MARKET INSIGHT

Targeted market commentary from Simeka Consultants & Actuaries

Fourth Quarter 2010

Economic Overview

The widespread fears of a possible double dip recession have calmed over the last quarter of 2010 and worldwide equity markets ran hard. Growth has continued to come from the emerging countries, supporting the emerging market hypothesis. However, money has been flowing to the emerging markets at an alarming rate, which has inflated asset prices. Conversely, developed market economies' asset prices now seem more attractive on a valuation basis, particularly equities. That is, even though the growth that is expected from these assets is lower, they are priced more cheaply.

QE 2 (Quantitative Easing Phase 2) has been rolled out in the US, dumping another US$600 billion in the US financial system. Some of this money has found its way to South Africa as part of carry trades and has influenced our domestic market.

Locally, supply-push inflation is a cause of concern in the form of oil and food prices. This will likely drive short-term interest rates higher by the end of 2011. An aggregate 19% increase to civil servants earnings will also increase the demand side of prices. Consumer expenditure is up about 8% y/y.

Short-term interest rates globally are still at the lower side of the cycle, though China has already started raising interest rates to curb its inflation. This makes bond yields relatively unattractive looking forward. The Euro has strengthened slightly against the US dollar, while the Rand has strengthened both against the dollar and the Euro, reflecting the economic challenges faced by Europe and the USA.

Market Commentary

The FTSE/JSE All Share index rallied by 9.5% in rand terms over the quarter, while the MSCI World Equity Index returned 9.1% in US dollar terms (3.8% in rand). Domestic resource companies did particularly well (16.5%). The rand-dollar exchange rate strengthened by 4.9%.

The repurchase rate was lowered by another 0.5% in September 2010 and then kept at that level, 5.5%. Inflation remains low at 3.5%, which could allow for further interest rate cuts, but the market is expecting no more, with the first increase expected at the end of 2011 or start of 2012. All this didn't bode well for bonds, which returned 0.7% over the quarter. If it weren't for December's 1.7%, the return would have been negative. Cash was only slightly better at 1.6% for the quarter.

2010 ended up being a good year for equity and bond investments, the FTSE/JSE up with 19.0% and the All Bond Index up with 15.0%, compared to the cash return of 6.9% (STeFI).

Manager Overview

Even though the FTSE/JSE was up 19% over 2010, it was down as many months as it was up (6/6). In this context, the range of returns provided by managers was wide. Below are some comments to summarise:

1. Stanlib are ahead of Coronation over the 4th quarter and the calendar year of 2010. Even though some big names left the business, the returns have been picking up. In some months asset allocation has added big value, but stock picking has been the consistent performance driver. Foord follows Coronation in third place over both periods.
2. Coronation continues to show very good returns in the global balanced space. Asset allocation, as well as stock picking, contributed to outperformance for the manager. Coronation is looking to global equity as a big source of outperformance going forward, particularly in the developed countries, citing favourable valuations.
3. Allan Gray has been the big seesaw-rider over the year. Through to March 2010, the Global Balanced Portfolio was positioned at the bottom of the rankings. This changed in Q2 of 2010 when Allan Gray posted significant outperformance of most of its peers, due to its defensive positioning. This same positioning, however, has cost the portfolio for the next two quarters and it now sits second to last over the quarter and year.
4. Re:CM, Oasis and RMB join Allan Gray at the bottom of the list.
5. Over 3 years, Coronation, Re:CM and Foord are top the list in that order, whereas over 5 years, the order becomes Investec, Coronation and then Allan Gray. Stanlib brings up the rear over both these periods.
6. In the conservative space, Coronation reclaimed the top spot, followed by Symmetry. Allan Gray and Investec round off the list from the bottom.

Outlook

The global economic outlook remains uncertain, though more stable than before. Equity markets have run ragged and the returns expectations are therefore more subdued for 2011. However, the last year has shown the danger of sitting out of the market. Long term investments need the (risky) market exposure in order to have growth potential. Money market returns are expected to remain low and bonds may even yield less than the fourth quarter.