

MARKET OVERVIEW - MAY 2009

SOUTH AFRICA

ECONOMY AND MARKETS

INTEREST RATES

As was widely anticipated interest rates in South Africa dropped by 1% with the repo falling to 8,5% and prime rate to 12%. The next meeting is on 28 May and the interest rate is likely to decline by a further 0,5% to 8%. The following rate decision will be in June, which at that stage there is also likely to be a further rate drop by 0,5% taking the repo rate to 7,5% and near its lows. Prime will move to 11%.

INFLATION

The CPI number for March came in a bit higher than expected at 8,5%. Inflation is proving to be sticky and the consensus for the April inflation due for release on the 27 May is 8,3% - so very little improvement. In the latter half of 2009 the rate should drop to around 7% and possibly lower by the end of 2009, given the higher base effect and rapidly slowing economy. PPI is expected to drop from 5,3% to 4% year on year.

CURRENCY

The slight increase in risk appetite saw a pick up in the carry trade, where foreigners bought the rand, making it one of the firmest currencies relative to the US dollar in 2009. It is exceptionally difficult to try and gauge the shorter and sometimes even the longer term relative moves of one currency versus another. The outlook for SA's balance of payments is negative, but the yields still remain attractive to foreigners.

	J203 ALSI	J210 Resource 20	J211 Industrial 25	J212 Financial 15	J253 Property	RSA Bonds ALBI
April 2009	1.6%	-3.0%	4.8%	5.2%	4.1%	0.96%
12 Month return	-30.3%	-42.7%	-19.9%	-19.3%	17.5%	15.0%
Current PE (Price/Earnings)	10.3	9.5	12.6	10.1		
Long Term PE (Price/Earnings)	14.5	14.2	15.1	12.3		
Current DY (Dividend/Price)	4.5%	4.3%	3.3%	6.4%		
Long Term DY (Dividend/Price)	2.7%	3.3%	2.0%	3.1%		

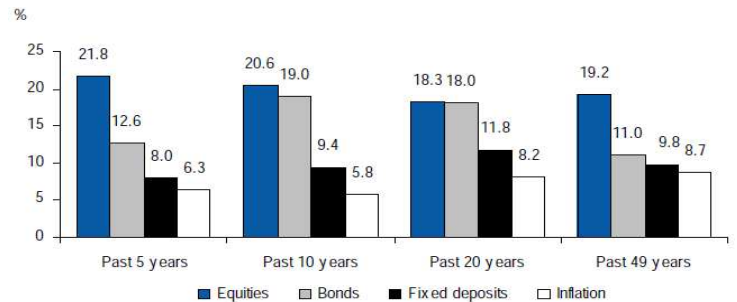
EQUITY

The recent JP Morgan report on the comparison of returns across property, own mortgage, Kruger rands, property unit trusts, fixed deposits, bonds and local equities continues to reflect that despite, or possibly because of, the high volatility, equities have continued to produce the best real after tax returns over longer periods of time.

One reason is that the value and price of a stake in a company has the ability to move up say 25%, or 35% in one year, which most other asset classes don't. The compounded effect of these gains, despite the occasional sharp drawdown, over many years is far superior to the compounded effect of other assets.

Despite the JSE All Share index losing 25,7% in 2008, an investment in the index held from January 2004, would have produced a 21,8% annual return. This compares to 8% for fixed deposit.

Arithmetic average annual rates of return - before tax to December 2008



Source: JP Morgan

FIXED INCOME AND PROPERTY

MONEY MARKET

With interest rates falling, shorter dated money market rates such as 3 month NCD paper continue to decline with rates now at 7,84%. With the expected further drop of 1% in the next 6 weeks, short term rates will fall accordingly. Money market starts looking less and less attractive.

BOND MARKET

At this stage SA still has one of the least attractive real rates on its bonds. Most money market managers have successfully avoided the long end bonds and over weighted cash. However as short term rates come down, more and more money will start to buy into longer duration instruments.

PROPERTY MARKET

Listed property has outperformed local equities, but there are some concerns. Locally property contains an element of gearing and while interest rates have and will decline further, an increase in vacancy rates will be negative for yields. Investors can't really expect a re-rating to compensate for the lower yields.

JSE All SHARE INDEX



We have updated the graph of the JSE All Share index over a 2 year period this month.

