Dynamic Wealth
Established in 1971

Castle Walk Corporate Park Block B
Cnr Swakop & Nossob Straat • Erasmuskloof
Tel +27 (0) 12 484 2000 • Fax +27 (0) 12 484 200

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MARKET ANALYSIS

Table 1: Key market indicators May 2009

INDICATOR	29 May 2009 closing	Monthly movement	Expectation for the month
ALSI	22 771	2 124 (+10.29)	Sideways
Industrial Index	20 644	644 (+3.22%)	Sideways
Gold Index	2 793	607 (+27.77%)	Sideways
Financial Index	15 429	365 (+2.42%)	Sideways
SA Property Index	296	-11 (-3.90%)	Sideways
Rand/dollar	R8.05/$	R0.62 (7.15%)	R7.90/$ -R8.20/$
Gold Price	$976	+$77 (+8.60%)	Sideways
Dow Jones	8 500	314 (+3.84%)	Sideways
FTSE-100	4 417	174 (+4.11%)	Sideways
Nikkei	9 522	1 028 (+12.11%)	Sideways
Hang-Seng	18 171	2 651 (+17.08%)	Sideways
All Bond Index (ALBI)	287 856	-1 367 (-0.47%)	Increase

Though many analysts still hold the view that the recent increase in share markets are nothing but a temporary correction in a bear market, we are of the opinion that there are enough fundamental evidence suggesting that the turning point was 3 March 2009 and that the share markets already are in a bull run. Dynamic Wealth has therefore changed the asset allocation of its multi managed funds to be overweighed in shares. Our single managed funds also benefited from the sharp increase in the ALSI by 25.7% between 3 March 2009 and 29 May 2009.

Although, fundamentally we expect that share prices will move sideways over the next few months the upward rally will continue from the third quarter.

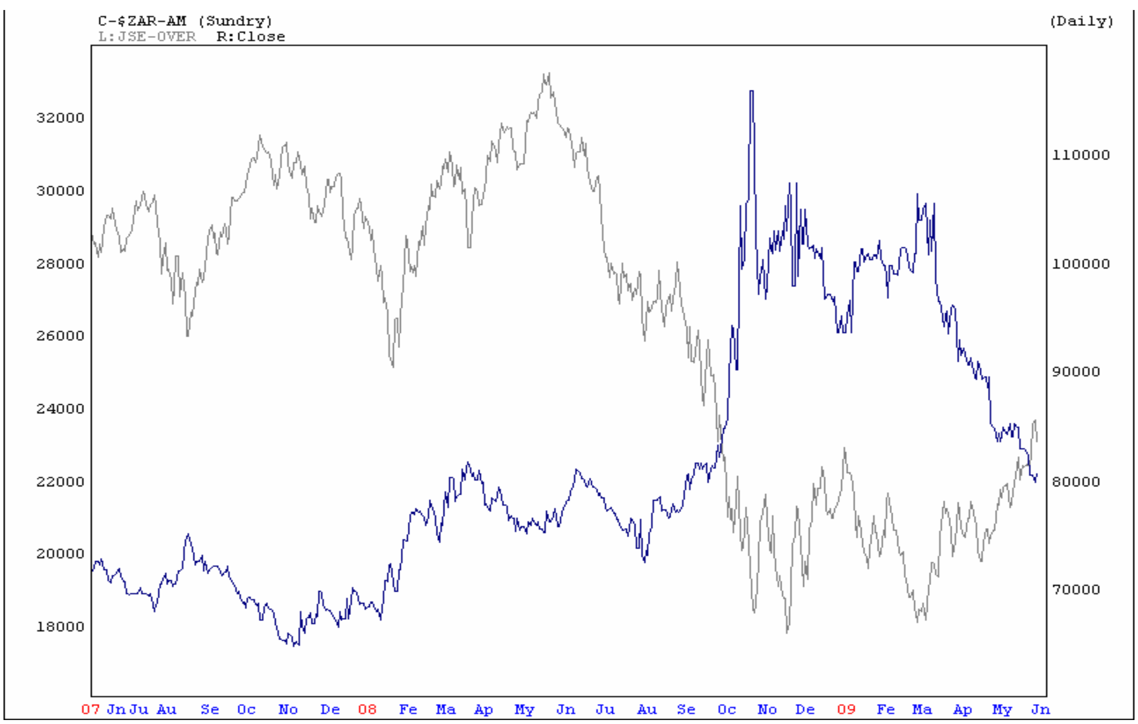
The recovery on Wall Street was lead by City Group's announcement on 3 March 2009 that it expected a profit for the first quarter of 2009. In the following two months five important international fundamental indicators improved the sentiment in favour of share prices. They were:

- The three consecutive months of increases in US house sales;
- The increase in US durable retail sales;
- The increase in the international oil price (and other commodity prices);
- The increase in Chinese and Japanese manufacturing output; and
- The better than expected economic growth rates for the US; China and India during the first quarter of 2009.

