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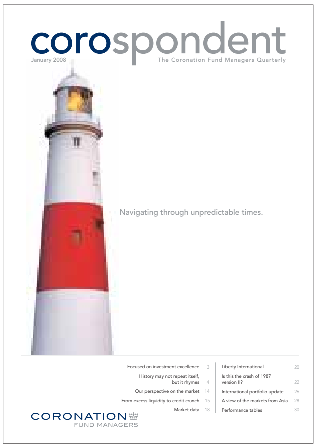
January 2008
The Coronation Fund Managers Quarterly

Navigating through unpredictable times.

CORONATION
FUND MANAGERS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Focused on investment excellence

by HUGO NELSON

As Coronation enters its 15th year of operation we are ever mindful of the importance of clients and proud to have achieved recognition as a leader in the South African investment management industry. Our aim is to deliver investment excellence where the strength of investment performance across all client portfolios reflects our philosophy of investing with a long-term time horizon.

People, philosophy and process are paramount in any investment management business. Investment markets are cyclical and the environment in which decisions are taken is characterised by risk and uncertainty. At Coronation we conduct original research with the aim of understanding everything about a company that will build a case for, or against, its inclusion in a client's portfolio. There is no crystal ball involved in investing; it requires strong analytical skills, perspective, patience and conviction.

Looking back on 2007

The year began with a flurry of private equity deals which buoyed the domestic equity market and significantly increased the level of shareholder activism. With the aim of achieving equitable treatment of all shareholders, institutional investors actively engaged with service providers to challenge their rights as shareholders on a number of deals. The Shoprite deal was a case which highlighted this most clearly. This extended to a number of investment mandates being re-examined as funds sought to follow their rights into unlisted vehicles – so often the end result of corporate action.

Despite the trend in recent years towards specialist mandates, trustees have started to investigate the merits of a balanced mandate as the importance of asset allocation and its inherent benefits become more widely understood. As a result, investor education at a number of levels and in varying forms has become a priority for the industry.

Staying with the global issue of corporate governance, the Financial Services Board released Circular PF130 – 'Good Governance Guidelines for Retirement Funds' mid-year. This is a comprehensive guide for pension fund trustees to carry out their duties, and serves as an early indicator of post-reform governance standards in the industry. In time this may form the basis of decisions to ensure future cost effectiveness and better governance in the administration and management of pension funds.

Among individual investors unit trusts continue to grow in popularity, with total industry assets under management increasing to R646 billion invested in 787 funds. The role of the unit trust industry in managing assets earmarked for retirement continues to grow. Since 2002, assets invested in prudentially regulated balanced funds increased fourfold to a current level of 20% of industry assets. It is interesting to note that unit trusts have become the preferred investment vehicle for personal pre-retirement saving through retirement annuities and preservation funds. In addition, individuals are increasingly choosing unit trust-linked living annuities over traditional pensions.

Of key consideration to the industry over the next five years will be the impact of the Social Security and Retirement Reform as proposed by Government in the second discussion paper circulated by National Treasury in February 2007. While the scope of the discussion paper is ambitious and the strategic imperatives are clear, much of the detail has yet to be formulated. This process will fundamentally change the landscape of the long-term savings industry and is therefore a key issue on our agenda. We support the principles defined by policymakers and believe change will assist in building a better, more equitable industry in the long term. We continue to engage with policymakers to contribute to the success of this important social reform.

Another interesting feature of the year was boutiquing (new start-ups), which led to the adding of more layers of complexity and a greater burden on the investor to choose appropriate managers and products. While investors attempted to navigate their way through the explosion of service providers and product, we used the opportunity to strengthen our message of a long-term investment philosophy and the Coronation DNA which anchors all our products. This is contrary to the recent trend in fund management of offering 'silos' with different investment philosophies.

Investment performance

Investment performance within our unit trust range remains strong and we are particularly pleased with the long-term performance of our core funds, all of which rank first in their categories and have significantly outperformed their benchmarks on an annualised basis since inception (excluding the newly launched Balanced Defensive Fund). Over the longer five-year period, the Coronation Capital Plus, Market Plus, Top 20 and Resources funds all achieved the best performance in their respective peer groups. The Coronation Strategic Income Fund is now the largest managed income fund in South Africa and the Coronation Capital Plus Fund retains its position as the largest absolute return fund in the country.

Within the institutional market solid long-term performance in our flagship domestic balanced portfolios places us 3rd over five years in the Alexander Forbes SA Large Manager Watch to end November 2007, and 3rd over the shorter three-year period. Similarly, the consistency of our superior performance in fixed interest is noted in our upper quartile position in the Alexander Forbes SA Bond Manager Watch to end November 2007.

The Coronation Multi-Strategy Arbitrage Fund closed to new investors in December 2006 and the Coronation Granite Fixed Income Fund won the 'South AfricaHedge Fund Award' for the Best Fixed Income Hedge Fund for 2006.

Product development

Our hedge fund range has attracted considerable interest from both local and international investors. In terms of our international offering to both institutional and individual investors, we have revamped the global product range and plan to introduce a number of new funds in early 2008. We are, in particular, very excited about the recent establishment of our global emerging markets unit, which capitalises on our domestic stockpicking skill and experience. By extending across the global emerging markets universe we plan to manage global emerging market portfolios from South Africa.

Over the past year, three new unit trust funds were added, namely, the Coronation Balanced Defensive Fund and the Coronation Dynamic Protector Fund, both of which are defensively managed offering lower risk growth for conservative investors, and the Coronation Preference Share Fund, aimed at investors who require tax-efficient income.

Transformation and ownership

Integral to our business, and the economy, is the achievement of sustainable broad-based black economic empowerment (BBBEE). Transformation is a key component of our long-term business strategy which is implemented through the transformation committee. While very much a work in progress, we are proud of the milestones we have achieved in transforming our business, and indirectly the financial services industry.

Post our financial year-end in September 2007, auditors KPMG Inc. audited our compliance with the generic scorecard contained in the Department of Trade and Industry's Broad Based Black Economic Empowerment Codes of Good Practice as gazetted on 9 February 2007. The outcome of this report is that Coronation's BBBEE status is that of a level four contributor. This is a procurement recognition that sees all Coronation clients receiving 100% acknowledgement for their procurement of Coronation's services.

During the year we were awarded the prestigious 'Eric Molobi Most Progressive Company Award for 2007' by The Association of Black Securities and Investment Professionals; achieved a further EmpowerDEX 'A' rating, and placed runner-up in the financial services category of 'The Community Growth Socially Responsible Investing Awards'.

A total of 31% of our business is owned by staff, of which 10% is held by the Imvula Trust, our empowerment partner made up of all current and future black staff.

We firmly believe that we have the right strategy in place and a business model that focuses on the needs of our clients. There are some exciting initiatives under way and we look forward to bringing a number of new and appropriate products to market in the early part of 2008.

Hugo Nelson

Hugo was appointed CEO in November 2007. He joined Coronation in 1999 as part of the investment team, initially as an equity analyst and later as a portfolio manager responsible for large institutional client portfolios and unit trust assets. Hugo is a medical doctor, Oxford University MBA graduate and holds a CFA.

History may not repeat itself, but it rhymes – Mark Twain

BY KIRSHNI TOTARAM

An opportunity for the smart money to prosper from the irrationality of others

Why do market crashes and banking panics happen? Conventional wisdom often tries to pinpoint period-specific causes or 'one big idea' – a sole cause so large that it can cover a multitude of sins. Unfortunately, the one big idea often ignores the considerable richness of detail that the recounting of a single crisis can reveal, and thus produces simplistic conclusions and the potential for inappropriate recommendations for decision makers.

In writing this article, we attempt to present an understanding of the major stock market crashes of the 20th century, with the aim of refuting the bear argument that sees parallels between the situation today and past market crises. We use the word 'crash' to suggest a sharp decline in stock prices and 'panic' refers to a run on banks that is inconsistent with economic reality and the ability of the bank to meet withdrawals. It is our observation that, more often than not, financial crises result from a convergence of forces, a 'perfect storm' within the financial system.

The panic of 1907

The downfall of a prominent speculator rocks the financial system and a prominent millionaire saves the day.

One hundred years ago, financial panic gripped the United States. The crisis lasted 15 months, during which time the stock market fell 37% from its 1906 peak, affecting virtually every industrial sector and causing the failure of at least 25 banks and 17 trust companies.

Recounting the events of 1907, talks once again of a 'perfect storm' within financial markets which had gathered in preceding years.

Preceding the crash and panic of 1907 the US had experienced a period of rapid economic growth. This growth created massive demand for external finance and, as in most economic expansions, imposed liquidity strains on the financial system within the US. The supply of capital was unable to keep pace with the rate of demand.

The financial system was highly complex with linkages by which trouble could spread and a great deal of complexity (mainly within trust companies) which made it difficult to know exactly what was going on within the system. In 1907, there were 16 000 financial institutions in the US (compared to 7 500 in 2007) all without a central bank or regulatory authority. This was a market which was highly fractionalised and localised.

A key concern for the Government of the time was the rise of the trust companies whose assets and activities had grown rapidly after the depression of the 1890s. The financial trusts managed money for estates, held stocks and other assets, and accepted deposits like banks. Many of their loans used real estate and stocks as collateral. When these prices fell and loans were not repaid, the trusts became bankrupt and in turn ruined investors' wealth.

> *The introduction of the Anti-Trust Act of 1890 was intended to break up companies with near-monopoly control over an industry. President Theodore Roosevelt was on a warpath against anti-competitive business practices and his aggressive application of this policy in the end contributed to the panic of 1907 (highlighting that poor leadership in economic and political circles can elevate the risk of a crisis).*

More than likely, the main cause of the crash was stock market and real estate speculation. However, a significant contributor to the panic was Augustus Heinze and the Knickerbocker Trust Company. In 1906, Heinze sold his shares in Montana copper mines for US$12 million and moved to New York to buy Knickerbocker Trust. In doing so he became a director in a national financial chain. Banking industry leaders, threatened by the developing trust companies, staged a financial attack on Heinze's Knickerbocker Trust. Their motive was to sway public and congressional opinion against trusts.

England was the global centre for capital at the time, and half of San Francisco's fire insurance was covered by British insurers. Losses stemming from the San Francisco earthquake on 18 April 1906 and resultant fire punished British insurers. As the winter of 1906 approached, a major credit deficit was in effect in New York as the two countries' financial systems were intertwined. While money drained from England in the form of pay-outs, interest rates rose in both England and the US, but mostly due to borrowing for speculation. High interest rates and real estate prices halted investment in capital goods.

In March 1907, overexpansion and poor speculation led to a stock market crash. Money became extremely tight and by summer, the Bank of England blocked US finance bills, bringing down gold reserves and causing a 'national liquidity drought'. A second crash occurred in October 1907. This time, directly precipitated by Heinze's brothers, who had used money borrowed from Knickerbocker Trust in a failed attempt to corner United Copper. On 21 October the National Bank of Commerce ceased to honour cheques of Knickerbocker Trust, causing a run on the trust company. By the end of the following day the National Bank of North America had failed and runs had been sparked on nearly every trust in New York.

