

Global Economic Comment

SEPTEMBER 2011

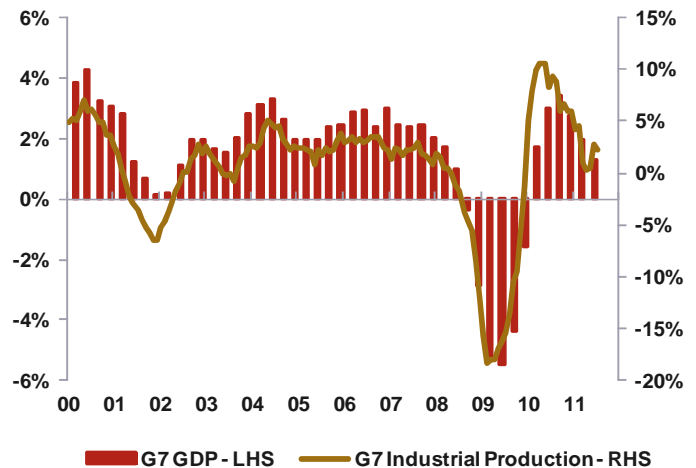
Financial market volatility continues to dominate news headlines. Following the US Federal Reserve Bank's recent two-day policy meeting, investors had to deal with the rather unexpected statement: "There are significant downside risks to the economic outlook, including strains in global financial markets." Central banks are, by their very nature, not prone to issuing statements without considering the impact of every word. With so much liquidity having been injected into global economies and with much of this liquidity finding its way into financial markets, it should come as little surprise that the daily movement in prices is often far from orderly. We do not anticipate that the current level of volatility will decrease, until a point is reached where the risk of policy error has lessened, and central banks start to withdraw liquidity from the markets. However, we believe that point is a long way off.

In order to gain some perspective at this juncture, we believe that two key questions need to be asked: Is the US heading for a double-dip recession and will this induce a contraction in US corporate earnings? Is the risk of policy error likely to lead to a disorderly default by Greece and will Italy face a funding crisis?

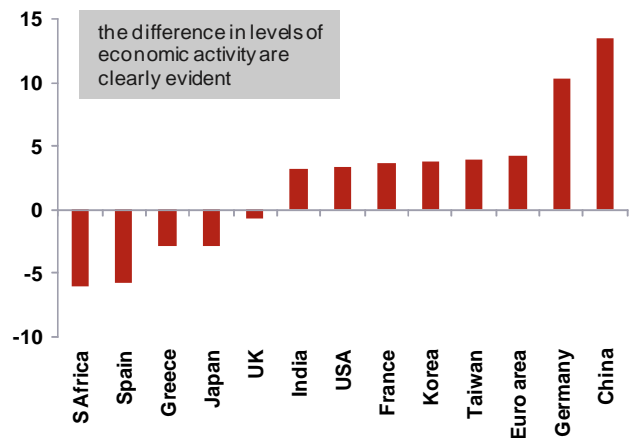
US outlook: Whilst a slowdown in the US is clearly evident, the broader indicators do not point to a deep recession. The Fed notes that it "...continues to expect some pickup in the pace of recovery over coming quarters." Why then, the pronouncement on downside risk? Our assessment, as pointed out in this and previous reports, is that a number of policy mistakes have already been made. The debacle over the debt ceiling in the US and the failure of ECB/European politicians to act decisively in dealing with the debt crisis in Greece, have heightened the risk of a collapse in the European banking system and consequent knock-on effect to global growth prospects. It is also important to appreciate that, as shown by Rogoff and Reinhert, economic recessions that result from overleveraging, take a number of years to resolve. The latest move by the Fed nicknamed "operation twist", will facilitate both the refinancing of mortgage debt and bank lending, and may end up being similar to QE2 in terms of the impact it has on injecting new stimulus into the economy.

Eurozone: What a mess. Greece is the least of all the Eurozone's problems. Either the ECB does not get it or its political masters have sterilised its ability to act with a comprehensive solution. With no clear plan, financial markets have started to take the ECB head on, by raising the cost of borrowing in Italy and Spain. Italy is the third-largest debt market in the world. Yields on ten-year government debt in Italy now exceed 5%, with the credit default swap market putting Italy on a par with Spain. Absent a clear statement of intent from the ECB, we fear that political intransigence will result in these levels being pushed higher, leading to a liquidity crisis. The core problem facing the Eurozone is relatively simple. None of the countries that are facing default or liquidity strains have a central bank to print money. They are trapped in the EU and are thus forced to introduce extreme austerity measures, as Germany and France have no desire to write out a big cheque to bail them all out. We remain deeply concerned that markets will have to get to a riot point before the ECB lifts its head out of the sand, notwithstanding the recent vote on providing additional funding to Greece, as the real issue remains the risk of a collapse in the Eurozone banking system, should Italy's liquidity crisis turn into a solvency crisis.

G7 Economic Growth & Industrial Production [1]



Industrial Production - YoY % change [2]



Forecast summary

	GDP		Ind Prod	CPI	Unemp
	2011	2012			
	Latest				
USA	1.6%	2.0%	3.4%	3.8%	9.1%
Japan	-0.4%	2.5%	-2.8%	0.5%	4.7%
China	9.0%	8.6%	13.5%	6.2%	6.1%
Britain	1.2%	1.6%	-0.7%	4.5%	7.9%
Euro area	1.7%	1.0%	4.2%	2.5%	10.0%
Australia	2.1%	3.8%	-3.3%	3.6%	5.3%
Hong Kong	5.8%	4.6%	2.0%	5.7%	3.2%
India	7.9%	8.2%	3.3%	8.4%	10.8%
South Korea	3.9%	4.1%	3.8%	5.3%	3.1%
South Africa	3.1%	3.6%	-6.0%	5.3%	25.7%

