

STANLIB

Weekly Focus

Week 8 | Issue 184

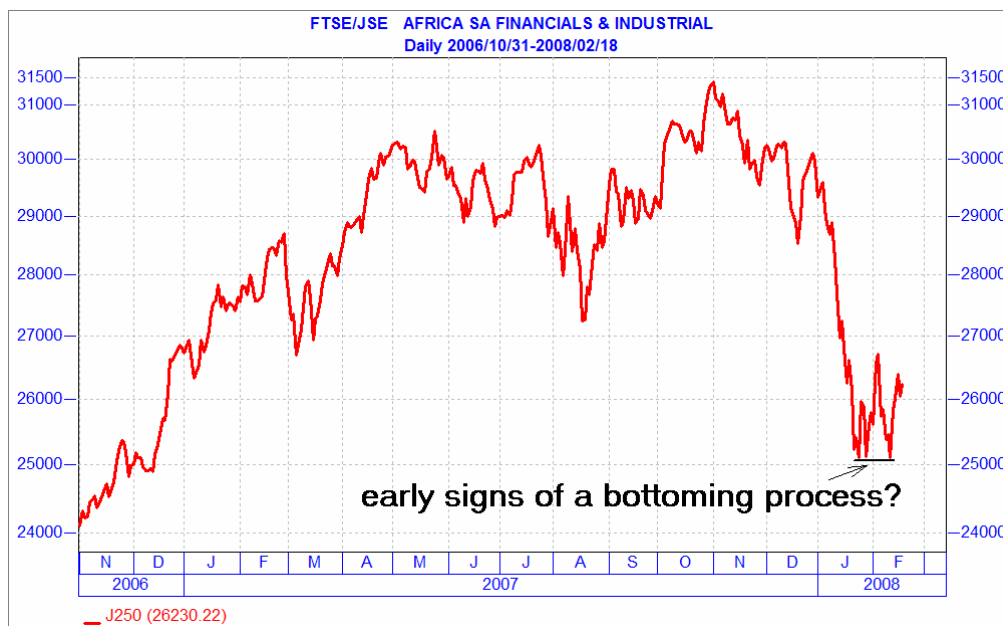
18 February 2008



Items covered: Financial & industrial shares rally, STANLIB unit trusts, snippets of info.

FINANCIAL & INDUSTRIAL INDEX BOTTOMING?

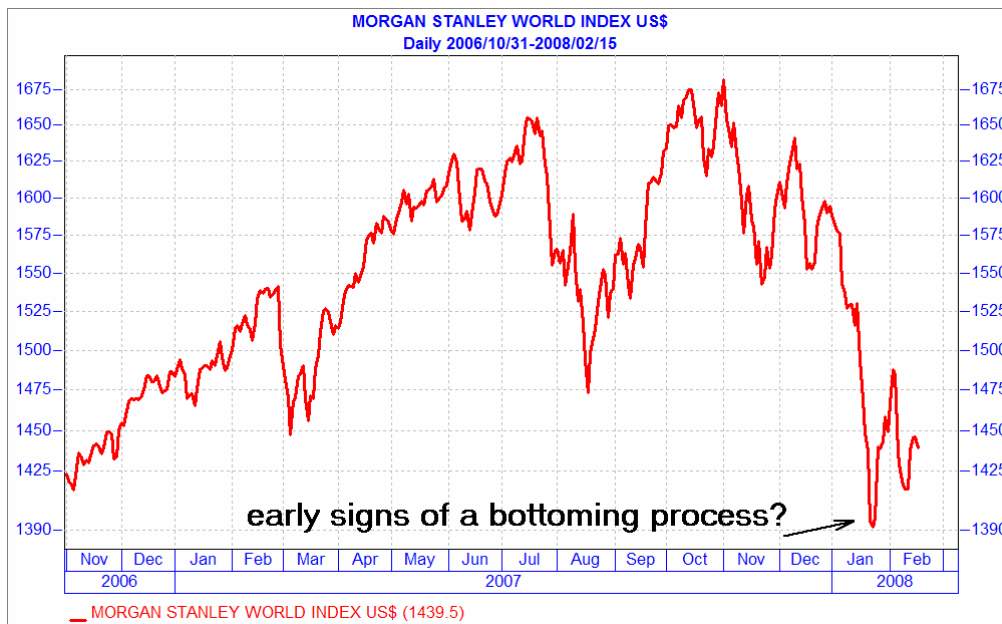
- Having discussed the Financial & Industrial Index last week, how it had fallen substantially early in 2008 and how pockets of good value were emerging, we noted with interest that the index rose 2.3% last week and is showing signs of possibly having bottomed (see chart below).



