



December Equity Market Commentary

Matt Brenzel

INTERNATIONAL

Things toppled in 2011. Thus we saw the demises of the “Brotherly Leader” of Libya, the “Dear Leader” of North Korea (only to be replaced by his pudding-faced son, aka “Brilliant Leader”), the President of Egypt, the Prime Ministers of Italy and Greece and – of course – our own Che Guevara wannabe, Julius Malema. The world’s financial leadership displayed similar changes. Who will forget the scandal around Dominique Strauss-Kahn at the IMF and the euphoria at the long-awaited retirement of Jean Claude Trichet at the ECB? Above all though, it was a year in which the common sense of the leadership of the European Union and the USA came up well short.

INDICES (US\$)	Month	Quarter	12 Months
MSCI World	-0.3%	6.7%	-9.4%
MSCI Emerging	-1.3%	4.1%	-20.4%
MSCI China	2.5%	8.0%	-20.3%
MSCI India	-6.0%	-14.3%	-38.0%
MSCI SA	-2.2%	6.1%	-17.3%
MSCI USA	0.8%	11.1%	-0.1%
MSCI Europe	-1.6%	4.9%	-13.8%

Source: BofAML

Great equity market returns in this kind of leadership vacuum could hardly have been expected. The flight to safety saw strong demand for gold bullion (+10% in the year) and bonds (US 30-year bonds were up 31%). Risk aversion took its toll in a very traditional way with equities underperforming and the more cyclical components such as Materials (-26%) and Emerging Markets (-20%), leading the downside. Reputations were wrecked in the process and retirements abounded: Stanley Druckenmiller, George Soros and Bill Miller. Others who got it wrong include luminaries such as Bill Gross and Warren Buffett (albeit for the second time only in his career).

Things are not going to improve overnight, especially in Europe. However, the US economy has bettered even the most optimistic of expectations and China will not crash-land. It’s all up to Angela and Nicolas.

1 good PIIG and 1 not-so-good PIIG.

Best country (US\$)	Quarter	Worst country (US\$)	Quarter
Ireland	22.3%	Greece	-27.5%
Peru	11.6%	Turkey	-15.7%
Thailand	11.5%	India	-14.3%

Best country (US\$)	Year	Worst country (US\$)	Year
Ireland	11.4%	Greece	-63.6%
Indonesia	4.0%	Egypt	-48.8%
New Zealand	1.1%	Argentina	-42.6%

Best sectors (US\$)	December	Worst sectors (US\$)	December
Health Care	2.5%	Materials	-5.0%
Banks	0.8%	Auto & durable services	-2.0%
Media	0.8%	Software	-1.9%

Best sectors (US\$)	Year	Worst sectors (US\$)	Year
Health Care	4.4%	Materials	-25.8%
Consumer Staples	3.3%	Diversified Financials	-24.4%
Retailing	0.0%	Banks	-21.1%

Defensive

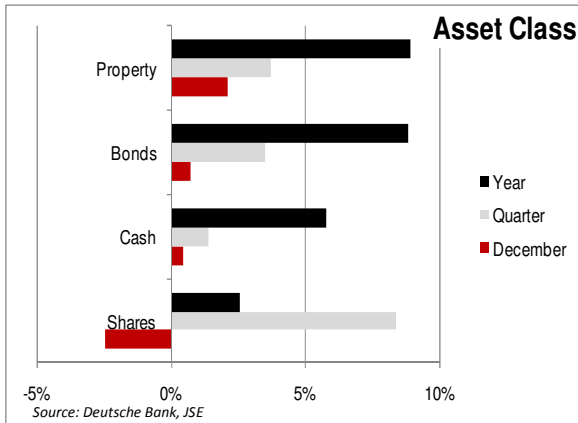
Top strategy (US only)	Quarter	Worst strategy (US only)	Quarter
Price Momentum	17.6%	Relative strength	4.2%
Earnings revisions	16.1%	ROE	7.5%
Low EV/EBITDA	15.6%	DDM valuation	9.8%

Top strategy (US only)	Year	Worst strategy (US only)	Year
Dividend Yield	18.5%	High Beta	-21.2%
ROE	8.3%	Low Price	-17.3%
RO Capital	5.9%	Low Price-to-Book	-16.7%

Source: BofAML



LOCAL (Ranking of the following 6 graphs is based on performance in the month. Shaded equity performers in the tables are ranked on weighted contribution.)



