MARKET INSIGHT

Targeted market commentary from Simeka Consultants & Actuaries

Second Quarter 2010

Economic Overview

Financial markets experienced extreme turmoil in Q2 of 2010 as fears of a possible double dip recession and economic recovery prevailed. Worldwide equity markets plummeted as the sovereign debt crises of Club Med countries and Ireland dominated headlines. Fears of social instability and political unrest further stemmed markets negatively as the worst performance for more than 20 years was recorded by equity markets in May.

The fiscal and low interest rate stimulus packages in developed nations have worked well since 2008 to assist a recovery. However, as governments face up to large budget deficits and debt obligations the decision to maintain or exit such stimulus strategies has come into focus.. In South Africa we have been fortunate in that public spending towards infrastructure has increased from R124,8bn in 2008 to R179,6bn in 2009 - an increase of 44% - which has come at an opportune time.

Simultaneously, the exchange rate of the Euro continued to weaken against other currencies, reflecting the economic turmoil prevalent in Europe. The Rand strengthened against the Euro by 5% in Q2. Economic indicators, in the United States especially, pointed to an economic recovery much slower and more modest than anticipated in 2009 and Q1 of 2010.

Market Commentary

The result was an adjustment to the FTSE/JSE All Share index of -8.2% in rand and -13.3% to the MSCI World index in US dollar terms (-8.8% in rand). The rand-dollar exchange rate weakened by 5.1%.

After the 0.5% reduction of the repurchase rate in March, returns earned on interest-bearing investments remained modest as the STeFi Composite index generated 1.7% for the quarter and the BEASSA All Bond TR index produced a return of only 1.1%. This shows the limited opportunity set available to investors in Q2 of 2010.

The difficult conditions and poor investment returns eroded the gains enjoyed in Q1 of 2010. The year-to-date return for the FTSE/JSE is -4.6%. The return over the same period for the money market is 3.6% and 5.6% for domestic bonds.

Manager Overview

As a result of the commotion in financial markets, some interesting changes occurred in the relative positioning amongst investment managers.

1. Through to March 2010, Allan Gray's Global Balanced Portfolio was the poorest performer when measured against its comparable peers for four consecutive quarters, leading to its position at the bottom of the rankings on 31 March 2010. This changed in Q2 of 2010 when Allan Gray posted significant outperformance of most of its peers. This recovery can be attributed largely to its low effective exposure to the domestic equity market where the manager uses a hedging strategy to partially protect the portfolios against market falls.
2. Re:CM holds a negative view on South African equity valuations and therefore follows a similar asset allocation strategy to Allan Gray, resulting in similar investment performance.
3. Amongst the large investment managers, Coronation continues to dominate the global balanced space. Coronation maintains low exposure to the domestic equity market, supplemented by exposure to listed offshore shares.
4. Investment managers to watch in the global balanced space include Investec, Prudential and Foord.
5. In the conservative space, Coronation was pushed out of the yellow jersey in Q2 of 2010 by Allan Gray, which has reduced exposure to the domestic equity market to below 10%.
6. However, over one year, Coronation's investment return remains at more than double that of Allan Gray as Coronation maintains much higher exposure to the domestic equity market.

Expectations are that financial markets will show some recovery in Q3 of 2010, in which case it is possible that the investment return paradigm that existed through to March 2010 may reassert itself. However, considering the uncertainty of the worldwide economic recovery, a prudent stance may yet pay off handsomely!