NOVARE®

A challenging environment…

Market Overview

December 2011

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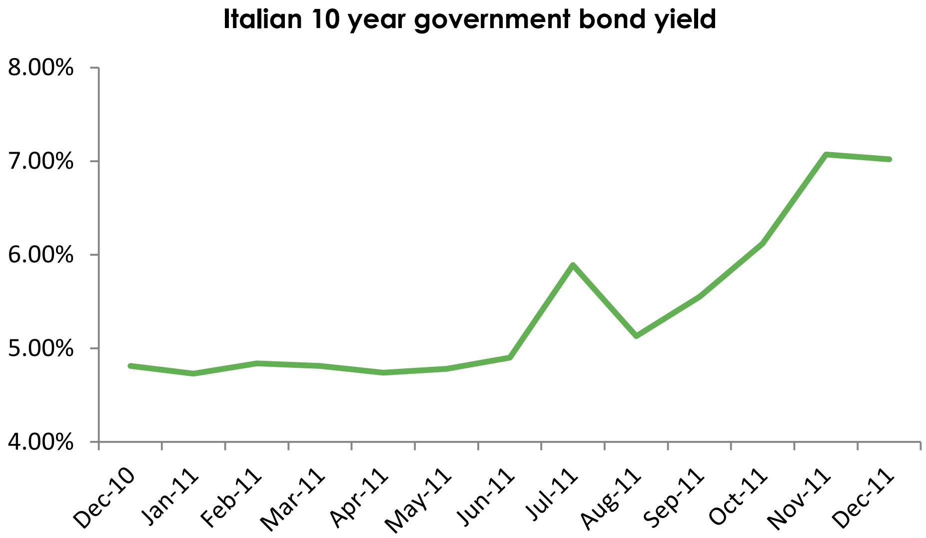
Fourth Quarter in Review

GLOBAL

The raging European sovereign debt crisis intensified during the quarter as problems spread from the periphery to core countries. The escalating borrowing costs of Italy and Spain brought into question the ability of core economies to devise a sufficient rescue package. The challenging political environment led to the resignation of both the Greek and Italian Prime Ministers. It also demanded more coordinated measures from politicians and officials to stabilise the crisis and prevent it from escalating. The measures were met with varying degrees of pessimism and the impact of the crisis started to spread beyond the borders of Europe. Borrowing costs in many parts of the world have been pushed up and stock markets have been put under pressure. Global growth has slowed down drastically.



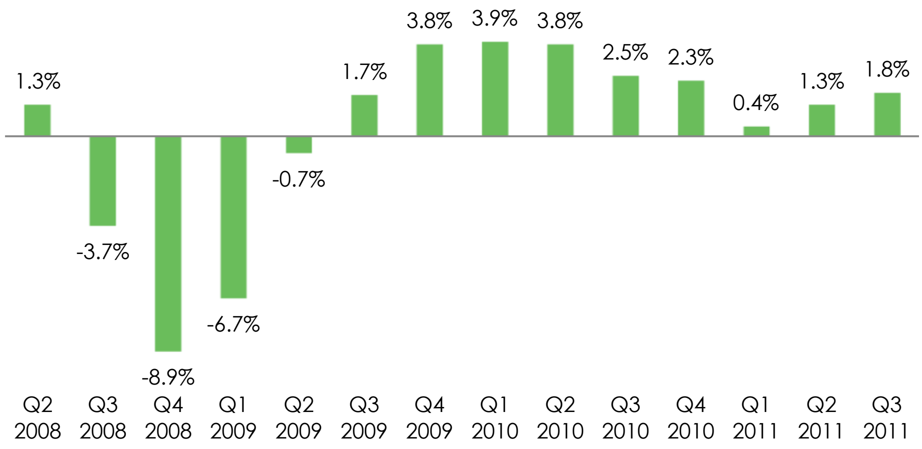
Source: Inet Bridge

The global growth trajectory has become more uneven. Emerging markets continued to outpace their developed market counterparts struggling to work through reducing their debt loads. Within developed markets, the US economy accelerated towards year-end compared to Europe which was heading for a recession. Financial turmoil and austerity measures in Europe put the brakes on economic output, which spilled over to emerging markets with strong trade links with the region. Several European countries continued to face credit rating downgrades or were placed on warnings from credit rating agencies.

After a difficult start to the year and having faced a credit rating downgrade by Standard & Poor's in August, US economic data started to surpass market expectations in the final quarter. The leading indicator for manufacturing activity picked up, actual manufacturing production strengthened and retail sales remained buoyant.

