

## Quarterly Commentary – March 2009

### Bonds

The bubble asset has faced some severe headwinds! In the UK, a routine government bond auction recently failed. We would not be the least bit surprised if the same happened in the USA in the near future. Insatiable central bank demand for bonds smacks of market manipulation, which always ends unhappily. At home, the ebullience surrounding the new measure of inflation was extremely short-lived. Bond bulls ecstatically applauded the new methodology as it was certain to provide them a windfall. Yet, in only its second month in its new livery, inflation rose from 8.1% to 8.6% thus once again humiliating a bandwagon full of forecasters. A yield of 8.5% on 10 year RSA bonds hardly seems to offer adequate compensation.

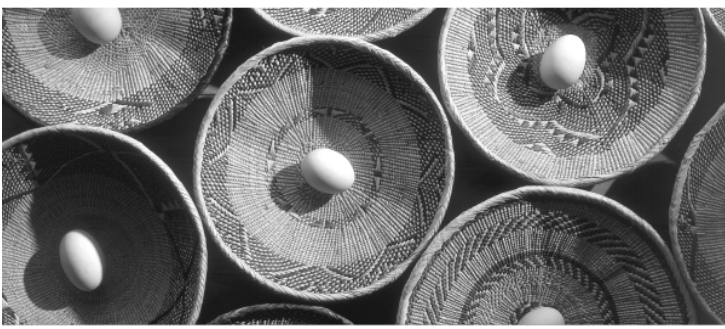
### Equities

It may not feel like this, but from its recent low point (20<sup>th</sup> November 2008), the All Share Index's total return has been +21% (to 3<sup>rd</sup> April 2009). The most frequent question we have received from clients in the past year has been "When do you think the bear market will bottom" and we gauge that we are expected to answer something along the lines of "within 18 months". We guardedly, nervously and hopefully think the answer may transpire to be – "It bottomed in November 2008". We have stated before that stock markets and economies are *not* very well correlated, and that just as global equity markets turned down long before we had hard evidence of a recession, so they would probably recover long before we knew that positive real GDP growth had resumed. For now at least, that course of events appears intact.

Given the documented asymmetry of amnesia, perhaps the next observation accords even less well with general recollection: now that all December financial year-end companies have reported, we can measure actual 2008 year-on-year earnings changes for the weighted average components of the JSE All Share Index. The answer is a growth rate of *positive* 6%. Agreed, that is not a tremendous achievement and is slightly negative in real terms, but it is a lot higher than doomsayers had been predicting. For bears who like to scavenge for vindication, consensus earnings growth expectations for the All Share over the next 12 months are *negative* 5%. Our first retort is to exhort them to examine the woeful track record of such forecasting. Our second is to observe that the index's historic PE multiple is barely (an undemanding) 10 times. So, we think that at least some of the awful economic news, such as vehicle sales being down 35% year-on-year, has been adequately discounted.

Among large cap financials to report in March (including Old Mutual, Nedbank, Liberty, Sanlam, FirstRand (interim results) and Standard Bank), mostly grim headline earnings numbers masked many much less problematic releases, such as higher than expected embedded values, ROE's, advances growths and capital adequacy ratios. One rating agency downgraded portions of Investec's and Old Mutual's debt, thereby confirming our long held view that rating agencies tend to be no more than lagging indicators with sorry track records.

Some recent results have drawn our attention back to another facet of business: overseas expansion. FirstRand had to take a substantial loss from a trading desk it runs in the UK and Old Mutual announced the cessation of all new business in its Bermuda operation. With pitifully few exceptions, notably in the mining arena and in other African countries, the graveyard of South African corporations' offshore subsidiaries is growing. Almost all talk of "hard currency earnings", "synergies", "untapped markets" and so on has ended up being claptrap. Think of the retailers in Australia and the financial services companies in the UK and USA. Having observed so many of these aspirations evaporating, we have become highly suspicious of the motivations. Could it be that senior management has ever squandered shareholders' funds to arrange for lavish emigration and early retirement? Surely not. The cosiness of a second passport? Are we too cynical? Among financials, Sanlam has probably been the most insulated from the global financial crisis, as it remained the most focused in its home market. Now it has announced its intentions to grow its



international asset management business. For its sake, we hope it can become more of an exception than a rule. Gold seems to be back in vogue. In previous reports we have explained why we currently hold no gold shares on clients' behalves. Maybe we also need to try to justify why we also hold no physical gold or equivalents. We offer three main reasons: 1. We don't really buy the popular storyline that gold is a safe haven asset in times of trouble. In that endeavour it has failed miserably several times in our careers. 2. We honestly can't forecast the price of gold. We don't think anyone else can either. 3. It produces no earnings or dividends yet incurs holding costs. We're just more comfortable buying assets for you that we can show with some conviction to be attractively valued and income producing.

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Orthogonal Investments