



# MONTHLY INVESTMENT REPORT

28 February 2009

## CPSA PROVINCIAL PENSION FUND

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■ FUND SPECIFIC ANALYSIS

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### FUTURE STRATEGY

- The Fund is currently under weight equities, under weight bonds & property and alternatives, but overweight cash and internationals.
- The Fund remains conservatively positioned to take advantage of the current volatile market conditions.

Fund Manager: Leo Vermeulen  
Fund Administrator: Nuraan Desai  
Novare Actuaries & Consultants



## CPSA Provincial Pension Fund

### FINANCIAL OVERVIEW

The market continued its downward spiral in February, contracting a further 9.9%. All the sectors did poorly for the month but Financials continued to be the worst hit, down another 12.2%. Industrials and Resources lost 11% and 8.8% respectively. The latter dragged down by the mighty Anglo American PLC that fell a staggering 24% during the month after reporting a 29% drop in 2008 profits. Furthermore this mining giant announced that it was suspending its dividend payment as well as cutting 19000 jobs this year. The interest rate sensitive bond and property sectors also fell 2.9% and 2.8% for the month respectively despite the Monetary Policy Committee shaving off one percent from the repurchase rate. Bonds ran considerably in 2008 and are now losing steam due to Rand weakness and the recently announced national budget deficit that will require an additional R62 billion of government bond issuance over the next two fiscal years. The January trade deficit of R17.4 billion also took the market by surprise, putting further pressure on the Rand.

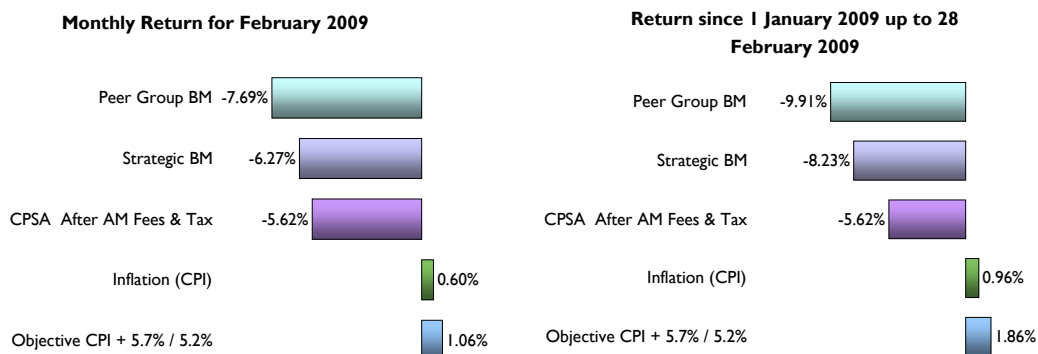
The long awaited 2008 fourth quarter gross domestic product (GDP) announcement confirmed that the domestic economy is contracting. The data revealed that the manufacturing sector that makes up 16% of GDP fell by a significant 21.8% bringing overall growth down by 1.8%. This data buoyed hopes of an emergency interest rate cut but this was later dashed by sticky inflation numbers. The latest inflation (CPI) number now includes Statistics South Africa's new methodology for gathering prices as well as the new category weights. Economists had expected inflation to fall dramatically but were disappointed by CPI coming in at 8.1% due mainly to stubbornly high food prices. The PPI numbers also revealed that agricultural food prices had shot up although overall PPI fell due to plummeting commodity prices.

