

**Investment Strategy Document (“ISD”)**

for

**Dummy client**

**(“Investor”)**

Prepared by

**Seed Investment Consultants (Pty) Ltd**

**(“Seed”)**

Seed is a registered Financial Services Provider. FSB registration number: 2346

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## 1. Introduction

The ISD is a unique investment strategy document for you, the investor. Seed doesn't sell products. We rather design an optimal investment strategy for you based on sound actuarial and investment principles. The outcome of this document is based on:

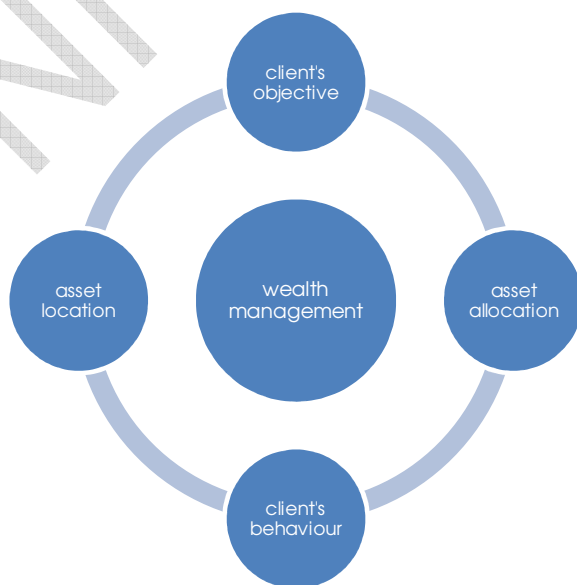
- The information you provided us and
- The assumptions we made about future long term assumptions

No estimate about the future will be 100% accurate. We recognize that. However, we try to estimate probabilities (or likelihood) of certain outcomes. We therefore estimate what is the most likely outcome in the future based on your unique situation and on our future set of assumptions. However, we do recognize that investing is as much (and probably more so) an art rather than a science. Therefore, we follow a balanced approach between theory and pure investment sense.

Our whole investment process is transparent because we believe investors want to understand these dynamics and we recognize the importance to interact with our clients in a meaningful way. We believe the investment process we follow below will address that.

## 2. Investment Process

Our investment process is holistic in that it firstly identifies your investment objectives, then develops an optimal asset allocation, then focuses on your investment behaviour and finally we consider the important asset location considerations like the appropriate custodians, tax and legal requirements. We recognize that there are a number of external factors like changes in the global market and economy. The diagram below illustrates our investment process in a simplified way.



## SECTION I – Client’s investment objective

### 1. Summary of your information

Please refer to **Appendix A** for a summary of the information you provided us. The correctness of this information is critical in establishing your ISD.

A summary of your information is as follows:

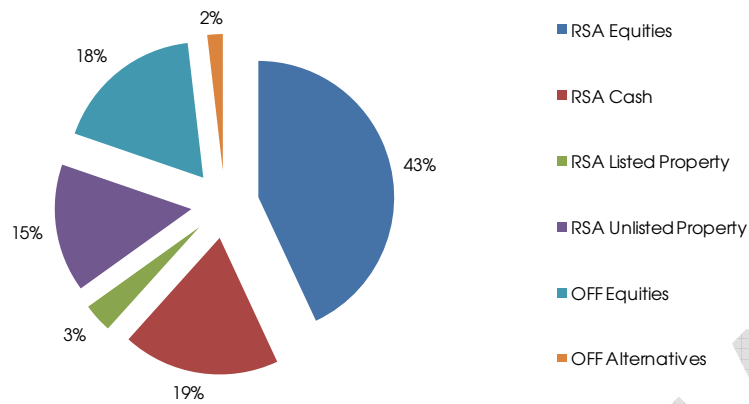
Name and Surname:	Dummy Client
Date of Birth:	01/07/1950
Gender:	Male
Name and Surname of Spouse:	Mrs. Dummy Client
Date of Birth:	01/07/1950
Expected retirement age:	62
Size of current value of assets: <sup>1</sup>	R15 012 491
Provident Fund	R4 396 342
Mr Portfolio	R3 412 608
Mrs Portfolio	R2 868 197
Secondary Property	R1 180 000
Secondary Property	R1 100 000
Living Annuity	R547 090
Retirement Annuity	R1 508 254
Total	<u>R15 012 491</u>

Based on the information you provided Seed your current asset allocation<sup>2</sup> is shown below.

Graph:

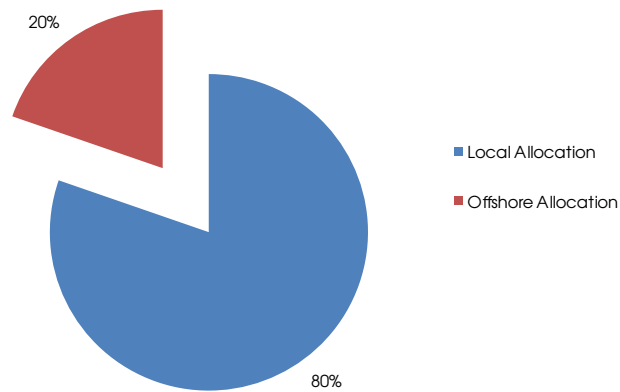
<sup>1</sup> We do not take into account primary property, cars, emergency savings and other assets that are not deemed for long term investing purposes.

<sup>2</sup> Asset Allocation – This is how your current assets (excluding primary homes and motor cars) are split between the different asset classes.



Your current asset allocation split between local and offshore<sup>3</sup> assets are shown below. Note that the definition for offshore is offshore domiciled assets plus offshore “swap” assets but excludes locally listed companies with a form of offshore revenue stream.

Graph:



## 2. Your investment and income requirements

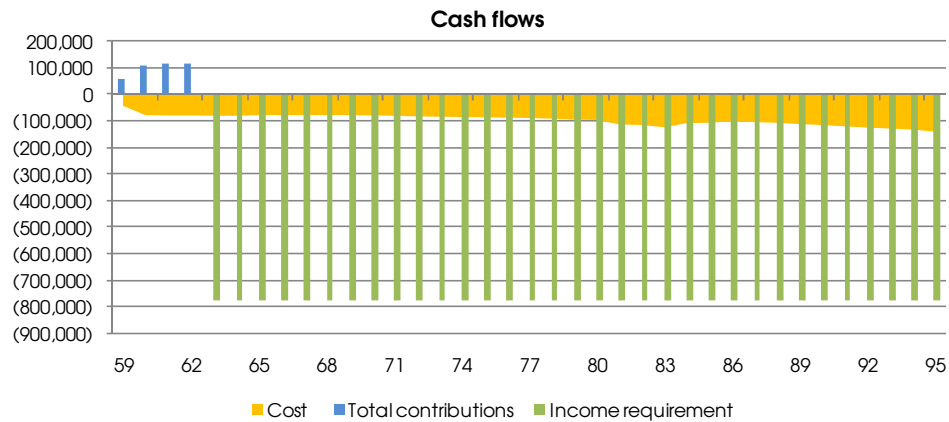
From our discussion we understood that your main investment objective is to be able to receive a targeted pension of R62,500 p.m. (net of tax). This pension amounts are all in today’s monetary terms and should increase at the rate of inflation.

