

## Markets Outlook

### “The quest for real returns”



# Asset Class Returns

For the six months to 30.06.09

	Rand Returns	US Dollar Returns
<b><u>SA Equities</u></b>		
SWIX	4.7	25.3
SA Listed Property	-2.3	17.0
SA Bonds	-4.9	13.9
SA Cash	4.8	25.1
<b><u>Int'l Returns</u></b>		
MSCI AC World	-8.5	9.6
Emerging Market	12.1	34.3
Bonds	-16.7	-0.2
Cash	-15.5	1.2



Source: OMIGSA



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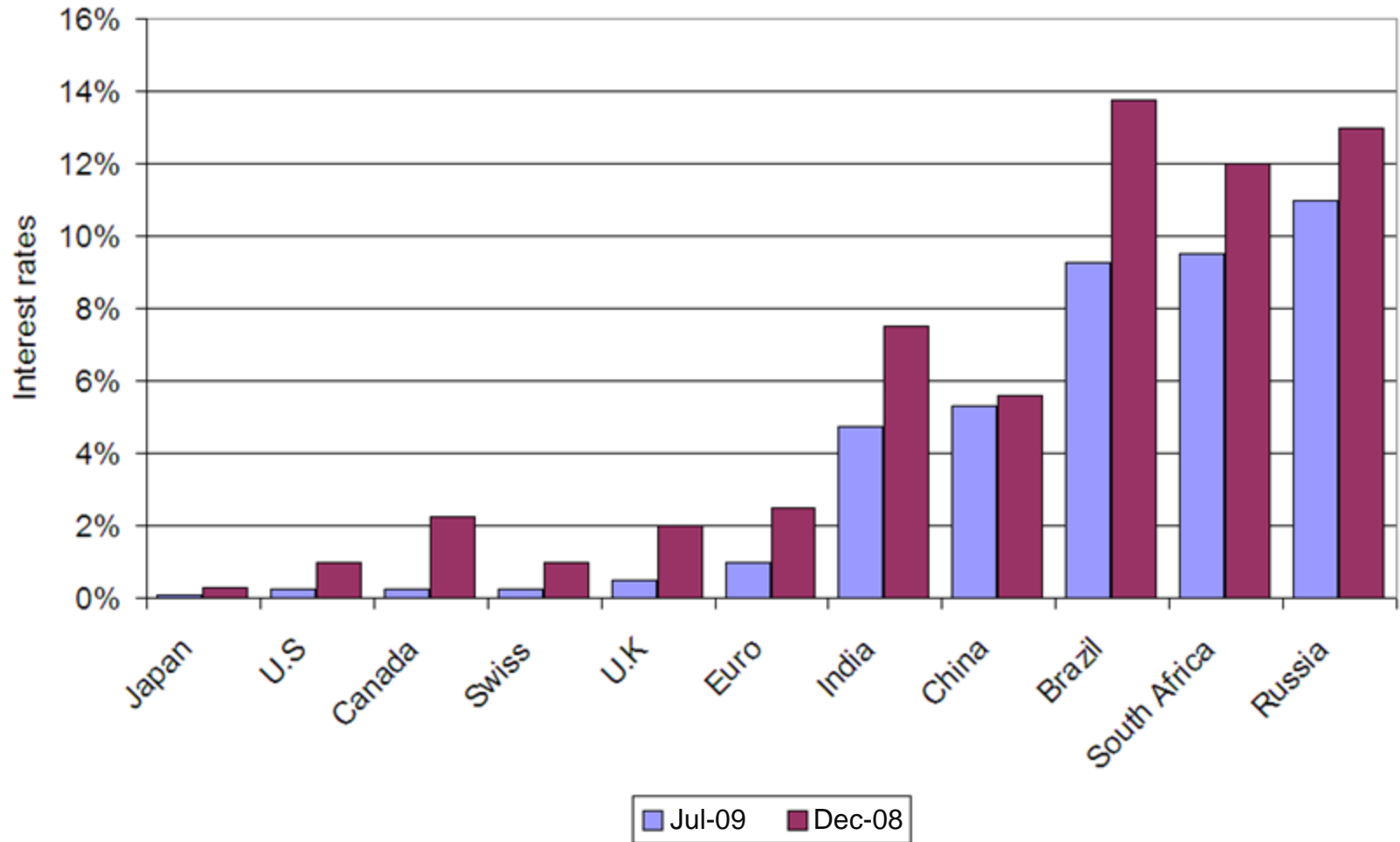
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# Freefalling: Change in interest rates

On average rates have fallen 40%



Source: OMIGSA



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# Yesterday's story

- ▲ Out of 46 countries, 44 have cut rates in the last six months
- ▲ 19 of these now have interest rates of 2% or lower
- ▲ The average rate of the G7 is 0.6%



Source: OMIGSA

# Implications of interest rate policy

- ▲ Negative real cash yields
  - Lower returns on defensive funds
  - Money forced out of cash
- ▲ Steeper yield curves
  - Subsidisation of banks by savers
  - Improved growth
- ▲ Long-term consequences
  - Inflation
  - Another bubble



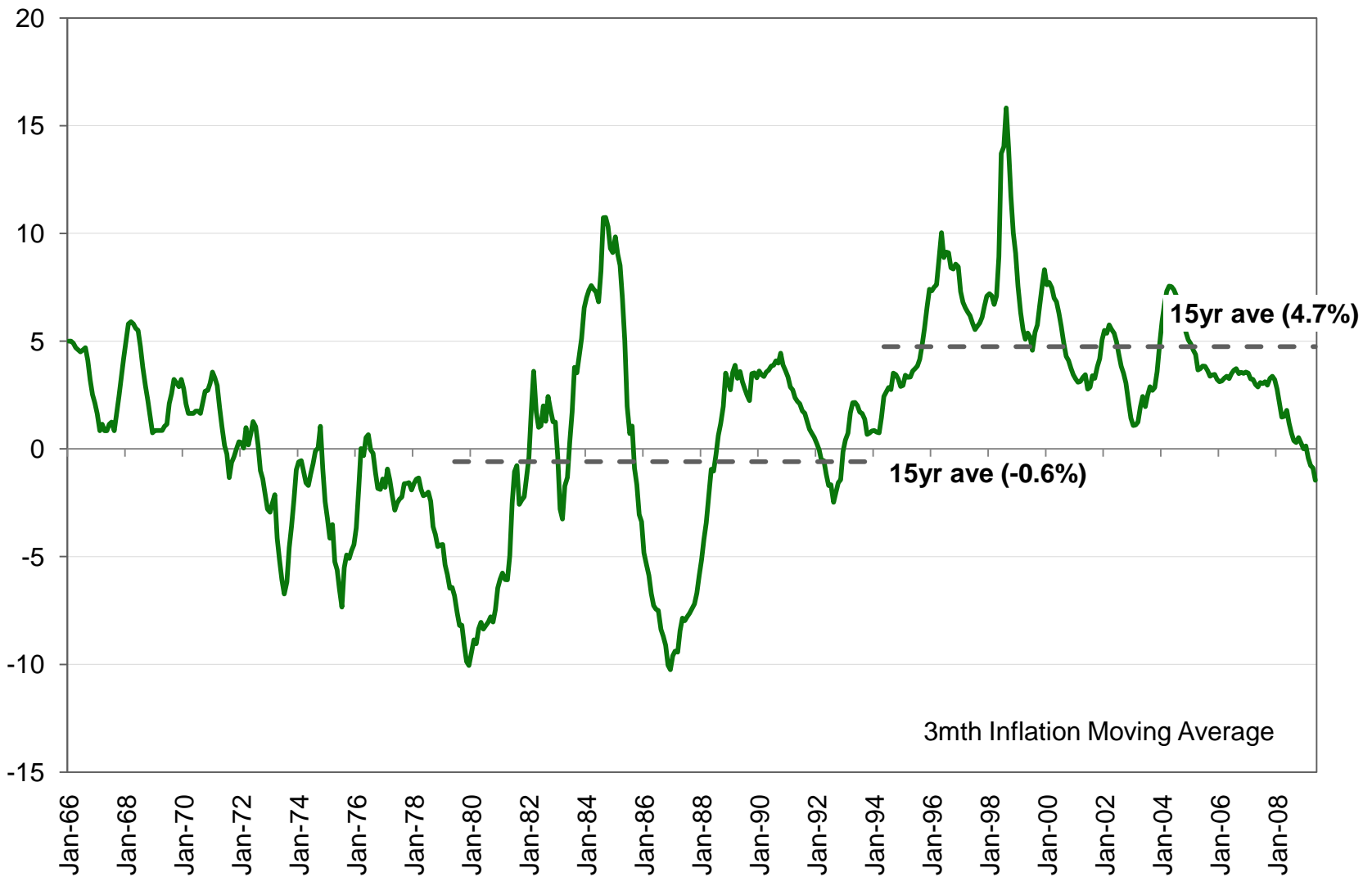
# Negative real interest rates

## 2010 forecasts

	CPI	Policy rate	Real Rate
Russia	9.7	5.75	-4.0
Canada	2.1	0.25	-1.9
USA	1.5	0.125	-1.4
UK	2.3	1.00	-1.3
South Korea	3.3	2.25	-1.1
Euro-area	1.1	1.00	-0.1
India	4.5	4.75	0.3
Japan	-0.8	0.10	0.9
Australia	2.4	3.50	1.1
SA	5.5	7.50	2.0
China	2.8	5.45	2.7
Brazil	4.4	8.75	4.4



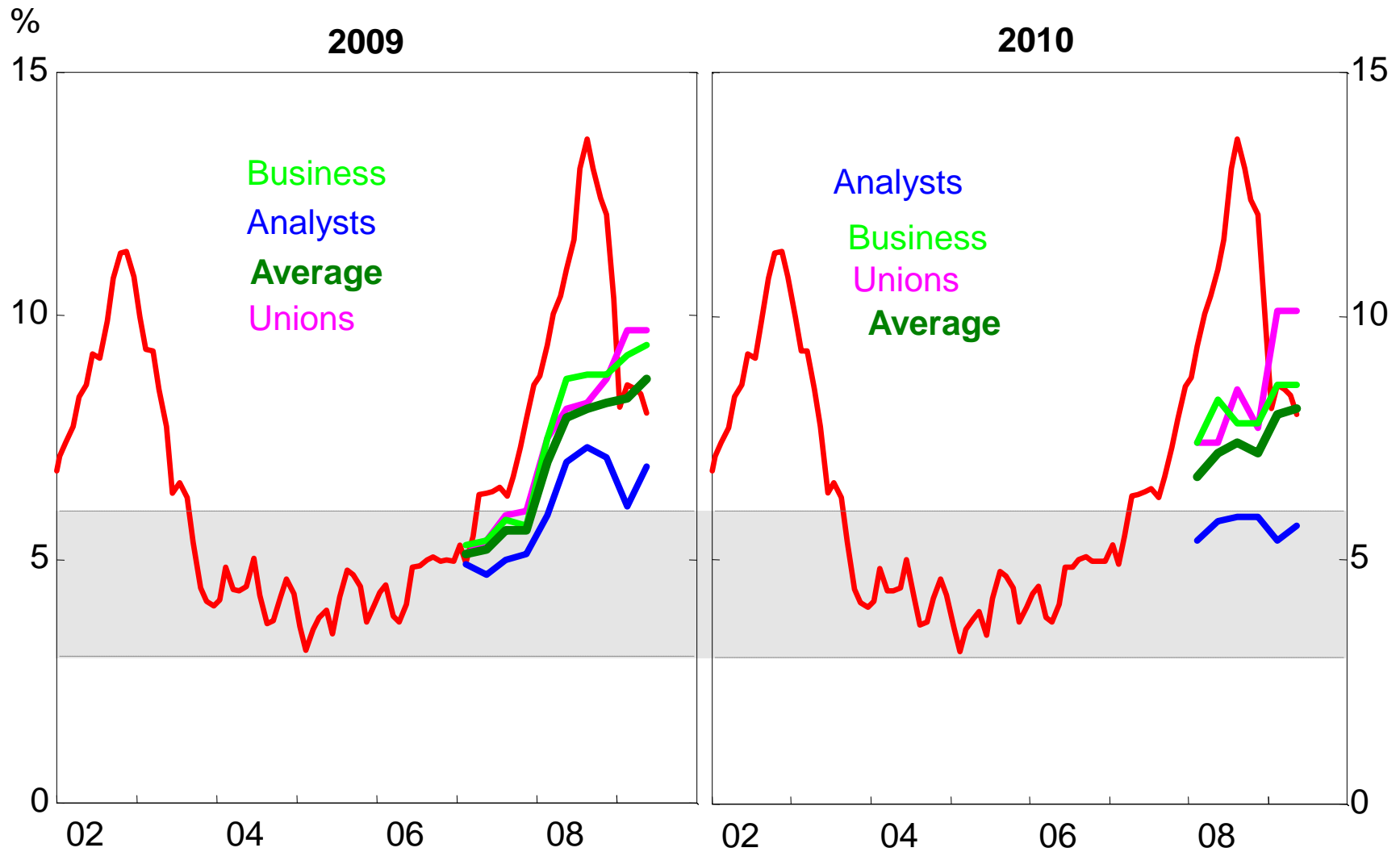
# Real SA Cash Yields (%)



