IMARA INVESTING IN AFRICA

Asset Management

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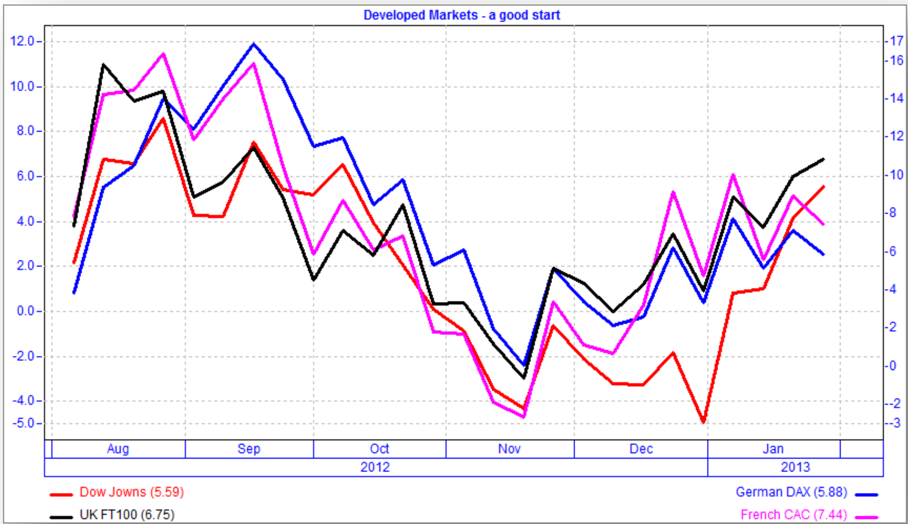
Feeling better now!!

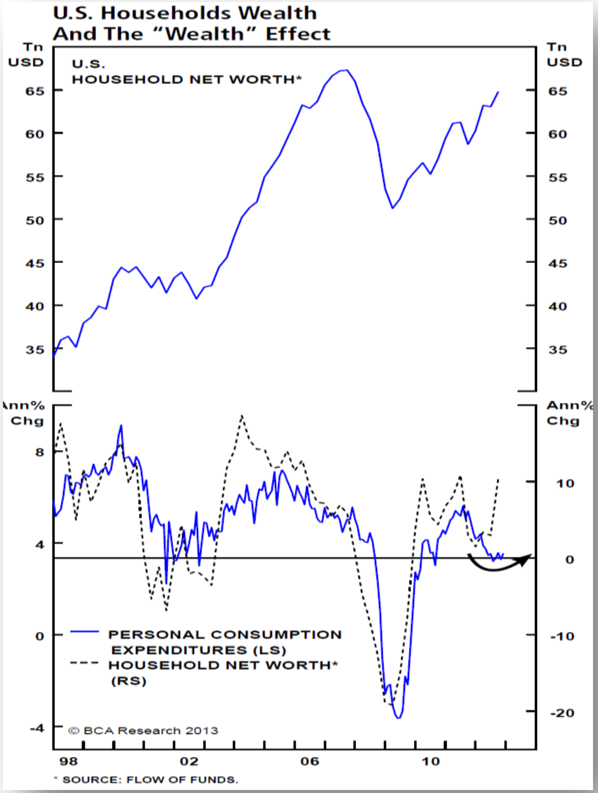
International

Going into 2013, the issues weighing on global markets remain similar to 2013, with uncertainty around the final outcome of the paralysis in Europe, the lifting of the debt ceiling in the US and the sustainability of reasonable global growth. Generally all indicators are turning positive and we are in a much better space now than we were 6 months ago, as monetary authorities have taken extraordinary steps to promote growth despite the fiscal constraints and have managed to stabilise the global financial system. Although deleveraging will remain the overriding theme, there are signs that global economic growth might be better than expected. Global data continues to surprise on the upside, with recent European, US and Chinese flash PMI figures beating expectations. This has filtered through to global markets which have had a solid start to the year.