We also understood that you prefer to manage your assets in a **living annuity** environment (i.e. managing the assets outside a guaranteed life annuity arrangement). Please note that this ISD needs to be updated regularly i.e. once every three years or sooner if your asset base or personal circumstances change significantly in the interim.

The graph below illustrates the total cash flows that your portfolio should finance in the future.

<sup>3</sup> Not that the definition for “offshore” is offshore domiciled assets plus offshore “swap” assets but excludes locally listed companies with a form of offshore revenue stream.

Graph



### 3. What are the risks of meeting your investment objectives?

We believe it is critical to define what the "risk" is you are facing. Unless we define it properly we will never be able to reduce that risk. Contrary to normal belief, that risk equals the volatility (i.e. unpredictability) of returns, we define risk as follows (in terms of priority):

- **Actuarial Risk** i.e. the risk of not meeting your long term liabilities (expected cash requirements)
- **Investment Risk** i.e.
  - The risk of not meeting your long-term investment objectives for example, outperforming Inflation + 5% over the long-term and
  - The risk of losing capital over the short- to medium-term.
- **Behavioural Risk** i.e. the risk of not buying consistently low and selling consistently high but rather following the herd.

Please refer to **Appendix C** for a detailed description of other risks that you will be exposed to in the market.

### 4. Your required real return

Based on the information you provided Seed, we estimated that you need a long term return on your assets of at least CPI (Inflation) – 2.4% p.a. in order to meet your pension payouts in real terms.

We calculated this required return by taking into account your current assets, pension requirement during retirement and expected life expectancy.

## 5. Summary of Seed's future set of assumptions

Seed uses a set of assumptions to value both your assets and liabilities (e.g. future pension payments) into the future. We estimate 1000's of possible economic scenarios in order to capture the likely impact of these economic scenarios on your investment portfolio. We therefore don't work with one set of future inflation rate but rather a range of possible rates. The same is true for real interest rates (i.e. difference between the repo rate minus inflation), equity returns, property returns, ZAR devaluations, wage increases etc. Please refer to **Appendix B** for a detailed summary of the assumptions used.

## SECTION II - Establishing the client's optimal asset allocation

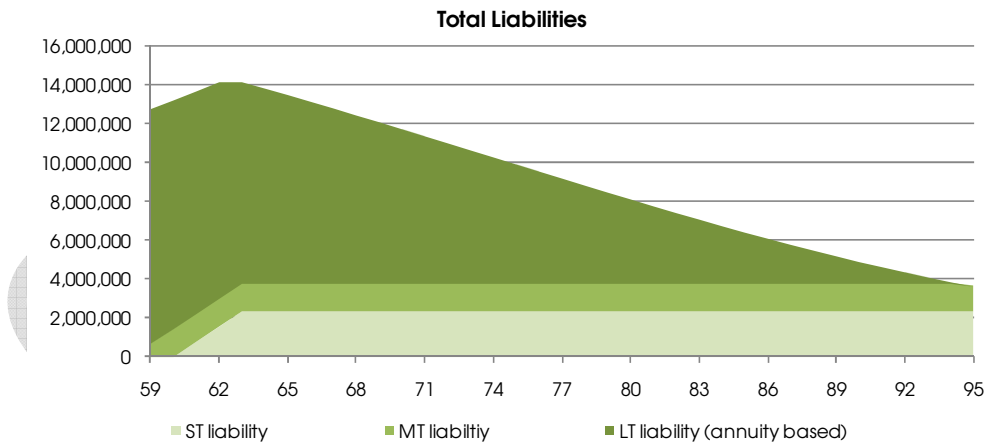
The asset allocation of your investments is driven by:

1. The size of your liabilities i.e. your income requirements in the future
2. The size of your assets and future contributions
3. The timing of your retirement

### 1. Size of your liabilities

We define liabilities as the present value of your future income requirements after retirement. The graph below illustrates the present value of your liabilities at different ages.

Graph



We divide your total present value of liabilities into three "buckets". They are:

1. The "ST liability" (Short Term liability) bucket is the present value of your income requirements for the first and ensuing three years.
2. The "MT liability" (Medium Term liability) bucket is the present value of your income requirements for the following two years.

- The "LT liability" (Long Term liability) bucket is the present value of your income requirements for the balance of the expected future years. We use the standard actuarial mortality tables to define the likely probabilities in the future.

Therefore, your total liability at any given age in the future is the sum of these three buckets.

Each of these three buckets will be impacted by different economic, social and political factors. In order to ensure that you have sufficient capital to finance your liabilities in future years, the most efficient way is to match your liabilities with a specific asset. We therefore divide your assets also into three buckets.

## 2. Size of your assets

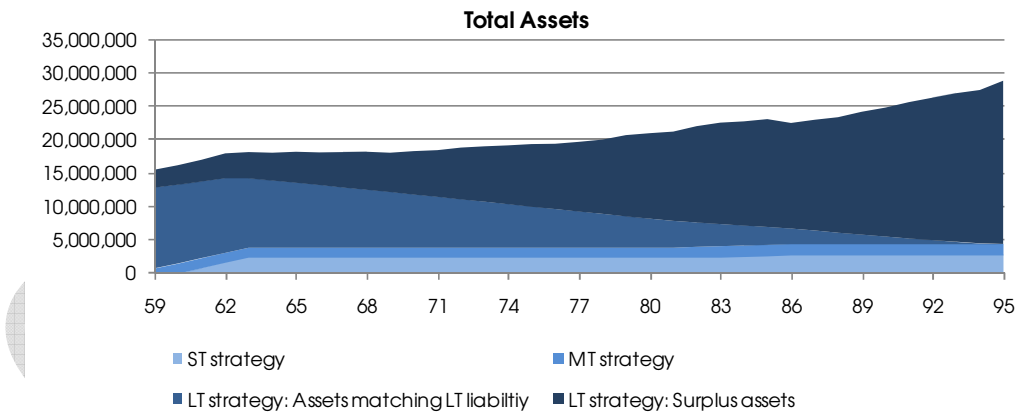
In order to match your assets with your liabilities we need to understand the following:

- Current value of your assets
- Your expected future savings towards retirement
- The likely growth of your assets in the future
- The characteristics of the different assets in the different market conditions

We projected your assets into the future based on our proprietary stochastic model. We then stress tested your portfolio under 100's of different scenarios.