Source: OMIGSA

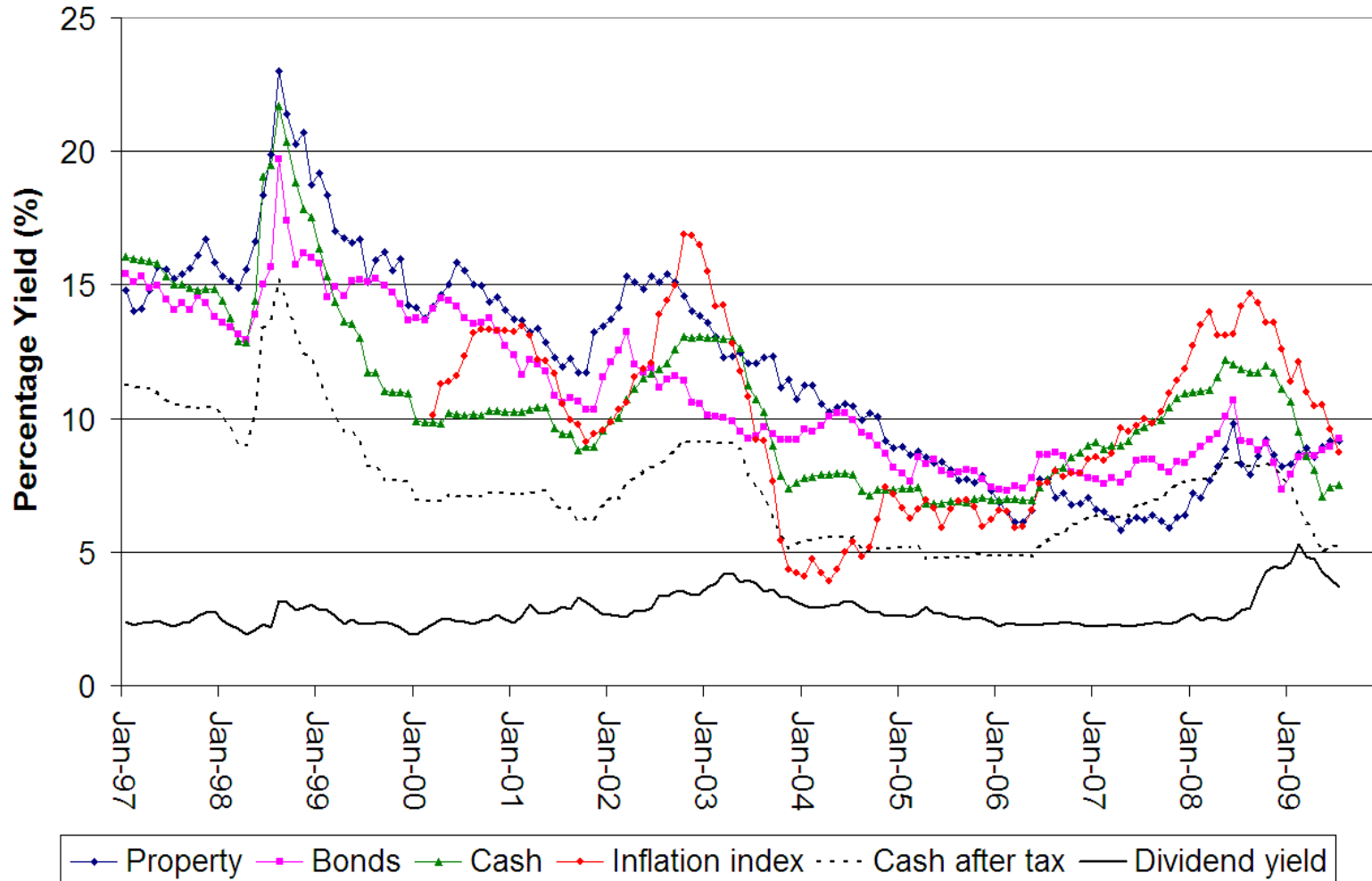
# SA data watch

## Inflation expectations



Source: OMIGSA, IRIS

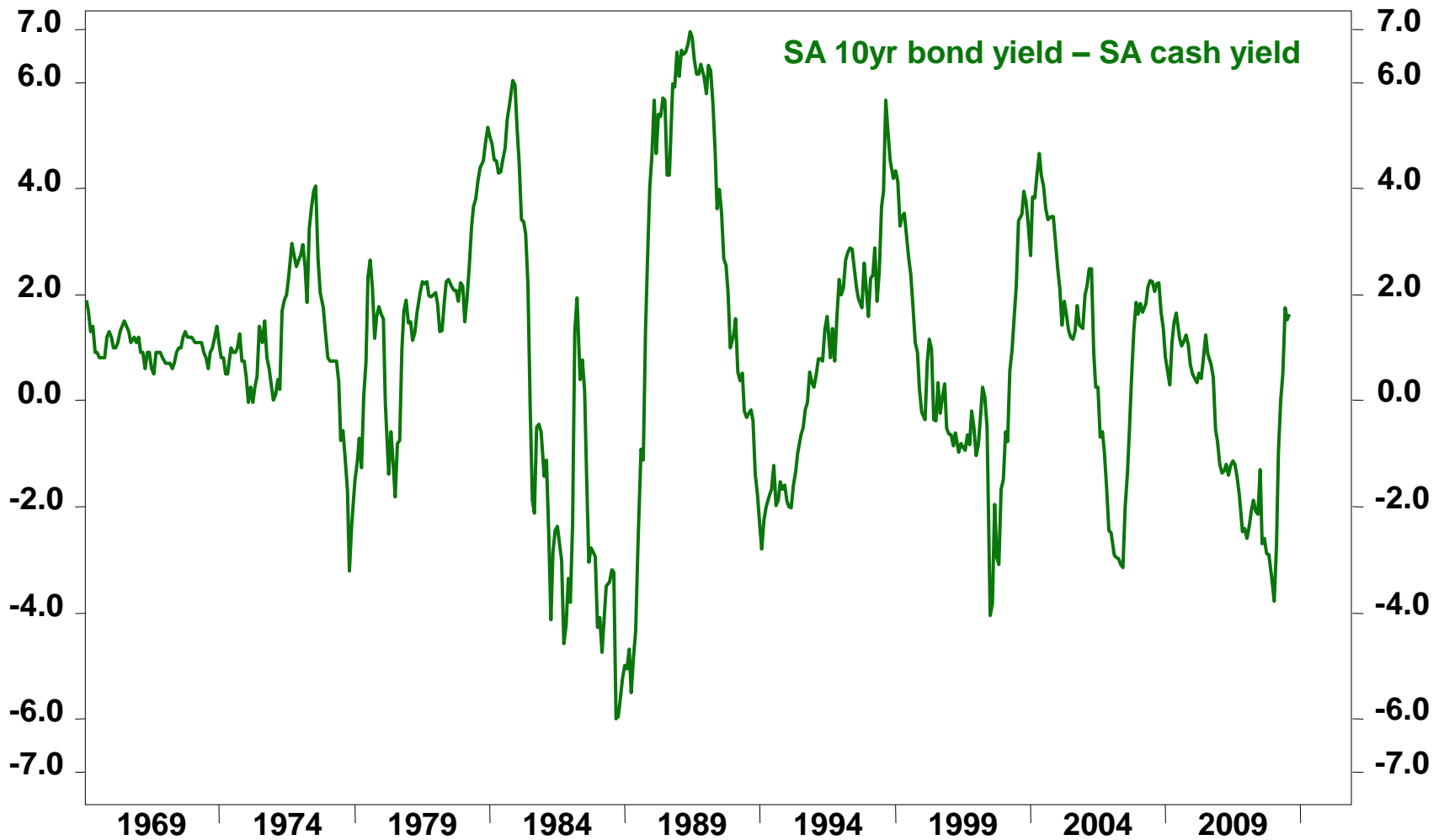
# The Quest for the Holy Grail Yield



▲ Note: assumed tax rate of 30%, ILB return is an approximation

Source: OMIGSA

# SA: Bond yields > cash yields



Source: INET



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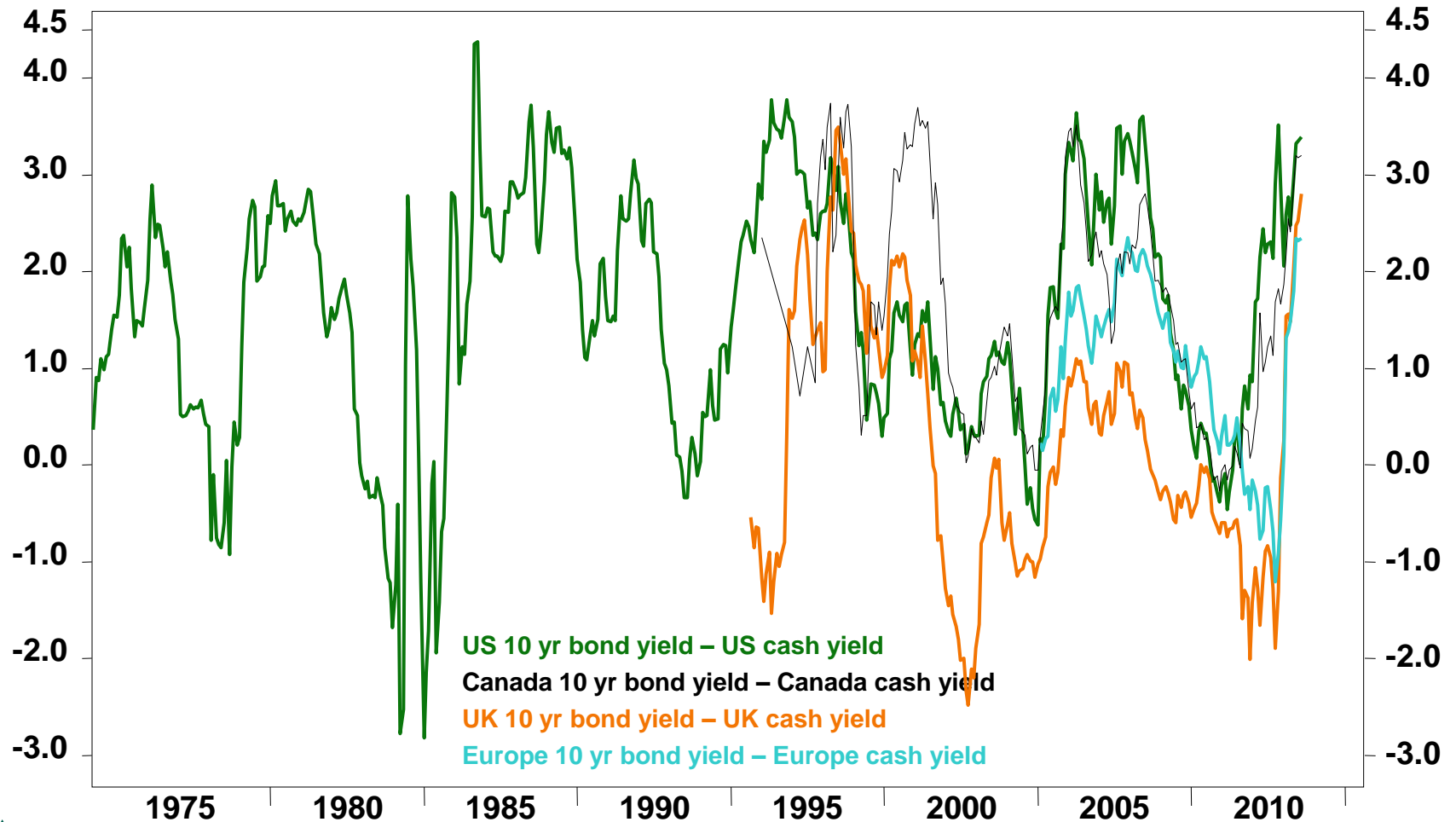
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# International: Steeper yield curves

