

MARKET OVERVIEW - MARCH 2009

SOUTH AFRICA

ECONOMY AND MARKETS

INTEREST RATES

With global interest rates at all time lows, central banks have now started a process of "quantitative easing" - a euphemism for printing money. Locally there is still a possibility of an intra meeting interest rate cut before the next meeting in mid April, when a further 1% is currently expected. The repo rate is currently at 10.5% and prime currently at 14%.

INFLATION

Consumer price inflation for January 2009 came in a bit higher than expected at 8.1% from 9.5% in December. Producer Price Inflation is at 9.2%. The consensus for headline inflation in January was 7.5%. Once again food inflation was on the higher end. The trend remains down off the higher base, but some components such as the fuel have probably seen their best price declines for a while.

CURRENCY

Global currencies are increasingly volatile, and this makes trying to forecast the rand very difficult. Capital flows are seeking out perceived low risk because yields are almost non-existent. The high probability of interest rates declining does not help the rand's direction. If anything, with risk aversion top priority, the rand is likely to depreciate relative to other currencies and the USD especially for the foreseeable future.

	J203 ALSI	J210 Resource 20	J211 Industrial 25	J212 Financial 15	J253 Property	RSA Bonds ALBI
February 2009	-9.9%	-8.8%	-11.0%	-12.2%	-2.8%	-2.9%
12 Month return	-37.6%	-47.7%	-25.0%	-36.2%	-1.0%	12.5%
Current PE (Price/Earnings)	8.2	8.4	10.9	5.3		
Long Term PE (Price/Earnings)	14.5	14.2	15.1	12.3		
Current DY (Dividend/Price)	5.3%	5.1%	3.8%	8.1%		
Long Term DY (Dividend/Price)	2.7%	3.3%	2.0%	3.1%		

EQUITY

There is absolutely no doubt about the extent of the problems in global economies. It's now very apparent that the financial credit crunch froze global trade from the 4th quarter of 2008. The global deleveraging continues to have a devastating effect on global GDP, sales, employment, company profits, tax revenues, commodity prices etc.

In this extreme environment it is natural that prices of companies will be under pressure, but the widespread economic malaise has brought on large doses of investor fear exacerbated by the ever present negative market news. It's ongoing fear that has continued to drive owners of assets out of these assets, driving prices lower, therefore creating a self-perpetuating cycle.

With cheap prices some value managers are finding good investments. There are some local companies that are now trading at very low multiples of their earnings, with low levels of debt, high cash or near cash on their balance sheets and ongoing ability to pay out dividends.

The overall dividend yield of the market is just over 5%, which gives an indication of the value, but will be skewed by many companies slowing or suspending their current dividend payments. The stage is being set for longer term positive real returns from these depressed levels. The big question now is "At what prices are these attractive enough to increase exposure to this asset class?"

FIXED INCOME AND PROPERTY

MONEY MARKET

As expected shorter dated money market rates such as 3 month NCD paper has come down to 9.73%. These were trading at 12% at the beginning of December 2008 and gives an indication of the reinvestment risk for investors that take too short term an investment horizon.

BOND MARKET

Low yields on government bonds may persist for some time. We consider all long bonds to be very expensive. Yields on the R157 have remained steady around the 8% level - currently at 7.89%. Strip away an inflation at say 5% and tax on the nominal, and there is very little margin of safety.

PROPERTY MARKET

Listed property has outperformed local equities, but still gave a negative return. The yields are reasonable, but likely to suffer from growing vacancies. While a lower interest rate environment may appear favourable, property yields track long bond yields over the longer term, which is not as positive.

GOLD



We highlighted the graph of gold in USD last month. The steady uptrend - albeit with a large dose of volatility - has been contrary to other commodities.

Gold acts as the ultimate store of value - i.e. over centuries it has tended to retain its purchasing power ability. The long term trend for the price of gold measured in US dollar terms appears very positive given that the interest rate on US dollars has been cut back and governments are having to print more US dollars to plug the holes left by the banking system in the wake of the credit crisis.