The pace of job creation also accelerated, causing the unemployment rate to fall from 9.1% to a near three-year low of 8.5% in December. Economic growth for the third quarter came in at 1.8%. Evidence that money newly created by the Fed is starting to seep into the economy is that US money and credit creation has been growing.

US GDP growth



Source: Bureau of Economic Analysis

Given the improved tone of economic data, the US Fed did not announce a third round of quantitative easing, but maintained its ultra-accommodative target rate of 0 to 0.25%. Deterioration in the global environment saw the Fed lower its 2012 economic growth forecast range from 3.3 to 3.7% to 2.5 to 2.9%. In the minutes from the December FOMC meeting, it was announced that officials will now publish their interest rate forecasts for several years ahead in an effort to provide forward guidance on policy to the market. Although core inflation has risen from 2% to 2.2%, the headline inflation rate has moderated and inflationary pressures have subsided. In December, the inflation rate decreased from 3.4% to 3.0%. The US congressional "super committee" failed to agree on a plan to cut the budget deficit, setting the wheels in motion for automatic spending cuts to start in 2013.

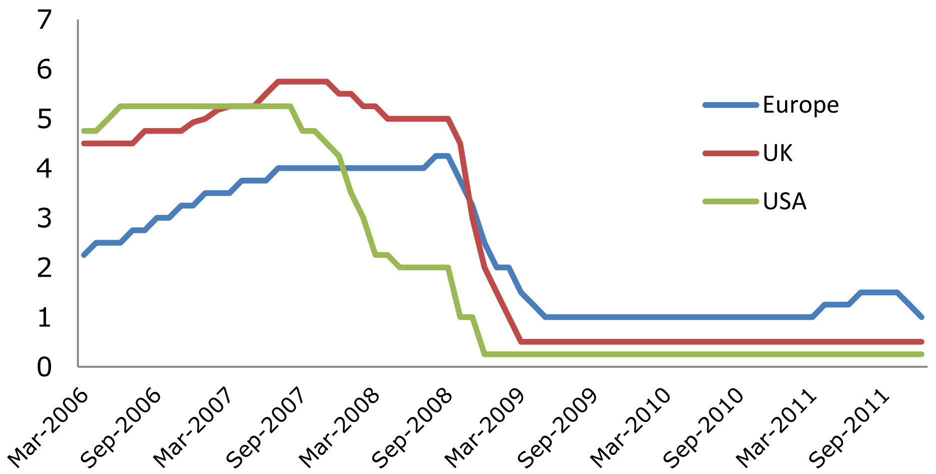
Despite the uptrend in most US economic data, the housing market continued to lag. Historical sales data was revised downwards, highlighting that the housing crash was even deeper than previously thought. House sales remained weak, although they have started to show some signs of improvement. Home prices, however, experienced an accelerated decline towards year-end. Mortgage rates continued to fall to record lows and, combined with the drop in home prices, valuation and affordability look even more favourable now than before.

At the start of last year, civil unrest in North Africa and the Middle East, the Japanese earthquake and tsunami as well as the US debt ceiling and credit rating downgrade dominated financial market headlines. Towards the end of the year, it was Europe and its leaders trying to secure a comprehensive rescue package to the debt crisis that drove market sentiment. Over the course of the year, Greece, Portugal and Ireland accepted bailouts. The contagion caused Italian and Spanish bond yields to rise, increasing their borrowing costs. In October, European officials announced a rescue plan, which included plans to enlarge the European Financial Stability Facility (EFSF), to recapitalise banks and for Greek bondholders to accept a haircut in order for Greece to avoid a default.

Optimism surrounding the rescue package failed to last, borrowing costs rose anew and for the first time core European economies were affected when it was feared that Italy is too big to bail out. The potential funding of an Italian rescue package put France's credit rating under pressure and Germany suffered a failed bond auction that saw its borrowing costs rise. As soon as if it looked like the Eurozone banking system was about to freeze up, six major central banks lowered the funding pressure on European banks in a coercive measure. The European Summit in December provided no "silver bullet" to the crisis, but it did give a clearer framework to an eventual solution.

The transition of leadership at the helm of the European Central Bank meant that Mario Draghi took over from Jean-Claude Trichet at the November meeting. He immediately set to reverse the most recent interest rate hikes and by December had lowered rates by 0.5% to 1%. He was criticised for not announcing outright purchases of sovereign bonds, but he did expand funding support for banks. Most critical was the introduction of the three-year, unlimited Longer Term Refinancing Operation program, which in essence is an unconventional back door quantitative easing program on massive scale. Although Mr Draghi's measures have not put an end to the crisis, they have eased the funding stresses on European banks and prevented systemic failure.