Global Equity (US\$)	Level	1 Month	3 Months	6 Months	YTD	12 Months
S&P 500	735.1	-11.0%	-18.0%	-42.7%	-18.6%	-44.8%
Nasdaq	1,377.8	-6.7%	-10.3%	-41.8%	-12.6%	-39.3%
MSCI Global Equity	750.9	-10.5%	-15.9%	-44.2%	-18.4%	-48.4%
MSCI Emerging Mkt	499.3	-5.7%	-5.3%	-47.8%	-11.9%	-57.2%
<b>Global Bond (US\$)</b>						
Global Bonds	415.6	-3.1%	-0.4%	1.1%	-6.9%	-1.9%
<b>Commodity Prices</b>						
Brent Oil (USD/Barrel)	44.9	2.2%	-11.3%	-60.8%	19.1%	-55.4%
Platinum (USD/oz)	1,070.0	8.2%	21.5%	-28.0%	15.4%	-50.4%
Gold (USD/oz)	941.4	1.3%	15.0%	13.3%	7.0%	-3.2%
<b>South African Mkt (Rand)</b>						
Africa All Share	2,031.7	-9.9%	-12.4%	-32.0%	-13.7%	-37.6%
Africa Top 40	1,830.5	-10.4%	-14.1%	-34.1%	-14.6%	-39.7%
Africa Resource 20	1,658.1	-8.8%	-11.4%	-39.6%	-11.2%	-47.7%
Africa Financial 15	1,822.9	-12.2%	-21.4%	-30.3%	-19.5%	-36.2%
Africa Industrial 25	2,213.5	-11.0%	-11.9%	-25.2%	-15.2%	-25.0%
Africa Mid Cap	3,817.7	-6.4%	-0.6%	-15.9%	-8.2%	-20.1%
Africa Small Cap	5,010.3	-8.3%	-7.9%	-23.1%	-9.5%	-33.3%
All Bond Index	286.4	-2.9%	1.4%	8.2%	-5.2%	12.5%
Stefi Composite	218.7	0.8%	2.8%	5.8%	1.8%	11.8%
Africa SA Listed Property - (SAPY)	565.5	-2.8%	0.8%	0.8%	-3.9%	-1.0%
MSCI Global Equity (R)		-11.5%	-15.7%	-26.9%	-11.5%	-33.0%
Global Bonds (R)		-4.2%	-0.2%	32.4%	-4.2%	27.5%
Rand Dollar Exchange Rate	10.07	-1.1%	0.2%	30.9%	5.7%	29.9%



## CPSA Provincial Pension Fund

### MARKET VALUES AND RETURNS



The table below (and on the following page) is the return matrix for the CPSA. It shows the various manager returns as well as that of the total portfolio for various periods and compares it with their respective benchmarks. The benchmark used for the portfolio is in line with its investment objective, which is CPI + 5.7% p.a. and CPI + 5.2% p.a. from 1 January 2009.

	Fraters	RMB	Allan Gray	FG IBF	Liberty Cash
Market Value	44,679,656	49,852,767	310,017,755	29,457,875	18,581,763
% of Fund	7.5%	8.4%	52.0%	4.9%	3.1%
Benchmark	JSE ALSI	JSE ALSI	AFGLMW	All Bond Index	n/a
Monthly Return	-7.35%	-9.42%	-6.11%	-2.79%	0.87%
Benchmark	-9.87%	-9.87%	-7.69%	-2.86%	n/a
Out/ Under Perf	2.52%	0.45%	1.58%	0.07%	n/a
Last 3 Months	0.19%	-11.86%	-2.10%	1.63%	-10.98%
Benchmark	-12.39%	-12.39%	-7.94%	1.40%	n/a
Out/ Under Perf	12.58%	0.53%	5.84%	0.23%	n/a
Calendar YtD	-6.88%	-14.12%	-4.95%	-4.81%	-6.03%
Benchmark	-13.70%	-13.70%	-9.91%	-5.17%	n/a
Out/ Under Perf	6.83%	-0.42%	4.97%	0.36%	n/a
Last 12 Months	-19.29%	-33.87%	-6.79%	13.56%	-22.35%
Benchmark	-37.59%	-37.59%	-21.59%	12.45%	n/a
Out/ Under Perf	18.30%	3.72%	14.80%	1.11%	n/a
Since July 2005	76.65%	42.17%	85.08%	38.14%	6.06%
Benchmark	44.52%	44.52%	45.41%	29.47%	n/a
Out/ Under Perf	32.13%	-2.34%	39.66%	8.67%	n/a
	Jul-05	Jul-05	Jul-01	Dec-03	Feb-02
Ann Since Inception	16.79%	10.07%	20.07%	10.33%	4.81%
Benchmark	10.56%	10.56%	13.29%	8.82%	n/a
Out/ Under Perf	6.22%	-0.49%	6.78%	1.51%	n/a