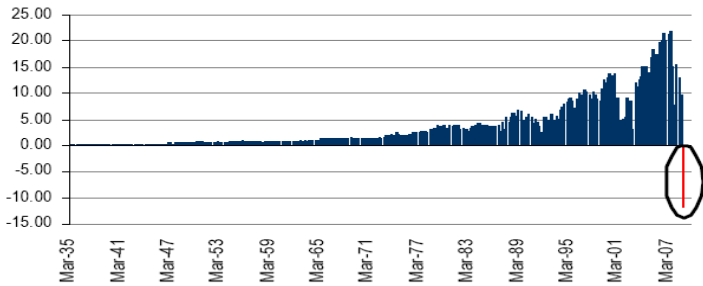
Gold companies naturally benefit from the firmer price and in SA on the weaker rand. In this respect they are geared to a rising rand price of gold, which has risen to over R300 000/kg.

Gold companies have suffered from lack of investor interest due to many years of not delivering against expectations. Towards the end of 2008 share prices were very low relative to the bullion.

The graph reflects the SA gold index relative to the gold price in rands.

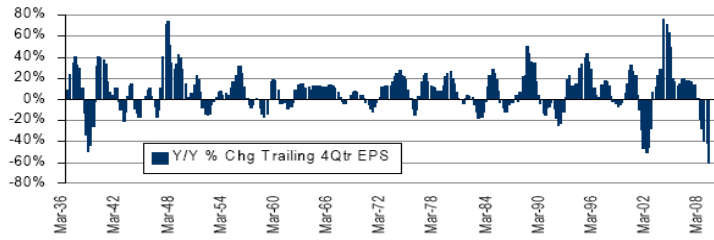
US S&P 500 EARNINGS

Chart 1: S&P 500 Quarterly EPS (\$)



Source: BAS-ML Investment Strategy, Standard & Poor's

Chart 2: S&P 500 Profits Cycle (From 1935)



Source: BAS-ML Investment Strategy, Standard & Poor's

In continuing to look at earnings as the long run driver of share prices, it's instructive to view what is currently happening to global corporate earnings. We continue to read about billion \$ losses and write offs across the multinationals and now for the first time ever, the quarterly reported EPS for the 500 companies that make up the S&P500 index was negative, with almost all the companies having reported.

Chart 2 indicates that while over the extended period of time, the nominal increase is up, earnings are cyclical. Coming off a high base the extent of the decline in corporate earnings is the largest ever recorded.

The last time earnings collapsed was in the 2001-2002 years, before moving up substantially as the low cost of debt allowed for excessive gearing. The current earnings collapse is proving to be extremely deep - hence the debate as to the new paradigm.

In 4th quarter 2002 EPS went as low as \$3 from a previous high of \$13.74 in March 2000. At the time these 4th quarter 2002 earnings numbers were firmed, the market had already made a low and started to steadily move up from there - gaining 100% from this level to its peak.

Currently the earnings number has been dropping for 6 quarters from a peak in June 2007. **The steep negative loss for the 4th quarter 2008 may prove to be the bottom if the Merrill Lynch forecasts for 2009 are to be believed.** Analysts are capitulating in their forecasts and so a lot of really bad news is getting priced into shares.

GLOBAL MARKETS - Dow at 5000?

The widely followed Dow Jones Industrial index continued to make fresh lows, now back at 1997 levels. Over the years the underlying constituents of this index have been rotated. Some of the companies that have seen prices decimated and so drag down the Dow in recent times include Bank of America, Citigroup, General Motors, and General Electric.

In September 2002, bond manager Bill Gross wrote a piece, titled "Dow 5000". At that stage the Dow was trading around 8500. Setting out his reasoning based on fundamentals, he maintained that "stocks stink and will continue to do so, until they are priced appropriately, probably around Dow 5000, S&P 650..."

