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Asset Management

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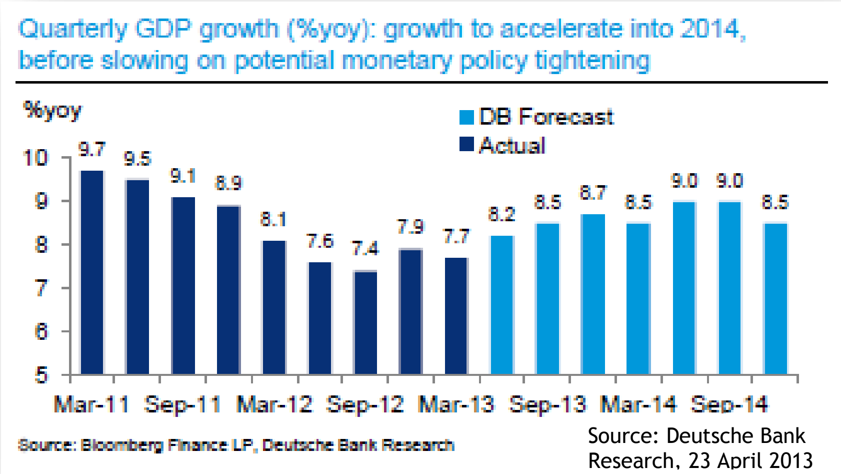
"Those who have knowledge don't predict. Those who predict don't have knowledge."
– Lao Tzu, 600BC

China GDP forecasts



Source: Deutsche Bank Research, 23 April 2013

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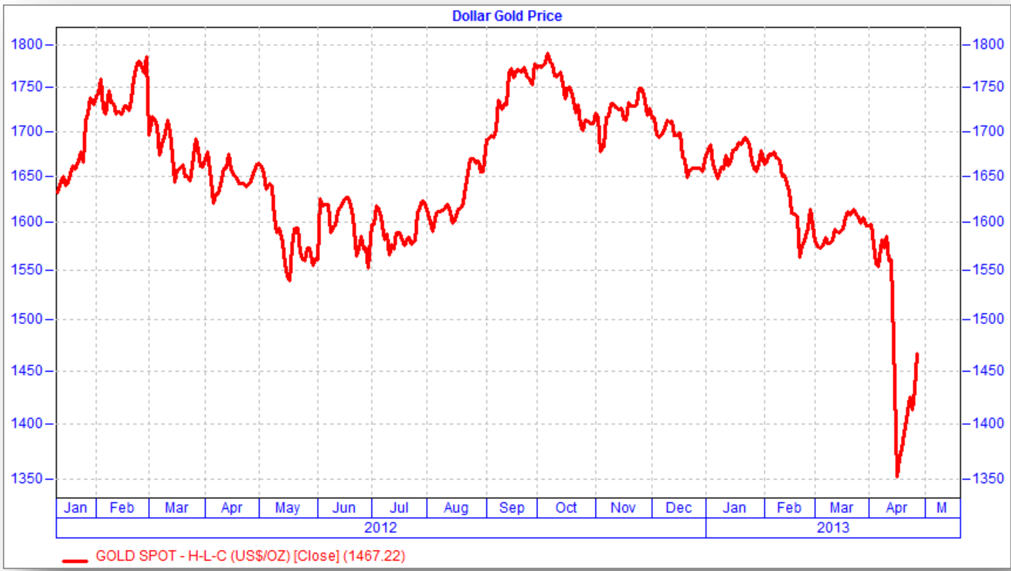
International

Stock markets have been quite volatile lately as mixed signals emerged regarding GDP growth in the US and China, the two main driving forces of the current global economic recovery. Chinese growth for the first quarter of this year was 7.7%, slightly below expected growth of 8%. This was somewhat surprising after very strong growth in credit extension in January and March and caused a sell-off in markets in general. We would like to emphasise that 7.7% growth given the size of the Chinese economy is still very good, which will remain supportive of commodities and global GDP longer term.

In our view, markets ignored some very important structural changes that are emerging in that economy. For decades, growth in China has been driven by spending on infrastructure as urbanisation continues to increase. This growth model has sparked concerns that all this spending on fixed investment will lead to an eventual oversupply of fixed assets and a potential credit bubble in the banking system. From a sustainability point of view, it is important that China's model shifts from fixed investment to a more inclusive consumption driven model. This is happening. In the latest number, consumption, although still relatively low given the size of the population, contributed more to first quarter GDP than fixed investment. China's economy is therefore modernising and becoming more capitalistic, which in the long run will be more sustainable. Slower growth therefore is not necessarily a bad thing if accompanied by a more mature and measured approach.



