

# The Weekly Focus

A market and economic update

14 June 2010



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# Newsflash

“Bafana Bafana may not raise the trophy next month. But South Africa can still emerge from the tournament a winner.”

## Market Comment

- It is heartening to see some return to risk-taking, with stock markets bouncing after a protracted period of weakness, even though skepticism remains high.
- Take, for example, the Aussie dollar (a commodity currency, much like the rand), which had declined by over 13% against the US dollar in six weeks. It has bounced by 5.5% in the past few days as commodity prices rally, which is also helping the rand.
- Economic news is continuing on the “two steps forward, one step backwards” trend.
- Technical analysts (chartists) remain negative for now, although the bounce is expected to continue for a few more days. Many markets dipped down below their 200-day moving averages and a few have managed so far to recover back above these much-watched levels. The US S&P 500 Index, currently at 1092, needs to get back over 1108, its 200-day moving average.
- We remain aware of the statistic noted a few weeks ago where, 45% of the time over the past 80 or so years, the US stock market has corrected by over 20% during mid-term election years. A big election is due there in November, which marks the half-way mark of Obama’s first four years in office. At its worst recently, the US stock market was down about 14%.
- The JSE All Share Index has recovered back to November 2009 levels (also March 2007 levels) and is now 7.8% below the mid-April high of 29,500 and down 2% year-to-date. The JSE Financial & Industrial Index is still up 1.75% year-to-date (including dividends). Hey, that’s not bad, considering the negativity since mid-April and its 29.6% return in 2009.
- Of particular interest are the big resource shares, namely Anglo and Billiton, because these shares were pummeled by the European crisis, the ever-strengthening dollar, the 23% fall in the copper price and 22% fall in the oil price as well as the nasty super tax announced by the Aussie government, which is due to start in 2012, but which will hopefully not survive in its current form. Billiton tumbled 25% in the past two months from 260 rand to 194 rand recently and is today back at 214 rand, but apparently needs to close over 215 rand to break the back of its down-trend, from a charting point of view.
- Anglo fell 22% from 350 rand in January to 274 rand recently and is now at 296 rand. UBS Securities has Anglo on a forward price-to-earnings (PE) ratio of just eight to end 2010 and Billiton on a forward PE of seven one year out (June 2011). Both are looking somewhat cheaper than the forward PE of 10.7 on the All Share Index.

- The JSE Banks Index fell 13% from its recent high in March and is attempting to recover now. Anecdotal evidence is that transaction volume remains quiet in banking circles, with cash-flush companies not borrowing and individuals battling to qualify for home loans. Consensus analyst earnings forecasts for Standard Bank reflect a 26% increase in earnings for calendar 2010, but the first four months of the year showed only a 7% increase, meaning that there will need to be a very sharp pickup in the remaining eight months for 2010 forecasts to be met, failing which forecast earnings will be down-graded, which is typically negative for shares.
- The real stars on the JSE have been the general retailers (Foschini, Mr Price, Truworths, Massmart, Woolies, amongst a few others) which are less than 1% from their three year highs. Mr Price, Massmart and Truworths recently reached all-time record highs. This sector comprises 3% of the All Share Index. It appears that the soccer passion is helping sales, although they've already had a big run (up 24% so far in 2010 after doing 31% last year).
- Meanwhile, the JSE listed property index fell 6% during the recent market pullback and is now attempting a recovery. It is back at 2007 levels (11% below its November 2007 record high). The historic dividend yield is 8.1%, with 6% dividend growth expected over the next year.
- The historic dividend yield of 8.1% compares favourably with the 8.5% yield on the STANLIB Income Fund - back in top position in its sector - especially with some growth potential (for Property dividends), albeit with higher risk than the Income fund. The Standard Bank Money Market Fund is yielding around 7% and the STANLIB Cash Plus fund around 7.5% by comparison.