Savers are subsidising the banks. Systemic risk – too big to fail  
Widows and orphans (0) Banks (1)



Source: INET



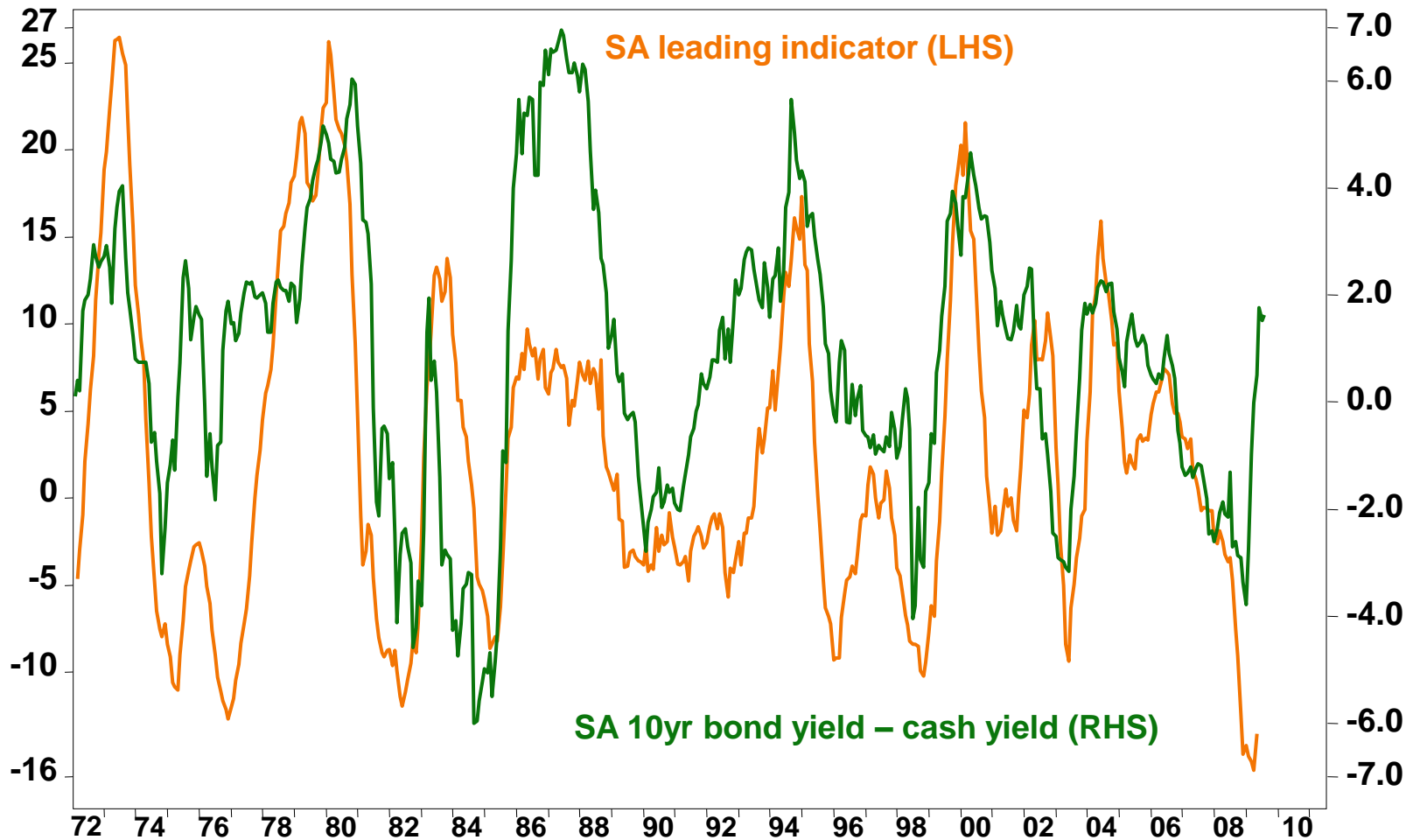
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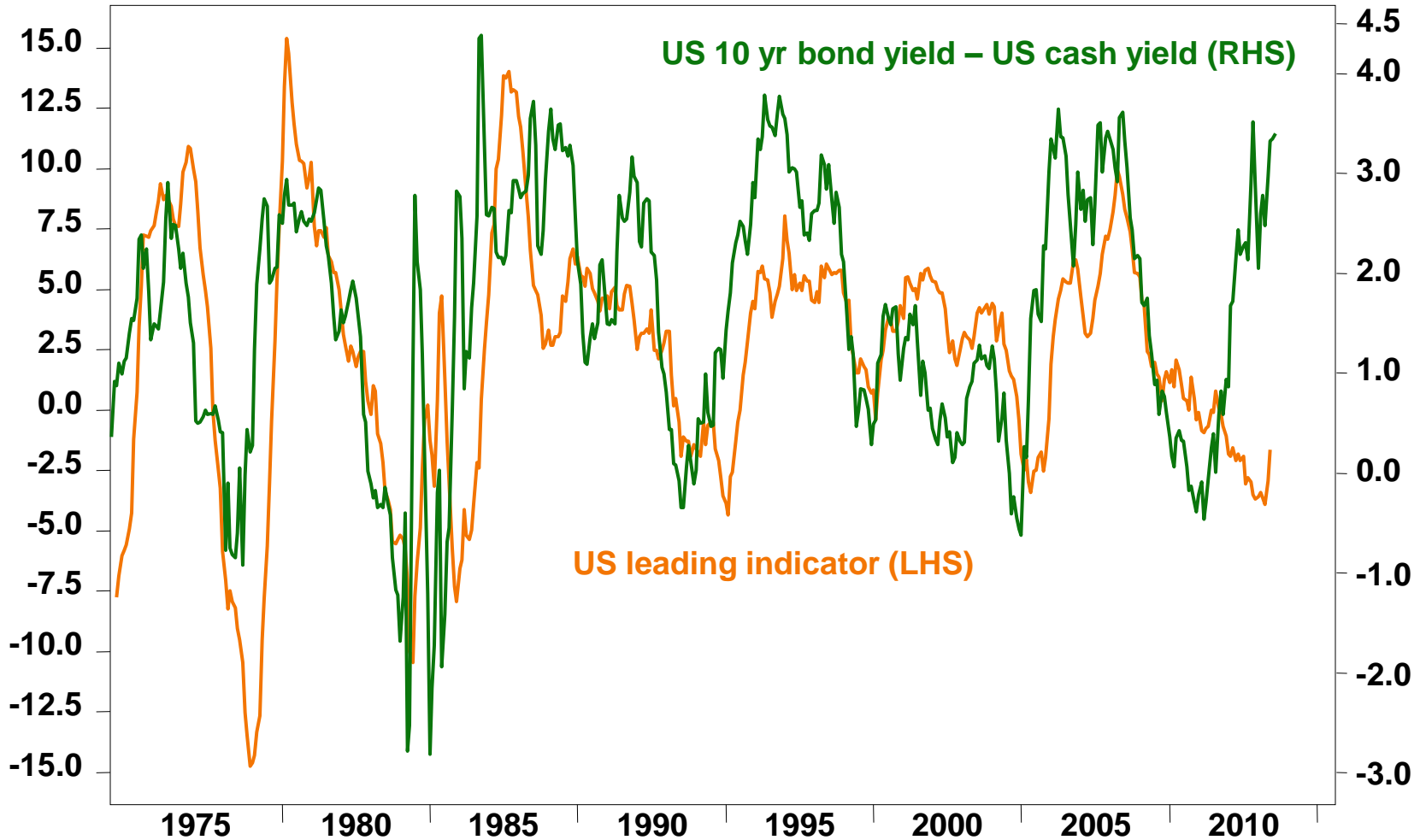
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# Positive for SA growth: A recovery will come



Source: INET

# Positive for US growth: A recovery will come



Source: INET

# Long-term implications

- ▲ Real interest rates cannot be kept too low for too long
- ▲ Volatility in 2010 as central banks unwind quantitative easing
- ▲ Big government, more taxes
  - OECD budget deficit f.8% of GDP in 2009
- ▲ Inflation?
  - More of a problem in SA
- ▲ Another bubble?
  - Chinese market up 75% YTD

