

MARKET OVERVIEW - JULY 2009

SOUTH AFRICA

ECONOMY AND MARKETS

INTEREST RATES

The repo rate has been slashed back dramatically from a recent peak of 12% in June 2008 to its current 7.5%. The expectation at the end of June was for a further 0.5% cut but this was not to be. We have now possibly seen the last of the rate cuts - a full 4.5% over the last 6 months. The failure to cut rates again was surprising, but inflation remains on the high end.

INFLATION

The CPI number for May again came in a bit higher than expected at 8.0%, although this is down from a peak of 13.7% in August 2008, it continues to remain on the higher end of consensus. The forecast is for this to drop down to 7.3% in June and then down to around 7% for the second half of 2009, with the higher base effect and rapidly slowing economy.

CURRENCY



	J203 ALSI	J210 Resource 20	J211 Industrial 25	J212 Financial 15	J253 Property	RSA Bonds ALBI
June 2009	-3.1%	-9.0%	0.2%	4.7%	0.8%	-0.23%
12 Month return	-24.9%	-43.9%	-7.3%	3.2%	-8.6%	19.3%
Current PE (Price/Earnings)	10.7	9.2	12.7	12.3		
Long Term PE (Price/Earnings) 10 years	14.5	14.2	15.1	12.3		
Current DY (Dividend/Price)	3.9%	3.6%	3.0%	5.3%		
Long Term DY (Dividend/Price) 10 years	2.7%	3.3%	2.0%	3.1%		

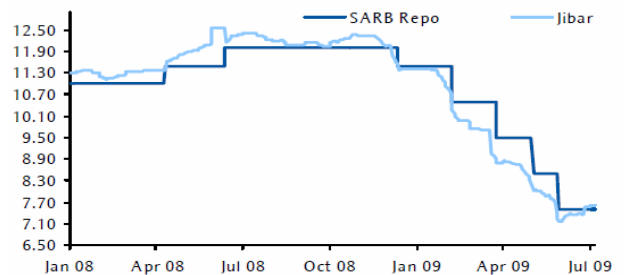
MONEY MARKET INVESTMENTS

Many investors are now suffering what is termed reinvestment risk. In a very short space of time short dated interest rates have fallen substantially. Globally this is even more pronounced with short dated interest rates coming down close to zero percent.

Despite the very low interest rates, at least they have been positive when compared to the negative total return over the last 12 months for investments into local equity.

Now going forward the depressed equity prices has resulted in more attractive yields. By comparison yields on shorter dated money market investments had moved down substantially and investors are not likely to be compensated for inflation running 8% and upwards.

Chart: SARB Repo rate and 3-month Jibar



FIXED INCOME AND PROPERTY

MONEY MARKET

We may be reaching the end of the interest rate cycle. The 3 month Jibar and the 3 month NCD, which is an indication of money market rates, traded at 7.7%. Slightly longer dated NCD do not provide much additional pickup. The 6 month is actually trading at 7.28% and the 12 months at 7.99%.

BOND MARKET

Local bonds have lost ground this year as yields have moved up. An investment into bonds lost 4.86% for the 6 months to end of June. The market locally became somewhat jittery about government's likely increase in issuance. The yield on the R157, which matures in 2015 is 8.7%. Both in absolute terms and in relative terms bond don't appear attractive.

PROPERTY MARKET

Listed property continues to struggle. While a defensive asset class generally, there is some concern about leases expiring in 2 years and beyond, which may not see the upward re-rating that we have been accustomed to. A growing vacancy element is also of concern. There is still a positive gap between leases expiring now and current rental rates, even though these spot rental rates have softened from the peak. Yields are running at 7%.

JSE ALL SHARE INDEX



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

For the time being the sideways movement of the overall market remains intact having extended the upper limit to 23 661.

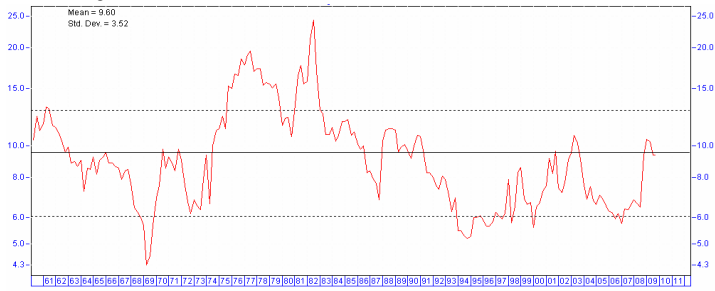
There is a close correlation of the local market to global equity markets, which have all moved up firmly in the last 3 months, but also showing signs of reversing.

With Chinese shares and commodity prices continuing to move up in general, there is some underpin to local resource shares.

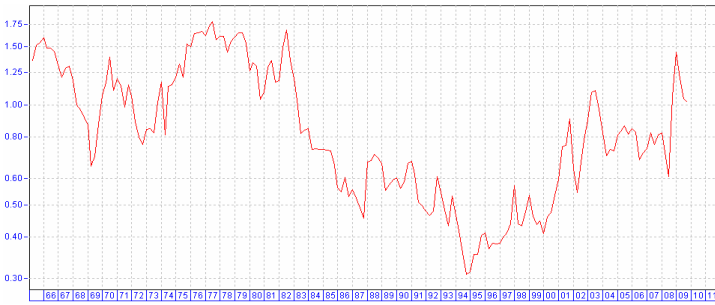
Our shorter term outlook remains cautious despite the apparent value, but taking a medium to longer term view we will look for opportunity to move to an overweight position.