Assuming you invest all your assets into the recommend asset allocation then the graph below illustrates the likely outcome. The graph illustrates the projection of your assets, less any income draw downs, based on averages.

Graph



The graph illustrates that you have sufficient assets (on average) to finance your income requirements and still have assets in your estate.

The "ST strategy" (Short Term strategy) represents the bucket of assets that matches the "ST liability" bucket. This ST strategy bucket will be sufficient to ensure you have enough assets to finance your short term income requirements for the first and ensuing three years irrespective of markets conditions.

The “**MT strategy**” (Medium Term strategy) represents the bucket of assets that matches the “MT liability” bucket. This MT strategy bucket will be sufficient to ensure you have enough assets to finance your medium term income requirements. The MT strategy is designed in such a way that the assets have a 90% probability of being able to finance your income requirements for years four and five from now.

The “**LT strategy**” (Long Term strategy) represents the bucket of assets that matches the “LT liability” bucket. This LT strategy bucket’s aim is to grow your portfolio in real terms in order to increase the likelihood of having sufficient capital to finance your income requirements in years beyond the short and medium term.

In order to reduce capital losses we believe it is critical to consider the following three points when constructing the LT strategy portfolio:

- Include a diversified pool of assets classes
- Include asset classes that increase in real terms but that are uncorrelated
- Include hedged (protected) equity funds

These points are some of the principles that the largest university endowments in the US apply when constructing their long term investment strategies e.g. Yale University Endowment. We use these principles when we calculate this optimized (or best) strategy.

Growing your capital base in order to achieve your objective is all about investing. Investing is essentially about **buying real assets** that produce an inflation adjusted income stream. Real assets include investing in your own business, which typically yields the highest returns, and other private businesses, which should yield higher returns because they can be acquired at cheaper prices than a listed business. **Listed businesses** have proven to earn very decent real rates of return, but again only when the investment was made at the appropriate time, i.e. not at very expensive levels. Depending on “deal flows” an allocation of 20% - 30% to a diversified range of fairly secure private equity deals is not uncommon. Seed believes that investments into private equity deals should always be considered and the likely returns weighed up against that of the listed market. These deals are not always available and for this reason we did not include a strategic asset allocation in our solution.

**Commercial Property** is another asset which has typically kept pace with inflation. This is because a landlord has some ability to escalate property rentals in line with inflation over extended periods of time. The inflation adjusted rental stream in turn results in an inflation adjusted property value. Residential property is more emotional when compared to typically steadier commercial property, and typically does not have as secure an income stream.

**Fund of Hedge Funds** has become a prominent asset classes over the last 10 years. The primary objective of a fund of hedge funds is to provide diversification and capital protection during periods when the equity markets go down. This will assist a total portfolio to grow faster than inflation. It is therefore an attractive asset class to consider in an overall portfolio of assets.

In the declining interest rate environment from peaking in 1998 to end of 2005, the performance of bonds and property surpassed that of equities. However over the longer term an investment into equities (private and listed) has proven to have been the best investment. Therefore it is ideal that investments are mostly made when prices are lower to reasonable, and new investment is reduced when prices are too expensive for the underlying assets.

Investing capital into retirement years is equally, if not more important than the years up to retirement. The biggest issue in this phase is the inability to tolerate mistakes for three main reasons which are self evident. Firstly there is far less ability to add to ones capital base outside of investment growth and more importantly, pressure is being applied to the capital base in the form of pension drawdowns. Secondly, the impact of inflation over time on the portfolio's real returns is often underestimated. Thirdly, the investor is carrying all the investment and mortality risk. Obviously the latter can be eliminated if a guaranteed life annuity is bought.

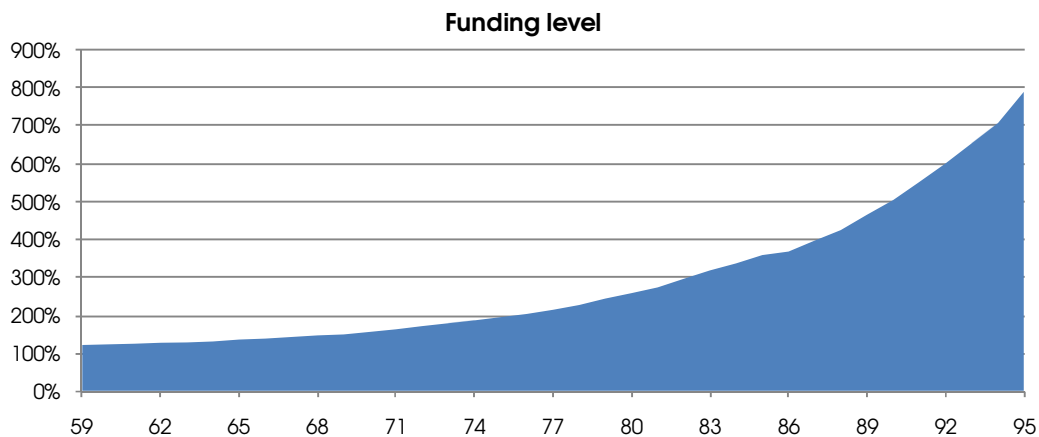
### 3. Funding level of your assets

Your funding level is the value of your assets divided by the value of your liabilities. This is calculated at every age in the future. A funding level of less than 100% means that you have less than R1 of assets to finance every R1 of liability. A funding level of more than 100% means that you have more than R1 of assets to finance every R1 of liability.

If your funding level at retirement is less than 80% or your assets deplete very quickly after retirement then you may want to consider buying a guaranteed life annuity instead.

The graph below illustrates your funding level over time.

Graph



At age 62 your funding level is equal to 126%. As you draw down your income requirement, your assets are still able to more than finance your liabilities. As a result your funding level improves to a level of 800% in later years.

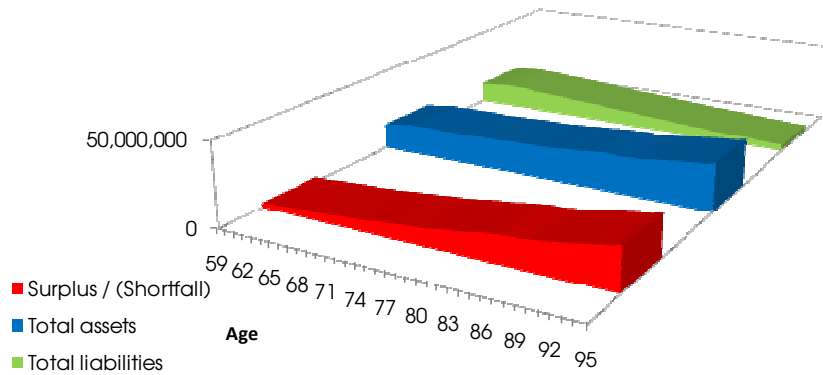
It is important to realize that your funding level is not only a function of the growth or reduction of your assets but also on the value of your liabilities. The "cost" of your liabilities can change over time. This can be as a result of:

1. Change in real interest rates
2. Change in income requirements due to higher than expected inflation
3. Change in health etc

As a result of the dynamic factors, you need to calculate your funding level i.e. assets versus liabilities at least every three years.

