MARKET INSIGHT

Targeted Market Commentary from Simeka Consultants & Actuaries

Second Quarter 2012

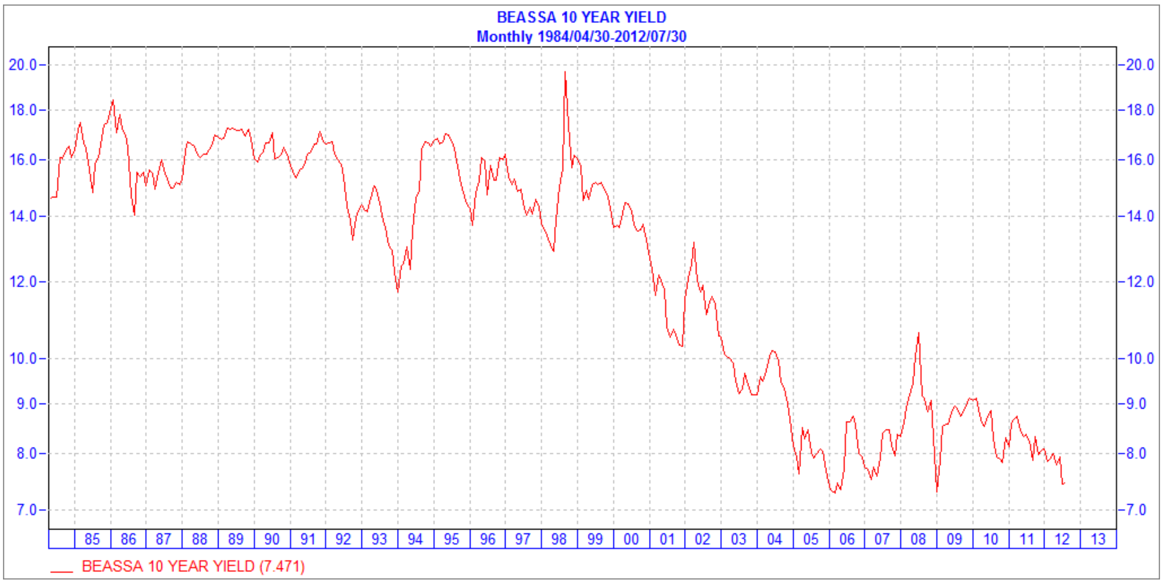
Market commentary

The second quarter produced a marginally positive return in equity with the All Share index up by 0,98% including dividends after a relatively strong June 2012. It however masks more significant movement in different sectors of the equity market with resources being the major detractor in performance and property in particular returning more than 10% over the quarter. Offshore equity returns have been flat to negative after a relatively strong performance during the last year in Rand-terms.

The longer term performance on listed property is equally impressive with an annualised return on 25% over the last 10 years and 14,85 over the last 5 years. Over this period the market capitalisation of the sector has also increased 5-fold, and a significant number of new funds entered the listed market.

South African bonds had a strong quarter returning 5,2% as fears of inflation subsided. Inflation on an annual basis dropped within the SA Reserve Bank range of between 3% and 6% to 5,7%. In this period the rand weakened slightly against the dollar but maintained its value against the euro. Investment inflows from foreign investors into our investment markets remained positive assisted by the inclusion of South African debt into world indices. This means that index tracker funds will now include investments into South African debt.

At a yield of 7,4% South African government debt are yielding much more than US 10 year debt at 1,5% but are also at historic lows. With the inverse relation between yield and capital in the debt market it means that funds have seen significant capital growth in this asset class. This means that based on yield to maturity South African debt is priced at similar levels than the debt of Spain and Italy. If that is however compared to inflation in the respective countries, the real yield demanded in Spain and Italy is much higher than in South Africa. Property prices in Spain for instance have fallen significantly in the recent past. It is also important to note that the cost of longer term borrowing in some of these European countries have increased significantly in the last number of years as opposed to the South African situation where the cost has decreased significantly.



Source: Inet-bridge

Interest rates in China, Brazil and India as well as rates determined by the European Central bank, have been reduced in recent months as economic activity slowed.

Manager Review

- Allan Gray is still maintaining a conservative view on local investments. The institutional portfolios have been closed to new investors for some time.
- The most consistent manager over 1 year, 3 year periods is still Foord.
- Stanlib and Coronation are continuing their good run in volatile markets.
- Investec after a relatively poor 2011 has performed well year to date and are again the top performer over 5 years.
- Some of the managers where there has been corporate restructuring such as Momentum, Cadiz and Prescient are lagging the pack. Unfortunately, these changes still reflect in the relatively poor performance with even more changes that occurred during this quarter at Momentum.

Outlook

As European governments found their way through the difficult process of dealing with too much debt and some European countries with the increasing cost of debt, markets remains volatile. In these circumstances politicians are struggling to hold on to their seats of power and a significant number of changes in governments have occurred, including that in France and Greece. Some major elections still need to occur during the year including that in the USA with important policy decisions on tax and expenditure that are pending.

The harvesting of dividends, rent and coupons is still an important part of returns, although higher dividend paying companies' prices have been bid up significantly. The price of 10 year borrowing by the USA have been bid down to an historic low of 1,5% per annum which is much lower than inflation and is clearly not sustainable.

Other Developments

The implications of Crisa, the code for responsible investment in South Africa, include the responsibility of asset owners which includes pension funds, to vote at the annual general meetings of companies. In South Africa, this is mostly done on behalf of pension funds by asset managers or their agents. Assisted by the economic situation there has in fact been worldwide participation by shareholders on issues such as

- Executive remuneration
- Use and control of capital.

Executive remuneration has been quite topical and relative to other labour costs has increased markedly over the last 10 years. In the search for yield, shareholders are likely to ask more and more questions about how thee capital is utilised.

The Financial Services Board has issued the final version of the enhanced regulation 28 reporting requirements (the minimum diversification rules). The first reports need to be submitted by September 2012 for the first and second quarter of 2012. Member level reporting has been postponed until the end of December 2012. It is clear that these regulatory requirements are onerous and will place some stress on system development and compliance processes of funds in the near future.

Dirk Oosthuizen

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