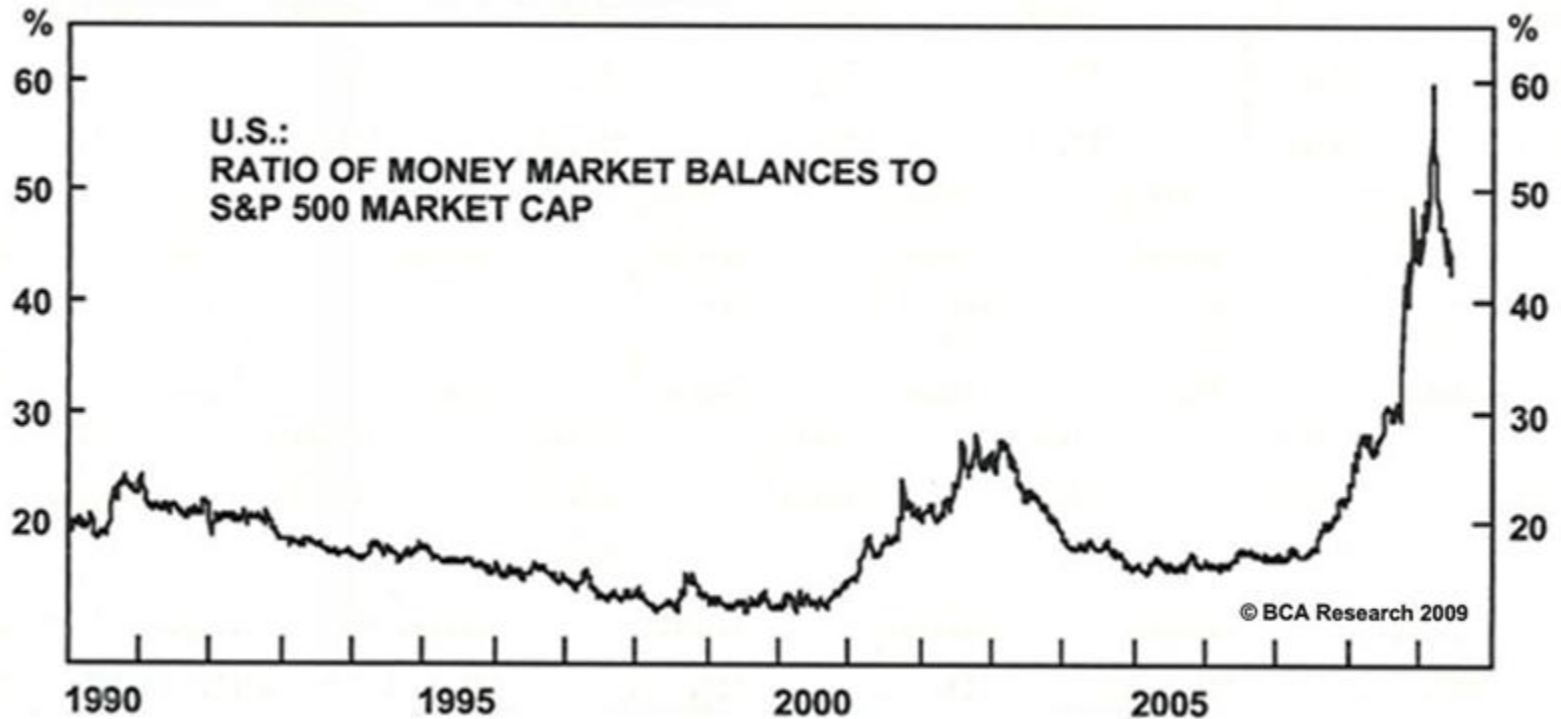


# asset allocation implications

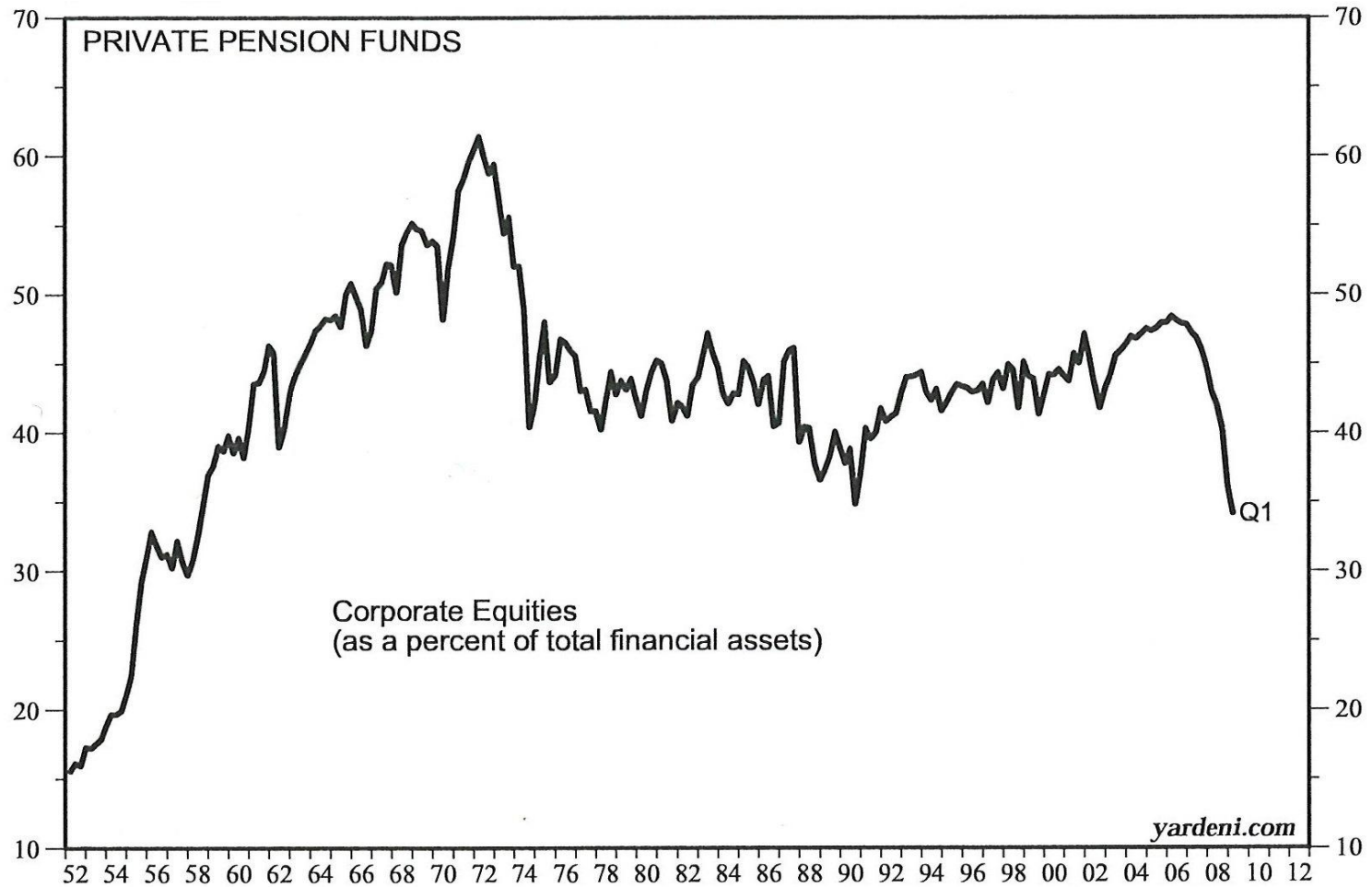


# U.S. cash levels are very high

Money market funds are greater than equity funds



# US Pension Funds: Allocation to equity



Source: Federal Reserve Board, Flow of Funds Accounts.



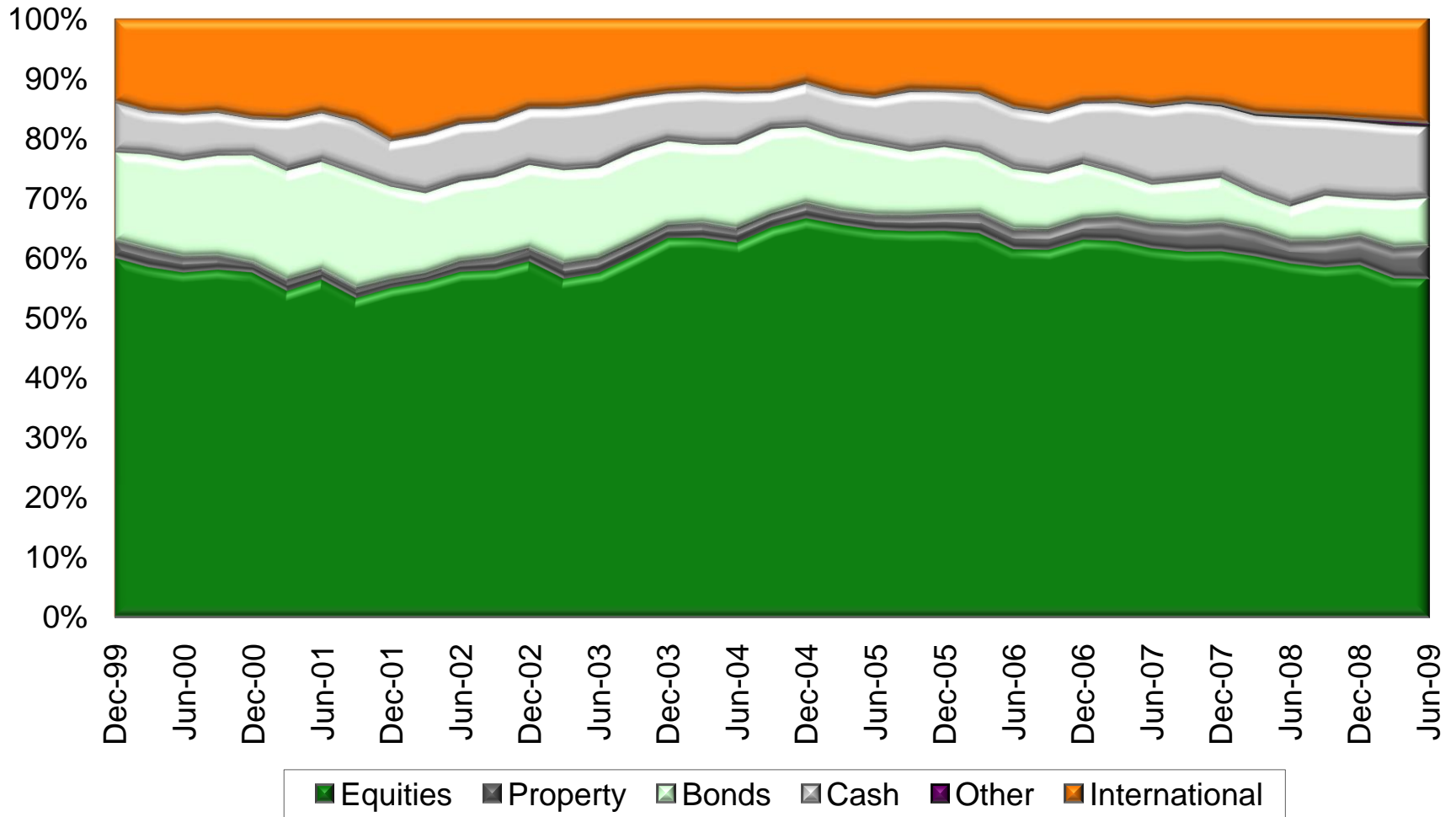
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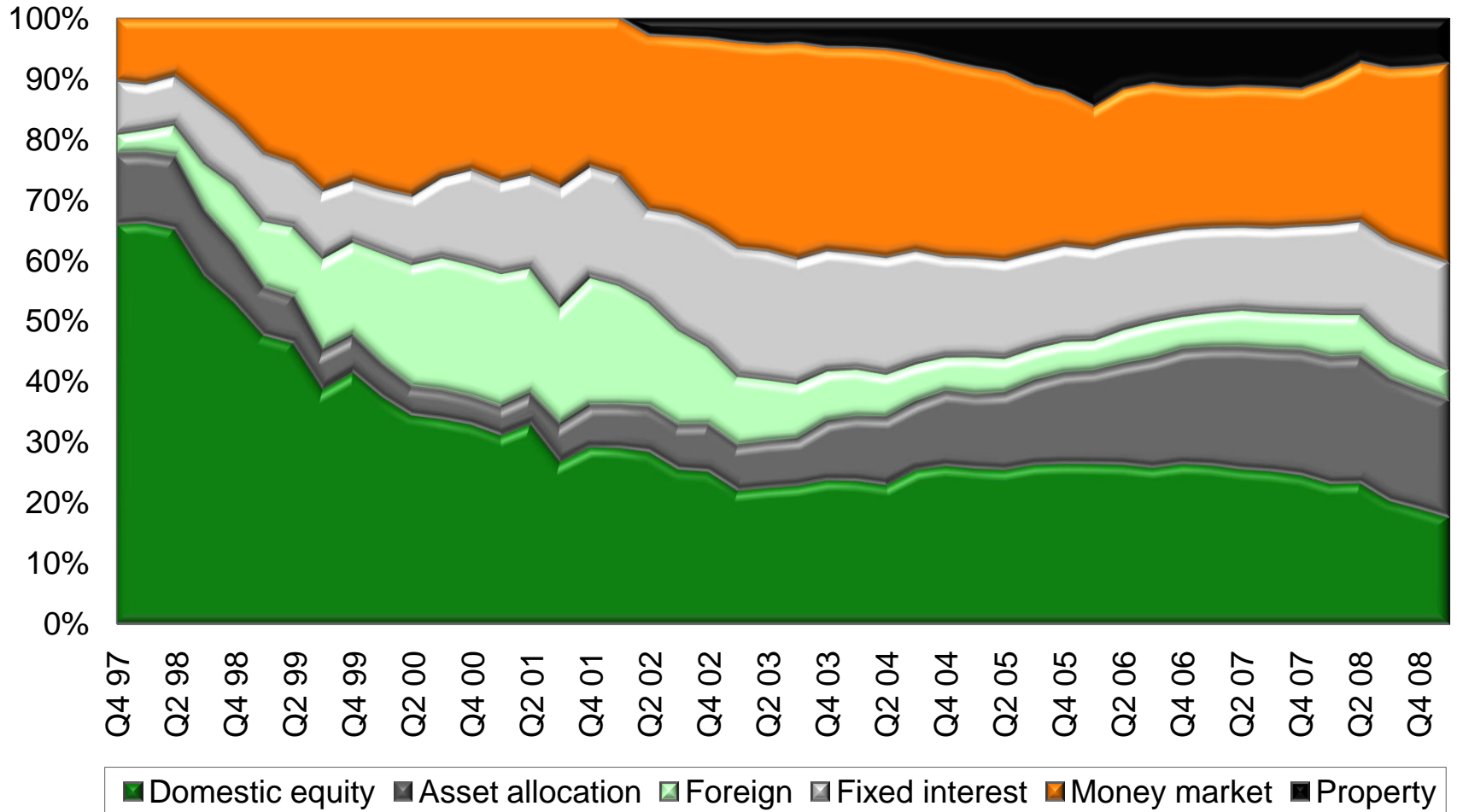
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# SA: Institutional asset allocation



