

MARKET OVERVIEW - APRIL 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. South Africa remains relatively slow in reducing interest rates in comparison to other countries. The MPC will announce the rate change on the 30th April and the consensus is for a drop of 1% to a repo rate of 8.5%. Banks' prime lending rate should drop to 12%.

INFLATION

Consumer price inflation for February 2009 came in a bit higher than expected at 8,6% from the 8,1% in January. The CPI number for March will be released on the 29th April and this should fall back down to the January level. Due to the high base cost effect, PPI for March should come in at around 5,7%. The stronger rand and benign oil price should contribute to the rate of inflation steadying down in the next few months.

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
March 2009	11.0%	14.6%	7.0%	14.1%	2.6%	0.04%
12 Month return	-28.5%	-38.1%	-19.3%	-21.8%	5.8%	13.1%
Current PE (Price/Earnings)	9.9	9.1	11.9	10.1		
Long Term PE (Price/Earnings)	14.5	14.2	15.1	12.3		
Current DY (Dividend/Price)	4.7%	4.5%	3.5%	6.4%		
Long Term DY (Dividend/Price)	2.7%	3.3%	2.0%	3.1%		

EQUITY

An investment into listed equities has been a very poor investment over the last 12 months. There is a high correlation across all global markets and the local JSE remains in a fairly tight trading range, far off the peaks of May 2008.

Investors need to understand that price movements of shares are FAR more volatile than the underlying steadier gains in intrinsic value. When prices are moving up investors feel more comfortable to invest, despite the same rands buying less value. Conversely when prices have fallen substantially, investors feel less enthusiastic about buying, despite the same rands buying more value.

The average PE of the JSE has fallen to and remains at below 10 times. This is historically cheap, but in March 2003 it fell to around 8 times. Admittedly it may still be understanding the higher company earnings, which should slowly unwind in 2009 and into 2010. So from a valuation perspective investors should not be concerned about their investments in the stock market, nor about steadily increasing their exposure. From a timing perspective however it does appear that we have some time on our hands. Because enthusiasm has been severally tempered there is no panic to buy into shares resulting in prices drifting sideways.

This is an excellent scenario for long term investors who remain underweight listed equities.

FIXED INCOME AND PROPERTY

MONEY MARKET

With interest rates falling, shorter dated money market rates such as 3 month NCD paper has come down from 2 months back of around 10% to currently 8,56%. As interest rates are dropped by another 1% at the end of April so money market starts looking less and less attractive.

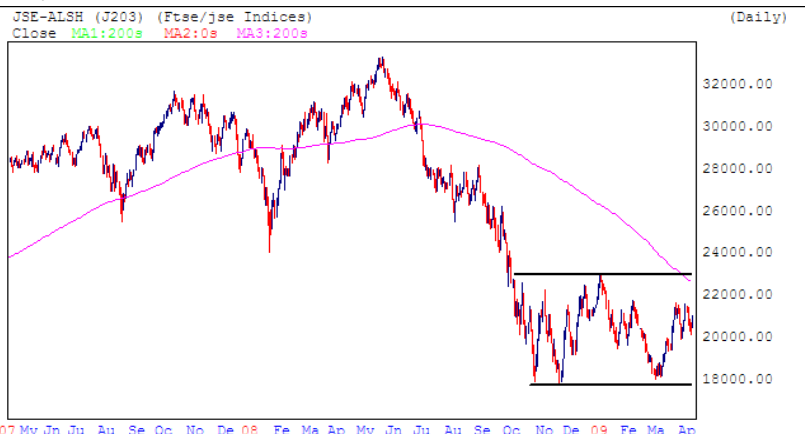
BOND MARKET

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 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 may at these levels as higher risk is factored into prices.

JSE All SHARE INDEX



The graph of the JSE All Share index over a 2 year period reflects the steep decline in prices from May 2008.

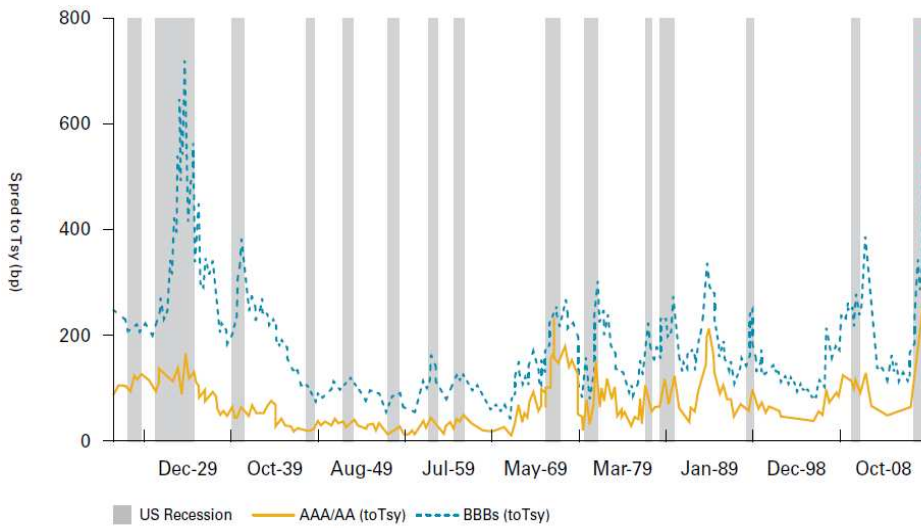
The index made a low of 17812 on the 27 Oct 2008, moved up through 22 000 and then fell again to a low of 18120 On 3 March.

For now at least the broad sideways pattern is intact. This is understandable given the standoff between those investors that are positive and those that are negative.

