A divergent world…

MARKET OVERVIEW: DECEMBER 2010

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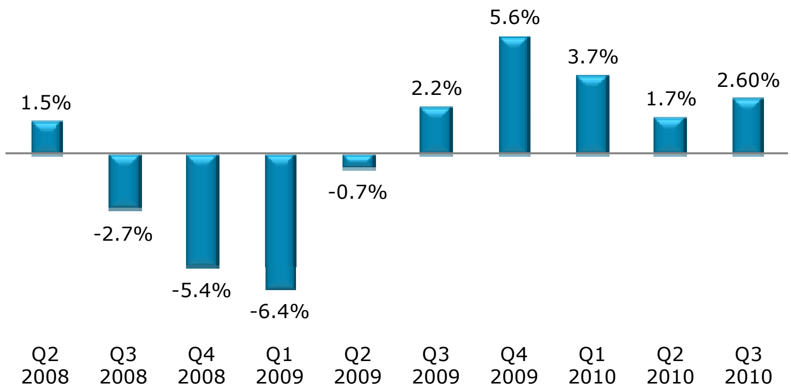
FOURTH QUARTER IN REVIEW

GLOBAL

The mid-year economic slowdown in 2010 gave way to resurgent growth during the final quarter of the year, quashing fears over the potential for a double-dip recession. Financial markets were driven by policy and political headlines, together with improved economic data that helped to calm investor sentiment. Global manufacturing data improved, economic news flow out of the US strengthened and fallout from the Greek crisis was contained in the euro-zone. As emerging markets soared ahead, the developed world had to implement further measures to stem the economic slide. The result has been a dislocation in growth and further divergence between countries and groups in terms of policy reaction and macro economic data.

In contrast to European fiscal austerity, the US decided to spend their way out of trouble. The US Federal Reserve did not disappoint with a second round of quantitative easing to the value of $600bn in November, emphasising the goal of supporting the economic recovery and keeping inflation within its targeted range. The program amounts to $75bn worth of Treasury security purchases per month until mid-2011. The mid-cycle economic slowdown earlier in the year spooked officials and deflationary pressures acted adversely on consumer price inflation. Core inflation fell to a record low of 0.9% in October. US economic growth did start to gain momentum, accelerating to 2.6% in the third quarter, up from 1.7% during the second quarter. After the Republican Party triumphed during mid-term congressional elections, political pressure pushed President Obama to extend "Bush-era" tax cuts, causing investment strategists to scramble in adjusting their growth expectations upwards for the US.

US GDP growth

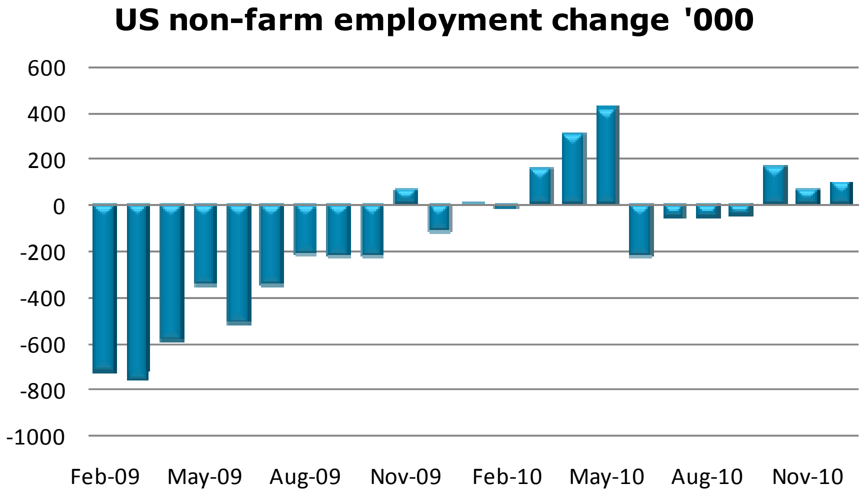


Source: Bureau of Economic Analysis

The US Fed's Beige Book, an indicator of economic health in different regions that was released in December, indicated that the US economy "continued to improve, on balance". Indeed, retail sales during October and November were quite robust and leading chain stores recorded a strong start to the holiday shopping season as discretionary spending improved. Consumer confidence rose, manufacturing sentiment improved, business spending accelerated and industrial production rose more than expected.

