## MONTHLY INVESTMENT REPORT

**30 November 2008**

# CPSA PROVINCIAL PENSION FUND

- FINANCIAL OVERVIEW
- MARKET VALUES AND RETURNS
- LONGER TERM RETURNS
- FUND SPECIFIC ANALYSIS
- PORTFOLIO STRATEGY
- MANAGER PERFORMANCE

## FUTURE STRATEGY

- The Fund is currently slightly 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

**Monthly Investment Report**
**30 November 2008**

# CPSA Provincial Pension Fund

## FINANCIAL OVERVIEW

The market staged a dramatic comeback in November with the FTSE/JSE All Share Index ending the month in positive territory, up 1.27%. In a turn of events Resource stocks that have been weighing the index down in the past few months were the top performers, with the sector up 5.12% for the month. Gold counters like Gold Fields, Harmony and AngloGold Ashanti produced strong double digit returns for the month. Financials also held their own, returning 4.74% for the month as the call for a December interest rate cut resounded louder and louder. Industrials were the worst performing sector, down 5.33% for the month. The forward rate agreement curve is beginning to price in higher probabilities of the Monetary Policy Committee cutting interest rates in December as opposed to the first quarter of 2009. This on the back of inflation having rolled over and streams of very poor economic data coming through. Headline CPI inflation fell by a full 1% in October, to 12.1%, from 13.1% in September, whilst CPIX inflation also declined recording 12.4% in October, lower than September's reading of 13.0%. Similarly, PPI, which is said to lead inflation, also fell bringing the reading to 14.5% year on year from the previous month's reading of 16.0%. Two key factors have driven PPI lower; a decrease in electricity prices and a further drop in commodity prices.

Other data releases pointed to an economy under significant pressure with vehicle and retail sales in decidedly negative territory. Third quarter economic growth showed that the economy had stalled, growing a mere 0.2% quarter on quarter. It came as little surprise that the manufacturing and wholesale and retail trade sectors disappointed, subtracting 2% points from growth while agricultural activity, construction and government services managed to push up GDP growth. Despite the Rand weakening 2.88% to R10.05/$, bonds and property staged a powerful rally during the month, returning 4.6% and 10.7% respectively.

| Global Equity (US$) | Level | 1 Month | 3 Months | 6 Months | YTD | 12 Months |
|---|---|---|---|---|---|---|
| S&P 500 | 896.2 | -7.5% | -30.1% | -36.0% | -39.0% | -39.5% |
| Nasdaq | 1,535.6 | -10.8% | -35.1% | -39.1% | -42.1% | -42.3% |
| MSCI Global Equity | 892.9 | -6.7% | -33.6% | -41.5% | -43.8% | -44.6% |
| MSCI Emerging Mkt | 527.0 | -7.6% | -44.9% | -56.4% | -57.7% | -57.6% |
| **Global Bond (US$)** | | | | | | |
| Global Bonds | 417.1 | 3.9% | 1.5% | 0.3% | 4.6% | 4.1% |
| **Commodity Prices** | | | | | | |
| Brent Oil (USD/Barrel) | 50.6 | -16.0% | -55.8% | -59.9% | -47.2% | -43.1% |
| Platinum (USD/oz) | 881.0 | 7.0% | -40.7% | -56.1% | -42.3% | -38.8% |
| Gold (USD/oz) | 818.2 | 12.8% | -1.5% | -7.7% | -1.8% | 4.5% |
| **South African Mkt (Rand)** | | | | | | |
| Africa All Share | 2,319.1 | 1.3% | -22.4% | -32.0% | -24.4% | -27.7% |
| Africa Top 40 | 2,131.9 | 1.6% | -23.3% | -34.1% | -24.0% | -27.8% |
| Africa Resource 20 | 1,871.9 | 5.1% | -31.8% | -45.5% | -28.3% | -32.7% |
| Africa Financial 15 | 2,318.0 | 4.7% | -11.4% | -8.8% | -23.9% | -28.0% |
| Africa Industrial 25 | 2,513.5 | -5.3% | -15.1% | -22.9% | -18.9% | -20.7% |
| Africa Mid Cap | 3,840.5 | -1.0% | -15.4% | -13.0% | -24.9% | -25.4% |
| Africa Small Cap | 5,437.3 | 1.4% | -16.5% | -20.0% | -32.4% | -33.2% |
| All Bond Index | 282.4 | 4.6% | 6.7% | 15.2% | 9.4% | 10.3% |
| Stefi Composite | 212.7 | 1.0% | 2.9% | 5.9% | 10.6% | 11.6% |
| Africa SA Listed Property - (SAPY) | 561.0 | 10.7% | 0.0% | 16.2% | -8.9% | -10.5% |
| MSCI Global Equity (R) | | -4.0% | -13.2% | -22.6% | -17.1% | -17.9% |
| Global Bonds (R) | | 6.9% | 32.6% | 32.6% | 54.4% | 54.1% |
| Rand Dollar Exchange Rate | 10.05 | 2.9% | 30.7% | 32.2% | 47.5% | 48.1% |