## CPSA Provincial Pension Fund

### MARKET VALUES AND RETURNS (CONTINUED)

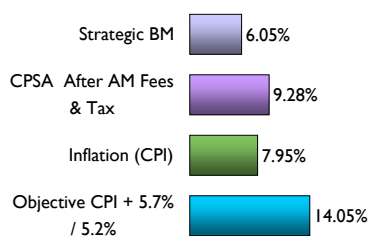
	Sortino	FG CPF	Stanlib IF	NOAF	Mayibentsha	Total
Market Value	19,499,491	8,313,487	17,587,817	45,479,414	53,042,050	596,512,076
% of Fund	3.3%	1.4%	2.9%	7.6%	8.9%	100.0%
Benchmark	JSE Listed Property	JSE Listed Property	All Bond Index	60% MSCI/40% JPMGGB	CPI + 4.5%	CPI + 5.7% / 5.2%
Monthly Return	-2.57%	0.84%	0.15%	-9.18%	-1.22%	-5.62%
Benchmark	-2.78%	-2.78%	-2.86%	-8.53%	0.97%	1.06%
Out/ Under Perf	0.21%	3.62%	3.02%	-0.65%	-2.19%	-6.68%
Last 3 Months	1.01%	2.55%	3.62%	-7.54%	-0.70%	-3.09%
Benchmark	0.80%	0.80%	1.40%	-9.71%	1.88%	2.13%
Out/ Under Perf	0.21%	1.75%	2.22%	2.17%	-2.58%	-5.22%
Calendar YtD	-3.14%	1.68%	0.79%	-7.56%	-1.06%	-5.62%
Benchmark	-3.89%	-3.89%	-5.17%	-8.97%	1.70%	1.86%
Out/ Under Perf	0.74%	5.56%	5.97%	1.41%	-2.76%	-7.48%
Last 12 Months	-0.57%	8.64%	13.54%	-9.04%	-6.51%	-10.38%
Benchmark	-1.03%	-1.03%	12.45%	-12.36%	12.90%	14.14%
Out/ Under Perf	0.45%	9.67%	1.09%	3.32%	-19.41%	-24.51%
Since July 2005	n/a	n/a	n/a	34.82%	41.15%	66.86%
Benchmark	n/a	n/a	n/a	27.50%	51.28%	57.64%
Out/ Under Perf	n/a	n/a	n/a	7.33%	-10.12%	9.22%
	Jul-07	May-07	Oct-06	Mar-04	May-03	Jul-02
Ann Since Inception	-1.32%	18.87%	10.46%	6.41%	14.23%	15.94%
Benchmark	0.03%	-3.81%	8.58%	6.39%	9.77%	11.51%
Out/ Under Perf	-1.36%	22.69%	1.88%	0.02%	4.46%	4.44%

### LONGER TERM RETURNS

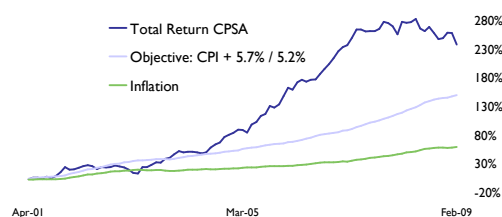
The Fund's Investment Objective is set over 3 year rolling periods. Longer term returns should be used to assess the Fund's performance when compared to its set Investment Objectives as short term market volatility may distort short term performance measurement.

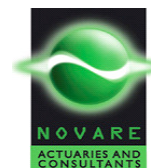
The cumulative graph below shows the Fund performance since 1 Jan 2001. It is benchmarked against its Investment Objective i.e. CPI + 5.7% / 5.2% as well as inflation.

#### Last 36 Months Annualised Return



#### Cumulative Returns since 1 Jan 2001





## CPSA Provincial Pension Fund

### FUND SPECIFIC ANALYSIS

The **Return Table** below shows the monthly returns added to the portfolio. It is compared to the Fund's Investment Objective (i.e. to outperform CPI plus 5.7% / 5.2% per annum) and its strategic Benchmark.

Period	CPSA Net of Fees & Tax	Objective: CPI + 5.7% / 5.2%	Strategic Benchmark	Market Value History
Last 12 Months	-10.38%	14.14%	-17.75%	
Mar-08	-0.41%	1.91%	-0.91%	676,710,448
Apr-08	0.39%	1.14%	1.33%	676,807,905
May-08	1.37%	1.17%	1.76%	683,814,016
Jun-08	-4.34%	1.83%	-2.40%	654,456,488
Jul-08	-1.16%	1.79%	-3.70%	645,737,997
Aug-08	1.93%	1.04%	1.06%	653,593,711
Sep-08	-2.87%	1.02%	-6.15%	635,400,233
Oct-08	-2.97%	0.75%	-4.86%	616,112,428
Nov-08	0.45%	0.55%	1.64%	617,320,945
Dec-08	2.68%	0.27%	1.75%	632,511,104
Jan-09	0.00%	0.78%	-2.09%	633,294,046
Feb-09	-5.62%	1.06%	-6.27%	596,512,075

The **Cash Flow Table** below, gives an indication of the Rand value that has been added to the CPSA portfolio. The added value is divided between cash in/out flows and the return achieved on the Fund's investments over various periods.