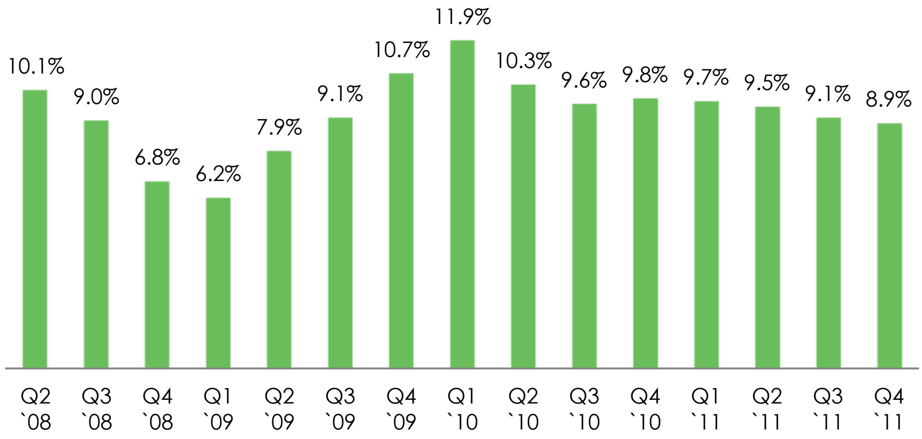
Global Interest Rates



Source: Inet Bridge

Financial markets continued to look to China as the sustained driver of economic growth. It had been feared that the Chinese economy might face a hard landing, but a sharp slow-down in its inflation rate meant that the People's Bank of China was able to cut the Reserve Requirement Ratio for banks for the first time since December 2008 – signaling the potential start of a monetary policy easing cycle. China's economic growth rate of 8.9% for the final quarter of the year proved to be better than expected, although it was slower than the previous quarter's rate of 9.1%. However, China's strong GDP growth number concealed a growing imbalance in that investments in the economy made the largest contribution to growth, while the contribution from consumption has been diminishing.

China GDP growth



Source: Trading Economics

Last year was a challenging one for financial markets. Assets deemed risky suffered from severe bouts of capital flight. Amongst global equities, emerging market and non-US shares performed worse than US equities. Emerging market bourses suffered from tighter monetary policy and a slow-down in economic growth, combined with capital repatriation due to the ongoing European crisis. As a result, emerging market currencies experienced their worst performance since 1997, despite strong economic fundamentals and the fact that the largest risks to the world economy reside in the developed world.

The MSCI Global Equity Index experienced a volatile quarter. From its trough, reached at the start of October to its peak near the end of October, the Index gained close to 17%. The Index ended up gaining 7.1% for the quarter to lift its yearly loss to -7.6%. US stocks delivered the best performance on the back of improving economic data and firm corporate earnings. US companies' profit margins reached record highs! The S&P 500 Index closed flat for the year. In contrast, the German DAX Index came under pressure due to the region's debt crisis and it lost 14.8% during the year. The Italian equity market lost a quarter of its value during 2011. The MSCI Emerging Market Index was also as unfortunate.

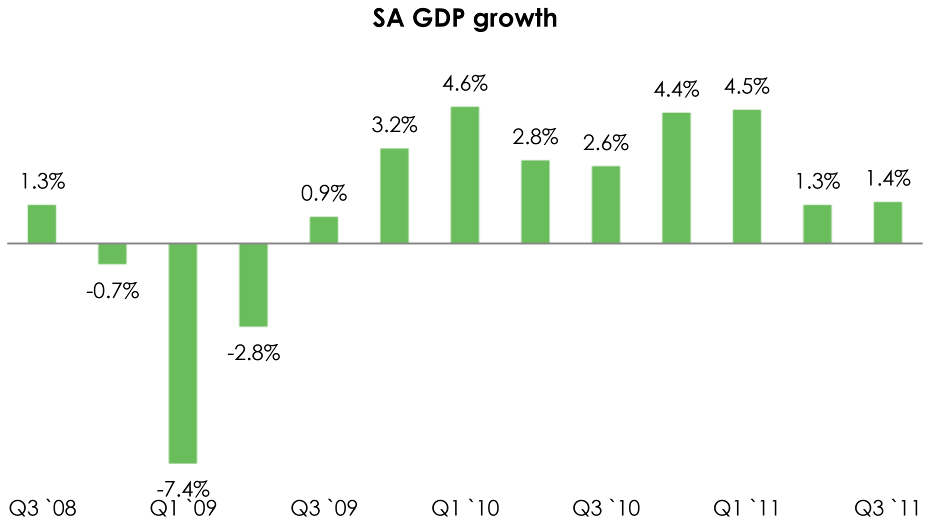
The Emerging Market Index closed 4.1% higher for the quarter but suffered a 20.4% loss for the year, lagging developed market equities over both periods.