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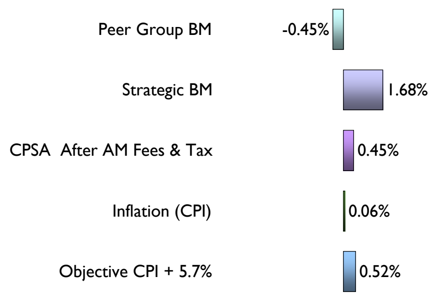
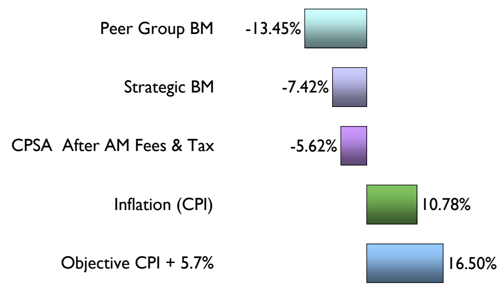
# CPSA Provincial Pension Fund

## MARKET VALUES AND RETURNS

**Monthly Return for November 2008**




**Return since 1 January 2008 up to 30 November 2008**




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.

| | Fraters | RMB | Allan Gray | FG IBF | Liberty Cash |
|---|---|---|---|---|---|
| Market Value | 44,670,734 | 56,750,446 | 317,213,980 | 29,049,466 | 17,646,001 |
| % of Fund | 7.2% | 9.2% | 51.4% | 4.7% | 2.9% |
| Benchmark | JSE ALSI | JSE ALSI | AFGLMW | All Bond Index | n/a |
| Monthly Return | -2.23% | -0.62% | 0.95% | 3.72% | -5.63% |
| Benchmark | 1.27% | 1.27% | -0.45% | 4.61% | n/a |
| Out/ Under Perf | -3.50% | -1.89% | 1.40% | -0.89% | n/a |
| Last 3 Months | -15.83% | -21.55% | -2.78% | 6.30% | -14.94% |
| Benchmark | -22.37% | -22.37% | -11.81% | 6.67% | n/a |
| Out/ Under Perf | 6.54% | 0.82% | 9.03% | -0.37% | n/a |
| Calendar YtD | -18.14% | -22.04% | -2.61% | 10.80% | -3.39% |
| Benchmark | -24.38% | -24.38% | -13.45% | 9.39% | n/a |
| Out/ Under Perf | 6.25% | 2.34% | 10.84% | 1.41% | n/a |
| Last 12 Months | -21.41% | -24.97% | -3.69% | 11.79% | -2.32% |
| Benchmark | -27.68% | -27.68% | -14.69% | 10.33% | n/a |
| Out/ Under Perf | 6.27% | 2.71% | 11.01% | 1.45% | n/a |
| Since July 2005 | 76.31% | 61.31% | 89.05% | 35.92% | 19.13% |
| Benchmark | 64.96% | 64.96% | 57.96% | 27.69% | n/a |
| Out/ Under Perf | 11.35% | -3.65% | 31.10% | 8.24% | n/a |
| | Jul-05 | Jul-05 | Jul-01 | Dec-03 | Feb-02 |
| Ann Since Inception | 18.05% | 15.02% | 21.16% | 10.51% | 6.79% |
| Benchmark | 15.78% | 15.78% | 15.04% | 8.98% | n/a |
| Out/ Under Perf | 2.28% | -0.76% | 6.11% | 1.54% | n/a |

