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.**

Quarterly Investment Analysis

December 2009

Fulcrum

advantage asset managers

Advantage economic and market commentary

December 2009

Overall summary

- 2009 will be remembered as the year where financial markets staged one of their most dramatic recoveries.
- Low interest rates around the world led to a resurgence in the appetite for risky assets.
- In South Africa, the Monetary Policy Committee followed its global counterparts, cutting the prime rate down to 10.5% as inflation eventually fell to within the target band.
- The Treasury also embarked on expansionary fiscal policy in light of the economic recession, pushing the budget deficit to 7.6% of GDP.
- Despite monetary and fiscal support, consumption expenditure remains very weak as unemployment levels and household indebtedness remain elevated.
- A sustainable economic recovery is heavily dependent on a vibrant consumer base; failure to resuscitate consumption expenditure could lead to a double-dip recession.
- Developed and emerging market equity markets staged impressive recoveries since the lows reached in March 2009.
- The rebound in equity markets and the economic recovery has come at the cost of burgeoning government debt levels.
- Developed economies are in particularly worse shape with the IMF forecasting national debt levels to rise to 114% by 2014.
- Emerging markets are in substantially better shape with the IMF forecasting national debt levels to rise to just 35% by 2014.
- Over the next few years advanced nations must engage in a very painful adjustment process to bring down debt levels; tax levels could rise dramatically while government expenditure is curbed significantly.

Commentary

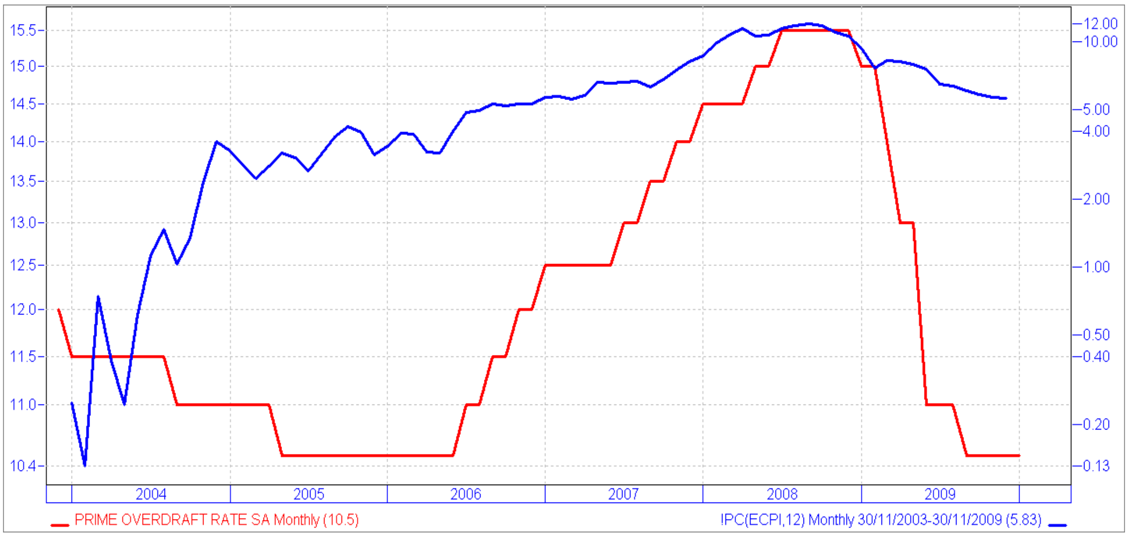
Domestic markets

- As we bid farewell to 2009, we acknowledge that this proved to be a dramatic year that saw financial markets recover from one of the most severe economic recessions.
- The first half of the previous year, 2008, proved to be a boon for risky assets with equity markets (particularly resource stocks) generating superb returns. Commodity prices, like oil and platinum, also reached all time highs. This was cut short mid 2008 when the credit crunch intensified and financial markets plummeted. 2008 as a whole saw the FTSE/JSE All Share index (ALSI) fall in excess of 20% while the All Bond index (ALBI) rewarded investors with a 17% return.
- In 2009, the tables turned with the ALBI lagging significantly as the ALSI generated a return of 32% while the ALBI closed down 1% for the year.
- 2009 will be remembered as the year of the return of risk to financial markets. With low global interest rates, investors used this opportunity to generate returns by investing in risky and high yielding assets.
- Foreigners have played a key role in the movements of the ALSI; buying over R72 billion of stocks while in 2008 they were net sellers of our equities to the tune of R54 billion. Inet Bridge statistics, which date back to 1986, reveal that the net stock inflows by foreigners recorded this year are the highest ever.
- 2008 provided gold investors with a return of 4%, as this precious metal proved to be a resilient investment due to its safe haven characteristics.
- The credit crunch led to widespread panic as financial markets collapsed and investors soon ploughed into safe haven investments like gold and US Treasuries.
- Gold also did exceptionally well in 2009, but for different reasons. The gold price reached its all time high during the first week of December when the price breached $1200 per ounce.
- For the year as a whole, the price rose 25% as this time investors where using gold as a hedge against a weak US dollar and consequently as a hedge against inflation.
- Other commodities also benefitted from the weak US dollar, recovering substantially after being decimated in 2008.
- Monetary and fiscal policy also played pivotal roles during the course of this year.