The flight to safety supported bonds, and more specifically, US treasuries where the 10-year US government bond yield remained below 2% for most of the quarter. German 10-year bund yields spiked as much as 0.6% after the failed bond auction in November, but strengthened to below 2% by year-end. The equivalent Italian bond yield continued to surge to levels above 7%, rendering Italian debt repayments unsustainable over the long run. The JP World Government Bond Index eked out a 0.1% gain for the quarter and closed 7.2% higher for the year. The US 10-year government bond was the best performing asset during 2011 with a 16.7% gain, it was followed by Brent crude and German 10-year bunds with returns of 13.9% and 13.7% respectively. Although gold lost some of its value in December, it still provided a 10.1% return for the year.

LOCAL

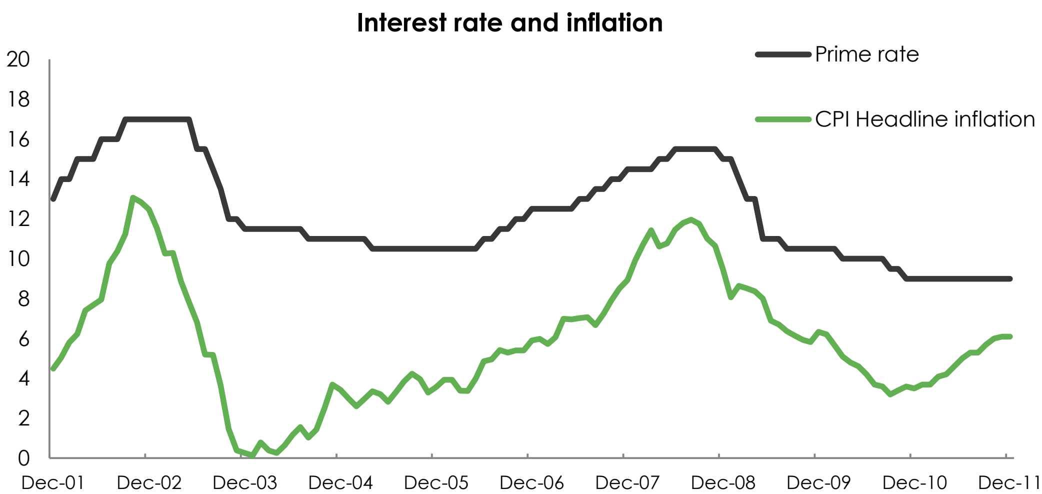
The South African economy remained a prisoner of the global economy during the quarter. Developments in Europe continued to affect the local economy negatively and foreign portfolio flows largely determined domestic asset class returns. Economic growth disappointed during the year, resulting in forecasts that were continuously revised downwards to adjust for deteriorating conditions.

GDP growth of 1.4% for the third quarter was slightly higher than the previous quarter's 1.3%. However, the data reflected an economy becoming ever more imbalanced with the tertiary sector growing strongly and the primary sector remaining weak. Furthermore, downside risks to the final quarter of the year's economic growth remain as releases for mining and manufacturing have been disappointing. Encouragingly, there has been a pick-up in investment growth. In November, mining production recorded a 4.6% year-on-year contraction, compared with a 12.7% contraction in October. It marked the fifth consecutive month of decline in the sector. Manufacturing production did lift in November, but activity remained subdued with a mediocre 2.6% growth rate from a year earlier. The slowdown in the second largest sector of the economy was driven by deteriorating demand for South African goods caused by the poor economic environment in Europe.



Source: Inet Bridge

Household spending growth, which has been the main underpin of GDP growth, moderated over the course of the year, but remained healthy. In the latest reading, retail sales grew by nearly 7% from a year earlier. This came despite slowing growth in real disposable income and rising inflationary pressures. Inflation has steadily surpassed the Reserve Bank's upper inflationary target of 6%, but stabilised at 6.1% in December. Demand pressures have not weighed in on prices, but rather it has been soaring transport and food costs that have been driving inflation higher. The rate of food price inflation was running at 12.6% on a year-on-year basis.

