



financial services group

# MONTHLY MARKET REPORT MAY 2011

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## MAY 2011 COMMENTARY

### The Great Grind

Current market conditions feel attritional; like two rugby sides battling for supremacy in the scrum or like two grand slam tennis players trading booming forehands. The longer attritional conditions persist the more likely the moment of surrender is to be spectacular. Perhaps that's a little grandiose of us. Put differently: this Great Grind we find ourselves in is likely to resolve itself in some kind of bull or bear trend, though not necessarily a spectacular one.

### The Great Grind, Part 1: Local Equities

Witness the chart alongside on the JSE All Share Index.

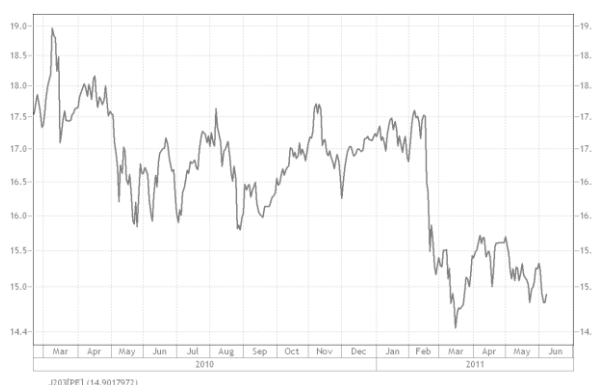
Note that our local equity market - in its aggregate - has been trading between 30,000 and 33,000 index points for *seven months*. In these seven months we've had any number of events that singly or collectively could have propelled the JSE to a level outside of this range, either above or below, and yet has failed to do so. What the chart, however, fails to illustrate is that while the level - or the price - of the market has largely gone sideways since October/November 2010, the market most certainly hasn't remained at the same valuation levels. There have been strong earnings growth reports from various counters across several sectors. In essence: the price of shares overall has remained the same whilst earnings have improved, in effect the market has become better valued and if it continues to improve will certainly pique our interest in acquiring additional equity exposure. The improvement in valuations is clearly illustrated in the JSE PE ratio chart, also alongside.

For completeness: our market is on a PE ratio of 14.9, its historical average - post 1994 - is around 14.5. At levels closer to 14.5 we're neutral on equities, however the trend appears to be downward and our neutral state will gradually give way to optimism as PE ratios fall below their historical averages. As a final comment: be cautious of those who use forward PE ratios as a basis on which to buy equities now, particularly those who seek to convince you that now has never been a better time to buy equities because forward PE ratios are at some kind of favorable level. Forward PE ratios contain a forecast level of future earnings that may or may not come to pass.

JSE All Share Index  
Daily, Feb 2010 - Jun 2011



JSE All Share Index, PE Ratio  
Daily, Feb 2010 - Jun 2011



### The Great Grind, Part 2: Local Interest Rates

Speaking of forecasts; we note that 1 year NCD's (Negotiable Certificates of Deposit) in our local market have already priced in an increase in interest rates of 50 basis points. Interestingly, this increase has been in the price (the interest rate) of an NCD since January 2011 but we're five months into 2011 and we haven't seen the first interest rate increase as yet.

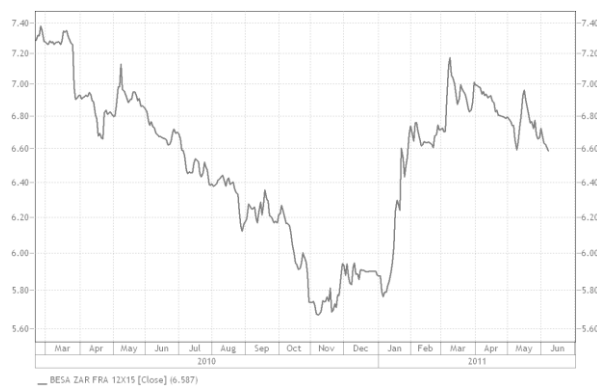
The chart alongside - the Bond Exchange of South Africa's 12 x 15 FRA (Forward Rate Agreement), which is the rate on 3 month debt in 12 months from now - clearly shows what the market expects interest rates to do. Whether the market ultimately turns out to be correct is another matter entirely. At its peak the 12 x 15 FRA indicated that the market had priced in a 150 basis point rise in 3 month interest rates between January 2011 and January 2012. It currently indicates that the market anticipates that rates will rise around 80 - 100 basis points between now and June of 2012. If we hazard a guess: that would be one interest rate increase of 50 basis points in the fourth quarter of 2011 and another of similar magnitude in the first quarter of 2012.

If you are so inclined please be in touch with your Financial Advisor or a member of NFB's Asset Management team should you wish to delve into this chart in greater detail.

12 month NCD  
Daily, Feb 2010 - Jun 2011



BESA ZAR FRA 12 x 15  
Daily, Feb 2010 - Jun 2011



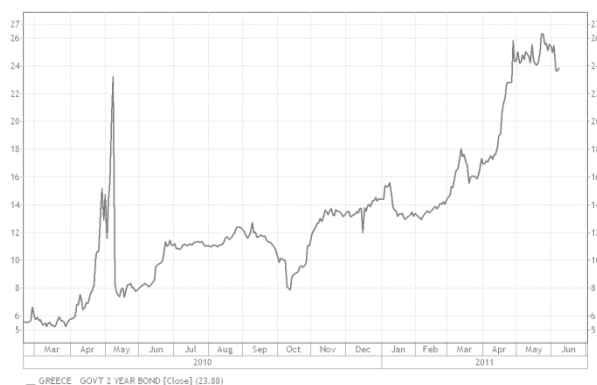
### The Great Grind, Part 3: Greek Debt

We've often spoken of the issues with and surrounding European debt in this Report, to which we wish to add nothing further other than the following: the interest rate attached to Greek debt has relentlessly ground its way higher; we imagine that there isn't very much room left before this situation resolves itself; spectacularly or otherwise.

If you have the stomach - we do not - it is possible to earn close to 25% *per annum* on Greek debt. Remember that Greece is a member of the EU and not some ponzi scheme.

You may note the most recent move to below 24%. This is as a result of continued claims by various EU spokespersons that the money to support Greece will be found somehow, even if this entails the unconstitutional, by EU standards, measure of simply printing the money required; though they will call it something prosaic, something like Quantitative Easing for example. And that may very well work for Greece but it is not a measure that can be extended to all outstanding European debt without severely and, perhaps permanently, comprising the euro.

Greek 2 year Government Debt  
Daily, Feb 2010 - Jun 2011



## MAY 2011 DATABANK

	Index Value	Last Month	Year-to-Date	1 Year
SA Repo Rate	5.50%	0.00%	0.00%	-1.00%
JSE ALSI	32,565	-0.82%	1.39%	21.17%
ALBI	350.97	1.44%	2.10%	11.44%
R157	7.53%	7.64%	7.31%	8.04%
USDZAR	6.80	3.72%	2.74%	-11.25%

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