	Since Jun 03	Since Jan 04	From 1 Jan 06	From 1 Jan 08	From 1 Jan 09
MV at Start	265,026,619	301,386,988	475,182,236	665,842,189	632,511,105
Cash In/Out Flow	(83,107,406)	(73,739,054)	(49,634,756)	(13,393,157)	(432,340)
Return	414,592,862	368,864,141	170,964,595	(55,936,957)	(35,566,690)
Current MV	596,512,075	596,512,075	596,512,075	596,512,075	596,512,075

**Attribution Analysis** measures the value added through stock and asset class selection, where the Fund's actual returns are compared to its benchmark return. The Asset Allocation out/under performance is the extra return achieved by the Fund by using tactical deviation from its long term strategic asset allocation. The Stock Selection out/under performance is the extra return achieved by the various Asset Managers of the Fund, by selecting equities/holdings which are different from the underlying benchmark indices.

	Last 12 Months	Last 3 Months	Last Month
CPSA Provincial PF Return	-10.38%	-3.09%	-5.62%
Total Out/(Under) Performance of Benchmark	7.37%	3.53%	0.65%
Out/(Under) Performance due to Asset Allocation	0.50%	-0.14%	0.17%
Out/(Under) Performance due to Stock Selection	6.87%	3.67%	0.48%
Residual Term	0.00%	0.00%	0.00%

The Fund's **Value at Risk** i.e. expected maximum loss over 20 working days at a 95% probability can be seen in the table. Compared to the sum of the individual Managers Value at Risk, it shows the diversification benefit achieved by combining various investment mandates.

Portfolio Expected Return	-1.03%
Portfolio Standard Deviation	2.59%
Individual Portfolio VaR	6.29%
Portfolio VaR	4.26%
Total Amount VaR	25,384,387

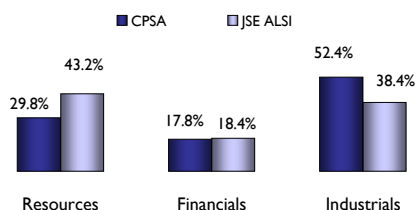


## CPSA Provincial Pension Fund

### FUND SPECIFIC ANALYSIS (CONTINUED)

#### Most recent strategic changes

Date	Transferred From:	Transferred To:	Amount
24-Aug-07	Investec Bank	NOAF	6,000,000
03-Sep-07	Investec Bank	Liberty Cash	2,798,103
16-Oct-07	Stanlib IF	NOAF	1,393,000
20-Dec-07	Allan Gray	Liberty Cash	5,000,000
28-Jan-08	Liberty Cash	NOAF	4,680,000
08-Feb-08	Allan Gray	Liberty Cash	2,000,000
14-Apr-08	Investec Treasury	Liberty Cash	37,235
12-May-08	Fraters	Liberty Cash	10,000,000
13-May-08	RMB Equity	Liberty Cash	10,000,000
01-Dec-08	Mayibentsha	Liberty Cash	5,000,000

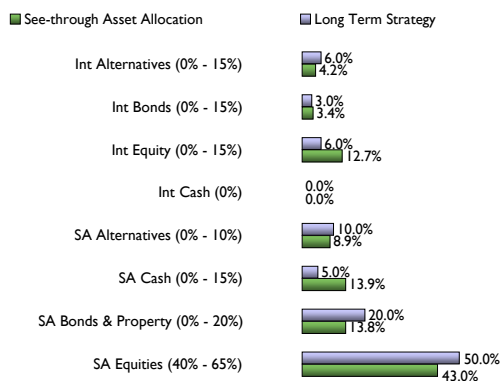


The fund is currently underweight Resources, slightly under weight Financials and overweight Industrials. For the month of February, Resources was the best performing sector (-8.8%), followed by Industrials (-11.0%), and Financials (-12.2%).

