

# The Weekly Focus

A market and economic update

30 August 2010



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# Newsflash

Retail shares have done well thus far

## Market Comment

- The JSE All Share Index has fallen by 5.8% in the past month and is now down 2% in 2010. In particular, the resources index (down 8.1% in the past month and down 12.2% so far in 2010) has struggled under the weight of the stronger-than-expected rand and lately fears of a sharp slowdown in Chinese growth and imports (car sales are now only up 13% year-on-year from over 100% recently), plus fears of a double-dip recession elsewhere.
- In particular, Anglo American is down 13% in the past month, while Billiton is down 7%, although that is partly because of its \$39bn bid for Potash, the big Canadian fertilizer producer. Anglo's fall is strange when compared with recent moves in the copper price, which is almost 20% higher than its recent low in June and only 8% below its April high.
- On the other side of the coin, our retail shares have done so well, with general retailers like Massmart, Truworths, Mr Price and others up 6% in the past three months and up 27% so far in 2010 (same for the food and drug retailers). Also, life insurance shares are up 5.7% in the past three months and are up 9.6% so far in 2010.
- We have mentioned quite frequently that when the rand is stronger-for-longer, SA Inc shares do better than exporters and rand hedges which have certainly been the case so far in 2010.
- STANLIB has changed its forecast and is now expecting one more interest rate cut in SA in September, which if it happens would be good news for SA Inc shares.
- Should one be selling the rand hedges at this stage? Probably not, because the resources index is now looking particularly cheap on a forward price-to-earnings ratio of just 7.6 twelve months out, versus the forward of 9.4 for financials and 9.2 for industrials. For the brave, this may be a buying opportunity.
- The other positive is that we are just a few days away from the end of the summer in the northern hemisphere, which heralds the return to work of many investors and traders, meaning that volumes should begin to pick up quite soon.
- UBS Securities stock-broking firm believes that emerging markets as a whole, but certainly including SA, are very undervalued at this stage on a forward PE ratio of just 10.5 times twelve months out versus the world's 12.1 times.

- BCA Research are also positive on emerging markets, remaining overweight, but are concerned about the price volatility in developed markets over the past few months and are “keenly aware of the potential risks in the G7 equity markets due to the uncertain economic climate in the US. As a tactical move, we are cutting our equity exposure to benchmark weight (from overweight).” Their view is to be underweight in Japan and the US and neutral in Europe and the UK.
- They are concerned about sluggish consumer spending in the US, their heavy debt loads and the housing slump there. Also, along the way there may be higher taxes and lower public-sector spending. There is now low visibility on the economic and financial outlook. They are negative on Japanese equities because of their high correlation with the yen (strong yen equals poor equity performance).
- Below we show a graph of the Chinese Shanghai Composite Index, which had a very bad first half of 2010, down 26.5%, because the authorities were tightening up, attempting to prick the property bubble and slow bank lending down.
- Recent reports indicate that the Chinese economy is responding well to these efforts to slow it down and the chart below of the stock market confirms this. Could this market possibly be leading global stock markets out of the current slump? After all, it is the biggest emerging market in the MSCI Emerging Market Index (17% of the index).



Source: I-Net Bridge

## Snippets of Info

- Robert Mugabe apparently has cancer, something which appears to have been kept remarkably quiet so far. Much of the world is unlikely to be particularly unhappy about this normally harsh news. Quite the contrary, it may be the best news yet.
- While the total return to-date in 2010 of the All Share Index is -2%, the JSE Listed Property Index has a total return (including dividends) of 19.3%, which is very handsome. The recent sharp downturn in SA government bond yields has been very positive for listed property shares because their yields are always being compared with bond yields. Currently the one year forward yield on property is around 7.8%, similar to the current ten year government bond yield (down from 9.4% in January).

**Paul Hansen**

**(Director: Group Advisory Services - Investments)**

# Economic Update

Most of the economic focus last week was on the local front. Although some of the data was somewhat disappointing, it still suggests that SA has convincingly exited the recession and is experiencing a slow, but steady economic recovery.