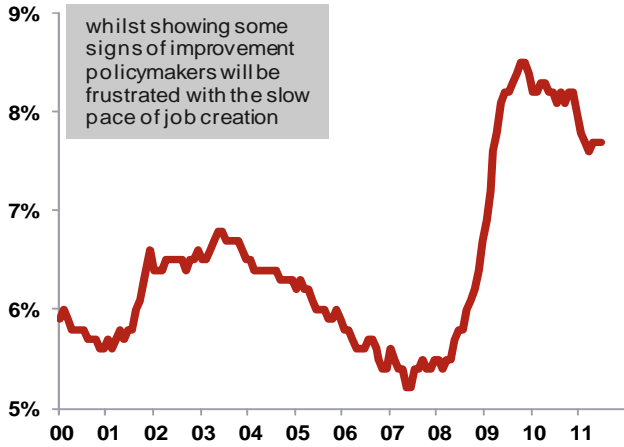
Source: Economist 1 October 2011



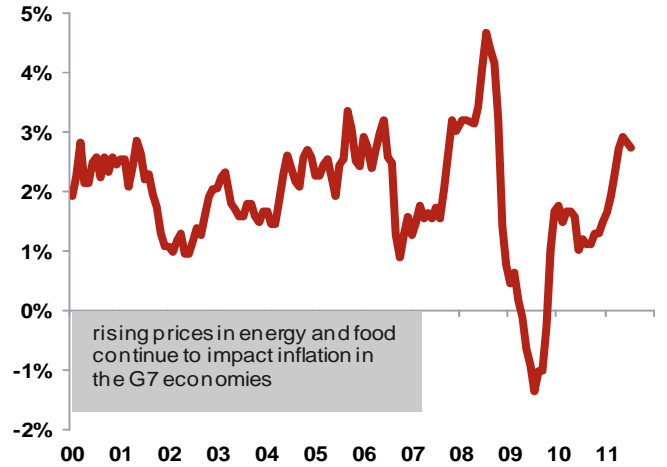
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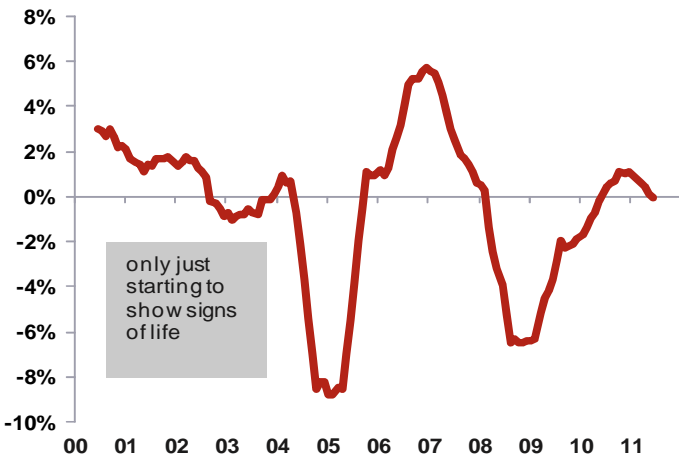
G7 Unemployment [3]



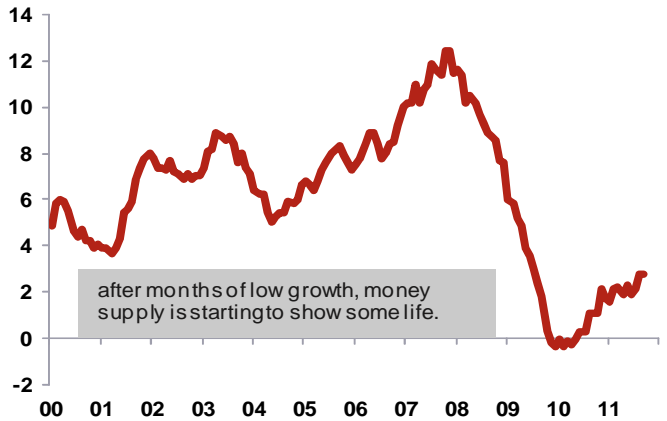
G7 Inflation [4]



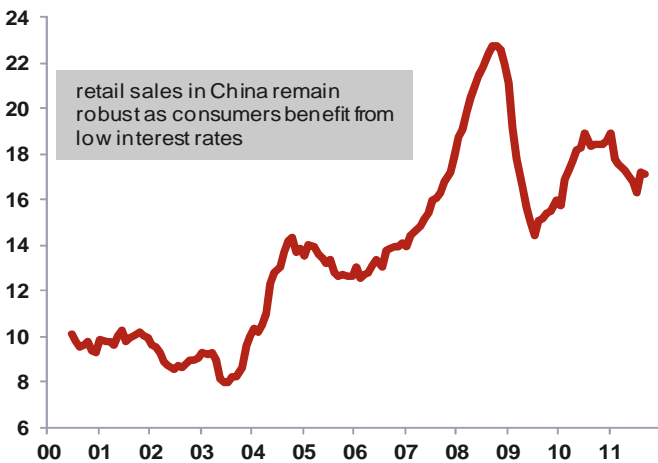
Eurozone - Retail sales - % change 12m [5]



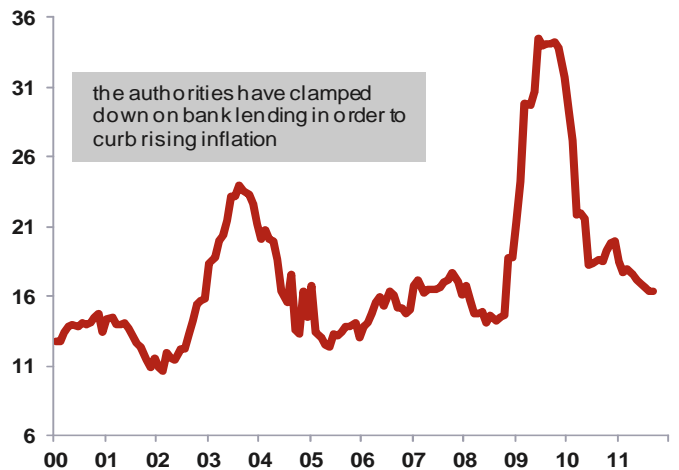
Eurozone Money Supply - growth yoy % [6]

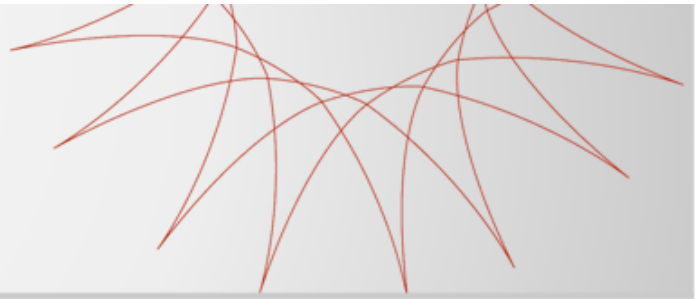


China Retail sales - % change 12m [7]



China Bank lending - yoy % [8]