## US Analyst Elaine Garzarelli turns bullish again

- In her latest weekly bulletin, Garzarelli says she now recommends removing the "hedge" from equity portfolios that she's advised holding for the past month or two. The hedge was in place to protect equity portfolios in the event of market declines. The reason for reducing caution is that her quantitative model (which monitors a range of economic, financial and sentiment indicators) on markets has turned more positive. Even though this model is dynamic and therefore subject to change, the more positive reading is cheering for markets.
- The bottom line is that in her view, based on her quantitative system, the US stock market has passed its low point (last Monday). If she's right, then this usually implies that most global stock markets, including our own, have seen their lows.
- She says the so-called "sentiment" reading has improved (investment advisors are more bearish), the libor (London interbank ) rate has stabilized for two weeks, the US corporate bond versus US government bond gap or spread has peaked (in her opinion), plus the commercial paper and junk bond yields in the US have stabilized (after rising) and US money supply has improved. In her quantitative system, these indicators have been upgraded from bearish to neutral.

- She notes that although the latest US economic indicators show the US economy is growing at a sluggish pace, with the leading economic indicator having dropped 8.5% over the past five weeks, she believes the stock market has been discounting this drop.
- Judging by the latest numbers, her forecast for US economic growth in 2010 is 3.3%, with 2.8% in 2011.
- She once again recommends buying into the US Industrial shares, Financial shares, Resources shares, the so-called Consumer Discretionary shares and the Semiconductor shares...in other words, the higher-risk cyclical shares, which she thinks have overly corrected on slow-down fears. She also likes the high yield ("junk") bond funds once again. These funds are paying dividend yields of anywhere from 9 to 15%.
- On the European crisis, she notes that although Europe accounts for 25% of US exports, most go to Northern Europe, which is economically stable; plus this region is benefiting from the weaker euro and from lower interest rates as money flows into the safest havens (Germany).
- The southern European countries, as well as Eastern Europe, are suffering from the opposite interest rate problem, as lenders fear those countries.
- The financial turmoil in Europe will likely keep the Federal Reserve on hold for many more months, in her view.
- She notes that Bernanke expects the negative impact of the recent fall in shares and Europe's weaker economic prospects to be offset by declines in US government bond yields and home loan rates plus the lower oil and general commodity prices. Mortgage rates are down from 5.5% to 4.5%.

## Snippets of Info

- US Federal Reserve (central bank) governor, Bernanke, says although the chance of a relapse into recession "can never be ruled out" (the so-called 'double-dip'), the US economy appears to have made an important transition from relying on government support and inventory rebuilding to private demand growth.
- But he noted that the unemployment rate is likely to stay high for a while, given the depth of the recent recession.
- JP Morgan reports from China that although the Chinese government's property tightening campaign has weighed on market sentiment, a host of property experts at JP Morgan's China Conference 2010 broadly agreed that investors with long-term time horizons should not be overly concerned. The market response thus far has been very typical of a normal correction and long term fundamentals remain supportive of property demand.

- Leif Johansson, CEO of AB Volvo, is quoted in today's Financial Times saying he saw no signs of a double-dip recession. "Outside Europe and North America, the markets are very strong. Inside Europe and North America they are improving but off extremely low levels." He also said he expects global sales of heavy trucks to hit new record levels this year on the back of surging demand in India and China. He noted that Volvo sold more trucks in Brazil in the first quarter of 2010 than it did in its core North American market.
- Meanwhile the CEO of Siemens, Europe's biggest engineering company, noted that the weaker euro has given European industry a tailwind. He also reiterated that the strength in emerging markets would help compensate for a more wobbly recovery in Europe and the US. Siemens last year earned 30% of its revenues of 76bn Euros from emerging economies and is one of the biggest foreign investors in China (FT).
- From Friday's Financial Times editorial: "South Africa's reputation for crime and violence has crimped foreign direct investment. The World Cup offers a chance to create a more favourable impression. South Africa is a beautiful country. A well organized and peaceful tournament beamed to a billion TV sets around the globe would do more than anything else to restore its brand. The Bafana Bafana (meaning "boys, boys") may not raise the trophy next month. But South Africa can still emerge from the tournament a winner."

**Paul Hansen**

**(Director: Group Advisory Services - Investments)**

# Economic Update

Last week there was very little domestic economic data released, with most of the attention focus on the key opening match of the 2010 Soccer World Cup on Friday, 11 June.

