Fulcrum

Fulcrum

Is the pen mightier than even the African spear – symbol of courage and personal challenge? Put it to the test with the Fulcrum portfolios – **suitable for those whose higher tolerance of risk has the potential to bring them greater rewards.**

Monthly Report

October 2009

Fulcrum

advantage asset managers

Advantage economic and market commentary

October 2009

Overall summary

- Local equity markets powered ahead on the back of strong earnings reports in the United States.
- Local bond markets faltered on prospects of higher electricity tariffs as well as a weaker rand.
- Domestic markets expressed relief at the latest budget deficit coming inline with expectations.
- Inflation and employment figures surprised on the downside fuelling some expectation of a further interest rate cut.
- International markets initially enjoyed some euphoria as the Dow Jones burst through the 10 000 level on the back of stronger earnings.
- Markets were later disappointed by a reversal in US consumer spending pointing to poor recovery in the absence of government stimulus.
- The United Kingdom continues to be in recession while Australia is the first G20 economy to raise interest rates.
- China continues to be seen as the economy to lead the world out of recession as they report strong third quarter growth.
- Risks to the Chinese rebound are on the back of the creation of asset bubbles due to excessive bank lending.

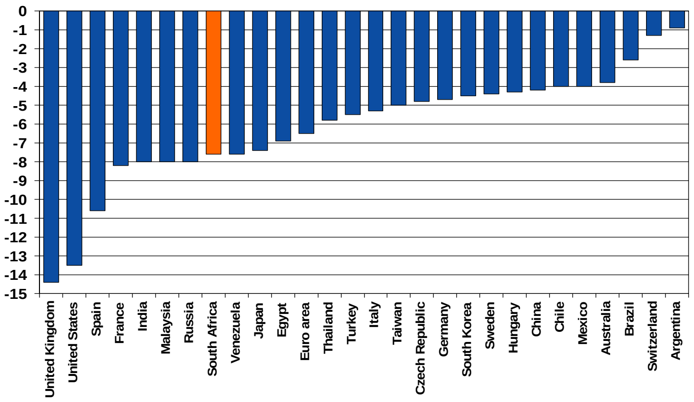
Commentary

Domestic markets

- Increasing risk appetite came to the fore strongly during the month of October as financial markets were buoyed by better than expected earnings reports in the United States.
- The FTSE/JSE All Share index (ALSI) ended the month up a significant 6% bringing returns for the year to 25.7%.
- The three major sectors of the ALSI all contributed to this performance but the top twenty resource stocks led the pack, returning 7.5% for the month.
- Rand weakness of 4%, as well as, increased stock purchases by foreigners during the month boosted resource shares.
- Fixed income returns failed to inspire with the bond market falling twenty four basis points for the month.
- For the 2009 year, to end of October, an investment in the All Bond index would have detracted value in the order of 2.28%.
- Bond returns for the month were initially down close to 2% up to the 27 October but retraced the majority of these losses on the back of key economic releases.
- Bond markets lost ground during the month due to Eskom's announcement of a need for further electricity tariff increases. Their requirement is for tariffs to increase by 45% per annum for the next three years, starting in 2010.
- Eskom tariffs would increase by 22c/kWh a year to 99c/kWh in 2012. This request will be formally considered by the energy regulator in February 2010.
- Higher electricity prices are invariably inflationary as they push up input costs for businesses and also increase household expenditure.
- The Monetary Policy Committee (MPC) has, on a number of occasions, warned about administered prices playing a role in keeping inflation higher.
- At the final MPC meeting, Mr Mboweni stated that the Reserve Bank's inflation outlook had *not* considered Eskom's latest tariff increase request. This calls into question the Bank's assertion that CPI is likely to return to within the inflation target range by the second quarter of 2010 and remain there until the end of 2011.
- Further pain for bonds came as the rand weakened during the course of the month to R7.81/$ from R7.51/$.
- What added to the rand's woes was an allegedly false statement that was promulgated by the Beeld newspaper. This paper stated that the Department of Economic Development had plans to freeze the exchange rate of the rand.
- The ministry vehemently denied these allegations but the rand weakness associated with the false announcement highlighted the market's sensitivity to radical moves to the left.
- Politically, a battle for the soul of the African National Congress is in full swing and resignations of the likes of Joel Nethitenzhe's allude to the left making greater progress.