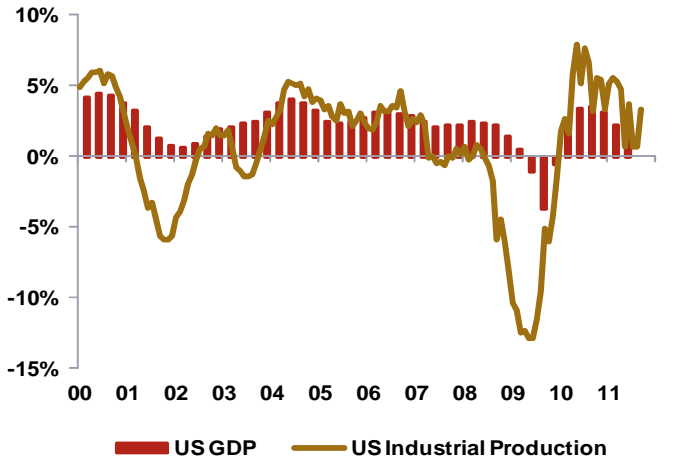




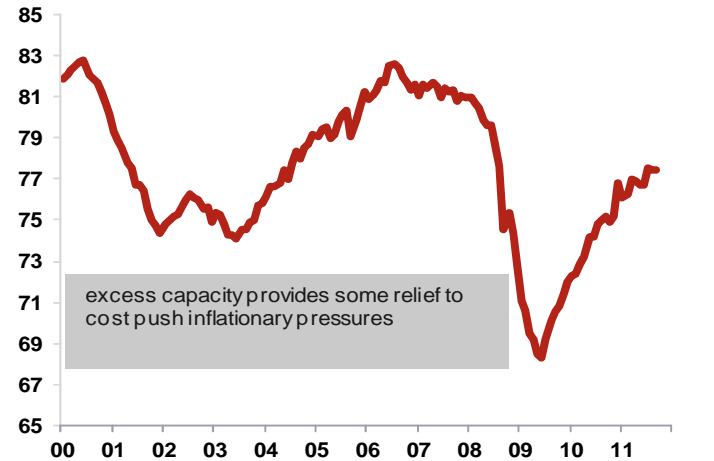
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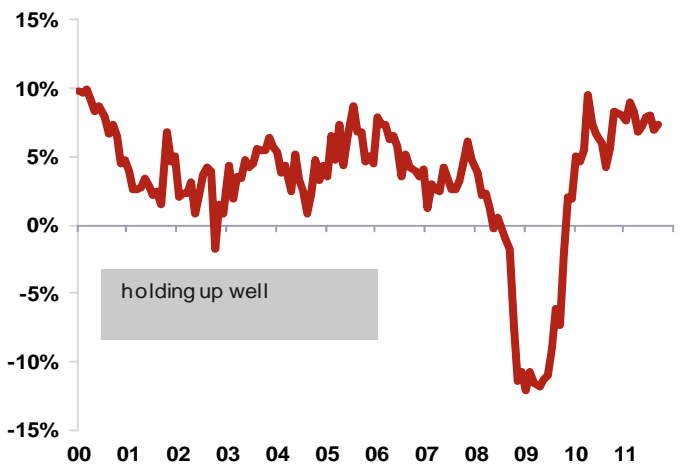
US GDP & Industrial Production - yoy % change [9]



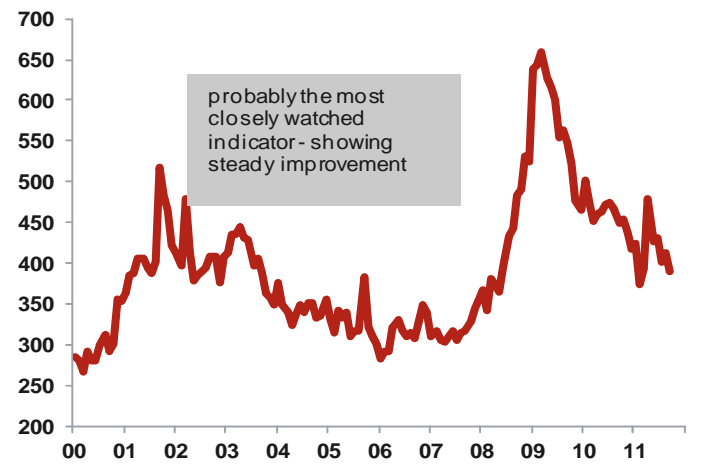
US capacity utilisation [10]



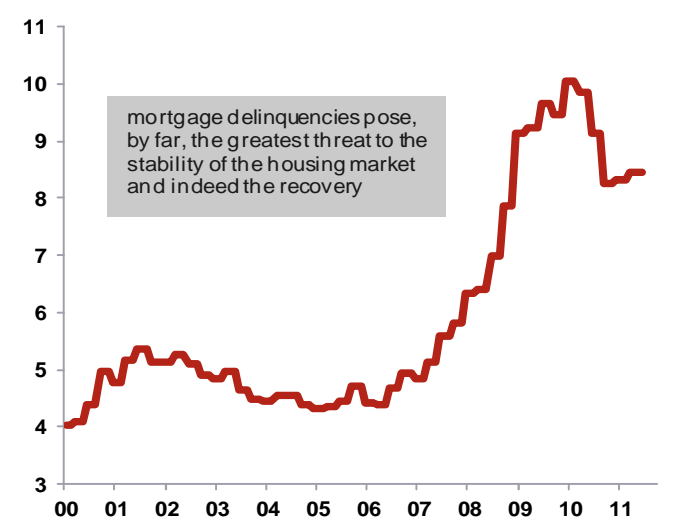
US Retail sales [11]



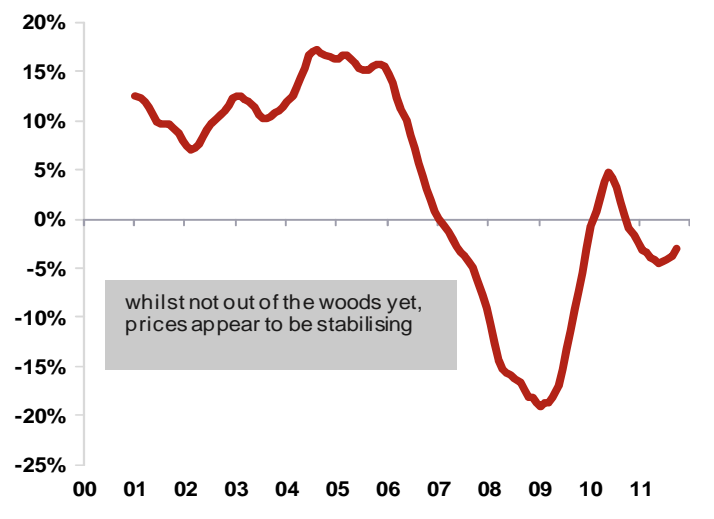
US Initial Jobless Claims [12]



US Mortgage delinquencies [13]



US Home prices - Case Schiller Index yoy % Chg [14]





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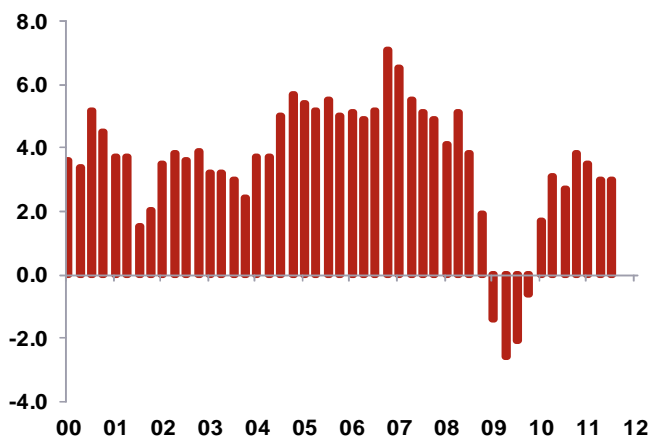
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The most recent statement by the SARB echoes the international message: "Since the previous meeting of the Monetary Policy Committee, the downside risks to the global and domestic growth prospects have increased. "...Heightened risk aversion has resulted in increased volatility of capital flows globally and a flight from what are perceived to be more risky emerging market assets. These developments have impacted on the domestic capital and foreign exchange markets."