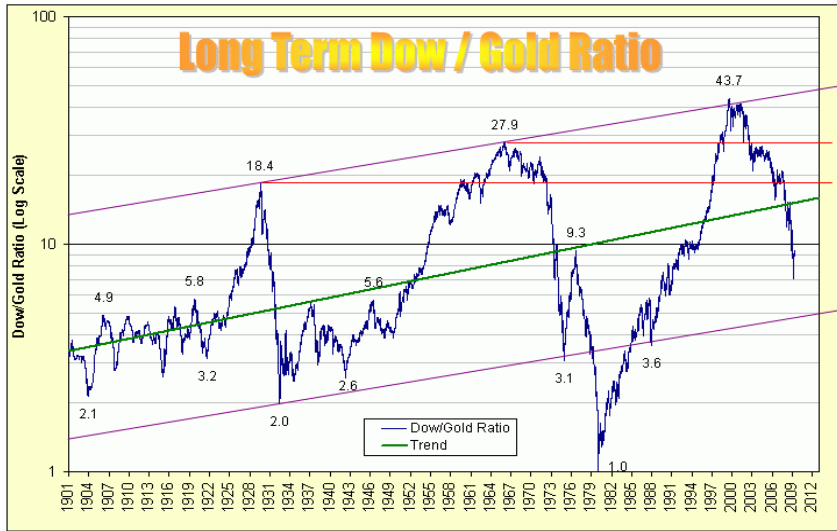
A sideways price movement can be very frustrating for investors as they look at their investment statements on a monthly basis. Some months their numbers are slightly up and the next month slightly down - but the aggregate it just does not appear to be going anywhere.

This is compounded when news reports highlight certain large moves, which you just cannot see in your portfolio. For example from the low in March, the JSE All Share index is up some 20%, but when one measures from the beginning of the year, it is up just 3%.

There is still a probability that the index trades sideways and comes back to test the recent lows. At these firmer prices, however, there are definitely more and more bullish investors around.

Our shorter term outlook remains cautious despite the apparent value, but taking a medium to longer term view we will look for opportunity to move to an overweight position.

RATIO OF PAPER ASSETS TO PHYSICAL ASSETS



Source: Sharelynx.com

This chart is a ratio of the US Dow Jones Industrial average - The Dow - to an ounce of gold in US dollars. Because both are priced in US dollars, what the index is essentially saying is looking at is how many ounces of gold will it take to buy the Dow Jones.

The Dow Jones is a price index of 30 of the largest US shares. It has had its problem companies - such as AIG and more recently GM which it will eliminate and replace with another large company - but it is a widely followed index of how well corporate US is doing.

When priced in US dollar terms, because of dollar depreciation, it looks more attractive than it really is. The index started at 40.94 in 1896 - making a high of 14164 in October 2007, giving a theoretical 5.4% compounded annual return. Remember this excludes dividends from the companies concerned, which on average would add a further approximate 3%.

Priced in an ounce of gold however it has moved up from around 5 times, peaking in the late 1960's and again in the late 1990's early 2000 when the Dow spiked through 11 700 in the technology bubble and the price of gold languished at around \$280/ oz.

At its extreme gold traded at 1 times Dow in 1980 and the Dow at 43.7 times an ounce of gold in the 2000 bubble. With gold moving up steadily since 2000 to its current \$950 and the Dow falling back, the ratio has come back to a more normalised level of around 9 times.

It is not prescriptive as to where the ratio will move to in say the next 2, 3 or 5 years even with this history, however the trend indicates that gold may continue steadily up relative to a unit of the Dow.

GLOBAL MARKETS - THERE IS VALUE IN RISK ASSETS

At the end of 2008 the S&P 500 closed at 903. Now, almost 5 months later, it is exactly back at this level. However it fell to an intra day low of 666.79 - some 26% down, before gaining 36% from this low at the beginning of March.

In US dollar terms, many foreign markets are up fairly sharply for the year as a whole.

The JSE is up around 14% in dollar terms and 52% from its March low.