Source: Alexander Forbes (June 2009)

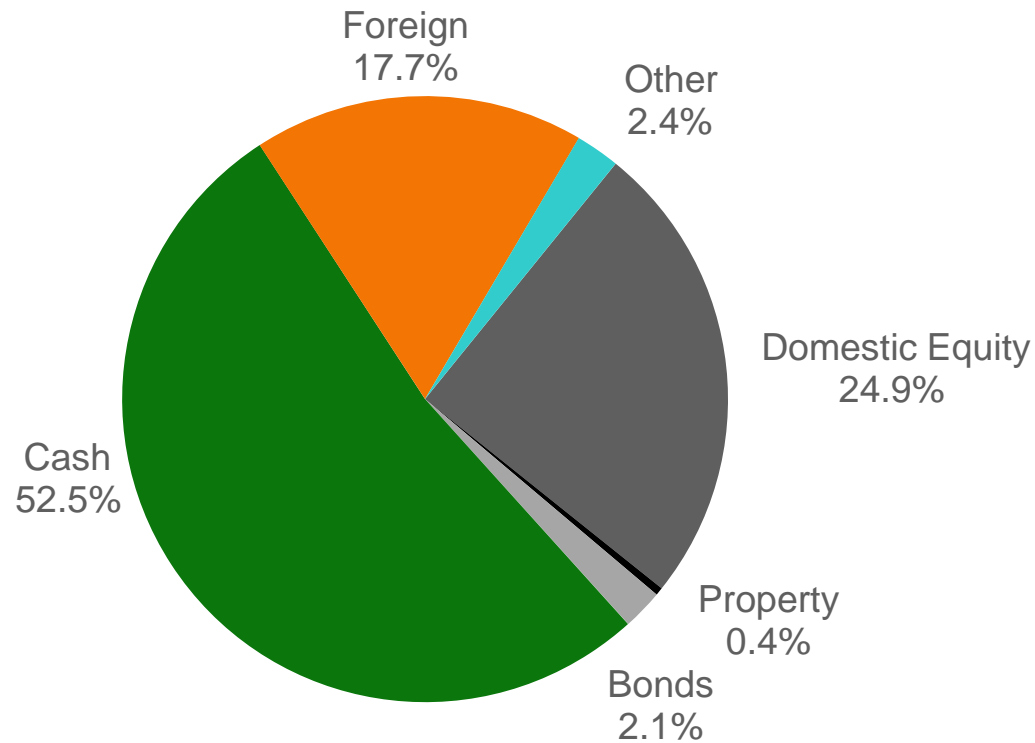
# SA: Retail asset allocation



Source: ASISA (March 2009)

# Domestic Asset Allocation - Prudential Low Equity Sector

Sector AUM = R27 bn



# Asset Allocation View

	Real Return	View	Comment
SA		<b>N</b>	
Equity	7.0%	<b>N</b>	Good long-term real return. Concerned about real earnings growth.
Property	6.0%	<b>+</b>	High yield of 9% but expect tough 18 months. Longer-term winner.
Bonds	3.0%	<b>N</b>	Looking interesting in the next year, but longer-term concerns about inflation.
Cash	2.0%	<b>-</b>	Lower real returns in next decade. Negative after-tax.
Offshore		<b>N</b>	
Equity	8.0%	<b>+</b>	Cheap compared to history. Prefer emerging markets in long-term.
Bonds	2.0%	<b>-</b>	No inflation risk in short-term but low nominal returns.
Cash	0.0%	<b>-</b>	Downgraded as rates fall sharply.

NB: These are long-term, real returns expected over the next five years



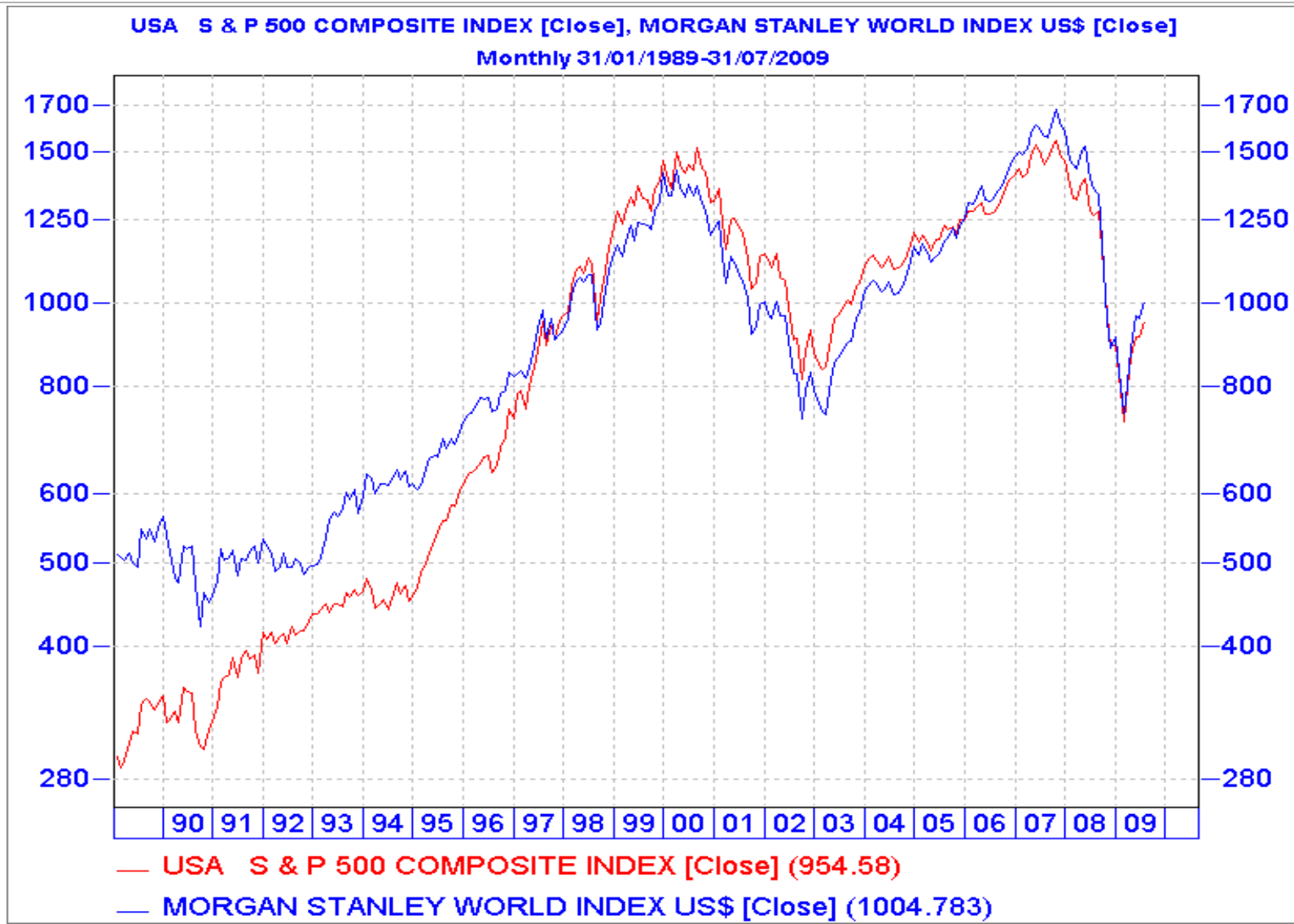
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# Volatility index continues to trend down



# Global Equity Markets



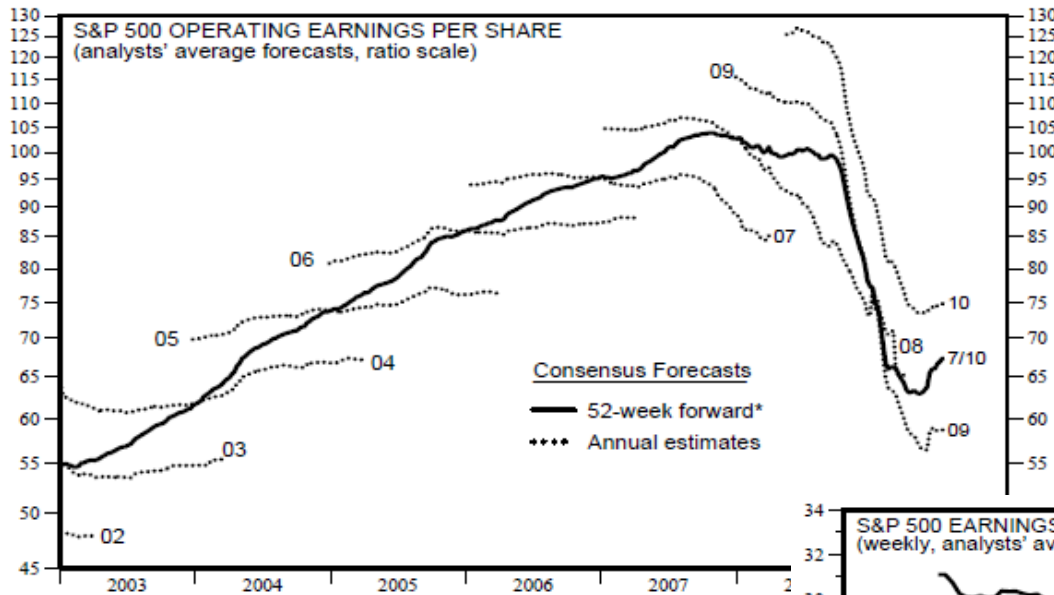
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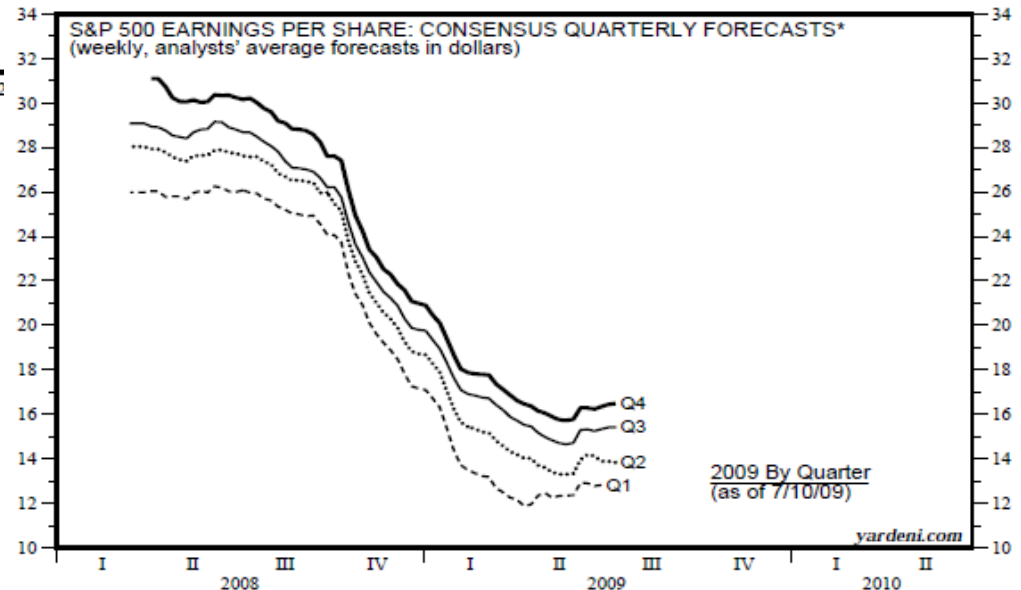
# US Earnings



