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MARKET AND FUND MANAGER PERFORMANCE – QUARTER 3, 2011

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Uncertainty around the Eurozone sovereign debt situation, particularly the position of Greece, and a gloomy view of prospects for the global economy saw investment markets fluctuate considerably over the third quarter of 2011, with the general mood being one of risk aversion. The local equity market as measured by the All Share Index declined by 5.5 percent over the quarter. Commodity prices fell sharply over the quarter, with the exception of the (US Dollar) price of gold which rose by just over 8 percent. All three major sectors comprising the All Share Index declined over the quarter, with Resources shares falling by 10.0 percent, Industrial shares by 3.3 percent and Financial shares by 3.1 percent. Within the Resources sector, the gold mining subsector bucked the trend by gaining 19.5 percent.

Developed market equities, as measured by the Morgan Stanley Capital International (MSCI) World Equity Index, declined by 16.5 percent in US Dollar terms with "emerging market" equities as measured by the MSCI Emerging Markets Index posting even weaker returns with a 23.2 percent decline over the quarter. The negative sentiment towards "risky assets" saw the Rand weaken by some 19 percent against the US Dollar over the quarter, and this helped to offset the negative investment returns earned on international equities for South African investors.

However, sentiment shifted dramatically from negative to positive for "risky assets" after the quarter end, as local and international equity markets rose sharply over the month of October. The All Share Index gained 9.3 percent, the MSCI World Equity Index 10.4 percent (in US Dollar terms) and MSCI Emerging Markets Index 13.1 percent (also in US Dollar terms), while the Rand strengthened by 1.8 percent against the US Dollar. The effect was that by early November the All Share Index had more than recovered from its losses over the third quarter, although its year-to-date performance was still rather lacklustre.

The lack of investor appetite for "risky assets" during the third quarter benefited the bond markets. The All Bond Index ended the quarter with a total return of 2.8 percent and the Barclays Inflation Linked Bond Index ended with a return of 3.0 percent, higher than the return on money-market assets (some 1.4 percent for the quarter).

International bond markets also saw a "flight to quality" with good returns for the global government bond indices published by JP Morgan (3.1 percent) and Citibank (2.4 percent) in US Dollar terms, and bond yields on US 10-year treasury debt falling from 3.2 percent p.a. to just below 2 percent p.a. over the third quarter. August also witnessed the highly unusual spectacle of US 10-year TIPS (inflation-linked government bonds) trading at a negative yield – in effect, investors were (briefly) so risk-averse that they were willing to pay the US Government to keep their money safe for them!

In our single manager "Industry Median" (Global Balanced) survey category, the range of SA Equity exposure at the start of the third quarter varied across the managers' portfolios between 37 percent and 67 percent, with managers maintaining exposure levels close to these levels over the quarter. Managers with a more "bearish" outlook and lower equity exposure, such as Allan Gray and Re:CM, were among the best performers in the quarter's performance tables.

In the corresponding survey table for the second quarter, Allan Gray (with their "bearish" market outlook) was ranked at the bottom of their peer group based on their 3 month and 12 month performance at that time. Our third quarter survey shows a different picture, with Allan Gray ranked first over the 3 month, 12 month and 10 year measurement periods. This dramatic improvement in ranking over short-term measurement periods reminds us that one can sometimes draw the wrong conclusions about the skill of an investment manager by looking at short-term performance in isolation - this is especially true when markets are volatile and relative performance can change very rapidly. Elsewhere on these pages, Erich Potgieter discusses the importance of long-term thinking in uncertain times like these when making investment decisions with a long-term investment horizon.

Investment thinker Benjamin Graham devoted a chapter in his well-known book "The Intelligent Investor" to the topic of market fluctuations. Graham offers the following advice on how investors should perceive price fluctuations: "They provide the investor with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal. At other times investors will do better if they forget about the stock market and pay attention to dividend returns and to the operating results of companies."

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