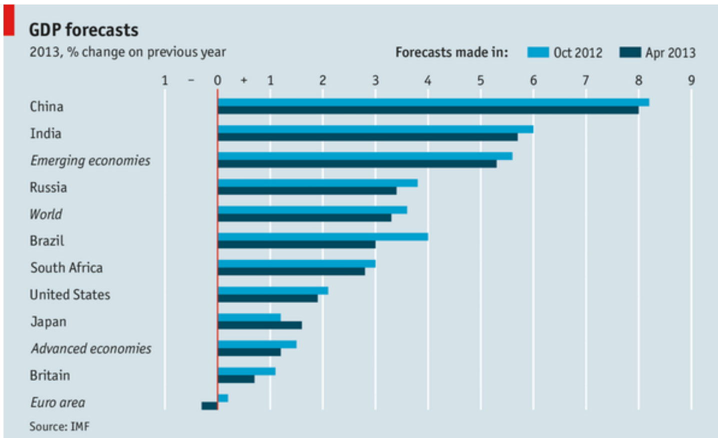
In Europe, the Cyprus fiasco has come and gone, with little impact on markets as the potential financial implications if they exit the Euro are relatively small.Not that we believe they will! Reports of the central bank selling gold did trigger a severe correction in the spot gold price as technical levels were breached which attracted large speculators and banks to join the fray. Eventually short covering entered the market together with other participants using this golden opportunity to replenish physical stock at very attractive levels. In our view, the spot market was manipulated as there is and was no fundamental reason for the metal's price to react that severely. The gold price has rebounded since then and is forming a base, which is a healthy scenario.

Britain's economy avoided a triple dip recession in the first quarter with reported GDP growth of 0.3% which was substantially better than the expected figure of 0.1%. From a year earlier, GDP rose 0.6%, the most since the fourth quarter of 2011. On a further positive note, European Commission President Jose Manuel Barroso has said that austerity had reached its natural limits of popular support and recent data suggests that debt-cutting was slowing.

After a promising start to the year, the US economy seems to be spluttering. After better than expected retail sales and housing data in January and February, employment growth and housing activity disappointed in March, raising suspicion about the sustainability of the economic recovery.

Some economists argue that most large companies hire people in the fourth quarter and smaller ones in the second quarter of each year which could explain the disappointing employment figure. Others point out that further possible reasons for the weaker data are an early Easter and that tax increases in January that are now taking effect.

The odds are then that the recovery in fact might not be faltering, but one can expect volatility in the short term as markets will react to high frequency data. GDP growth for the first quarter in 2013 came in at 2.5%, below estimates of 3%, but in our view still very good for such a large economy.



The International Monetary Fund has revised down its growth forecast for the world economy to 3.3% in 2013. Emerging economies will once again lead the pack, growing by 5.3%. China and India look most impressive, though both have slowed in recent years. Rich countries will shuffle along at 1.2%, but that average will disguise a wide variance. America's economy will expand by 1.9%; the hapless euro area will contract by 0.3%. Both have averted disasters (America's fiscal cliff and a break-up of the euro, respectively). But high debt, deficits and uncertainty over the euro area's periphery continue to act as a drag. In Japan, the recent fiscal and monetary stimulus will spur growth of 1.6%.Economist

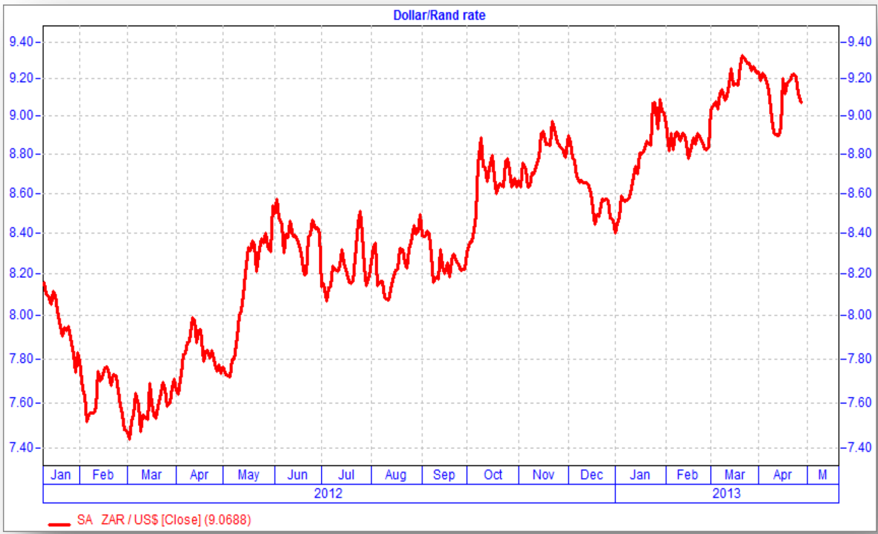
Source: The Economist, 19th April 2013

The IMF has however revised global growth downwards to 3.3% for 2013. Emerging markets will grow 5.3% with China and India being the most impressive at 8% and 5.7% respectively.