JSE EARNINGS YIELD AND RATIO OF ALL SHARE EARNINGS YIELD TO 10 YEAR SA GOVERNMENT BOND YIELDS

JSE earnings yield



JSE earnings yield / yield on 10 year bond



These two charts paint a long term picture of SA equity valuations.

The first is the earnings yield of local equities from 1960 to date. The average earnings yield (EY) over this time is 9.6%. The EY is the inverse of the PE ratio, but in many respects EY is easier to understand.

A company such as Pick n Pay for example has a current price per share of R35. The last 12 months produced headline earnings per share of R2.08. Shareholders will benefit from these earnings by way of a dividend and with the surplus being reinvested for future growth. In the last year shareholders received a dividend of R1.70 from total earnings.

The EY for Pick n Pay is currently at 5.9%. An investor paying R35 is at least expecting a 5.9% historical yield and because earnings should move up, a slightly higher future yield.

The average yield over the years across all listed shares has been 9.6% with at times investors prepared to accept as low as an average of 5% in 1994 and far less in 1969, when shares were very expensive.

The average yield for all shares on the JSE is at currently its long term average.

The second chart is a relative chart against the 10 year bond yield. At a ratio of 1 times, investors can expect the same yield from shares as they can expect from long term interest rates.

This indicates that shares are relatively attractive in terms of valuation, but also indicates that investors are possibly nervous of earnings falling back from high levels over the next year or so. The last time this ratio was at this level was in 2003.

GLOBAL MARKETS

Looking to global yields, we find the following:

In many cases prices of real assets have sufficiently declined so that valuations are once again back to reasonable levels again, but this is however not true across all markets.

This is seen in the attached first chart of price to earning multiples across various global markets. A 14 times PE for the US is a yield of 7%. At this yield on a relative basis when compared to 3.3% yield on 10 year bonds, shares are attractive.

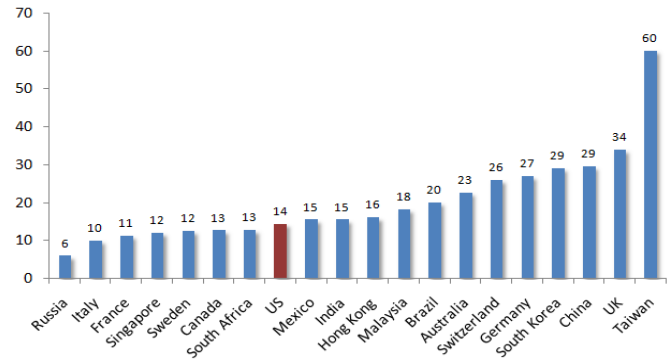
The second chart is the yields on the US 10 year Treasury notes from 1970 to date. The 25 year period of declining interest rates has allowed global companies to take on more and more debt, replacing shareholders equity. The availability of debt also allowed company mergers and acquisitions, which further boosted return on owners equity.

At the same time the refinancing of this debt became cheaper and cheaper, which had a natural and sustained income boost to leveraged balance sheets.

The risk is now that we are close to the bottom as far as both shorter dated and longer dated interest rates can go. Some investors may be satisfied with a nominal return of 3.3% on 10 year bonds, but there is a risk that interest rates move back to a level that more closely reflects the risks and the supply and demand mechanics.

The risk for all investors is that the suppliers of capital, start to demand a more realistic yield on their capital, especially in the face of greater issuance. In this environment yields on bonds will trend upwards. Global equities should fare better coming off a far less expensive base, but a rising interest rate environment is not ideal.

Country P/E Ratios

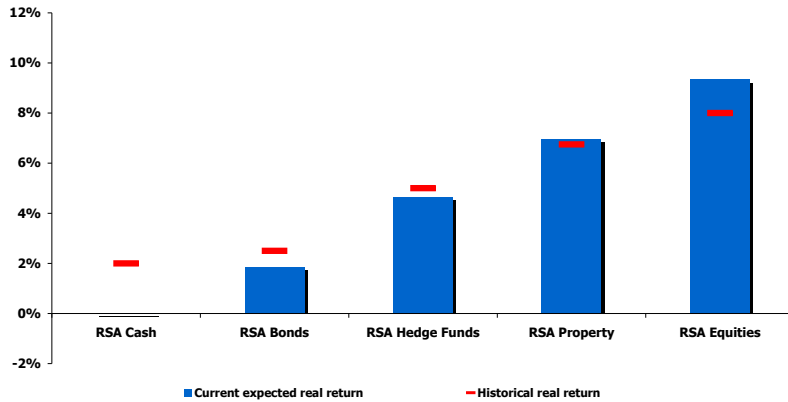


10 Year US T-Note Yield



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.

- Inflation linked and ordinary bonds are indicating an implied future inflation rate of 6.55%. The current historical rate of 8% inflation and proving sticky.

- Money market rates are yielding around 7.5% and therefore even before tax going forward they will not produce a positive real return. Historically before tax money market should yield 1.5% to 2% real rate. i.e. cash is proving to be expensive at the current yields.

Bonds have been expensive for a while now and in June and July the yields moved up to 8.78% for the R157 on the scare of additional issuance. Bonds have lost 4.86% for the year to date. At current yields relative to longer run expected inflation, they are still not fantastic value.

- Local property yields have improved slightly as prices have come off. On a historical basis the yields look attractive relative to other asset classes. Some property companies are trading at discounts to net asset value.

- The long run average earnings yield for an investment in local equities is 9.6%. The current yield for all equities is at this level at 9.4%. We can conclude that equities are reasonably priced.

HOUSEVIEW

LEGEND - RELATIVE TO BENCHMARK

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

3 MONTHS 12 MONTHS

Inflation	flat	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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