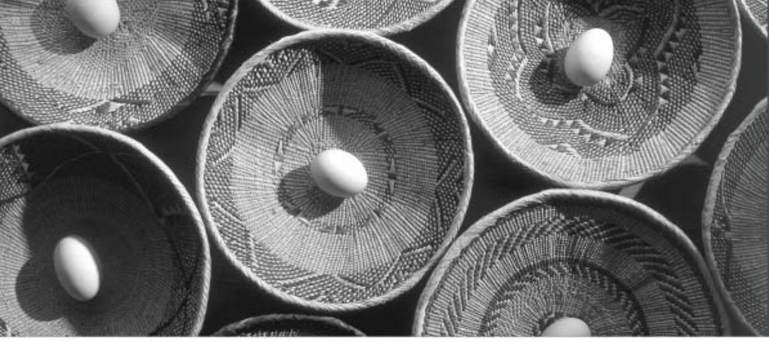


ORTHOGONAL
investments

Monthly Commentary – June 2010

As substantial holders of **BHP Billiton** on clients' behalves, we were disenchanted when the now ex Prime Minister of Australia, Kevin Rudd, announced a so-called super tax on mining companies (April 2010 commentary). His disputatious scheme appears to have cost him his job. We suspect that the mining companies played a subtle but powerful role in his departure, as did the incoming Prime Minister, Julia Gillard, who is Australia's first female PM (and first red-haired PM, as she herself chose to highlight, if you'll pardon the pun). Incidentally, two of the three CEO's of the most aggrieved mining companies (Billiton and Exxaro) are South Africans. Ms. Gillard promptly and pragmatically backpedalled on the tax and we can be sure that the end result will be a diluted version of Mr. Rudd's bizarre proposal. It did not help that Mr. Rudd could not actually articulate the definition of a *super profit*. Hopefully Ms. Gillard will do a better job of the enigmatically re-named *Minerals Resource Rent Tax*. This may be apocryphal, but we hear that one clever retort to the government's campaign to persuade voters that the proposed tax would benefit them was to point out how voters' pension funds had been considerably harmed by falling share prices as a direct result of the tax. As we write, the recovery in Billiton's share price has so far been disappointingly asymmetrical to its earlier weakness. We maintain our position that it is a great, well-managed business, and is demonstrably cheaper than single commodity mining shares such as those of gold and platinum producers.

In June both **Barloworld** and **Pick 'n Pay** announced long overdue decisions to withdraw from failed and ill-advised forays into offshore markets. The former has announced the sale of its Scandinavian car rental business (Avis) to a management consortium, while the latter announced the sale of its Australian retail operations (Franklins) to Metcash Australia.

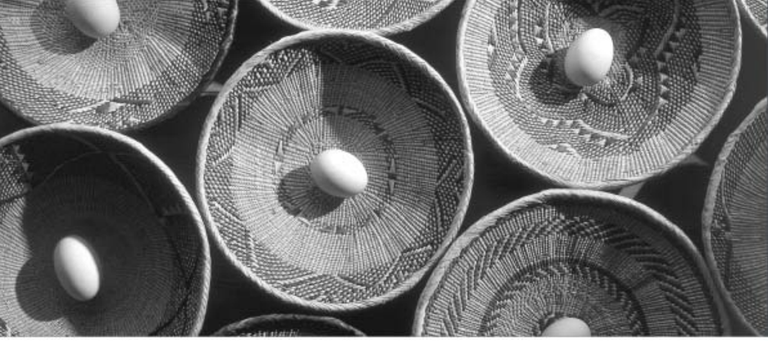
In both instances the companies had paid handsomely some years ago to acquire underperforming businesses in sophisticated and well served markets in which management had little or no experience. They join a long and undistinguished list of South African casualties on foreign shores.

As holders of Pick 'n Pay shares, we are encouraged by this development. The price received exceeds the book value of the investment and the roughly R1.4bn proceeds will be used to finance the group's much needed establishment of a distribution centre network and the opening of stores in some of our neighbouring countries. The group operating margin, return on equity and headline earnings will show immediate improvement, while management will be able to devote their undivided attention to the domestic business.