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# CPSA Provincial Pension Fund

## MARKET VALUES AND RETURNS (CONTINUED)

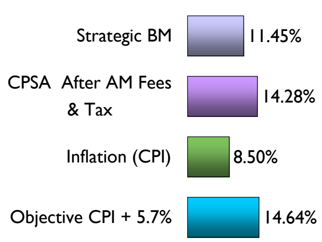
| | Sortino | FG CPF | Stanlib IF | NOAF | Mayibentsha | Total |
|---|---|---|---|---|---|---|
| Market Value | 19,306,059 | 8,106,364 | 16,973,399 | 49,188,008 | 58,416,489 | 617,320,946 |
| % of Fund | 3.1% | 1.3% | 2.7% | 8.0% | 9.5% | 100.0% |
| Benchmark | JSE Listed Property | JSE Listed Property | All Bond Index | 60% MSCI/40% JPMGGB | CPI + 4.5% | CPI + 5.7% |
| Monthly Return | 9.97% | 0.91% | 2.25% | -0.57% | -0.84% | 0.45% |
| Benchmark | 10.70% | 10.70% | 4.61% | 0.33% | 0.43% | 0.52% |
| Out/ Under Perf | -0.73% | -9.79% | -2.36% | -0.91% | -1.27% | -0.07% |
| Last 3 Months | -0.36% | 2.43% | 4.11% | 7.03% | -5.47% | -5.33% |
| Benchmark | 0.04% | 0.04% | 6.67% | 3.63% | 1.35% | 1.64% |
| Out/ Under Perf | -0.40% | 2.39% | -2.56% | 3.41% | -6.82% | -6.97% |
| Calendar YtD | -8.50% | 7.77% | 11.00% | 6.35% | -6.76% | -5.62% |
| Benchmark | -8.91% | -8.91% | 9.39% | 7.58% | 15.30% | 16.50% |
| Out/ Under Perf | 0.41% | 16.68% | 1.60% | -1.23% | -22.06% | -22.12% |
| Last 12 Months | -10.47% | 8.74% | 12.06% | 6.74% | -7.10% | -7.01% |
| Benchmark | -10.52% | -10.52% | 10.33% | 6.88% | 16.74% | 18.07% |
| Out/ Under Perf | 0.06% | 19.26% | 1.72% | -0.14% | -23.84% | -25.08% |
| Since July 2005 | n/a | n/a | n/a | 45.82% | 42.15% | 72.18% |
| Benchmark | n/a | n/a | n/a | 41.21% | 50.75% | 56.71% |
| Out/ Under Perf | n/a | n/a | n/a | 4.61% | -8.61% | 15.47% |
| | Jul-07 | May-07 | Oct-06 | Mar-04 | May-03 | Jul-02 |
| Ann Since Inception | -2.25% | 20.24% | 9.92% | 8.54% | 15.05% | 17.18% |
| Benchmark | -0.52% | -41.65% | 8.92% | 9.06% | 10.16% | 11.88% |
| Out/ Under Perf | -1.73% | 61.89% | 1.00% | -0.52% | 4.90% | 5.31% |

## LONGER TERM RETURNS

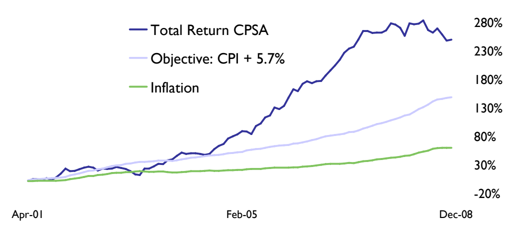
The Fund's Investment Objective is set over 3 year rolling periods. Longer term returns should be used to assess the Fund's performance when compared to its set Investment Objectives as short term market volatility may distort short term performance measurement.