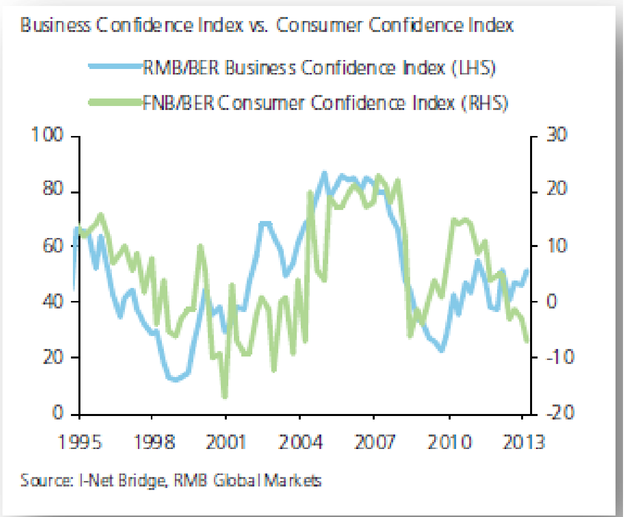
Although stock markets in general have performed well year to date, we anticipate further price increases for the remainder of the year. Chances are that economic growth, particularly in the US, might surprise on the upside supported by the fact that more than 2/3rds of US companies that reported earnings over the last quarter beat expectations. This together with weak global inflationary pressures and low negative real yields from income producing asset classes ,supports our argument for more positive returns to come from equities in 2013.

Local

The rand has been one of the worst performing currencies year to date, depreciating by 7.5% against the dollar driven by the large current account deficit, lower commodity prices and labour unrest. We don't see any reason why the current account deficit will improve in the short term and in fact the weak currency will make it even worse as the higher value of exported goods in rand terms will be countered by lower export volumes due to tumbling commodity prices. Rand weakness and expected above inflationary wage increases could also pose a threat to inflation in the second half of the year. These factors and expected blackouts this winter is more than likely to continue to underpin weakness in the local currency. The chart below indicates that the weaker trend remains very much intact.



Consumer demand remains weak as suggested by a sharp drop in the Kagiso PMI in March which came in at 49.3 compared to the sharp jump in February to 53.6. Manufacturing also contracted by 2.9% y/y from 3.7% previously supporting the weak demand environment. On the positive side, the RMB/BER Business Confidence Index rose in the first quarter mainly due to pre-emptive demand for new vehicles and larger trade items as further currency weakness is expected.



Source: RMB Global Markets Research, 17th April 2013

On the investment front, the JSE all share is more or less flat year to date and was up 3.5% for the month of April after a 7.6% correction in March as weaker economic data and jitters around Cyprus negatively impacted investor sentiment. Industrial rand hedges continue to outperform the market as a whole driven by good foreign demand and upward revisions in forecast earnings numbers due to the impact of the weaker rand.

The outlook for resource counters remains muted despite the benefit of a weaker currency, as there is no sign as yet of a rebound in spot commodity prices. Supply constraints should however over the medium have a positive impact on spot prices which will further be buoyed by sustained positive economic data.

In conclusion

- Despite Chinese GDP growth for the first quarter not quite meeting general estimates, growth remains robust at 7.7%.
- The important factor though is that the economic model in China is gradually shifting towards a larger consumer component which is good for long term sustainability.
- Gold is consolidating after a severe 'manipulated' sell-off by speculators and at current levels is reflecting more realistic fundamental value.
- Britain's first quarter GDP growth was much better than expected and comments made by the European Commission President that austerity has reached a natural limit, is positive news for future economic growth in the region.
- Slightly weaker than expected US economic data in quarter one might be due to specific once-off factors and it is more than likely that growth there will surprise on the upside.
- Locally, rand weakness is likely to continue which supports our investment case for industrial rand hedges.
- Consumer demand in SA remains weak which should offset the inflationary pressures caused by the weak rand.
- The outlook for resource counters remains uncertain despite a weaker currency as there are no indications of a catalyst to drive spot commodity prices higher.

Sincerely

Chris Botha

Dave Eliot