ME Investor Confidence Index Q2 2010

Offshore sovereign debt crisis weighed on confidence in Q2

5 Aug 2010

Key Findings and highlights for Q2:

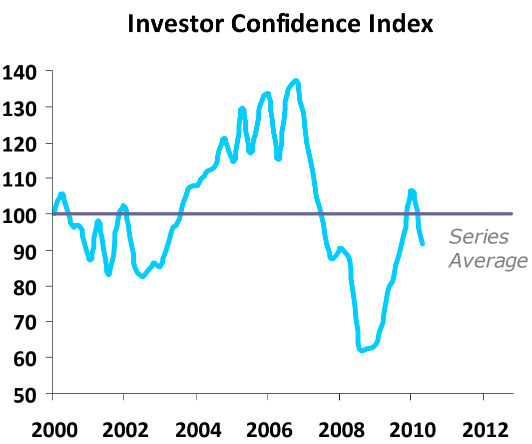
ICI Key Findings	*Q2 2010*	*Q1 2010*	*Q2 2009*
Index: 2000 = 100	**92.0**	106.7	75.9

- *The Maxim-ETM Investor Confidence Index (ICI) fell in Q2 2010 to 92.0 from a revised 106.7 in Q1 2010 (prev 105.9). The index remained around 16 index points, or 21.3%, higher than a year earlier when it recorded a reading of 75.9 in Q2 2009.*
- *The latest ICI reading was driven lower almost exclusively by offshore risk factors pertaining to the European sovereign debt crisis and the rise in global investor risk aversion.*
- *The local asset rotation into equities that began in Q2 2009 reversed in Q2 2010, highlighting subdued confidence levels among local investors. The rotation away from equities saw funds moved into bonds and back into cash in roughly equal proportion.*
- *Fixed income asset allocation remained strongly on the up in line with previous quarters as funds continued to take advantage of improving real yields, better government finances, and healthy offshore demand.*

Notes: *Preliminary Index – As we await the latest release of the leading indicators data from the SARB for June, we use the average of the Apr-May readings and this might result in a modest change in the revised version of the index.*

Maxim-ETM Investor Confidence Index

	Q1	*Q2*	*Q3*	*Q4*
2000	100.0	105.4	96.9	96.3
2001	87.4	98.1	83.0	96.2
2002	101.7	85.4	82.4	86.2
2003	85.9	95.0	98.7	107.0
2004	107.8	111.6	113.6	121.0
2005	114.6	129.3	116.9	130.2
2006	133.1	115.1	133.0	137.1
2007	123.8	107.4	97.2	87.6
2008	90.4	87.0	62.3	62.3
2009	64.7	75.9	83.4	94.4
2010	106.7	**92.0**		



Investor Confidence Index **Q2 2010**

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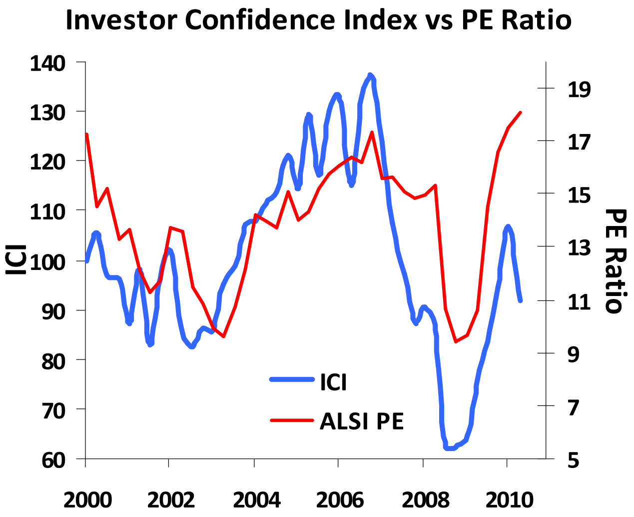
Summary of the Latest Findings

- The **Maxim-ETM Investor Confidence Index (ICI)** fell in Q2 2010 to 92.0 from a revised 106.7 in Q1 2010 (prev 105.9). The index remained around 16 index points, or 21.3%, higher than a year earlier when it recorded a reading of 75.9 in Q2 2009.
- The latest ICI reading was ***driven lower almost exclusively by offshore risk factors*** pertaining to the European sovereign debt crisis and the rise in global investor risk aversion.
- The local asset rotation into equities that began in Q2 2009 reversed in Q2 2010, highlighting ***subdued confidence levels among local investors***. The rotation away from equities saw funds moved into bonds and back into cash in roughly equal proportion.



