

Market Dynamics

September 2009



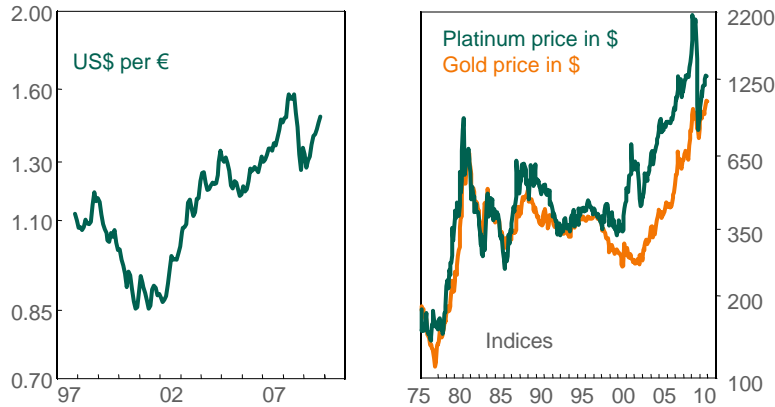
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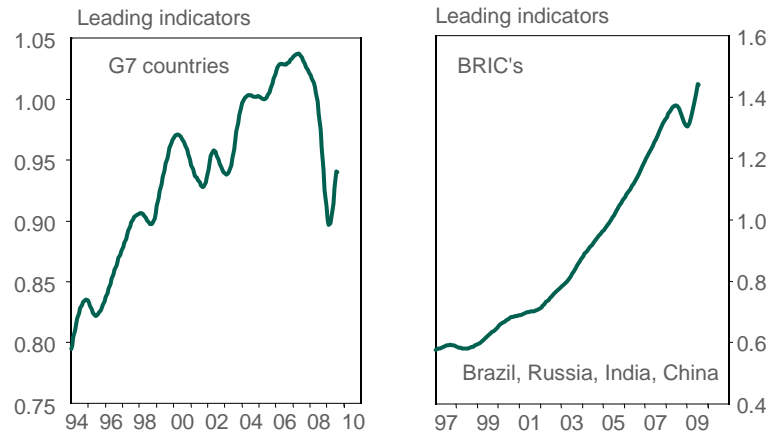
World Economic Overview and Outlook

US\$ weakens and precious metal prices rise



Source: OMI GSA (Iris)

Global recovery on track



Source: OMI GSA (Iris)

- ▲ The global stabilisation signs that have been emerging since April 2009 have gradually been transformed into outright economic recovery over the past few months. The upturn, which was first evident in Asia, has spread over a fairly broad front and overall global growth is likely to be fairly solid during the third quarter.
- ▲ The solid global recovery and extreme liquidity creation have undermined the value of the US dollar. As it slipped further over the past month against all major currencies, precious metal prices benefited, with gold rising to an all-time high.
- ▲ While the strength of the recent economic upturn has surprised most analysts, there are still considerable concerns over the sustainability of the recovery. The key concerns revolve around the eventual fading of stimulus measures, weak labour markets around the world and ongoing debt de-leveraging by highly indebted households in many parts of the world.
- ▲ We share these medium-term concerns. As a result, and given the limited risk of any meaningful rise in global inflation over the next 12 to 18 months, economic policy settings will remain expansionary until such time as policymakers are confident that the risk of a serious growth relapse has faded.
- ▲ Despite the stronger economic data over the past month and growing confidence that the world has already entered an economic recovery, global equity markets rose only moderately in August and September. This should not be too surprising, given the very strong rally since early March.

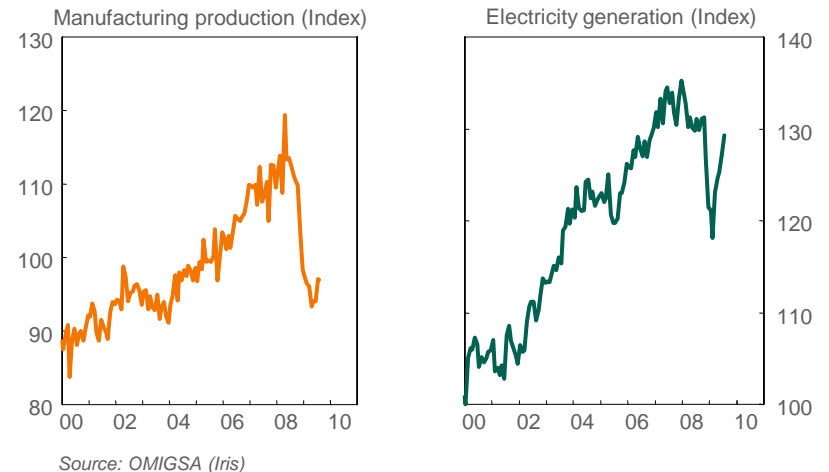
OMI GSA Economic Research Unit view: *While short-term prospects continue to brighten, there are still many obstacles and risks that cloud medium-term prospects.*