The graph below illustrates a summary format of the present value of your liabilities, assets and surplus/(shortfall) in future years.

Graph

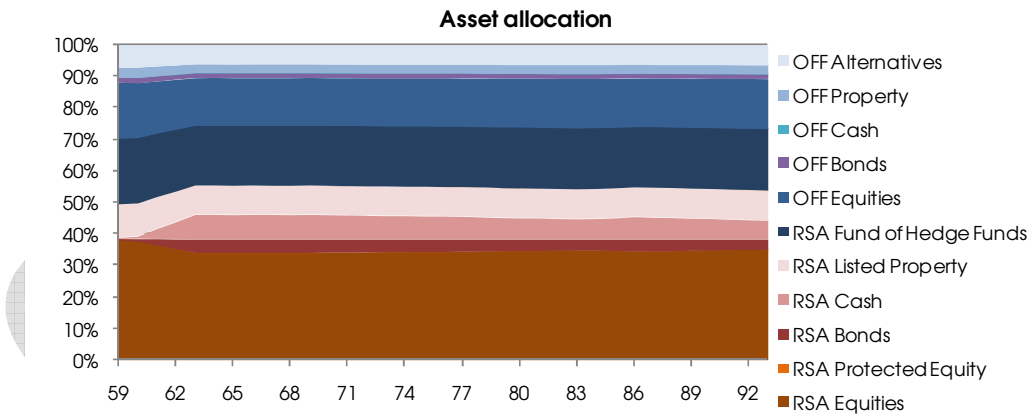


#### 4. Your recommended asset allocation

Each of the short term, medium term and long term buckets of assets have their own characteristics.

However, on a consolidated basis the recommended asset allocation today and in the future is shown below.

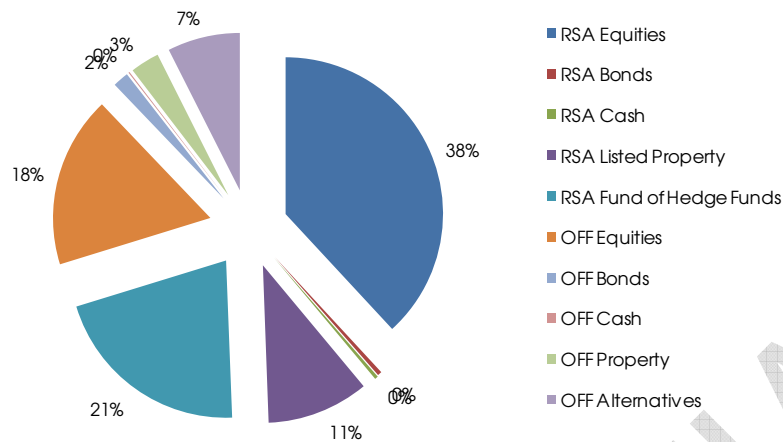
Graph



Over time the allocation to volatile assets like local equities, property and offshore assets will reduce while more cautious assets like cash and bonds will increase over time.

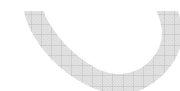
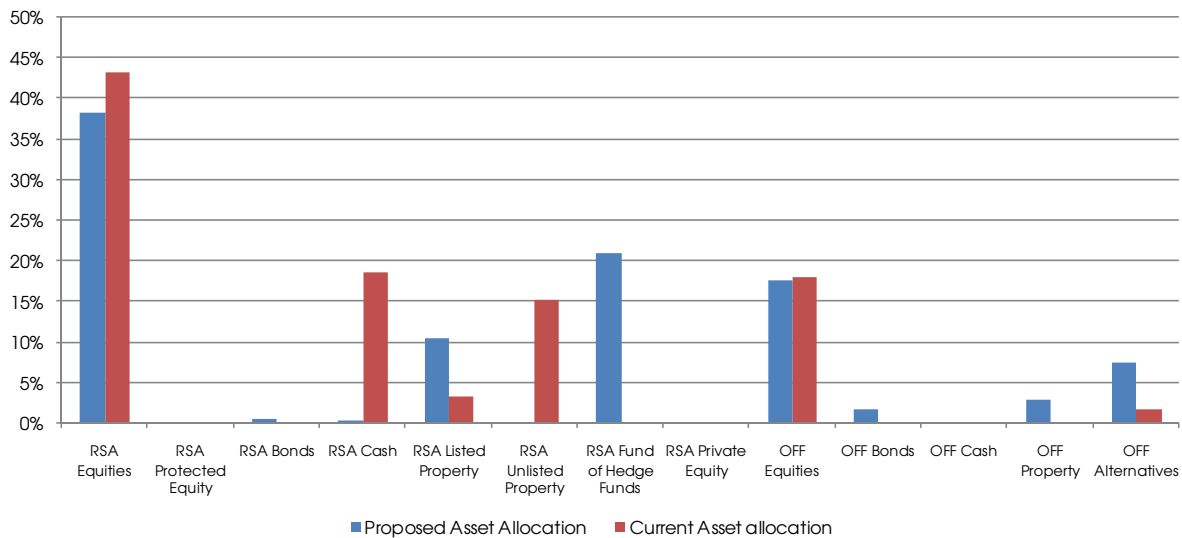
The graph below illustrates the asset allocation of the recommended strategy at your current age.

Graph



We recommend investing in a well diversified portfolio where the underlying asset classes exhibit **low correlation** against each other and they are all **growth assets**. The graph below illustrated the comparison between your current strategy and the proposed asset allocation. Seed recommends that we align your portfolio, over time, as close as possible to this proposed asset allocation. Seed has drafted a separate document proposing an implementation process.

Graph

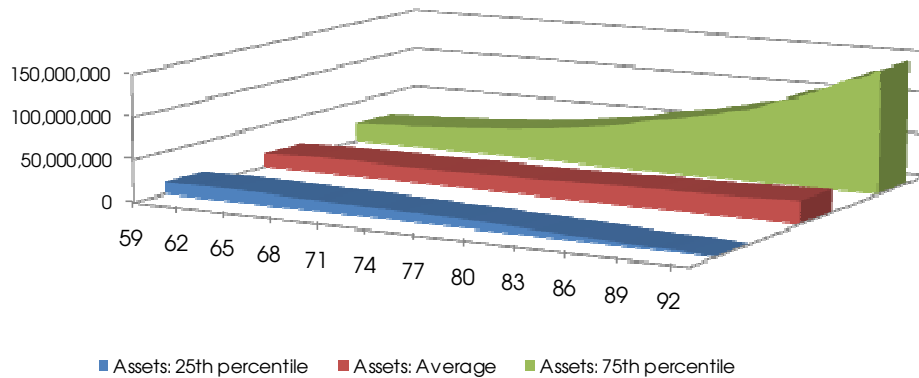


## 5. Stress testing your asset allocation

It is important to stress test any portfolio and to understand the likely impact of future events. We simulated your portfolio 100's of times each with different scenarios. We used data from 1960 to assist us with this process.