- GDP grew by a disappointing 3.2%q/q in Q2 2010. SA GDP growth estimate for 2010 has revised down slightly from 3.1% to 2.9%. The detailed breakdown of the Q2 2010 GDP performance revealed a slightly more encouraging performance than the headline growth rate suggests.
- The disappointment in the Q2 2010 GDP growth performance was mostly due to a sharp fall-off in mining activity. Mining output fell by a dramatic 20.8%q/q, annualised in Q2 2010 due to a combination of strike activity and mine related stoppages.
- Our expectation is that SA's economic growth during 2010 will be 'front-loaded' in the sense that the growth rate for the first half of the year is likely to be stronger than the second half; that is the norm when hosting a large sporting event such as the World Cup Soccer. However, the fall-off in activity in the second half of 2010 is unlikely to be all that dramatic considering that SA interest rates are expected to, at least, remain at 30-year lows, inflation is well under control, household disposable income is on the rise, and credit demand should systematically rise.
- **SA consumer inflation (CPI)** was lower than expected in July. Headline CPI inflation rose by 0.6m/m, with the annual rate falling further to 3.7%y/y compared with 4.2%y/y in June.
- The most notable aspect was a further increase in electricity prices, BUT the increase was lower than generally expected at 16.3m/m. (We expected an increase above 20m/m). This brought the annual rate of electricity inflation down to 19.4%y/y from 24.7%y/y in June. Stats SA has indicated that almost all of the municipalities increased electricity tariffs in July and submitted their data timorously for the July inflation survey. When NERSA made the price increase ruling this year they indicated that if municipalities had previously increased their electricity tariff by more than what was allowed, then they were not entitled to increase tariff by more than around 15% this year. It would appear that this was a more significant factor in containing electricity inflation.
- Other key price changes during the month included a decline in the petrol price (-1.9m/m), 3.9m/m decline in restaurant and hotel prices, which follows the sharp increase recorded in June that was associated with the World Cup. In contrast, food inflation rose 0.5m/m in July, which is the largest monthly increase since the beginning of the year. The annual rate of food inflation remains exceptionally low at 1.1%y/y, but there is some evidence of modest upside pressure in international food prices. The path of food inflation is critical to the outlook for consumer inflation into 2011.

- Consumer inflation is expected to remain around current levels for another two months, helped partly by base effects, sustained low food inflation, a firm Rand and very modest global inflation. Looking further-out, the electricity price hike, other service costs and administered prices as well as a concerning increase in wage demands will tend to push inflation somewhat higher into 2011.
- **SA Producer Inflation (PPI)** rose by a fairly substantial 1.3%/m, but the annual rate of change moved noticeably lower to 7.7%/y from 9.4%/y in June 2010. During July 2010, electricity prices rose by a further 17.4%/m, which added a significant 1.8 percentage points to the monthly change in PPI.
- Agricultural inflation rose by relatively high 0.8%/m in July. There has emerged some concern about an upward drift in international food prices, which if sustained, could translate into a general upward bias in SA food prices off a very low base. This has become a crucial area of focus in the past few weeks.
- Locally the economy has experienced mixed data. Retail sales and manufacturing activity have moved noticeably higher, consumer income has risen appreciably, house prices continue to recovery, car sales remain robust and confidence levels remain elevated. In contrast, mining activity deteriorated significantly in Q2 2010, hurting SA's overall Q2 2010 GDP performance. Manufacturing PMI readings have moved sharply lower, pointing to a slowdown in manufacturing activity in Q3 2010, exports remain sluggish and credit demand is struggling to gain traction. Retail sales are also likely to slow in Q3 2010, given the higher base established by the World Cup in May and June and the impact of public sector strike in August.
- In view of the data released last week and the outlook for interest rates, it is clear that there is still a window of opportunity for the Reserve Bank to cut rates. We have previously described SA inflation as being in the 'sweet spot'. After much discussion internally, we think that the Reserve Bank will use this window of opportunity to cut rates by 50bps in September. This will clearly be a close call, as some people on the MPC will, undoubtedly, argue that rates have already been cut substantially and that the economy does not require further stimulus. Furthermore, while inflation is currently in the 'sweet spot' there are some upside risks that should not be ignored. (Cutting rates to weaken the Rand is a nonsense argument).Crucially, irrespective of the interest rate decision in early September, it is clear that domestic interest rates are unlikely to rise for an extended period of time.
- **South Africa's leading economic indicator** fell for the second consecutive month in June 2010. The annual rate of change has continued to slow, off a very high base, suggesting some loss of growth momentum.