Local Economic Overview and Outlook

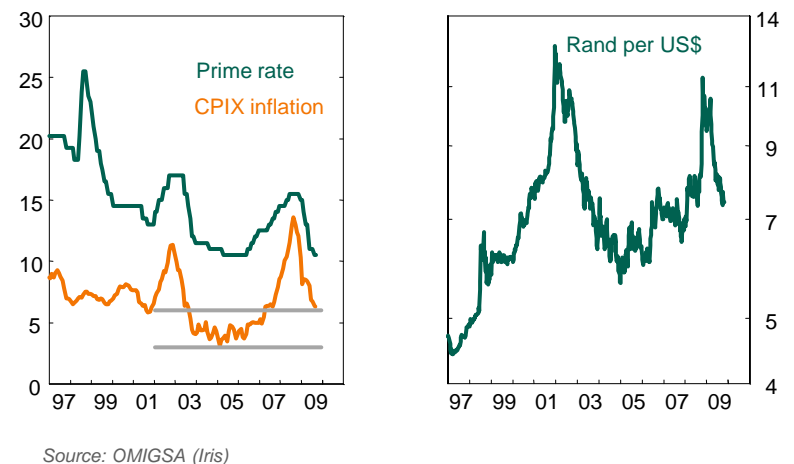
- ▲ The latest local data releases point to a moderate recovery in the local economy. The economically sensitive volume of electricity generated continued its uptrend in August and is more than 25% up from the cyclical low recorded in February. Key indicators, such as mining and manufacturing production, also rose in the past few months, pointing to a moderate recovery in Gross Domestic Product (GDP) in the third quarter, following the cumulative 3% decline over the preceding three quarters.
- ▲ While there are clear signs of a recovery in certain production sectors of the economy, consumer demand remains weak. Car sales are at best stabilising at extremely depressed levels, credit demand remains weak and retail sales are also yet to show any meaningful recovery signs.
- ▲ On a more positive note, inflation has eased a little further to 6.4% in August. The strong rand, decelerating food inflation and oil reasonably stable around \$70 per barrel hold the promise of a further deceleration in the months to come. But, while the shorter-term inflation prospects have improved, there are still some significant medium-term risks, including still-high wage demands, rapid rises in administered prices and stubbornly high inflation expectations.
- ▲ The rand remains firm, even though it eased off its recent strongest levels following the announcement that the proposed MTN/Bharti deal had been cancelled. With the global recovery on track, precious metal prices rising, the current account deficit narrowing and local interest rates still relatively high in a global context, the rand may remain on a firm footing for some time still.
- ▲ The interest rate outlook is now uncertain. With rates down sharply from their peaks and the economy showing early signs of recovery, chances are the SARB will now leave rates unchanged for some time. However, downside inflation surprises and/or failure of consumption to recover could trigger yet another rate cut.

OMIGSA Economic Research Unit view: *The local economy remains depressed and will recover only slowly during the second half of the year. This keeps open the possibility of a further lowering of local interest rates.*

Real economy showing signs of recovery



Inflation still easing, rates followed so far



Equity Sector Overview and Outlook

Resources

- ▲ The basic materials sector delivered a return of 12.6% for the third quarter versus the FTSE/JSE All Share Index's (ALSI) 13.9%, with the gold/PGM and oil/gas sectors underperforming.
- ▲ The initial strong performance was based on evidence of an earlier-than-expected recovery in China and India, with signs of stabilisation in the G7, dampened later by rapidly strengthening producer currencies such as the rand.
- ▲ We expect most 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 – such as Anglo American plc.

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 September '09 the small cap and mid-cap indices returned 1.7% and 2.8%, respectively, while the FTSE/JSE Top 40 Index decreased by 0.2%.
- ▲ The sustainability of the economic recovery becomes more convincing as more positive economic data emerges. Global markets have had a very strong bounce and have discounted a fair amount of this recovery already. The strength of the recovering earnings growth will determine how the markets react over the next six months.
- ▲ Many companies reporting results in this quarter to September '09 are showing that the last six months have been very tough and that the trading conditions remain difficult. Turnover numbers have not been that badly hit, but margins are under pressure. Current trading is starting to indicate that the top line is also now under some pressure and the majority of prospect statements remain very cautious.
- ▲ The risk appetite of investors appears to be picking up as the global momentum starts to improve. Small caps will also perform much better in a stronger rand environment; however, we do feel that the rand will be subject to shocks from these levels.

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. Lower interest rates will favour the relative performance of small over large caps.*

Equity Sector Overview and Outlook (cont.)