Domestic growth forecasts have again been revised downward whilst inflation expectations have risen. This combination of declining growth and rising inflation poses a challenge to monetary policy going forward, and is a feature being experienced in a number of emerging markets. Year-on-year inflation as measured by the consumer price index (CPI) for all urban areas was unchanged at 5.3% in August 2011. This is, however, expected to be short-lived as rising energy prices, the structural increase in administered prices and a turnaround in food prices impact on forward expectations. Rand weakness during the quarter presents potential upside risk to the inflation outlook. The extent to which the rand remains weak will largely be a function of how long the global risk aversion trend lasts, as the domestic currency tends to be more sensitive to global risk perceptions than most of its emerging-market peers. The main upside risks to the inflation forecast continue to emanate from administered prices and exogenous factors. Food prices are expected to maintain their upward momentum for some time. Global food price indices have remained relatively stable, although at elevated levels, during the past few months. However, global wheat and maize prices have increased by around 70% over the last year, and have impacted on the domestic prices of these commodities. These increases have been compounded by the weaker exchange rate. As evident throughout the world, consumption expenditure moderated to an annualised rate of 3.8%, compared with an increase of 5.2% in the first quarter. Expenditure by consumers is expected to remain constrained to some extent by low rates of credit extension and continued debt deleveraging by households. Growth in credit by banks remains muted, with rates of between 3% and 6%, depending on the sector.

On the positive side, wage settlements continue to rise at a level well above inflation. This has, to some extent, provided an underpin to retailers. Whilst current wage settlements are at a lower rate than evidenced over the last two years, the level is still well above inflation. Interestingly, most wage adjustments have occurred in the public sector and not the private sector. The public-sector median wage in many job categories now exceeds the level paid in the private sector. In this regard, South Africa is moving rapidly towards becoming a welfare state. With over 15 million people dependent on social grants and the size of the public sector swelling by the day, administrators would be well advised to look north at Greece and Italy, where the long-term consequences are all too clear to see. Allied to this is the loss of jobs in the manufacturing sectors of our economy. Since the start of the great recession, South Africa has shed over 300 000 jobs with barely a mention. An almost complete lack of any cogent industrialisation policy by government does not bode well for future capital formation and job creation.

Domestic Economic Growth (%) [15]



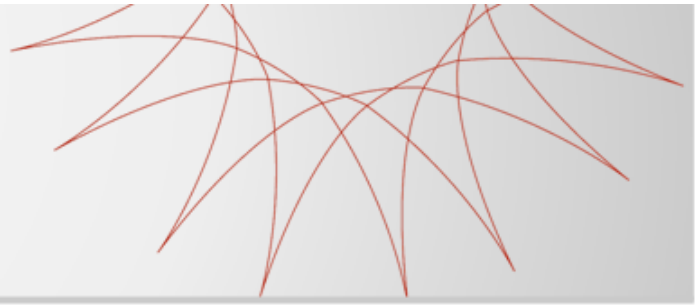
Vunani composite domestic leading indicator [16]



Forecast summary

SA	2010	2011	2012	2013
		forecast		
Economic growth (GDP)	2.8%	3.2%	3.1%	3.6%
Private consumption exp	4.4%	4.5%	4.0%	4.2%
Government consumption	4.6%	4.4%	4.5%	4.5%
Inflation (CPI) year end	3.5%	6.0%	5.2%	4.9%
Inflation (CPI) average	4.3%	4.9%	5.6%	4.9%
Current a/c as % of GDP	-2.8%	-3.1%	-3.2%	-3.0%
Producer price index year end	5.8%	10.1%	5.7%	6.6%
Repo rate (year end)	5.5%	5.5%	6.0%	6.5%
Prime rate (year end)	9.0%	9.0%	9.0%	10.5%
R / \$ exchange rate (Q4 average)	6.89	8.17	8.68	9.23

source: Vunani Fund Managers



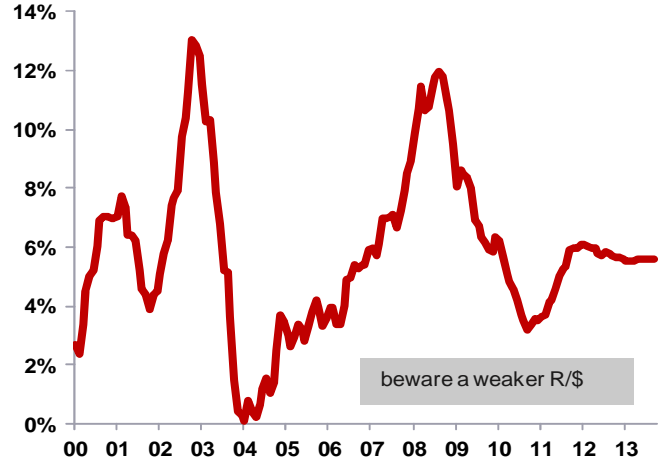
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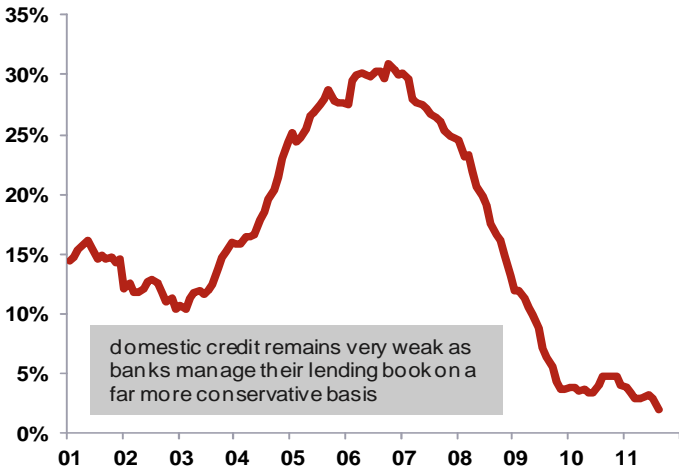
SA Retail sales - yoy % change [17]



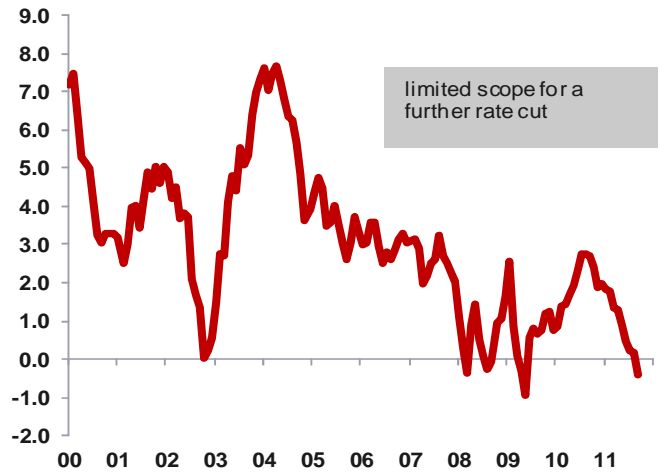
SA CPI - yoy % change [18]