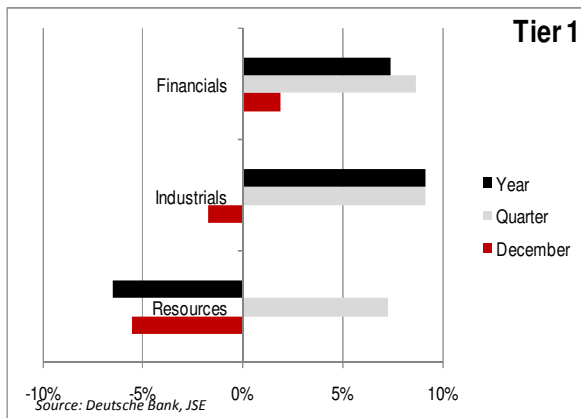
ALSI	%ch Qtr	Rank	ALSI	%ch Year	Rank
Billiton	9%	1	SAB Miller	20%	1
Sasol	15%	2	Old Mutual	31%	2
Anglos	8%	3	Sasol	11%	3
Amplats	-4%	164	Billiton	-12%	164
Redefine	-8%	163	Anglos	-14%	163
Telkom	-9%	162	Implats	-28%	162

Property	%ch Qtr	Rank	Property	%ch Year	Rank
Growthpoint	5%	1	Capital	7%	1
Resilient	7%	2	Resilient	7%	2
Sycom	13%	3	SA Corp.	9%	3
Redefine	-8%	20	Redefine	-7%	20
Acucap	-3%	19	Hyprop	-7%	19
Hyprop	-1%	18	Emira	-14%	18

Bonds	%ch Qtr	Rank	Bonds	%ch Year	Rank
Inf-Linked	4%	1	Inf-Linked	13%	1
7-12 Years	4%	2	7-12 Years	10%	2
3-7 Years	3%	3	3-7 Years	10%	3
Cash	1%	6	Cash	6%	6
1-3 Years	2%	5	12+ Years	6%	5
12+ Years	3%	4	1-3 Years	9%	4

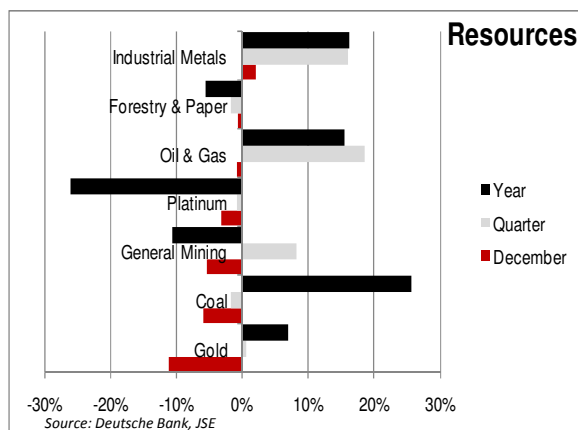
Pretty much a "kyk weer" with Property ending the year as the winning asset class, as was the case in 2010 when it recorded a return of 30%.

Shares were beaten up courtesy of Europe, but the surprise was the bond market which no-one gave much of a chance at the beginning of the year. Macro fallout soon afforded it safe haven status, though.



Resource counters had a negative year as a result of the large cap General Miners (given the misnomer of "being defensive") grossly underperforming.

With the events in Europe capping the performance of Financial shares, it was left to industrials to end 2011 as the leading Tier 1 sector.



RESI	%ch Qtr	Rank	RESI	%ch Year	Rank
Billiton	9%	1	Sasol	11%	1
Sasol	15%	2	Anglogold	5%	2
Anglos	8%	3	Harmony	14%	3
Amplats	-4%	23	Billiton	-12%	23
Northam	-9%	22	Anglos	-14%	22
Lonmin	-7%	21	Implats	-28%	21

Commodity prices were blitzed in 2011, with most being down by +/-20% in US\$-terms and flattish in ZAR-terms. The Rand gold price was the notable exception, having risen by 33% over the last 12 months.

The Industrial Metals sector was driven to No.1 spot by Kumba (+17%), despite the Rand iron ore price remaining largely unchanged.