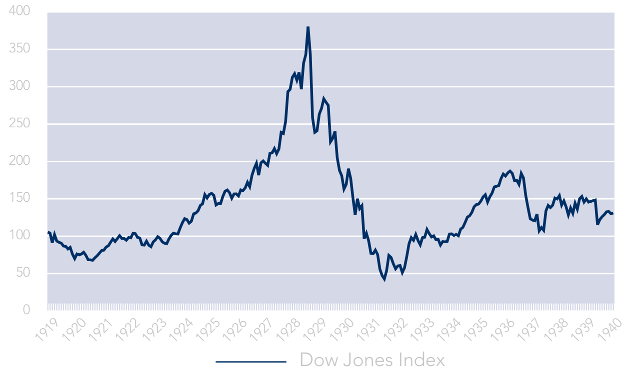
When the financial situation in New York continued to deteriorate, JP Morgan – the man, not the firm – decided to take charge. Neither elected nor appointed to the task, he simply decided that the time had come to take action. To restore confidence, JP Morgan, working together with the Secretary of the Treasury, organised a group of bank executives and the US Treasury to transfer money to troubled banks and buy stocks. This action soon ended the panic. Banking chiefs, led by JP Morgan, later concocted the central-banking scheme that became the Federal Reserve Act of 1913.

Indeed, in history many scholars reiterate the importance of collective leadership in managing financial system liquidity during times of crisis. Friedman and Schwartz wrote in 1963: 'the detailed story of every banking crisis in our history shows how much depends on the presence of one or more outstanding individuals willing to assume responsibility and leadership … In the absence of vigorous intellectual leadership by the Board or of a consensus policy in the community at large … the tendencies of drift and indecision had full scope. Each failure to act made another such failure more likely.'

History also suggests that investor emotions can significantly influence the severity of a crisis. In 1907, history recounts suicides; letters describing overly buoyant or depressed markets; anxiety amongst depositors and bank executives; etc. Indeed, the very word 'panic' suggests a suspension of rationality by investors and the public at large. This is a source of much debate and contemplation – undue fear and greed by investors cause market prices to depart from those dictated by economic fundamentals. The crash of 1907 was no exception to this.

It is clear that the economy and banking system of the time would have benefited enormously from a Federal Reserve System. A central bank may have been able to stabilise the banks and could have allowed for a soft landing without the widespread depositor panic. By pumping liquidity into the system the Government would have been able to take on the role of JP Morgan.

The 1929 stock market crash



The Crash of '29 was – taking into consideration the full scope and longevity of its fallout – the most devastating stock market crash in American history. Two catchphrases, '**Black Thursday**' and '**Black Tuesday**', evoke this collapse of stock values. Both are authentic, for the crash was no one-day affair. The initial crash occurred on Black Thursday – 24 October 1929 – but it was the catastrophic downturn of Black Tuesday – 29 October 1929 – five days later, which precipitated widespread panic and the onset of unprecedented and long-lasting consequences for the US. The collapse continued for one month. By the time the crash was completed in 1932, stocks had lost nearly 90% of their value. Economists and historians disagree as to what role the crash played in subsequent economic, social, and political events. Some consider it to be the beginning of the Great Depression, but most believe it was just one symptom.

In fact it was Alan Greenspan who supported this theory in a statement to congress in 2003: 'While bubbles that burst are scarcely benign, the consequences need not be catastrophic for the economy. It was not the crash but the ensuing failures of policy that led to the Great Depression.'

No consensus exists to the exact cause of the crash. Many argue that one of the primary causes was the attempt by important people and the media to stop market speculators. A second probable cause was the great expansion of investment trusts, public utility holding companies and the amount of margin buying, all of which fuelled the purchase of stocks and investment trusts, and drove up prices. Public utilities, utility holding companies and investment trusts were all highly leveraged using large amounts of debt and preferred stock. These factors seem to have set the stage for the triggering event. The sector was vulnerable to the arrival of bad news regarding utility regulation which came in October 1929. As utility stocks fell dramatically margin buyers were forced sellers and panic selling of all stocks was triggered.

There is much to criticise in conventional interpretations of the 1929 stock market crash. In December 1929, many expert economists, including Keynes and Irving Fisher, felt that the financial crisis had ended and by April 1930 the Standard and Poor's 500 composite index was at 25.92, compared to a 1929 close of 21.45. There are good reasons for thinking that the stock market was not obviously overvalued in 1929 and that it was sensible to hold most stocks in the fall of 1929 and to buy stocks in December 1929 (admittedly this investment strategy would have been devastatingly unsuccessful).

Following World War I, the United States experienced a broad economic expansion fuelled by new technologies and improved production processes. Between the years 1927 and 1929, industrial production output increased 25%. Electricity was more widespread and the purchases of electrical appliances, as modern conveniences, took hold. Ford had created assembly lines that allowed cars to be produced at lower cost.

> *The stock market benefited greatly from the expanding economy. From 1926 to 1929, the market indices moved up nearly 400%. Investors frequently talked about the great wealth that could be made in the stock market. Relaxed credit terms from banks and stockbrokers fuelled the buying frenzy.*

Interestingly, economists who have later examined the fundamentals from the 1920s believe there was not a stock market bubble ready to burst by 1929. In fact, most of the stock values had merely tracked the rise in expected dividend payments. The economy was expanding rapidly and companies were enjoying this expansion. Those same companies that were enjoying these prosperous years had increased dividends and were expected to continue to do so.

So how did this roar come to a screeching halt? What exactly contributed to or caused the great stock market crash of 1929?

Many people blamed investors for taking speculative approaches to the market and driving stock prices well in excess of fundamental values. But in reality, it was once again a combination of several factors spread across the financial system that triggered the meltdown.

For a start, the banking structure at the time was, once again, poor. There were too few Federal restrictions on start-up capital requirements for new banks. As a result, many banks were in fact highly insolvent. When these banks started to invest heavily in the stock market, results proved to be devastating, once the market started to decline. By 1932, 40% of all banks in the US had gone out of business.

During 1929 the public were bombarded with statements of outrage by public officials regarding the speculative orgy taking place on the New York Stock Exchange. If the media say something often enough, a large percentage of the public may come to believe it. By 29 October the overall opinion was that there had been excessive speculation and the market had been too high. Even the *Federal Reserve Bulletin* of February 1929 states that the Federal Reserve would restrain the use of 'credit facilities in aid of the growth of speculative credit'. In fact, the Fed did hike interest rates on broker loans to try and curb some of this excessive behaviour.

> *However, by 1929 many individuals within the US had invested within the stock market. Fuelled by an increase in personal savings (boosted by wage increases over the prior five years of economic boom), the prospect of making relatively easy money, growing dividend streams of most companies, easy monetary policy and reinforced regulations had made investors feel that they were protected from fraud and perhaps falling stocks.*

Black Thursday – 24 October 1929

The stock market in reality crashed over a period of five days. However, the first sign of trouble came on Black Thursday – 24 October 1929. Each trading day the stock exchange typically traded around 4 million shares, but on Black Thursday a record 12.9 million shares were exchanged.

The systems for tracking market prices could not keep up with the trading volume, perhaps contributing to panic selling on the day. At one point, ticker tapes were running nearly 90 minutes behind the market and by market close on 24 October, a fall of around 9% had been registered.

At 1pm the following day, several leading Wall Street bankers met to find a solution to the panic and chaos on the trading floor. Acting on their behalf, the vice president of the Exchange, Whitney, placed a bid to purchase a large block of shares in US Steel at a price well above the current market. As amazed traders watched, Whitney then placed similar bids on other 'blue chip' stocks. This tactic was similar to that which ended the panic of 1907, and while it succeeded in halting the slide that day, the respite was temporary.

Black Monday – 28 October 1929

The slight recovery in the market on Friday, 25 October, led to a sense of security over the weekend as investors bought into the possibility of the market rebounding. But this was short-lived as conditions deteriorated and high trading volumes once again put pressure on the flow of information.

On Black Monday, trading volumes were near 9.25 million shares and market confidence declined sharply. By the end of the day, the market was down another 13%.

Black Tuesday – 29 October 1929

This is the day that most historians agree dealt the final blow to the Roaring 1920s and heralded the start of the Great Depression. On Black Tuesday, a record 16.4 million shares changed hands and the ticker tape machines fell behind by nearly three hours. With all hopes of a market recovery dashed, panic selling took hold and the market fell.

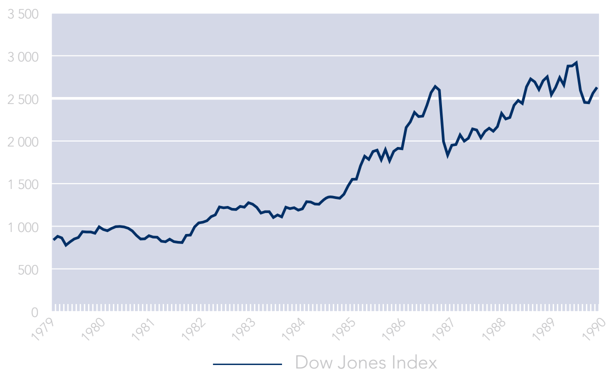
In a bid to restore confidence in the market, the Rockefeller family and other financial giants bought large quantities of stocks, but their efforts failed to stem the flow. The Dow Jones lost another 12% that day and the ticker did not stop running until about 7:45pm. The market lost US$14 billion in value in one day, bringing the loss for the week to US$30 billion; 10 times more than the annual budget of the Federal Government and far more than the US had spent in all of World War I.

Over the next month the market continued to decline sharply; however, it would not bottom until July 1932 when the Dow hit 41 from a high of 381 in 1929. That's a decline of nearly 90%. Although the market started to rise in 1932, it was to be another 25 years before the Dow would climb above its 1929 levels.

Post 1929 the stock market continued to track the economy, this time in the negative direction. Since the consumer outlook was decidedly pessimistic, the economy contracted sharply. Companies were hard hit by the decrease in consumer spending, a trend which would continue for nearly three years.

Apart from the panic selling on those fateful days in October of 1929 there was nothing unusual or 'inflated' about stock prices in the days preceding or following the crash. It was panic selling that brought the market to its knees. The simple laws of supply and demand were in place – with no one left willing to buy stocks and everyone trying to sell at the same time, the market had nowhere to go but down. It was only in 1954 that markets had fully recovered all of these losses.

58 years later, Black Monday – 19 October 1987



'Stocks plunge 508 points amid panicky selling: Percentage decline greater than in 1929 – The stock market crashed yesterday.' Wall Street Journal, 20 October 1987

On 19 October 1987 stock markets around the world crashed. The Dow Jones closed down 22.6% for the day, down 36.7% from its closing high less than two months earlier.

1986 and 1987 were banner years for the stock market. These years were an extension of an extremely powerful bull market started in the summer of 1982 fuelled by hostile takeovers, leveraged buyouts and merger mania. The philosophy of the time was that companies would grow exponentially simply by constantly purchasing other companies. In leveraged buyouts, a company would raise massive amounts of capital by selling junk bonds and initial public offerings (IPOs) were becoming a commonplace driver of the markets.

'Microcomputers' were also a top growth industry as people started to view the personal computer as a revolutionary tool that would change the way of life and create wonderful profit opportunities. The investing public were thus caught up in a contagious euphoria similar to that of any other bubble and market crash in history. People bought stocks on margin, believing prices could only ever go up, business optimism was high (though showing signs of strain) and novice investors considered annual returns of 30% from balanced funds as the norm.

Despite the strong economic growth, the Securities and Exchange Commission was unable to prevent shady IPOs and conglomerates from proliferating. It was in early 1987 that numerous investigations of illegal insider trading took place, which created a wary stance from many investors. Also, due to the extremely strong economic growth, inflation was now becoming a concern. In response, the Fed rapidly raised short-term interest rates, but this also hurt stocks. Many institutional trading firms started utilising portfolio insurance to protect against further stock dips. This resulted in an increase in the trading volumes in the futures market resulting in instability in both the futures and stock markets.