Advantage economic and market commentary (continued)

- Minister Pravin Gordhan's maiden mini-budget speech mitigated bond market losses as the market sighed some relief that the budget deficit was inline with expectations.
- In the 2009/10 fiscal year, a shortfall of R70 billion in government revenue is expected translating to a budget deficit of 7.6% of GDP (up from the forecast of 3.8% of GDP announced in February).
- The Treasury expects GDP growth to remain below trend for a considerable period, with this only reaching 3.2% by 2012.
- Consequently the budget deficit of 2012/13 will still be at 4.2% of GDP. Many analysts consider the Treasury's growth expectations to be too conservative and expect some positive surprises.
- The majority of the tax revenue shortfalls come from value added tax and corporate tax receipts, which amount to R30.8 billion and R21 billion respectively.
- This is clear ramification of the recession that has hit our economy as well as the rest of the world.
- Budget deficits as a share of GDP across the globe have soared; this is not a local phenomena as evidenced by the graphic below:



Source: Stanlib

- In financing our deficit, government has to issue more bonds (debt) to raise these required funds.
- The net borrowing requirement moves to R175 billion of which R11 billion will be raised via foreign loans with the balance to be raised in domestic short and long term loans (bonds).
- In as much as increased bond supply should theoretically have weakened bonds, the mini-budget served to strengthen yields as the deficit outcome proved inline with expectations.
- Further support for bond yields came during the few days of the month.
- Consumer price inflation (CPI) surprised on the downside for September coming out at 6.1%, lower than consensus expectations of 6.3% and just a touch above the upper band of the target range.
- CPI has breached the 3-6% target range for well over two years now; the last time that it was within the range was in February 2007 when the reading was 5.7%.
- Producer price inflation continued its deflationary trend falling 3.7% in September alluding to further downward pressure in CPI.
- Statistics South Africa released its latest Labour Force Survey, which indicated that 484 000 jobs were lost in the third quarter of 2009!
- This pushed up the official unemployment rate to 24.5%.
- The manufacturing sector alone shed 150 000 jobs while the retail trade sector shed 110 000 jobs.
- Job losses for the year to date for all sectors amount to close to a million jobs.
- This report as well as the positive inflation numbers have led some analysts to believe that there may be scope for another interest rate cut.
- An important issue to consider is the effectiveness of the transmission mechanism. That is, whether the cuts in interest rates are flowing through to consumers via further access to financing.
- When a reserve bank follows expansionary monetary policy it can choose to cut interest rates to stimulate the supply of money but without the velocity of that money, the effectiveness of loose monetary policy is negated.
- With this in mind, it was disappointing to see that private sector credit extension (PSCE) growth moderated even further in September, down to 1.5% year-on-year from 2.3% in August.
- One of the key components within PSCE is the total loans and advances which fell 0.18% in September led by decreasing advances to the corporate sector. In light of this one wonders whether the MPC will be convinced to cut rates again if the velocity of that money is seemingly muted.
- Equity markets were initially buoyed by strong earnings reports from the US, pushing the Dow Jones past the critical 10 000 level.

Advantage economic and market commentary (continued)