Financials

- ▲ The FTSE/JSE Financial Index had a strong performance over the quarter and marginally outperformed the FTSE/JSE Shareholder Weighted All Share Index (SWIX). The SWIX ended the quarter 13.9% up while the Financials Index gained 15.1%.
- ▲ Within the financial sector, the banking sector gained 14% while the life sector gained 17.4%. There was some strong performance from some small cap financials.
- ▲ The financial sector was buoyed by the second quarter's Gross Domestic Product (GDP) numbers that came in stronger than expected, raising hopes that the worst of the recession is over.
- ▲ We expect the operational environment for financial sector companies to remain tough in 2009 with loan impairment ratios for banks and policy termination rates for life companies remaining above trend.
- ▲ Although impairment ratios for banks are still trending up, the rate of decline has slowed, and we believe earnings will surprise in the medium term as the ratios begin to recover.

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

Industrials

- ▲ Industrials continued to perform well in September '09.
- ▲ Performances were quite varied, with no one sector of the market standing out as a good or bad performer. Rather it was a month where individual shares stood out.
- ▲ For the last few years, macro themes have been very strong and we have seen extreme dispersion in performance between sectors, but not that much within sectors. Momentum has been a strong factor in the market as opposed to valuation. It is our opinion that this will revert back to valuation, which will mean that strong stock picking skills will be important. September was one such a month.
- ▲ Within retailers, Clicks, Massmart and Mr Price share prices all increased more than 10%, while Foschini and Spar were only up 2% and 4%, respectively.
- ▲ Pioneer Foods was up 7% while its competitor Tiger Brands was down 3%.
- ▲ There do not seem to be any "dripping roasts" left in industrials, but there are still several shares that have defensive earnings qualities that are priced reasonably. It is these we are currently seeking out, as many other shares have a very healthy economic recovery already priced in.

Investment Research view: The sector is now starting to look expensive, although some of the defensive shares are still offering some upside.

Equity Sector Overview and Outlook (cont.)

Property

- ▲ The listed property sector continued its defensive ways, posting a quarter to September 2009 total return of 12.2%, which outperformed the bonds' return of 5.5%, but slightly underperformed equities' return of 13%. Year-to-date the sector has underperformed equities (returning 9.7% versus 18.3%), but has outperformed bonds' negative 1.6%.
- ▲ Some 66% of the property companies by market cap reported their results during the quarter to September 2009. Most companies reported distribution (dividend) growth in line with our expectations. However, growth in distributions has slowed to upper single-digit levels compared to double-digit growth seen in 2008.
- ▲ A clear trend in the results was the increase in vacancies, which was expected. In most companies, vacancies were still below 5% and therefore not a material concern at this stage. However, we have seen a marked reduction in rent growth on expiring leases, especially in the retail sector where the rent growth was around 10% on expiring leases last year and has now dropped to below 5%.
- ▲ Hardest hit were companies with large exposures to community shopping centres and it is clearly evident that small tenants in those centres are taking strain. Larger shopping centres are still trading well, with no noticeable signs of concern at this stage.

Investment Research view: *In our view 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 (12%-14%).*

Fixed Interest Overview and Outlook

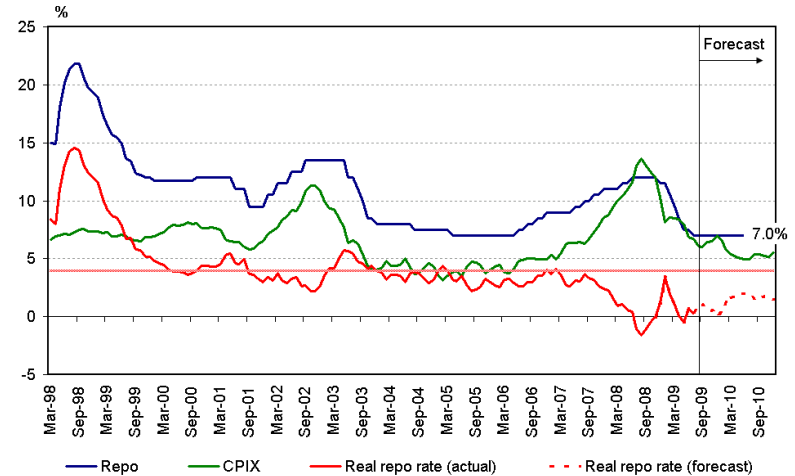
- ▲ The slope of the yield curve steepened marginally during September '09, as bond yields retraced to higher levels at month-end. As a result, the bond market underperformed cash, with the 12-year+ maturity band rendering the worst performance.
- ▲ The market initially received limited support from improved global risk appetite, a strong currency and slightly better-than-expected PPI and monetary-aggregate growth data. However, at month-end, this was overshadowed by negative foreign trade data, the news on the MTN/Bharti deal and another upward adjustment to the size of the weekly RSA government bond auction.
- ▲ We maintain that RSA bond yields should retrace to higher levels in the short term, particularly considering our view that bottom of the interest rate cycle has been reached, and the upside risk to the national budget deficit. We maintain a healthy appetite for corporate and other non-government debt, which is still offered at attractive spreads over RSA government debt.