**Analysts now estimate earnings will fall 10.4% in 2009 and rise 27.5% in 2010.**

\* Time-weighted average of current and next years' consensus earnings estimates.  
Source: Thomson Financial.

**Analysts estimate a y/y earnings decline through Q3-2009 and positive growth in Q4-2009. Here are their forecasts: -32.3% (Q1), -30.0% (Q2), -11.8% (Q3), and +196.6% (Q4).**



\* Consensus expected S&P 500 operating earnings per share for each quarter shown.  
Source: Thomson Financial.



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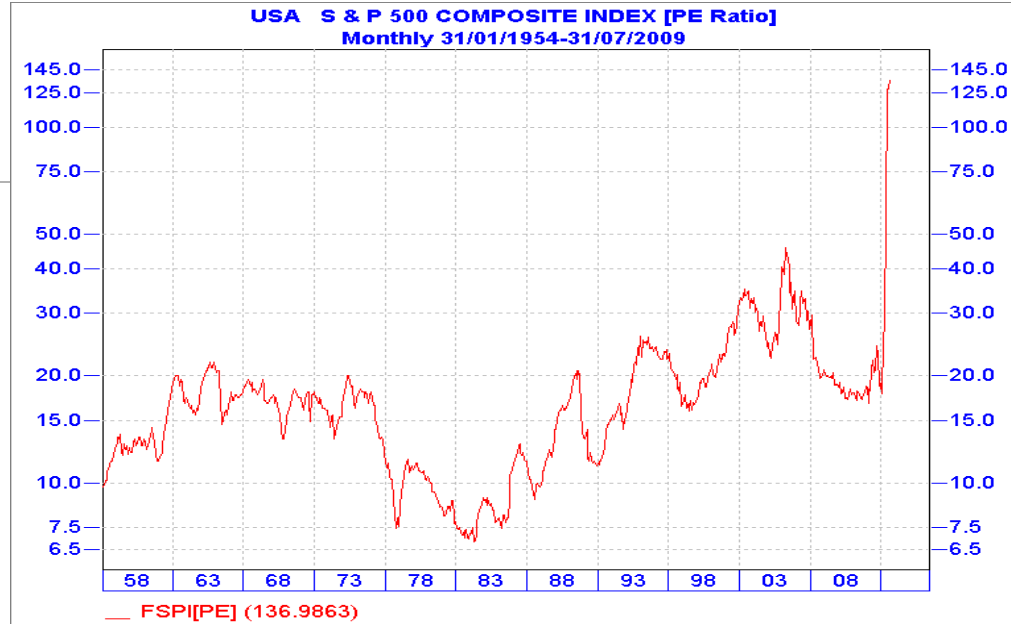
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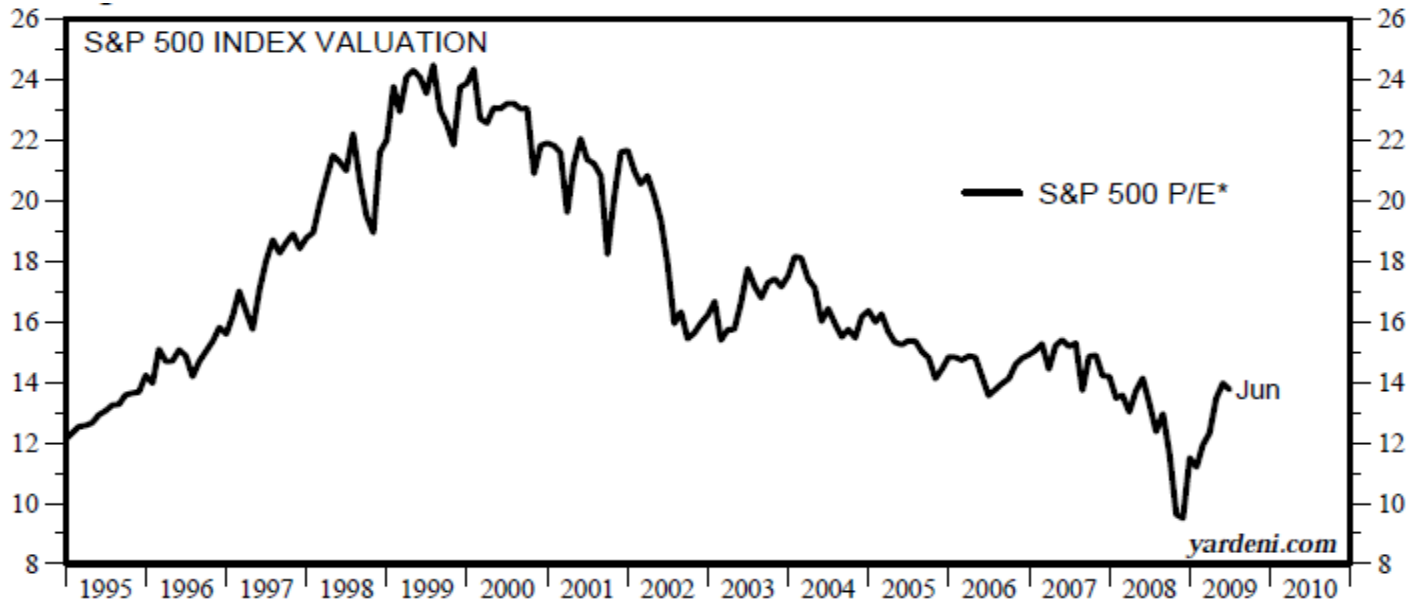
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# US PE ratings

Historic, as reported earnings



Forward, operating earnings



\* Price divided by 12-month forward consensus expected operating earnings per share using mid-month data.

Sources for all charts: Standard & Poor's Corporation, Thomson Financial, and Haver Analytics.



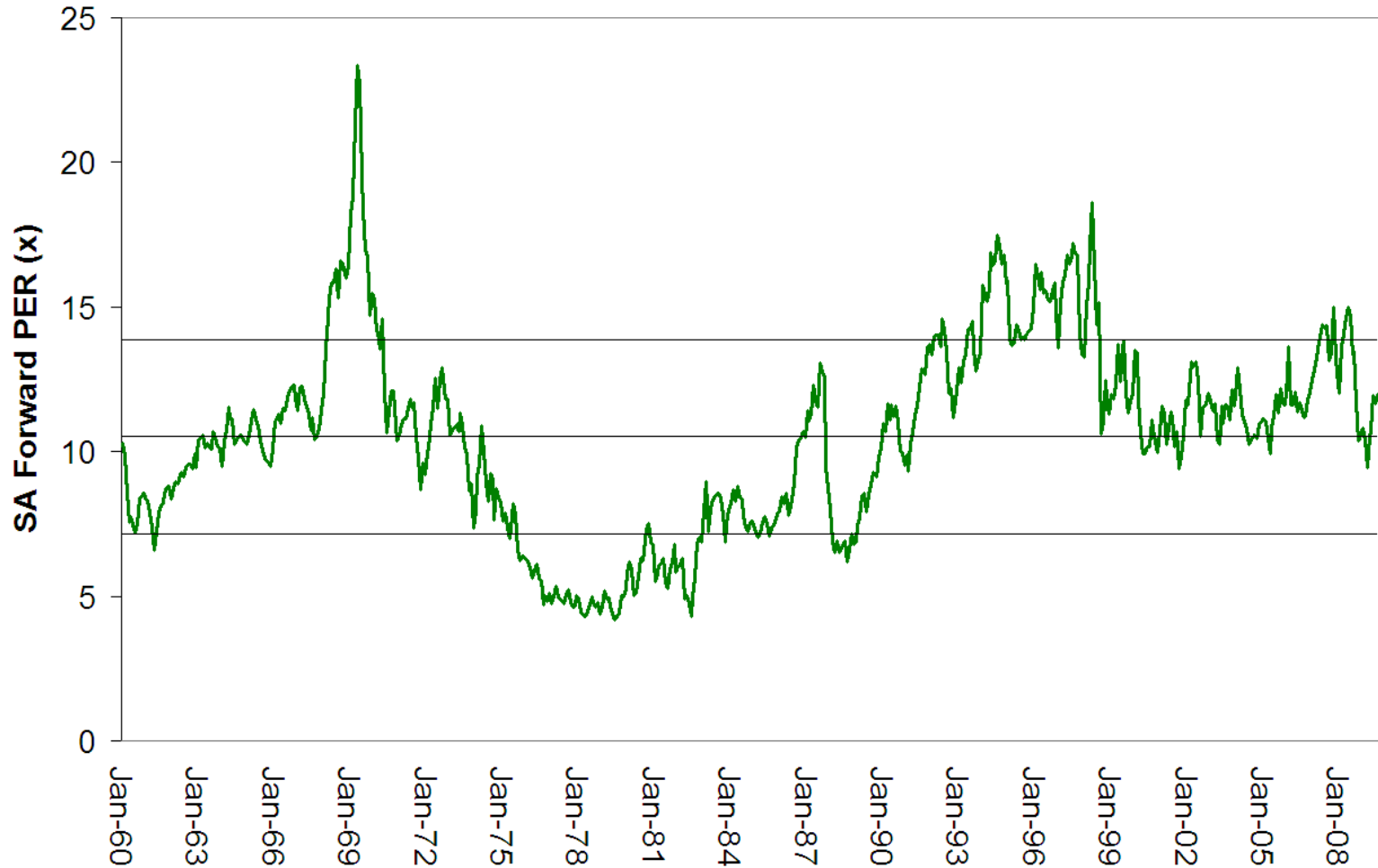
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# SA: Forward price:earnings ratio (x)