The graph below shows the projection of your assets based on the 25<sup>th</sup> percentile (i.e. worst case scenario), the 75<sup>th</sup> percentile (i.e. best case scenario) and the average scenario.

Graph



The graph above shows that there is a probability of a pension shortfall if the worst case scenario materialises. This is only likely to occur after age 90.

## 6. Dynamic global economic view

We regularly update our view on the global economy and asset classes. Based on our view we manage the exposure to the different asset classes. This allows us to take advantage of miss-priced assets versus more expensive assets. We will therefore manage the portfolio within limits around the strategic asset allocation.

Please see **Appendix E** for a summary of our current market overview.

## 7. Researching the best asset managers

Currently there are more unit trusts than listed companies. This makes it even more important to have a structured process when it comes to selecting the best performing unit trusts (i.e. asset managers). We don't believe in only looking at historic performances when it comes to selecting unit trusts. Instead, we consider five major factors and a number of sub-factors when it comes to selecting the best unit trust managers. A balanced approach is therefore necessary when selecting these managers. The five major factors are:

- Company structure e.g. administration and sustainability
- Percentage ownership of management
- The credibility of the investment process
- The skill of the investment professionals
- Historic performances and statistics

The first four factors are “qualitative factors” while the last factor is the “quantitative factor” that considers historic performances and risk statistics. Canadian research<sup>4</sup> has shown that asset managers with certain characteristics generally outperform their peers. These are:

- The individuals managing the assets owns a large part of the company
- The managers are generally bottom-up stock selectors
- The managers experience a low turnover of staff
- The managers manage a relatively small portfolio

We believe these criteria are critical to consider when selecting managers.

The details of the funds are described in the [Implementation Document](#).

## 8. Risk management

Risk management is critical to the whole process. In order to manage the risks described in this document, one has to ensure that the process is reviewed regularly and that all parties adhere to their requirements. This includes the following points:

- The investor needs to review his/her long term objective regularly
- The optimal strategic asset allocation needs to be updated if and when important information changes
- The investor’s portfolio is implemented as represented in this document
- The portfolio has to be managed according to the limits specified in this document
- The unit trust managers manage the investors’ assets according the agreed mandate stipulated by the Collective Investment Schemes Act and the Financial Services Board
- The Hedge Fund manager manages the investor’s assets according the policy mandate and according to the Long Term Life Assurance Act

This regular review of the objectives, investment strategy and relevant asset managers is an ongoing process.

## SECTION III – Client’s investment behaviour

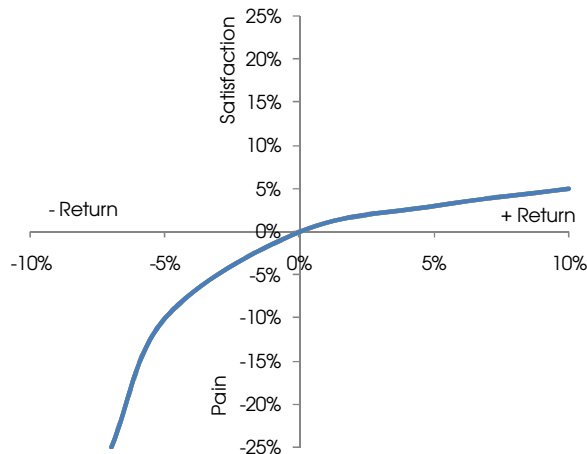
### 1. Understanding your emotional investment behaviour

Your attitude towards risk will have an impact on the sustainability of your long term portfolio. To put it simply, we don’t believe it is efficient to structure a portfolio for a client that deviates too far from his/her personality or attitude towards risk. This is not an easy task to quantify.

A typical investor’s emotion to positive returns and negative returns can be illustrated in the following graph.

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<sup>4</sup> “Institutional or Entrepreneurial Management?” Canadian Investment Review (Spring 2005)



The graph shows that with a 10% gain the level of "satisfaction" is minimal. However the level of "pain" someone feels for losing only say 7% is substantial.

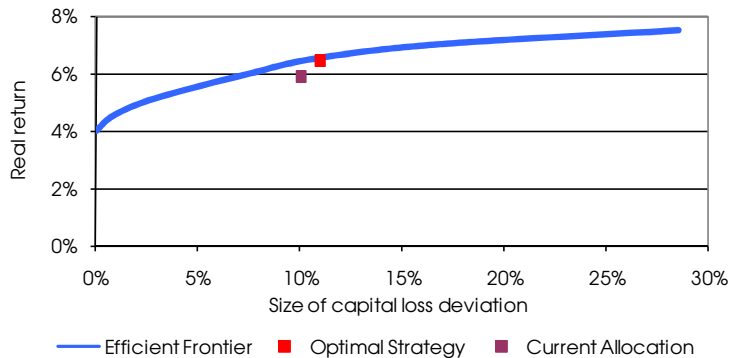
Seed recognizes this behaviour and the best way to manage this behaviour is to have clear indication what the level of risk is of the underlying portfolio. This is shown in graph below.

## 2. Managing your behaviour

Seed uses an efficient frontier to manage emotional behaviour. Refer to **Appendix D** for a list of definitions that explains how the efficient frontier works.

The graph below shows the proposed asset allocation against the efficient frontier.

Graph:



The graph shows that the proposed asset allocation will on average give you a return of about CPI + 6.5% but due the level of "growth" assets the portfolio could lose about 12% on average in any one year. The graph shows that by combining a diversified range of uncorrelated growth assets one is able to reduce the risk of losing capital. You as a client need to be comfortable with the level or risk the portfolio could display in the future.

Also note that your required return is CPI - 2.4% p.a. and the proposed strategy will target a return of CPI + 6.5%. This is likely to increase your pension surplus over time. This was detailed in Section III.

## SECTION IV – Asset location of the client’s investments

In terms of asset location it is important to consider

1. Cost effective, transparent and tax friendly legal structures i.e. products available in the market
2. Appropriate and safe custodians of the client’s assets
3. Estate planning and the creation of a will for the client.

### 1. What investment structures does Seed use?

There are various legal structures available in the market when it comes to investing ones assets. We refer to these legal structures as products. Examples of products are:

- Local and offshore unit trusts
- Unit linked policies
- With profit policies
- Retirement annuities
- Pension funds
- Preservation funds
- Endowment policies
- Limited liability partnerships
- Investment linked living annuities
- Guaranteed life annuities
- Direct investments in shares, bonds, cash or property

As consultants it is our responsibility not only to understand these legal structures but more so the underlying investments and tax consequences of these legal entities.