- Fixed income asset allocation remained strongly on the up in line with previous quarters as funds continued to take advantage of improving real yields, better government finances, and healthy offshore demand.
- The real underlying fundamentals of the SA economy continued to improve in Q2, albeit at a slower pace than in Q1 and Q4 2009, suggesting that the loss in investor confidence had more to do with offshore sentiment factors and the growth risks posed by the European sovereign debt crisis than with deteriorating domestic growth outlook. That said, ***leading indicators of the real economy have started to level off and it would not be surprising to see growth momentum begin to slow in Q3***.

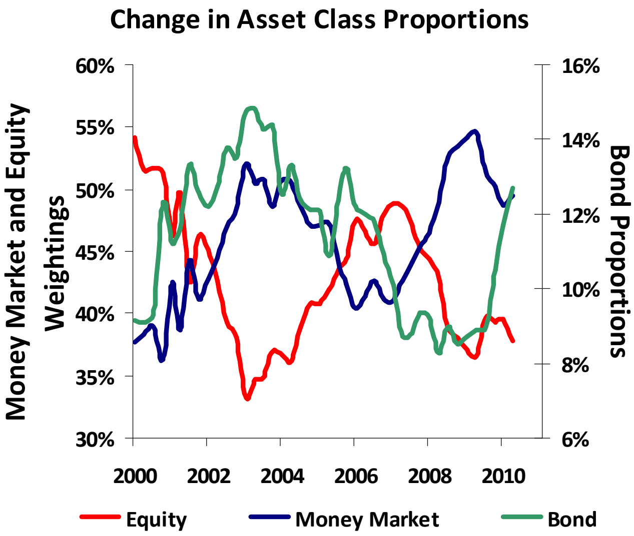
	Equities	*Bonds*	*Cash*
Q2 '09	36.6%	8.9%	54.5%
Q3 '09	39.7%	9.0%	51.5%
Q4 '09	39.3%	10.5%	50.2%
Q1 '10	39.6%	11.7%	48.7%
Q2 '10	37.8%	12.7%	49.5%

Numers may not add up to 100% due to rounding

Analysis of Changes in Asset Allocation

Q2 was a quarter in which Bonds again enjoyed healthy rotation action, continuing a well worn trend that started in Q1 2009 and really accelerated in Q4 2009. Funds upped their weighting in ***bonds*** from 11.7% to 12.7% in Q2 2010, and it looks as though this will continue for at least few more quarters going forward. Perhaps one of the most disappointing features of the Q2 ICI reading was the dip in equity allocation. This was the sharpest drop in allocation to ***equities*** since Q3 2008, which was a time of severe equity market distress precipitated by the collapse of Lehman Brothers. It was clear this was the result of the panic that set in regarding the European sovereign debt crisis. The allocation to equities fell from 39.6% in Q1 to 37.8% in Q2. Surprisingly there was a strong rotation back into cash, which was part and parcel of the rotation play out of equities, as players took to the sideline amid a considerable degree of uncertainty. The ***money market*** allocation increased from 48.7 to 49.5% in Q2.

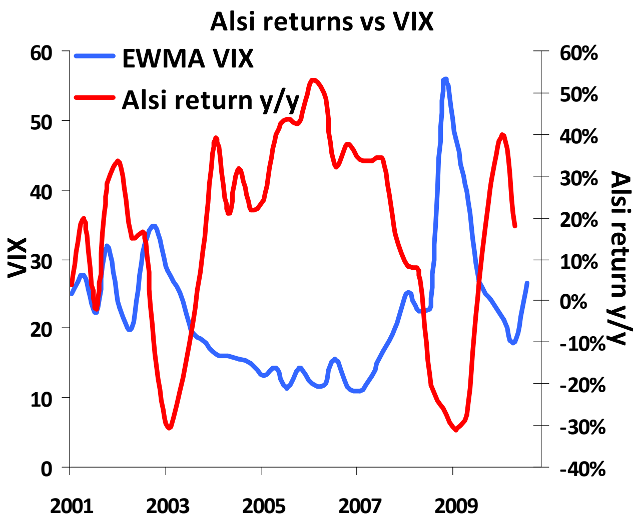
Bonds: With underlying inflation pressures subsiding quite fast in SA due to stagnant money supply and credit growth, investors are finding that bond yields are offering a particularly attractive real risk-adjusted return. The allocation into bonds may well still have quite a bit further to rise in the quarters ahead. Local funds will also have been enticed into bonds by the improvement in government finances in Q2 as Treasury announced revenue overruns in major tax categories such as VAT and personal income. This probably means a lower 2010/11 deficit than originally forecast and therefore lower bond issuance than expected. Foreign demand for bonds has also been very strong in h1 2010, enticing local players into the market to take advantage of capital gains.