In addition, corporate profits from current production rose to a new all time high in the third quarter as firms benefitted from improved demand and cost cutting measures.

The disappointment in the US has been on the employment front and in the housing market. Fewer jobs were created than what was expected and the unemployment rate has remained elevated with the drop from 9.8% in November to 9.4% in December merely reflecting a smaller workforce with more discouraged employment seekers. Public sector job shedding was a major drag during the latter half of the year while private sector employment failed to impress. The only silver lining was positive job creation in the manufacturing sector during 2010 for the first time since 1997. Housing data continued to bump along at the bottom and home prices, as measured by the S&P Case-Shiller Home Price Index, fell during October and November. After some signs of recovery in the spring, home sales, housing starts, and home price appreciation moved back to, or close to, record lows during the latter half of 2010. Although banks were confronted with legal issues surrounding home foreclosures, they still seized more than a million homes during 2010 – a record high.



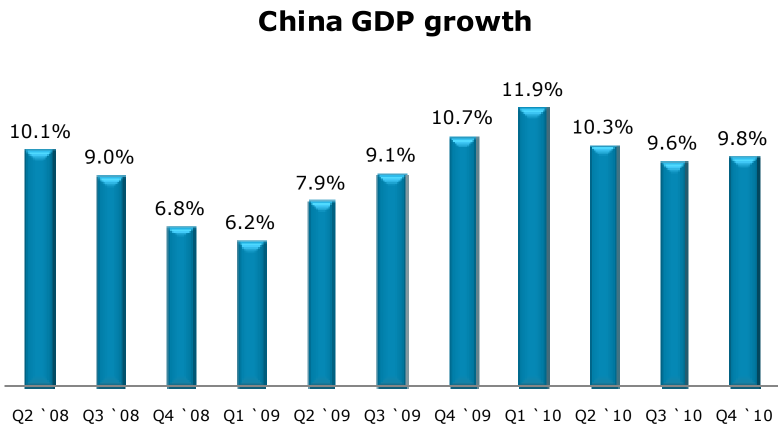
Source: INet

The European sovereign debt crisis escalated during the quarter as the focus shifted to Ireland, which is hampered by a troubled and over-leveraged banking sector. The Irish government had to swallow its pride after initial reluctance to accept the €85bn bailout package from the European Commission, International Monetary Fund and European Central Bank. The turmoil in peripheral Europe has shown few signs of subsiding as borrowing costs for these countries have risen and remained elevated. Rising borrowing costs were in part due to many of the peripheral countries being downgraded by credit rating agencies. To resolve the turmoil, European officials set up the European Stability Mechanism that will start in 2013 and which has been designed to provide a permanent framework for managing future debt crises. Large scale austerity is also underway in most of Europe as countries try to reign in their massive fiscal deficits.

Outside of the peripheries, the European recovery is gaining traction. German authorities announced that their economy probably expanded by 3.6% during 2010, its fastest pace in two decades as strong global demand and a weakened euro powered its exports market. During the third quarter, German GDP grew by 0.7% from the previous quarter compared to overall European growth of 0.3%. In broader core Europe, lending to the private sector has shown signs of strong improvement, alongside a sharp rise in economic and business sentiment. Strong economic data from core Europe and rising inflationary pressures have made the European Central Bank's decision to leave interest rates unchanged tough amidst the fiscal consolidation in peripheral Europe that is keeping their economies depressed. European inflation accelerated to 2.2% on a year-on-year basis in December.