Domestically, the tax relief announced by Minister Trevor Manuel and the reduction (by four percentage points) in the repo rate by the Monetary Policy Committee (MPC) contributed to expectations for private consumption expenditure and investment to start a gradual increase during the latter part of the year. A return to risk by foreign investors is evident in their increasing purchases of local shares as well as the stronger rand exchange rate. The recovery in foreign portfolio investment in South Africa contributed towards the sharp appreciation of the rand over the last two months. (See figure 1):

Both the bond- and listed property markets moved sideways despite the sharp reduction in interest rates, but we expect both markets to turn positive over the next two months.

Figure 1: The strong relationship between the ALSI and the R/$ exchange rate (reverse relationship)



TECHNICAL ANALYSIS

FIGURE 2: THE TOP-40 INDEX

The market performed according to the technical forecast and thus in line with the prediction made in the last report of March 2009, namely "*I am of the opinion that one should buy shares now for a short-term rally. The rally in the Top-40 index can go back up all the way to 20500 levels.*" The gain in the Top-40 index was a healthy 32.7%. I am of the opinion that the Top-40 index will move into a sideways pattern for the next few months.

ECONOMIC ANALYSIS

INTERNATIONAL

Various economic indicators show that the world economy is still in contraction mode - albeit at a slower pace. Preliminary indicators of the change in gross domestic product (GDP) in the first quarter of 2009 (Q1 2009) in various countries show a continuation of the large contractions experienced last year. However, the contraction in the US economy tapered off in Q1 2009. Though expectations are for a protracted and slow recovery, the smaller contraction (if sustained) is good news because "*just as the US ran the world into a recession, it will lead the world out of such recession*".

Analysis of the economic performance of several large economic regions is made difficult by the lack of a universal accepted measure for the change in GDP. For example, the USA uses the seasonally adjusted and ***annualised*** (SAA) quarter over quarter (QoQ) change in GDP, whereas the UK and Euro area utilize the seasonally adjusted and ***unannualised*** (SAU) QoQ change. By comparison China does not provide any meaningful QoQ change in GDP – it solely relies on the year on year (YoY) change.

The USA SAA QoQ change in GDP was -5.7% in Q1 2009 (Table 2). Comparing this to the UK announcement of -1.9% and the -2.5% (Table 3) of the Euro area might create the impression that the US economy is much weaker. However, ***unannualising*** the USA indicator (to make it comparable to that of the European countries) for Q1 2009 changes the SAA of -5.7% into a SAU of -1.46%.

Table 2					
Seasonal Adjusted and *Annualised* QoQ % change in GDP					
	2008 Q1	**2008 Q2**	**2008 Q3**	**2008 Q4**	**2009 Q1**
SA	1.7	5.0	0.2	-1.8	-6.44
USA	0.87	2.83	-0.51	-6.34	-5.72
UK	1.61	0.0	-2.77	-6.25	-7.39
Euro	2.42	-1.19	-1.20	-7.01	-9.63
Japan	1.5	-2.2	-2.9	-13.5	-14.2

Moreover, the Q1 contraction in the US is a bit milder than the -1.6% registered in Q4 2008. In contrast, as the two tables show, the contraction in the UK, Euro area and Japan worsened. China's year over year growth in GDP (not comparable to the quarter over quarter rates) was 6.1% in Q1 2009 – much slower than the 10% of Q4 2008.

Table 3					
Seasonal Adjusted and *Unannualised* QoQ % change in GDP					
	2008 Q1	**2008 Q2**	**2008 Q3**	**2008 Q4**	**2009 Q1**
SA	0.43	1.24	0.05	-0.46	-1.65
USA	0.22	0.70	-0.13	-1.62	-1.46
UK	0.4	0.0	-0.7	-1.6	-1.9
Euro 16	0.6	-0.3	-0.3	-1.8	-2.5
Japan	0.4	-0.6	-0.7	-3.6	-3.8

However, international commodity prices, stock market indices and world trade indicators point towards the start of a recovery. Both the International Energy Agency and Energy Information Administration revised their projections for oil consumption upward contributing to an increase in the oil price to $72 per barrel from $40 in January 2009. Though this might seem extraordinary it must be borne in mind that the oil price should never have dropped to below the economic unviable level of $45 per barrel. The same applies to the sharp declines in share markets. Both indicators are reacting on future expectations which points to a recovery in world demand and a return to profits for companies. The Baltic Dry Index – an indicator of world trade in dry goods – is continuing its increase albeit from a low base confirming a slow recovery. GDP numbers and unemployment rates will recover much later - lagging commodity prices and share market performances. Steep acceleration in commodity prices and share markets is not expected. A more gradual improvement is more feasible.