Money Market: Funds unwound from cash rapidly in Q3 2009 and this continued in Q4 and Q1. This was a systemic pattern of funds freeing up liquidity in a lagged response to the equity rally that had begun in Q2 2009 in order to take on more risk and stay in touch with peers in the markets as general returns for more aggressive funds climbed strongly. The bias to move away from money market funds had been driven by falling interest rates leading to higher opportunity costs of holding cash balances, and less financial market distress and need for liquidity. In the previous ICI release for Q1 we pointed out that the prospect for further rotation of funds away from money market seemed extremely likely barring another major global financial shock. In the event something akin to a financial shock occurred as Greece and other southern European states were found to have highly vulnerable public finances, causing offshore bond markets to come under massive pressure, equity sentiment to fall on growth fears, and equity volatility to rise. All these factors made Q2 a period in which rotating in cash was the natural default option of a domestic investment community that remains inherently cautious.

Equities: We have argued in previous ICI releases that the jump in the Q3 2009 ICI equity allocation was reactive rather than predictive because it had much to do with a desire among funds not to miss out on the equity rally that was already under way as opposed to a genuine value-driven rotation. The same can be said of the allocation away from equities in Q2 2010 and it is less reflective of an underlying panic than it is a reflection of funds adopting reactive defence strategies in a much more volatile period caused by unpredictable shocks in the major offshore economies. Having said that it would be misleading to say the underlying sentiment is outright bullish, and there is no doubt that local funds remain nervous of increasing equity exposure at a time when valuations are arguably fully front-loaded when so many offshore global growth risks abound. Any rise in equity allocation in the quarters ahead would likely be gradual rather than rapid.

Analysis of Risk Aversion



Widely known as a risk aversion barometer, the VIX index estimates the implied volatility over the next 30 days by taking a weighted blend of prices for a range of options on the S&P 500 index. This index is typically used as a proxy for risk aversion levels. A lower VIX index means lower levels of risk and higher confidence. It is for this reason that the VIX is often informally referred to as the 'fear factor index'.

The debt travails of the Eurozone's members in Q2 created a mini-panic across global markets and raised the risk of a debt contagion that could ultimately become a full scale banking crisis. The ripple effects of this event could be very negative indeed for economic and market performance, and so it was not surprising to see the VIX index climb sharply in Q2. The rise in the VIX accounted for almost the entire decline in the ICI in Q2, a very clear indication that the predominant driving force for poorer confidence among local and offshore funds investing in SA was in fact driven by offshore factors and global fears.

Analysis of Leading Indicators

The South African leading economic indicators form a portion of the overall Investor Confidence Index (ICI). At face value these are not indicators of investor confidence per se, but rather a set of early warnings of changes coming in *real economic activity*. However, the leading indicators of real activity are included because investors in large part base investment decisions on the underlying real economic environment.

In this sense, the leading indicators are a proxy for investor confidence in the future earnings environment and the extent to which offshore economies will help/hurt the local economy. While financial market confidence is very important, real market confidence is as, if not more, important, especially over the longer term.

Recent quarters saw a huge surge in growth in leading indicators, reflecting the stimulus-driven offshore economic recovery and the associated jump in commodity prices which has clearly benefited the local mining sector and has also seen some of the large industrial, export-oriented manufacturers performing well in recent months. In the previous ICI release for Q1 we argued that going forward the leading indicator component is likely to exert less upward pressure on the ICI as the pace of recent gains will not be sustained. In Q2 we have seen y/y growth in the leading indicator index remain stagnant, while q/q growth has declined very sharply. This should be seen as an early warning signal that GDP growth in Q3 and Q4 2010 will slow considerably as the rapid pace of economic recovery seen in h2 2009 and h1 2010 simply cannot be sustained. The leading indicator component was not a significant drag on the ICI in Q2, but in Q3 and Q4 we expect it to exert more pronounced downside pressure on investor confidence.