The cumulative graph above shows the Fund performance since 1 Jan 2001. It is benchmarked against it's Investment Objective i.e. CPI + 5.7% as well as inflation.

**Last 36 Months Annualised Return**




**Cumulative Returns since 1 Jan 2001**



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# 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% per annum) and its strategic Benchmark.

| Period | CPSA Net of Fees & Tax | Objective: CPI + 5.7% | Strategic Benchmark | Market Value History |
|---|---|---|---|---|
| Last 12 Months | -7.01% | 18.07% | -9.13% | |
| Dec-07 | -1.48% | 1.34% | -1.85% | 665,842,188 |
| Jan-08 | -3.81% | 1.60% | -1.80% | 639,182,042 |
| Feb-08 | 6.09% | 0.79% | 6.82% | 676,975,352 |
| Mar-08 | -0.41% | 2.05% | -0.89% | 676,710,448 |
| Apr-08 | 0.39% | 2.22% | 1.44% | 676,807,905 |
| May-08 | 1.37% | 1.61% | 1.81% | 683,814,016 |
| Jun-08 | -4.34% | 1.73% | -2.41% | 654,456,488 |
| Jul-08 | -1.16% | 2.58% | -3.62% | 645,737,997 |
| Aug-08 | 1.93% | 1.20% | 1.09% | 653,593,711 |
| Sep-08 | -2.87% | 0.64% | -6.14% | 635,400,233 |
| Oct-08 | -2.97% | 0.46% | -4.97% | 616,112,428 |
| Nov-08 | 0.45% | 0.52% | 1.68% | 617,320,945 |

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 07 | From 1 Jan 08 |
|---|---|---|---|---|---|
| MV at Start | 265,026,619 | 301,386,988 | 475,182,236 | 602,209,484 | 665,842,189 |
| Cash In/Out Flow | (81,316,466) | (71,948,114) | (47,843,816) | (27,570,905) | (11,602,216) |
| Return | 433,610,791 | 387,882,071 | 189,982,524 | 42,682,366 | (36,919,028) |
| Current MV | 617,320,945 | 617,320,945 | 617,320,945 | 617,320,945 | 617,320,945 |

**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 | -7.01% | -5.33% | 0.45% |
| Total Out/(Under) Performance of Benchmark | 2.12% | 3.96% | -1.24% |
| Out/(Under) Performance due to Asset Allocation | 0.90% | 0.32% | -0.53% |
| Out/(Under) Performance due to Stock Selection | 1.22% | 3.64% | -0.71% |
| 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 | -0.69% |
| Portfolio Standard Deviation | 2.49% |
| Individual Portfolio VaR | 6.49% |
| Portfolio VaR | 4.09% |
| Total Amount VaR | 25,243,124 |

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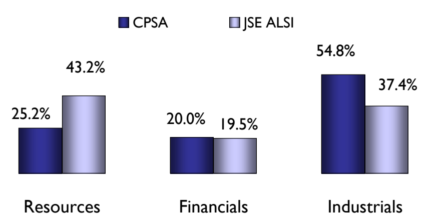
# CPSA Provincial Pension Fund

## FUND SPECIFIC ANALYSIS (CONTINUED)

### Most recent strategic changes

| Date | Transferred From: | Transferred To: | Amount |
|---|---|---|---|
| 10-Aug-07 | Liberty Cash | Investec Bank | 8,786,000 |
| 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 |

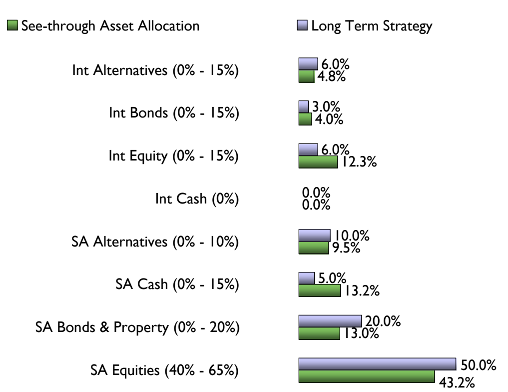



The fund is currently underweight Resources, slightly over weight Financials and overweight Industrials. For the month of November, Resources was the best performing sector (5.1%), followed by Financials (4.7%), and Industrials (-5.3%).