CPSA Top 15 Shares	% of CPSA Equities	% JSE ALSI
ANGLOGOLD ASHANTI	9.16%	4.19%
SAB	7.61%	6.82%
MTN GROUP	7.05%	6.40%
SASOL	6.15%	6.39%
HARMONY	5.00%	2.08%
REMGRO	3.83%	1.16%
SANLAM	3.27%	1.33%
STANBANK	3.10%	3.95%
COMPAGNIE RICHEMON	2.92%	2.79%
AFRICAN RAINBOW	2.33%	0.38%
NAMPAK	2.25%	0.34%
SAPPI	2.18%	0.41%
ILLOVO	2.05%	0.18%
REINET INV SCA	1.83%	0.72%
TONGAAT	1.81%	0.16%

### PORTFOLIO STRATEGY

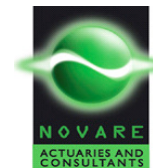
#### Strategic vs. Actual Asset Allocation



The CPSA Pension Fund is currently:

- under weight equities
- under weight bonds & property
- over weight cash
- underweight alternatives, and
- over weight international

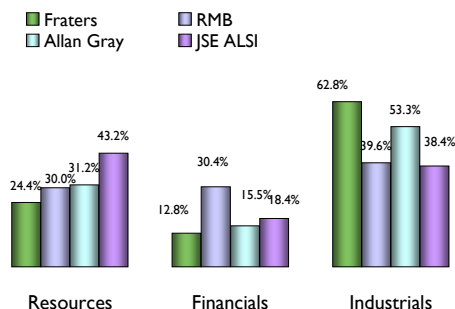
The Fund is fairly conservatively positioned to take advantage of current volatile market conditions.



## CPSA Provincial Pension Fund

### MANAGER PERFORMANCE

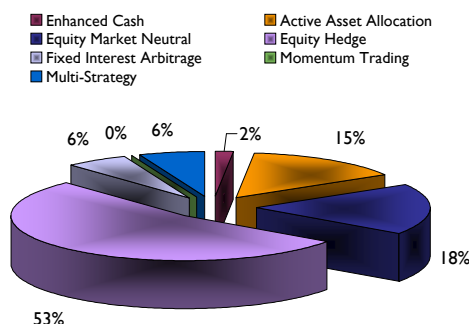
Equity Manager	Fraters	RMB
Inception Date	Jul-05	Jul-05
Classification	Concentrated	Concentrated
Benchmark	JSE ALSI	JSE ALSI
Return since Inception	76.65%	42.17%
Benchmark	44.52%	44.52%
Annualised Return	16.79%	10.07%
Benchmark	10.56%	10.56%
Information ratio	0.17	(0.03)
Sharp Ratio	0.14	0.04



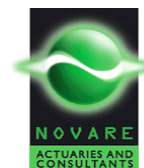
All the Equity Managers were underweight Resources at the end of February 2009. Fraters and Allan Gray were significantly overweight Industrials at the end of February 2009 while RMB had a slight overweight exposure to this sector. Sector allocation and stock selection still remains critical in the current economic environment.

Manager	Mayibentsha	FG CPF	FG IBF	Sortino
Inception Date	May-03	May-07	Dec-03	Jul-07
Return since inception	117.2%	37.3%	67.5%	-1.3%
Ann Return since inception	14.2%	18.9%	10.3%	-1.3%
Avg Monthly return	1.13%	1.48%	0.84%	0.07%
% + months	75.7%	95.5%	71.4%	45.0%
% - months	24.3%	4.5%	28.6%	55.0%
Max Drawdown	-6.0%	-0.1%	-5.1%	21.7%
Std Deviation	6.1%	n/a	6.8%	6.8%

### Mayibentsha Strategic Asset Allocation



Mayibentsha Fund of Funds remains defensively positioned as a result of current market turmoil and ended only marginally softer for the month. Positive strategy contributions came from managers within their Equity Market Neutral space, whereas Equity Long-Short, Fixed Income and the remaining small allocations to directional strategies experienced a more trying month, given the global market backdrop. Almost without exception, all managers continue to maintain very low levels of net exposure, contributing to Mayibentsha Fund of Fund's continued defensive positioning going into March.

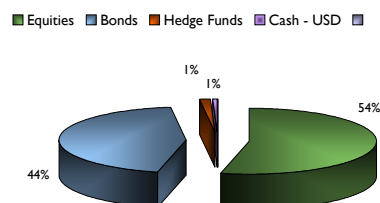


## CPSA Provincial Pension Fund

### INTERNATIONAL MANAGER PERFORMANCE

**Fund Name** : Novare Offshore Advised Fund  
**Manager** : Standard Bank Fund Administration Jersey Limited  
**Advisor** : Novare Investments (Pty) Limited  
**Custodian** : Standard Bank Jersey Limited  
**Auditors** : PricewaterhouseCoopers CI LLP  
**Trustee** : Capita Trust Company (Jersey) Limited  
**Domiciled** : Jersey, Channel Islands  
**Inception Date** : March 2004  
**Benchmark** : 60% MSCI Global Equity Index  
 : 40% JP Morgan World Government Bond Index

