



financial services group

MONTHLY MARKET REPORT OCTOBER 2010

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OCTOBER 2010 COMMENTARY

Before we begin (again)...

We seem to have struck a rich vein of form with September's edition of this Report drawing an equal amount of positive responses to that elicited by August's edition. Again we extend our heartfelt thanks to those who took the time to respond. Previous editions of the Monthly Market Report (MMR) can be found on NFB Asset Management's website (www.nfbam.co.za), together with the Fund Fact Sheets of the various funds we manage.

A Punchier Letter

As there is so much to comment on we thought we'd take a different approach to this edition of the MMR. Instead of an essay dedicated to one or two particular topics we thought we'd address several in punchier, bullet point format. Let's begin:

- Six hundred billion dollars - the size of the US Federal Reserve's latest round of Quantitative Easing (also known as QE2) - is a frighteningly large amount of money. If someone were to give you a dollar every second - why they would do so is irrelevant - it would take them 19,000 years before they had given you 600 billion dollars. And even so they would still be 405 million dollars short. Frighteningly large amounts of money have economic and market effects, though they may lurk under the bed for a while.
- The Fed's express intention with QE2 is to lower medium term interest rates; having already done everything they can to lower short-term interest rates by lowering the Fed Funds Rate right down to the zero bound (central banks cannot lower interest rates below 0%, hence the term "zero bound"). A side effect - or unexpressed intention - is that 600 billion dollars have been thrown at weakening the dollar. A weaker dollar equates to a stronger rand. Those who have been asking for the South African Reserve Bank (the SARB) to weaken the rand must now be hard pressed to come up with a way for the SARB to create 600 billion dollars of counter-currency measures. Perhaps hard pressed is too gentle. Impossible is more like it.
- Speaking of the SARB; Gill Marcus - the Governor of the Reserve Bank - and her fellow Monetary Policy Committee Members are highly likely to lower the South African Repurchase Rate by a further 50 basis points during November. By the time you read this they may already have done so. That will bring total cuts for the year to 150 basis points, following the surprise cut in March and the fully-anticipated cut in September. Total cuts for the cycle would then amount to 650 basis points, since rates peaked at 12% back in June 2008. And further cuts cannot be completely ruled out. Expect further commentary on this from us over the next few months.
 - As an aside in June 2008 a mortgage bond of a million rand financed over the traditional 20 year period at the prime overdraft rate would have attracted monthly payments of around R13,500. A similar mortgage taken out at the end of November - assuming rates are cut again - would attract payments of R9,000. That is a significant fillip to anyone's income statement. Put another way: a R13,500 monthly payment gets you a R1.5m mortgage. That's a lot more home than it bought in June 2008.
- One of the reasons compelling the SARB to lower interest rates is that inflation has hit a level of just 3.2%, consistently surprising economists on the downside. Whilst we anticipate that the majority of inflation's deceleration is behind us we do believe that inflation is likely to remain lower for longer. The risk, therefore, of a policy error - i.e. lowering rates and then finding inflation accelerating through the upper limit of the target range - is minimal. However, lowering interest rates in an attempt to weaken the rand is not only pandering to the masses but, also, is folly of the first order.
- Changing tack: we note with some measure of concern the blow-out in CDS - credit default swap - rates in Ireland and Greece. CDS rates are a measure of the cost of protecting against default, we simplify greatly here but the point remains valid. Should these rates continue to expand there is an increasing risk of European Sovereign Credit Crisis 2, with attended weakness in the euro relative to the dollar - though whether SC2 overwhelms QE2 is almost anyone's guess.

We trust that you've enjoyed the alternative format of this month's Report and look forward to being in touch with you again in a few weeks for what will be, incredibly, the last MMR of 2010.

OCTOBER 2010 DATABANK

	Index Value	Last Month	Year-to-Date	12 Months Ago
SA Repo Rate	6.00%	-0.00%	-1.00%	-1.00%
JSE ALSI	30,430.90	3.31%	9.99%	15.44%
ALBI	344.75	1.04%	15.30%	16.79%
R157	7.04%	7.30%	8.39%	8.41%
USDZAR	6.98	0.39%	-5.61%	-10.56%

All charts and data are sourced from I-Net Bridge.