MARKET INSIGHT

Targeted market commentary from Simeka Consultants & Actuaries

Third Quarter 2010

In contrast to the second quarter of 2010, equity markets, with the exception of Japan, have shown marked improvement in value. This improvement has continued after quarter end. As the sovereign debt crises in Greece and other European countries were systematically dealt with, governments started to face up to significant budget shortfalls. In contrast, the USA has been contemplating a further expansion of its balance sheet by buying debt and therefore releasing more cash into the financial system. The USA is still concerned about the falling prices of property (deflation).

With consistent low interest rates in the USA (0,25%) and Japan (0,1%), overseas investors have been searching for higher yielding opportunities. Some of the investors have been buying emerging market assets, which has resulted in emerging market currencies strengthening markedly when compared to developed market currencies. Assets held in European emerging market bond funds have increased from €44,5bn at the end of 2008 to €96,4bn at the end of July 2010. South Africa has received a share of these portfolio investment flows totalling R72,5bn in the year-to-date and R179,6bn since the start of 2009. In 2009, R98,9bn of portfolio investment flows into the country related to equity purchases and R80,7bn to debt purchases. In context, the expected total net borrowing requirement of the government is R171,5bn for the fiscal year 2010/11 and Gold and Foreign Exchange reserves of the SA Reserve Bank were R319bn at the end of May 2010.

The ability of central banks in emerging economies to control exchange rates by building up Foreign Exchange reserves is therefore limited due to the sheer scale of these inflows. The Institute of International Finance is projecting $825bn of private capital flows to emerging economies for 2010. In 2009, these flows were $581bn.

In South Africa, the Rand/US Dollar exchange rate therefore improved from R7,66/$ to R6,97/$, improving even further after quarter end. During the quarter, the Rand has marginally weakened against the Euro from R9,36/€ to R9,50/€. A further sign that investors are concerned about the value of developed market currencies is the increase in the gold price to $1319/oz – a 19% rise since the start of the year! In general, we expect currencies to change with the relative difference in inflation over a long period of time. However, predicting exchange rates is notoriously difficult and even though exporters in South Africa are complaining about the strength of the Rand, a purchasing power index, which compares the cost of a Big Mac burger in various countries, still indicates that the Rand is under-valued against the US Dollar!

The SA Reserve Bank reduced its repurchase rate by a further 0,5% to 6% in September 2010 in line with inflation which at 3,5%, is well within the SARB's target range of between 3% and 6%. It is also an indication of lower than expected economic activity within the country. Yields on debt instruments have fallen over the quarter and provided significant gains. Bonds provided returns of 8% and cash 1,68% over the quarter.

The year-to-date returns on the JSE have swung around from the end of June 2010 to an 11,2% gain since the start of 2010.

Comparing relative performance of investment managers, those managers with a higher exposure to equity have shown improved performance and those with a negative outlook have underperformed during the last year. Most investment managers have used the stronger currency to extend their offshore exposure during the last year, in line with opportunity granted by the authorities.

- Allan Gray and Investec are still the strongest performers over 5- and 3-year periods. Allan Gray's performance over the last year and a bit is disappointing. With the exception of Q2 2010, it has lagged its peers over the last 2 years. It is still maintaining a low effective exposure to the domestic equity market.
- Coronation, Prudential and Foord have continued their strong performance amongst the Global Balanced portfolios, although Coronation has lowered domestic equity exposure significantly and has therefore not participated as much in the equity bull market of Quarter 3 of 2010.
- Over the short-term, Stanlib has maintained a higher domestic equity exposure, which has paid off over the last year. Its 3-year and 5-year performance numbers are still very disappointing.

The global economic outlook remains uncertain as is indicated through the low interest rate environments in many parts of the world. In a period where there is a geographical rebalancing of the world economy, it can be expected that investment portfolios may show some volatility. We maintain that a well-diversified balanced portfolio is still advocated for retirement savings.

Graph from http://bigmacindex.org/year/2010-big-mac-index.htm