### NOAF Asset Allocation



	1 Month	3 Months	Year to Date	Since Mar 04
NOAF	-9.18%	-7.54%	-7.56%	36.45%
Benchmark	-8.53%	-9.71%	-8.97%	36.31%
Out/Under perf	-0.65%	2.17%	1.41%	0.14%
MSCI GEI	-11.45%	-15.74%	-11.45%	6.32%
JPM WGBI	-4.15%	-0.16%	-4.15%	89.51%
Rand / \$ *	-1.08%	0.20%	5.72%	51.31%

\* Negative change indicates Rand strength

\* Table up to 31 december 2008

Underlying Managers of NOAF	Fund Allocation	3 Months	Year to Date	Last 12 Months	Since May 04
<b>Global Equity</b>	<b>53.66%</b>				
Morgan Stanley Global Brands (SICAV)	19.62%	-5.9%	5.7%	-29.8%	4.4%
Investec Global Strategic Equity	16.29%	-15.7%	-13.7%	-36.3%	n/a
Fortune Global Equities	2.03%	-10.5%	-9.8%	-16.2%	n/a
Templeton Global	15.72%	-0.7%	-0.9%	12.4%	n/a
<b>Global Bonds &amp; Property</b>	<b>44.47%</b>				
Franklin Templeton Global Bond	19.10%	6.1%	8.6%	-32.3%	n/a
Franklin Templeton Global Total Return	16.92%	-8.5%	6.3%	1.6%	n/a
PIMCO Total Return Bond	8.44%	3.4%	5.5%	31.0%	n/a
<b>Global Alternative</b>	<b>1.36%</b>				
Quellos ILF Ltd	1.36%	-6.3%	5.8%	-2.1%	n/a
<b>Global Cash</b>	<b>0.50%</b>				
Fidelity Institutional Cash - USD	0.00%	0.2%	5.7%	24.6%	49.3%
Cash	0.50%	n/a	n/a	n/a	n/a

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## NOVARE HOUSEVIEW MATRIX –MARCH/APRIL 2009