- The SA leading indicator has a good correlation with the OECD leading indicator (with a short lag). SA's leading indicator tends to lag the global economic cycle, both into a slowdown/recession as well as into a recovery, but only by about 1 to 2 months. Importantly, this relationship appears to have gotten stronger over the years (mainly due to the increased globalisation of South Africa) and the lag has shortened from around 6 months a decade ago to around 1 to 2 months currently. The fact that the OECD leading indicator (and more recently the US leading indicator) has continued to moderate on an annual basis, suggests that SA's leading indicator is also likely to move lower in the months ahead.
- According to a survey done by Stats SA last week, the World Cup provided a welcome income boost for the **accommodation industry** in June. The survey indicated that income from accommodation jumped by a massive 81.7%/y/y, with hotel income up 82.6%/y/y, guest-house income up 130.3%/y/y, camping site income up 104.1%/y/y and other accommodation income up 62.6%/y/y. But the boost was mostly due to increased tourism tariffs?
- Until June, the accommodation industry was struggling with low occupancy levels and poor pricing power (increased competition). In fact, the number of bed nights sold had been declining for most of the past year, while prices had tended sideways to lower. However, in June occupancy levels rose (albeit disappointingly) and the industry took the opportunity to significantly increase prices. The modest increase in bed nights sold suggests that the number of foreign visitors disappointed somewhat in June and also that business travel was largely absent during that the World Cup. Occupancy rates remained well below expected levels (especially within the hotel industry, with many foreign visitors, including the media, opting to use guest-houses). Maybe the opportunistic increase in tariffs by the industry was too aggressive. More recent data suggests that occupancy levels have since fallen significantly and accommodation rates have once again become far more competitive.

The next Reserve Bank MPC meeting is on 8 and 9 September 2010.

**Kevin Lings and Laura Jones**  
(STANLIB Economics)

# Weekly Market Analysis

Currencies/ indices/ commodities	Friday's Close 27/08/10	Weekly Move (%)	YTD (%)
<b>Indices</b>			
*MSCI World - US Dollar	1089.24	-0.41	-6.78
*MSCI World - Rand	7973.92	-0.56	-7.94
*MSCI Emerging Market - US Dollar	970.04	-1.83	-1.96
*MSCI Emerging Market - Rand	7101.32	-1.98	-3.18
All Share Index - US Dollar	3665.12	-0.79	-1.97
All Share Index - Rand	26738.91	-0.93	-3.35
All Bond Index	340.06	0.31	13.70
Listed Property J253	800.46	0.61	19.28
<b>Currencies</b>			
US Dollar/Rand	7.30	-0.14	-0.61
Euro/Rand	9.30	0.12	-11.43
Sterling/Rand	11.31	-0.32	-4.80
Euro/US Dollar	1.27	0.19	11.52
<b>Commodities</b>			
Oil Brent Crude Spot Price (\$/bl)	76.12	3.64	-1.40
Gold Price \$/oz	1238.20	0.84	12.86
Platinum Price S/oz	1534.50	1.66	4.42

Source: I-Net Bridge

\* MSCI - Morgan Stanley Capital International

# Rates

These rates are expressed in nominal and effective terms and should be used for indication purposes ONLY.

## Standard Bank Money Market Fund

Nominal: 6.65% per annum

Effective: 6.85% per annum

STANLIB is required to quote an effective rate which is based upon a seven-day rolling average yield for Money Market Portfolios. The above quoted yield is calculated using an annualised seven-day rolling average as at 27 August 2010. This seven-day rolling average yield may marginally differ from the actual daily distribution and should not be used for interest calculation purposes. We however, are most happy to supply you with the daily distribution rate on request, one day in arrears. The price of each participatory interest (unit) is aimed at a constant value. The total return to the investor is primarily made up of interest received but, may also include any gain or loss made on any particular instrument. In most cases this will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of reducing the capital value of the portfolio.