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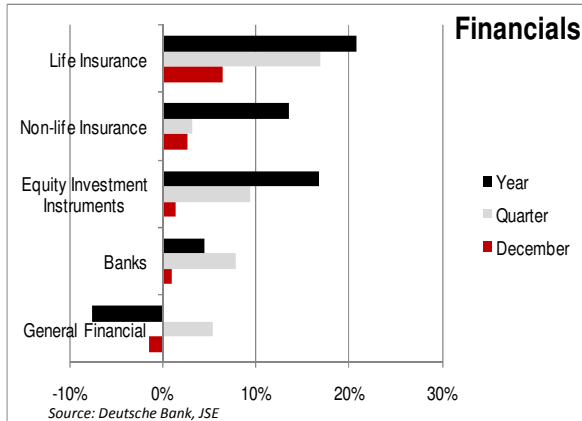
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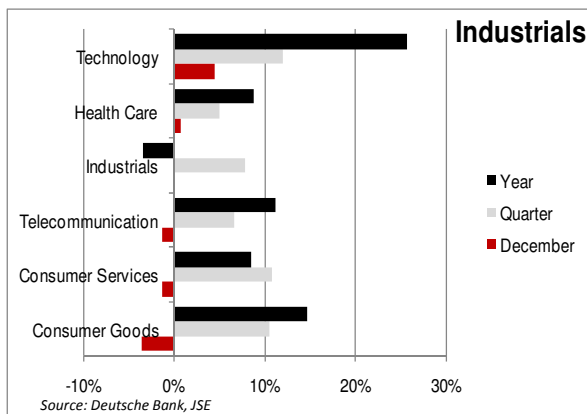
ASSET MANAGEMENT



FINI15	%ch Qtr	Rank	FINI15	%ch Year	Rank
Old Mutual	31%	1	Old Mutual	31%	1
Standard	6%	2	Reinet	21%	2
FirstRand	6%	3	FirstRand	6%	3
Capshop	-3%	16	Standard	-8%	16
Investec plc	-2%	15	Investec plc	-22%	15
Liberty	-1%	14	ABIL	-11%	14

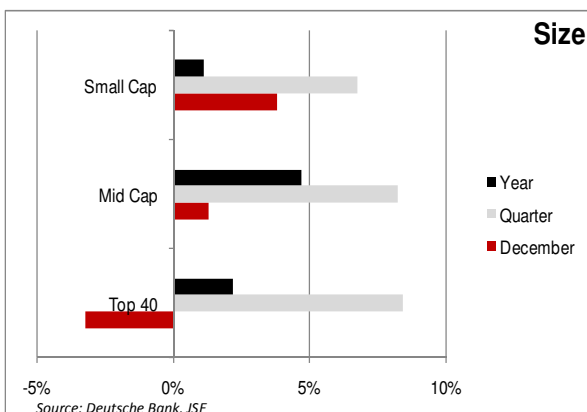
Old Mutual drove Life Insurance to No.1 in both the quarter as well as the year as a result of its ongoing strategy of divesting itself of several albatrosses.

ABIL has fallen out of favour as it faces competitive pressures from several entrants into the unsecured loans market.



INDI25	%ch Qtr	Rank	INDI25	%ch Year	Rank
Pick 'n Pay	28%	1	Tiger Brands	30%	1
Imperial	17%	2	Life Health	39%	2
Tiger Brands	19%	3	Woolies	45%	3
Telkom	-9%	26	Netcare	-13%	26
Vodacom	-2%	25	Steinhoff	-6%	25
Mondi Ltd	-2%	24	Sappi	-30%	24

Although Technology stocks (EOH +58%, Datatec +22%) led the Industrials in 2011, their overall impact was muted given their relatively small size. The switch into defensive mode drove counters such as Tiger Brands and the search for growth, several retailers. Construction lagged



Top40	%ch Qtr	Rank	Top40	%ch Year	Rank
Billiton	9%	1	SAB Miller	20%	1
Sasol	15%	2	Sasol	11%	2
Anglos	8%	3	Old Mutual	31%	3
Amplats	-4%	42	Billiton	-12%	42
Capshop	-3%	41	Anglos	-14%	41
Investec plc	-2%	40	Implats	-28%	40

Mid Caps	%ch Qtr	Rank	Mid Caps	%ch Year	Rank
Foschini	24%	1	Life Health	39%	1
Imperial	17%	2	Reinet	21%	2
Barloworld	24%	3	Metrex	69%	3
Redefine	-8%	61	Sappi	-30%	61
Telkom	-9%	60	PPC	-22%	60
Northam	-9%	59	Aveng	-24%	59

