



# market watch

15 March 2010

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- Business cycle upswing narrowly focused
- Total private sector credit extension still in the red
- SA economy needs accelerating final sales

The acceleration in domestic real economic activity into 2010 remained narrowly focused off a depressed base, with manufacturing production ballooning and the services industries (two-thirds of our economy) still lacklustre. This trend mirrors what is being experienced in other regions around the globe.

Still-depressed consumer goods and machinery and equipment production suggests domestic demand remains stagnant, with seasonally-adjusted real retail sales growth negative in the final quarter of last year and total private sector credit extension still in the red even after ticking up in December (see graph).

One positive development was the improvement in household instalment sales and leasing finance, although this was modest and largely based on a relative improvement in vehicle sales driven by rental companies building up their fleets in advance of the Soccer World Cup.

Meanwhile, total inventories experienced an extraordinarily sharp decline, which, taken at face

value, suggests the level of inventories has been cut too far for the current level of final sales. In this event, growth would be spurred on by a mere stabilisation in final sales. However, the fall in inventories relative to sales has not been nearly as sharp as suggested because there has been a severe decline in final demand and in manufacturing exports.

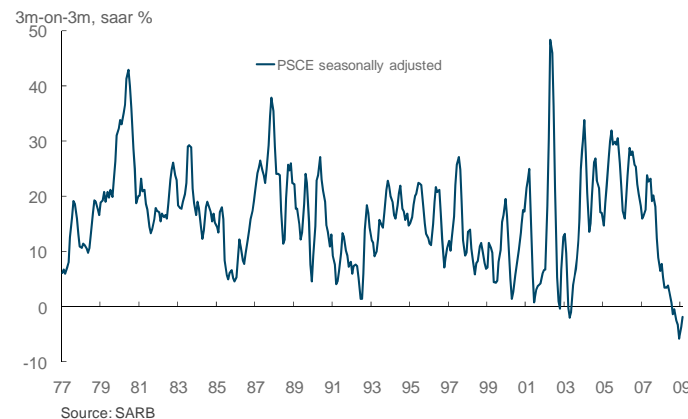
The overall level of manufacturing exports remains far below last year's level and final sales, according to my calculations\*, literally collapsed through last year, with declines in manufacturing exports, spending on household durable goods and investment in private sector equipment.

Based on my estimate of final sales, the decline in industrial and commercial inventories has not been especially sharp over the past year. In fact, the fall in inventories relative to final sales is no steeper than in the previous business cycle downturn from December 1996 to August 1999. After that downturn there was only a gradual recovery in the inventory/sales ratio and thus it took several years to return to a level close to the mid-1990's peak.

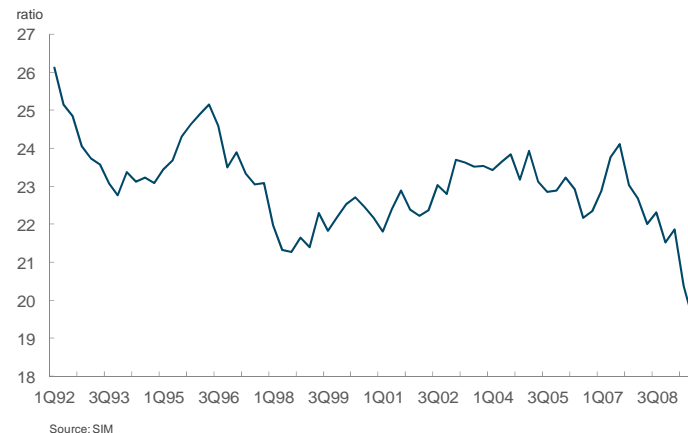
So we are likely to be disappointed if we think a bounce in inventories and mere stabilisation in final sales will be sufficient to boost SA growth. Instead the local economy needs a sustained acceleration in final sales – and thus consumer demand – before the recovery will broaden meaningfully to the services sectors.

\*Visit our blog, <http://blog.simintelligence.co.za>, for an expanded version of the article and a description of our measure of final sales.

## Private sector credit extension still in the red



## Inventories / final sales





**Claude van Cuyck**  
**Head of Equities &**  
**Portfolio Manager**

**BCom (Hons); CFA**

- Global equities celebrate dual anniversary
- Stock markets continue to rally
- Dollar loses ground against key currencies

During the second week of March, global stock markets celebrated two happy and not-so-happy anniversaries. On the one hand, equity investors celebrated the staggering returns they had experienced over the past year after stock markets hit their lowest point in the wake of the sub-prime crisis. On the other, the following day marked the 10-year anniversary of the bursting of the Nasdaq bubble - and a lost decade for US investors whose equity investments have actually declined.