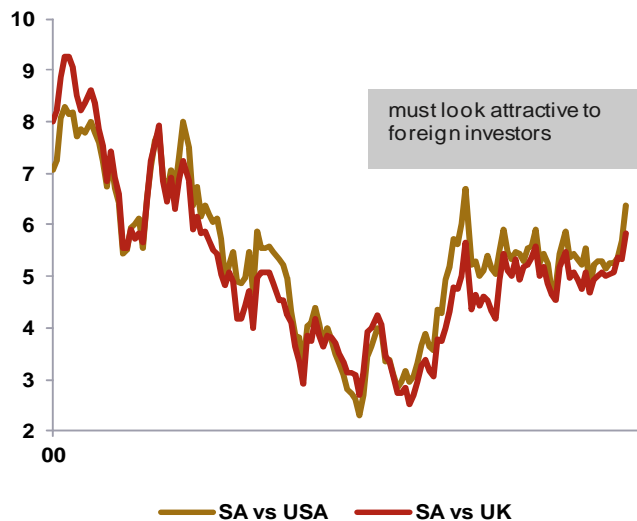
SA Domestic credit - yoy % change [19]



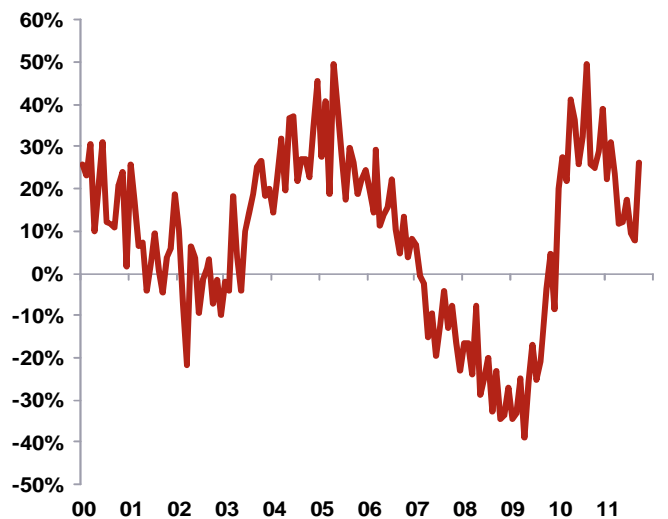
3 Month BA Rate vs Inflation [20]



Real interest rate differentials [21]



SA Total Vehicle Sales - yoy % change [22]





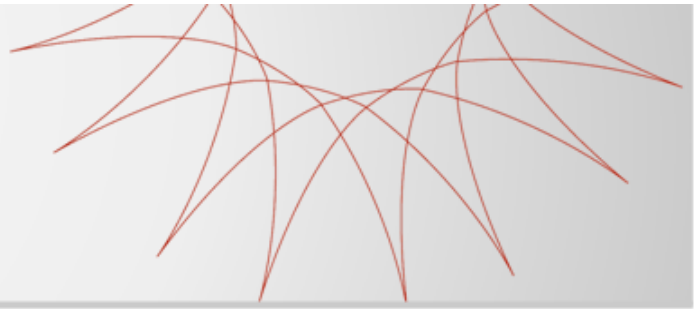
Global Financial Market Overview

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PERFORMANCE TABLE	Q3:2011	Q2: 2011	Q1: 2011	Q4:2010	YTD	1 Yr	2 Yr	3 Yr
Developed Markets (in US\$)						annualised		
MSCI	-16.5%	0.6%	5.0%	9.1%	-11.8%	-3.8%	1.6%	0.5%
Dow Jones Industrial	-12.1%	0.5%	6.7%	7.3%	-5.7%	1.2%	6.0%	0.2%
S&P 500	-14.3%	-0.6%	5.6%	9.9%	-10.0%	-1.2%	3.5%	-1.0%
FTSE 100 index	-13.7%	0.0%	0.8%	6.3%	-13.1%	-7.6%	-0.1%	1.5%
Japan: Nikkei	-11.4%	0.6%	-4.6%	9.2%	-14.9%	-7.1%	-7.3%	-8.2%
JP Morgan Global Bonds	2.3%	3.2%	0.7%	-1.9%	6.3%	4.3%	5.0%	7.8%
Developing Markets (in US\$)								
Brazil	-24.8%	-5.6%	2.0%	2.7%	-27.6%	-25.7%	-8.2%	-3.4%
China	-14.6%	-5.6%	4.3%	5.7%	-16.0%	-11.2%	-8.0%	0.9%
India	-16.3%	-4.7%	-7.5%	1.0%	-26.2%	-25.5%	-3.4%	3.7%
Russia	-25.9%	-11.2%	15.8%	19.1%	-23.7%	-9.1%	0.1%	-6.9%
South Africa	-13.6%	-4.9%	-2.4%	12.7%	-19.8%	-9.6%	3.1%	8.0%
Turkey	-15.4%	-8.9%	-4.4%	-4.4%	-26.3%	-29.5%	-3.1%	0.0%

SELECTED FINANCIAL DATA		Sep-11	Jun-11	Mar-11	Dec-10	Sep-10	Jun-10	Mar-10	Dec-09
%Ch 12 m									
Brent Oil (\$/bl)	34%	107	112	115	92	80	74	80	78
CRB commodity index	7%	306	338	354	327	287	256	274	284
Sterling / Dollar	-1%	1.56	1.60	1.61	1.56	1.57	1.51	1.49	1.62
Euro / dollar	-2%	1.34	1.45	1.41	1.34	1.36	1.22	1.33	1.43
Gold(\$/oz)	23%	1,613	1,506	1,426	1,406	1,307	1,235	1,107	1,088
Platinum (\$/oz)	-8%	1,525	1,725	1,770	1,748	1,650	1,542	1,619	1,456
World metals index	-6%	157	185	197	196	167	141	167	158

Something quite unprecedented has happened during the quarter under review: The dividend yield on the S&P 500 rose above the yield on the US ten-year treasury. The last time this happened was in the late 1950s. Notwithstanding the fact that US companies are in pretty good shape, investors are demanding a higher risk premium for holding equities. Earnings, whilst robust, do not hold sway over price movements, as market participants struggle to assess the risks associated with so many potential structural breaks in sovereign debt markets. Even a casual review of the history of price movements in stock markets reveals a simple observation: Risk is priced very rapidly, whilst growth is discounted rather more slowly. We remain concerned that the continued impasse in Europe discussed above, will lead to another rout in global equity markets. Of particular concern is the ongoing rise in interbank lending rates in Europe, and the trend amongst major industrial groups of withdrawing funds from their traditional banks, mostly French and Italian, and depositing these funds with the ECB. Put simply, the European banking system is slowly freezing up. The reason for this is the link between each of these countries. Italy has around 1.5 trillion euros in debt. Of this, Italian banks hold 295 billion euros, with French banks holding a high proportion of both Italian bank and sovereign debt. Germany in turn, holds a high proportion of French debt. With 100 billion euros in equity, major Italian banks would not withstand any sovereign debt crisis as they also hold 220 billion euros' worth of gross exposure to other Italian banks and have 450 billion euros in external deposits, making them highly vulnerable. Any recession would also impact on the 1.7 trillion euros owed to them by Italian businesses and households. So the call to add capital is moot. Who would supply capital of this magnitude simply to absorb losses? It's important to remember in the context of this rather dire picture, that whilst Greece is bankrupt, Italy and Spain are not. They face a liquidity crisis, not a solvency crisis. Were Greece to be ring-fenced and rates for Italy to be brought down, by the ECB buying bonds in the open market, Italy and Spain would be able to finance themselves. Why then, has a clear plan to achieve this not been implemented? The answer is that it is politically unpalatable to France and Germany to bail out Greece. Yet the alternative may cost Germany a great deal more in the long run. Liquidity crises are dangerous. The fear of insolvency, however unjustified, becomes a self-fulfilling prophecy as an unreasonably punitive interest rate causes a crippling deterioration in government finances. For as long as investors fear that they will not get paid on their sovereign bonds, the market will remain dysfunctional. Similarly banks, who believe their liquidity position to be under threat, will hold onto their liquid assets, as is the case at the moment. To solve this crisis once and for all, the ECB needs to declare in a clear and credible way, that it will act as the unlimited lender of last resort for solvent sovereigns. If this happens, then Greece can default without impacting on the other nations, with the fallout from Greece much more easily absorbed by a recapitalised euro-area banking system. Another ominous development is the exit by depositors from their position in Eurozone banks and the transfer of these funds to US institutions. This somewhat ironic development explains the dollar strength seen over the quarter as risk aversion runs high. The smell of a 2008-style panic run on the banks in the Eurozone is in the air again, with the consequent systemic shock to markets if the ECB bungles this one as well.