On Friday, 17 October, the stock market was down 9%. Markets had been gradually falling for the week following poor trade deficit numbers in the US. Portfolio insurance trades comprised a large percentage of the day's sales order (with no corresponding purchases) and many of these trades ignored the ballooning bid-ask spreads and market impact and simply executed. Going into Monday, 19 October, many investors and traders, unable to execute all their sell orders on the Friday, were left with a massive overhang. Also, by this time common stockholders wanted to sell simultaneously. The market couldn't handle the volumes and sales couldn't be executed without buyers.

> *During the course of one day, US$500 billion was wiped off the Dow Jones index, and markets across the globe collapsed in the same fashion. Lead indicators of Australia and Singapore showed losses of nearly 50%.*

Individual investors desperately tried to sell their shares via their brokers and unable to do so suffered enormous losses. Despite their having no control over the market's direction, some brokers even lost their lives at the hands of clients who had lost fortunes. Sadly, the majority of investors who were selling didn't even know why they were selling, except that they 'saw everyone else selling'. Unit trust investors sold their managed funds which forced fund managers to liquidate assets to pay redemptions, and so the avalanche continued. This irrational behaviour caused the extreme market crash and most futures and stock exchanges were shut down for the day.

> *Many feared that the crash would trigger a recession. However, the Fed's intervention by lowering short-term interest rates steadied investor sentiment. Remarkably, the markets recovered quickly from the worst one-day stock market crash in history. Unlike the crash of 1929, the market quickly started on a bull run once again, powered by companies buying back their own stocks which were undervalued as a result of the crash. Additionally, the Japanese Nikkei index was embarking on its own massive bull market. This tremendous momentum helped pull the US stock market to heights never seen before.*

A number of explanations have been offered as to the cause of this crash, although none as the sole determinant. Included in the list are computer trading on portfolio insurance, illiquidity, trade and budget deficits and overvaluation.

The crash itself was not caused by portfolio insurers or arbitrageurs per se, but simply by too many people wanting to sell their stocks at the same time. If futures had not been around, dynamic portfolio insurers would have sold actual stocks – the other route to achieve 'portfolio insurance'.

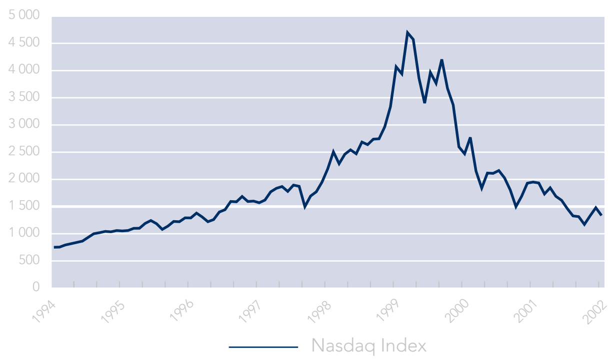
While these technical factors may have led to a sharper fall, they were certainly not the root of the problem. The Brady Commission and a multitude of academic and industry-led studies have attempted to find the cause of the 1987 crash, sparked by the similarity in price movement patterns of 1929, and speculation that a great depression was again to follow as in the 1930s.

Since then, a variety of factors have been cited as the underlying fundamental causes of the crash. Currency worries, the US trade balance, trade deficits, inflation and interest rates and worries over taxation reform have all been blamed (to an extent) for creating the climate of uncertainty that preceded the crash. However, the crash itself did not coincide with changes in any of these fundamental factors, all of which had been brewing for some years. Furthermore, many of these factors were centred on the US alone or on only a few countries, and indeed may have favoured the United States' trading partners. Thus, the effects of the crash should not have been felt consistently worldwide.

It seems likely that the crash was simply the bursting of a speculative bubble. Interest rates rose to the point where implied valuations built into stock prices were stratospheric. When you can get 17% from bank accounts it makes very little sense to put money in the stock market, especially when the market is sitting on the back of such a sustained bullish phase. It was quite obvious that the stock market in 1987 was in a speculative frenzy, just as it was obvious when tech stocks got out of hand more recently. The only reason why people remained invested for so long, even though it was clearly mad to do so, was that there appeared no end to the prosperity when the stock market had done nothing but make people wealthy for a decade.

A benefit of the 1987 stock market crash was the implementation of the circuit breakers system, which electronically stops stocks from trading if they fall too quickly – thus preventing any future one-day vertical drops of this nature.

Irrational exuberance – the dot-com bubble



9 August 1995 will go down in history as the birth of the dot-com boom. It all started with the IPO for Netscape, a tiny, two-year-old software maker in Silicon Valley with almost no revenues and zero profit. On Netscape's first day of trade, the stock escalated from US$28 to US$72 – astonishing all investors.

In the early 1990s, the personal computer was rapidly gaining acceptance for business and personal use. It was at last becoming more reasonably priced and user-friendly, a veritable business tool essential in gaining a competitive edge. Business applications were invented to aid the user in accounting, calculating taxes and word processing. Computers also began to compete with television as a form of entertainment as PC video games flooded the marketplace. Corporations such as Microsoft prospered enormously as almost every computer system contained their operating system software.

During this time, the US computer industry focused more on high-margin computer software than physical hardware. Software companies earned a mark-up from selling licensed information at minimal cost and computer hardware became a commodity product, i.e. virtually indistinguishable from the product of any other competitor. Asian companies, with low manufacturing costs, produced virtually all the hardware components at this point. Software, however, was protected as intellectual property with patents. Therefore a product such as Microsoft Windows is a one-of-a-kind product. This creates a strong barrier to entry, a benefit which is highly sought after in business.

Eventually, several of these start-up companies were identified by serious venture capitalists looking to finance operations, taking them public and reaping massive profits. Soon the fledgling start-ups began to pay their employees with company shares, creating instant wealth for early shareholders on listing. The majority of the software companies were started in Silicon Valley, near San Francisco, which was a technology mecca. The Nasdaq index of technology stocks was rising extremely fast, creating many millionaires.

> *On 5 December 1996, Alan Greenspan delivered a speech in which he made the following statement: 'But how do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions, as they have in Japan over the last decade.' Little did he know that 'irrational exuberance' was on its way to becoming the catchphrase of the boom. The bubble lasted until March 2000 when the Nasdaq peaked above 5100.*

The fundamentals of the dot-com bubble were horrible. IPOs were going sky high while the business model of many of these companies showed no realistic way to turn a profit. These big warnings were everywhere during the dot-com bubble – yet ignored by most.

The optimism for the dot-com bubble was further supported by the belief that internet business was somehow going to instantly take off. Huge issues such as customers paying heavy shipping fees were regarded as unimportant, and the stock market rallied believing that everyone would be buying groceries online and ordering pizza from a dot-com site. But life-altering trends do not happen overnight.

Several economists even postulated that we were in a 'new economy' where inflation was virtually non-existent and stock market crashes obsolete. Even worse, it was said that earnings were not relevant in picking stocks! The 'old economy' referred to industrial stocks, such as those in the Dow Jones Average. 'Paradigm shift' was yet another catchphrase of the time, a synonym of 'new economy'. Investors were enraptured by these buzzwords as they deceptively described something as sleek, sexy and exciting.

The stock market rallied during the dot-com bubble for good reason. The whole world was excited about internet-based companies. Investors were optimistic and this fuelled a multi-year rally with seemingly endless momentum. Public interest in stock market investing was widespread and certainly more prevalent than decades before. Many factors contributed to this – the more risk-seeking baby boomer generation, the rise of defined contribution funds and the growth in the unit trust industry.

By early 2000, investors realised that the dream was in fact a bubble. Within months, the Nasdaq crashed from 5 000 to 2 000, wiping out hundreds of stocks as quickly as they had appeared. Panic selling ensued as investors lost trillions of dollars. The stock market kept crashing down to 800 in 2002, with one high flier, Microstrategy, sliding from US$3 500 per share to US$4! In the fallout, accounting scandals were uncovered where companies artificially inflated earnings, leaving shareholders crippled. In 2001, the US economy entered a recession as the Fed repeatedly cut rates in an attempt to stem the flow. Millions of workers were now jobless and had lost their life savings.

Needless to say, the new economy was not up to all the hype, and traditional economic principles still continue to hold over the long term.

Today – is this a repeat of history?

There are many who believe that a number of signs prevalent in previous market crashes can be seen today, existing in different forms within the financial and economic systems. Concerning most market protagonists is the startling similarity to 1907:

- The global financial systems are complex, interdependent with a proliferation of new products, new players (hedge funds), cross-listings across global exchanges, etc. The sub-prime contagion has given us just a brief insight into some of the complexity that exists within the system. Much of what we have seen thus far relates to de-leveraging. The key question to ask is: What does this portend?
- The buoyant world economy was spurred by the huge amounts of liquidity pumped into the system by global central banks over the past decade.
- Investor euphoria around stock market participation.
- A fall in real estate prices – lowering the collateral on which excessive gearing has been taken by many individuals – often to fund short-term spending.

While we have sympathy for many of the concerns expressed, our case is centred on two key elements: the first is that stock market valuations at present are not excessive and if anything are already pricing in a large degree of bad news. In fact, stock prices over the past few years have mirrored the underlying growth that we have seen in company earnings and capital returned to shareholders. Secondly, we believe that the mechanisms exist today to ensure that, in the event of any global liquidity crunch, disciplined, collective action will provide the necessary safety buffers needed. We have already seen a demonstration of this when the Bank of England bailed out Northern Rock for £25 billion.

Tony Gibson, in his article, addresses many of these key concerns and linkages and provides evidence as to why we do not believe this is the start of an enduring bear market.

There are remarkable similarities between all the market crashes and in the words of Winston Churchill: 'The further backward you look, the further forward you can see.'

Most likely history will never repeat itself in the same way, but one needs to heed carefully the drivers which can trigger a crisis or panic. Above all, complacency is the biggest challenge. The most dangerous is the statement 'this time it's different!', when most often it is not.

Markets rarely correctly foresee coming financial disaster, which is why there is constant opportunity for the smart money to prosper from the irrationality of others.

References include:

The Panic of 1907 – Robert F. Bruner and Sean D. Carr, *Irrational exuberance* – Robert J. Shiller, *Age of Turbulence* – Alan Greenspan, *The Panic of 1907* – Fred E. Foldvary, *Anticipating the stock market crash of 1929: The view from the floor of the stock exchange* – Eugene N. White, *A Brief History of the 1987 Stock Market Crash with a Discussion of the Federal Reserve Response* – Mark Carlson.

Kirshni Totaram
Kirshni heads up the institutional business. She is a qualified actuary and a former manager of the Coronation Property Equity Fund.

Our perspective on the market

by KARL LEINBERGER

A weak quarter for domestic equities and bonds

We continue to remind investors that market returns over the last five years (25.4% p.a.) have been abnormally high. International and local markets have benefited from a low base and a very asset-friendly environment. We expect the next few years to be more challenging and returns to be more muted. That environment should better suit a disciplined and valuation-driven investment house like Coronation.

The global economic environment remains uncertain. The US economy is flirting with recession as a liquidity squeeze in the banking system has caused a credit crunch in the broader economy. House prices are under pressure and this will force consumers to retreat. With inflationary pressures in the system the Fed also cannot respond as freely as it did in the last cycle. Notwithstanding these concerns, we are not negative in our outlook for global equity markets. Although emerging markets are pricing in a lot of good news, developed market equities are attractively priced and there is no doubt that the global economy is more balanced and robust than it was in the last cycle.