| CPSA Top 15 Shares | % of CPSA Equities | % JSE ALSI |
|---|---|---|
| SAB | 8.21% | 6.49% |
| MTN GROUP | 7.78% | 6.80% |
| ANGLOGOLD ASHANTI | 6.84% | 2.68% |
| SASOL | 5.37% | 6.69% |
| STANBANK | 4.49% | 4.61% |
| HARMONY | 4.03% | 1.21% |
| REMGRO | 3.89% | 1.13% |
| COMPAGNIE RICHEMON | 3.78% | 3.16% |
| SANLAM | 3.68% | 1.26% |
| ABSA | 2.63% | 1.23% |
| BHPBILL | 2.46% | 14.02% |
| NAMPAK | 2.20% | 0.29% |
| SHOPRITE | 2.00% | 0.86% |
| ANGLO | 1.78% | 10.81% |
| AFRICAN RAINBOW | 1.75% | 0.30% |

## PORTFOLIO STRATEGY

**Strategic vs. Actual Asset Allocation**




The CPSA Pension Fund is currently:
- under weight equities
- under weight bonds & property
- over weight cash
- slightly underweight alternatives, and
- over weight international

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

**Monthly Investment Report**
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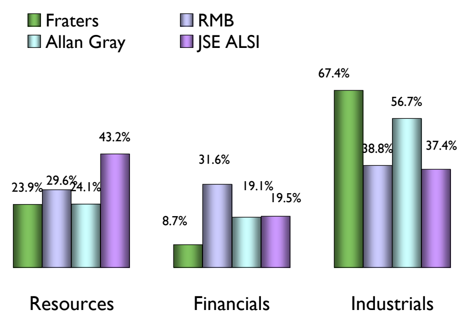
# CPSA Provincial Pension Fund

## MANAGER PERFORMANCE

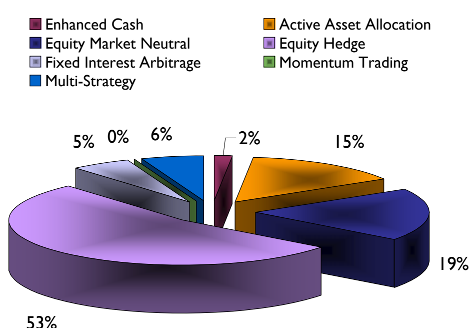
| Equity Manager | Fraters | RMB |
|---|---|---|
| Inception Date | Jul-05 | Jul-05 |
| Classification | Concentrated | Concentrated |
| Benchmark | JSE ALSI | JSE ALSI |
| Return since Inception | 76.31% | 61.31% |
| Benchmark | 64.96% | 64.96% |
| Annualised Return | 18.05% | 15.02% |
| Benchmark | 15.78% | 15.78% |
| Information ratio | 0.05 | (0.04) |
| Sharp Ratio | 0.17 | 0.11 |




All the Equity Managers were underweight Resources at the end of November 2008. Fraters and Allan Gray were significantly overweight Industrials at the end of November 2008 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 | 118.8% | 33.9% | 64.8% | -2.3% |
| Ann Return since inception | 15.1% | 20.2% | 10.5% | -2.3% |
| Avg Monthly return | 1.19% | 1.58% | 0.85% | 0.02% |
| % + months | 76.1% | 94.7% | 73.3% | 47.1% |
| % - months | 23.9% | 5.3% | 26.7% | 52.9% |
| Max Drawdown | -6.0% | -0.1% | -5.1% | 21.7% |
| Std Deviation | 6.1% | n/a | 6.1% | 7.3% |

**Mayibentsha Strategic Asset Allocation**




Mayibentsha Fund of Funds continues to remain defensively positioned in these continued volatile markets. From an underlying strategy perspective, their Multi-strategy posted positive returns, while Market Neutral was flat for the month. Mayibentsha's Asset Allocation benefited from the market turmoil, whereas Fixed Interest and Equity Long/short detracted slightly from overall performance. The underlying funds continue to be defensively positioned with net exposure and leverage at historical low levels, helping the Mayibentsha Fund of Funds to limit losses during yet another volatile month.

