



financial services group

MONTHLY MARKET REPORT AUGUST 2009

Asset Management

AUGUST 2009 COMMENTARY

On Interest Rate Aggression

During the month the South African Reserve Bank surprised the broader market by lowering interest rates by an additional 50 basis points, taking the repurchase rate down to 7% and cumulative interest rate decreases to 5%. Interest rates are now at the same low achieved in 2005/06 and the forward rate agreement (FRA) market has begun pricing in the probability of a further 50 basis point reduction before the end of 2009.

Whilst those who are indebted will most certainly welcome this latest cut in interest rates there is commentary in the market that the Bank has been too cautious. Consider that the Bank of England cut interest rates in half when they lowered the Overdraft Rate from 1% to 0.5% back in March this year.

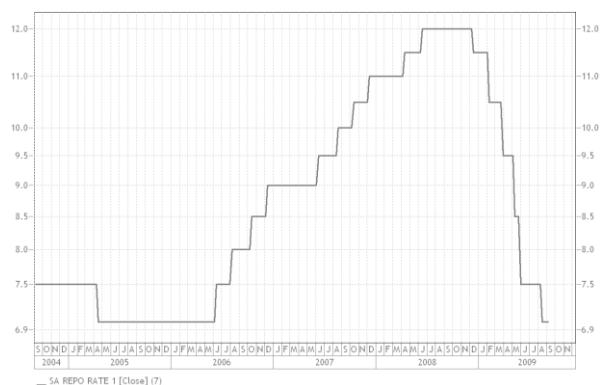
Since the crisis began interest rates in the UK are down 90%, in the US they are down 95% and even in the Euro-region, where authorities have been somewhat more cautious, rates are down 75%. In South Africa rates are down just over 40%. It can easily be argued that back in June when the Bank elected not to lower rates and GDP growth was still in the can that they could easily have done so.

Regardless of whether the Bank was aggressive enough or not we anticipate that we have reached the end, or are close to the end, of this cycle in interest rates and we further anticipate that rates will stay at these levels for some time.

There is some speculation in the market that Gill Marcus, our soon-to-be-Governor, is more inclined to target economic growth alongside inflation rates and that if this doesn't lead to rates being lowered further that this may well lead to rates staying at these lower levels for longer.

The real risk now is that the Bank lowers interest rates so late into the cycle that things have already begun to turn and that these lower rates lead to asset pricing bubbles and inflationary concerns some time down the road. We submit that a policy error in this direction may be the lesser of two evils (the other evil being that rates aren't low enough for long enough and the country slips into a low growth, high unemployment and deflationary environment - note the PPI chart, which indicates that Producer Inflation is already in deflationary territory).

SA Repurchase Rate, Weekly
Aug 03 - Aug 09



Gross Domestic Product, Quarterly, Annualised
Dec 03 - Jun 09

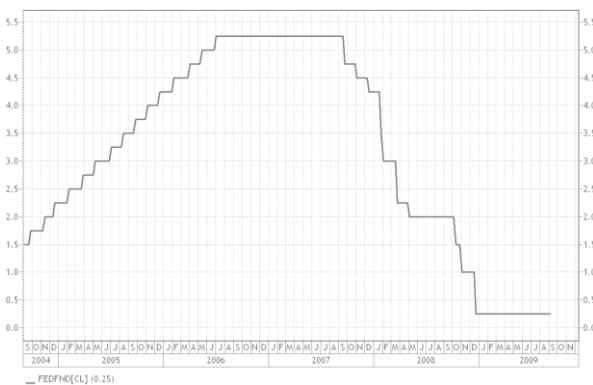


And Other Items Of Interest

**Producer Price Index, Annual Change
Jul 06 - Jul 09**



**US Fed Funds Rate, Weekly
Aug 06 - Aug 09**



Looking further out - toward the middle of 2010 or a short time beyond that - we anticipate that interest rates around the world will begin rising (we note that Israel recently raised rates 25 basis points to 0.75%). The timing of these increases is likely to be the Greatest Balancing Act of our time. Raise rates too early and risk crippling an already limping global economy. Raise rates too late and risk building long-term inflationary conditions into the global economic fabric. Raising rates before banks have recapitalised (cleansed themselves) risks pushing the financial system back to the brink it was so precariously perched on this time last year.

Again we submit that banks will err on the side of lifting rates later rather than sooner. Especially in an environment of gargantuan debts. Inflationary conditions reduce the economic impact of debt obligations. As incomes rise, as a result of adjusting for inflation, outstanding debt obligations remain the same and therefore become easier to serve over time. Given that the US forecasts a trillion dollars in additional debt for each of the next ten years we don't anticipate that newly reappointed Fed Chairman Ben Bernanke will be increasing the Fed Funds rate until late into next year.

AUGUST 2009 DATABANK

	Index Value	Last Month	Year-to-Date	12 Months Ago
SA Repo Rate	7.00%	-0.50%	-4.50%	-5.00%
JSE ALSI	24,929.42	2.77%	15.90%	-10.01%
ALBI	160.87	0.81%	-8.08%	1.83%
R153	7.43	7.64%	7.30%	9.77%
USDZAR	7.77	-0.05%	-18.44%	1.02%

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