

Market Commentary

26 November 2007

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Turbulent times continue... I felt like a prophet within weeks of my last communication as the US Fed reduced interest rates leading to a strong rally in world markets. The JSE reached a record high of 31,728.18 in early October (Approx 5% above the peak reached in July, and 27% above the lowest point of the year). I believed that the 'sub-prime' impact would be short lived and accurately priced into world markets – I was wrong.

The exposure of financial institutions such as JP Morgan; Citigroup; CSFB etc. to packaged and unitised mortgage debt in the USA has led to large write-downs of assets that can't help but impact on their profitability. This in turn leads to reductions in share price. Only as these companies release their results, is the extent of 'sub-prime' becoming clear. The US Fed has contributed to weakness in the Dollar by reducing interest rates despite the inflationary pressures created thereby. This strategy benefits the US economy by making US exports more competitive, while allowing the US consumer some space to continue spending.

Economics 101

Inflation, simplified as far as possible, can be broken into two driving factors: 'Demand pull' inflation and 'Supply push' inflation. The affect that inflation has on goods/services can be described as elastic or inelastic in nature.

Demand pull: There is more demand than there is supply – This leads to the price being bid upwards by consumers.

Supply push: The cost of supplying the good has risen – Prices must be raised in order for suppliers to survive.

Elastic: There are numerous alternatives to the good in question - Should the price increase, sales will reduce dramatically (Colgate v Aquafresh; Mercedes Benz v BMW etc).

Inelastic: There are few/no alternatives – Should the price increase, there will be limited/no change in sales.

Oil, from a South African perspective, is an example of inelastic demand subject to Supply 'push' inflation – SA has no control over the price of oil imports, and the selling price of local produce is largely determined by global market prices. With limited viable alternatives to oil at this stage, sales are relatively constant regardless of price.

Food (overall) is similarly inelastic in demand, but prices are almost entirely demand driven. Wheat may be very elastic when compared to maize, but wheat and maize together are very inelastic in demand.

The point

There has been criticism of the SA Reserve Bank in doggedly pursuing their inflation targeting strategy despite inelastic food and oil prices being largely responsible for overall inflation in SA. Despite this, Tito Mboweni has remained steadfast in his approach to inflation targeting, with a further rate hike in December practically a foregone conclusion. This is despite the negligible effect that interest rates have on food and oil consumption.

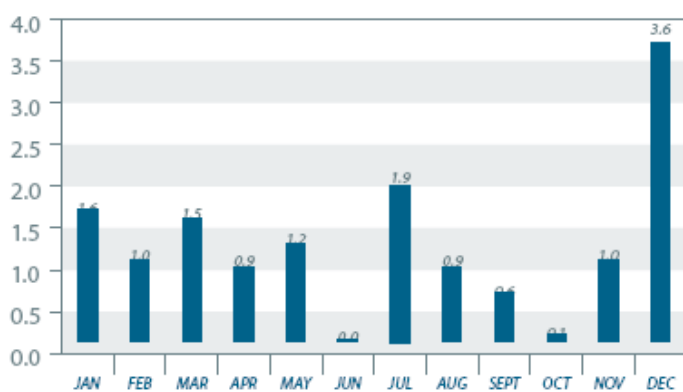
The growing interest rate differential between the Rand and Dollar is largely responsible for the recent Rand strength as 'flighty' capital flows enter SA. This capital is unfortunately contributing heavily to the JSE's volatility. On a more positive note, international interest in South Africa appears to also be of a longer-term nature, as evidenced by the Standard Bank and Vodacom deals.

South Africans appear to finally be realising that the value of one's home is no longer a 'golden goose' that will fund one's lifestyle indefinitely through re-mortgaging. This is leading to pressure on new vehicle sales and durable goods sales in the retail environment. The National Credit Act and higher interest rates appears to be resulting in residential properties having 'For Sale' signs rusting on their pavements while 'Sold' signs take an extended holiday.

As can be seen from these graphs of the All-Share Index – the JSE remains unusually volatile.

It is clear that had investors panicked in August, and sold out their equity holdings, it would have resulted in their missing the massive upswing in late September and early October. At the time of writing, the year to date performance of the JSE is around 16.16%. This is not an inspiring figure, but comfortably beats every major world index barring the Hang Seng.

I believe the portfolios remain appropriate and should continue to weather the market conditions. Historically December is a good month on the JSE, as evidenced by the below graph showing the past 40 years' average returns month-on-month. Let's hope history repeats itself!



As usual, please feel free to contact my office should you want to discuss/review your investment holdings.

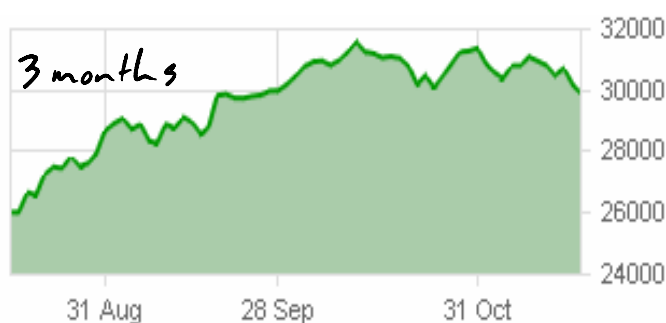
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- Further investment and retirement planning needs.
- Fiduciary services (Wills and trusts)
- Tax affairs and returns
- Short term insurance needs

Our offices will be closing on the 22nd of December, reopening on the 2nd of January. I will be available on my cell in case of emergency.

I wish you and your families a fantastic festive season, and look forward to a less eventful 2008!

Kind Regards,



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