## STANLIB Cash Plus Fund

Effective Yield: 7.24%

## STANLIB Dividend Income Fund

Effective Yield: 4.75%

STANLIB is required to quote a current yield for Income Portfolios. This is an effective yield. The above quoted yield will vary from day to day and is a current yield as at 27 August 2010. The net (after fees) yield on the portfolio will be published daily in the major newspapers together with the "all-in" NAV price (includes the accrual for dividends and interest). This yield is a snapshot yield that reflects the weighted average running yield of all the underlying holdings of the portfolio. Monthly distributions will consist of dividends (currently tax exempt) and taxable interest. Interest will also be exempt from tax to the extent that investor's are able to make use of the applicable interest exemption as currently allowed by the Income Tax Act. The portfolio's underlying investments will determine the split between dividends and interest.

The Manager has received a circular, (CISCA Circular No.11), from the Registrar of Collective Investment Schemes regarding a joint investigation of National Treasury, SARS and the FSB, which is currently in progress with regard to dividend income fund type portfolios. The Manager is obliged, in terms of this circular, to bring the following to your attention with regard to this investigation. The outcome of the investigation could affect certain structures and SPVs (special purpose vehicles) used by underlying investments of these types of portfolios, which may result in possible adverse tax consequences, and may require amendments to existing legislation. The abovementioned regulators still have concerns which could impact negatively on the future of these portfolios and the continuation of these portfolios can therefore not be guaranteed. The Manager however do not believe that there is any current cause for concern regarding the STANLIB Dividend Income Fund and should there be a more definitive outcome from the investigation investors in our STANLIB Dividend Income Fund will be informed timeously of any legislative changes that may affect their investment.

## Liberty Investments' Life Annuities

Current Rates for 30<sup>th</sup> August - 3<sup>rd</sup> September 2010

Payments are assumed to be paid monthly in advance with no guarantee period or annual escalation in income. Ages indicated assume client is the exact age shown. No tax has been deducted.							
Gender		Male			Female		
Age last birthday		55	60	65	55	60	65
Contribution	R 100,000	R 724	R 788	R 870	R 653	R 698	R 760
	R 250,000	R 1,830	R 1,992	R 2,197	R 1,652	R 1,765	R 1,922
	R 500,000	R 3,675	R 3,998	R 4,410	R 3,317	R 3,544	R 3,859
	R 1,000,000	R 7,364	R 8,011	R 8,835	R 6,648	R 7,102	R 7,733

The table above shows the monthly annuity that an annuitant will receive for life in return for the single premium in the left hand column. Note that the annuity depends on the annuitant's exact age and gender.

The rates above were calculated assuming maximum commission and will be enhanced if a commission discount is selected.

# Glossary of terminology

<b>Bonds</b>	A bond is an interest-bearing debt instrument, traditionally issued by governments as part of their budget funding sources, and now also issued by local authorities (municipalities), parastatals (Eskom) and companies. Bonds issued by the central government are often called "gilts". Bond issuers pay interest (called the "coupon") to the bondholder every 6 months. The price/value of a bond has an inverse relationship to the prevailing interest rate, so if the interest rate goes up, the value goes down, and vice versa. Bonds/gilts generally have a lower risk than shares because the holder of a gilt has the security of knowing that the gilt will be repaid in full by government or semi-government authorities at a specific time in the future. An investment in this type of asset should be viewed with a 3 to 6 year horizon.
<b>Cash</b>	An investment in cash usually refers to a savings or fixed-deposit account with a bank, or to a money market investment. Cash is generally regarded as the safest investment. Whilst it is theoretically possible to make a capital loss investing in cash, it is highly unlikely. An investment in this type of asset should be viewed with a 1 to 3 year horizon.
<b>Collective Investments</b>	Collective investments are investments in which investors' funds are pooled and managed by professional managers. Investing in shares has traditionally yielded unrivalled returns, offering investors the opportunity to build real wealth. Yet, the large amounts of money required to purchase these shares is often out of reach of smaller investors. The pooling of investors' funds makes collective investments the ideal option, providing cost effective access to the world's stock markets. This is why investing in collective investments has become so popular the world over and is considered a sound financial move by most investors.
<b>Compound Interest</b>	Compound interest refers to the interest earned on interest that was earned earlier and credited to the capital amount. For example, if you deposit R1 000 in a bank account at 10% and interest is calculated annually, your balance will be R1 100 at the end of the first year and R1 210 at the end of the second year. That extra R10, which was earned on the interest from the first year, is the result of compound interest ("interest on interest"). Interest can also be compounded on a monthly, quarterly, half-yearly or other basis.
<b>Dividend Yields</b>	The dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its share price. The higher the yield, the more money you will get back on your investment.
<b>Dividends</b>	When you buy equities offered by a company, you are effectively buying a portion of the company. Dividends are an investor's share of a company's profits, given to him or her as a part-owner of the company.
<b>Earnings per share</b>	Earnings per share is a measure of how much money the company has available for distribution to shareholders. A company's earnings per share is a good indication of its profitability and is generally considered to be the most important variable in determining a company's share price.
<b>Equity</b>	A share represents an institution/individual's ownership in a listed company and is the vehicle through which they are able to "share" in the profits made by that company. As the company grows, and the expectation of improved profits increases, the market price of the share will increase and this translates into a capital gain for the shareholder. Similarly, negative sentiment about the company will result in the share price falling. Shares/equities are usually considered to have the potential for the highest return of all the investment classes, but with a higher level of risk i.e. share investments have the most volatile returns over the short term. An investment in this type of asset should be viewed with a 7 to 10 year horizon.

