



Monthly Commentary – March 2011

In March, the three main domestic asset class returns were: Equities = 0.52%, bonds = 0.49% and cash = 0.47%. Reliable monthly total returns for all three asset classes go back to November 1985 (bonds being the limiting class here). In those 304 months, the dispersion of returns in March 2011 set an all time record for being the lowest. Not a productive month for strategists and asset allocators.

JAPAN

The awful destruction caused first by the earthquake and then more catastrophically by the tsunami drew comparisons with the Kobe earthquake in 1995. That measured 7.2 on the Richter scale; March's earthquake measured 9.0. The seismic energy released by an earthquake scales with the 3/2 power. So, the destructive power of the Fukushima earthquake versus the Kobe earthquake was: $= (10^{(9.0-7.2)})^{(3/2)} = 501$ times more powerful. At the time of the Kobe earthquake, Japan made up 30% of world stock market capitalization (down from a peak of over 50% during the Japanese stock market bubble). Today it makes up around 10%, much more in line with its share of world GDP. There was subsequently a 25% drawdown on the Nikkei 225 index. At the time of writing, the Nikkei is just 5% lower than the day of the recent earthquake. We surmise that the lower impact on the stock market from a more powerful earthquake is due mainly to the substantially lower starting valuation (PE multiple) this time around.

Japanese PE ratio



Source: UBS, Datastream

SELECTED COMPANY NEWS

FirstRand (held) : FirstRand reported interim results to December 2010. These were the first results since the significant restructuring in which FirstRand unbundled Momentum and disposed of its holding in Outsurance. Given the torrid times that the group experienced two years ago, it was heartening to see indications of a return to form, with some divisions' earnings close to previous peak values. Gross advances, revenues and non interest income were all up, with normalised earnings (on a pro forma basis) up 20%. The credit loss ratio reduced from 1.52% to 0.92% and dividends per share were up 25%. FirstRand also reported the highest Return on Equity in the banking sector, at 18.7%. This is comfortably above its cost of equity.



Standard Bank (held) : Standard Bank reported disappointing full year results to 31 December 2010. Headline earnings declined 4%. The group bad debt ratio did decrease (from 1.6% to 1.04%) but this was negated by a very disappointing performance in the international operations with an increase in bad debts in certain of the European and Asian businesses. Increased expenditure in the African operations contributed to a 9% increase in operating expenses, resulting in an unsatisfactory increase in the cost to income ratio.

Old Mutual (held) : Old Mutual reported good results with improved disclosure, especially with respect to the generation of cash within the group. Concerns about Old Mutual being able to meet its debt reduction targets subsided. Gratifyingly, Old Mutual increased the dividends paid to 4p per share from 1.5p, at a 4x cover. The FGD surplus increased from its low of £900m in Q109 to £2.1bn. Sales, net client cash flows and new business margins improved. The US businesses remains an area of major concern as asset management experienced significant net outflows. The US life business is in the process of being sold, with indications recently received that regulatory approval has been received in the State of Maryland.

MMI (not held): December 2010 saw the listing of a new insurance company, MMI Holdings, born from the merger of Metropolitan and Momentum. In March MMI published its maiden results, which were complicated by the fact that they included six months' performance of the old Momentum business and one month of the Metropolitan business. On a pro forma basis, the results were quite good, with strong performance in the retail units, especially that of Metropolitan Retail. The group's capital position seems strong, with a group CAR cover of 2.5x and excess capital, (after dividends) of approximately R4bn. The group declared a dividend of 63 cps (42c interim plus 21 cps special). The current dividend yield is 5.1%, one of the highest in the sector.

BHPBilliton (held): With Iron ore, copper and oil prices persistently high, cash has been pouring into the BHP Billiton coffers apace. The brains trust at the company has wasted no time in finding homes for this largesse, as the following recent announcements illustrate: A further US\$554 Million Investment at the Escondida copper mine, a US\$400 million expansion at Hunter Valley Energy Coal in New South Wales, three metallurgical coal projects in the Queensland amounting to US\$2.5 billion and approval of US\$6.6 billion of capex at the Western Australia Iron Ore operations. This comes in addition to the company's US\$4.75 billion entry into the US Shale gas market and a US\$10bn expanded share buyback program, both announced in February.

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