Global Financial Market Chartbook

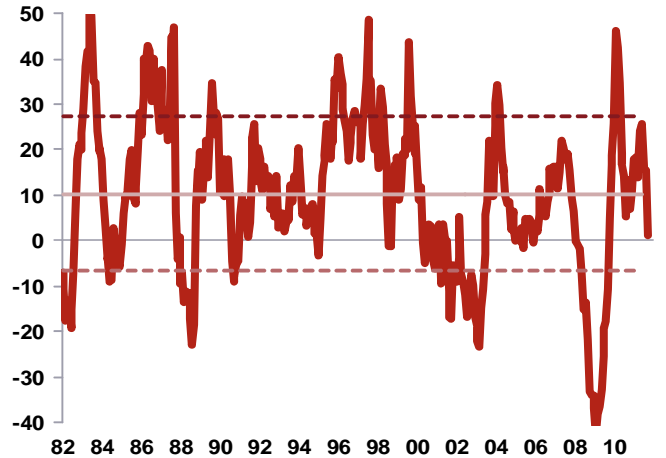
SEPTEMBER 2011

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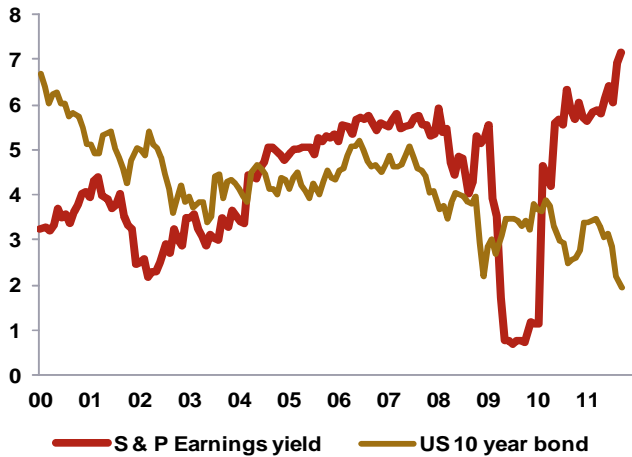
Dow Jones Industrial Index [23]



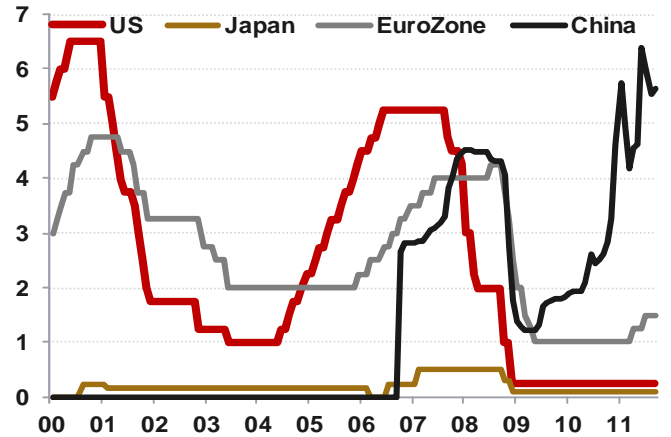
Dow Jones - yoy % change [24]



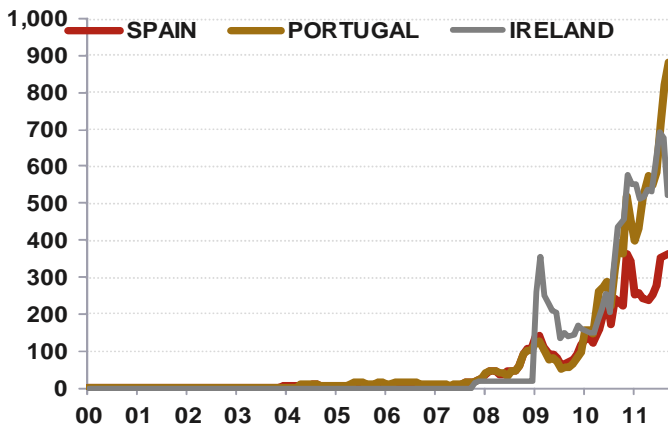
US S&P 500 - Earnings yield [25]



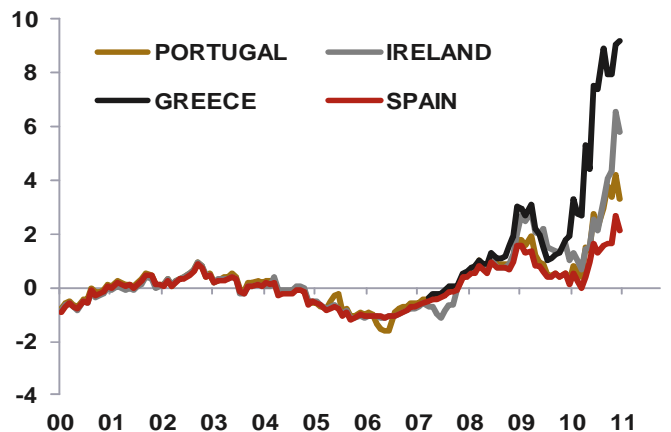
Central Bank rates [26]



Credit Default Swaps - distressed nations [27]



Global Bond Spreads - distressed nations [28]