SOUTH AFRICA

Though the Q1 2009 contraction in the South African economy was worse than that in the US, it was not as bad as in the UK, Euro area and Japan (See table 2 and 3). It also shows that the South African recovery will lag the USA and probably follow the UK and Euro route. Like the UK, Euro area and Japan, South Africa's contraction deepened in Q1 2009. The contraction will continue in Q2 and Q3 which will ensure at least four quarters of negative SAA growth. These contractions should however be milder than the -6.4% registered in Q1 2009. South Africa's recovery will be reliant on an increase in international demand which necessitates a recovery in the US economy. This should assist a recovery in Europe - South Africa's major trading partner - which should support South African exports. Domestically, lower interest rates, government spending and public works related job creation should assist the recovery which is expected to occur by Q4 2009/Q1 2010.

TABLE 4: KEY ECONOMIC INDICATORS

ECONOMIC INDICATOR	Latest*	Period	Previous	2008	2007
Consumer Price Inflation (CPI) – Inflation target	**8.4%**	Apr	8.5%	11.5%	7.1%
Production Price Inflation: (PPI)	**2.9%**	Apr	5.3%	14.2%	10.0%
M3-Money Supply Growth	**8.8%**	Apr	10.6%	13.6%	22.2%
Growth in Credit to the Private Sector	**8.7%**	Apr	8.5%	13.6%	23.7%
Repo Rate	**7.5%**	May	8.5%	11.5%	11.0%
Prime Rate	**11%**	Mei	12.0%	15.0%	14.5%
Current Account Deficit (CAD) – actual amount (R'billion)	**-R33.5**	Q 1	-R33.3	R169.2	R146.1
Trade Deficit(-)/surplus (R'billion) – SARS amount)	**-R20.5**	Apr	-R19.0	-R64.5	-R69.3
Net foreign purchases of shares and bonds (R'billion)	**R10.1**	Apr	R8.1	-R74.7	R83.8
Reserves after financing of the CAD (R'billion)	**R0.2**	Apr	R1.04	R26.1	R47.8
Net total foreign reserves (R' billion)	**$34.5**	May	$33.4	$33.5	$31.3
Economic Growth	**-6.4%**	Q 1	-1.8%	3.1%	5.1%
Retail Sales	**-6.7%**	Apr	-4.9%	0.1%	6.5%
Manufacturing Production-Volume	**-11.7%**	Apr	-21%	0.9%	4.6%
Unemployment (official definition)	**23.5%**	Q 1	21.9%	23.2%	25.5%

* The terms period, latest and previous refer to year-on-year growth for the latest and previous months. Economic growth refers to quarter-on-quarter growth expressed in annual terms adjusted for seasonal factors – previous refers to the same growth rate between the previous two quarters. Cumulative numbers refer to the total amount from the beginning of the year to the respective months.
** The trade deficit calculated by the South African Revenue Service (SARS) is larger than that of the South African Reserve Bank (SARB) as the SARS-number excludes trade with the customs union countries. The SARB amount is used for calculating the CAD.

Economic growth

In order to confirm Statistics SA's negative growth rate of 6.4% for Q1 2009, the South African Reserve Bank had to reduce its GDP estimate (measured by total spending) by R16.2 billion (*Seasonal Adjusted and Annualised in real terms*). The actual reduction in spending was R6.99 billion in Q1 2009. The discrepancy between Statistics SA and the Reserve Bank's GDP estimates has been more than R10 billion since 2007 and is becoming a source of concern.

Components of GDP

Contractions in household spending and export earnings were the main reasons for the Seasonal Adjusted but Unannualised Quarter over Quarter GDP to shrink by 1.7% in Q1 2009. This follows the contraction of 0.46% in Q4 2008. The GDE posted a positive growth rate mainly on account of a slower rate of decline in inventories as well as positive government and investment spending.

Table 5

Seasonal Adjusted and Unannualised Quarter over Quarter % change in GDP							
	Households	*Government*	*GFCF*	*GDE*	*Exports*	*Imports*	*GDP*
2008 Q2	0.31	-0.52	1.27	-0.42	9.27	1.93	1.24
2008 Q3	-0.24	2.46	1.77	0.17	0.99	1.16	0.05
2008 Q4	-0.67	0.88	0.74	-0.99	-4.38	-5.14	-0.46
2009 Q1	-1.26	1.45	0.65	0.55	-18.12	-7.71	-1.65

Households

Households experienced their third consecutive quarter of spending contraction. Moreover, Table 5 shows that the rate of contraction is increasing (from -0.24% in Q3 2008 to -1.3% in Q1 2009.)

