ORTHOGONAL
investments

Monthly Commentary – January 2010

The year began with negative equity markets (-3.50% on the All Share), just like in January 2009 (-4.25%). As with last January, the market started positively, before succumbing to various fears, both real and imagined. But, the similarities end there. Last year, President Obama was being adoringly inaugurated. This year, his party has just lost three key elections in a row (New Jersey, Virginia and Massachusetts). Last year, Chairman of the Fed, Ben Bernanke, was being viewed as something of a knight in shining armour, the hero who could save the world from a 1929 style depression. He did contribute to disaster aversion (although we still regard the bail-out as ill-informed and as boding badly for the time remaining until the inevitable next financial fiasco), yet this year he barely scraped through being elected to a second term. Last year, equity markets were braced for earnings annihilation. This year, a stout recovery is already discounted (on 31 Dec 2008 the PE on the JSE All Share Index was 9.45; today it is 16.60). Last year, corporate bond spreads in many countries were at 100 year highs; this year they are much narrower, helped by the fact that the *ex post* default rate has been dramatically lower than the panic induced, *ex ante* or implied default rate. Last year, ten year US Treasury bond rates were absurdly low, at 2.17%, having been propelled there by the madness of crowds and the folly of so-called "safe haven" assets. After one of the worst bond bear markets in decades, they finished 2009 at 3.84%. South African ten year government bonds also sold off sharply, from 7.33% to 9.10%.

In summary, a year ago asset markets were priced for a deep and prolonged recession. As the year progressed, economic news was indeed grim, but not nearly as grim as had been factored, so equities and corporate bonds rebounded strongly and government bonds got hammered. The moral of the story, as always, is that macro-economics and conventional wisdom (our favourite oxymoron, along with military intelligence and Virgin Active) are best ignored in favour of dispassionate valuation.

Of course, some things remain unchanged. Politicians, oblivious to the egg on their faces, continue to loudly lay one hundred percent of the blame on financial markets and to exonerate themselves while making various u-turns. This seems a pathetic way of chasing votes, but that won't stop them. The following quote illustrates our point:

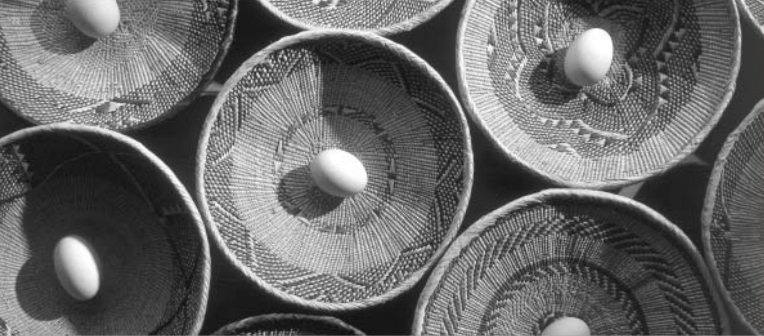
"What you as the City of London have done for financial services, we as a government intend to do for the economy as a whole." - **Gordon Brown, Mansion House speech, June 2002**

In 2010 we need to look out for increasing politicisation of central banks, in most developed countries as well as at home. This shallow, knee-jerk response is very dangerous as observed a few days ago:

"Students of history are well aware of the course we chart when we discuss the possibility of politicising the Federal Reserve system. They know the pathologies that afflicted Weimar Germany and modern Zimbabwe, and the economic mess that cripples Argentina. Those who will determine the future scope and shape of our central bank would do well to keep these lessons in mind and to resist the agreeable urge to strike out at the Fed." - **Richard Fischer, President of the Federal Reserve Bank of Dallas**

Orthogonal Investments (Pty) Ltd
7th Floor, Letterstedt House, Newlands on Main, Newlands, 7700
Telephone number: 021 670 4940 Website: www.orthogonal.co.za Email: info@orthogonal.co.za

Orthogonal Investments operates under Peregrine iQ's asset management license and is considered by the Financial Services Board as an authorised representative of Peregrine iQ. Peregrine iQ (Pty) Ltd is an authorised financial services provider (license no. 608) approved by the Registrar of Financial Services Providers (www.fsb.co.za) to provide intermediary services and advice in terms of the Financial Advisors and Intermediary services Act 37 of 2002.
Market fluctuations and changes in rates of exchange or taxation may have an effect on the value, price or income of investments. Since the performance of financial markets fluctuate, an investor may not get back the full amount invested. Past performance is not necessarily a guide to future investment performance. All returns are rand returns, unless otherwise stated. Investment deals done on behalf of clients by Orthogonal Investments are all done on an arms' length basis.



ORTHOGONAL
investments

On this theme, we are not overly concerned by the rabble rousing calls from the ANC Youth League to nationalise South African mines. Not only has the idea been dismissed by the Minerals Minister, but the burden of proof on the ANCYL to point to a well run state owned enterprise would have proven insurmountable (with the exception of SARS, who some readers may regard as being *too* efficient!).

Rowan Williams-Short
CIO - Orthogonal Investments

Orthogonal Investments (Pty) Ltd
7th Floor, Letterstedt House, Newlands on Main, Newlands, 7700
Telephone number: 021 670 4940 Website: www.orthogonal.co.za Email: info@orthogonal.co.za

Orthogonal Investments operates under Peregrine iQ's asset management license and is considered by the Financial Services Board as an authorised representative of Peregrine iQ. Peregrine iQ (Pty) Ltd is an authorised financial services provider (license no. 608) approved by the Registrar of Financial Services Providers (www.fsb.co.za) to provide intermediary services and advice in terms of the Financial Advisors and Intermediary services Act 37 of 2002.
Market fluctuations and changes in rates of exchange or taxation may have an effect on the value, price or income of investments. Since the performance of financial markets fluctuate, an investor may not get back the full amount invested. Past performance is not necessarily a guide to future investment performance. All returns are rand returns, unless otherwise stated. Investment deals done on behalf of clients by Orthogonal Investments are all done on an arms' length basis.