The graph highlights that on a year ago the S&P500 had rallied a phenomenal 68% by March 9. But viewed from a longer-term perspective, the index is still nearly 20% lower than the tech boom peak established in 2000.

Meanwhile, the 2009 global and local equity rebound has continued into 2010, despite concerns about valuations. On international stock markets, the S&P500 has gained 7% since mid-February and European and Asian stock markets between 5% and 9%.

In SA, the All Share Index increased 5% with financials the best performing sector (up 6%) and Resources the laggard (up 3.5%).

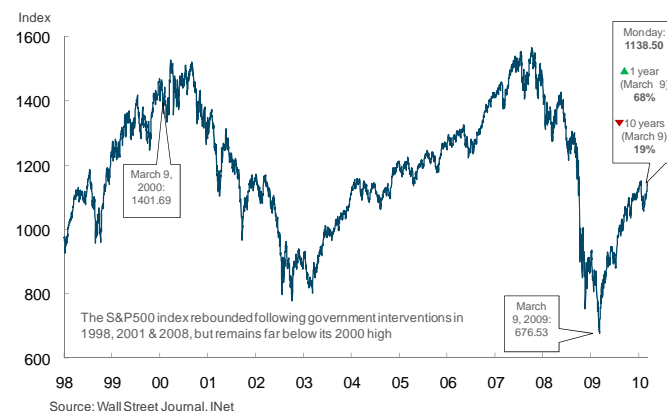
The SA equity market is at best fairly valued but we do see potential in the small-cap universe where there are more stocks that are trading at price to earnings ratio of less than 10 times (see graph). With concerns about the Greek government's heavy indebtedness waning after having dominated the global news since the beginning of the year, the dollar's strength against the euro has dissipated somewhat more recently. Since mid-February, the Dollar Index has declined 0.6% and 1.6% from its high point on February 18. Against the euro, the greenback shed 1.2% from mid-February to mid-March.

At home, the rand continued rallying against the dollar, gaining 4.4% since mid-February and appreciating to below R7.40 to the dollar despite general consensus that the local unit is overvalued at less than R8 to the dollar.

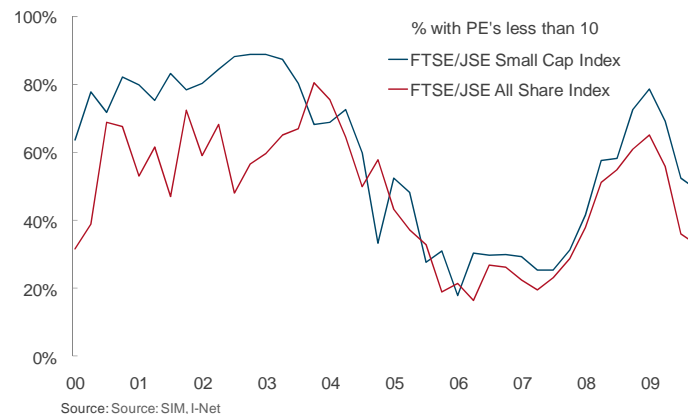
On capital markets, global 10-year government bond yields began their upward march again in March on concerns about how the developed world is going to reduce their massive fiscal deficits after retracing in late February. Safe haven demand for US Treasuries also waned in March as fears about the potential for a Greek sovereign default faded away.

The local bond market was dominated by the release of Budget on February 17, which underlined the government's commitment to prudent economic management. It also reaffirmed the SA Reserve Bank's inflation targeting mandate. The Finance Minister did, however, surprise the market by announcing that Treasury will issue new 20- and 30-year bonds. This resulted in a selloff in the R209 bond in particular. Eskom's approved tariff increase of an average 25% a year over the next three years was lower than expected and thus less of a negative factor for the inflation outlook – and bonds.

**US stock market still way off 2000 highs**



**Attractive hunting ground in small caps**





Getting around low yields

**Candice Paine**  
Head of Retail

BCom (Hons); CFA

The 2007 credit market crunch – and its painful aftermath – has arguably hurt investors reliant on income the most. While highly indebted consumers benefit most from the unprecedented easing in monetary policy globally, the saver and income-reliant investor are at the receiving end of near-zero interest rates in the US and historically low rates elsewhere in developed markets.