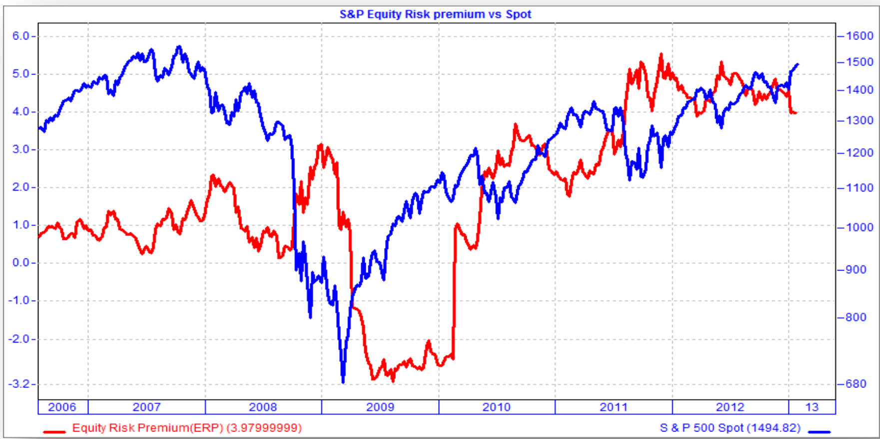
Developed Markets – a good start.

We expect China to revert to trend growth this year, growing at about 8.5% as urbanisation and planned fixed investment by the newly elected leadership kicks in. US growth also might surprise on the upside driven by continued increases in house prices and the stock market, so the “wealth effect” has commenced at a pace.



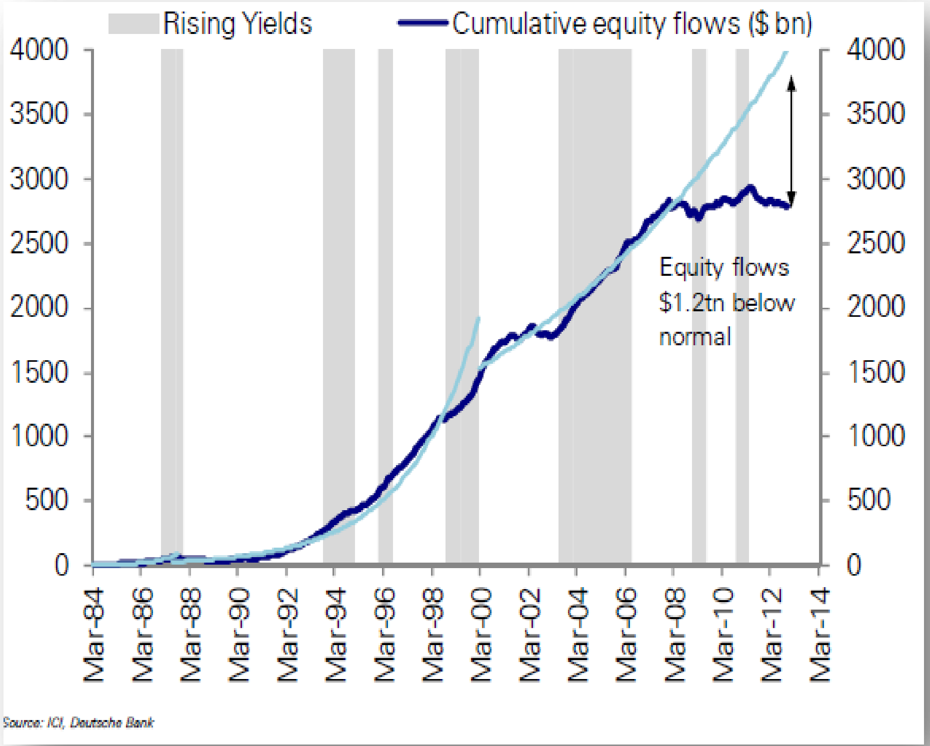
The household savings rate in the US has fallen in line with improvements in the labour market, further indicating that some confidence has been regained. This is important, as private consumption accounts for 70% of that economy.

Source: BCA Research, January 2013



So, the global economy is clearly improving but equity multiples are still fairly low despite the buoyant markets of late and Equity Risk Premiums(ERP) remain high, due in part to the fact that The Fed continues to buy vast amounts of treasuries driving down rates across the curve, in particular at the short end of the market. Equity Risk Premium is defined as the Earnings Yield on equities less the yield on long dated government bonds. It’s in effect a hurdle rate for company profits to grow at to match the yield on a risk free asset such as bonds. The higher the number, the cheaper equities are. So although high, the ERP is skewed by the Fed's transactions. Nevertheless, we believe that there is room for the ERP to narrow via share price increases as well as getting back to interest rate normality in the next year or two.

Also, since 2009, US corporate profits have beaten expectations driving multiples down further. The main reason behind this phenomenon has been a flight to safety, i.e. bonds; and no confidence in the business climate with investors therefore not prepared to pay up for future earnings. As can be seen in the next chart, equity weightings by fund managers remain well below historical standards and should reverse at some stage based on positive underlying fundamental factors. Another possible positive for equities!