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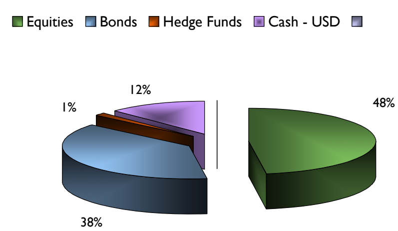
# CPSA Provincial Pension Fund

## 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 | -0.57% | 7.03% | 6.35% | 47.58% |
| Benchmark | 0.33% | 3.63% | 7.58% | 50.97% |
| Out/Under perf | -0.91% | 3.41% | -1.23% | -3.39% |
| MSCI GEI | -4.03% | -13.24% | -17.08% | 26.18% |
| JPM WGBI | 6.88% | 32.64% | 54.35% | 89.81% |
| Rand / $ * | 2.88% | 30.68% | 47.54% | 51.01% |

* Negative change indicates Rand strength

| Underlying Managers of NOAF | Fund Allocation | 3 Months | Year to Date | Last 12 Months | Since May 04 |
|---|---|---|---|---|---|
| **Global Equity** | **47.91%** | | | | |
| Morgan Stanley Global Brands (SICAV) | 19.79% | 1.4% | -0.2% | 0.1% | 62.9% |
| Investec Global Strategic Equity | 11.63% | -23.0% | -32.4% | -31.7% | n/a |
| Fortune Global Equities | 4.52% | -8.7% | -21.2% | -21.5% | n/a |
| Templeton Global | 11.96% | -15.5% | -22.9% | -23.1% | n/a |
| Fortune Explorer | 0.00% | -16.9% | -30.3% | -28.2% | n/a |
| **Global Bonds & Property** | **38.28%** | | | | |
| Franklin Templeton Global Bond | 28.18% | 29.4% | 51.1% | 52.3% | n/a |
| Franklin Templeton Global Total Return | 10.10% | 17.6% | 36.4% | 37.6% | n/a |
| **Global Alternative** | **1.42%** | | | | |
| Quellos ILF Ltd | 1.42% | 22.8% | 28.4% | 29.1% | n/a |
| **Global Cash** | **12.40%** | | | | |
| Fidelity Institutional Cash - USD | 9.62% | 31.4% | 51.6% | 52.8% | 78.9% |
| Cash | 2.78% | n/a | n/a | n/a | n/a |

# NOVARE HOUSEVIEW MATRIX – NOVEMBER/DECEMBER 2008

## RSA Equities

In line with developments around the globe, domestic growth is under significant pressure. This can be seen from a number of surveys and data releases that continue to reflect that business and consumers are struggling. Vehicle sales, retail sales, Purchasing Managers survey, business and consumer confidence surveys have all plunged. The Treasury has estimated GDP growth for 2009 at 3% but we believe that this view may be too optimistic which does not bode well for domestic equity performance.
Furthermore, we believe that company earnings have much further to fall in the local market and that this will further undermine domestic equity performance.
The recent bull run was largely driven by foreign portfolio inflows. As foreigners have had to deal with problems in their own markets they have continued to withdraw their funds. In October they withdrew in excess of R20bn. Losing this key support for our market keeps us under weight this asset class.