Global markets

- Global financial markets had a volatile trading month; rallying substantially during the course of the month, only to reverse all the gains by the end of the month.
- This was later completely reversed in the last few days of the month when US consumer spending numbers disappointed bitterly, calling into question the strength of any US recovery in the absence of government stimulus.
- For the month, the Dow Jones Industrial index started the month at 9712 and ended the month at the exact same level, though having reached a high of 10 092 on 19 October.
- Emerging markets performed inline with that, rising only two basis points for the month.
- US banking giant, JP Morgan Chase & Co, pushed the Dow Jones above 10 000 when it reported its biggest profit since 2007.
- JP Morgan posted earnings per share of 82 cents compared with the average analyst estimate of 51 cents as recorded in a Bloomberg survey.
- The banking giant reported $3.6 billion in profit for the third quarter boosted by the investment banking arm.
- Investment banking revenue from fixed income surged to a record $5 billion, this compared to markdowns of $3.6 billion the previous year.
- It was also important to note though that their consumer loan book still recorded losses; specifically, credit card loans and home mortgage losses continued to rise.
- According to Bloomberg's summary of the earnings for the S&P 500 in the third quarter, 81% of the companies showed positive earnings surprises.
- In all, 349 of the 500 companies reported (70%) and of those 282 surprised on the upside, 22 came inline with expectations and 44 disappointed on the downside.
- The fortunes of the market were reversed on the last trading day of the month when the US consumer spending numbers eclipsed the more positive US GDP numbers for the third quarter.
- Real GDP surprised on the upside when it increased 3.5% in the third quarter of 2009 after decreasing 0.7% in the second quarter of the year. This was the first increase in GDP since the second quarter of 2008. The Bureau for Economic Analysis noted that the rise in real GDP was attributable to three factors, namely:
  - Consumer spending turned up strongly. Spending on new cars and trucks was a big contributor, reflecting the federal "cash for clunkers" program, which was in effect in July and August.
  - Housing increased for the first time in 15 quarters.
  - Inventory investment, exports, and government spending also added to growth.
- What disappointed the markets was data relating to consumption expenditure which reflected that spending adjusted for price changes, fell 0.6% in September, after increasing 1% in August.
- In August, the spike in spending reflected the federal CARS program ("cash for clunkers"). This $3 billion programme offered customers sums of $3500 and more towards the cost of a new vehicle.
- The likes of General Motors saw sales fall 45% in September after the end of the programme.
- In essence, what spooked the markets is the notion that any economic recovery was likely to lose steam in the absence of sustained government stimulus.
- The United Kingdom continues to be plagued by woes as GDP for the third quarter dropped unexpectedly.
- The Office for National Statistics noted that GDP fell 0.4% for the quarter. The median expectation for the 33 economists surveyed by Bloomberg reflected expectations of 0.2% positive growth with none of them expecting a contraction.
- The UK economy has now shrunk for six consecutive quarters.
- The UK services industry accounts for three quarters of the economy and this shrank by 0.2% led by distribution, hotels and restaurants.
- Within the G20, Australia became the first country to raise interest rates.
- During the first week of October, the Reserve Bank of Australia (RBA) raised their overnight cash rate by twenty five basis points to 3.25%.
- The bank's governor, Glenn Stevens, noted that economic conditions in Australia had been stronger than expected and that they expected growth through 2010 to be close to trend. Furthermore he highlighted that unemployment had not risen as had been expected and that housing credit growth had been solid with dwelling prices (house prices) rising appreciably.
- Amongst the developed nations, Australia has done well in the midst of this global recession due to aggressive stimulus, sound banking controls and also as a result of strong commodity demand from China.

Advantage economic and market commentary (continued)

- This country technically avoided a recession (two consecutive quarters of contraction in GDP) as there was only one quarter of economic contraction in 2008.

Emerging markets

- October proved unspectacular for the emerging market composite with the overall index being flat for the month.
- Within that though, the Chinese market powered ahead; the Shanghai Composite index was up close to 8% for the month.
- This result was largely driven by GDP for the third quarter coming in at a stunning 8.9%.
- Bloomberg News reported that the Chinese cabinet would maintain the stimulus measures but also that inflation concerns were starting to come to the fore.
- The Chinese National Bureau of Statistics stated that according to preliminary estimation, the GDP of China in the first three quarters of this year was 21,781.7 billion yuan, a year-on-year increase of 7.7%.
- Bloomberg News highlight the importance of domestic demand as consumption, including household spending, contributed four percentage of the total and investment added 7.3 percentage points.
- A decline in net exports of goods and services shaved off 3.6 percentage points. Prior to the global crisis, trade contributed 2.6 percentage points to economic growth in 2007.
- China has countered an 11 month slide in exports as demand for Chinese goods in other countries has waned. In terms of growth by quarters, it was up 6.1% for the first quarter, 7.9% for the second, and 8.9% for the third quarter.
- The Chinese statistics bureau stated that urban fixed-asset investment had climbed 33.3% in the first nine months of the year as the $586 billion stimulus plan spurred the construction of roads and power plants.
- What needs to be watched closely is whether China's stimulus measures, which include over a trillion US dollars in loans, will not lead to asset bubbles in equity and property markets.
- The Chinese National Bureau of Statistics continued to highlight that in September, sales prices were up another 2.8% year-on-year.

Summary

- Financial markets continue to be haunted by the prospects of anemic economic recovery in the absence of government stimulus measures.
- Poor employment and lower than expected inflation data in South Africa have raised some hope of further monetary easing.
- Australia averted a recession due to effective stimulus measures, sound financial systems and commodity demand from China.
- China continues to be seen as the economy to lead the world out of recession as they report strong third quarter growth.