Advantage economic and market commentary (continued)

- In 2008, the Reserve Bank continued to hike interest rates pushing the prime rate to 15.5% in June 2008. With commodity prices pushing up petrol and food prices, inflation surged to about 12% midyear.
- As the credit crisis and financial meltdown took hold, the Monetary Policy Committee (MPC) began cutting interest rates. The MPC cut the repurchase rate by 500 basis points ("bps"), moving the prime rate down to 10.5%, figure 1.

Figure 1

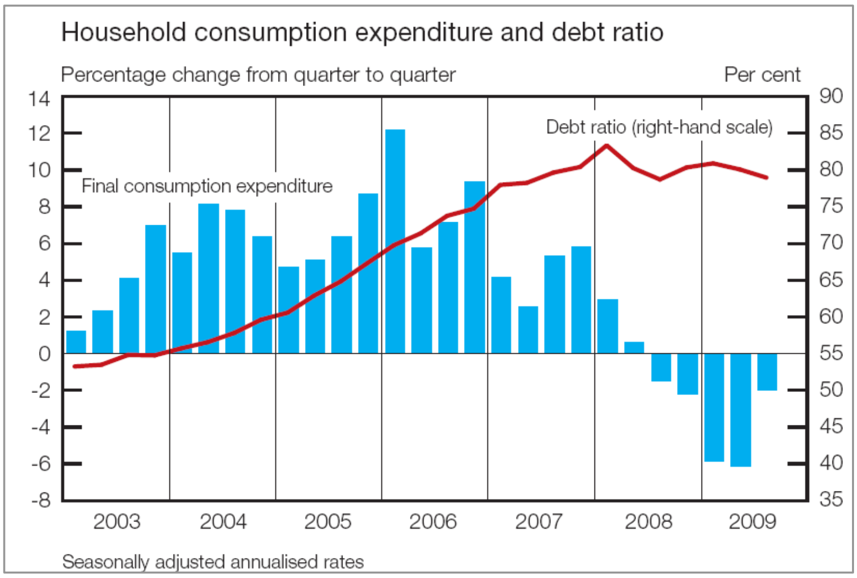


- Inflation has since moderated to within the 3-6% target band due to the rising output gap on the back of the economic recession.
- The petrol price (95 unleaded coast) which peaked above R10 per litre in 2008 has now moderated to R7.69 per litre. Similarly food price inflation which was growing at an average of 17% year-on-year in 2008 has slowed down to a 4% year-on-year growth in November 2009.
- The stronger rand, which rallied 22% in 2009, played a key role in keeping imported inflation low.
- Fiscal policy has also undergone dramatic adjustments as the 5% per annum economic growth rate recorded in 2005 to 2007 began to evaporate; moderating to 3.7% in 2008.
- More importantly, the Treasury expects 2009 to record an economic contraction of 1.9%.
- The last recession in South Africa was recorded in 1992 when growth contracted by 2.1%. Lower economic growth resulted in tax revenues from individuals and corporates falling off, putting pressure on the fiscal envelope.
- The Treasury notes that for the 2008/9 financial year, the budget deficit stands at -1% of GDP while for the 2009/10 year this grows to -7.6% of GDP. The Treasury is to be commended for its conservative stance in the good years, whereby in 2006/7 and 2007/8, the nation recorded small budget surpluses of 0.6% and 0.9% of GDP respectively. This has allowed it room to respond to the economic recession without widening the deficit and pushing up national debt levels excessively.
- In South Africa national government debt is still around 25% of GDP with the Treasury estimating that this will grow to beyond 30% in the next two years.
- Considering the International Monetary Fund's (IMF) estimates for the growth of national debt to GDP of other countries, South Africa compares favourably.
- For European countries like France and Germany, national debt levels are estimated to grow to beyond 80% of GDP in 2010.
- A similar outcome is projected for the United Kingdom, while for the United States the IMF estimates gross national debt to GDP of beyond 90%.
- In Italy and Japan, the IMF has significantly worse expectations with gross national debt to GDP expected to grow beyond 120% and 220% respectively for these countries.
- The irony, that may have puzzled a few in 2009, is how the stock markets could stage such an incredible comeback while the real economy is haemorrhaging?
- Of course stock markets are leading indicators and as such its recovery is expected to precede economic recoveries.