## RSA Bonds

Interest rates in South Africa remain oppressively high despite rates falling dramatically in the global economy. Our growth picture has turned for the worst but the inflation outlook continues to improve. Oil prices have plunged and petrol prices will follow suit bringing about much needed relief.
Forward Rates are pricing in interest rate cuts as early as December 2008 but with the Rand trading at levels beyond R10/$, there are definite risks to this view. The Monetary Policy Committee will have to balance the risks of the Rand depreciating on the back of lower interest rates as the carry trade benefit is reduced as opposed to the risks of the domestic economy stalling. At this stage, we hold the latter view; that concerns of domestic overkill may well prevail and we may see some policy reprieve.
As such we believe that this is the opportune time to close our under weight position in this asset class. Furthermore, corporate spreads have widened giving rise to attractive pickings.

## RSA Property, Alternatives & Cash

Property yields are now at attractive levels and with our benign view of inflation and interest rates, we continue to find this asset class compelling. The main detractor comes from our expectation that Property Income will come under pressure in line with falling GDP growth. This leads us to maintain our on weight position in this asset class as some headwinds remain.
We continue to advocate a neutral exposure to alternative assets as they play a key role in reducing risk via the diversification opportunities that they provide for portfolios.
Although cash has been very good to us in recent market conditions, it is now beginning to lose some of its appeal. While we remain over weight this asset class, we have pared the exposure down somewhat, favouring the other asset classes.

## International

International equities have suffered immensely over the very recent three months and the bottom remains elusive. Worse yet prospects of global economic recession imply that there is unlikely to be a bounce back in financial markets. Rather, a long and hard road lies ahead were international equity returns are likely to be soggy and desperately uninspiring. As such we maintain our under weight position.
In the United States, advance third quarter GDP growth numbers reflected a modest 0.3% contraction but we believe that in the fourth quarter, the growth picture will worsen considerably. Numerous surveys and data releases bear testimony to this. The October US ISM manufacturing survey plummeted as the stronger dollar and slowing global activity undermined export performance. The unemployment rate jumped to 6.5% in October while US Retail sales plunged; both of these are at worse levels than those recorded during the 2001 recession. The October Consumer Confidence surveyed confirmed that indeed, the outlook is bleak. We look to further fiscal and monetary stimulus to help to kick start this economy.
The outlook in other developed countries is also gloomy. In the United Kingdom, the Bank of England recently slashed interest rates by 1.5% and the governor, Mervyn King, issued a sombre assessment of the economy. Specifically that the inflation scare is behind us but they forecast 2009 GDP growth for the UK at -1.3% The UK economy faces major headwinds as house prices are expected to fall further and a large proportion of national income has been derived from the now defunct financial services industry. The Euro zone as well as Japan are now in technical recession as GDP growth contracted in the second and third quarters of 2008. Export-led saver countries like Germany and Japan are likely to come out of this malaise before the US and UK due to stronger fiscal balances that can be used to stimulate domestic demand.
In essence, the global interest rate cutting cycle is to continue well into 2009 and our view remains positive on the outlook for International Bonds, while we continue to sideline the riskier equity asset class.

**NOVARE HOUSE VIEW: NOV/DEC 2008**

| | Balanced Fund | Relative | Present Month | Previous Month |
|---|---|---|---|---|
| **RSA** | **85%** | **ON** | **85%** | **84%** |
| RSA Equities | 50% | UNDER | 42% | 42% |
| RSA Bonds | 15% | ON | 15% | 13% |
| RSA Property | 5% | ON | 5% | 5% |
| RSA Alternatives | 10% | ON | 10% | 10% |
| RSA Cash | 5% | OVER | 13% | 14% |
| **International** | **15%** | **ON** | **15%** | **16%** |
| Int Equity | 9% | UNDER | 7% | 7% |
| Int Bonds | 3% | OVER | 6% | 6% |
| Int Alternatives | 3% | UNDER | 0% | 0% |
| Int Cash | 0% | OVER | 2% | 3% |

**BANK OF ENGLAND INFLATION REPORT PRESS CONFERENCE: Wednesday 12 November 2008**

**Opening Remarks by the Governor, Mervyn King**

Since the August *Report,* the economic landscape has changed. As a result, the downward revision to the inflation outlook in today's *Report* is the largest in any one quarter since the Monetary Policy Committee was set up. It is very likely that the UK economy entered a recession in the second half of this year. The preliminary estimate of the fall in output in the third quarter was 0.5%, a little more than the fall in the Committee's central projection in August. But since then three factors have transformed the outlook.