SA manufacturing production declined in April by 1.0%*m/m*, in-line with expectations. Production is likely to soften in Q2 2010 given the increased labour unrest and extra down-time associated with the World Cup Soccer.

Market conditions in Europe remain subdued as a result of credit tightening. Greece is expected to remain in recession for most of 2010/2011 although there is clear evidence that the government is trying to effect its agreed fiscal austerity programme. In contrast to some private sector research, the introduction of the severe austerity programme is likely to reduce overall economic growth, certainly initially. At some point, once the austerity programme has been more fully completed, it will start to lead to a more positive outcome for the overall economy; but that will take some time.

The worse than expected decline in US retail activity during May was mainly due to a record 9.3%*m/m* drop in sales of building materials. This is possibly due to the ending of a government rebate on sales of energy saving devices. This seems especially likely given the large increase in this category's sales last month. Although US retail sales are still improving on a trend basis, our base-case view is that US consumer activity will struggle to regain the previous peaks, especially given the still sluggish growth in private sector employment.

## South Africa

### SA Manufacturing Production

- In April 2010, SA manufacturing production fell by 1.0% *m/m* (seasonally adjusted), compared with a revised increase of 3.0%*m/m* in March.
- On an annual basis, production is still up a very healthy 8.7%*y/y*; despite the monthly decline. Production has improved significantly relative to the decline of -15.3%*y/y* recorded in August 2009 and the -21.7%*y/y* in April 2009. Manufacturing activity is out of recession, but the stability/improvement remains a little fragile, especially in Q2 2010 due to four key factors:
  - First, it is entirely possible that the inventory adjustment is mostly completed (which boosted production in late 2009 and early 2010, after destroying production in late 2008 and early 2009), and that a sustained rise in production is now much more closely related to a sustained rise in final demand
  - Second, the increased labour unrest, especially in May with the Transnet strike, would have hurt some areas of production

- Third, the ending of key infrastructure projects related to the World Cup most likely resulted in less output from local industry
- The downward trend in the PMI confirms the negative picture drawn by the monthly growth data and implies a slowdown in the sector

## Global

### Greece

- Greece GDP declined by 1.0%q/q (-3.8%q/q, annualised) in Q1 2010 and by -2.5%/y. This was slightly below expectations for a decline of 0.8%q/q, and compares with a decline of 0.8%q/q in Q4 2009. Greece has now been in recession for six consecutive quarters, declining by around 2% in calendar 2009.
- The Q1 2010 GDP decline reflected continued relatively broad-based weakness including a 14.6%/y decline in fixed investment spending (especially construction activity). Final consumption fell by 0.7%/y, mainly due to a massive 9.0%/y fall-off in government consumption spending.
- In contrast, private consumption spending actually rose by 1.5%/y, despite the increase in the VAT rate.
- In terms of foreign trade, although exports fell by 0.5%/y, imports plunged by 6.6%/y, which means that the external trade deficit decreased by 15.8%/y, contributing positively to the rate of change in GDP.

## United States

### US consumer credit

- US consumer credit rose by a very modest \$1.0bn in April. This was actually slightly above market expectations, which was for a decline of \$1.0bn. The previous month's data was revised from an initial increase of +\$2.0bn to a decline of \$5.4bn. US consumer credit (which excludes mortgage finance) has fallen in 15 of the last 18 months. Prior to January 2009, US consumer credit rose each month for a consecutive 125 months.
- Since the middle of 2008 the US consumer has been trying to de-leverage. This was reflected in a dramatic fall-off in mortgage advances during 2008/2009, but also in a sharp decline in consumer credit. This decline in consumer credit has been very unusual relative to the history of consumer credit. For example, over the years from 1995 to 2008 US consumer credit rose by a total of \$1.56 trillion or at an average of \$111.7 billion a year. In contrast, during 2009, US consumers reduced their credit (excluding mortgages), by a significant \$109.7 billion.
- The ratio of US household debt to disposable income is at 126.7% (Q4 2009), having peaked at 135.9% in Q1 2008 (new data out this week). However, at 126.7% the indebtedness ratio is still well above the average for the past ten years of 118%. Fortunately, the debt servicing ratio has

declined to 12.6% of disposable income, which is still relatively high but well below the peak of 13.92% recorded in Q1 2008. It is also encouraging to see that US personal income has started to rise year-on-year (at least in nominal terms) and that consumer spending has now increased for 7 consecutive months (year-on-year, in nominal terms). The rate of growth in spending is outstripping the rate of growth in income, which means that personal savings levels are, once again, moving lower.