Chinese officials also had to contend with rapidly rising inflation pressures within an economy that bounced back sharply. Economic growth for the third quarter decelerated to 9.6% from 10.3% in the previous quarter, but increased again in the fourth quarter to 9.8%. Chinese real estate prices rose sharply, with prices in major cities having escalated at a double digit pace for more than a year. However, the accelerating inflation figure, which reached 5.1% in November, has mostly been driven by rising food prices and core inflation has remained relatively subdued. Monetary policy was tightened on several occasions during the quarter, either through higher reserve requirements for banks or increased borrowing costs.

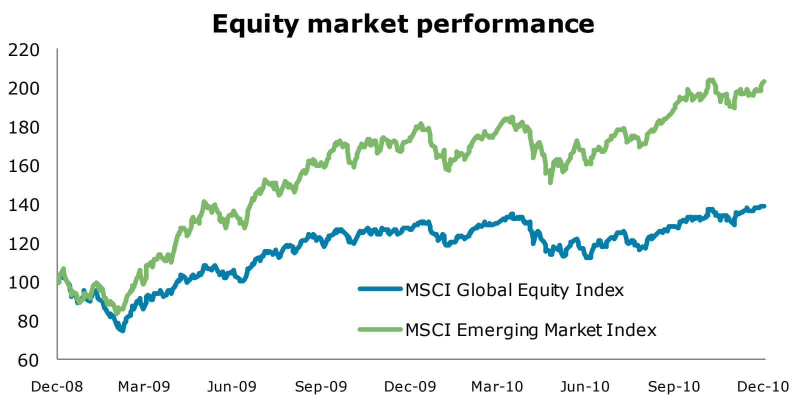
The People's Bank of China has raised the reserve requirement ratio for banks by 7% since September, and twice raised interest rates by 0.25% each in surprise decisions. Tighter monetary policy seems to have had the desired effect so far as Chinese money supply growth has moderated.



Source: Trading Economics

The currency debate continued. The US put pressure on China to revalue their currency more aggressively while developing countries like Brazil implemented measures to fight unwanted currency appreciation. During October, Brazil twice hiked the tax charged on foreign capital inflows. Emerging market economic growth has been strong, resulting in a process of interest rate policy normalisation at many of their central banks. Monetary policy was also tightened to fight off inflationary threats, which due to the high weighting of food and energy costs in emerging markets' inflation baskets, have affected them more adversely than developed countries. The undesired effect of higher interest rates in the developing world, compared to the developed world, is the attraction of capital flows that has continued to support stronger exchange rates in developing economies.

Stock prices rallied to recovery highs during the quarter, driven by monetary stimulus in the developed world, signs of a reacceleration in the US economy, a continued recovery in company profits and more certainty over the financial support that peripheral Europe will enjoy, in particular Ireland. The MSCI Global Equity Index delivered a return of 8.6% over the quarter, outperforming emerging markets' return of 7.1%, and pushing its 12-month return up to 9.6%. Emerging markets gained 16.4% during 2010. Since bottoming out in March 2009, the MSCI Global Equity Index has rallied by 86% and emerging markets by a phenomenal 142%. The commodity market took its cue from the economic boom in developing countries and the CRB Commodity Index rose by 16% over the quarter. The strong surge in the commodity index was driven by the copper price (up 21% over the quarter) and the rise in the price of oil (up 16.6% over the quarter).



Source: INet

In the bond market, the adage of "buy on the rumour, sell on the fact" held true as US Treasury bonds rallied on the expectation of a second round of quantitative easing, only to sell off after the announcement. The subsequent rise in bond yields seems to have negated the US Fed's efforts to push down yields through the quantitative easing program. From a low point of 2.4% in October, 10-year US Treasury yields have risen in excess of 1%.