During this sideways pattern, our view has to rather remain slightly underweight. While there was some expectation that the March rally would take prices back and possibly through the 22 000 level, this quickly lost steam.

Our current view is to slightly overweight equities where possible should the index come back to 18 000 and underweight should it reach the 22 000 level. Clearly there is also risk in this strategy but despite attractive valuations, while levels of uncertainty remain at the high end, we will remain underweight.

US CORPORATE YIELD SPREADS



Source: RE.CM, Moodys, Yield Book, NBER, Morgan Stanley Research

While not that prevalent in South Africa, in the US many companies, prompted by low interest rates, raised finance by issuing debt.

Where the US government is currently issuing 10 year debt at 2.9%, the yields on corporate debt, depending on the rating and perceived riskiness, is trading at levels not seen in the past.

The chart indicates the yields of AAA and BBB corporate bonds over the US government treasury yields.

Sparked by the failure of Lehman Brothers and perpetuated by the ongoing crisis, many companies, especially financial institutions, find themselves unable to service their debt obligations. Owners of this debt have been sellers and with a general low appetite for risk, buyers have been few.

At the same time rating agencies have been downgrading debt, which in turn forces owners out.

The result of all of this has been a very sharp rise in yields, which now probably more closely reflects the true riskiness of owning corporate bonds.

However an investor must always make an assessment of whether he is being paid to take on risk. So yes, there is risk in owning corporate bonds, but if the yields are 6, 7, and 8% above treasury yields and a large portfolio can reduce company specific risk, then this area looks like a good opportunity.

GLOBAL MARKETS - THERE IS VALUE IN RISK ASSETS

Last month we highlighted the fact that there is still a possibility that the US index, the Dow Jones Industrial Average, has not yet made its low and despite rallies, the index makes fresh lows.

From a valuation perspective however value investors get excited when prices are down.

It means that prospective returns from a lower price become that much more attractive.

One US based firm, GMO, has up until recently had a long held bearish view on valuations, but has become very positive in recent months about annualised 7 year returns from these levels. While they concede that prices can still decline, their approach is to overweight assets when prices are cheap.

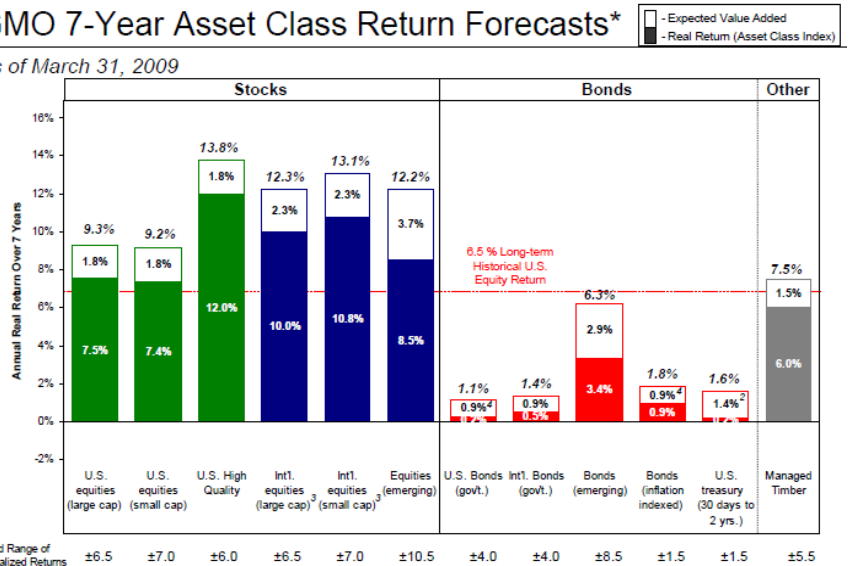
It is a widely known and oft quoted fact that an investment into listed equities across various countries has given an approximate 7% - 7.5% annual rate of return above inflation. However because the return from equities is not smoothed, this average means that many times investors are earnings far above and far below the required 7.5%.

Right now entry prices are low and so while risk appears higher because of the recent slide in prices and the higher volatility, risk is actually lower than it was 12-18 months back and prospective returns are higher.

BUT, and here is the rub. Because of the incredible flight to safety, the ongoing credit crunch, lower corporate earnings, there is a possibility that enthusiasm for risky assets remains muted for some time and investors make no or worse yet, negative returns for the first 12 months or 24 months, before producing the very probable 7 year average of 13% real.

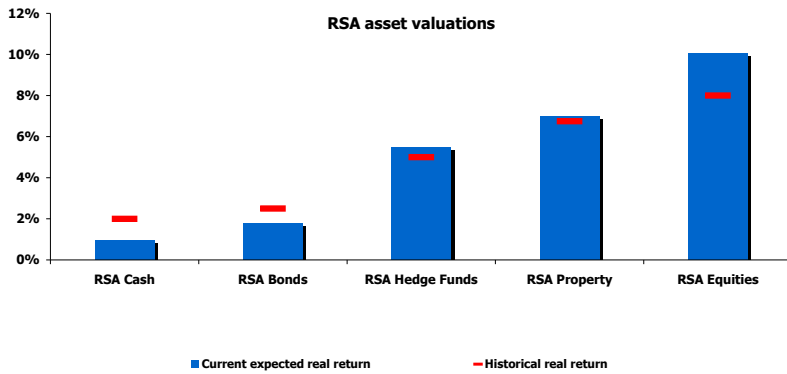
GMO 7-Year Asset Class Return Forecasts*

As of March 31, 2009



Source: GMO

LONG TERM EXPECTED REAL RETURNS



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 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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