<p><b>RSA Equities</b></p> <p>Equity markets seem to have embarked upon the long-awaited revival that investors have been so desperately anticipating. It finally seems that all the efforts of policymakers are being rewarded by the markets as the All Share Index has surged beyond the 21000 level after having tested the 18000 resistance level at the beginning of March.</p> <p>We also now feel comfortable to increase the equity exposure on the back of tentative signs that the worst is behind us. Some key data in the US is starting to surprise on the upside and the domestic markets are also to benefit from the MPC's interest rate cutting cycle that has now seen 250 basis points lopped off in the past four months. We see scope for further cuts of 200 basis points as we believe that the output gap will widen as GDP growth disappoints on the downside. We believe that our economy is most likely in recession as employment and consequently consumption expenditure are contracting. We are however optimistic that towards 2010, a more robust picture will emerge.</p>	<p><b>RSA Bonds</b></p> <p>We continue to advocate an under weight exposure to bonds as we believe that inflation will be sticky coming down and Treasury issuance will apply pressure on yields.</p> <p>The latest February CPI reading of 8.6% from 8.1% in January surprised economists as services inflation accelerated. Furthermore Eskom has recently announced that it will need to apply for significantly larger tariff increases, with speculation that the increases could be in excess of 35%. The reasons that they give for the additional funding is based on Rand weakness which increases input costs as well as the fact that due to the credit crisis, accessing capital markets has become much more expensive. All of this at a time where they desperately need to rollout their expansion plans that include maintaining and building power stations.</p> <p>Our valuation models also reflect that current government bond valuations are too demanding while corporates are looking much more attractive as spreads have blown out over the past few months.</p>	<p><b>RSA Property, Alternatives &amp; Cash</b></p> <p>Property has remained resilient over the past while, benefitting from lower interest rates. Yields have ticked up slightly but remain at fairly attractive levels. Ten year bond yields have rallied, pushing to levels lower than those of property yields. Occupancy rates remain benign and we continue to maintain an over weight exposure to this asset class. The Treasury's expectation of rebounding growth into 2010 will boost property income.</p> <p>Our over weight allocation to Cash has helped us over the past year. We intend to keep drawing down on this exposure in favour of riskier asset classes. Our view of aggressively falling interest rates means that the returns for Cash will approach 7% by mid year. We believe that we can expect double digit returns from the likes of Property and Equities.</p>																																																																					
<p><b>International</b></p> <p>Investors across the globe have been cheered by rebounding equity markets and the gloom is making way for renewed optimism. The latter was initially sparked off by news that Citigroup, which had already received \$45 billion in government rescue funds, had generated an operating profit of \$8.3 billion in the first two months of 2009. This news suggested that the banking crisis was coming to its end.</p> <p>Furthermore, news that the US Federal Reserve would aggressively expand its balance sheet also boosted equity markets. The Fed announced that it would increase the size of its balance sheet by another \$1 trillion to \$3 trillion engaging in quantitative easing measures. Bond yields rallied sharply lower as the Fed was now a buyer of long term government bonds whereas its normal operations to control money supply are typically focused within short term debt. This sent the US dollar to sharply weaker levels due to the threat of inflation in the medium term on the back of excessive money supply.</p> <p>Another key support for riskier asset classes has been the Obama administration's revelation of its plan to deal with toxic assets. They announced a public-private investment programme where the prices of these assets are to be determined using an auction process and private investors are to take stakes at favourable rates. This plan was well received with heavy weights like Pimco and BlackRock already stating their interest in such an initiative.</p> <p>Furthermore, there are tentative signs that the real economy is beginning to perk up as US housing starts unexpectedly rose by 22% from the January reading as work began on 583 000 homes. The market was also pleasantly surprised by US made durable goods that rose unexpectedly for the first time in February after six months of steady declines. Specifically, these rose by 3.4% while consensus expectations were for a decline of 2.4%.</p> <p>For now we still favour corporate debt as the spreads remain excessively high but in time we will boost the equity exposure.</p>	<table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <thead> <tr> <th colspan="5">NOVARE HOUSE VIEW: MAR/APR 2009</th> </tr> <tr> <th></th> <th>Balanced</th> <th>Relative</th> <th>Present</th> <th>Previous</th> </tr> <tr> <th></th> <th>Fund</th> <th></th> <th>Month</th> <th>Month</th> </tr> </thead> <tbody> <tr style="background-color: #92d050;"> <td><b>RSA</b></td> <td><b>85%</b></td> <td><b>ON</b></td> <td><b>85%</b></td> <td><b>85%</b></td> </tr> <tr> <td>RSA Equities</td> <td>50%</td> <td>ON</td> <td>50%</td> <td>48%</td> </tr> <tr> <td>RSA Bonds</td> <td>15%</td> <td>UNDER</td> <td>13%</td> <td>13%</td> </tr> <tr> <td>RSA Property</td> <td>5%</td> <td>OVER</td> <td>6%</td> <td>6%</td> </tr> <tr> <td>RSA Alternatives</td> <td>10%</td> <td>ON</td> <td>10%</td> <td>10%</td> </tr> <tr> <td>RSA Cash</td> <td>5%</td> <td>OVER</td> <td>6%</td> <td>8%</td> </tr> <tr style="background-color: #ffff00;"> <td><b>International</b></td> <td><b>15%</b></td> <td><b>ON</b></td> <td><b>15%</b></td> <td><b>15%</b></td> </tr> <tr> <td>Int Equity</td> <td>9%</td> <td>UNDER</td> <td>7%</td> <td>7%</td> </tr> <tr> <td>Int Bonds</td> <td>3%</td> <td>OVER</td> <td>6%</td> <td>6%</td> </tr> <tr> <td>Int Alternatives</td> <td>3%</td> <td>UNDER</td> <td>2%</td> <td>2%</td> </tr> <tr> <td>Int Cash</td> <td>0%</td> <td>ON</td> <td>0%</td> <td>0%</td> </tr> </tbody> </table>	NOVARE HOUSE VIEW: MAR/APR 2009						Balanced	Relative	Present	Previous		Fund		Month	Month	<b>RSA</b>	<b>85%</b>	<b>ON</b>	<b>85%</b>	<b>85%</b>	RSA Equities	50%	ON	50%	48%	RSA Bonds	15%	UNDER	13%	13%	RSA Property	5%	OVER	6%	6%	RSA Alternatives	10%	ON	10%	10%	RSA Cash	5%	OVER	6%	8%	<b>International</b>	<b>15%</b>	<b>ON</b>	<b>15%</b>	<b>15%</b>	Int Equity	9%	UNDER	7%	7%	Int Bonds	3%	OVER	6%	6%	Int Alternatives	3%	UNDER	2%	2%	Int Cash	0%	ON	0%	0%
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## Quantitative Easing

Econometrix Treasury Management, 10 March 2009

In this edition of Viewpoint we take a brief look at some of the dynamics and implications of quantitative easing policy. As central banks increase liquidity provision to the financial system through corporate and government asset purchases it is time to question what the longer term consequences for inflation and growth will be.

