8%. The strong performance in the life sector was driven by Sanlam and Old Mutual up 9.6% and 8.6%, respectively.
- ▲ 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 will lift operating results in 2011. We believe some counters in the sector still present value, with ratings below historic averages.*

Industrials

- ▲ Both the FTSE/JSE All Share Industrials Index and the FTSE/JSE All Share Index (ALSI) bounced back strongly in October, with most of the gains being made in the last few days of the month, after the European Central Bank announced the bailout package for Greece. The rand was relatively stable over the month, after falling sharply in September. For the month, both the Industrial Index and the ALSI rose more than 9%. This means that for the year-to-date, the Industrial Index is up 9.5% and the ALSI up 3.5%.
- ▲ Richemont was up a massive 27%, buoyed by strong quarterly sales figures from other luxury companies like Gucci and LVMH, as well as continued strong growth in Swiss Watch Industry exports. Nearly all the local retailers recorded double digit advances: Truworths +14%, Mr Price +15%, Woolworths +15% and JD Group +16%.
- ▲ You had to search long and hard to find stocks that declined. Murray & Roberts was one of the few, down 7% for the month and 40% for the year. Murray & Roberts announced that it has another problem contract, this time in Australia, and it will be taking another write-off. Its two big recent write-offs relate to work it conducted on the Gautrain and on the Madupi power station.

Equity Research view: *Following the strong bounce in October, many of the industrial shares are looking expensive once again. This is particularly true for the higher quality businesses and the more defensive businesses.*



Equity Sector Overview and Outlook (cont.)

Property

- ▲ The FTSE/JSE SA Listed Property Index (SAPY) provided a 2.6% total return in October. This was lower than the All Bond Index's 2.8%, the FTSE/JSE All Share Index's 9.3% and General Retail's 14.1%.
- ▲ News flow over the month was disappointing, with the two specialist funds that reported showing a fall in distributions compared to the comparable period. The positive price impact of the 40 basis point reduction in bond yields allowed the sector to show positive growth over the month.
- ▲ Following the price movement, listed property now offers improved value relative to both nominal bonds and equities. It is more defensive compared to other equities as most of its earnings are based on medium-term contracts. As a result, it should perform better in an economic downswing.

Equity Research view: *The sector offers a one-year forward yield greater than 8%, which comfortably exceeds the 10-year bond yield, and distribution growth approximating inflation. Downside operational risk has reappeared, but base funding rates have reduced. Vacancies are plateauing, but may still increase in some pockets. 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 (a key concern). The direct commercial property market remains resilient, although signs of strain are appearing. On a long-term secular view, property is attractive as existing rents are below feasibility rentals for developments, even with softer building costs.*



OLD MUTUAL

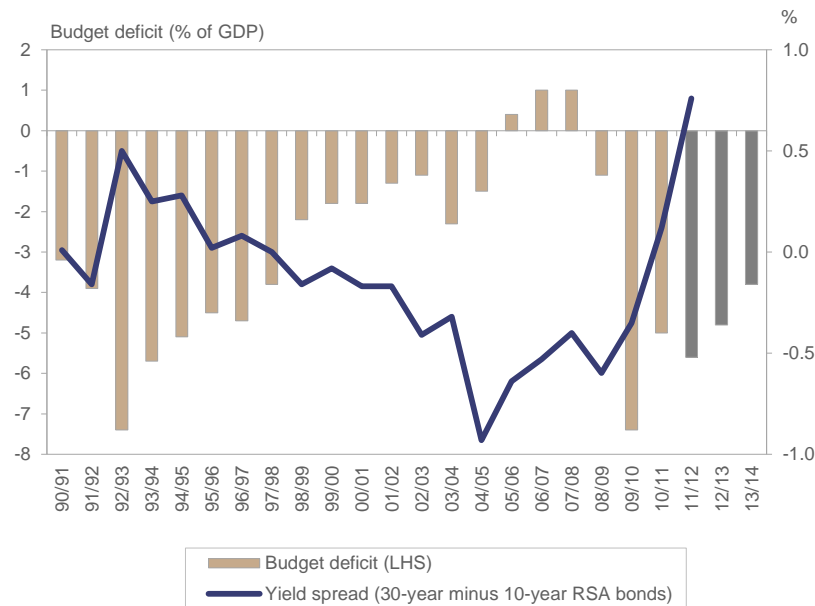
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Fixed Interest Overview and Outlook