Our view on the domestic economy has not changed. The consumer is under pressure after a very aggressive response by the Reserve Bank to a spike in inflation that has largely been driven by rising food and energy prices. Notwithstanding this headwind, we expect investment spending to underpin growth for the next few years.

Equities had a weak quarter, returning -3.0%. For the first time in a while resources (-7.5%) underperformed both the industrial sector (+1.7%) and financials (-0.7%). Sasol, Exxaro and our zero gold position contributed to performance. We have reduced our weighting in resources after some profit-taking in Sasol, a stock that has been a major holding in our portfolios for many years. We are not uncomfortable with this underweight position – commodity prices are significantly higher than normal, long-term levels, and demand is under pressure at a time when supply is finally responding to several years of high prices.

Karl Leinberger
Karl is head of research. He has been with Coronation since 2000 and is co-manager of the Coronation Balanced Plus Fund.

Tiger Automotive, Shoprite and Remgro contributed to performance, while Trencor, Amaps, Naspers and Woolworths detracted. We remain defensively positioned in the domestic universe. While interest rate-sensitive stocks have declined materially, they have generally not reached the lows of the third quarter of 2006, despite a materially worse outlook.

Financials had another poor quarter. African Bank and Old Mutual contributed to performance, while Investec (a recent addition to our portfolios) and Absa detracted. South African banks are now priced at between 7 and 8 times earnings one year forward. These ratings are as low as they were at the market low in early 2003 and we think they present a compelling opportunity for the patient, long-term investor.

Bonds (+0.9%) underperformed cash (+2.7%). We remain underweight bonds. While yields are looking a lot more attractive, we have resisted increasing our weighting until we have more clarity on the commitment of the ANC's new leadership to inflation targeting. Property stocks finally responded to the weakness in our bond market with a return of -0.4% in the quarter. We remain underweight property, with the view that the sector is priced for perfection.

From excess liquidity to credit crunch

by CHANTAL VALENTINE

The change in global backdrop will likely dominate economic conditions this year

For the past few years, we have been warning (some might say harping on) about excess liquidity in global markets being unsustainable. 'This time it's different' and 'a new paradigm' were over-used and, ultimately, redundant phrases. The sub-prime meltdown in the US from the middle of last year started off a chain reaction back up the liquidity chain, and most readers will be aware that by the end of 2007 the major central banks were actively involved in trying to alleviate sharply tighter credit conditions not just in secondary capital markets, but in bank lending itself.

That global growth will slow this year is almost a given; the question revolves more around the extent to which this will happen. Consumers seem almost certain to lead the slowdown, with oil prices approaching US$100/barrel and property prices under pressure in a number of advanced economies. Consumers are also finding it harder to access bank finance. The key is how much the credit crunch impacts; it is not only consumers but companies that are facing tightening lending conditions in the major economies, and even interbank lending has slowed. Banks are having to take previously securitised assets back onto their balance sheets, crowding out other lending due to, inter alia, capital adequacy considerations. Should this process go too far, healthy as well as unhealthy lending stops. Companies would then find it more difficult to finance working capital and investment, exacerbating the overall slowdown and likely leading to employment contraction as well. This potential domino effect is what central banks have been working to mitigate.

The last few months of 2007 saw a number of major central banks pumping liquidity into the banking sector, sometimes (as in the case of the US) accompanied by cuts in interest rates. The lessons of the Japanese deflation of the early 1990s appear to have been learnt, and from that perspective pre-emptive action by central banks is welcomed. However, it is not simply a case of the proverbial helicopter dropping cash. There is a problem for central banks: global inflation is threatening to be the highest in a number of years. Different central banks have differing approaches – the US Federal Reserve for example seems happy that it can reverse the rate cuts when necessary, while the European Central Bank seems loathe to do anything on the rate side while inflation remains a threat. Whatever the response, though, it is certainly the case that higher inflation will have to limit the extent to which central banks can provide monetary accommodation to offset the effects of the credit crunch.

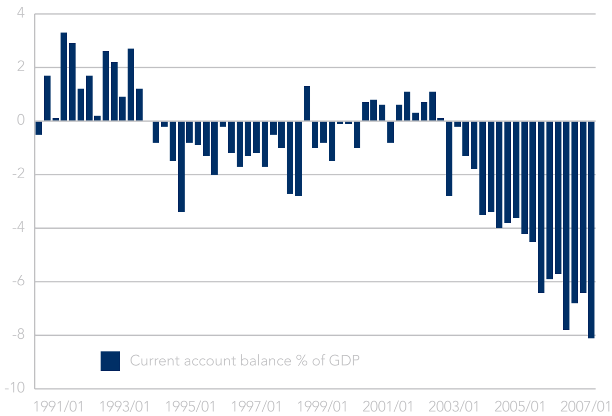
Chantal Valentine
Chantal joined Coronation as economic and fixed interest strategist in 2003. With 16 years' experience in analysing local and global markets, she plays a critical role in the investment decision-making process.

Consensus forecasts are for very slow growth in the US, with some now forecasting recession. However the other major economies, while soft in some regions, are expected to escape recession. Overall, growth in the advanced economies is expected to slow to below trend this year. With the background of some slowdown in global growth – ranging anywhere from moderate to severe – we look at what the implications for South Africa might be.

Before we get to anything SA-specific though, we remind readers that South Africa sits very much in the global emerging markets (EM) asset class. The positives that have worked on the country over the past few years are very much linked to what has been happening to the asset class. Despite the slowdown already evident in some areas of the developed world, EMs have continued to perform well. The thesis of EM decoupling is very much in vogue – although many analysts seem to think this will be the case only if the US does not slow 'too much' (this seems to be below 1.5%). Such an analysis implies, to us, that there is not in fact a true decoupling and indeed, given how integrated global markets and capital flows are, over and above trade linkages, we would be surprised to see a true decoupling. That said, EM growth rates have outperformed G10 for some years now and a number of these countries are seeing domestically led growth, with the good performance partly a result of many EMs having strengthened their fundamentals significantly over the past decade or so. In general, therefore, while we do not think EM would be completely unaffected we do see growth holding up relatively well.

The main risk for that benign scenario is similar to what we see as the main global risk for South Africa: that the liquidity crunch leads to a drying-up of flows to EM. So far we have seen sporadic instances of financial flows reversing, but in general they remain reasonable. For South Africa, the key consideration here remains the large current account deficit (which reached some 8.1% of GDP in the third quarter of 2007). Unlike many of the Asian and some of the Latin American EMs which have current account surpluses to help buffer such effects, the large shortfall in South Africa means that any significant reduction in capital inflows – or worse, outflows – will be noticeable. A related aspect is that slower global growth would dampen export growth (and potentially export prices), limiting any possible improvement in the current account deficit. The rand thus remains a key point of vulnerability although, as has been the case, a weak US dollar could still help provide a buffer.

LARGE CURRENT ACCOUNT DEFICIT LEAVES RAND VULNERABLE



Source: SA Reserve Bank

A weakening in the rand against a background where there is already pressure on inflation would naturally be a negative, and could potentially presage further interest rate rises. This is a risk that will remain for a while. CPIX inflation is likely to have easily breached 8% by the time this article is published, and concern will remain around inflation for a while. However, we maintain our view that there is not enough emphasis placed on the lag effects of the rand on inflation. The rand moves that we have already seen last year should help exert downward pressure on CPIX from the second quarter onwards. Demand-led inflation pressure simply isn't an issue, with the categories that cover consumer durable and semi-durable goods either in deflation or barely positive (less than 1%) inflation. Rather, the main risks to inflation remain largely exogenous to monetary policy: oil and food remain high, and Eskom's approval for a 14.2% tariff increase this year will hurt. Monetary policy therefore has been largely, by necessity, aimed at limiting the effects of these increases on inflation expectations.

We are more concerned about oil than food. Food prices remain high, but inflation measures the percentage change, and this has been receding; rand oil prices, on the other hand, have been rising again. The relative stability of the rand over the past year has been important in mitigating the effects of higher commodity prices. Should the rand start weakening significantly, it will have more of an effect on inflation late this year and early next year. The SA Reserve Bank (SARB) will likely remain cautious, albeit now caught between a rock and a hard place: more and more evidence of a slump in consumer demand versus inflationary factors beyond its control. We continue to believe, however, that actual inflation outcomes in the second half of this year will surprise both the SARB and consensus on the downside, and there should be room for rate cuts later this year.

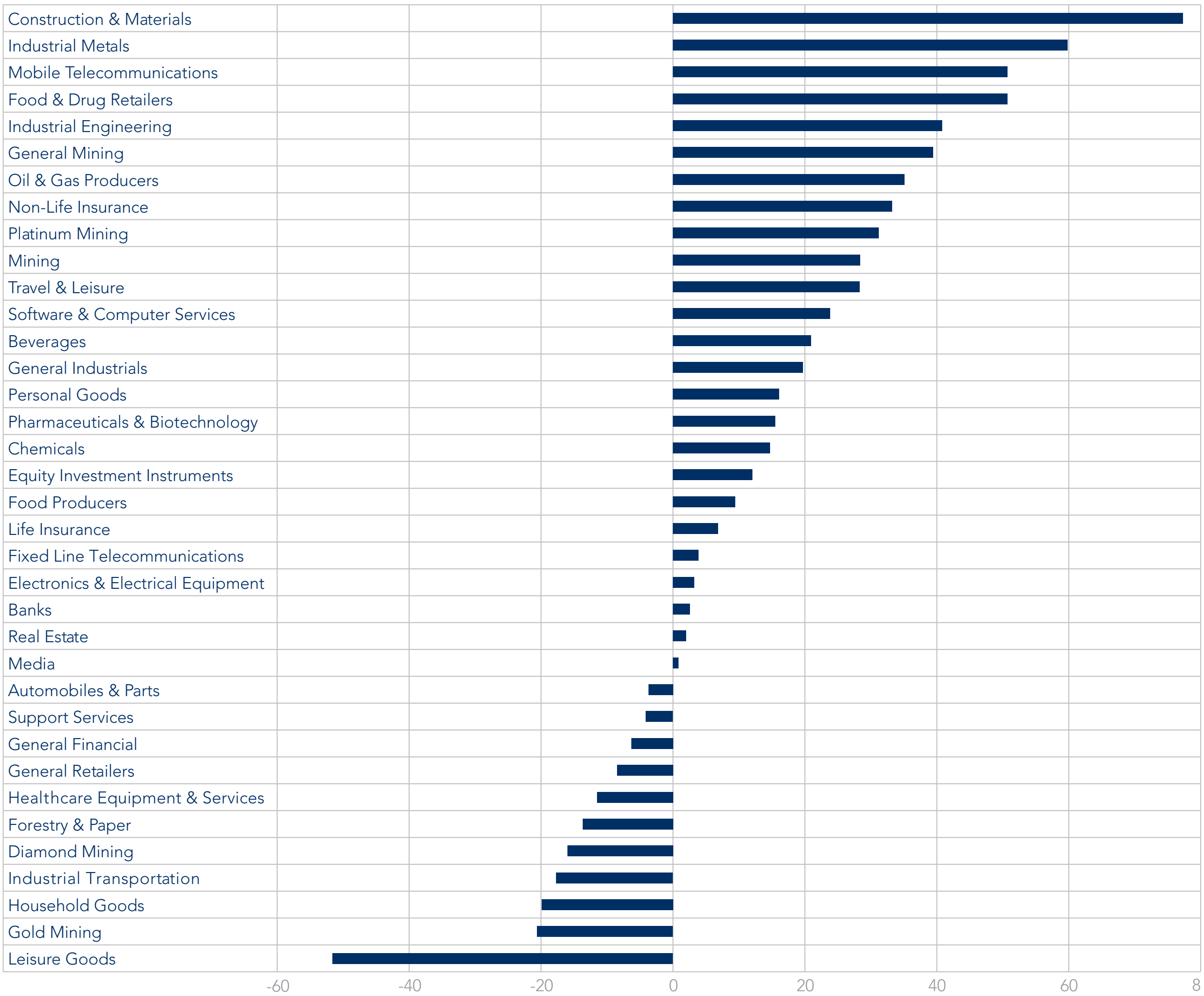
While the interest rate hikes haven't had much of an effect on inflation, they are certainly hurting consumers. We expect a deceleration in consumer spending to around 4.5% this year, from growth rates of 7% to 8%+ over the past three years. This is a significant slowdown, and we attribute most of it to the effects of the interest rate rises but also impacted by the dampening effect of higher inflation on real incomes. Fixed investment is likely to save the day, as it is (currently) less interest rate sensitive, with the infrastructure programme being a key driver at present (though we do expect some dampening effect of interest rates in certain areas of private sector investment). Overall, GDP growth is likely to remain around the 5% level.