Source: OMIGSA



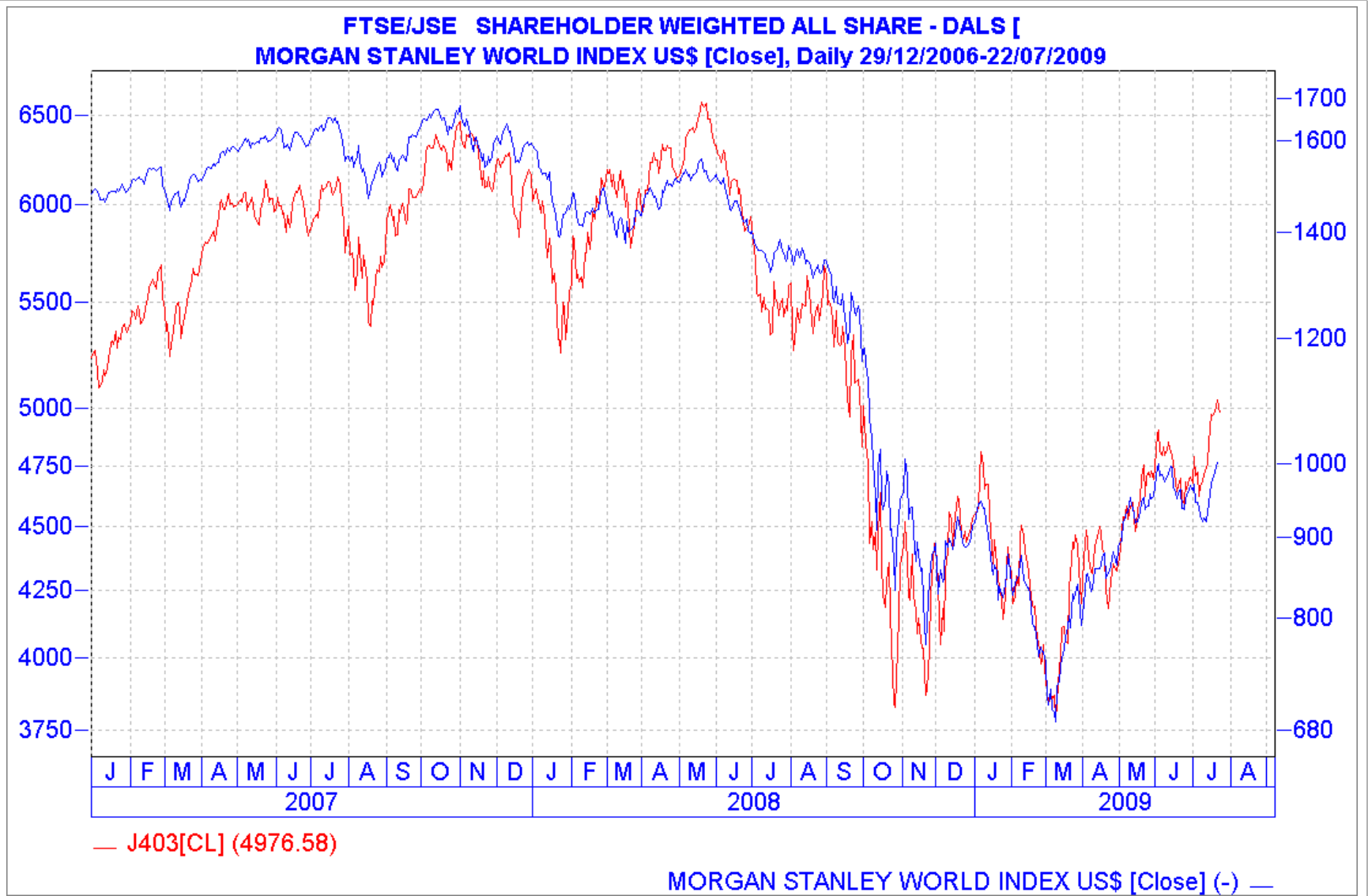
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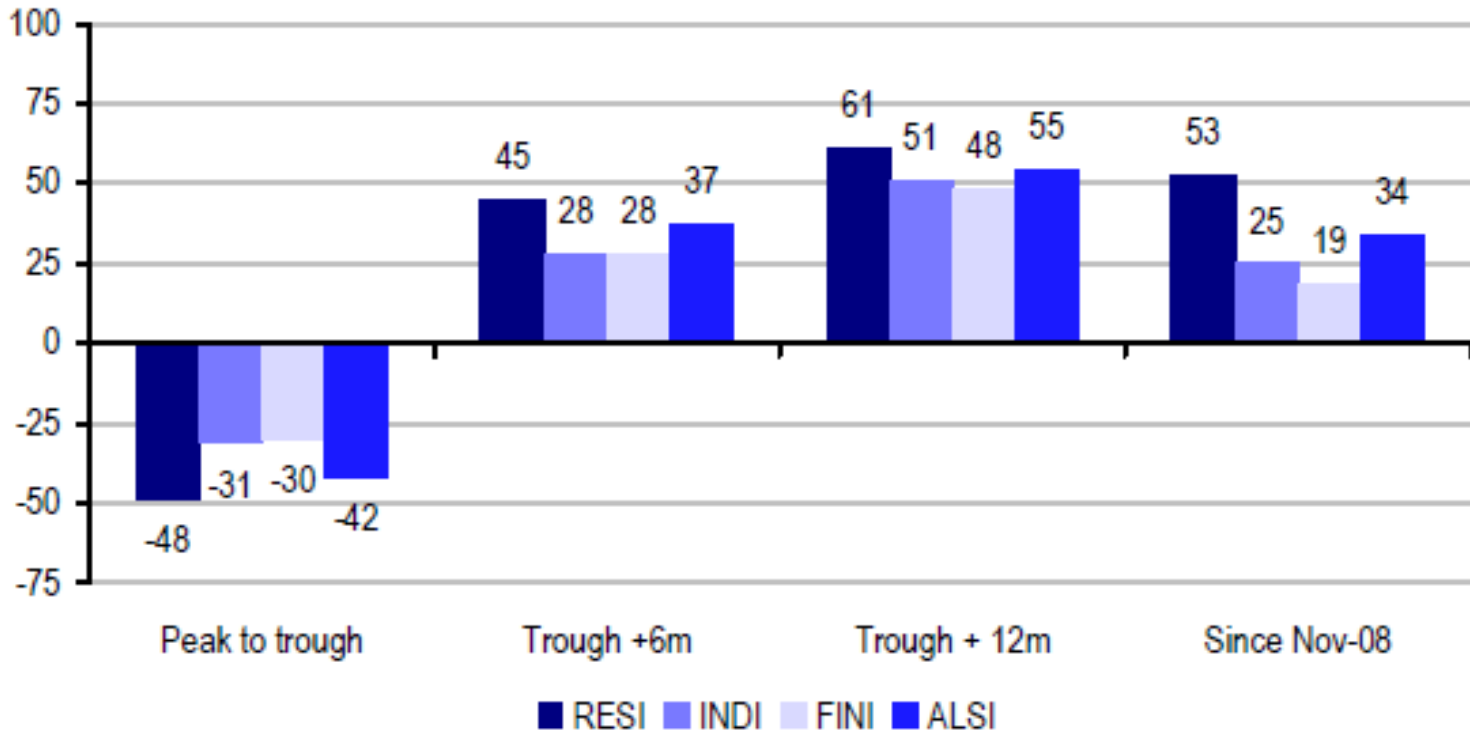
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# Trading Pattern – Broadly sideways or Melt Up?



# Previous bear markets – subsequent rallies

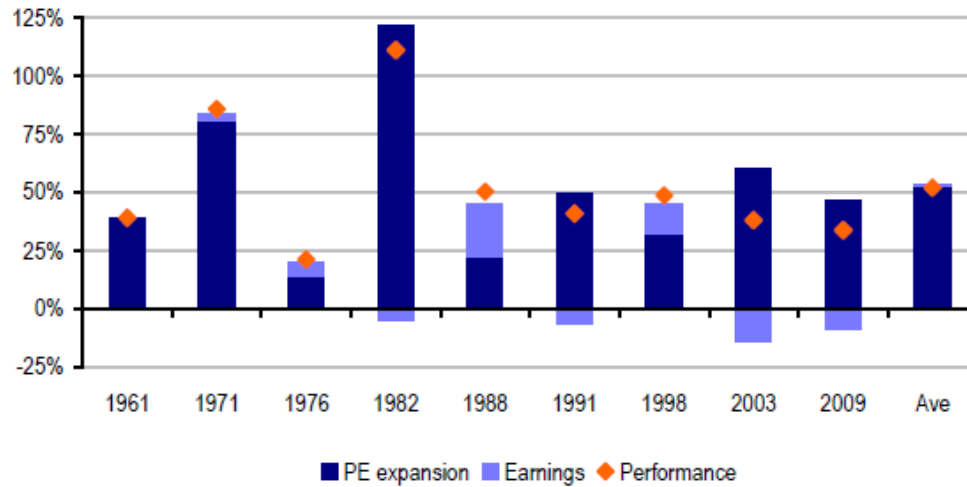
Chart 2: Bear market experience – performance into and after bear markets (%)



Source: INET, UBS, based on month end prices, capturing 9 bear markets since 1960 including the '08 bear market

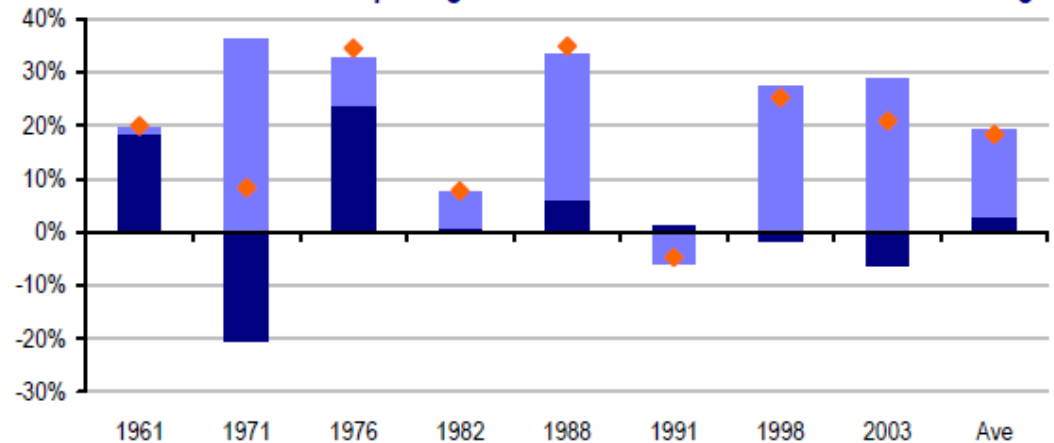
# Mostly rerating first – then earnings in question