In SA, although interest rates have not declined as much as they have internationally, they are still low compared with history and are likely to stay that way for an extended period. In fact, there is still a chance that there may be another interest rate cut, given likely downside inflation surprises this year as a result of the strong rand, declining food prices, falling services costs and lower-than-expected authorised electricity rate increases. However, the window on that possibility is quickly closing as developed markets begin normalising monetary policy; after which a slow rise in interest rates is inevitable.

Meanwhile, the impact on bond yields of low domestic interest rates and high government funding requirements was already apparent last year, when SA long bond yields increased 176 basis points during the year. The key point to note is that a bond’s yield rises when the price of the bond declines.

So when the bond yields are rising, the value of bonds in general are declining, and the opposite also holds true when yields are declining. Thus last year bond holders saw about a 1% decline in returns, as measured by the All Bond Index. This compares with an almost 70% rise in the JSE All Share Index.

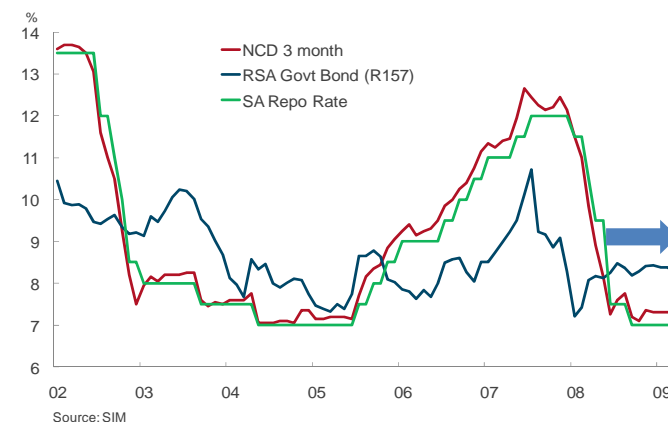
In an environment of low interest rates and rising bond yields, those investors seeking better income and unwilling to take on the higher risks associated with equities inevitably need to consider funds that diversify away from traditional sources of income such as government bonds and money market instruments, into yield-enhancing assets, namely corporate or state-owned enterprise bond issues, listed property and preference shares.

Given the lower credit ratings these non-sovereign borrowers are awarded compared to government paper, they inevitably offer higher yields to investors, who, in turn, benefit from better income distributions. This also means more risk than investing in ‘safe-as-houses’ government bonds - where the possibility of default is much less likely (but not impossible given current unsustainable public deficit situations in the developed world). However, there are many good quality corporate and parastatal bonds, with an extremely low likelihood of defaulting.

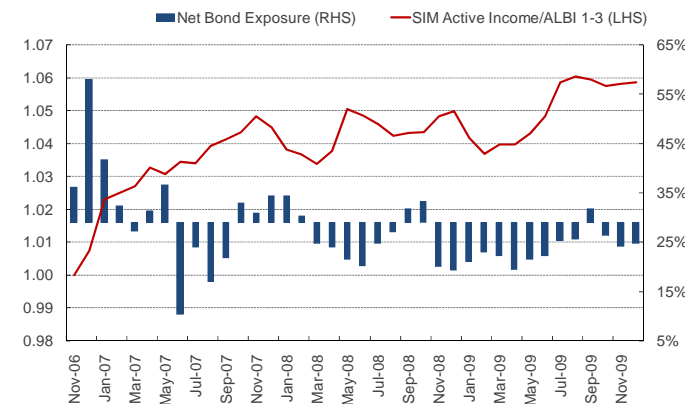
As a leading player in the SA fixed interest industry, SIM has built up significant capabilities in analysing and investing in non-government credit.

In taking advantage of its skills in this arena, the SIM Active Income Fund, a varied specialist fixed interest fund, outperformed its benchmark over one, two and three years, delivering 9.95% (2.6 percentage points above its benchmark) for the year to end-January.

