financial services group

MONTHLY MARKET REPORT
DECEMBER 2009

DECEMBER 2009 COMMENTARY

Themes for 2010, and beyond

We're not ones for New Year's Resolutions, nor are we ones for forecasting what the New Year might hold. Remember that forecasts tell you more about the person doing the forecast than they tell you about the future.

We're managers and custodians of our client's assets, to which we apply long-term, balanced thinking which changes not at all when new calendars are unwrapped.

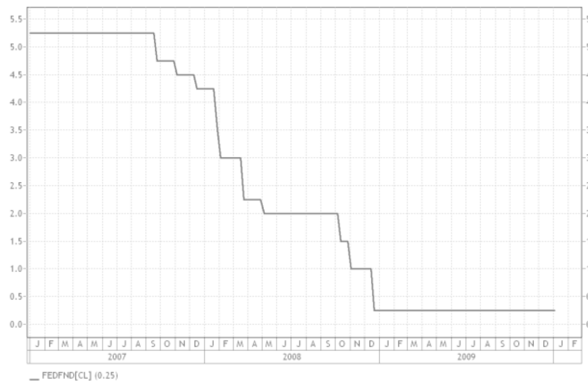
However, there *is* some attraction in revisiting our three main investment themes on our return to the office. We trust that you had an enjoyable and safe break, and we wish you well on your return. May 2010 be a blessed one for you and your family.

Theme 1: Policy Changes
Interest rates are at extreme lows, having been radically reduced – and correctly so – by central banks in economies on the brink of financial meltdown. In addition, almost incomprehensible amounts of money – through quantitative easing (QE) and bailout/stimulus packages – were used to plug the holes in the dam wall. The key questions are: when, how and how quickly do interest rates revert to historical norms and – again – when, how and how quickly do central banks step back from QE and bailout packages.

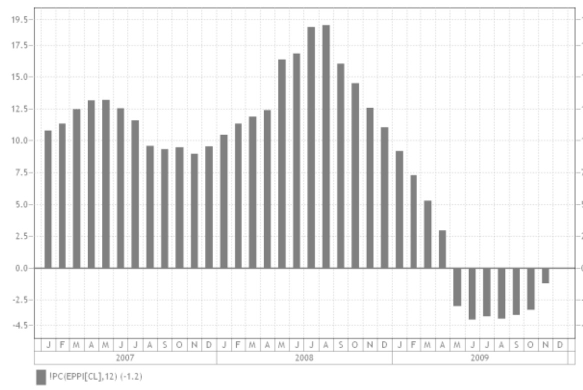
We anticipate that the globe is close to the end of QE and bailout packages, though perhaps not anywhere close to the *withdrawal* of these stimulus measures. We further anticipate that interest rates will remain at these super-low, accommodative levels for much of 2010, despite the recent actions of Israel, Norway and Australia, who have lifted interest rates.

Theme 2: Inflation v Deflation
The debate of whether the globe experiences inflation or deflation over the coming months and years is very closely related to our first theme. Classic economic theory dictates that with so much money sloshing around the global economic system, chasing the same amount of goods and services – and perhaps *fewer* goods and services as inventory levels have been dramatically run down and unemployment has risen – that the general price level should rise, that we should have some measure of inflation. However, as can be seen by the return of South African inflation to within the target range, disinflationary trends are evident and in some cases, as can be seen from our negative year on year change in producer inflation, even outright deflation.

Fed Funds Rate, Weekly
Dec 06 – Dec 09



SA Producer Price Inflation, Monthly
Dec 06 – Dec 09



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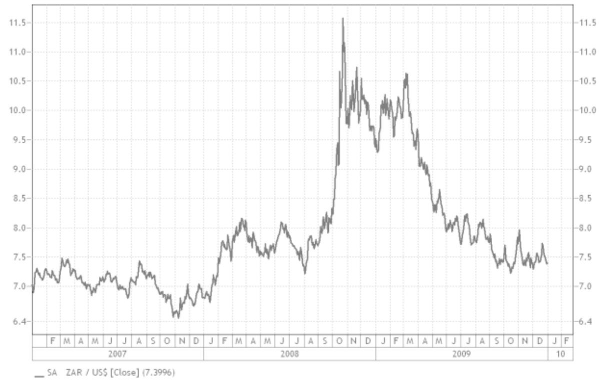
The transmission mechanism for stimulus measures to result in inflation is the propensity for banks to lend, known as the velocity of money. For as long as banks don't pass on stimulus received from central banks to consumers in the form of credit, global inflation will remain muted. Banks have been in the process of shoring up their balance sheets, only when they begin to lend again, when the velocity of money rises, will we look for inflation. For now, and much of 2010, we anticipate muted inflation dynamics, which will enable central banks to maintain interest rates at super-low levels. Almost a self-reinforcing, virtuous circle.

Theme 3: The USD
The direction of any foreign exchange rate is notoriously difficult to call. We don't aspire to peg a value to any currency, but do from time to time identify when a currency is over or under-valued. The rand is particularly strong at present and, whilst it is not inconceivable that it strengthens further from this point, it does present an attractive risk-adjusted opportunity to introduce or extend offshore exposure within your portfolio.

For the last 15 months or so the euro and pound have been dramatically stronger than the dollar. This is largely the result of the massive amounts of money being thrown at the system by the US Fed and Treasury. Similar moves have been made by the ECB and the BOE, but because currencies are relative plays these moves have been relatively less aggressive than their American counterparts. We anticipate that the coming months' currency markets will be less about determining which presents the greatest/safest store of value and more about which one is less worse off than the other. In the majority of cases we would recommend a blend of USD, EUR and GBP exposures.

USDZAR, Daily
Dec 06 – Dec 09



EURUSD, Daily
Dec 06 - Dec 09

DECEMBER 2009 DATABANK

	Index Value	Last Month	Year-to-Date	12 Months Ago
SA Repo Rate	7.00%	0.00%	-4.50%	-4.50%
JSE ALSI	27,666.45	2.87%	28.63%	28.63%
ALBI	299.01	1.20%	-0.99%	-0.99%
R157	8.39%	8.42%	7.21%	7.21%
USDZAR	7.40	-0.1%	-22.31%	-22.31%

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