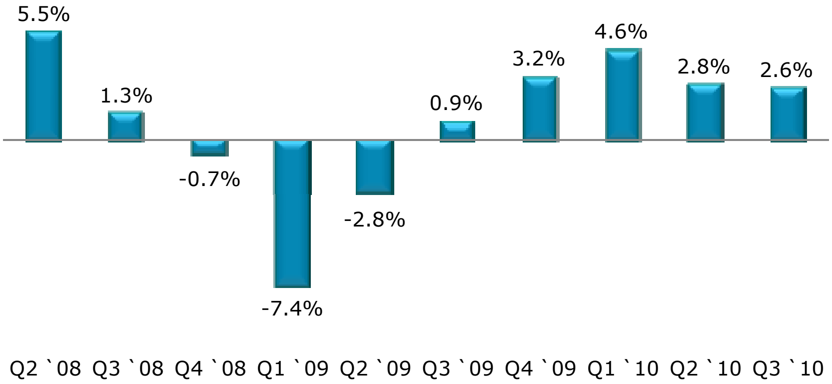
In Europe, the prevailing debt crisis pushed bond yields of peripheral countries to fresh highs. The Greek 10-year government bond yield ended the quarter at 12.6% and the Irish equivalent at 9.3%. The sell-off in global bond markets caused the JP Morgan World Government Bond Index to close 1.8% lower for the quarter, while ending 6.4% higher for the year. Emerging markets experienced a bumper year of attracting investment flows and the JP Morgan Emerging Market Bond Index rose 12% for the year.

LOCAL

The South African economy recovered towards the end of the year from the mid-year slow-down as the global backdrop improved and domestic industrial action, that crippled the manufacturing sector during the second and third quarters of the year, was resolved. The economy is currently caught in something of a sweet spot with low inflation, decent economic growth and historically low interest rates. Fundamentally, the economy is in a healthy position with debt metrics that have improved (compared to many countries where these have deteriorated), coupled with prudent and conservative government economic policies. The Achilles heel remains stubbornly high unemployment.

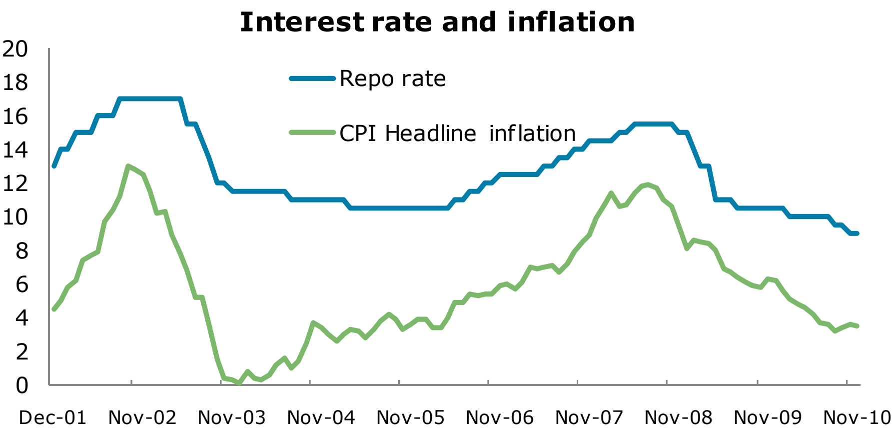
The pace of economic growth decelerated slightly in the third quarter as industrial strike action reduced output, but the primary sectors of the economy performed extremely well with a recovery in mining output and agriculture production due to a bumper maize crop. GDP growth for the third quarter came in at 2.6%, down from a downwardly revised 2.8% in the second quarter and a robust 4.6% in the first quarter. The slowdown was in tandem with more subdued global growth, and it is expected that the domestic economy grew by 2.8% for the 2010 calendar year. Industrial action during the year resulted in more days being lost due to strike action than in any of the preceding five years.