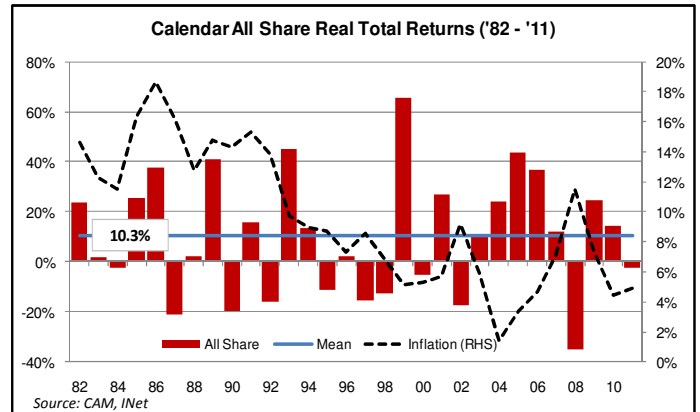
Small Caps	%ch Qtr	Rank	Small Caps	%ch Year	Rank
Supergroup	28%	1	EOH	58%	1
Omnia	14%	2	Metair	59%	2
Oceana	28%	3	Pan Afr. Res	62%	3
Avusa	-19%	61	Group 5	-38%	61
Group 5	-12%	60	Merafe	-45%	60
Sentula	-17%	59	Atgri	-31%	59

Midcaps also provided the best return in 2010: 30%, followed by Small Caps (25%) and Top 40 (+17%).

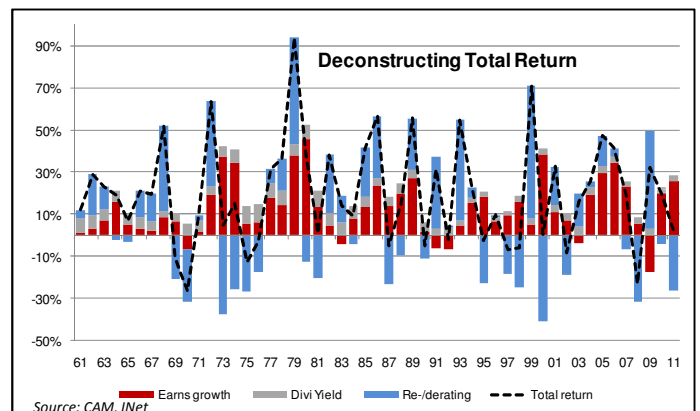


SOME OTHER THOUGHTS

- We have often stated that the equity market appeared to be almost bullet-proof in the face of the macro issues that investors had to deal with in 2011. Thus no one should have been surprised that 2011 produced a negative real return. Indeed, most would view the -2.5% number with relief as it compares most favourably with the other years that experienced negatives, the worst of which was -35% in 2008, when the market fell by 23% and inflation rose by nearly 12%.



- Breaking down the nominal return in 2011 of +3% we note the following: i) earnings growth came through at about +26% for the year (adjusting for those companies whose year-ends are 31st December and who have yet to report). This is the 9th best year of earnings performance on record in the period under review. #1 was 1980, when earnings leapt by 46%; ii) the dividend yield averaged 3% in the past year, which is more-or-less line with what we have seen over the past few years. Excluding the dividend, the return from the All Share Index would have been -0.4% in 2011.



We calculate that the actual dividend payout rose by some 15% in the year, which – with earnings growth at +26% - implies that corporates have increased retentions; iii) by deducting the earnings and dividend growth rates from total return, we calculate the amount of re- or derating meted out to the market. In 2011, this amounted to a derating of -26% and is the 4th worst number on record since 1961. In 1973, the market derated by -38% (oil crisis), in 2000 it recorded -41% (Dot.com Bubble) and in 2008, -32% (Great Recession).

- So where within the equity space does value lie – or not? The table alongside presents an overview of the historical returns of the All Share Index and its major Economic Groups over the past decade. The green shading highlights the top performer in any one particular year and the pink, the worst performer.