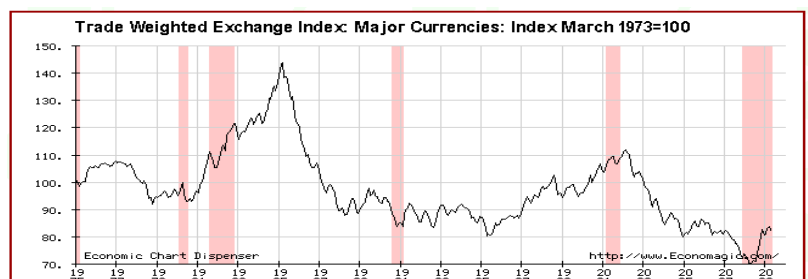
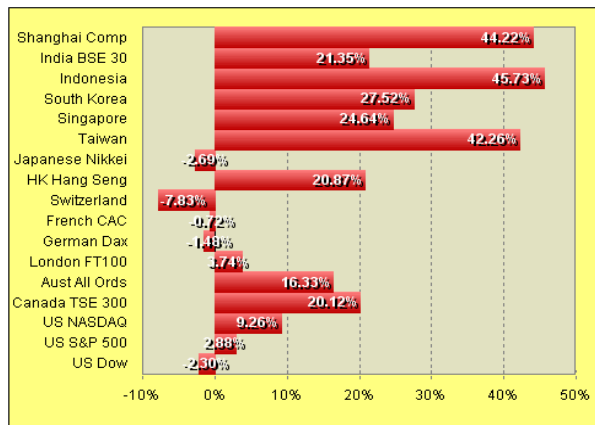
China is up 44%, Indonesia is up 45% and Taiwan up 42%.

The next chart is the US dollar index, or more correctly the Trade weighted index. The period 2002 to mid 2008 saw a long run depreciation of the US dollar against its trade basket to a new low of around 70.

When the financial crisis took hold in mid and then more substantially in late 2008, global investors became risk averse and returned their global assets to the safety of the US dollar and US treasuries, strengthening the dollar against a basket.

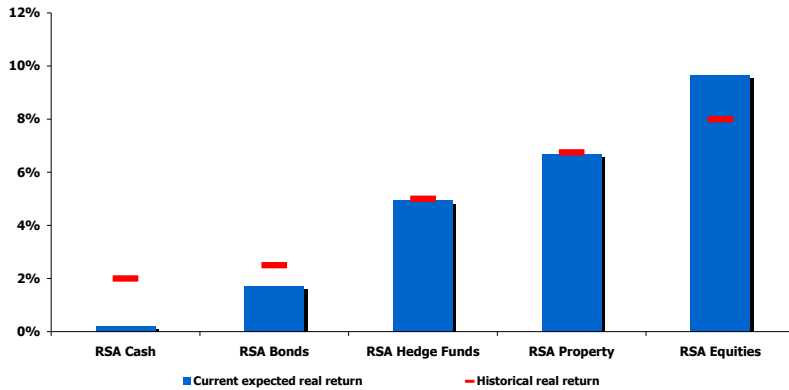
This upward move in the US dollar, triggered by risk aversion, is seen by many as a "temporary blip". In 2009 as investors have become less risk averse in 2009 so the US dollar has weakened slightly.

While we believe that the US dollar will continue to depreciate against real goods in the long run, this is not necessarily the case against other currencies, where fundamentals are difficult, if not impossible to determine.



LONG TERM EXPECTED REAL RETURNS

RSA asset valuations



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

Despite the recent volatility in prices, the longer term valuation outlook has not changed too much. The longer real asset prices remain depressed, the better the long run returns.

- Cash has been a temporary safe haven, but increasingly so it is not going to provide an adequate return to investors as rates come down.

- Bonds yields are hovering around 8%. They remain expensive, especially against the backdrop of rising issuance from government that is moving from a fiscal surplus to a fiscal deficit.

- Property yields have come down as companies have reported. While the valuation differential between property and bonds appears to be reasserting itself, property is not massively cheap and there are some risks. Selected managers have started nibbling at property shares.

- There is value in the current equity prices. Historical yields are attractive. The big question remains, have prices fully anticipated the ongoing decline in earnings, margins and ability to pay dividends. We continue to watch earnings announcements to try and gauge the extent to which they have been priced in and look for opportunity to move to overweight.

HOUSEVIEW

LEGEND - RELATIVE TO BENCHMARK

High Overweight	++
Overweight	+
Neutral	=
Underweight	-
High Underweight	--
Change from previous month	BOLD

3 MONTHS 12 MONTHS

Inflation	down	flat
RSA Equities	-	+
RSA Resources	-	+
RSA Industrials	-	+
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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