### Taking monetary easing to a new level

Quantitative easing effectively entails the purchasing of corporate and government debt by the central bank with printed money to allow government to absorb corporate credit risk of companies with access to the debt markets, and to monetise the national debt. In the current phase of financial calamity in the global economy this is seen by most policy makers, mainstream economists and the mainstream financial media as an indispensable monetary mechanism that can be employed to ease the pressure on banks, as well as reduce longer dated bond yields to prop up key asset markets. But if it were that easy then all countries around the world would be sitting on zero % interest rates and printing money like mad. The fact is that quantitative easing is another step toward full central monetary planning in an economy, and like all government-planned action it eventually sets in motion the law of unintended consequences, creates a set of winners and losers, and if handled inappropriately and used in excess can lead to currency debasement, punitive inflation, and gross capital misallocation.

### The policy has its limits

Quantitative easing tends to have far less benefit for those medium and smaller sized companies that do not have access to the sophisticated credit markets and rely on the banking system for their financing requirements. Although potentially shoring up toxic bank balance sheets, in itself it does not guarantee that the banks will step up lending to smaller companies to ride out the storm. Risk is being re-priced and confidence levels are low on the back of asset price deflation, which in itself ensures that bank balance sheets are gradually being eroded. Many might argue that the central banks need to employ all the tools at their disposal to prevent this recession from turning into a depression, but at what cost? Too much quantitative easing threatens to misprice debt assets and lead to a misallocation of financial resources at a time when the market mechanism is desperately trying to rediscover fair and accurate pricing. There is not so much a lack of liquidity as there is a much larger demand than before for holding money in cash balances, and this has exposed a massive dislocation in capital markets which the market is now trying to work through. In much the same way as the cheap credit offered by the Fed from 2003 created a massive market distortion and huge misallocation capital, surely quantitative easing now threatens to do even worse?

### Inflation and the Japanese experience

It has also long been argued that such actions from central banks fuel general price inflation. In fact, this is the hope among central banks themselves: that an inflation of the money supply will counteract the dramatic slowing in the velocity of money circulation which threatens to pull economies into wholesale deflation. Normally inflation is an ally of governments in debt, and the underlying policy ideology of today's central bankers is that the answer to a clamour for holding money in the form of liquid cash balances is to create more money that can be used in the credit markets. This seems all very well, but once households have shored up their balance sheets and begin spending and investing again, there is the real risk of another inflationary burst. Unless all the liquidity that was pumped into the system is carefully sterilised again, then inflation pressures could get out of control. In a worst case scenario for economic growth, rampant inflation will push interest rates much higher. Boosting money supply through ballooning a central bank's balance sheet does not however automatically translate into inflationary traction, as the case of Japan makes clear. Many will say that if Japan's experience is anything to go by, quantitative easing will not help restore growth to any significant extent and will do little to boost prices out of deflation territory. One might argue that global growth will remain very weak for years to come and that the excess capacity built up through the boom years will help reduce longer term inflationary pressures. However it could equally be argued that the expansion of the Bank of Japan's balance sheet between 2001 and 2006 is going to be dwarfed by the radical action being adopted by the likes of the Bank of England and especially the US Fed. Furthermore, Japan has sustained very high household savings rates (a cultural phenomenon) and huge trade surpluses which have helped absorb massive amounts of Japanese government bonds and yen liquidity. At the same time weak GDP growth can in large part be attributed to Japan's demographic decline, aging population and low immigrant levels.

### Quantitative Easing is a gamble

The same cannot be said for the US, UK and much of Europe where household savings are close to zero %, large trade deficits prevail, and population growth is kept solid with the demographic energy from high rates of immigration. For now Western households are saving in the wake of a financial crisis which is reducing trade deficits and will keep the lid on inflation for quite a long time despite huge injections of new money into the system. If those savings rates keep rising to much higher levels then rampant inflation will be avoided and a liquidity trap will set in. If however households eventually choose to leverage off their better savings positions to embark on another credit spending spree that wipes those savings out again, then a wave of unlocked liquidity will be unleashed into the economy which could cause high inflation levels, a selling of government debt securities, and a rapid weakening of the major currencies. With the risk of a stagnating Japan-style liquidity trap, or a hyper-inflationary high interest rate environment, it is hard not to view quantitative easing as anything but another gamble, that despite the best intentions is getting in the way of a much needed market correction.

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