SA GDP growth



Source: Statistics South Africa

Given ultra-stimulative monetary policy in developed markets, earlier signs of weakness in the domestic and international economies and decelerating inflation, the Reserve Bank's Monetary Policy Committee followed on September's interest rate cut by lowering rates with another 0.5% cut in November. The Reserve Bank Governor noted that projected inflation was sufficiently contained to allow for a reduction in the repo rate to 5.5% - the lowest level in 30 years. Consumer price inflation fell to a cyclical low of 3.2% in September, before increasing to 3.5% in December, mainly on the back of higher transport, food and petrol prices. The strength of the rand helped to contain most imported price pressures. The rand was the fourth strongest currency in the world during the last quarter of the year and the third strongest behind the Japanese yen and Australian dollar during 2010.



Source: INet

Amidst historically low interest rates and strong growth in wages, consumers made a remarkable recovery. The Reserve Bank's monetary policy easing reduced debt servicing costs, and together with low inflation and strong wage growth, real disposable income grew. Improved consumer confidence and higher disposable incomes led to higher household consumption expenditure and retail sales. Consumer confidence data revealed that consumers felt more confident about the present time to buy durable goods and this was evident in the real growth in household expenditure numbers that recovered to 5.9% in the third quarter of the year. It is only the troubled housing market that has not yet shown signs of improving. According to the Absa Home Price Index for December, home price growth deteriorated further to -0.8% on a year-on-year basis

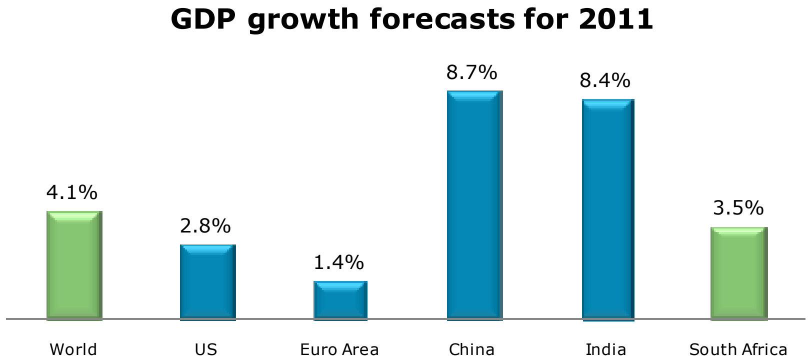
Manufacturing activity picked up towards the end of 2010 and by November output had risen to 4.6% year-on-year. The increase was driven by a rise in transport production which was a continuation of the recovery in output after the negative impact of industrial action during the third quarter. The manufacturing sector, however, has been one of the poorest contributors to the employment situation in South Africa. The unemployment rate remained stubbornly high at 25.3%, although employment statistics showed tentative signs that the job market had stabilised. Most of the jobs that were created were in the public sector, rather than the private sector. The government announced the *New Growth Path* initiative to be implemented soon, which follows on from the now defunct *ASGISA* program. The *New Growth Path* is the most significant piece of policy to be formulated by President Zuma's administration and contains proposals to create an additional five million jobs by 2020.

In his Medium Term Budget Policy Statement, the Minister of Finance presented a prudent framework, with a forecasted budget deficit for the fiscal year that will narrow to 5.3% of GDP and continue to narrow in the following years. The speech held few surprises, except for a further relaxation in foreign exchange controls. Initially, exchange controls were relaxed for individuals before the rules applicable to pension funds were altered as well. Pension funds can now take up to 25% of their portfolio value offshore, up from 20%. The relaxation of exchange controls did little to depreciate the rand. The domestic equity market benefitted from the improved global investor sentiment and ongoing improvement in company earnings. The FTSE/JSE All Share Index gained 9.5% during the quarter to lift its return for the year to 19.0%. The resources sector was the best performer during the quarter, closing 16.5% higher over the period. It was driven by the improved global economic outlook and rising commodity prices. The financial sector was the worst performing sector, declining by 0.8%. Sentiment was dampened by the announcement that HSBC had withdrawn from the proposed takeover of Nedbank, massive job cuts at Standard Bank, and the financial crisis in Europe. The industrial sector was the best performing sector for 2010, delivering a return of 26.7% compared to financials' 14.8% and resources' 12.3%.