Futuregrowth view: *The positive slope of the yield curve is expected to remain intact, in 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 our holding of medium-dated money market assets.
- ▲ In the bond funds, we will maintain an underweight modified duration given the investment view.
- ▲ In terms of yield curve tilts, we are running underweight positions to the one- to three-year and 12-year+ maturity bands, whilst holding an overweight tilt to bonds in the seven- to 12-year band.

Futuregrowth view: *In contrast to money market and RSA bonds, non-government debt continues to offer the promise of superior returns.*

Limited room for further policy easing unless inflation surprises on the downside



Sources: OMIGSA & I-Net

- ▲ The RSA CPI-linked bond market is looking more interesting compared to a few weeks ago, but is still not attractive enough to build a large position.
- ▲ We maintain a low listed property holding on a weak economic growth outlook, preferring nominal bonds, particularly attractively priced non-government debt. Preference shares have lost a little colour and we have been slowly reducing exposure.

Economic Indicators to September 2009

	Latest Data		Previous Year
Exchange Rates:			
Rand/US\$	September-09	7.51	8.24
Rand/UK Pound	September-09	12.02	14.76
Rand/Euro	September-09	11.00	11.68
Rand/Aus\$	September-09	6.57	6.67
Interest Rates:			
Prime Overdraft	September-09	10.50%	15.50%
3-month NCD rate	September-09	6.95%	12.10%
R157 Long Bond Yield	September-09	8.29%	8.86%
Inflation:			
CPI (y-o-y)	August-09	6.4%	13.7%
National Accounts:			
GDP Growth (y-o-y)	June-09	-2.8%	4.2%
GDP Growth (q-o-q, annualised)	June-09	-3.0%	5.0%
HCE Growth (y-o-y)	June-09	-3.6%	3.3%
(Household Consumption Expenditure)			
GFCF Growth (y-o-y)	June-09	5.7%	11.3%
(Gross Fixed Capital Formation)			
Balance of Payments:			
Trade Balance (cumulative 12month)	August-09	-\$3.63	-\$9.36
Current Account (% of GDP)	June-09	-3.2%	-7.3%
Capital Account (% of GDP)	June-09	4.6%	8.1%
Forex Reserves (incl. gold)	August-09	\$37.04	\$34.77
Other:			
Manufacturing Production (y-o-y) (seasonally adjusted)	July-09	-13.6%	3.5%

Market Indicators to September 2009

	1 Month (%)	Quarter (%)	Calendar Year (%)	12 Months (%)	3 Yrs (%)	5 Yrs (%)
Equity						
All Share Index	0.3	13.9	18.6	7.7	6.7	19.5
Shareholders Weighted Index	0.4	13.9	19.2	9.1	8.4	20.4
All Share/Resources 50%	0.5	14.7	19.3	9.5	7.4	19.6
Top 40 Index	-0.2	13.3	17.1	5.4	5.6	18.8
RAFI® 40 Index	-0.4	15.5	23.2	13.2	9.1	21.1
RAFI® All Share Index	0.2	15.6	19.8	10.4	8.3	21.0
Resources Index	-0.6	11.1	16.0	1.1	3.9	18.8
Financial Index	-0.2	15.2	20.2	6.5	1.6	14.9
Industrial Index	1.4	16.3	20.3	15.4	12.2	22.8
Mid-cap Index	2.8	17.5	28.6	25.4	13.8	24.3
Small-cap Index	1.7	15.2	20.4	8.8	9.9	23.9
Interest-Bearing						
ALBI BEASSA	0.1	3.0	-2.0	9.1	8.0	8.5
STeFI	0.6	2.0	7.2	10.3	10.1	8.9
Cash	0.5	1.6	6.2	9.2	9.7	8.3
Property						
SA Quoted Property Index	2.1	12.2	9.6	18.9	16.4	25.7
International						
MSCI World Index (R)	1.2	15.4	2.9	-10.0	-4.6	7.4
MSCI World Index (\$)	4.0	17.6	25.6	-1.6	-3.8	4.1
JPM International Bond (R)	-0.5	4.0	-14.8	4.3	8.5	10.1
US 1-month LIBOR (R)	-2.7	-1.7	-17.3	-7.0	3.0	7.1
Inflation (Estimated)						
CPI	-0.1	2.3	7.3	6.2	8.8	7.2

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Regulatory Information

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