Source: I-Net Bridge

- This is not surprising when one considers that last Monday the index was trading on an historic price-to-earnings ratio (PE) of just 12, which is the lowest it has been since 2004, which was very early in the bull market. The PE was down from 17.5 seen in January 2007.

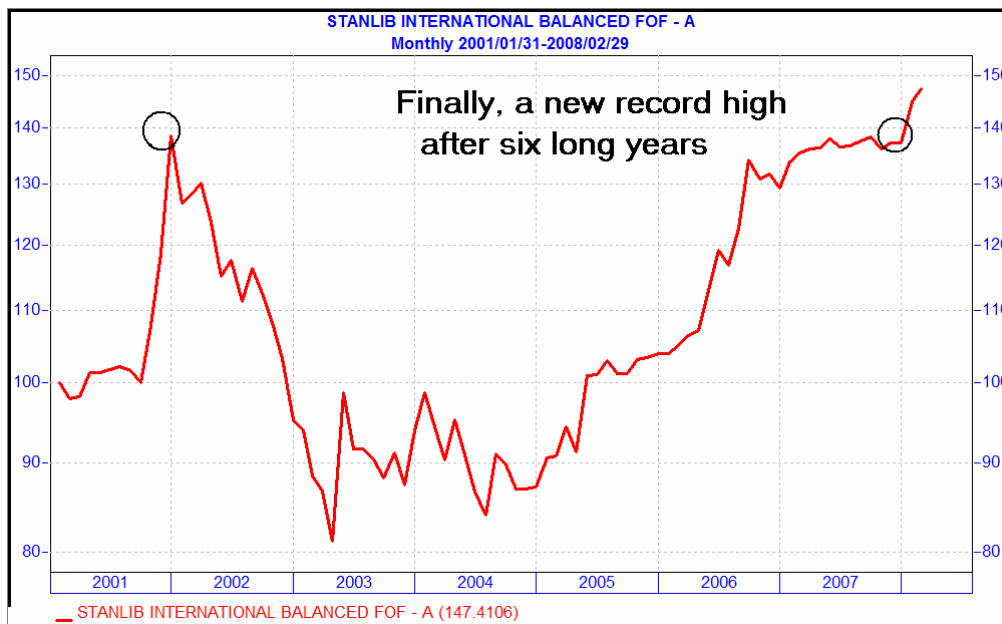
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- The forward PE was a mere 10.3, last seen in 2003 when the stock market began its big bull run and way below the 14.3 average of the new SA (1994 to now). That is ridiculously cheap, great value!
 - Similarly the banks index was one week ago down 30% from its record high on an historic PE ratio of just 8.7, way below its new SA average of 12.2 and the lowest PE since 2002/2003 when global markets were very weak. The dividend yield was 4.3% versus the new SA average of 3%. The banks index rose 4.9% last week, not surprisingly.
 - General Retailers were 41% below their record high (lowest since 2001) on an historic PE of 8.7 versus the new SA average of 13.9; the dividend yield of 5.2% was double the new SA average of 2.6%. The index rose 5.9% last week.
 - The Construction Index was down 22% on a forward PE of 13.5, quite reasonable considering the growth prospects. The index rose 5.1% last week.
 - So, all-in-all, the signs are there that a rally may have begun from very oversold levels where great value was evident - still is. It is usually the case that the best value in shares is evident during times of maximum pessimism. We only have to look at the events of January 2008 to know that the levels of pessimism in this country had sunk to multi-year lows and this depressed sentiment was reflected in share prices, creating great buying opportunities.
 - Similarly, overseas markets have been showing similar tendencies (see chart below). Risk aversion is at such an extreme (risk appetite at a new low) and cash levels are so high offshore because of the credit crunch. The challenge is to identify the catalyst that will cause markets to rally, but clearly good value is evident.
 - Take Chinese shares as an example. They were very expensive last year as the Chinese stock market soared well over 100%. Now they're down 30% from their highs and the 'H' shares in Hong Kong (Chinese shares that are listed on the Hong Kong exchange) are trading on a forward PE ratio of just 14 times, which also seems good value.



Source: I-Net Bridge

STANLIB UNIT TRUSTS EXCELLING

- The latest unit trust performance numbers show the STANLIB Shari'ah Fund to be 1st over three and six months out of 62 funds in the huge General Equity sector.
- STANLIB Prosperity Fund is in top quartile over 3 months, 6 months, one year, 3 years and 5 years in the same huge General Equity sector.
- The STANLIB Resources Fund in particular, but even the STANLIB Gold & Precious Metals Fund hit all-time record highs last week!
- The STANLIB International Aggressive Fund of Funds (a recent Raging Bull award winner), the STANLIB International Balanced Fund of Funds (see chart below) and the STANLIB International Conservative Fund of Funds also hit all-time record highs last week, finally surpassing their previous highs of over six years ago (late 2001)!