The bond market suffered from a mid-quarter blip as the European sovereign debt crisis weighed on risk appetite and sentiment. It did, however manage to gain a further 0.8% during the three months to take its year to date return to 15% - a strong recovery after the 1% decline suffered in 2009. The yield on the 10-year government bond, the R207, initially fell to 7.68% as the price rallied on news of the surprise interest rate cut in November, but peaked at 8.39% as the yield deteriorated on Irish debt crisis concerns and a general flight to safety. Foreign portfolio inflows into the bond market to the value of R57.1bn for 2010 far outpaced the R16.9bn that went into the equity market, notwithstanding the R17.1bn that left the bond market during the last quarter. Listed property gained 3.1% during the quarter and was the best performing asset class for the year with a return of 29.6%.

OUTLOOK

Diverging outlooks for growth, inflation and economic policy in major economies suggest greater economic volatility during 2011. Furthermore, unprecedented policy measures make the economic outlook increasingly uncertain. In the US, officials are trying to inflate the economy out of its problems, while in Europe policy measures are aimed at austerity and clamping down on spending, rather than increasing it. It is yet to be seen which policy route will work best in the long run. In contrast to accommodative monetary policy in the developed world, emerging economies are in a process of policy normalisation, raising interest rates to ward off inflation and overheating economies. Overall, the macro environment for 2011 should be above trend global growth and very accommodative monetary policy. One would expect the "risk on, risk off" behavior to remain a feature of financial markets during the year.



Source: World Bank Economic Outlook: January 2011

There are three major issues for 2011. The first is the debt crisis in the euro area peripherals and the potential for financial instability caused by continued deterioration. Secondly, deteriorating US public sector finances is an increasing concern as the economic agenda in the US will be driven by election considerations, rather than long-term consequences. And lastly, China will continue to feature prominently due to its undervalued currency, growing inflation concerns and the effect of tighter monetary policy to combat an overheating economy and property market.

European sovereign stress will continue to build in the absence of a clear path to fiscal sustainability. The peripherals are taking the necessary steps toward deficit reduction, but long-term solvency requires that they have access to long-term financing at subsidised rates. Fiscal austerity will have the negative consequence of dampening economic growth prospects in these economies and some might fall back into recession. It is expected that Portugal will be the next domino to fall due to its poor fiscal position and heavy debt rescheduling burden during the first half of 2011. Significant economic slack in the region will probably contain core inflation and keep monetary policy accommodative, while bail-out packages will amount to "kicking the can down the road". Core Europe will continue to benefit from loose monetary policy and cheap currency, growing at a much faster pace than the peripheries.

Although there is much skepticism over the US's second round of quantitative easing, the economy should continue to accelerate into the year on the back of super-easy policy. Manufacturing activity has rebounded after a mid-cycle slump and the services sector is showing strong signs of stepping up. The employment backdrop should also start improving, although it will remain a headwind to the economic recovery. The pace at which firms have grown profits faster than sales has been unmatched in the last 50 years as a result of productivity gains (cutting costs and reducing the staff compliment). But going forward, companies will have to start employing more people to maintain profitability. The US housing market is expected to remain weak and will have a challenging year ahead. It will continue to act as a drag on economic growth as it will take many years for the housing bubble to fully unwind.

Above-trend economic growth and ultra accommodative monetary policy creates a favourable back-drop for risk assets. Furthermore, company balance sheets are strong and profitability should continue to improve in developed markets as economies operate below full capacity. Developed market stock prices are relatively cheap on a historical price-earnings valuation basis and are much more attractively valued than bonds when comparing earnings and dividend yields to bond yields. Bond yields will struggle amidst moves away from ultra-accommodative monetary policy, and rising inflation expectations. We thus prefer to be overweight global equities and underweight global government bonds.