**Yields to move sideways**



**SIM Active Income outperformance**



Source: SIM

## strategy summary

Domestic		
	Position	Justification
<b>Equities</b>	Overweight	<p>We introduced an overweight equities position in the fourth quarter of 2008. In response to the repricing of the equity market, we reduced this overweight position in the second and again in the third quarter, but remain marginally overweight given the market's current valuation.</p> <ul style="list-style-type: none"> <li>• Overweight industrials</li> <li>• Slightly overweight financials</li> <li>• Underweight resources</li> <li>• Underweight small caps</li> </ul>
<b>Bonds</b>	Overweight	<p>We retained our overweight position in bonds. With ten-year bonds yielding above 9%, and given our long-run inflation assumption, long bonds offer a real return of just below 4%. During the fourth quarter, we increased our overweight position in inflation-linked bonds in response to a rise in yields on the RSA 2023 inflation-linked bonds to about 3.2%.</p> <p>SA inflation-linked bonds are attractive relative to global developed market inflation-linked bonds, which are currently at very low levels. US 10 year Tips are trading at just above 1%, while similar European bonds are trading well below 1%. These low real rates are partly a reflection of the historically low short-term policy rates in these economies.</p>
<b>Cash / Fixed Interest</b>	Underweight	Better returns offered by other asset classes.
<b>Property</b>	Neutral	We retained our neutral position to property based on current valuations.

International		
	Position	Justification
<b>Equities</b>	Overweight	<p>We reduced our overweight position in international equities during the quarter. In US dollar terms, the MSCI World Index rallied more than 65% off its low point at the beginning of March 2009 when we increased our overweight position. Over the same period, the MSCI Emerging Markets Free Index rallied almost 100%. In the last few months of 2009, developed market earnings surprised on the upside relative to consensus forecasts. The US market is now trading at a normalised earnings price to earnings (PE) ratio, or long-run trend earnings, of around 22. The last time the S&amp;P 500 traded at a trend PE below this was in the mid-1990's. Based on most long-run measures, however, global developed equity markets do seem fairly valued if we consider the period since the mid-1990's as an anomaly when stock markets were consistently overvalued.</p>
<b>Bonds</b>	Underweight	<p>We introduced an underweight in global bonds during the fourth quarter of 2009 given that 10-year treasury yields have only been lower than their current level during the Great Depression and during, and in the immediate aftermath of, the Second World War when long term yields were fixed at 2.5%. The investment case that supports the current low bond yields in the US is a deflationary situation similar to Japan's but we believe the odds of this playing out in the US and Europe are low. We are agnostic in our view of whether inflation will become a problem globally.</p> <p>We no longer prefer corporate bonds to sovereign bonds because developed market credit has performed particularly well and is now in line with the default risk of these companies.</p>
<b>Cash</b>	Underweight	Our underweight position in offshore cash contracted as a result of a reduction in our overweight position in global equities and a shift from neutral to slightly underweight in global bonds.

**Note:** Text highlighted in bold indicates updates to the previous house view published in market watch.

## market statistics ALL FIGURES QUOTED AS AT 12/03/2010

### Top 20 SA Stocks (listed in market capitalisation order)

SA Top 20	Price in cents	MTD%	YTD%
BHP Billiton	24 790	7.29	4.60
Anglo American	30 490	10.27	-4.57
SABMiller	21 094	6.54	-2.52
MTN Group	11 806	5.50	0.14
Sasol	28 500	1.08	-4.36
Standard Bank Group	11 450	6.55	12.25
Richemont AG	2 823	10.49	13.46
Impala Platinum	19 801	5.41	-2.45
Naspers -N	30 150	4.69	0.50
Anglo Gold Ashanti	28 000	1.09	-8.58
FirstRand	1 965	8.03	7.14
Old Mutual	1 393	6.34	5.69
Anglo Platinum	69 900	-2.17	-11.80
Goldfields Ltd	9 035	1.69	-7.79
Sanlam	2 510	2.74	10.33
ABSA	13 760	3.61	7.08
Bidvest	13 950	5.68	8.14
Remgro	9 695	7.72	8.69
Shoprite	7 849	4.79	20.35
Liberty International	5 450	-1.27	-7.75

### Group 8 Global Equity Indices

Index	Level	MTD%	QTD%	YTD%
S&P 500	1 150	4.12	3.13	3.13
S&P/TSX (Canada )	12 014	3.30	2.28	2.28
Russian RTS	1 535	10.39	6.23	6.23
FTSE 100 (UK)	5 626	5.06	3.93	3.93
CAC 40 (France)	3 927	5.89	-0.23	-0.23
DAX (Germany)	5 945	6.19	-0.21	-0.21
FTSE MIB (Italy)	22 565	7.10	-2.94	-2.94
Nikkei 225 (Japan)	10 751	6.17	1.94	1.94

### Outreach 5 Global Equity Indices

Index	Level	MTD%	QTD%	YTD%
Bolsa (Mexico)	32 578	2.98	1.42	1.42
Bosvepa (Brazil)	69 341	4.27	1.10	1.10
China SE Shang. Comp	3 013	-1.26	-8.05	-8.05
Nifty 50 (India)	5 137	4.36	-1.23	-1.23
FTSE/JSE All Share	28 262	5.60	2.15	2.15