#### US Retail Sales

- In May 2010, US retail sales fell by a very disappointing 1.2%*m/m*. This was well below market expectations for a rise of 0.2%*m/m*. The April 2010 reading was revised up to 0.6%*m/m* from 0.4%*m/m*. US retail sales performed well over the three month period from February 2010 to April 2010.
- If motor sales are excluded, retail sales fell by an equally disappointing 1.1%*m/m*, below expectations for a rise of 0.1%*m/m*. If vehicle sales and petrol sales are excluded (which is appropriate since sales are reported in nominal terms) retail sales were down 0.8%*m/m*. This was also well below expectations for +0.2%*m/m*.
- On an annual basis, US retail sales are up 6.9%*y/y* (in nominal terms), which is still encouraging, but below the peak of 9.0%*y/y* in April 2010. Importantly, excluding vehicles and gasoline, sales are up a more modest 4.4%*y/y*, which is well below the average from 2004 to 2007 of 5.5%.

**Kevin Lings and Laura Jones**  
(STANLIB Economics)

# Weekly Market Analysis

Currencies/ indices/ commodities	Friday's Close 11/06/10	Weekly Move (%)	YTD (%)
<b>Indices</b>			
*MSCI World - US Dollar	1080.68	1.92	-7.51
*MSCI World - Rand	8293.78	0.36	-4.25
*MSCI Emerging Market - US Dollar	917.18	0.40	-7.31
*MSCI Emerging Market - Rand	7038.96	-1.14	-4.03
All Share Index - US Dollar	3503.60	2.63	-6.29
All Share Index - Rand	26849.17	1.10	-2.95
All Bond Index	315.89	0.63	5.62
Listed Property J253	729.07	0.14	8.64
<b>Currencies</b>			
US Dollar/Rand	7.66	-1.49	4.40
Euro/Rand	9.30	-0.30	-11.42
Sterling/Rand	11.15	-0.85	-6.14
Euro/US Dollar	1.21	1.23	-15.18
<b>Commodities</b>			
Oil Brent Crude Spot Price (\$/bl)	74.26	4.40	-3.81
Gold Price \$/oz	1225.90	0.57	11.77
Platinum Price S/oz	1538.00	1.85	

Source: I-Net Bridge

\* MSCI - Morgan Stanley Capital International

# Rates

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

## Standard Bank Money Market Fund

Nominal: 6.74% per annum  
 Effective: 6.95% per annum

A constant unit price will be maintained. Past performance is not necessarily a guide to future performance. A schedule of fees and charges and maximum commission is available on request from the Manager. Commission and incentives may be paid and if so, are included in the overall costs. The yield is calculated using an annualised seven-day rolling average as at 11 June 2010.

## STANLIB Cash Plus Fund

Effective Yield: 7.49%  
 This is a current yield as at 11 June 2010.

## STANLIB Dividend Income Fund

Effective Yield: 4.89%  
 This is a current yield as at 11 June 2010.

## Liberty Investments' Life Annuities

Current Rates for 14<sup>th</sup> June - 18<sup>th</sup> June 2010

Payments are assumed to be paid monthly in advance with no guarantee period or annual escalation in income. Ages indicated assume client is the exact age shown. No tax has been deducted.							
Gender		Male			Female		
Age last birthday		55	60	65	55	60	65
Contribution	R 100,000	R 788	R 852	R 932	R 717	R 761	R 822
	R 250,000	R 1,993	R 2,152	R 2,355	R 1,815	R 1,925	R 2,079
	R 500,000	R 4,000	R 4,320	R 4,726	R 3,644	R 3,864	R 4,173
	R 1,000,000	R 8,015	R 8,655	R 9,468	R 7,302	R 7,742	R 8,360

The table above shows the monthly annuity that an annuitant will receive for life in return for the single premium in the left hand column. Note that the annuity depends on the annuitant's exact age and gender.