Chart 3: Decomposing returns 12-months after the bear market trough



Source: UBS

Decomposing 12-24 month returns after bear market trough



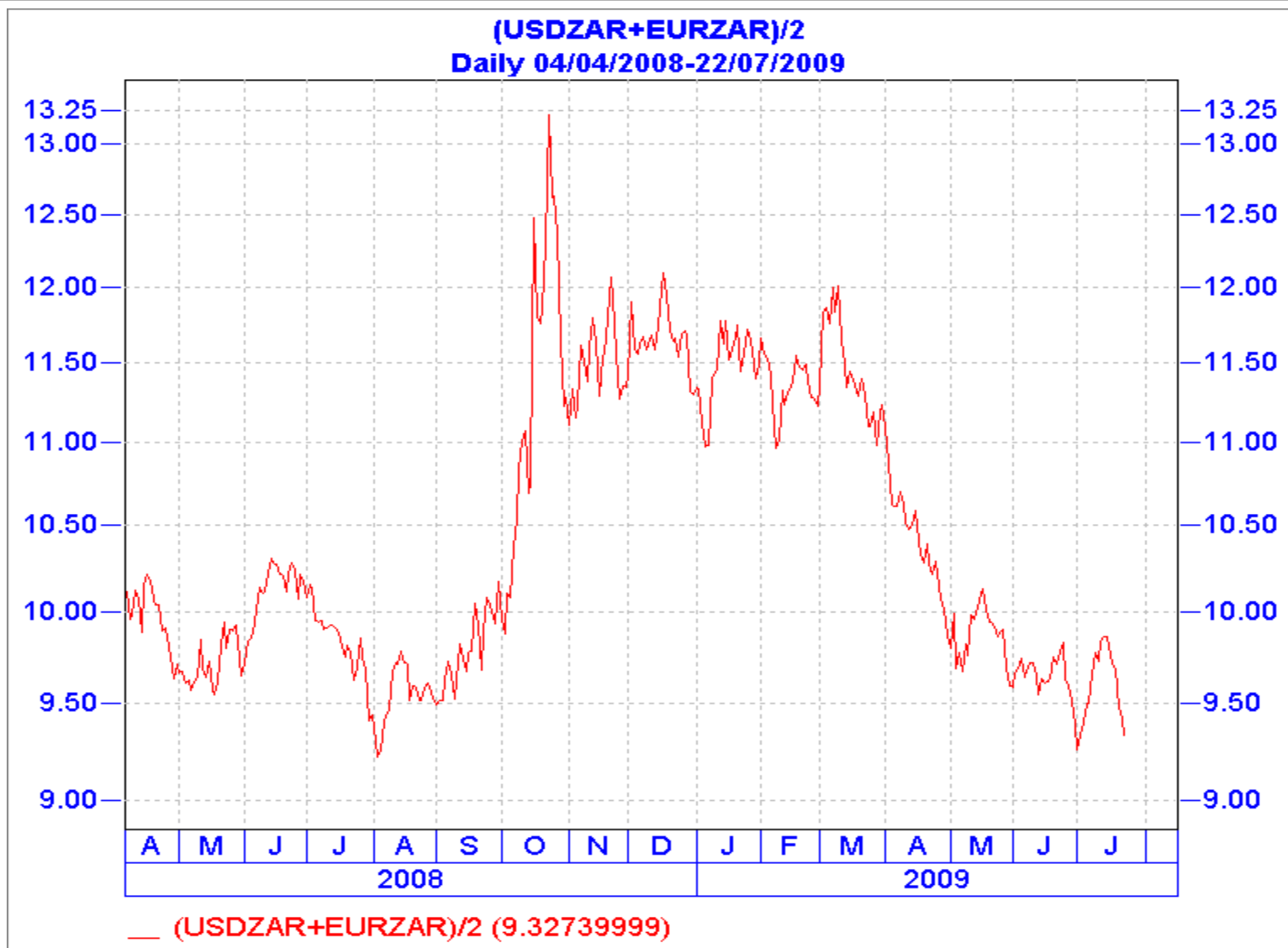
# Offshore equity has been the worst asset class in the last decade

Annual ranking to end June

Ranking	Jun-99	Jun-00	Jun-01	Jun-02	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08	Jun-09	5 Year return	10 Year return
1	SA Real Estate 26.7%	Foreign Equity 28.9%	SA Real Estate 31.8%	SA Equity 10.5%	SA Real Estate 30.1%	SA Equity 29.4%	SA Real Estate 52.8%	SA Equity 43.2%	SA Real Estate 43.0%	SA CPI 11.6%	SA Real Estate 24.0%	SA Real Estate 22.0%	SA Real Estate 21.9%
2	SA Cash 18.4%	SA Real Estate 25.2%	SA Bonds 29.6%	Foreign Equity 10.0%	SA Bonds 23.6%	SA Real Estate 15.9%	SA Equity 45.9%	Foreign Equity 23.7%	SA Equity 39.1%	SA Cash 10.6%	SA Bonds 17.9%	SA Equity 18.9%	SA Equity 13.9%
3	SA Bonds 16.8%	SA Bonds 19.2%	Diversified 16.2%	SA Cash 9.8%	SA Cash 12.8%	Diversified 12.1%	Diversified 28.2%	SA Real Estate 23.5%	Diversified 24.3%	SA Equity -1.2%	SA Cash 11.5%	Diversified 13.5%	Diversified 12.8%
4	Foreign Equity 16.0%	Diversified 17.9%	SA Equity 12.5%	SA CPI 9.2%	SA CPI 6.4%	SA Cash 9.2%	SA Bonds 19.0%	Diversified 20.2%	Foreign Equity 23.8%	SA Bonds -1.7%	SA CPI 8.5%	SA Bonds 9.0%	SA Bonds 12.7%
5	Diversified 15.5%	SA Cash 11.6%	SA Cash 10.4%	Diversified 8.9%	Diversified 6.2%	SA Bonds 5.1%	Foreign Equity 16.0%	SA Cash 6.8%	SA Cash 8.3%	Foreign Equity -2.7%	Diversified 1.1%	SA Cash 8.9%	SA Cash 9.8%
6	SA CPI 7.1%	SA CPI 7.9%	SA CPI 6.4%	SA Real Estate 7.4%	SA Equity -8.1%	SA CPI 5.0%	SA Cash 7.3%	SA CPI 4.8%	SA Bonds 7.5%	Diversified -2.8%	SA Equity -17.2%	SA CPI 6.9%	SA CPI 6.9%
7	SA Equity -0.2%	SA Equity 4.7%	Foreign Equity -3.1%	SA Bonds 6.8%	Foreign Equity -27.5%	Foreign Equity 1.1%	SA CPI 3.5%	SA Bonds 3.9%	SA CPI 6.4%	SA Real Estate -19.2%	Foreign Equity -30.8%	Foreign Equity 3.6%	Foreign Equity 1.9%

Source: OMIGSA

# Rand – a risk play?



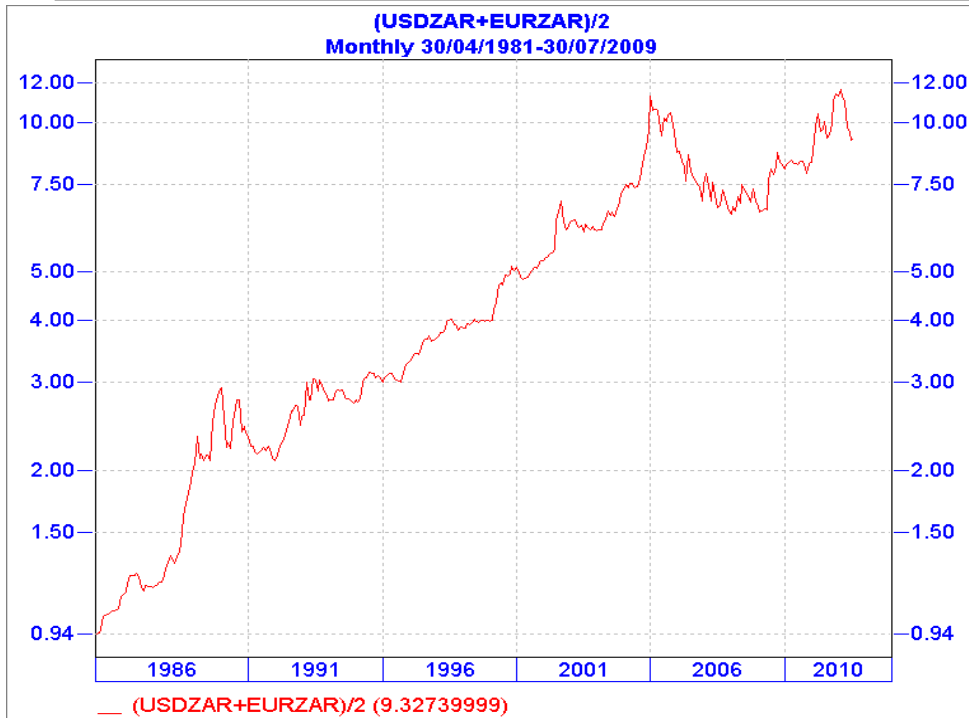
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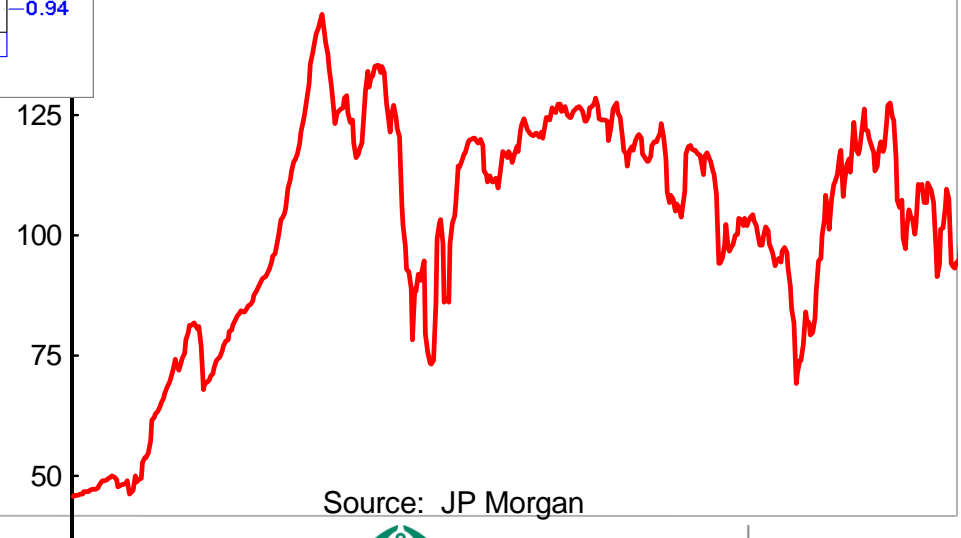
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# Longer term perspective



## Real trade weighted Rand



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# Conclusion

- ▲ Cash yields will remain low in the next year
  - Better growth
  - Negative real returns. **A big issue for low risk funds and retail investors.**
  - Pressure to find alternative yield: Property & Corporate
  - Underweight cash
- ▲ Equity valuations are reasonable
  - Offshore equity looks relatively attractive
  - Keep the long-term perspective



# PORTFOLIO POSITIONING AS AT 20 JULY 2009

EBGF & mirrors R22,0bn

	<u>Fund</u>	<u>Tilt</u>	<u>Min</u>	<u>BM</u>	<u>Max</u>
<b>IBA</b>	<b>17.3</b>	-6.2		<b>23.5</b>	
CASH/MM/FSC	<b>8.1</b>	-1.4	4.5	<b>9.5</b>	14.5
Bonds	<b>9.2</b>	-4.8	10.0	<b>14.0</b>	21.0
<b>Equity</b>	<b>45.9</b>	1.9	36.5	<b>44.0</b>	51.5
<b>Direct Property</b>	<b>10.2</b>	2.7	5.0	<b>7.5</b>	10.0
<b>Quoted Property</b>	<b>1.0</b>	1.0	-	-	2.5
<b>Alternatives</b>	<b>7.1</b>	2.1	2.5	<b>5.0</b>	7.5
<b>Global</b>	<b>18.4</b>	-1.6	15.0	<b>20.0</b>	25.0
<b>IBA</b>	<b>4.8</b>	-0.7	-	<b>5.5</b>	10.5
Bonds	<b>2.7</b>				
Credit	<b>0.3</b>				
Money Market	<b>1.8</b>				
<b>Equity</b>	<b>10.5</b>	-0.5	6.0	<b>11.0</b>	16.0
<b>Alternatives</b>	<b>3.2</b>	-0.3	2.0	<b>3.5</b>	7.0
<b>Total Equity</b>	<b>56.4</b>	1.4		<b>55.0</b>	



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# Regulatory Information

## Old Mutual Investment Group (South Africa) (Pty) Limited

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Telephone number: +27 21 509 5022

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