According to the Quarterly Bulletin spending on all three categories of goods contracted. On a SAA basis spending on durable goods contracted by another huge 19.2% (-20.1% in Q4 2008), whilst that on semi-durable and non-durable contracted by respectively -7.9% and -12.2%. Spending on services however accelerated to a rate of 7.5% from a contraction of -0.1% in Q4 2008.

Whereas household spending contracted by -1.26% (QoQ seasonal adjusted but unannualised in real terms), household disposable income contracted by -1.14%. As a result households' rate of dissaving continued. Though the QoQSA rate of dissaving receded by 56% in Q1 2009 it was still -0.1% of disposable income (-0.2% in Q4 2008.)

With disposable income on a real declining trend but credit growth still increasing albeit at a very slow rate, total debt to disposable income increased to 76.7% in Q1 2009. Due to lower interest rates the debt service ratio declined from 11.7% in Q4 2008 to 10.9% in Q1 2009.

Government

General government expenditure accelerated from a QoQSA rate of 0.9% in Q4 2008 to 1.45% in Q1 2009. However, this was mainly on account of consumption expenditure (e.g. two military aircrafts were purchased) as its QoQSAA rate of real gross fixed capital formation slowed from 2.3% in Q4 2008 to 0.6% in Q1 2009. The slow pace of government investment is a source of concern as the economy foregoes the positive multiplier impact of investment on jobs.

Real Gross Fixed Capital Formation (GFCF)

GFCF posted positive QoQSA growth of 0.65% in Q1 2009 but it was at a slower pace than the 0.74% in Q4 2008. Both private business enterprises and general government's pace of investment slowed. However, public corporations upped their investment to 6.4% (QoQSAA) from 4.1% in Q4 2008.

Current Account Deficit (CAD)

According to the Reserve Bank the CAD increased to 7% of GDP in Q1 2009 from 5.8% in Q4 2008. This is the seasonal adjusted and annualized CAD. Table 6 below however shows that the actual CAD remained the same as in Q4 2008 when the seasonal adjusted and

annualised GDP was only 5.8% of GDP. This shows that the acceleration in the CAD ratio can be ascribed to the seasonal adjustment factor. Thus, even though the actual CAD was R33.5 billion, the Reserve Bank adjusted it upward by 22% to R41 billion which creates the wrong impression about the CAD. The Reserve Bank's persistence with this calculation method will eventually undermine the credibility of this number.
Nevertheless, the CAD was comfortably financed by foreign inflows. The Reserve Bank was however not able to identify the major source of inflows, namely unrecorded transactions. Unrecorded transactions amounted to R20.9 billion. A welcome sight was the turnaround in portfolio flows with foreigners purchasing shares and bonds of R9 billion in Q1 2009 compared to a sell-off of R57 billion in Q4 2008. This shows that risk appetite is returning – another early indicator of a recovery in world demand

Table 6

Actual Current Account Deficit (CAD) and its components									
	Trade		***Services***		***Income***		***Customs Union***		***CAD***
	(R.billion)	***% of total***	(R.billion)	***% of total***	(R.billion)	***% of total***	(R.billion)	***% of total***	
2008 Q4	6.050	***18.2***	5.397	***16.2***	15.990	***48.0***	5.867	***17.6***	33.304
2009 Q1	9.916	***29.6***	3.844	***11.5***	12.975	***38.7***	6.806	***20.3***	33.541

Inflation and interest rates

Not with standing a sharp drop in demand, CPI will remain sticky due to the structural problems in the economy which is putting upward pressure on prices. In addition, the increase in the oil price and expected sharp increases in electricity tariffs should maintain a rate of increase in CPI of above 7%. Due to the return to risk appetite the rand exchange rate should stay firm alleviating some price pressures from the foreign sector. Despite this negative inflation picture another reduction of 50 basis points in the repo rate is expected.

Conclusion

The South African economy will weaken further in Q2 and Q3 of 2009 following the sharp contraction in Q1 2009. Household spending will remain mute, whilst growth in real disposable income should be negative. Fixed investment will remain under pressure and increased government spending will not compensate for these declines. However, preliminary indications are for a return to growth by Q4 2009/Q1 2010. This is mainly as a result of an expected improvement in the US economy. A further reduction of 50 basis points in the repo rate next week will support such recovery.

Prof. Chris Harmse	**Johann van Tonder**	**Tony Gustavo**
Chief Economist	**Economist**	**Senior Trader & Technical Analyst**

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