### Bonds

		Maturity	Yield
SA Bonds	R157	2016	8.18
International Bonds	US 10-year	2016	3.49
	UK 10-year	2016	3.15
	JP 10-year	2016	1.13

### Commodities

	Price	QTD %	YTD %
Gold (US \$/oz.)	1101.9	0.45	0.45
Oil (Brent) (US \$/barrel)	79.02	2.36	2.36
Platinum (US \$/oz.)	1607	9.66	9.66
Silver (US \$/oz.)	17.07	1.13	1.13

### Currencies

	QTD%	YTD%
Rands per Dollar	7.64	-2.95
Rands per Pound	11.99	1.50
Rands per Euro	10.45	5.95

## fund performance

Domestic fund performances as at 28 February 2010 (* CPIX & TER figures as at 31 January 2010)							
Collective Investment	1 year (%)	3 years (%)	5 years (%)	Since Inception (%)	TER °	Launch	Domestic Fund Category
<b>SIM Absolute Return Income A</b> * CPIX + 3% over rolling 2-years (31/01/10)	<b>8.90</b> 9.50	<b>8.67</b> 11.23	<b>8.70</b> 9.85	<b>9.44</b> 9.27	1.12%	1-Apr-04	Fixed Interest Varied Specialist
<b>SIM Active Income A1</b> BEASSA All Bond (1 - 3) Index	<b>10.04</b> 7.65	<b>10.32</b> 9.10	-	<b>11.00</b> 9.28	0.83%	3-Nov-06	Fixed Interest Varied Specialist
<b>SIM Inflation Plus</b> * CPIX + 4% over rolling 3-years (31/01/10)	<b>13.85</b> 10.50	<b>5.38</b> 12.23	<b>9.40</b> 10.85	<b>10.17</b> 11.07	1.17%	1-Apr-99	AA Targeted A&R Return
<b>SIM Balanced R</b> Median of Morningstar AA Prudential Variable Category	<b>32.66</b> 23.21	<b>4.40</b> 4.57	<b>13.73</b> 12.90	<b>15.03</b> 15.03	1.23%	1-Feb-95	AA Prudential Variable Equity
<b>SIM General Equity R</b> FTSE/JSE All Share Index	<b>49.66</b> 48.30	<b>4.73</b> 4.11	<b>18.05</b> 17.90	<b>14.83 (1993)</b> 18.69	1.15%	26-Jun-67	Equity General
<b>SIM Top Choice Equity A1</b> 97% FTSE/JSE SWIX, 3% STeFI	<b>44.28</b> 46.81	<b>5.68</b> 4.40	-	<b>13.04</b> 9.96	1.41%	18-Aug-06	Equity General
<b>SIM Value R</b> FTSE/JSE All Share Index	<b>59.45</b> 48.30	<b>6.29</b> 4.11	<b>18.46</b> 17.90	<b>25.08</b> 18.69	1.75%	1-Oct-98	Equity Value
<b>SIM Property A</b> Capped SA Listed Property Index	<b>24.77</b> 25.89	<b>4.79</b> 4.16	<b>17.49</b> 17.62	<b>21.55</b> 22.24	1.71%	1-Apr-04	Real Estate General

Source: Morningstar. Lump sum investment in SA Rand with income reinvested. Calculated on a NAV-NAV basis. YTD performance is total growth percentage, all other periods are annualised growth rate. SIM calculated benchmarks.

° TER - (Total Expense Ratio) is calculated as a percentage of the average Net Asset Value of the portfolio which was incurred as charges, levies and fees related to the management of the portfolio. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs. TER figures as at 31 January 2010.

### Important Notices

Collective investments are generally medium to long-term investments. The value of units may go down as well as up and past performance is not necessarily a guide to the future. Collective investments are traded at ruling prices and can engage in borrowing and scrip lending. Collective investments prices are calculated on a net asset value basis, which is the total value of all assets in the portfolio including any income accrual and less any permissible deductions from the portfolio. Portfolio performance is calculated on a NAV to NAV basis and does not take any initial fees into account. Annualised growth rate. Income is reinvested on the ex-dividend date. The source is Morningstar. A schedule of fees and charges and maximum commissions is available from the management company/scheme. Commission and incentives may be paid and if so, would be included in the overall costs. Forward pricing is used. The following charges are levied against the portfolio: brokerage, auditor's fees, bank charges and trustee fees. Member of the ASISA.

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