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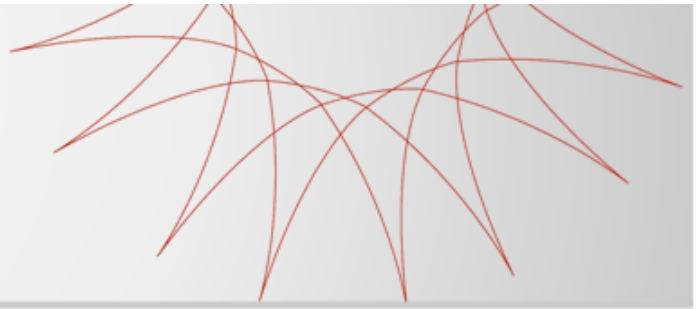
PERFORMANCE TABLE	Q3:2011	Q2: 2011	Q1: 2011	Q4:2010	YTD	1 Yr	2 Yr	3 Yr
	annualised							
FTSE/JSE All Share Index	-5.8%	-0.6%	1.1%	9.5%	-5.4%	3.6%	12.0%	10.6%
FTSE/JSE Res 20 Index	-10.4%	-5.7%	2.4%	16.5%	-13.4%	0.9%	6.5%	4.7%
FTSE/JSE Fin 15 Index	-4.4%	0.4%	1.3%	-0.8%	-2.7%	-3.5%	9.0%	8.0%
FTSE/JSE Ind 25 Index	-3.2%	3.9%	0.9%	7.4%	1.4%	8.8%	18.6%	17.0%
All Bond Index	2.8%	3.9%	-1.6%	0.7%	5.1%	5.9%	10.5%	10.0%
Inflation linked bonds	3.1%	3.8%	1.2%	1.0%	8.2%	9.3%	9.6%	10.0%
Cash	1.3%	1.3%	1.3%	1.4%	3.9%	5.4%	6.0%	7.2%
Rand / \$	19.7%	-0.6%	2.8%	-4.9%	22.3%	16.3%	4.4%	-1.0%
Rand / Euro	10.5%	1.8%	8.8%	-6.6%	22.5%	14.4%	0.1%	-3.4%
MSCI in Rands	-0.1%	0.0%	7.9%	3.8%	7.8%	11.9%	6.1%	-0.5%
Global Bonds in Rands	23.4%	2.7%	3.3%	-6.6%	30.9%	22.3%	10.4%	7.4%

The search for yield by global investors over the last two years has resulted in significant capital flows to emerging markets, with consequences for their exchange rates and asset prices. The pattern of flows has not been smooth. During bouts of global risk aversion, there has been a tendency for these flows to reverse to so-called safe havens. Risk aversion associated with recent events in the US and Europe has resulted in a high degree of volatility. Since the beginning of the year, non-residents have been net sellers of equities to the value of R16.9 billion and net buyers of bonds to the value of R44.3 billion. However, since the beginning of September, non-residents were net sellers of both bonds and equities valued at R4.6 billion and R7.6 billion respectively. These recent outflows, together with increased risk aversion, have contributed to the high degree of volatility observed in the JSE all-share index, in domestic bond yields and in the exchange rate. The rand has traded against the US dollar in a range of between R6.68 and R8.33. Since the beginning of the year, the rand has depreciated by 18.6% against the US dollar.

The volatility in equity as well as bond markets presents the investor with both longer-term opportunity and short-term risk. Bond yields for example, discount a break-even inflation rate of just under 7% on a ten-year view. Contrast this with the yield on a US ten-year treasury bond, which currently yields under 2%, compared with prevailing inflation in the US of 4.5%. Clearly the market should correct this imbalance by reducing the rate on domestic bonds and raising the rate on US treasuries. In a world of uncertainty where the value of assets is largely being determined by liquidity flows, this price normalisation is unlikely to occur over the short term. Rather, we can expect to see a pattern of sudden violent movements in asset prices as market participants move between a "risk-off" and a "risk-on" frame of mind.

In our view, taking advantage of the opportunities presented requires a clear assessment of the value of the asset versus the risk implied by excessive liquidity movements in the particular asset class. Within the context of equities, we see significant value in the more cyclical stocks, with less value evident in the more defensive counters. Clearly the major risk, as referred to above, is a further de-rating of the market as investors seek a higher equity risk premium. One way to deal with the uncertainty attached to the heightened level of uncertainty is to value each opportunity on the basis of a "low-road" scenario versus a "normalised" scenario.

Based on this approach, we still see equities delivering a better return than cash over the next 12 months, but with the distinct prospect of negative returns over the next quarter as the cumulative effect of policy mistakes take time to work through.

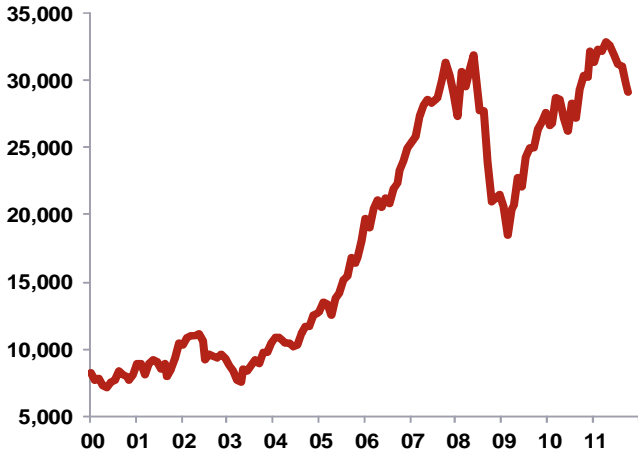


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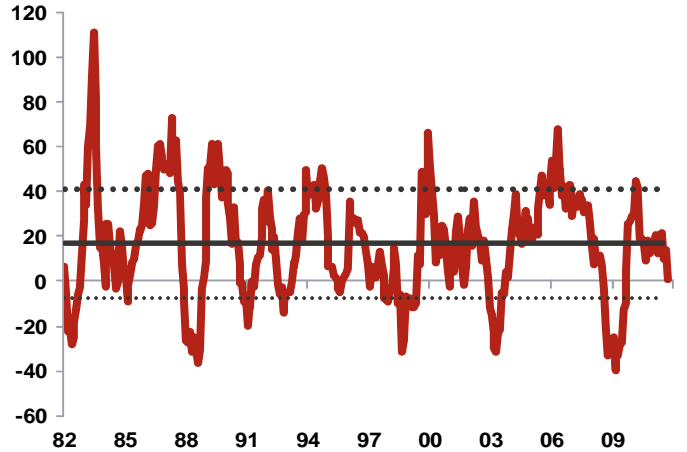
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Source: Inet

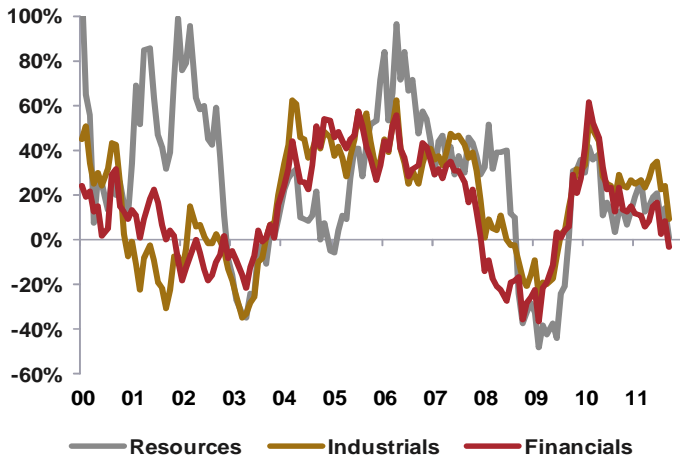
FTSE / JSE All Share Index [29]