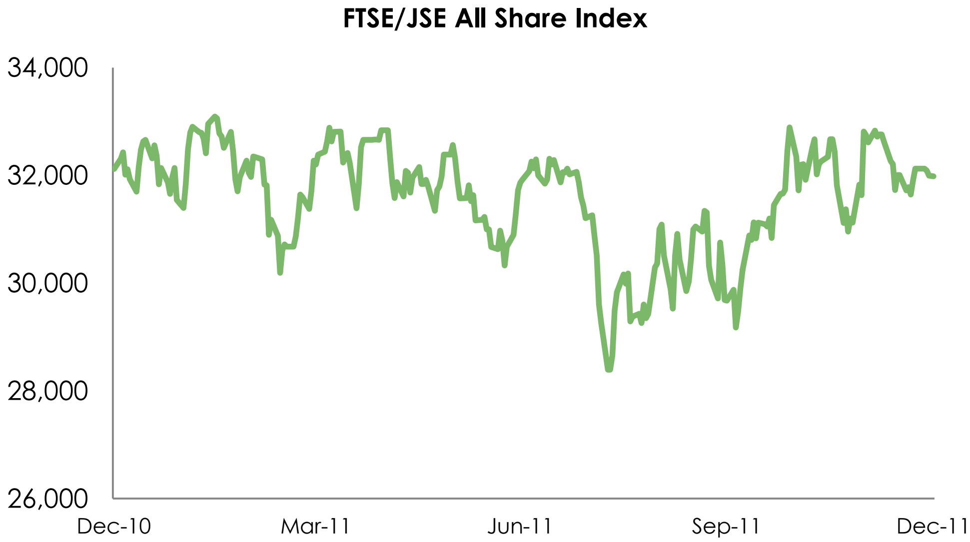


Source: Inet Bridge

The Reserve Bank has steadily revised its inflation forecast upwards, but once again kept interest rates unchanged at the November meeting. The Monetary Policy Committee forecast that inflation would peak at 6.3% in the first quarter of 2012. However, at the latest meeting in January 2012, the peak was revised up to 6.6% to be reached by the second quarter of 2012.

The revision came on the back of the sharp depreciation in the rand. While inflation forecasts have been revised upwards, domestic growth expectations have been revised downwards. The latest GDP growth expectations in January 2012 were for growth of 2.8% in 2012, accelerating to 3.8% in 2013.

Heightened risk aversion on the back of concerns over the outlook for Europe has kept the pressure on domestic asset class returns. The FTSE/JSE All Share Index recovered by 8.4% during the quarter to lift its year-to-date return out of negative territory to 2.6%. Gains during the quarter were broad-based across the different sectors, but for the calendar year, the resources sector was by far the worst performing sector with a decline of 6.7%. In contrast to the negative returns achieved within the resources sector, industrial and financial shares gained 10.5% and 6.6% respectively. Company earnings growth continued to recover during the year, peaking at 44% from a year earlier and ending the year at a healthy 35%. In dollar terms, the local equity market returns were disappointing due to the sharp depreciation in the currency.



Source: Inet Bridge

Apart from offshore assets in rand terms, domestic listed property was again the best performing asset class for the year with a return of 8.9%. For the final quarter of the year, it delivered 3.7%. Domestic bonds' returns weren't far behind and the All Bond Index closed 8.8% higher for the year (3.5% for the quarter), easily outperforming cash's return of 5.7% for the year. The domestic bond market experienced its second consecutive year of strong foreign portfolio inflows, with foreign investors buying R37.5bn worth of bonds. This compares to foreigners selling R17.2bn worth of domestic equities over the same period. The rand kept its composure against the dollar during the quarter, strengthening slightly to R8.07. For the calendar year, the rand was sharply lower, having depreciated by 21.9% against the greenback which made it the worst performing emerging market currency in the world.

Outlook

The year ahead will prove to be a challenging one with macro-economic risks dominating the investment environment. The world economy is dangerously sick and there is no quick fix to improve its health and a prolonged period of nursing will be necessary. European officials will have to walk a tight-rope in their efforts to contain the financial crisis, avoiding the many pitfalls. In contrast to the start of last year, financial market participants are pessimistic about the global economic and financial outlook. However, negative sentiment together with monetary reflation in both the developed and developing world might just be what is needed to lift investment returns during the year. There are three key issues that will shape 2012: the European debt crisis, the fiscal position and strength of the US economy and the Chinese economy's ability to avoid recession.

The US economy accelerated coming into 2012, but there are many reasons to believe that this stronger growth path will not be maintained. The US will have to unwind many of the stimulus policies that were responsible for stronger growth in 2011 and will face numerous years of fiscal consolidation that will weigh in on future economic growth. It is, however, a presidential election year and policy deadlines might be pushed forward. Additional monetary stimulus cannot be ruled out, and should conditions deteriorate, the US Fed might respond with an additional round of quantitative easing. The Fed has also changed the way it provides feedback and from the January 2012 meeting onwards; it will give guidance on the expected future level of interest rates. This should peg lower interest rate expectations for longer.