Source: I-Net Bridge

SNIPPETS OF INFO

- The US trade deficit (imports minus exports) fell 6% in 2007, its first decline in five years, because exports grew by a sturdy 12.7% to a record; but the deficit with China grew by 10% and China overtook Canada as the biggest source of US imports (Financial Times).
- Iron ore prices have jumped 65% in the latest deal negotiated with Japanese importers. Iron ore is used to strengthen steel and global steel production and prices have been rising worldwide. This is good news for Kumba, Exxaro, Anglo American and Billiton.
- The Financial Times points out that Japanese exports to China have quintupled in the past seven years, whereas their exports to the US are about flat over the same period. Exports to the US are still 40% higher than to China, but the latter is catching up rapidly.
- Unfortunately, food prices continue to soar. In the US soyabean prices surged last week to a record high, as did wheat used to make bread (has trebled in the past year). Maize prices are just below their twelve year highs.

Paul Hansen (Group Director, Retail Investing)

Economic Update

Markets offshore still appear quite fragile, given the current credit crisis, most noticeably in the world's largest economy, the USA. USA January retail sales held-up better than expected, boosting short term morale, however the trend is still firmly lower. This sentiment was continued by a sharp decrease recorded in consumer confidence in February, as measured by the University of Michigan. The latest economic data points towards further easing by the Fed in March. Much stronger Japanese GDP data allowed the Bank of Japan enough room to leave interest rates at 0.5% last week.

Locally, all eyes will be on the Budget presented by Finance Minister Trevor Manuel this Wednesday 20 February at 14h00. Growth is likely to be revised down, with little hope of any significant tax cuts for individuals. SA manufacturing production and retail sales slowed significantly in December 2007, hurt by high interest rates and inflation. The weakening trend in manufacturing looks set to continue due to the recent electricity outages.

GLOBAL

- In January 2008, **US retail sales rose by 0.3%*m/m*, versus expectations for sales to decline by 0.3%*m/m***. The better than expected performance was partly due to increased sales of gasoline, which is a price effect. (US retail sales are presented in nominal terms). In addition, sales of clothing rebounded strongly in January, after a disappointing December.
- On an annual basis, US retail sales are still up 3.9%*y/y*, which on the surface appears reasonable, however there are a number of important factors that need to be taken into account in assessing this upward trend. Firstly, the **data is reported in nominal terms**, which given the slightly elevated inflation rate, suggests that in real terms sales are only marginally positive. Secondly, **gasoline sales are now up a massive 23%*y/y*, representing mostly the gasoline price increase and not volume growth**.
- Consequently, if gasoline sales are excluded, retail sales are up only 2.0%*y/y* in nominal terms; and therefore essentially flat in real or volume terms. If both gasoline and motor vehicle are excluded, sales are well down on the average annual growth of 4.3% in 2007 and a long-term average of 5.4%.

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- All of this suggests that US retail sales have slowed noticeably over the past year, reflecting a combination of higher interest rates during most of 2006/2007, slowing employment growth, slumping consumer confidence and a worsening wealth effect through declining house prices. The most recent cuts in US interest rates as well as the impending fiscal stimulus will help to stabilise sales in the months ahead, but in the interim retail activity is set to worsen before improving later in the year.

SOUTH AFRICA

The following are our main pre-budget expectations:

- Government is likely to **revise down their growth outlook for the next three years**, especially the expected increase in fixed investment spending. The Minister is also expected to discuss the impact of the current electricity crisis.
- At the end of December, government's tax revenue was again ahead of budget, although the revenue **overrun is unlikely to be as impressive as previous years**. Most sources of tax revenue are ahead of budget including individual tax, company tax, transfer duties, and the fuel levy. There are two notable exceptions, VAT and customs duty, which are both below the original budget estimate.
- **It is unlikely that Manuel will substantially reduce taxes in this year's budget**, given the efforts by the Reserve Bank to contain inflation as well as the likelihood that tax revenues could be under-pressure next year.
- At the end of December 2007, **government's expenditure was essentially in-line with budget**. Many commentators criticise government for not spending enough. In that regard it must be recognised that total expenditure is currently a massive 15.2% ahead of last year – not exactly sluggish growth. The criticism should rather be focused on the composition of expenditure (far too little fixed investment spending vs. consumption spending) as well as the effectiveness of expenditure. **The focus in this year's National Budget** is likely to be on the expenditure side, especially the increased fight against crime, industry support, support of Eskom, World Cup 2010, increased social payments, skills development and education, and improved health care.