INVESTMENT REMAINS ROBUST AS CONSUMER SPENDING DECELERATES

Source: SA Reserve Bank

A final note on politics, where some focus has shifted to election issues. Presidential succession issues in South Africa and the US may lead to some uncertainty in these markets, while in emerging markets – currently most notable in Kenya and Pakistan – election and democracy issues have led to some instability and resultant concerns over both economies and markets. Markets have been complacent about political risks in the past few years, but when underlying economies are performing less well and risk aversion in general is higher, we may see more reaction to political news. Apart from the US presidential elections, over 40 elections of various sorts (municipal, parliamentary and/or presidential) are due in a host of emerging market countries this year, including Russia, Pakistan, and Brazil; while by year-end Turkey will be gearing up for local elections in 2009.

JSE 2007 PERFORMANCE



MARKET MOVEMENTS

	Qtr 4 2007	2007
	%	%
All Share Index R	(3.0)	19.2
All Share Index $	(2.2)	22.0
All Bond R	0.9	4.2
All Bond $	1.7	6.7
Cash R	2.7	10.1
Resources Index R	(7.5)	29.1
Financial Index R	(0.7)	3.0
Industrial Index R	1.7	17.8
MSCI World $	(2.3)	9.6
S&P 500 $	(3.3)	5.5
Nasdaq $	(1.1)	14.6
MSCI Pacific $	(4.6)	5.6
Dow Jones EURO Stoxx 50 $	4.2	22.3

KEY ECONOMIC DATA

	2005a	2006a	2007e	2008f
	%	%	%	%
HCE	6.9	8.2	7.0	4.6
GFCF	8.9	13.8	15.7	13.0
GFCF	8.9	13.8	15.7	13.0
GDP	5.0	5.4	5.0	5.0
Current a/c % of GDP	(3.8)	(6.4)	(7.4)	(7.1)
CPIX average	3.9	4.6	6.5	6.7
Prime rate (year-end)	10.5	12.5	14.5	13.0
R/$ year-end	6.33	7.02	6.83	7.50
R/EUR year-end	7.51	9.27	9.94	10.28

Liberty International

by EDWIN SCHULTZ

A highly attractive investment, particularly at current levels

As investors we are not often presented with the opportunity to buy great companies at attractive prices. When we are, and our conviction is high, it makes sense in the words of the great investor Charlie Munger to 'call your shots and load up'. We believe that such an opportunity has presented itself in the UK-listed property sector, and in particular Liberty International.

Edwin Schultz

Edwin is a key member of the Coronation absolute investments team. He has co-management responsibility for all absolute portfolios and the Coronation Property Equity Fund.

The magnitude of investor pessimism is clear from the moves in share prices over the past year. Since the beginning of 2007 the UK-listed property sector is down by 43%. The large market cap stocks have not been spared, with British Land down 48%, Hammerson down 40%, and Liberty International down 29%.

What has caused this extreme reaction? The phenomenon is partly a global one, with large sell-offs in the US, Europe and Australia, but has been particularly severe in the UK. The answer lies partly in the US sub-prime crisis, and the resultant credit crunch that has affected the UK property market. Commercial property purchased is typically financed by debt, as the rental streams from the underlying properties are quite secure, and typically underpinned by long-term leases. With the property securitisation market literally having closed down in the UK, property finance has become very difficult to come by, and hence investor demand for property has diminished significantly. Added to this, valuers have been taking a more cautious view of UK property, investors are concerned about the high level of indebtedness of the UK consumer and a general economic slowdown. This has created a potent cocktail for declining share prices in an already nervous investment environment.

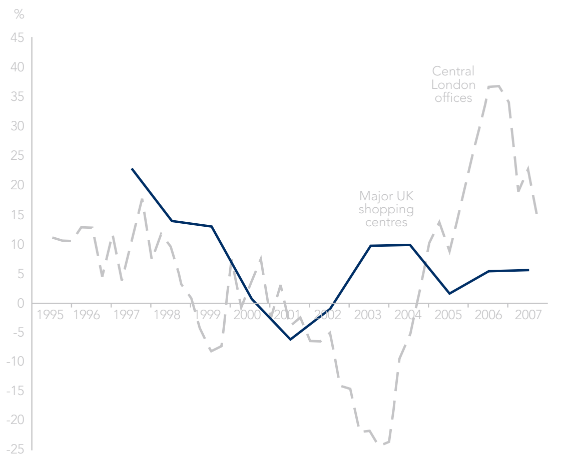
The first fact that alerts us as long-term investors to a potential investment opportunity here, is the main reason offered for the price declines and continued investor bearishness, being lack of property finance and hence investor demand. In the long term the value of a property asset should be determined by the underlying rentals to be received, discounted at an appropriate discount rate. Investor demand for property at a particular point in time has no bearing on this valuation.

In terms of long-term rental growth, we think Liberty International is particularly well placed, owning a number of the largest prime shopping centres in the UK. Despite negative economic sentiment and pressure on retail sales, their centres are trading well. These malls are by nature very defensive, and rental growth is much less cyclical than the underlying economy or retail sales. The company is also largely unaffected by the current credit crisis, with a conservative loan-to-value ratio of 39%, and the bulk of this debt fixed to match the long duration of leases. Initial UK lease terms are typically 20 to 30 years, and the weighted duration of Liberty International's debt is around 10 years. The cost of finance for the company is more closely aligned to the long-term bond rate in the UK, which has declined over the past year to the current level of 4.5%. Management recently commented that their cost of finance has remained largely unchanged despite the current credit crunch in the market in general. This leaves them particularly well placed to acquire quality assets as prices decline due to distressed selling.

It is important to recognise the quality and scarcity of the underlying properties held. In the UK, planning permission and environmental requirements for developing new malls is extremely tight. This results in very long lead times to develop, and enhances the dominance of existing malls as the population grows. As an example, the company has finally received the go ahead for the development of the Westgate mall in Oxford. When the centre finally opens in 2011, it will be the culmination of a process that extended over eight to 10 years. Similarly, the large St David's development in Cardiff is scheduled for opening in 2009. These developments add significantly to a quality pool of scarce assets, and usually show significant rental growth in their debut rent reviews five years hence.

Despite this fact, Liberty International is currently trading at a massive 25% discount to underlying net asset value. While valuers have been downgrading property values over the past six months, and are expected to continue doing so in the next six to 12 months, this must be placed in context. While commercial property values have increased significantly globally over the past few years, including the UK, a lot of this is due to significant rises in office property values, which tend to be much more cyclical than retail properties, as can be seen from the graph below.

ANNUAL GROWTH IN THE MARKET VALUES OF MAJOR UK SHOPPING CENTRES AND PRIME CITY OF LONDON OFFICES



Major UK shopping centres = Brent Cross, Lakeside, Merry Hill, MetroCentre and Nottingham (rent index), Lakeside, MetroCentre (average yields)
Market value calculated by dividing market rents by market yields – values of actual properties would move less owing to in-place leases

Source: Company data, Colliers, CB Richard Ellis, Morgan Stanley Research

In addition, we believe that prime quality shopping centres are valued conservatively relative to other retail asset classes such as secondary centres, retail warehouses and prime high street shops. We believe there is more risk of declines in these property values, and that prime centres will be much less affected. In this regard the 25% discount provides a reasonable margin of safety.

Perversely, the environment for UK-listed property companies has in one sense actually improved over the past year. With the introduction of REIT (Real Estate Investment Trust) legislation in the previous budget, income received in the company is received tax-free, and only ultimately taxed in the hand of the final investor. This makes UK-listed property much more attractive for tax-free UK pension fund investors than previously. In addition, the absence of capital gains tax in the company allows much more flexibility for the sale of properties.

It is interesting to note that at least one shrewd investor is seeing opportunity in the current turmoil. The Singapore government real estate fund (GIC) had recently acquired strategic stakes in Bluewater shopping centre, WestQuay Southampton (from Hammerson) and MetroCentre (from Liberty International). These centres were all bought at a slight premium to the values as determined by valuers at that stage and as reflected in the company books. GIC are known as strategic investors and, as they are a sovereign fund, have a long-term investment horizon, not clouded by short-term performance pressures and sentiment. Recent weakness has been used by the GIC to acquire a 6% stake in Liberty International.

Another point that gives us confidence in our investment case is the quality of management. Many of the Liberty International directors have been with the company for periods up to 20 years, and have demonstrated the ability to do new developments, additions and value enhancing acquisitions. We believe that the company can continue to show dividend growth in excess of inflation over the long term, which would suggest that the company can trade at a yield well below long dated government bond rates.

Investor sentiment towards UK-listed property is likely to remain negative for the foreseeable future, as credit issues linger, pressure on retail sales intensify, and valuers continue to write down property values. But we believe that patient investors with a long-term time horizon will do well to buy at current levels.

We are certainly loading up in the funds we are managing on behalf of our investors.

Is this the crash of 1987 version II?

by TONY GIBSON

We certainly don't think so – but many will disagree. This is their argument:

Many commentators noted that on 19 October 2007, the 20th anniversary of the Crash of '87, the US stock market fell by 2.56%; stating that, in a curious parallel, the woes besetting world markets as a result of the crash in the credit markets, are every bit as severe as those which hit equities back in 1987 – but which threaten to have more impact on the US and the global economy.

Most will concede that the stock market can close down for a while and it really doesn't matter all that much. Their belief is that the primary function of the stock market is not to finance company operations, but to price assets. Companies go public once, and most come to the equity market for capital sporadically, and then typically to finance long-lived projects or acquisitions. However, they point out that credit markets are different. These are the source of liquidity to fund operations which, if dysfunctional, threaten the economy. That is why the problems that began in the US sub-prime market, and spread to encompass a wide section of the mortgage market and the commercial paper market, are so serious that they have galvanised central banks and government financial authorities to move swiftly to try to restore these markets to normalcy.

But success has been limited. The new ±US$80 billion fund being put together to provide liquidity to Structured Investment Vehicles (SIVs) has been viewed sceptically by Warren Buffett, Alan Greenspan and Bill Gross – not an auspicious beginning – and markets appear to be beginning to worry that a return to normalcy might not be the most likely outcome. Many share that concern.

The difference between what is unfolding now and the Crash of '87, or the problems with Long Term Capital Management in 1998, is that these were confined to Wall Street, whereas current credit-related issues extend more broadly, even to the value of the largest asset of most consumers, their home.