There are other signs which indicate that the US economy will remain buoyed. The labour market has been improving at a stronger than expected pace, the housing market seems to have bottomed out, manufacturing activity has been robust, credit growth has been accelerating and corporate profitability remains high with companies having large amounts of cash on their balance sheets. These factors should prevent the US economy from facing another recession, bar any major fallout in the Eurozone. Although the US has small trade linkages with Europe, its financial linkages with the troubled region are of greater concern. A blow-out in Europe would have more catastrophic consequences than the demise of Lehman Brothers in September of 2008.

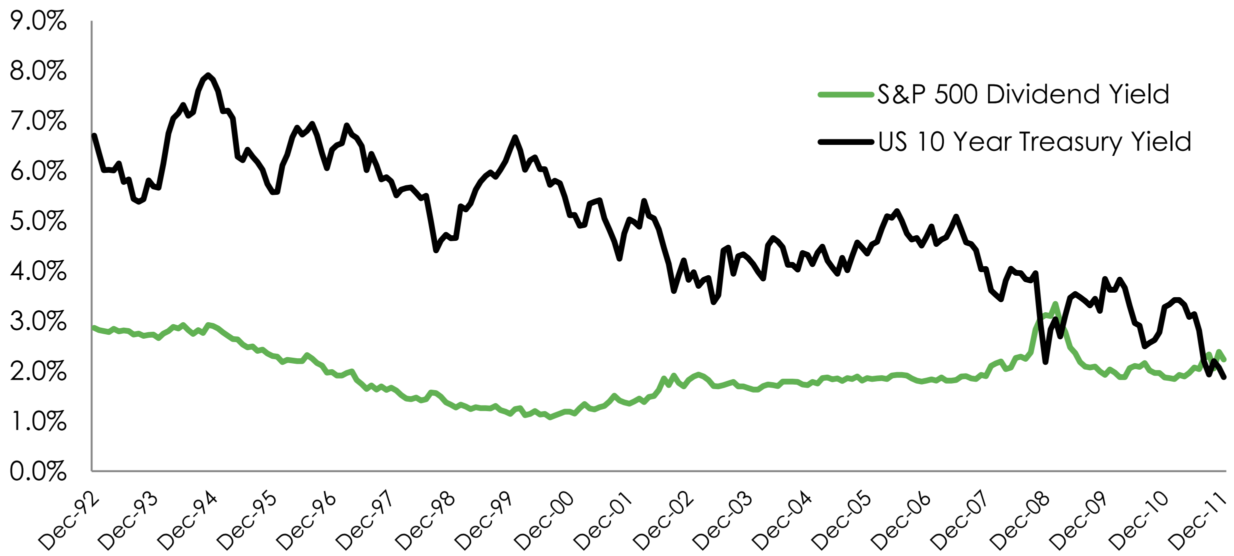
Europe is in a precarious position, but an inflection point might have been reached with the announcement of the European Central Bank's Longer Term Refinancing Operation program in December 2011, which bought European banks three years to recapitalise themselves, reduce their leverage and restructure their businesses. Although it is not a silver bullet to end the crisis, it does bring more financial stability to the region, having removed the tail risk of European bank default.

European countries, however, face a challenging debt refinancing schedule this year that has the ability to throw the global recovery into a deep recession should the crisis spiral out of control. It does seem that the European Central Bank's measures have provided additional support to the debt uptake of countries that have to refinance their existing debt obligations.

Decelerating inflation in the developed world and in emerging markets will allow for a renewed round of monetary policy easing given the headwinds the global economy is facing. This is especially important for the Chinese economy which is forecasted to contribute nearly a third of global growth this year. Chinese inflation is set to fall rapidly, giving policymakers scope to stimulate growth and prevent the economy from experiencing a hard landing. China's leadership change at the end of the year is a big risk. Seven out of nine members of the Standing Committee - the most powerful decision-making body - will be changed. Further major changes in the government and military will also take place. It is uncertain what consequences these will have.

Although the financial and economic outlook remains uncertain, the easing of funding stresses in Europe and the global reflation push that is underway should help the global economy to muddle its way through. Low economic growth is not all that bad, especially if it goes hand-in-hand with low inflation and monetary policy easing. Company earnings are strong and even though profit margins are expected to be close to peaking, earnings should remain positive. Coupled with relatively low valuations, global equities should outperform bonds over the next twelve months. Investor risk appetite has been low, and an improved, or even stable, macro-economic environment might be the catalyst for renewed appetite and a strong bull-run in equities. The S&P 500 Index's dividend yield of 2.2% is ahead of the US 10 year treasury's yield of 2% and its price-earnings-ratio of 14.5 is undemanding according to historical values.