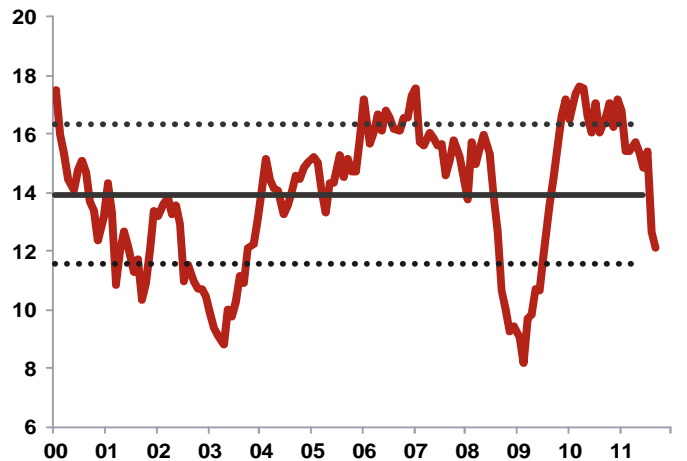
JSE All Share Index- 12 Month Rate of Change [30]



FTSE/JSE Sector rolling 12 month returns [31]



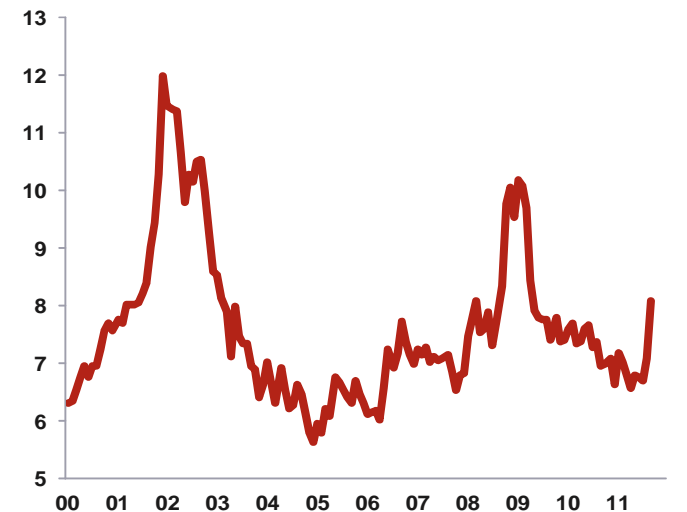
FTSE / JSE - P:E ratio % [32]

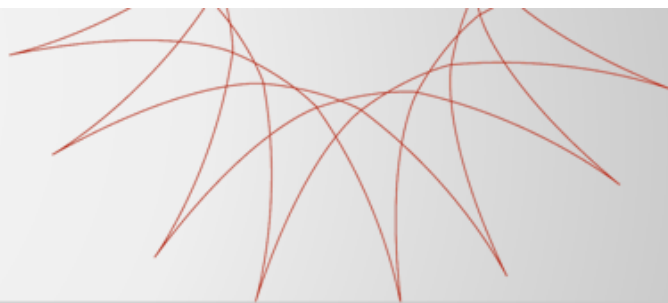


Domestic Bond Yield - R157 [33]



US\$ / Rand exchange rate [34]





Key Data

SEPTEMBER 2011

INTERNATIONAL

	Sep-11	Jun-11	Mar-11	Dec-10	Sep-10	Jun-10	Mar-10	Dec-09	Sep-09	Jun-09
MSCI World index (\$)	3783	4531	4504	4290	3934	3454	3947	3819	3666	3118

DEVELOPED MARKETS

US

Dow Jones Industrials	10,913	12,414	12,351	11,578	10,788	9,870	10,836	10,428	9,712	8,447
S&P 500 index	1,131	1,321	1,328	1,258	1,145	1,041	1,173	1,115	1,057	919
P/E ratio	13.99	15.58	17.04	17.48	17.06	17.67	22.62	87.72	131.58	128.21
Div yield (%)	2.32	2.07	1.92	1.87	2.01	2.10	1.88	1.92	2.07	2.36
3 month TB rate (%)	0.01	0.02	0.10	0.12	0.16	0.15	0.16	0.05	0.13	0.18
Federal funds target rate (%)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Long bond - 30 year yield (%)	3.00	4.40	4.52	4.46	3.65	3.97	4.79	4.64	4.03	4.29
CPI inflation rate (%)		3.43	2.70	1.39	1.14	1.09	2.37	2.76	-1.32	-1.25

UK

FTSE 100 index	5,128	5,946	5,948	5,900	5,549	4,914	5,678	5,398	5,134	4,249
3 month interest rate	0.81	0.72	0.71	0.60	0.60	0.60	0.49	0.55	0.55	1.15
Long bond - 30 year yield (%)	3.63	4.24	4.38	4.26	3.93	4.23	4.57	4.47	4.12	4.35
CPI inflation rate (%)		4.20	4.00	3.70	3.10	3.20	3.40	2.90	1.10	1.80

Japan

Nikkei Dow	8,700	9,816	9,755	10,229	9,369	9,383	11,090	10,546	10,133	9,958
Long bond yield	1.01	1.14	1.24	1.12	0.93	1.11	1.40	1.29	1.27	1.39

DEVELOPING MARKETS

SA

All Share Index - J203	29,674	31,865	32,204	32,119	29,456	26,259	28,748	27,666	24,911	22,049
P/E Ratio	12.12	14.85	15.40	17.19	16.56	16.05	17.65	17.20	14.53	10.63
Div yield (%)	2.98	2.56	2.46	2.20	2.34	2.37	2.00	2.20	2.64	4.00
Resources index - Afeisa RES*	915	995	1,064	1,032	901	850	935	925	818	745
P/E Ratio	11.27	15.15	16.15	19.73	19.42	27.28	30.58	19.27	13.11	8.31
Div yield (%)	2.71	2.11	2.01	1.67	1.93	1.64	1.51	1.63	2.12	4.00
Financial index - Afeisa FIN*	517	535	535	539	538	473	516	469	443	390
P/E Ratio	11.67	12.93	12.63	13.20	13.74	11.93	13.66	15.28	14.74	10.59
Div yield (%)	4.65	4.30	4.30	4.18	4.03	4.34	3.96	4.13	4.35	5.59
Industrial index - Afeisa - IND*	538	553	533	547	511	434	458	442	417	365
P/E Ratio	16.86	17.31	17.05	17.30	16.85	14.42	15.39	14.57	13.39	11.89
Div yield (%)	3.17	2.85	2.87	2.53	2.62	2.77	2.51	2.62	2.81	3.29

SA Interest Rates

Prime lending rate Month end (%)	9.00	9.00	9.00	9.00	9.50	10.00	10.00	10.50	10.50	11.00
3 month NCD rate Month end (%)	5.65	5.65	5.65	5.70	6.05	6.75	6.80	7.30	7.10	7.70
Repo rate (%)	5.50	5.50	5.50	5.50	6.00	6.50	6.50	7.00	7.00	7.50
Long bond yield (%)	8.35	8.39	8.76	8.15	7.90	8.86	8.62	9.08	8.86	8.96