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Advantage Asset Managers

[1]http://www.bloomberg.com/apps/news?pid=20601087&sid=aktHmtKQaKO8

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Performance report - October 2009

Fulcrum	1 Month	3 Months	6 Months	12 Months	36 Months*	60 Months*
Fulcrum Aggressive	3.81%	7.62%	20.16%	19.02%	8.38%	16.74%
Benchmark	3.44%	7.78%	20.43%	20.00%	7.37%	16.89%
Fulcrum Balanced	3.54%	7.11%	18.93%	17.62%	8.56%	16.68%
Benchmark	3.23%	7.31%	18.91%	18.94%	7.53%	17.12%

*Annualised

- Performance figures are nominal, gross, and non-annualised (except where indicated otherwise).
- All returns to 31 October 2009.

Market indices

	1 Month	% Change at 3 months	% Change at 12 months	% Change at 36 months	% Change at 60 months
CPI*	0.37%	1.78%	4.85%	8.34%	6.91%
R/$ Exchange rate	-4.35%	2.66%	-29.27%	-11.21%	-0.70%
All Share index	0.29%	9.11%	21.60%	-5.27%	3.24%
Shareholder Weighted index (SWIX)	6.02%	9.68%	29.23%	7.14%	21.08%
Financials	4.44%	9.14%	29.34%	8.02%	20.93%
Industrials	4.81%	9.49%	29.87%	1.25%	15.33%
Resources	5.10%	10.73%	26.77%	12.25%	22.48%
MSCI World index (All countries)**	7.49%	8.81%	30.86%	5.29%	22.70%
Citigroup Composite index	6.38%	4.14%	-5.02%	6.38%	4.14%
ALBI	3.59%	5.68%	-6.31%	10.00%	10.55%
STeFI	-0.22%	1.43%	9.33%	6.85%	7.97%

*For September 2009
** MSCI World index (All Countries) return adjusted to correspond with international investment prices received.

Advantage Fulcrum Aggressive

October 2009

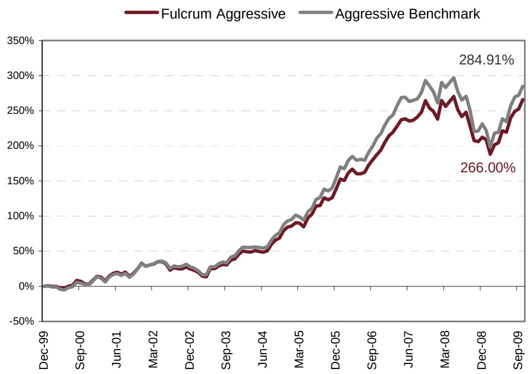
Portfolio mandate

The asset allocation of the portfolio is managed dynamically relative to the benchmark. The underlying managers have been given broad active mandates within their specific market sectors. The portfolio is constructed to maximise the stock selection bets of an array of specialist managers and minimise, where possible, the style and industry biases at the aggregate portfolio level. In addition, the tactical asset allocation component is expected to add value in market extremes by adjusting the portfolios exposure to mispriced assets.

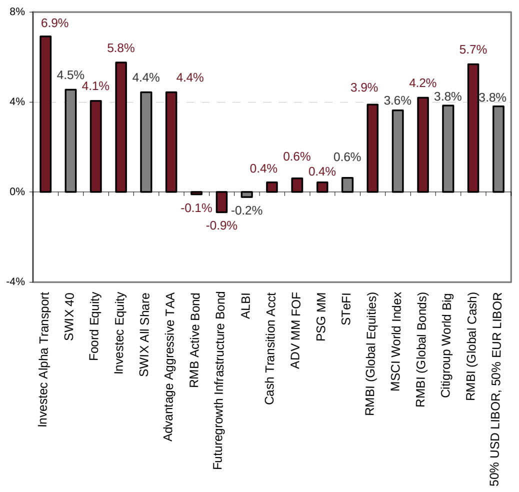
Key information

Launch date	January 2000
Investment horizon	Long term (12 years plus)

Cumulative returns since inception



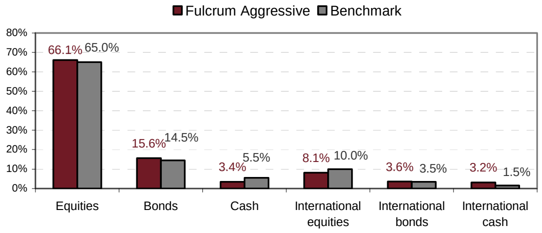
Performance of portfolio managers: 31 October 2009



Investment strategy

The asset allocation and risk profile are dynamically managed relative to the benchmark. The benchmark allocation to Equities:Bonds:Cash is 75:18:7.