When the US Federal Reserve cut rates all the way to 1% in an attempt to ameliorate the effects of the technology burst in 2001/02, it accomplished something seen only once before. It brought about the first recession in the US since 1990, but it was only the second recession ever recorded that did not involve housing (which boomed over that time). In 2007/08, however, housing is in a severe slump, and it will be unlikely to avoid it dragging down the rest of the US economy. While almost all recessions have involved a housing decline, there have been two prior housing declines that did not involve recession – 1951 and 1967, when a large increase in military spending offset the effects of housing on consumption. In the meantime, a reliable forecaster of whether the problems in housing will lead to recession in 2008, the prediction market at Intrade, pegs the odds at around 45%.

> *The issue for the stock market and for the global economy is the extent to which the slowdown in US consumption will spill over into a decline in global production in 2008.*

It is widely recognised that the US has been the marginal consumer to the world, and the current account deficit reflects that. Fuelled by low interest rates and people withdrawing equity from their homes to finance spending, consumption as a percentage of GDP rose from 66% in the late 1990s to a record high of more than 70% today. Going forward, the most likely direction is not up, with housing prices falling and job growth slowing.

Worryingly it was the recent withdrawal of liquidity that led to the sub-prime collapse as the Fed removed the monetary accommodation provided by very low interest rates. Due to this change, US homeowners could not make the increased payments on their homes when adjustable rate loans reset. A further bearish point is that current resilience of corporate demand and the strength of many macro-economic indicators such as employment, are entirely consistent with the theory that demand deterioration will start in housing and consumer spending before spreading to the wider economy.

The pessimists therefore confidently state that there can be no doubt that the deterioration in the housing markets in several Western countries is particularly grave, and the impact on some consumer spending has already been dramatic. Certain UK retailers are reporting a sharp fall in sales over the prior year, part of which may be due to a poor fashion collection but may be equally attributable to the endless media commentary about economic slowdown. House prices in the UK have now fallen for three consecutive months and a crisis of confidence is emerging. Higher mortgage rates, combined with rising energy prices, are acting as a drag on consumer discretionary income in many countries and retail sales are holding up only as a result of heavy discounting. Best Buy, a consumer retailer in the US, reported good sales over the Thanksgiving weekend but only due to an unusually high level of incentives.

> *Into this potentially confusing investment scenario has to be added the role of central banks, whose injections of liquidity can alter the long-term direction of economies and the short-term direction of sentiment.*

It is clear that any change in interest rates will have no significant impact on economic performance and hence corporate earnings for at least six, if not 12 months. However, the stock markets can take huge comfort from any apparent evidence that the central banks are on their side. Commentary from the Fed in late November made it perfectly clear that the desire to avoid moral hazard had been firmly replaced with the intent to support the economy and financial markets. After all, it was only in 2002 that the world was worried about deflation. The forces that gave rise to those fears – high debt, excess global labour, falling real prices for technology, and a global savings glut – have not disappeared. The recent locking up of large parts of the credit market certainly does not help.

Therefore, when the Fed took the unprecedented step on 17 August 2007 of cutting the discount rate between meetings, and changing its policy statement between meetings, having only 10 days prior affirmed its views that the risks of which it was most concerned were those of inflation and growth, it signalled just how rapidly things had changed. The 50 basis point cut at the September meeting was consistent with this.

But those holding a more optimistic view will argue as follows:

While expecting a material two-quarter slowdown extending through March 2008 from housing weakness and financial market turbulence, the bulls maintain the view that the economy will skirt a recession. This is predicated on the belief that global (non-US) growth, a proactive Fed, and the brimming reservoirs of Greenspan dollars roaming the world, will continue to support the US economy and global markets.

Looking at the US economy they also point out the following:

Employment indicators have weakened materially, but unemployment at 5%, jobless claims still below 350 000 and ISM employment indicators are all consistent with a less-than-recession slowdown. Most forecasts assume the unemployment rate peaks at an average 5.1% in the second quarter of 2008. Growth in hours worked through December was much stronger than the sharp declines usually associated with recessions.

They see the drag on the US economy as relatively limited, a temporary hangover from excess liquidity of the Greenspan years plus an expensive, time-consuming breakdown in the securitisation process. The structure of the economy is basically sturdy, supported by small business, innovation, a relatively low unemployment rate and fast global growth. The current slowdown is thus more of a one-time phenomenon related to the 2003/04 Fed error and private sector mistakes, rather than a deeper lack of US competitiveness.

That said, they accept that the recovery from the 2007/08 slowdown will likely be tepid, due to the hangover from low interest rates earlier in the decade. With the US dollar weak and oil and gold prices correspondingly high, they concede that inflation will remain problematic during 2008. The Fed may cut interest rates further in January, but think it will have to hike later in 2008 due to persistently high core inflation.

They also concede that they don't expect growth or earnings to be as strong in coming years as when the Fed turbo-chargers were roaring away. But the good news is that much of the Greenspan excess found its way into useful economic activities around the world – infrastructure and better fiscal positions in developing countries, Asia's renewed boom after the deflationary crisis of 1997/98, and lower unemployment rates practically worldwide, a huge engine for future growth.

With this as the backdrop, the factor that gives the bulls the most confidence is the rapidly increasing bearish sentiment in financial markets at present. For instance, at the end of every year, polls of analysts and strategists provide an outlook for the year ahead. With magical similarity, the average upside expected for the main developed equity markets is usually 12%, give or take a little. Not so today. The all-pervading bear atmosphere has led to the lowest expected growth for the year ahead since the beginning of 2003. The bear case is all very logical and sensible – frozen credit markets, slower corporate profits growth and a risk of US recession – but the disquiet is that most of these concerns have been worries for months and have already led to a significant correction – including the first 10%+ fall in the S&P500 in five years. A lot of this merchandise is already in the shop window.

In a broader market context, the negativity is so pervasive that enormously positive news is taken for granted and cast as meaningless. In recent months, the ECB pumped US$500 billion of liquidity into credit markets to free up the logjam. After a momentary bounce, pundits quickly labelled the infusion as 'not enough'. Suddenly, a huge wave of liquidity was viewed as a negative. Sentiment continues to reside at multi-year lows. Nearly every economist is predicting a recession or significant slowing 2008. Numerous stocks and indices look oversold on technical analysis – if a business is suffering from economic headwinds or is perceived to be suffering, there is almost no bid for the equity at any price. Consequently, they argue, the number of mispriced equities is larger than at any time over the past five years.

In summary, they believe that there are simply too many names (especially in technology and discretionary consumer) that are trading at or below recession multiples, below asset liquidation value and/or at double-digit free cash flow yields.

The opportunity therefore, from a big picture perspective, is that the US economy endures only a modest recession in 2008, or no recession at all. Unlike the credit crisis-led recession of the early 1990s, corporate balance sheets are flush with cash, interest rates are sharply lower and the plunge in the US dollar's value provides a boost to the US export economy, while simultaneously attracting foreign buyers of US equities in the form of cross-border M&A activity.

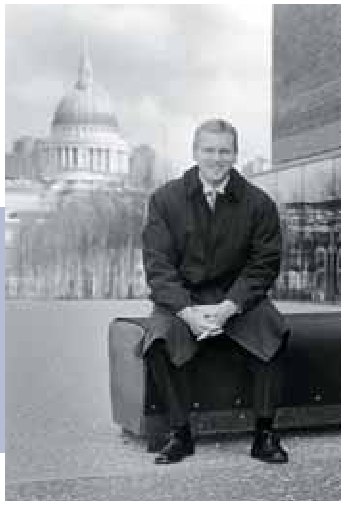
The optimists will further argue that current market volatility, which in all likelihood will continue, does not mean that the medium-term outlook for the major equity markets is a decline. Rather, over the next two years or so global equities are quite likely to provide a return more or less in line with their long-term average rate of return of about 10% per annum. They do recognise that there is a serious possibility of a drop of, say, 10% to 15% over the coming weeks and months. They do not however believe that the odds of such a decline are very high for three reasons:

- Valuations are moderate.
- Central bank reductions in interest rates are almost always positive for equity markets and are likely to happen.
- It is rare for serious down markets to begin when the mood is overwhelmingly gloomy, as it is now.

The gloom is focused on the financial sector, with many investors now only too well aware of acronyms such as SIV, CDS, CDO, ABX, SWF; terms that few would have known at the beginning of 2007. A common comment also now heard from eminent observers is that 'it will take longer to resolve and is worse than anyone thinks'. This is almost a universal view to such an extent that what it amounts to in paraphrase is 'we think that this is more serious than we think it is' – a contradiction in terms which suggests that the full gravity of the subprime crisis and its credit crunch ramifications, hard to recognise though they are, may already be encapsulated in markets. What this situation of inadequate information produces is inefficiency in markets, and from market inefficiency comes opportunity.

Our view at Coronation tends towards the side of the bulls. Again, while conceding that the current correction may well continue, we believe it to be a correction rather than the start of an enduring bear market. The core point is that we are still in a classic reflationary cycle, which means that one should own equities rather than bonds. After the Fed frightened investors with inflation fear talk in November, the contagion effects of not cutting were shown in full force, and quite wisely the Fed has returned to an accommodative stance. It would seem likely that the Fed will deliver a total of 100 to 200 basis points of Fed funds easing in this cycle. Also, another crucial aspect of previous reflationary cycles has now kicked in – the rate cuts are going global. Three of the five G7 central banks are now in rate cut cycles since both Canada and the UK started to cut recently. The other two (ECB and BoJ) are firmly on hold for now, but there is a good chance that the ECB will also ease if growth surveys weaken much further.

Tony Gibson
Tony is a founder member of Coronation. He was responsible for establishing Coronation's international business in the mid 1990s, and has managed the Coronation Global Equity Alternative Strategy Fund since launch in 1996.



Coronation Global Equity Fund of Funds

The Global Equity Fund of Funds returned -1.39% for the quarter against -2.3% by the benchmark MSCI World Index. Since inception, the fund has produced an annualised return of 5.47% against the benchmark of 3.5%

Equity markets fell during the quarter as a steady stream of bad news flowed from banks, retailers and economists. Writedowns on sub-prime assets by major US banks and, in some cases, capital raising showed the gravity of the credit crisis. The Fed cut rates by another 25 basis points in December, and joined other central banks in a major liquidity-providing exercise in an effort to bring down the interbank lending rates. Weak retail sales and a falling housing market also prompted the Bank of England to cut rates by 25 basis points. By the end of December, it was almost consensus that the US was heading for a recession in 2008 and how this would affect the rest of the world, especially the booming emerging markets, weighed heavily on investors' minds.

For the period, the fund was underweight North America and overweight Asia, which helped performance. The fund also benefited from Copper Spire having gone into cash for the last six weeks of the quarter pending the fund's closure.

UOB Kinetics Paradigm enjoyed a strong quarter, being marginally negative in US markets which fell almost 4%. This was driven by their exposure to oil and financial exchanges, which benefited from rising oil prices and increased trading volumes during the recent market volatility. Comgest Nouvelle Asie returned 4.3% for the period, during which time the market was down 1.5%. Comgest held up well during the period and the Edinburgh Partners Europe Fund enjoyed a good quarter, falling only 0.8% compared to the -3% of the European indices. Edinburgh Partners have not enjoyed the best of years as the lack of exposure to emerging markets together with high exposure to Ireland has held them back. We trust that this is a turning point in the fund's performance.

On the downside, Japan had another poor quarter, falling almost 9% (in yen terms). We have remained optimistic and retained exposure to the country through Morant Wright Japan and IFDC Japan Dynamic funds. Although Morant Wright has a conservative approach and is naturally defensive, its exposure to small caps resulted in an in-line performance over the quarter. IFDC is more growth-orientated, but as that is in short supply in Japan at present, it too fell in line with the index.