Considering this dismal record, one wonders why the management of Weylandts, a growing unlisted South African furniture manufacturer and retailer that has just announced its intention to enter the Australian market, believes their experience will be different. The odds would appear to be stacked heavily against them.

We are often asked why we believe that the **value style** of investing will continue to deliver outperformance, given that its methodology and principles are so well known. The reason, we always say, is that most investors, when faced with an hysterical market, don't have the "intestinal fortitude" to follow their heads and be contrarian when the rest of their being demands the comfort of being part of the herd.

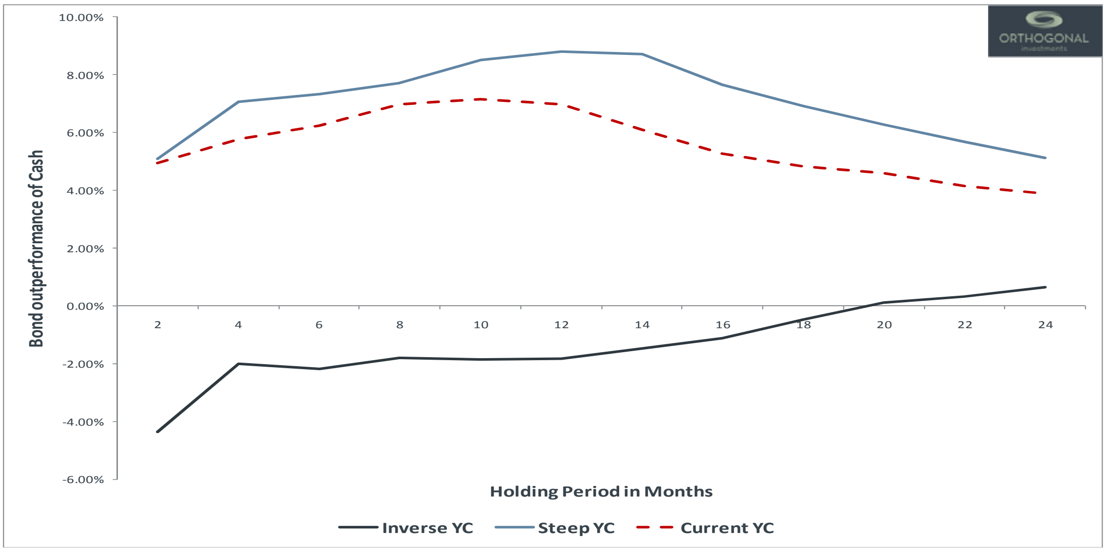
One of our founders, Douw Steenekamp, recently had an experience that perfectly illustrates this behavior. During a visit to Toronto he was taken to visit the CN Tower, which, at 553m high (more than half the height of Table Mountain!) was until recently the tallest free standing structure on the planet. A section of the floor of the observation deck, 342m up, is constructed of glass panels allowing one a breathtaking view of the streets below. While the view was spectacular, the most interesting observation was to see how few people could muster the courage to walk onto the glass section to enjoy an unobstructed view, despite the fact that everyone is informed that the panels are certified as able to withstand the combined weight of fourteen hippos.



It is, we believe, this same irrational fear that renders most people incapable of practicing contrarian value investing, despite their awareness of its long-term success.

Bonds

We recently expanded a methodology that we first devised for examining the relationship between starting equity valuations and subsequent returns. Our interest here is to search for a fundamentally sound indicator (which needs to be mean reverting for statistical reasons) which has reliably foreshadowed subsequent returns of bonds relative to cash. It turns out that the shape of the yield curve fits the bill rather nicely. The chart below shows (black) annualized returns subsequent to inverse yield curves and the returns (blue) subsequent to steep yield curves. The stippled red line, using current valuation levels, suggests that bonds are poised to beat cash over the next 24 months.



Rowan Williams-Short

CIO - Orthogonal Investments

Orthogonal Investments (Pty) Ltd
5th Floor, Letterstedt House, Newlands on Main, Newlands, 7700
Telephone number: 021 670 4940 Website: www.orthogonal.co.za Email: info@orthogonal.co.za