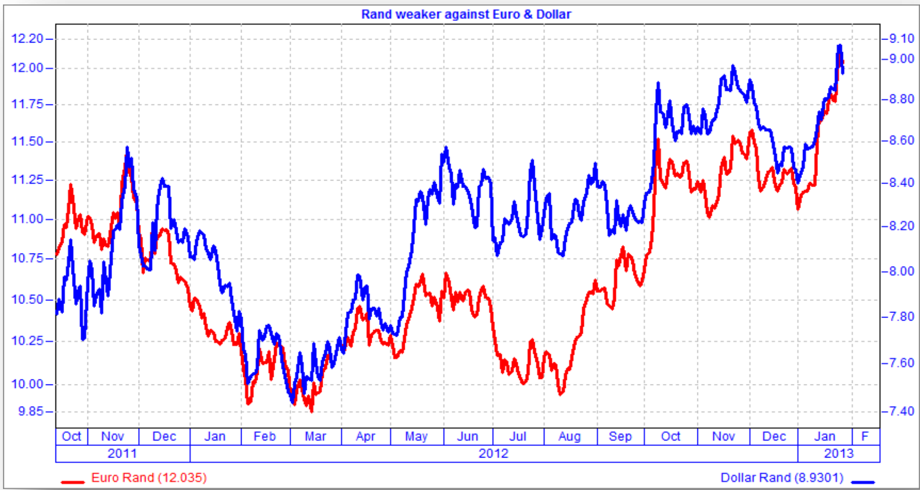


Cumulative inflows into US equities have essentially been zero since 2007.

We therefore, given the overall improvement in profits and global backdrop, anticipate falling ERP's, mostly due to multiple expansions rather than a big sell-off in bonds although some asset class rotation is expected as real yields are currently in negative territory, but fear is not entirely out of the system yet. But, as things continue to improve, eventually inflationary expectations will emerge which will see a more forceful switch into risk-on assets such as equities.

South Africa

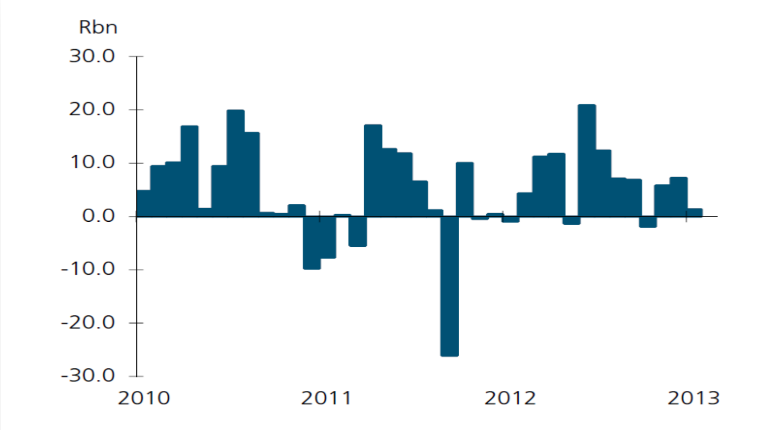
Locally things have deteriorated on the macroeconomic and social/political fronts. Continued labour unrest, widening current account deficit and uncertainty regarding the future of mining rights, lead to aggressive foreign selling of our bonds and as a result saw the Rand break the very important technical and psychological level of USDZAR 9.0.



Continued labour unrest, widening current account deficit and uncertainty regarding the future of mining rights lead to the rand breaking the very important technical and psychological level of USDZAR 9.0.

The on-going uncertainty regarding government's stance on future mining rights in particular, is worrying as the current account deficit is mainly funded by foreign buying of our shares and bonds. Foreigners are now close to neutral year to date with the inward rush early in the year nearly reversed. The monthly deficit that needs to be funded is about R17bn. If this funding dries up, the rand will weaken further and we might then be at risk of another ratings agency downgrade.

Figure 1: SA daily foreigner flows



Source:Bloomberg; RMB Global Markets
Data as at January 2013

We are currently only one notch away from junk bond status - precarious to say the least.