Coronation Global Bond Fund of Funds

The fund returned 2.06% for the quarter, and since inception has produced an annualised return of approximately 6.74% versus the 5.81% of the index.

Bond markets around the world rallied both in response to rate cuts, or hints of rate cuts, as the global economy took a battering from the credit crunch. Additionally the government bond market benefited from a flight-to-quality as investors avoided equities and corporate credit. In this environment the defensive low-duration positioning of our underlying funds hampered overall performance.

Of the weaker performances the Credit Agricole Obligations Internationales Fund lost -0.08% as its short on the Canadian dollar (CAD) lost money. While the fund does have an offsetting long in the commodities block in the form of Australian dollars, the rally in the oil price obviously caused the CAD position to lose a disproportionate amount. Meanwhile, the Templeton Global Bond Fund gained 0.45% as it suffered from a long corporate credit position placed too early.

The strongest performance over the quarter came from the Mellon Global Bond Fund, which returned 5.3%. Mellon is the highest duration manager in the portfolio and also benefited from the British pound rally over the period.

Coronation Global Equity Alternative Strategy Fund of Funds

The fund held up well in the quarter, returning 0.65%. This is against the MSCI World Index return of -2.3% for the period.

There were a number of portfolio changes at the start of the quarter. The Ivory Flagship Fund and the Marathon Vertex Japan Fund were redeemed. New investments were made into the Prusik Asia Fund, Real Return Asia Fund and the Trivium Fund. In October 2007 the KDA Capital European Fund was redeemed.

Only four of the 12 managers produced negative returns for the quarter, as several saw their short books contribute substantially to returns for the first time in 2007. The weighted average exposure of the fund was 47% net long, with a gross exposure of 154%.

Among US managers, Trivium posted a disappointing loss of 8.7% in the quarter after gaining 16% since the start of the year. However, our other four US managers outperformed the S&P500 in the quarter, with North Sound being the top performer with a return of 12.9%.

In the Asia book, two of the four managers produced negative returns for the quarter, with Indus Japan being the worst performer. The addition of the two Asia ex-Japan funds during the period proved beneficial.

In contrast to the European markets, all three European managers produced positive returns for the quarter. Adelphi was the top performer with a return of 3.69%.

Coronation Relative Value Fund of Funds

The fund returned 0.41% in the fourth quarter, bringing the year's performance to 4.83%.

The liquidity pullback which started in the third quarter continued through much of the fourth quarter. The TED spread, which measures the spread between the Fed funds rate and the Libor rate, reached new highs in December. This indicates that banks are very restrictive in their intra-lending which impedes a functioning financial system. At the same time, the uncertainty increased several risk spreads in which hedge funds typically invest and equities sold off. These series of events had an adverse effect on several funds and we saw correlation between our funds rise.

Two factors should support the markets going forward:

- The central banks in Europe and North America appear resolute in their efforts to resolve the liquidity crisis. They have not drastically reduced interest rates, preferring more subtle ways of injecting capital into the financial markets. The co-ordinated efforts among central banks should work to ease the liquidity crisis in time.
- The capital provision from the Middle East and Asia where capital providers have acquired sizeable equity stakes in Citigroup, UBS, and Morgan Stanley. This should strengthen the banks' balance sheets and ultimately work as a boost of confidence for financials. Additionally, Saudi Arabia is planning to raise the largest sovereign wealth fund in the world, dwarfing Abu Dhabi's US$900 billion fund. Thus capital does exist, and we expect the big players in the financial industry to survive, ultimately easing the liquidity crisis. The direction of economic growth and the equity markets does however remain more uncertain.

Diversification is an important component of any portfolio which is best provided by funds following niche strategies. In the Coronation Relative Value Fund of Funds we continue to search for uncorrelated funds that will bring stable performance regardless of the direction of the equity markets.

Coronation Multi-Strategy Fund of Funds

The fund returned 1.29% for the fourth quarter, bringing the year's performance to 6.91%.

Equities rallied strongly in October, only to sell off in November and much of December. Since a directional equity exposure was a sizeable position in the fund, performance behaved much in sync with the markets. After the third quarter, we looked for sizeable positions of distressed mortgage bond and other structured finance to be sold by large market participants in the fourth quarter. This sale did not materialise and thus we retained a sizeable equity position and a cash buffer. The forced selling may still be a possibility as downgrades continue to put pressure on the holders of these securities, but it seems to be a slower process than we had anticipated.

The portfolio has now shifted to a less directional equity market exposure, although we continue to hold some emerging market positions. We have increased our exposure to equity long/short and niche strategies. The portfolio will aim to capitalise on the opportunity set mentioned above, i.e. the potential for severe offloading of debt securities in the market, as well as a number of others that we believe will produce strong returns in the foreseeable future. Directional equity exposure will be a smaller part of the portfolio, with exposure concentrated towards growth regions.

Note: Returns for Global Equity and Global Bond are actual, while all other fund returns are estimates at time of writing. All returns are net of fees.

A view of the markets from Asia

Guest contributor

HEATHER MANNERS
Prusik Investment Management LLP, an independent Asian specialist investment manager

We expect that, due to a much harder economic environment in 2008, companies will find it more difficult to surprise on the upside. While there is plenty of press coverage and talk of a possible recession in the US, we do not think that such an outcome is yet priced into markets. Indeed, history shows that, based on the last 22 years of IBES data, the consensus has never forecast a decline in earnings. While it is fair to say there is no current sense of looming weakness in forecasts, this is clearly not a reliable indicator. At the company level, we think that some cracks are beginning to emerge.

There are signs of a slowdown in demand for the PRC-based export manufacturers, and the new labour laws in China will also start to impact profitability. In particular, the share prices of a number of China-based Taiwanese manufacturers are beginning to discount the impact of the cost increases on profitability which the new labour laws will generate. Such increases in the cost of labour come on top of rising raw material and energy costs. As a result, corporate earnings would likely already have been under pressure even before making allowance for the added possibility of weakness in end-user demand as, unfortunately, there are already signs of a corporate capital expenditure slowdown in the US.

We have already seen tangible signs of such cost pressures among the smaller Hong Kong based manufacturers. For example, Hung Hing Printing, not a company in which we have invested, announced interim results in November, where operating profit declined by 45% year on year, and its operating margin dropped from 20.8% to 17.6%. The reasons for this decline in margins cited by the company were twofold – rising labour and raw material costs and increasing levels of competition, reflective of excess supply relative to demand.

Our core themes remain coal, food, education, electricity, transmission and distribution, gold, telecoms, companies set to benefit from declining interest rates and companies with exposure to a select range of strong Asian domestic demand pockets such as surveillance. We are undertaking even more stringent reviews of our holdings and have disposed of our exposure to companies dependent on cyclical OECD demand. We have retained holdings with exposure to sectors where we see a particular supply demand dynamic which, we believe, is relatively immune to the economic cycle. This includes sectors such as food and coal. We have also maintained our exposure to sectors where we think that public sector driven investment programmes will be the major demand driver. For example, our investments in companies which supply equipment to develop power transmission and distribution or surveillance systems meet such criteria. We are also increasingly focusing on companies which supply basic necessities. Medium-term revenue and earnings growth trends for these companies may be more modest but positively, are reasonably secure. Such attributes could, we think, become increasingly rare as next year progresses.

In taking a closer look at coal, we note that while speculation on Chinese overtures towards RioTinto's diversified materials asset portfolio dominates the headlines, the smaller coal producers across the region appear to be seeing offers and counter-offers almost weekly! We have been participating in the action via our investments in Macarthur Coal and Felix Resources. Both investments are among the fund's larger holdings. We have also invested in Tata Power, Gujarat NRE Coke and Yanzhou Coal. A fair few of the region's mining CEOs have dropped into our offices to see us. This has given us an insight into how the various players expect the industry structure to evolve. What's new? In November, Xstrata offered investors a price 60% above the offer New Hope for Resources Pacific. Macarthur Coal bought and sold coking coal assets in Australia, and Straits Asia bought more Indonesian coal assets. On our favoured valuation measure, Xstrata's bid for Resource Pacific valued its thermal coal assets at an EV/reserves of over US$8 per tonne. Macarthur's deal looks to have been valued at similar levels. Straits acquired its assets at a slightly higher EV/reserves valuation of under US$10, again for thermal coal assets. The industry bids are therefore being priced at a reasonable premium to the listed sector. However, we think that these bids and the sector are still grossly undervalued. Don't sell your coal concession yet!

We estimate that cash costs per tonne of coal produced in Australia have risen to nearly US$45 for thermal coal and US$60 for coking coal. Next month, we believe that the new contract prices will be set at US$90 per tonne for thermal coal and US$150 for coking coal. If we add in US$10 per tonne to take into account depreciation and required future capital expenditure, the operating margin per tonne for thermal coal is around 39% or US$35 per tonne and for coking coal is even higher. For anyone who is a believer in the long-term coal price staying at current levels, paying US$8 per tonne of reserves, reserves being a proven and regulated figure, seems a very modest price. We believe that coal assets, especially those with future transport links such as Felix's and Macarthur's mine assets are worth nearer US$20 per tonne. Interestingly, that was the implied value at which the share prices of the premier Chinese coal companies were trading in October. We think therefore that there is potential for sizeable further upside for our coal-related investments without even taking into account the fact that, as coal prices rise, more resources become reserves. This was the logic behind our prediction two months ago that Felix's shares could rise sixfold.

And what about the impact of a US downturn? Forty percent of US power generation is coal fired. In the event of a recent US recession, could this have an impact on the coal price? During the Asian crisis, which knocked 14% off the region's GDP, power-generating levels still rose at 3% per annum. They were about the only thing that did!

Coal demand is probably therefore reasonably insulated, especially as the US market accounts for less than 5% of coal demand in the sea-borne thermal coal market.

Even if we did see a tick down in US consumption, the scale of generating capacity expansion we expect to see in India, China and Indonesia should more than 'trump' any slowdown.

The Prusik Asia Fund is a holding in both the Coronation International Active and Global Equity Alternative Strategy funds.