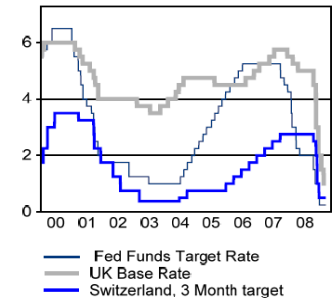
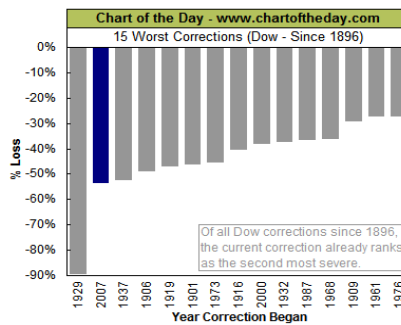
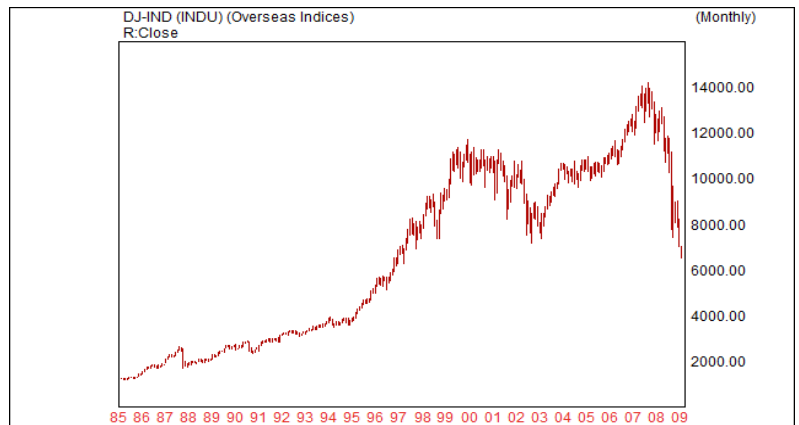
His reasoning was sound, US shares remained expensive and had been declining from a peak of 11500, but what he did not factor in was the impact of monetary stimulus. Interest rates had been taken down to 1% in the US, which boosted lending in various forms and in turn asset prices.

The excessive leverage is what we are all paying for now, but once gain and now in bigger measures, central banks are taking interest rates to zero and printing money. Now however there is little appetite for more debt, but this will not stop the resolve of central banks to create more money and "buy" their fresh issue of bonds.

This time around, there is a high possibility that the Dow gets to the 5000 level. The S&P500 is remarkably close to the 650 level.

We are reaching a point of maximum pessimism in equity prices, and while the underlying fundamentals remain weak, there is a risk for those out of the market that prices have a large up rally from the very oversold levels.

The charts reflect the Dow, an historical context of the decline in the Dow - now the second biggest correction on record and the 3rd graph the base rates across 3 main countries.

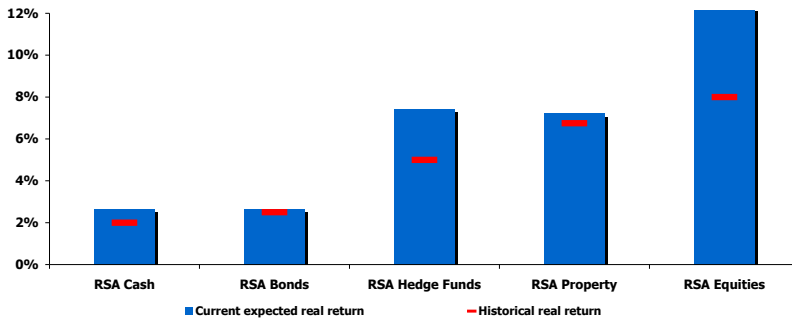


Of all Dow corrections since 1896, the current correction already ranks as the second most severe.

— Fed Funds Target Rate
— UK Base Rate
— Switzerland, 3 Month target

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 is a temporary safe haven, but not likely to provide real returns over the next 2-3 years, especially after tax.

- Bonds yields are down again at under 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.

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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