The domestic economy will benefit from the tailwind of an accelerating global economy, although the manufacturing sector will struggle to remain competitive if the strength of the rand prevails. The manufacturing sector should continue to recover from the disruption of industrial action, but the leading indicator for this sector is pointing to only marginal expansion ahead. The World Bank expects the South African economy to grow by 3.5% in 2011 and 4.1% in 2012 as the government steps up its infrastructure spending program and consumer spending improves. This compares to its forecast of 4.2% growth for the world and 6.4% expansion for emerging markets during 2011. The local economy should also benefit from gradual recoveries in employment and credit conditions.

The rand's trajectory will be the most important driver of inflation during the coming year. Barring any external shocks, inflation should be well contained within the Reserve Bank's targeted band as companies have very little pricing power and the rand's strength continues to have a disinflationary impact. It is expected that the Reserve Bank will remain on hold with monetary policy at a very accommodative level with the potential for one further cut should the rand appreciate further and inflation surprise to the downside. Low interest rates should provide an underpin for lower debt servicing costs and improving demand conditions should entice private sector fixed investment spending once again.

In line with the outlook for global equities, our outlook for domestic shares remains positive. The equity market is currently fairly to cheaply valued on a twelve month forward price-to-earnings ratio basis and will benefit further from the low interest rate environment, strong expected company earnings growth over the next two years and the market being under-owned by domestic and foreign investors. The bond market is fairly valued, and the direction will be determined by how well the European debt crisis is contained, what the rand's movement will be and how soon investors will start pricing in future interest rate hikes. Bonds should provide investors with better returns than the money market where yields are at historical lows. But our view is that equities will outperform bonds over the next year. It should also be remembered that some apprehension is needed for a cyclical bull market to run its course.

ASSET CLASS RETURNS

	Level	3 Months	6 Months	12 Months
Headlines Indices				
Africa All Share	3,701.33	9.47%	24.02%	18.98%
Africa Top 40	3,310.90	9.89%	24.60%	17.22%
Africa Mid Cap	7,353.21	6.61%	20.64%	30.27%
Africa Small Cap	8,854.07	11.30%	22.58%	24.65%
Africa Fledgling	6,173.89	9.14%	18.37%	21.63%
Africa Resource 20	2,841.13	16.50%	24.79%	12.28%
Africa Industrial 25	4,321.31	7.36%	28.73%	26.65%
Africa Financial 15	3,313.13	-0.82%	14.86%	14.76%
Africa Financial and Industrial 30	3,875.80	4.65%	24.10%	22.01%
Africa Capped All Share	21,091.77	9.26%	23.79%	19.56%
Africa Shareholder Weighted	8,961.38	8.13%	23.62%	20.86%
All Share Economic Group Indices				
Africa Oil & Gas Index	2,549.7	13.37%	29.17%	20.14%
Africa Basic Materials Index	2,977.6	15.81%	23.89%	11.72%
Africa Industrials Index	4,816.2	8.42%	25.64%	24.02%
Africa Consumer Goods Index	3,892.7	9.30%	24.25%	25.92%
Africa Health Care Index	4,837.9	3.30%	18.09%	21.07%
Africa Consumer Services Index	8,713.6	8.26%	35.13%	42.79%
Africa Telecommunications Index	9,661.8	7.27%	33.32%	19.52%
Africa Financials Index	3,596.8	-0.10%	15.04%	16.56%
Africa Technology Index	2,860.6	-0.41%	23.12%	42.32%
All Share Sector Indices				
Africa Chemicals	3,620.3	11.01%	19.19%	28.05%
Africa Electronic & Electrical Equipment Index	4,196.6	5.70%	15.60%	13.82%
Africa Industrial Engineering Index	8,030.2	16.03%	25.19%	37.61%
Africa Automobiles & Parts Index	3,423.2	19.53%	53.79%	151.75%
Africa Beverages Index	3,726.2	4.48%	12.19%	11.41%
Africa Food Producers Index	6,198.6	8.16%	16.76%	20.83%
Africa Health Care Equipment & Services Index	7,063.2	8.94%	15.24%	12.56%
Africa Pharmaceuticals & Biotechnology Index	12,026.4	-2.31%	17.46%	23.81%