We avoid financial products, which are often complex and not inherently designed to benefit the investor, but the institution selling them. We believe it is critical to retain flexibility for investors’ assets, whilst at the same time keeping it simple. Seed generally makes use of transparent, cost effective and tax friendly legal structures like unit trusts, unit-linked endowment policies and living annuities.

The particular products that Seed recommends are detailed in the [Implementation Document](#).

### 2. What custodians does Seed use?

In the wake of the financial crises it became evident that quality custodians of assets are of primary importance. Seed never accepts client’s assets on its own balance sheet. The client’s assets are always held by a custodian and as a result the quality of the custodians becomes critical. The client always has direct access to its assets via the custodian.

The particular custodians that Seed recommends are detailed in the [Implementation Document](#).

### 3. Importance of estate planning

Seed recognises the importance of setting out a clear plan for one's estate. Seed has a formal agreement with one of the best estate planning companies in South Africa, The Louis Group. As a client of Seed you will have access to lawyers who will assist you with your will and estate planning. Seed will assist you in this process. Please refer to [www.louisgroupint.com](http://www.louisgroupint.com) for more information on their credentials.

## SECTION V – Conclusion

### 1. What is the next step?

It is important that you understand this investment strategy document. We would like the opportunity to discuss it with you in more detail. Once all your questions have been answered, the next step will be to implement your portfolio as detailed in the implementation document.

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## Appendix A – Investor’s Information

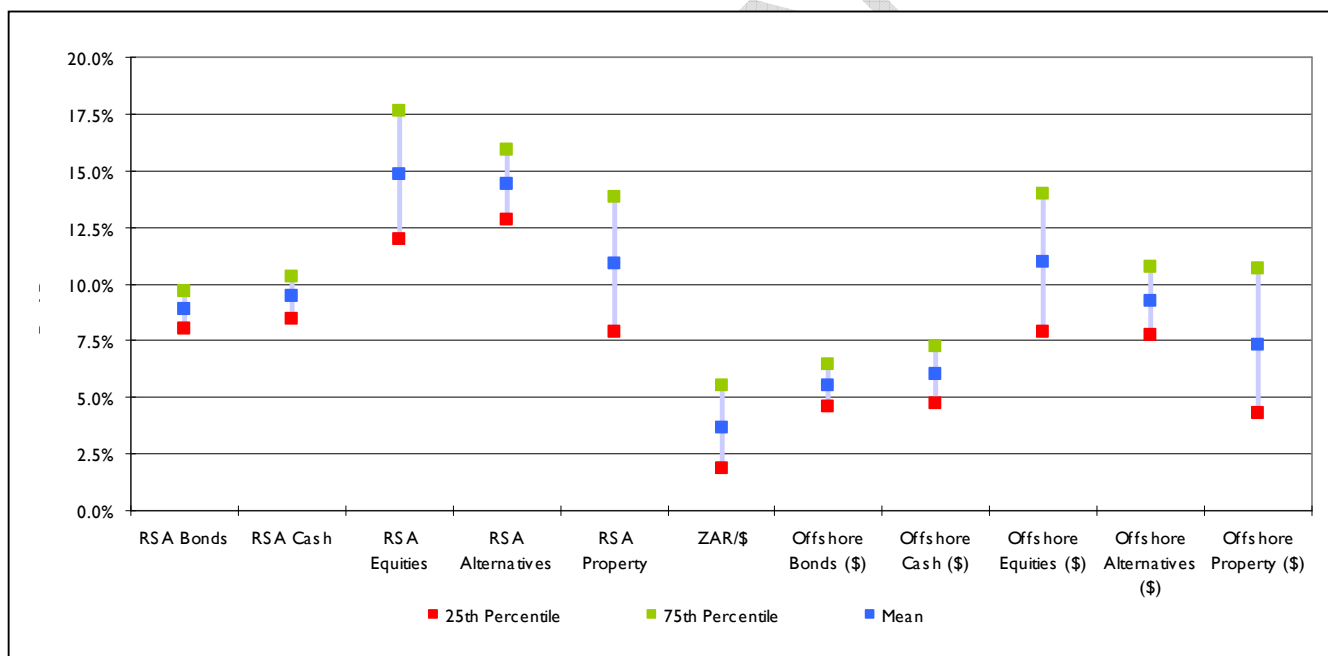
For completeness we attach your completed questionnaire.

## Appendix B – Summary of assumptions

The most important assumptions we make and use in our analysis are:

- The expected returns for the different asset classes
- The future inflation rate
- The volatility (or uncertainty) of these returns and
- The correlation (or interplay) between the asset classes.

The nominal returns we expect the asset classes to produce over the next 5 – 10 years are as follows:



Inflation

We assume the average long-term inflation rate to be around 5.5% to 6% with a minimum of 3%.

Salary inflation

We assume salary inflation to be 2% above that of inflation over the long term. This includes promotional increases.

## Appendix C – Other risks

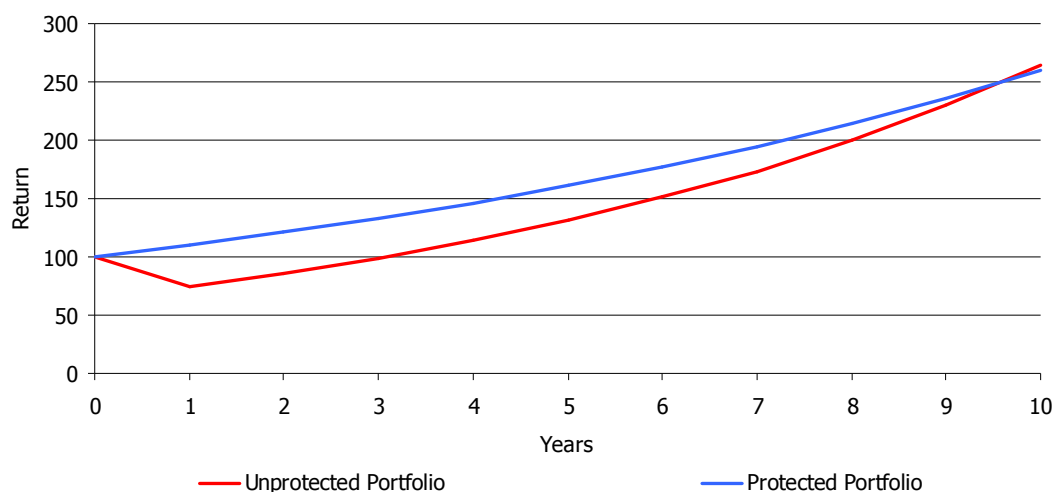
### Investment Risk

As explained earlier investment risk can be defined in terms of not meeting your long term investment objective and by losing capital over the short to medium term. Let us look more closely at this permanent loss of capital.

