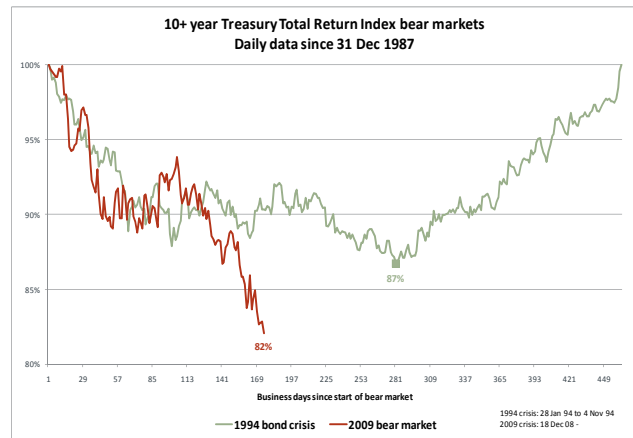
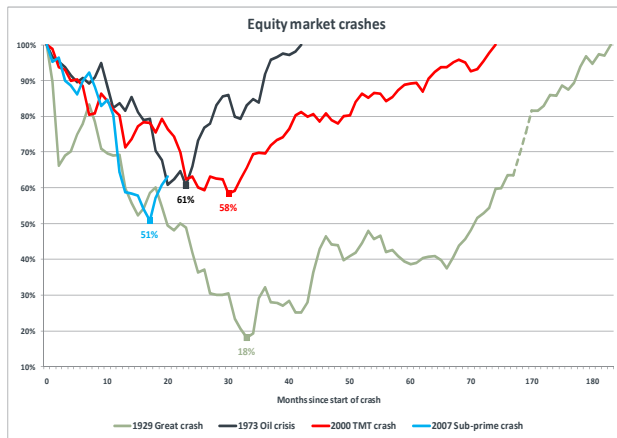


## Quarterly Commentary – June 2009

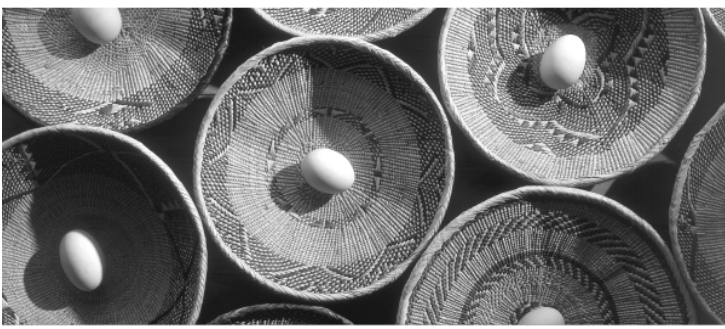
Equities are followed much more publically than bonds, so the awful recent bear market, which doomsayers tried their damndest to relate to the 1929 Great Crash, was widely reported. Here we plot a chart of total return draw-downs for the S&P500 for each of the major crashes of the last century:



Less well reported has been the spectacular crash in the bond market. In December, giddy hordes rushed into euphemistically named “safe haven” US Treasury Bonds amid fears of apocalyptic outcomes in equity markets, helping to drive 3 months Treasury yields to an incomprehensible *minus* two basis points and even 10 year yields to a low of 2%.

At the time (January '09 commentary) we cynically remarked that we had an era not of risk-free bonds but of return-free bonds. We were wrong: 10 year Treasuries were about to deliver hugely negative returns off this absurd base.

In our careers, there has been one other notable bear market in US bonds. In February 1994, Fed Chairman Greenspan surprised markets by raising overnight rates from 3.00% to 3.25%. This sparked a sell-off in 10 year yields, from 5.87% to 7.11% and was the cause of the spectacular bankruptcy of Orange County, California, which had up to that time been the wealthiest county in the USA. So, recent market events led us to compare the current bear market to the 1994 market for 10 year US bonds, along the same lines as the equity chart shown above.



The current bond bear market is worse than the 1994 crash. Once again, high prices (low yields) begat negative returns. Whereas the South African equity market plunged headlong with US equities, perhaps ominously, the local bond market has ignored a substantial part of the sell-off in US bonds. *Ceteris paribus*, this renders local bonds expensive.