Dividend vs Bond Yield

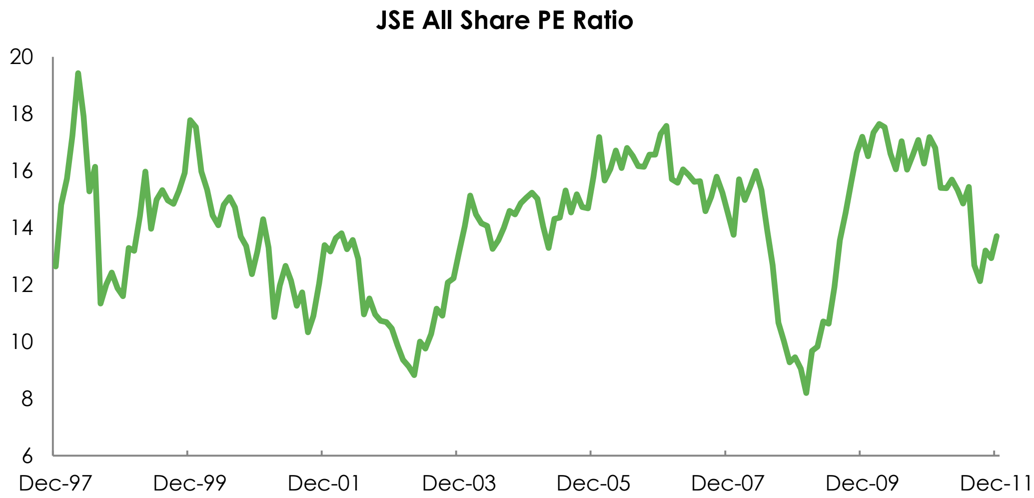


Source: Inet Bridge

The local economy's growth will be constrained by the global and, more specifically, the European, slowdown this year. Europe is South Africa's largest trading partner. Growth is expected to remain below trend which will prompt a cautionary approach by the South African Reserve Bank with respect to monetary policy. The deteriorating inflation outlook is likely to prevent the Reserve Bank from cutting interest rates with monetary policy on hold until the end of the year. The Reserve Bank has continuously revised its inflation forecast upwards given the impact of the depreciation in the rand and rising food costs. Inflation is only expected to fall below the Reserve Bank's upper target of 6% in 2013.

Domestic demand conditions should find support this year from above-inflation wage increases, historically low interest rates and a recovery in employment. Banks are also slowly easing on their lending requirements which should see stronger credit growth taking place. The outlook for manufacturing and mining is more uncertain. The leading indicator for industrial production has given mixed signals, but in general, is indicative of a sector struggling to find traction.

Company earnings growth is expected to remain strong throughout the year, although lower than what was reported in 2011. Nonetheless, the equity market's price-earnings ratio already reflects the prior year's high earnings and at the current level of below 13 times, it remains attractive. In addition, dividend yields are close to 3%. The equity market will be supported by continued low interest rates, firm company earnings growth, resilient domestic demand and attractive valuations. Global developments and international risk aversion pose the biggest threat to the domestic market's outlook, but the probability of these risks and worst case scenarios are slowly diminishing and should herald in strong returns from the equity market.



Source: Inet Bridge

The local bond market will be supported by continued low interest rates and international investor appetite, but the asset class is facing increased headwinds. The deteriorating inflation environment and fiscal outlook will start putting bond yields under pressure. In a lower economic growth scenario, the government's budget deficit reduction efforts will be tested and could result in a higher bond issuance schedule causing yields to rise. The risk has increased that bonds could underperform cash over the next twelve months.

Most of the risks posed to the global outlook have already been factored into asset prices. The environment for risky assets should continue to improve slowly as policymakers place floors under the respective crises. It will not be a smooth ride with volatility a certainty, but exposure to risky assets should contribute positively to investment returns this year.