All investments carry a certain degree of risk of permanent loss of capital. However this needs to be reduced as far as possible, so that the investment return to risk ratio is in the investors favour.

In looking to maximize the return to risk ratio, we believe that 2 elements are key, firstly diversification of investments and managers and secondly attempting to invest more when values are apparent and looking to protect capital as valuations become stretched. This is never an exact science, but an attempt must be made based on the evidence available. Downside protection is imperative at day 1 when investing a large lump sum, as this graph indicates:

The Benefits of Protection



#### Assumptions

Capital Loss: 25% immediately after investing

Subsequent Gains: 15%pa

Protected Portfolio: 10%pa

An immediate loss means 9 years of additional 5% returns just to get back to breakeven. This is a tall order, which is why we place a lot of emphasis on risk protection. A method of deriving some protection is to invest into a diversified portfolio.

**Reinvestment risk**

This is the risk resulting from the fact that interest or dividends earned from an investment may not be able to be reinvested in such a way that they earn the same rate of return as the invested funds that generated them. For example, falling interest rates may prevent bond coupon payments from earning the same rate of return as the original bond. At the extreme, where too high a weighting is held in cash to protect capital, then should interest rates go sideways to slightly down, the investor will have to continually reinvest at lower and lower rates of return.

Many investors have suffered from this risk over the past few years as interest rates have moved down structurally. They have suffered a double loss in that real assets, such as property and shares have moved up, and so by not investing initially, they had to invest in at later years and at higher costs.

**Custodian or institutional risk**

This is the risk which can't typically be quantified. While the percentage may be low, when it does occur, it has the possibility of seriously damaging a large portion of an investor's wealth. For this reason, we pay particular attention to this risk, and only use grade A type institutions when placing client's investment funds. Smaller institutions may offer attractive fee structures, but the higher risks are just not fully compensated for. While the regulatory environment cannot be relied upon, the advantage of placing funds with a larger institution means that the regulator will step in quicker and give their full support to clients, and ensure a smoother process, which may not happen with smaller institutions.

**Default risk (Credit Risk)**

This is the risk that a bond issuer will default, by failing to repay principal and interest in a timely manner. Bonds issued by the government, for the most part, are immune from default (if the government needs money it can just print more). Bonds issued by corporations are more likely to be defaulted on, since companies often go bankrupt. Municipalities occasionally default as well, although it is much less common.

**Currency risk (Exchange rate risk)**

This is the risk that an investment's value will be affected by changes in exchange rates. For example, if money must be converted into a different currency to make a certain investment, changes in the value of the ZAR currency relative to foreign currencies will affect the total loss or gain on the investment when the money is converted back. This risk affects businesses, but also affects individual investors who make international investments.

## Appendix D – Definitions

“**Downside Deviation**” is a value representing the potential loss that may arise.

“**Efficient Frontier**” is the line on a risk-reward graph comprised of all efficient portfolios. An efficient portfolio is a portfolio that provides the greatest expected real return for a given level of downside risk, or equivalently, the lowest level of downside risk for a given expected return. This efficient portfolio is also called an optimal portfolio.

“**Funding level**” is equal to the present value of your assets and future contributions divided by the present value of your future liabilities. If the funding level is more than 100% it means that you have more assets to cover your liabilities (i.e. pension payments) while a funding less than 100% means that you don't have enough assets to fund the required pension.

“**Guaranteed life annuity**” is where the insurer guarantees to make payments to the annuitant while he/she is still alive. The annuitant receives a pension for a minimum period even if the annuitant dies during that period. The annuitant therefore transfers the investment risk and the mortality risk to the insurer. The building blocks of a guaranteed annuity are generally a smoothed bonus fund.

“**Investment-linked life annuity**” (living annuity) is an annuity (paid as a monthly pension) based on a percentage (between 2.5 and 17.5 percent) of the annual value of the underlying capital. The annuitant (pensioner) chooses the underlying investments and takes the investment risk and mortality risk. The annuitant therefore remains in control of the assets. On the annuitant's death, the remainder of the capital is transferred to his/her estate. The building blocks of these annuities can be either a smoothed bonus funds or unit trusts. Unit trusts are the most transparent to the investor.

“**Stochastic model**” is a mathematical process whereby different economic scenarios are modelled in future years to come. These economic scenarios assist consultants in determining an optimal portfolio.

“**Strategic Asset Allocation**” is the process of dividing investments among different kinds of assets, such as stocks, bonds, property and cash, to optimize the risk/reward tradeoff based on an individual's or institution's specific situation and goals. It is a key concept in financial planning.

“**Unit linked policy**” is where the value of the policy is directly linked to the value of the underlying assets and where full transparency is available. Again these policies are issued by life companies and governed by the Long Term Insurance Act.

“**Unit trusts**” is where the underlying assets are valued daily and where full transparency is available. Unit trusts are governed by the Collective Investment Schemes Act. The investor can also at any time terminate (or withdraw) from the unit trust immediately, normally without any fee.

## Appendix E – Current market overview



### Market Overview - October 2008

#### SOUTH AFRICA

##### INTEREST RATES

Global G10 countries are either in recession or heading that way quickly. On 8 October 6 central banks lowered their interest rates in a concerted effort to provide liquidity. Locally, inflation came in slightly higher than forecasted, but is likely to have peaked, and with global interest rates down, SA should have ample capacity to follow suit.

##### INFLATION

Inflation is at is now at 13,6% for Aug. This should drop to around 12% in December and then into single digits in 2009. Money supply as measured by M3 plummeted in August to 15,4%. There still appears a high probability that the first interest rate cut could be in April 2009. This is supported by the base effect, modifying basket and oil price falling. The weaker rand is, however, a negative factor.

##### CURRENCY

Global credit concerns appear to be behind the quick sell off in the rand versus the US dollar to its current over R9/USD. This is a decline of around 30% for the year to date. This is in part US dollar strength. Given the global crisis, SA political risk, ongoing current account deficit etc, the longer trend is likely to be weaker against a basket of currencies.