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- Government is well on track to **achieve another budget surplus**, roughly in-line with the MTBPS estimate of around R11bn or 0.5% of GDP.
 - It will be crucial to see what **support government is willing to provide Eskom**, either in the form of a massive cash injection or through a government guarantee.
 - It is possible that there is some **additional relaxation of exchange control**, especially the move to a prudential offshore limit for pension funds and unit trusts. As far as we can tell, government is still committed to the gradual relaxation of exchange control.
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- **In December 2007, SA manufacturing production fell substantially.** Although manufacturing production is typically volatile on a month-by-month basis, the swings in production during the past three four months have been exceptionally large, and relate in part to the strike in the motor industry in September.
 - During 2007 manufacturing production grew by 4.1% compared with 2006. This was lower than the 4.8% increase recorded in 2006. Nine of the ten major manufacturing sectors reported an increase in output during 2007, with the motor industry being the only division to show a decline.
 - Manufacturing has experienced solid, albeit volatile, growth during the past 4 years. Initially the sector benefited from the vibrant growth in consumer spending, as well as the boom in the residential construction sector. In addition, the manufacturing sector had probably also learned to cope reasonably well with the stronger rand. However, the current slowdown in motor car sales as well as the moderation in general consumer activity, including a softening in demand for residential properties, has contributed to the weakening trend. Added to this the relative strength of the rand in the second half of 2007 has probably led to ongoing competition from imported products.
 - There is little doubt that the manufacturing sector has lost momentum in the past few months, after an impressive performance towards the end of 2006 and into the first half of 2007. The recent increases in interest rates; a moderation in residential housing activity; a slowdown in consumer spending and the more recent electricity outages are all likely to work-against manufacturing activity over the next 6 to 12 months. Consequently, manufacturing activity is expected to continue to slow in the months ahead, albeit off a relatively high base.

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- **According to this latest survey by Stats SA, retail sales fell by a worrying 0.5%/y in real terms in December.** The market was expecting an increase of 1.7%/y. The past two months represent the first annual decline in retail spending since 2001! **The trend is clearly reflecting a very sharp slowdown in retail activity.**
 - This slowdown in consumer activity is especially evident in the durable goods component of consumer activity, including passenger cars, furniture and appliances. Oddly, food sales have also slowed significantly, which could reflect the impact of the current high cost of food (food inflation is up at 13.5%/y).
 - The key question now is to what extent retail sales and consumer spending will slow further during 2008. Unfortunately a number of key economic factors will start to impact more fully on consumers:
 - **Interest rates have risen by 400bps** since June 2006 and are back at 2003 levels.
 - While consumers have increased their use of asset based finance, there has been a very **noticeable rise in credit card and private label consumer card debt.**
 - The **cost of servicing debt** is back to an eight year high.
 - **Summonses for debt are now clearly trending higher**, but off a very low base.
 - **Insolvencies** are still close to an all time low, but are also expected to move higher within the next 6 to 9 months.
 - **The petrol price** is set to increase further in March.
 - **House price growth** has slowed and the equity market has weakened recently. This is dampening the wealth effect, which will hurt consumer activity.
 - Introduction of the **National Credit Act (NCA)** should continue to slow growth in consumer credit.
 - The recent **electricity outages have impact negatively** on retail activity as well as confidence level.
 - **The combination of the above factors is likely to result in a further slowdown of consumer activity, off a high base, in 2008.** There is little doubt that the higher debt servicing costs are eating

into disposable income, while the higher inflation rate is eroding real income growth. CPIX inflation remains well above the target and is set to remain relatively high for most of 2008.

Kevin Lings and Melissa Rankin

STANLIB Economics and Group Retail Investing

Rates

The following yields are calculated using an annualised seven-day rolling average as per the unit trust industry standard. These rates are expressed in normal and effective terms and should be used for indication purposes ONLY.

STANDARD BANK MONEY MARKET FUND

Nominal: 10.51% per annum

Effective: 11.03% per annum

A constant unit price will be maintained. Past performance is not necessarily a guide to future performance. A schedule of fees and charges and maximum commission is available on request from the Manager. Commission and incentives may be paid and if so, are included in the overall costs. The yield is calculated using an annualised seven-day rolling average as at 15 February 2008.

STANLIB CASH PLUS FUND

Effective Yield: 11.21%

This is a current yield as at 15 February 2008.

PROTECTION SERIES RATES

These rates are indicative and are subject to change.

Fund	18 Months	36 Months
STANLIB Prosperity Fund	17.26%	34.86%
STANLIB Gold Fund	19.23%	48.70%
STANLIB International Equity Fund of Funds	17.26%	34.86%
STANLIB Multi-National Fund	17.26%	34.86%
STANLIB Alsi 40 Fund	11.85% (12 months only)	-

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