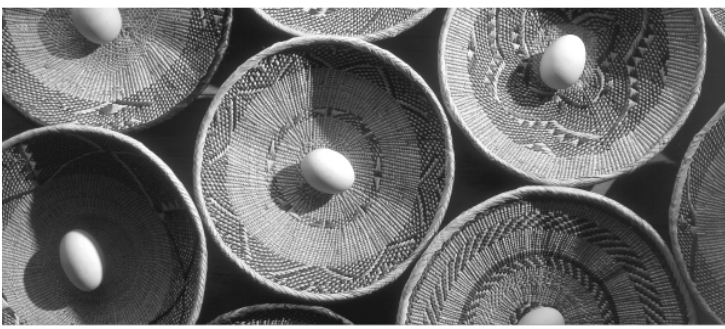
Source: I-Net

## Technical analysis

A wonderful quote from veteran stockbroker Dr James Greener: "Considerable excitement has been caused on Wall Street by the news that the Coppock Index has given a buy signal. This allegedly nearly infallible technical indicator is brewed from a mesmerising mix of market momentum metrics". We detest the pseudo-science of technical analysis, also known as charting. In this case, the Coppock Index missed a 40% rise in the S&P500, and in the short while since its most recent buying trigger, Wall Street has dropped back by 6%. Chalk that up as another loss for the chartists. It is easy to think of a more apt, rhyming name for the Coppock Index.

## China

We have long been sceptical of rapid and smooth releases of Chinese macro-economic data, so we felt a bit vindicated by the following remarkable admission: "Despite the NBS [National Bureau of Statistics, China] assurance, the head of the bureau, Ma Jiantang, cited the need to "continuously improve the quality and credibility of China's official data" on April 17 [2009] following a critical commentary on the Wall Street Journal website, Xinhua News Agency reported. The National People's Congress has found "serious fabrication" in official statistics, the report said.



## The real economy

Last month, after the release of the surprisingly poor first quarter GDP growth data, we pointed out that there is a poor correlation between financial markets and GDP growth. The past month provided further evidence of this fact. Whereas a large number of companies, across a variety of industries, either reported or warned of large decreases in their earnings, the FTSE/JSE All Share index declined by only 3%. Examples are Sasol (oil & chemicals - warning of a 40%-50% decline), Grindrod (freight & logistics – warned of a 50%-60% decline), Aveng (construction - warning of a 15%-20% decline), Eqstra (equipment & vehicle leasing - warning of a 85%-95% decline), FirstRand (financial services – warning of a 28%-33% decline), ABSA (financial services – warned of a 25%-35% decline), Naspers (media – reported a 22% decline in diluted headline earnings per share) and Telkom (telecommunications – reported a 46% decline in headline earnings per share). This bad news is clearly what the market saw coming last year and partly warranted the 45% drawdown that appears to have ended on 20 November 2008. Hopefully the 24% bounce we have seen since that low point will prove to be equally prophetic!

Some recent company news that is of relevance to our clients' portfolios:

**BHP Billiton** announced a JV with Rio Tinto for all its Western Australian iron ore production assets. The two companies will market and sell the output from the JV separately to their clients. Billiton expects to pay Rio \$5.8bn to raise its interest in the JV from 45% to 50%. The JV will require regulatory approval and is slated to realise \$10bn (NPV) from synergies.

**FirstRand** announced that Sizwe Nxasana will succeed Paul Harris as group CEO, in what looks to us like a well-planned, gradual succession. Later in the month, FirstRand hosted an investor update at which the message relayed was quite disappointing. The group pointed to conservative earnings expectations for the second half of the 2009 financial year driven by increases in impairments and bad debts as well as poor performance in various businesses, most notably Private Equity, FICC (fixed income, currencies and commodities) and the SPJI (Special Projects International) portfolio. In a significant change in strategy, FirstRand indicated that they would be de-risking the balance sheet with reduced capital to be allocated to the investment bank. Further, FirstRand will also be exiting most of its developed markets businesses in order (in concert with its competitors) to focus on growing its business into Africa.

**Anglo American** received an unwanted merger proposal from Xstrata. The board is reported to have taken less than two hours to reject the proposal.

**Sasol** issued a profit warning, suggesting that headline earnings per share for the year to June 2009 will be down 40% to 50%. Consensus expectations were for flat earnings – this just days before year-end. Once again we marvel at the futility of forecasting.

**Rowan Williams-Short**  
CIO  
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