<b>Financial Markets</b>	Financial markets are the institutional arrangements and conventions that exist for the issue and trading of financial instruments.
<b>Fixed Interest Funds</b>	Fixed interest funds invest in bonds, fixed-interest and money market instruments. Interest income is a feature of these funds and, in general, capital should remain stable.
<b>Gross Domestic Product (GDP)</b>	The Gross Domestic Product measures the total volume of goods and services produced in the economy. Therefore, the percentage change in the GDP from year to year reflects the country's annual economic growth rate.
<b>Growth Funds</b>	Growth funds seek maximum capital appreciation by investing in rapidly growing companies across all sectors of the JSE. Growth companies are those whose profits are in a strong upward trend, or are expected to grow strongly, and which normally trade at a higher-than-average price/earnings ratio.
<b>Industrial Funds</b>	Industrial funds invest in selected industrial companies listed on the JSE, but excluding all companies listed in the resources and financial economic groups.
<b>Investment Portfolio</b>	An investment portfolio is a collection of securities owned by an individual or institution (such as a collective investment scheme). A funds ' portfolio may include a combination of financial instruments such as bonds, equities, money market securities, etc. The theory is that the investments should be spread over a range of options in order to diversify and spread risk.
<b>JSE Securities Exchange</b>	The primary role of the JSE Securities Exchange is to provide a market where securities can be freely traded under regulated procedures.
<b>Price to earnings ratio</b>	Price to earnings ratio or p:e ratio, is calculated by dividing the price per share by the earnings per share. This ratio provides a better indication of the value of a share, than the market price alone. For example, all things being equal, a R10 share with a P/E of 75 is much more "expensive" than a R100 share with a P/E of 20.
<b>Property</b>	Property has some attributes of shares and some attributes of bonds. Property yields are normally stable and predictable because they comprise many contractual leases. These leases generate rental income that is passed through to investors. Property share prices however fluctuate with supply and demand and are counter cyclical to the interest rate cycle. Property is an excellent inflation hedge as rentals escalate with inflation, ensuring distribution growth, and property values escalate with inflation ensuring net asset value growth. This ensures real returns over the long term.
<b>Resources and Basic Industries Funds</b>	These funds seek capital appreciation by investing in the shares of companies whose main business operations involve the exploration, mining, distribution and processing of metals, minerals, energy, chemicals, forestry and other natural resources, or where at least 50 percent of their earnings are derived from such business activities, and excludes service providers to these companies.
<b>Smaller Companies Funds</b>	Smaller Companies Funds seek maximum capital appreciation by investing in both established smaller companies and emerging companies. At least 75 percent of the fund must be invested in small- to mid-cap shares which fall outside of the top 40 JSE-listed companies by market capitalisation.
<b>Value Funds</b>	These funds aim to deliver medium- to long-term capital appreciation by investing in value shares with low price/earnings ratios and shares which trade at a discount to their net asset value.

*Sources: Unit Trust and Collective Investments (September 2007), The Financial Sector Charter Council, Personal Finance (30 November 2002), Introduction to Financial Markets, Personal Finance, Quarter 4 2007, Investopedia ([www.investopedia.com](http://www.investopedia.com)) and The South African Financial Planning Handbook 2004.*

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