The rates above were calculated assuming maximum commission and will be enhanced if a commission discount is selected.

# Glossary of terminology

<b>Bonds</b>	A bond is an interest-bearing debt instrument, traditionally issued by governments as part of their budget funding sources, and now also issued by local authorities (municipalities), parastatals (Eskom) and companies. Bonds issued by the central government are often called "gilts". Bond issuers pay interest (called the "coupon") to the bondholder every 6 months. The price/value of a bond has an inverse relationship to the prevailing interest rate, so if the interest rate goes up, the value goes down, and vice versa. Bonds/gilts generally have a lower risk than shares because the holder of a gilt has the security of knowing that the gilt will be repaid in full by government or semi-government authorities at a specific time in the future. An investment in this type of asset should be viewed with a 3 to 6 year horizon.
<b>Cash</b>	An investment in cash usually refers to a savings or fixed-deposit account with a bank, or to a money market investment. Cash is generally regarded as the safest investment. Whilst it is theoretically possible to make a capital loss investing in cash, it is highly unlikely. An investment in this type of asset should be viewed with a 1 to 3 year horizon.
<b>Collective Investments</b>	Collective investments are investments in which investors' funds are pooled and managed by professional managers. Investing in shares has traditionally yielded unrivalled returns, offering investors the opportunity to build real wealth. Yet, the large amounts of money required to purchase these shares is often out of reach of smaller investors. The pooling of investors' funds makes collective investments the ideal option, providing cost effective access to the world's stock markets. This is why investing in collective investments has become so popular the world over and is considered a sound financial move by most investors.
<b>Compound Interest</b>	Compound interest refers to the interest earned on interest that was earned earlier and credited to the capital amount. For example, if you deposit R1 000 in a bank account at 10% and interest is calculated annually, your balance will be R1 100 at the end of the first year and R1 210 at the end of the second year. That extra R10, which was earned on the interest from the first year, is the result of compound interest ("interest on interest"). Interest can also be compounded on a monthly, quarterly, half-yearly or other basis.
<b>Dividend Yields</b>	The dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its share price. The higher the yield, the more money you will get back on your investment.
<b>Dividends</b>	When you buy equities offered by a company, you are effectively buying a portion of the company. Dividends are an investor's share of a company's profits, given to him or her as a part-owner of the company.
<b>Earnings per share</b>	Earnings per share is a measure of how much money the company has available for distribution to shareholders. A company's earnings per share is a good indication of its profitability and is generally considered to be the most important variable in determining a company's share price.
<b>Equity</b>	A share represents an institution/individual's ownership in a listed company and is the vehicle through which they are able to "share" in the profits made by that company. As the company grows, and the expectation of improved profits increases, the market price of the share will increase and this translates into a capital gain for the shareholder. Similarly, negative sentiment about the company will result in the share price falling. Shares/equities are usually considered to have the potential for the highest return of all the investment classes, but with a higher level of risk i.e. share investments have the most volatile returns over the short term. An investment in this type of asset should be viewed with a 7 to 10 year horizon.