First, the short-run indicators for activity declined markedly. Surveys and reports from the Bank's Agents suggest that in September and October there was a sharp fall off in demand, both at home and abroad. Growth in the fourth quarter is likely to be materially weaker than the Committee expected in August. And, as we saw this morning, unemployment in the UK has risen at the fastest rate for seventeen years.

Second, following the failure of Lehman Brothers, the most serious banking crisis since the outbreak of the First World War reduced the supply of credit to the real economy, and, in some cases, led to a cessation of lending altogether. Confidence has been badly affected. All this will restrain demand looking into next year.

Third, although CPI inflation did rise above 5% in September, its expected future path has fallen very significantly. Oil and other commodity prices have more than halved since their peak. In August, the projections were conditioned on a starting level for the oil price of around $124 a barrel, whereas today's *Report* assumes a level of $64 a barrel. In the space of a few months, we have gone from the highest rate of manufacturing input price inflation in nearly thirty years to the lowest monthly rate on record. And measures of short-run inflation expectations have fallen back sharply.

In response to those three factors, there have been significant policy actions. On 8th October, the UK authorities announced a plan to recapitalise the banks in order to repair banks' balance sheets and thereby restore confidence in the UK financial system. Other countries have taken similar measures. Central banks around the world cut interest rates in a coordinated move in early October. And the MPC cut the Bank Rate again last week. The Committee's latest projection for GDP growth is shown in Chart 1 (below). The central projection is for output to decline over the next year, so that four-quarter growth falls further in the near term. That is markedly lower than the projection in August, reflecting the impact of the banking crisis on credit supply and the sharp falls in confidence in the real economy. Further ahead, domestic demand should gradually start to recover as the impact of lower interest rates, the effects of the bank recapitalisation programme on credit availability, and some recovery in real take-home pay take hold. And that, together with a pickup in exports following the fall in sterling's effective exchange rate, should support a recovery in output growth to slightly above its long-run average. But in the central projection, inflation reaches the 2% target in the second half of 2009 and then moves materially below the target. The weakness in inflation further out in the forecast period reflects weak demand which, despite a material slowing in the growth rate of potential supply, opens up a margin of spare capacity and pulls down on price and wage increases.

For some time, the Monetary Policy Committee has faced a balancing act between the upside risk to inflation from continuing high inflation in the near term, and the downside risk that a sharper or more prolonged slowdown could pull inflation well below the target in the medium term. Over the past two months, the three factors I described earlier have turned the prospects for inflation decisively to the downside. As a result, the Committee judged at its meeting last week that, to return inflation to the target, it was necessary to cut Bank Rate by 1 ½ percentage points to 3%. The outlook for inflation has changed substantially. But the Committee's approach to setting monetary policy has not. It continues to set interest rates in a deliberate, forwardlooking manner in order to ensure that inflation is on track to hit the inflation target in the medium term. That approach has served the UK economy well over the past eleven years. And I am confident that it will continue to do so in these exceptional and difficult times.

Chart 1 GDP projection based on market interest rate expectations

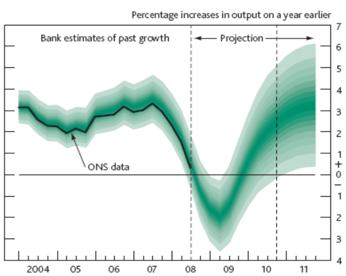
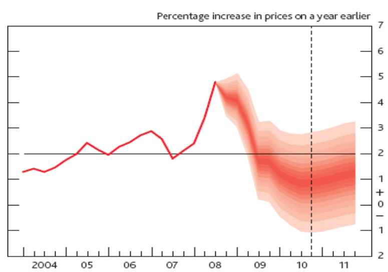



Chart 2 CPI inflation projection based on market interest rate expectations

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