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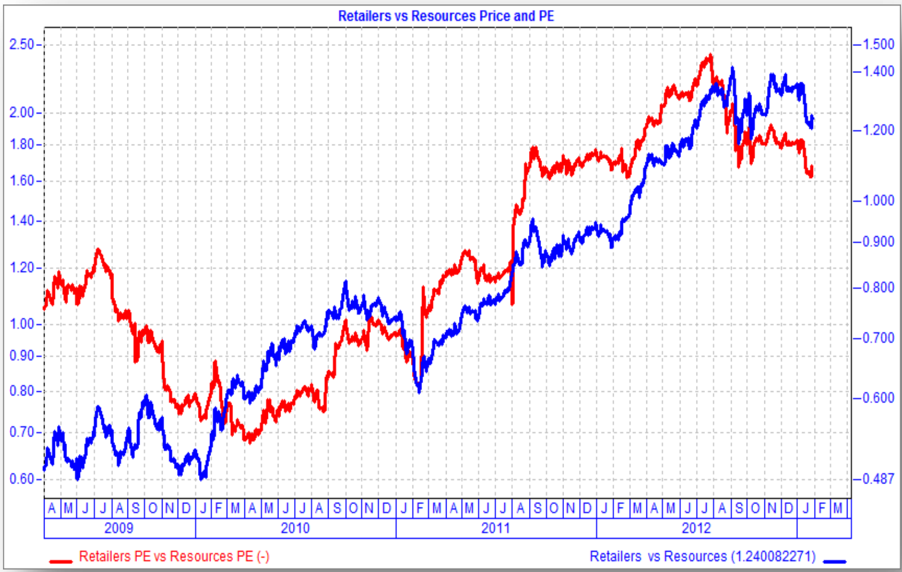
On the other hand, a weak currency is of course good for exporters and therefore bullish for the All Share index as about 40% of the overall market consists of these "Rand hedge" counters. We therefore expect continued asset class rotation out of bonds into equities, low PE cyclical stocks (miners) could outperform high PE stocks that need a strong rand (retailers) over the next 12 months.



This chart indicates that sector rotation has started, with miners rerating relative to retailers despite fears relating to mineral rights. It's the value proposition that is the overriding factor.

After leaving the repo rate unchanged last week, the SARB has indicated a more hawkish view on inflation and expects CPI to average 5.8% from 5.5% previously for 2013. Among the reasons for the change were higher wage settlements, rising food/electricity prices and a weaker rand. GDP growth was also been revised downwards from 2.9% to 2.6% for 2013. The budget balance is expected to be in deficit for the next 3 years largely driven by continued higher wage demands. We anticipate that the rate of increase in social grants will probably decline in the upcoming budget but with a looming general election, we still think this will be a major drag on our finances and don't expect meaningful cuts in social spending.

We are hopeful that more will be forthcoming on how government intends to implement the planned R850bn in infrastructure spending, as very little has happened on this front. Further downgrades are on the cards if we don't cut the rate of expenditure and engineer a sustained economic recovery. Fixed investment in the country's infrastructure can add a great deal to our sustained economic revival.

Generally, fundamentals for local equities remain positive given the global backdrop and solid earnings growth prospects buoyed by a weak rand and aggressive expansion into the rest of Africa by local companies. We expect sector rotation to continue into commodity counters out of expensive industrials. The global search for yield has seen our bond market rerate due to foreign flows and could reverse quickly in the event of risk aversion retreating, when capital will start flowing back into developed markets. The FTSE is on a forward PE of 9x compared to the JSE

ALSI on 12x. But SA being perceived as a springboard into the rest of Africa, particularly on the consumer front, remains a compelling story for foreigners.

In Conclusion

- The issues weighing on markets remain similar to last year, although generally things appear to have stabilised and are improving;
- Europe's recession appears to have bottomed and we think the US and China can surprise on the upside in terms of growth which is supportive of higher commodity prices;
- US politics will remain volatile over the short term, but we anticipate the debt ceiling to be lifted as neither the Republicans nor Democrats can afford slower growth;
- Globally, it should be the year for equities with ERP's falling as multiples expand due to better growth, negative real bond yields and inflation increasing slightly;
- In SA, things are getting worse. The current account deficit, rand weakness, labour unrest and ratings downgrades will remain the main risks for the year;
- Within our balanced portfolio approach ,we have increased our weightings to cyclical stocks on a valuation basis, which should be further supported by a falling currency;
- The Africa story will remain a theme which will probably protect portfolios somewhat if some of the risks intensify;
- We await the Feb. national budget for some clarification around the 'long proposed' fixed infrastructure investment by the State to help support a sustained economic recovery; as opposed to relying on indebted consumers to drive economic growth;

Sincerely

Chris

Chris Botha

Dave

Dave Eliot