<b>Financial Markets</b>	Financial markets are the institutional arrangements and conventions that exist for the issue and trading of financial instruments.
<b>Fixed Interest Funds</b>	Fixed interest funds invest in bonds, fixed-interest and money market instruments. Interest income is a feature of these funds and, in general, capital should remain stable.
<b>Gross Domestic Product (GDP)</b>	The Gross Domestic Product measures the total volume of goods and services produced in the economy. Therefore, the percentage change in the GDP from year to year reflects the country's annual economic growth rate.
<b>Growth Funds</b>	Growth funds seek maximum capital appreciation by investing in rapidly growing companies across all sectors of the JSE. Growth companies are those whose profits are in a strong upward trend, or are expected to grow strongly, and which normally trade at a higher-than-average price/earnings ratio.
<b>Industrial Funds</b>	Industrial funds invest in selected industrial companies listed on the JSE, but excluding all companies listed in the resources and financial economic groups.
<b>Investment Portfolio</b>	An investment portfolio is a collection of securities owned by an individual or institution (such as a collective investment scheme). A funds ' portfolio may include a combination of financial instruments such as bonds, equities, money market securities, etc. The theory is that the investments should be spread over a range of options in order to diversify and spread risk.
<b>JSE Securities Exchange</b>	The primary role of the JSE Securities Exchange is to provide a market where securities can be freely traded under regulated procedures.
<b>Price to earnings ratio</b>	Price to earnings ratio or p:e ratio, is calculated by dividing the price per share by the earnings per share. This ratio provides a better indication of the value of a share, than the market price alone. For example, all things being equal, a R10 share with a P/E of 75 is much more "expensive" than a R100 share with a P/E of 20.
<b>Property</b>	Property has some attributes of shares and some attributes of bonds. Property yields are normally stable and predictable because they comprise many contractual leases. These leases generate rental income that is passed through to investors. Property share prices however fluctuate with supply and demand and are counter cyclical to the interest rate cycle. Property is an excellent inflation hedge as rentals escalate with inflation, ensuring distribution growth, and property values escalate with inflation ensuring net asset value growth. This ensures real returns over the long term.
<b>Resources and Basic Industries Funds</b>	These funds seek capital appreciation by investing in the shares of companies whose main business operations involve the exploration, mining, distribution and processing of metals, minerals, energy, chemicals, forestry and other natural resources, or where at least 50 percent of their earnings are derived from such business activities, and excludes service providers to these companies.
<b>Smaller Companies Funds</b>	Smaller Companies Funds seek maximum capital appreciation by investing in both established smaller companies and emerging companies. At least 75 percent of the fund must be invested in small- to mid-cap shares which fall outside of the top 40 JSE-listed companies by market capitalisation.
<b>Value Funds</b>	These funds aim to deliver medium- to long-term capital appreciation by investing in value shares with low price/earnings ratios and shares which trade at a discount to their net asset value.

*Sources: Unit Trust and Collective Investments (September 2007), The Financial Sector Charter Council, Personal Finance (30 November 2002), Introduction to Financial Markets, Personal Finance, Quarter 4 2007, Investopedia ([www.investopedia.com](http://www.investopedia.com)) and The South African Financial Planning Handbook 2004.*

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In terms of the ASISA Code of Practice for Advertising of Collective Investment Schemes in Securities and ASISA Standard Pricing and Valuation, STANLIB is required to quote an effective rate which is based upon a seven-day rolling average yield for Money Market Portfolios. This seven-day rolling average yield may marginally differ from the actual daily distribution and should not be used for interest calculation purposes. We however, are most happy to supply you with the daily distribution rate on request, one day in arrears. The price of each participatory interest (unit) is aimed at a constant value. The total return to the investor is primarily made up of interest received but, may also include any gain or loss made on any particular instrument. In most cases this will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of reducing the capital value of the portfolio.

Collective Investment Schemes in Securities (CIS) are generally medium to long term investments. The value of participatory interests may go down as well as up and past performance is not necessarily a guide to the future. An investment in the participations of a CIS in securities is not the same as a deposit with a banking institution. CIS are traded at ruling prices and can engage in borrowing and scrip lending. Different classes of units apply to this portfolio and are subject to different fees and charges. A schedule of fees and charges and maximum commissions is available on request from STANLIB Collective Investments Ltd (the Manager). Commission and incentives may be paid and if so, would be included in the overall costs. This portfolio may be closed. Forward pricing is used. TER is the annualised percent of the average Net Asset Value of the portfolio incurred as charges, levies and fees. A higher TER ratio does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs. This portfolio is valued on a daily basis at 15h30. Investments and repurchases will receive the price of the same day if received prior to 15h30. The Manager is a member of the ASISA.