Asset Class Returns

	3 Months	6 Months	12 Months
Headlines Indices			
Africa All Share	8.38%	2.05%	2.57%
Africa Top 40	8.44%	1.33%	2.20%
Africa Mid Cap	8.24%	6.10%	4.72%
Africa Small Cap	6.77%	4.34%	1.10%
Africa Fledgling	6.09%	5.83%	2.18%
Africa Resource 20	7.71%	-3.48%	-6.74%
Africa Industrial 25	8.97%	5.44%	10.46%
Africa Financial 15	9.64%	4.83%	6.63%
Africa Financial and Industrial 30	9.15%	5.15%	9.66%
Africa Capped All Share	8.36%	2.42%	3.04%
Africa Shareholder Weighted	8.26%	3.62%	4.26%
All Share Economic Group Indices			
Africa Oil & Gas Index	18.60%	11.51%	15.44%
Africa Basic Materials Index	5.78%	-5.68%	-8.31%
Africa Industrials Index	7.88%	2.91%	-3.43%
Africa Consumer Goods Index	10.55%	8.22%	14.66%
Africa Health Care Index	5.07%	7.68%	8.80%
Africa Consumer Services Index	10.77%	9.40%	8.56%
Africa Telecommunications Index	6.68%	1.81%	11.22%
Africa Financials Index	8.68%	5.26%	7.37%
Africa Technology Index	12.05%	17.61%	25.71%
All Share Sector Indices			
Africa Chemicals	9.84%	-0.76%	0.72%
Africa Electronic & Electrical Equipment Index	3.16%	-2.67%	-4.60%
Africa Industrial Engineering Index	8.15%	9.83%	16.79%
Africa Automobiles & Parts Index	23.27%	28.95%	67.01%
Africa Beverages Index	9.24%	18.28%	23.04%
Africa Food Producers Index	13.55%	17.15%	17.16%
Africa Health Care Equipment & Services Index	4.73%	4.04%	11.43%
Africa Pharmaceuticals & Biotechnology Index	5.43%	11.84%	5.45%
Africa General Retailers Index	15.52%	17.54%	19.61%
Africa Travel & Leisure Index	8.27%	-0.11%	-11.44%
Africa Support Services Index	1.67%	-5.97%	-18.85%
Africa Industrial Transportation Index	13.25%	5.45%	-1.95%
Africa Food & Drug Retailers Index	20.27%	27.92%	26.87%
Africa Fixed Line Telecommunications Index	-9.30%	-17.88%	-20.48%
Africa Banks Index	7.80%	4.21%	4.46%
Africa Non-life Insurance Index	3.12%	10.24%	13.59%
Africa Life Insurance Index	16.92%	12.45%	20.76%

Africa General Financial Index	5.31%	-4.33%	-7.58%
Africa Equity Investment Instruments Index	9.36%	11.52%	16.84%
Africa Software & Computer Services Index	11.40%	17.14%	21.57%
Africa Gold Mining	0.69%	20.32%	6.87%
Africa Platinum & Precious Metals	-0.77%	-10.43%	-25.98%
Africa Property Unit Trusts - (PUT)	5.69%	8.99%	12.19%
Africa SA Listed Property - (SAPY)	3.73%	6.00%	8.93%

Bonds, Cash & Inflation

All Bond Index	3.51%	6.41%	8.82%
Stefi Composite	1.39%	2.82%	5.73%
CPI - New Headline (Previous Month)	1.18%	2.66%	6.12%
CPI - History Rebased (Previous Month)	1.18%	2.66%	6.12%

Currencies

Rand Dollar Exchange Rate	-0.30%	19.35%	21.90%
Rand Pound Exchange Rate	-0.58%	15.73%	21.60%
Rand Euro Exchange Rate	-3.40%	6.78%	18.34%
Dollar Euro Exchange Rate	-3.20%	-10.60%	-3.19%
Dollar Yen Exchange Rate	0.00%	4.84%	5.69%
Niara Dollar Exchange Rate	0.95%	7.01%	6.65%

Commodity Prices

Brent Oil (USD/Barrel)	1.21%	-4.14%	13.16%
Gold (USD/oz)	-3.70%	4.23%	10.06%
Platinum (USD/oz)	-8.62%	-19.19%	-21.24%
Copper ($/Ton)	5.92%	-18.78%	-22.44%
CRB Index	2.40%	-9.69%	-8.26%

Global Bonds & Equity

Global Bonds (R)	-0.15%	23.17%	30.71%
MSCI Global Equity (R)	6.80%	6.02%	12.62%
Global Bonds	0.14%	3.21%	7.22%
S&P 500	11.15%	-4.77%	0.00%
Nasdaq	7.86%	-6.07%	-1.80%
MSCI Global Equity	7.11%	-11.16%	-7.61%
MSCI Emerging Mkt	4.08%	-20.05%	-20.41%
FTSE	7.67%	-7.71%	-7.64%
DAX	6.88%	-20.06%	-14.82%

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