	All Share	Oil & Gas	Basic Materials	Industrials	Consumer Goods	Health Care	Consumer Services	Telecommunication	Financials	Technology
2002	-8%	4%	21%	7%	-25%	-9%	17%	3%	-7%	-65%
2003	16%	-4%	2%	23%	1%	20%	44%	114%	18%	49%
2004	25%	33%	36%	61%	28%	41%	69%	47%	52%	8%
2005	47%	93%	18%	26%	50%	36%	29%	46%	35%	30%
2006	41%	18%	49%	49%	44%	45%	34%	33%	36%	30%
2007	19%	35%	28%	18%	14%	-3%	6%	42%	3%	24%
2008	-23%	-14%	-31%	-26%	-6%	-17%	-10%	-14%	-26%	-36%
2009	32%	10%	38%	22%	37%	77%	45%	10%	28%	54%
2010	19%	20%	12%	24%	26%	21%	43%	20%	17%	42%
2011	3%	15%	-8%	-3%	15%	9%	9%	11%	7%	26%

Source: Deutsche Bank, JSE

From the table, the following emerges: i) Telecommunications produced the single best performance in one year: +114% in 2003; ii) the worst performance in a year was produced by Technology: -65% in 2002; iii) Technology stocks (+26%) were the best performers in 2011 and were marginally pipped to the post in 2010 by Consumer Services (+43% vs +42%); iv) Basic Materials shares were the worst performers in the past two years (+12% and -8%). It is the only Group to have achieved the dubious distinction of two consecutive years of relative underperformance in the period reviewed. No Group has achieved two consecutive years of outperformance.

If we now overlay ratings with some of the data in the previous exercise, we get the table alongside which shows the compounded 2-year returns of the Economic Groups (ranked in order of best to worst) and their Price-to-Earnings relative rating to the All Share Index. We note the following: i) the Consumer Services Group (Food & Drug Retailers, General Retailers, Media) has the highest PE relative to the All Share of all the Groups

Economic Groups	Returns			PE Relative to All Share Index		
	Year-to-2011	Year-to-2010	2 year comp.	Ave. since Dec 2001	Spot	Premium/Discount
Technology	26%	42%	79%	1.1	1.5	36%
Consumer Services	9%	43%	55%	1.1	1.6	52%
Consumer Goods	15%	26%	44%	1.2	1.4	16%
Oil & Gas	15%	20%	39%	0.8	0.9	5%
Telecommunication	11%	20%	33%	1.0	1.2	18%
Health Care	9%	21%	32%	1.0	1.3	24%
Financials	7%	17%	25%	0.9	1.0	23%
Industrials	-3%	24%	20%	0.9	1.1	24%
Basic Materials	-8%	12%	2%	1.1	0.7	-33%

Source: Deutsche Bank, JSE, IBES

and is also the most expensive in terms of its history over the past decade; ii) conversely, the Basic Materials Group (Forestry & Paper, Gold, Platinum, Industrial Metals, General Mining) has the cheapest absolute and relative rating.

So, in looking what to get rid of, we would recommend to start by trawling through those Consumer Services and Technology shares which are on unsustainable ratings and to look at buying in those counters within the Basic Materials complex which are trading at deep discounts to their historical averages.

- The event horizon of a black hole is the point at which any celestial body can no longer defy the former's strong gravitational pull. The question that most analysts are grappling with at the moment is whether Europe is not at that point now, with the "gravitational pull" in this instance, being a severe recession. Most of the equity market volatility of 2011 was as a result of the apparent ineptitude of the Euro leaders in addressing sovereign and banking debt problems. This is likely to come to a head in the first quarter of 2012 as there are sizeable bond rollovers to take place. The question is: will they be rolled and - more importantly - at what price?

Our view is that the fiscal bungling that characterised 2011 will moderate in 2012 as leaders and policymakers get a better handle on what is required. Included in this assumption is that some hard decisions will be taken on cutting back on the profligate welfare programmes that have led to the problem. Innovative ways will have to be sought to redress the imbalances, such as lengthening the retirement age and cutting back on defense spending. Voluntary euthanasia might be a step too far, at this stage.

Additional Quantitative Easing programmes cannot be excluded, although the most recent examples have proven to have had less of an impact on the real economy (by raising money supply and credit) and more of an effect on bank reserves. Unless deleveraging by the consumer comes to an end, this is not likely to change. Until then, we take heart from the ability of the US economy to regenerate itself, the monetary and fiscal maneuverability of the Chinese economy to avoid a hard landing and above all, the relative cheapness of the share market.

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