FUND	LAUNCH DATE	1 YEAR	3 YEARS	5 YEARS	SINCE LAUNCH	TER
SOUTH AFRICAN COLLECTIVE INVESTMENTS						
DOMESTIC EQUITY FUNDS[1]						
Equity	15-Apr-96	16.92%	30.75%	▲ 31.97%	▲ 20.58%	1.44%
FTSE/JSE Shareholder Weighted All Share Index		18.06%	33.55%	30.40%	15.34%	
Top 20	1-Oct-00	13.54%	33.41%	▲ 31.74%	▲ 28.27%	1.38%
FTSE/JSE Top 40 Index		18.97%	35.45%	28.30%	21.58%	inc. performance fee of 0.23%
FLEXIBLE FUNDS (MARKET-RELATED BENCHMARKS)[1]						
Balanced Plus	15-Apr-96	13.10%	▲ 25.82%	▲ 25.35%	▲ 18.67%	1.49%
Composite Benchmark[2]		14.00%	24.91%	23.82%	16.18%	
Market Plus	2-Jul-01	14.20%	25.19%	▲ 27.21%	▲ 24.82%	2.00%
Composite Benchmark + 2% [2]		16.00%	27.23%	26.01%	21.54%	inc. performance fee of 0.55%
FLEXIBLE FUNDS (INFLATION-LINKED BENCHMARKS)[1]						
Capital Plus	2-Jul-01	9.46%	▲ 18.18%	▲ 18.57%	▲ 17.89%	2.80%
CPIX + 4% per annum		12.45%	9.80%	9.15%	9.95%	inc. performance fee of 1.30%
SA Capital Plus	1-Apr-04	9.29%	▲ 19.05%	X	▲ 21.01%	2.85%
CPIX + 3.5% per annum		11.95%	9.30%	X	8.65%	inc. performance fee of 1.41%
Absolute	2-Dec-02	11.07%	▲ 23.13%	▲ 25.75%	▲ 25.48%	4.11%
CPIX + 6% per annum		14.45%	11.80%	11.15%	11.09%	inc. performance fee of 2.64%
Optimum Growth	15-Mar-99	10.36%	▲ 21.48%	▲ 19.43%	▲ 18.94%	2.05%
CPIX + 5% per annum		13.45%	10.80%	10.15%	11.41%	inc. performance fee of 0,82%
DOMESTIC EQUITY SECTOR FUNDS[1]						
Industrial	1-Jul-98	11.18%	28.44%	▲ 33.86%	▲ 21.30%	1.23%
FTSE/JSE Industrial Index		17.80%	31.30%	32.96%	15.31%	
Financial	1-Jul-98	▲ 6.06%	21.73%	▲ 28.82%	▲ 14.15%	1.44%
FTSE/JSE Financial Index		3.03%	23.53%	27.63%	10.87%	
Resources	1-Oct-99	▲ 41.82%	▲ 50.48%	▲ 33.37%	▲ 33.39%	1.22%
Domestic Equity – Resources and Basic Ind. Mean		39.49%	46.91%	29.18%	31.40%	
Smaller Companies	1-Apr-97	▲ 23.80%	31.76%	32.53%	18.25%	1.19%
Composite Benchmark[3]		20.27%	34.55%	35.72%	19.44%	
FIXED INTEREST FUNDS[1]						
Strategic Income	2-Jul-01	▲ 7.73%	▲ 9.32%	▲ 11.54%	▲ 12.55%	1.12%
BEASSA All Bond Index (1-3 years)		7.07%	6.80%	9.07%	9.42%	
Property Equity	20-Nov-00	18.79%	27.75%	29.69%	▲ 25.68%	1.42%
Domestic Real Estate General Mean		21.76%	29.38%	31.28%	25.15%	
Bond	1-Aug-97	▲ 4.29%	▲ 7.30%	10.58%	13.82%	0.87%
BEASSA All Bond Index		4.21%	6.79%	10.63%	14.01%	
Income	3-Apr-00	6.79%	▲ 6.96%	8.58%	▲ 10.82%	0.90%
BEASSA All Bond Index (1 – 3 years)		7.07%	6.80%	9.07%	10.32%	
Money Market	1-Oct-99	▲ 9.44%	7.92%	8.70%	9.52%	0.35%
Alexander Forbes Short Term Fixed Interest 3-month Index		9.41%	7.96%	8.77%	9.61%	
Cash Plus	1-Jul-05	8.45%	X	X	7.39%	0.68%
Alexander Forbes Short Term Fixed Interest 3-month Index		9.41%	X	X	8.12%	
ONSHORE INTERNATIONAL FUNDS[1]						
International Active Fund of Funds	1-Aug-97	5.32%	19.43%	6.08%	▲ 13.43%	2.67%
MSCI World Index (ZAR)		7.02%	20.69%	12.20%	9.95%	

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Unit trusts should be considered a medium- to long-term investment. The value of units may go down as well as up. Past performance is not necessarily an indication of future performance. Unit trusts are traded at ruling prices and can engage in scrip lending and borrowing. Fluctuations or movements in exchange rates may cause the value of underlying investments to go up or down. A schedule of fees and charges is available on request from the management company. Commission and incentives may be paid and, if so, are included in the overall costs. Forward pricing is used. A member of the Association of Collective Investments, South Africa.

The TER (total expense ratio) is calculated as an annualised percentage of the average NAV of the portfolio incurred as charges, levies and fees in the management of the portfolio for the period 1 January 2007 to 30 September 2007, as well as the performance fee accrued over the 12 months to 30 September 2007. A higher TER ratio does not necessarily imply a poor return nor does a low TER imply a good return. The current disclosed TER cannot be regarded as an indication of future TERs. For further information regarding our fee structure please contact us or visit our website.

▲ denotes outperformance and ▲ denotes outperformance since launch. Figures of one year and less indicate percentage change. Figures of one year and more indicate the annualised growth rate.

1. Figures are quoted from Morningstar as at 31 December 2007 for a lump sum investment and are calculated on a NAV-NAV basis with income distributions reinvested.
2. Benchmark for the Balanced Plus and Market Plus funds comprises: 63% Equity (Capped All Share Index), 22% Bonds (All Bond Index), 10% Foreign (60% MSCI Equity gross, 25% JP Morgan Global Bond Index, 15% JP Morgan USD 3-month Treasury Bill) and 5% Cash (Alexander Forbes Short Term Fixed Interest Index) – Effective 1 April 2006.
3. Benchmark for the Smaller Companies fund is a market cap weighted index of the FTSE/JSE Small and Mid Cap Indices.
4. Figures are quoted from the Independent Retirement Fund Survey as at 30 November 2007.

FUND	LAUNCH DATE	1 YEAR	3 YEARS	5 YEARS	SINCE LAUNCH	OUTPERFORMANCE
PENSION FUNDS[4]						
MARKET-RELATED BENCHMARK PORTFOLIOS						
GLOBAL BALANCED						
Houseview	1-Nov-99	20.44%	▲ 28.39%	▲ 24.64%	▲ 20.81%	▲
Median of Global Large Manager Watch		20.46%	27.85%	24.55%	20.26%	
Managed One	1-May-96	21.60%	▲ 28.71%	24.32%	▲ 20.17%	▲
Upper Quartile of Global Large Manager Watch		22.65%	28.02%	25.23%	17.64%	
Managed Two	1-Apr-00	▲ 21.44%	▲ 29.67%	▲ 25.51%	▲ 21.18%	▲
Composite Benchmark[5]		19.69%	27.70%	22.82%	16.91%	
DOMESTIC BALANCED						
Domestic Houseview	1-Apr-04	23.35%	▲ 29.67%	X	▲ 31.82%	▲
Median of South African Large Manager Watch		24.56%	29.08%	X	30.77%	
SPECIALIST EQUITY						
Core Equity	1-Mar-04	▲ 30.52%	▲ 36.37%	X	▲ 37.29%	▲
FTSE/JSE Shareholder Weighted All Share Index		29.21%	36.18%	X	36.07%	
Houseview Equity	1-May-00	28.69%	37.09%	▲ 33.77%	▲ 25.25%	▲
FTSE/JSE Shareholder Weighted All Share Index[6]		28.75%	37.13%	30.22%	21.84%	
Aggressive Equity	1-Jan-04	28.19%	35.35%	X	▲ 35.78%	▲
FTSE/JSE Shareholder Weighted All Share Index		29.21%	36.32%	X	35.69%	
SPECIALIST FIXED INTEREST						
Cash Plus	1-Sep-02	8.89%	▲ 7.98%	▲ 9.14%	▲ 9.44%	▲
Alexander Forbes Short Term Fixed Interest Index		9.18%	7.85%	8.81%	9.01%	
Flexible Fixed Interest	1-Dec-04	▲ 9.65%	▲ 11.19%	X	▲ 11.19%	▲
BEASSA All Bond Index (1 – 3 years)		6.90%	6.75%	X	6.75%	
Active Bond	1-Aug-00	▲ 5.73%	▲ 8.46%	▲ 11.34%	▲ 13.81%	▲
BEASSA All Bond Index		4.88%	7.56%	10.62%	13.15%	
INFLATION-LINKED BENCHMARK PORTFOLIOS						
Global Absolute	1-Aug-99	▲ 17.34%	▲ 24.93%	▲ 23.24%	▲ 21.59%	▲
CPIX + 7% per annum		14.88%	12.51%	12.05%	13.30%	
Domestic Absolute	1-Apr-02	▲ 18.25%	▲ 25.23%	▲ 24.78%	▲ 24.50%	▲
CPIX + 5% per annum		12.88%	10.51%	10.05%	10.63%	
Capital Preserver	1-Oct-05	▲ 17.82%	X	X	▲ 19.57%	▲
CPIX + 6% per annum		13.88%	X	X	11.98%	
Medical Aid Absolute	1-May-04	▲ 15.37%	▲ 20.76%	X	▲ 22.46%	▲
CPI + 4.5% per annum		12.92%	10.21%	X	9.70%	
INTERNATIONAL FUNDS[7]						
Global Equity Long Only (US$)	1-Jul-00	▲ 10.87%	▲ 15.62%	▲ 19.42%	▲ 5.47%	▲
MSCI World Index (US$)		9.57%	13.30%	17.53%	3.48%	
Global Equity Long Only (ZAR)	1-Jul-00	▲ 8.11%	▲ 23.09%	▲ 13.96%	▲ 5.53%	▲
MSCI World Index (ZAR)		6.83%	20.62%	12.16%	3.54%	
Global Bond (US$)	2-Jul-03	8.15%	▲ 3.80%	X	▲ 6.74%	▲
Citigroup World Government Bond Index (US$)		10.95%	3.12%	X	5.81%	
Global Bond (ZAR)	2-Jul-03	5.45%	▲ 10.51%	X	▲ 4.78%	▲
Citigroup World Government Bond Index (ZAR)		8.18%	9.78%	X	3.96%	
Global Equity Alternative Strategy[7, 8] (US$)	1-Aug-96	7.03%	6.70%	9.01%	▲ 11.08%	▲
MSCI World Index (US$)		9.57%	13.30%	17.53%	7.86%	
50% MSCI World Index + 50% US T-Bill (US$)		7.04%	8.72%	10.13%	6.05%	
Global Equity Alternative Strategy (ZAR)	1-Aug-96	4.35%	13.59%	4.03%	▲ 15.16%	▲
MSCI World Index (ZAR)		6.83%	20.62%	12.16%	11.82%	
50% MSCI World Index + 50% US T-Bill (ZAR)		4.56%	15.82%	5.14%	9.96%	
Relative Value (US$)	1-Jan-00	▲ 4.83%	▲ 7.44%	▲ 6.96%	▲ 7.22%	▲
US T-Bill (US$)		4.53%	4.31%	3.07%	3.31%	
Relative Value (ZAR)	1-Jan-00	▲ 2.21%	▲ 14.39%	▲ 2.07%	▲ 8.60%	▲
US T-Bill (ZAR)		1.92%	11.05%	(1.64%)	4.64%	
Multi-Strategy Fund (US$)	1-Aug-02	6.91%	7.32%	▲ 6.54%	5.78%	
LIBOR +3% (US$)		8.42%	7.83%	6.47%	6.33%	
Multi-Strategy Fund (ZAR)	1-Aug-02	4.24%	14.26%	1.67%	▲ (1.79%)	▲
LIBOR +3% (ZAR)		5.79%	14.61%	1.74%	(1.07%)	

5. Benchmark for Managed Two comprises 60% Equity (Capped All Share Index), 20% Bonds (All Bond Index), 15% Foreign Equity (MSCI World Index) and 5% Cash (Alexander Forbes Short Term Fixed Interest Index).
6. Benchmark for Houseview Equity changed from FTSE/JSE Capped All Share to the Shareholder Weighted All Share Index on 1 July 2007.
7. Figures quoted as at 31 December 2007, with estimates for fund returns for the period.
8. This fund is available to institutional investors only. An estimate was used for December's fund performance.

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