- ▲ There is no doubt that the latest Eurozone agreement contains the most comprehensive list of actions of all the fourteen summits held over the last twenty-one months. It was no surprise, then, that the September bout of risk aversion made way for the so-called “risk-on” trade. For South Africa this meant net foreign bond purchases of just over R9.6bn in October, compared to a net outflow of R18bn the previous month. As a result, both the local currency and the bond markets have had a stronger month, although they failed to regain all the ground lost since the start of September. The yield of the 10-year RSA government bond rallied from 8.30% to close the month at 7.88%. In contrast, inflation-linked bond yields drifted higher, causing them to underperform cash and nominal bonds.
- ▲ Although comprehensive in terms of proposed actions, we believe that the latest Eurozone agreement still lacks important detail, contains some unrealistic macro assumptions and will, most likely, encounter obstacles on the long road to implementation. More importantly, it is far from certain that even the planned leveraged European Stability Fund will be large enough to ease rising tensions over the potential mega-problem, Italy. The fact that it struggled to convince investors to take up its bonds merely two days after the outcome of the recent summit, underscores the risk.
- ▲ Locally, steadily rising inflation behaved in line with our expectations, but we were somewhat bemused by the positive market reaction to the outcome of the Medium-Term Budget. The fact is that budget-deficit revisions for the current and forthcoming fiscal years have gradually deteriorated since October last year. The National Health Insurance “elephant”, risks to macro-economic assumptions and worrying trends in the composition of public spending (rising share of social grants and state employee bill at the cost of infrastructure improvement) all lengthen the list of concerns.

Yield curve slope is steepening sharply in reaction to rising inflation and the high net funding requirement



Sources: I-Net, National Treasury, Futuregrowth

Futuregrowth view:

Our investment view remains defensive, with focus on short-term capital preservation while carefully considering potential investment opportunities into market weakness, especially with regards to inflation-linked bonds.

Economic Indicators to 31 October 2011

	Latest Data		Previous Year
Exchange Rates:			
Rand/US\$	October-11	7.95	6.98
Rand/UK Pound	October-11	12.78	11.20
Rand/Euro	October-11	11.02	9.71
Rand/Aus\$	October-11	8.38	6.87
Interest Rates:			
Prime Overdraft	October-11	9.00%	9.50%
3-month NCD rate	October-11	5.50%	5.85%
R157 Long Bond Yield	October-11	6.59%	7.04%
Inflation:			
CPI (y-o-y)	September-11	5.7%	3.2%
National Accounts:			
GDP Growth (y-o-y)	June-11	3.2%	2.9%
GDP Growth (q-o-q, annualised)	June-11	1.3%	2.8%
HCE Growth (y-o-y) (Household Consumption Expenditure)	June-11	4.9%	4.7%
GFCF Growth (y-o-y) (Gross Fixed Capital Formation)	June-11	2.4%	-5.2%
Balance of Payments:			
Trade Balance (cumulative 12month)	September-11	\$1.08	-\$1.30
Current Account (% of GDP)	June-11	-3.3%	-2.9%
Capital Account (% of GDP)	June-11	3.3%	3.6%
Forex Reserves (incl. gold)	September-11	\$52.84	\$42.96
Other:			
Manufacturing Production (y-o-y) (seasonally adjusted)	August-11	5.8%	5.2%

Source: OMIGSA

Market Indicators to 31 October 2011

	1 Month (%)	Quarter (%)	Calendar Year (%)	12 Months (%)	3 Yrs (% p.a.)	5 Yrs (% p.a.)
Equity (FTSE/JSE)						
All Share Index	9.4	5.1	3.5	9.4	18.7	9.7
Shareholders Weighted Index	7.7	4.6	3.7	9.5	19.1	10.5
All Share/Resources 50%	8.9	5.1	5.1	10.7	19.5	10.5
Top 40 Index	10.4	5.7	4.0	10.2	18.0	9.2
RAFI® 40 Index	9.2	4.5	3.1	8.7	20.2	11.2
RAFI® All Share Index	9.7	3.7	1.7	7.4	19.0	10.4
Resources Index	11.2	4.7	-3.1	4.0	15.6	6.6
Financial Index	5.8	4.1	4.5	6.8	17.1	5.1
Industrial Index	9.5	5.8	9.5	15.8	22.2	15.3
Mid-cap Index	4.8	2.4	1.4	5.3	24.3	13.7
Small-cap Index	1.9	-0.5	-3.6	3.2	16.8	10.0
Interest-Bearing						
ALBI BEASSA	2.8	4.1	8.0	7.7	11.2	8.9
STeFI	0.5	1.4	4.8	5.8	7.6	8.6
Cash	0.4	1.2	4.1	4.9	6.6	8.0
Property						
SA Quoted Property Index	2.6	3.2	7.7	9.6	22.7	15.8
International						
MSCI World Index (R)	8.4	10.4	16.2	16.1	3.5	0.9
MSCI World Index (\$)	10.4	-6.2	-2.7	2.3	11.4	-0.4
JPM International Bond (R)	-1.5	18.8	28.1	18.1	1.3	9.3
US 1-month LIBOR (R)	-1.8	17.7	19.6	13.8	-6.5	3.7
Inflation (Estimated)						
CPI	0.3	1.1	5.5	5.9	5.1	7.0

Source: OMIGSA

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Regulatory Information

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