	RSA Bonds ALBI	J203 ALSI	J210 Resources 20	J211 Industrials 25	J212 Financials 15	J253 Property
September 2008	2.4%	-13.2%	-21.9%	-7.7%	-2.1%	-3.3%
12 Month return	6.0%	-18.0%	-24.0%	-10.0%	-16.9%	-12.3%
Current PE (Price/Earnings)		9.4	8.7	12.1	7.6	
Long Term PE (Price/Earnings)		14.5	14.2	15.1	12.3	
Current DY (Dividend/Price)		4.3%	4.5%	2.7%	6.2%	
Long Term DY (Dividend/Price)		2.7%	3.3%	2.0%	3.1%	

##### EQUITY MARKET

Share prices have crashed back over August and September. In the last 3 months resources shares have fallen back 38%. The 2 large caps, Anglos and Billiton have been hard hit, down 59% and 52% respectively. Over this same period, industrials and financials have also been under pressure, but not to the same extent as resources. Over the last 3 months the Industrial index is down 5.9%, while to the end of September the Financial 15 index has had a 3 month gain of 11.9%. Interest rate sensitive property shares fared better over the last 3 months, up 23.1% off a low base. The US credit crunch together with a wave of pessimism has affected global asset prices. The JSE All Share index, weighted to resources, has been hard hit. A 50 year history of the JSE indicates that when values are at current levels, the following 5 year average return equates to an average of 20% per annum. There are no guarantees only degrees of probability.

#### FIXED INCOME AND PROPERTY

##### MONEY MARKET

During global crisis, money market rates remained at around 11%-12%. The yield curve remains inverted with longer dated bonds at far lower levels than cash. With a high probability of rates falling next year, investors will want to watch for the reinvestment risk of cash.

##### BOND MARKET

In this global credit crisis, bond returns have been positive as yields have fallen. Locally, the 3 month return from bonds was 12.6%. At current yields, bonds still represent a safe haven, but the outlook for real returns from 8,94% is not fantastic.

##### PROPERTY MARKET

Listed property has had an excellent 3 month return from a low base, before pausing in September. Yields above 9%, together with growth prospects, make property appear to be a better prospect than bonds at this stage.

#### Rand / Dollar

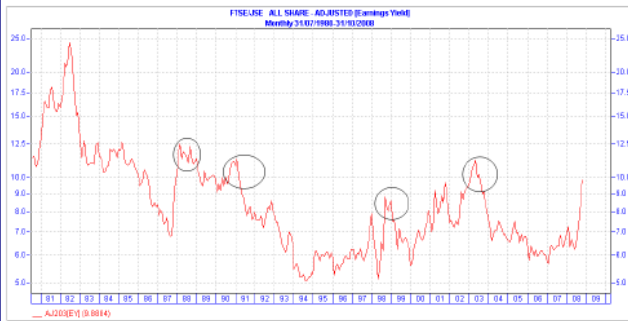


The depreciation of the Rand versus global currencies to a trough in December 2001, and the weakness in 2002 and early 2003, coincided with a low point in SA equities. From a global perspective, the best time to buy SA local equities was around 2002.

The rand has slipped back to R8,50/dollar, and then suddenly to almost R9/USD, the last time it was at this level was in January 2003.

The trend has turned and while there will be bounces of strength along the way, a negative trend becomes self reinforcing. At some point, a weak rand will provide an underpin to rand hedge resources.

## FTSE/JSE All Share Earnings Yield



This graph depicts the historical earnings yield of the JSE from 1981, with circles, relatively attractive entry levels.

The long term earnings yield from 1960 is approximately 8.55%. The last 10 year earnings yield is approximately 7%. The recent price weakness has taken the long term yield up (i.e shares have got cheaper) back to relatively attractive levels again.

Investors want to overweight when valuations are attractive, i.e. when yields are as high as possible. However because valuation is a function of earnings AND prices, its not that simple.

Buying at the beginning of 1994 (The JSE gained 53.7% in 1993), proved with hindsight to be expensive. The annual compounded return for the next 7 years was only 10.6% and for 10 years to end of 2003 the same at 10.7% per annum.

By contrast buying at the end of 1990 (note the higher yield) and holding for 10 years would have yielded an annual 14.8%. The market decline at end of 1998 and April 2003, proved to be excellent entry points.

**Prices have dropped substantially. There is value. But corporate earnings may start to come under pressure in this environment and this is likely to put some pressure on yields. However baskets of more attractive shares can be constructed and we will be looking for opportunity to increase equity exposure.**

## Global Markets yield on US 10 year Treasury note



### Chart A - US 10 year Treasury Yield

The yield on the US treasury 10 year bond has fallen back to a low of 3.49% - close to multi decade low.

In times of uncertainty, global cash has sought out a safe haven.

At its peak in 1981, the yield that investors accepted on US 10 year treasury paper escalated to around 16%. Over time riskier assets were sought out, and lenders were comfortable in receiving a lower yield on government paper.

This may change in the future. In the shorter term riskier assets have been dumped and cash flows to safe haven bonds have pushed yields lower, but in the medium to longer term, lenders may not be willing to accept 3.6% in USD terms.

### Chart B - Relative Valuation of JSE to S&P 500

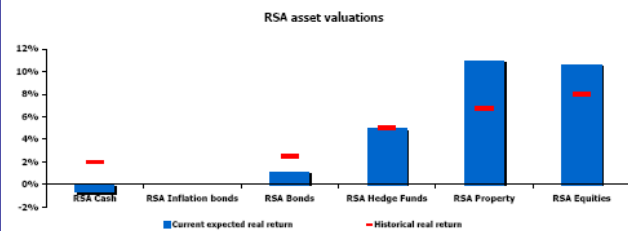
In relative valuation terms, South Africa along with most emerging markets move from times of being expensive to times of being relatively cheap.

In 1998 through the rand collapse of 2001 to 2002/2003, South African assets got very cheap on a relative basis. Since then they have been getting more expensive, while the US S&P 500 has, on a relative basis, been getting cheaper.

The current decline, both in the market and the rand versus the US dollar is bringing the local market and other emerging markets back in line to more normal relative valuations.



## LOCAL REAL EXPECTED RETURNS - Long term



This table provides an indication of the current expected real returns from local assets relative to longer term real rates from the assets.

- Cash is a temporary safe haven, but highly unlikely to provide real returns over the next 3 years and more.

- Bonds have already repriced over the last 3 months. Now not as attractive on current inflation outlook.

- Property yields have risen, and at around 11% historical definitely appear to be pricing in risk. Again like with equities, forward earnings growth may be more muted, but on a relative and absolute basis, there does appear to be value.

- The massive recent decline in equity prices and especially in certain sectors has resulted in value. This is seen in the historical yield which has now risen to over 10%. Compared to more recent and longer term average, this is very attractive. **Yes negative sentiment can get more pessimistic and drive prices lower and so for the time being we will remain slightly underweight.**

## Legend

Relative to benchmark			3 months	12 months
High under weight	--	Inflation	down	down
Under weight	-	RSA equities	--	+
On weight	=	RSA Resources	--	+
Over weight	+	RSA Industrials	--	+
High over weight	++	RSA Financials	--	+
		RSA Bonds	-	=
		RSA Cash	++	-
		RSA Property	-	+
		RSA Hedge funds	=	=
		Offshore	+	+
		OFF Equities	=	=
		OFF Bonds	+	+
		OFF Cash	+	=
		OFF Property	=	=
		OFF Hedge funds	-	=

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