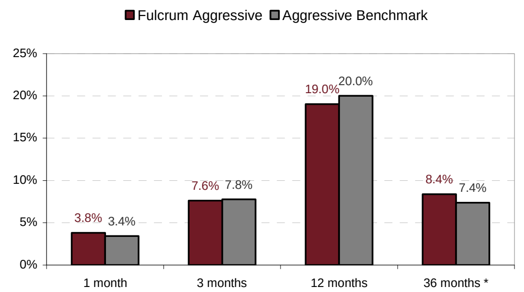
Asset allocation as at 31 October 2009



Manager allocation as at 31 October 2009

Local equity managers	
Coronation House View	21.8%
Investec Alpha Transport	5.0%
Foord Equity	34.7%
Investec Equity	25.5%
Momentum Beta Block	4.9%
Momentum Value Block	7.9%
Tactical asset allocation	
Advantage Aggressive TAA	100.0%
Private equity	
Momentum	100.0%
Local bond managers	
RMB Active Bond	80.0%
Futuregrowth Infrastructure Bond	20.0%
Local cash managers	
PSG Money Market	1.9%
Prescient Money Market	59.8%
RMB Money Market	38.4%
International	
RMBI (equity)	55.0%
RMBI (bonds)	24.1%
RMBI (cash)	20.9%

Performance summary to 31 October 2009



* Annualised

NOTE: Returns are gross returns, before the deduction of fees.

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Fulcrum

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asset managers

Advantage Fulcrum Balanced

October 2009

Portfolio mandate

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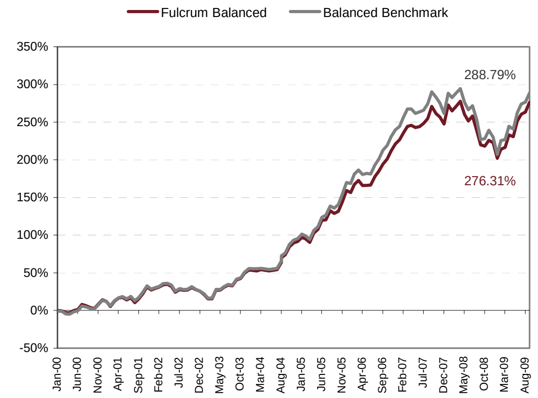
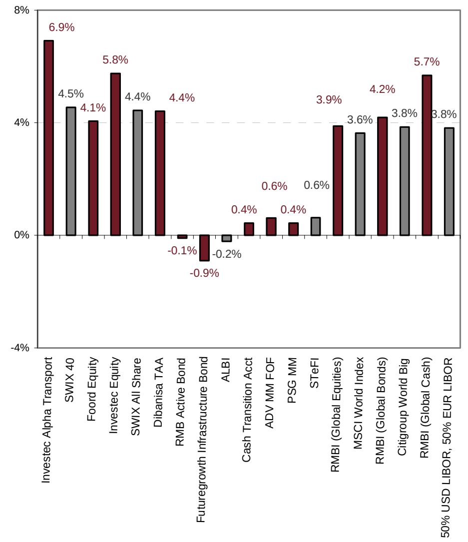
Key information

Launch date	January 2000
Investment horizon	Medium term (6-12 years)

Cumulative returns since inception



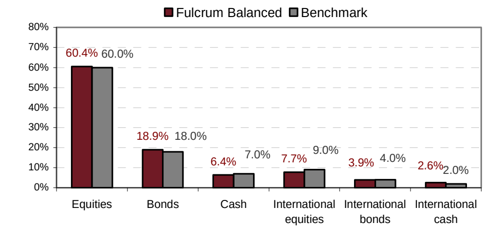
Performance of portfolio managers: 31 October 2009



Investment strategy

The asset allocation and risk profile are dynamically managed relative to the benchmark. The benchmark allocation to Equities:Bonds:Cash is 69:22:9.

Asset allocation as at 31 October 2009



Manager allocation as at 31 October 2009

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Foord Equity	34.7%
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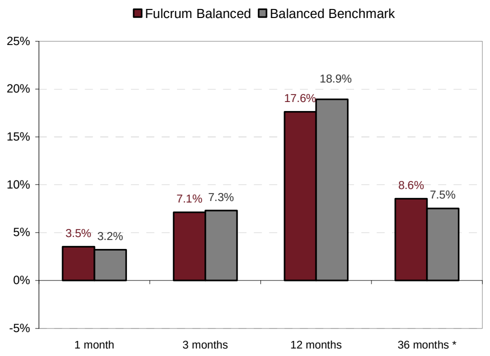
Momentum Beta Block	4.9%
Momentum Value Block	7.9%
Tactical asset allocation	
Advantage TAA	100.0%
Private equity	
Momentum	100.0%
Local bond managers	
RMB Active Bond	80.0%
Futuregrowth Infrastructure Bond	20.0%
Local cash managers	
PSG Money Market	1.9%
Prescient Money Market	59.8%
RMB Money Market	38.4%
International	
RMBI (equity)	54.8%
RMBI (bonds)	27.3%
RMBI (cash)	17.9%

Performance summary 31 October 2009



*Annualised

NOTE: Returns are gross returns, before the deduction of fees.