Africa General Retailers Index	10,955.1	6.22%	32.40%	61.46%
Africa Travel & Leisure Index	6,868.2	8.38%	26.04%	16.44%
Africa Media Index	22,431.5	13.60%	48.43%	29.41%
Africa Support Services Index	4,577.9	14.39%	39.01%	34.27%
Africa Industrial Transportation Index	4,291.4	11.54%	40.49%	38.82%
Africa Food & Drug Retailers Index	14,874.9	2.90%	22.09%	49.57%
Africa Fixed Line Telecommunications Index	5,681.1	-1.30%	9.39%	10.27%
Africa Banks Index	5,092.8	-0.02%	14.49%	15.77%
Africa Non-life Insurance Index	4,048.3	15.37%	23.90%	31.20%
Africa Life Insurance Index	2,044.3	-5.79%	13.07%	12.99%
Africa General Financial Index	5,364.2	5.31%	19.73%	24.82%
Africa Equity Investment Instruments Index	3,498.8	-1.40%	6.18%	1.92%
Africa Software & Computer Services Index	2,066.3	-1.01%	22.38%	41.47%
Africa Gold Mining	1,243.9	6.13%	5.10%	12.45%
Africa Platinum & Precious Metals	2,968.3	19.20%	16.42%	5.72%
Africa Property Unit Trusts - (PUT)	7,045.4	2.54%	14.15%	25.50%
Africa SA Listed Property - (SAPY)	869.8	3.13%	17.23%	29.62%
Bonds, Cash & Inflation				
All Bond Index	343.7	0.75%	8.85%	14.96%
Stefi Composite	250.6	1.56%	3.27%	6.93%
CPI - New Headline (Previous Month)	112.8	0.45%	1.17%	3.58%
CPI - History Rebased (Previous Month)		0.45%	1.17%	3.58%
Currencies				
Rand Dollar Exchange Rate	6.62	-4.87%	-13.68%	-10.55%
Rand Pound Exchange Rate	10.31	-5.61%	-9.92%	-13.14%
Rand Euro Exchange Rate	8.84	-6.63%	-5.61%	-15.76%
Dollar Euro Exchange Rate	1.34	-1.73%	9.44%	-6.56%
Dollar Yen Exchange Rate	0.01	2.50%	8.85%	14.95%
Niara Dollar Exchange Rate	149.86	-1.55%	-0.03%	1.68%
Commodity Prices				
Brent Oil (USD/Barrel)	94.75	16.62%	26.72%	22.73%
Gold (USD/oz)	1,421.4	8.56%	14.42%	29.59%
Platinum (USD/oz)	1,770.0	6.95%	15.42%	20.45%

Copper ($/Ton)	9,739.5	20.93%	49.49%	32.58%
CRB Index	332.8	16.01%	28.73%	17.44%
Global Bonds & Equity				
Global Bonds (R)		-6.56%	-8.48%	-4.81%
MSCI Global Equity (R)		3.27%	6.11%	-2.01%
Global Bonds	484.3	-1.78%	6.02%	6.42%
S&P 500	1,257.6	10.20%	22.02%	12.78%
Nasdaq	2,652.9	12.00%	25.77%	16.91%
MSCI Global Equity	1,280.1	8.55%	22.93%	9.55%
MSCI Emerging Mkt	1,151.4	7.05%	25.43%	16.36%
FTSE	3,094.4	7.91%	21.66%	12.08%
DAX	611.3	12.07%	17.81%	18.46%

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