Advantage Asset Managers Registration Number 2004/023064/07

- Authorised as a financial services provider (FSP) under the Financial Advisory and Intermediary Services Act, 2002 number 19840
- Registered as an administrator in terms of Sec 13B of the Pension Funds Act, number 24/401

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Glossary

Active risk (tracking error): This is a forecast of the difference in returns between your portfolio and its benchmark. This figure represents the amount by which you can expect your portfolio to deviate from the benchmark at 68% confidence. By positioning the portfolio to be different from the benchmark, in areas where there is expected outperformance, the fund manager is taking active risks in anticipation of deriving an active return in excess of the benchmark.

Active returns: These are the fruits from active management. Active management is the pursuit of investment returns in excess of a specified benchmark as opposed to passive management which seeks only to match the benchmark returns.

Benchmark: A portfolio that is used as a point of reference against which the performance of another portfolio is measured. The goal of an active manager is to exceed the return on the benchmark portfolio. An example of a benchmark portfolio is the JSE All Share index.

Benchmark volatility: This is an annualised forecast of the benchmark's volatility. It represents the amount that you can expect the value of the benchmark to fluctuate over a one year period at 68% confidence.

Dividend yield: Most recent annual dividend divided by the current market price.

Growth stocks: Companies that have long term growth forecasts which are significantly greater than growth in nominal GNP. Growth can come from a number of areas: leverage, acquisitions, growth in revenues per share, increased efficiency, investment of retained earnings. As such, growth stocks tend to be more volatile, lower yielding in terms of dividends paid out, smaller in terms of capitalisation, higher risk and potentially higher return.

Industry risk: Indicates the degree to which the fund manager allows the under or overweighting of industries in the fund, relative to the benchmark, to dominate the return in the fund. Typically, a fund with an industry risk figure of 1,00% or lower has little variation in industry weightings relative to the benchmark. A fund with an industry risk of 4,00% or above has aggressively either under or overweighted certain industries in the portfolio.

Information ratio: An extremely useful tool that measures the ratio of returns in excess of the benchmark in a portfolio against the degree of risk that was assumed by the manager to achieve those returns. The higher the ratio, the greater the returns and the lower the risk. A negative information ratio suggests that not only was the performance poor, but a great deal of risk was assumed by the portfolio as well. Information ratios are an excellent way to compare portfolio managers with very different styles and levels of aggressiveness.

Portfolio volatility: This is an annualised forecast of the portfolio's volatility. It represents the amount that you can expect the value of the portfolio to fluctuate over a one year period at 68% confidence.

Stock selection risk: Identifies the degree to which the fund manager allows the selection of specific companies to drive the fund's performance. The higher the number, the more aggressive the fund manager is in terms of selecting stocks that are distinctly different to the market as a whole. A stock selection risk number of around 1,00% suggests a very low stock selection bet. A figure of 4,00% and above suggests a fairly aggressive bet on specific companies. Typically, a fund with a smaller number of shares or shares that may be atypical from the market as a whole will have much higher stock selection risk. One word of caution, in the BARRA model, the stock selection risk number is also synonymous with that portion of performance that cannot be explained by the market, industry, or style movements.

Style risk: Indicates the degree to which the fund manager allows a particular investment style to dominate the performance of the fund. Examples of investment styles might be funds that concentrate on small companies, large companies, value shares, growth shares, success shares, emerging companies, blue chip shares etc. The style of a particular fund can often explain up to 90% of the active return of the fund. Funds with a style risk number of below 1,00% could be viewed as being style neutral. Funds with a figure of 4,00% or more would be seen as taking an aggressive "bet" on their particular style.

Value stocks: Value stocks have proven to be long term performers because, when bought, their prices tend to be low relative to others in the sector and low relative to companies' fundamentals. This will mean that price tends to be low relative to earnings potential, book value, sales and dividends. Companies included here may well be blue chip companies in mature industries but, buying when the price is cheap, long term performance can be expected. Tends to be a less volatile strategy than growth stock investing.

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