Advantage economic and market commentary (continued)

- The issue is the massive strength of the recovery in financial markets, which would imply going back to growth levels closer to 5% as opposed to the rather measly 1.5% projected by the Treasury for 2010.
- We know that artificially low global interest rates have led to speculative investor activity boosting risky assets.
- The risk of a double dip recession would manifest if consumption expenditure did not rebound.
- Consumption expenditure is the biggest driver of gross domestic product, accounting for at least 62% of this. As such, any sustainable economic recovery needs to be consumer led.
- Consider the first two quarters of 2009, economic growth fell at -7.4% and -2.8% respectively, while for these same quarters, consumption expenditure also fell at -5.8% and -6.1% respectively.
- In the third quarter of the year, positive growth of 0.9% was recorded but it is disturbing to note that consumption expenditure remained mired in negative territory recording another contraction of 2%.
- Strong growth in general government expenditure in that quarter helped to boost the growth rate.
- The big question then is when will the consumer eventually stand up?
- The consumer still faces major headwinds with rising unemployment, as well as, high rates of indebtedness.
- Statistics South Africa reported that in the nine months ending September 2009, close to 1 million jobs had been shed in the country.
- Coupled with this, household debt to disposable income remains exceptionally high at 79%, figure 2.
- It is therefore little surprise that credit extension has continued to fall despite lower interest rates – households are simply unable to absorb anymore debt.

Figure 2



Source: Reserve Bank Quarterly Bulletin

- Entering 2010 there is tentative optimism that the worst is over.
- The World Cup is expected to provide the country with a much needed economic boost.
- One hopes that this, as well as, continued expansionary monetary and fiscal policies will lead to rising employment levels and consequently stronger and broader based economic growth.

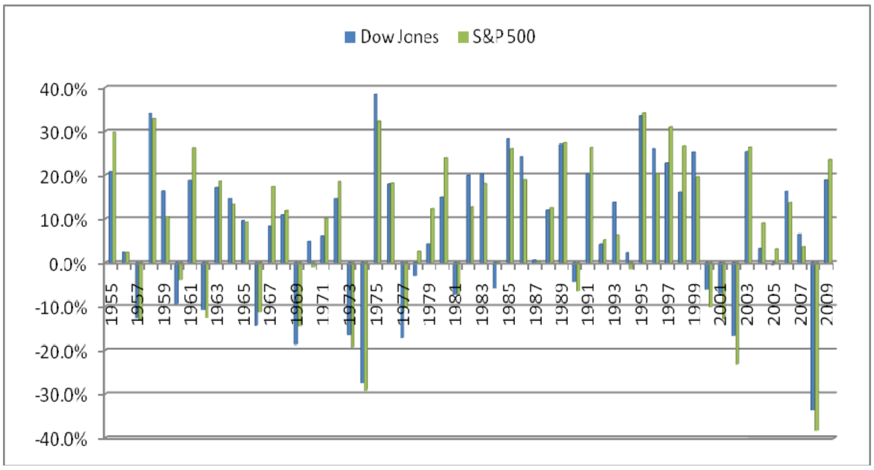
Global markets

- Global financial markets experienced a massive turnaround in 2009 as the credit crunch began to ease its vice-like grip on global economies.
- Governments across the globe acted swiftly slashing interest rates and providing economic stimulus packages.
- The Dow Jones Industrial Average (Dow) crossed the historic 14 000 level in October 2007 but by March 2009, the index had collapsed to just below 7000.
- The Dow had last traded at these levels in April 1997 – this meant that an investment in this index over the past twelve years would have offered no return to the investor.

Advantage economic and market commentary (continued)

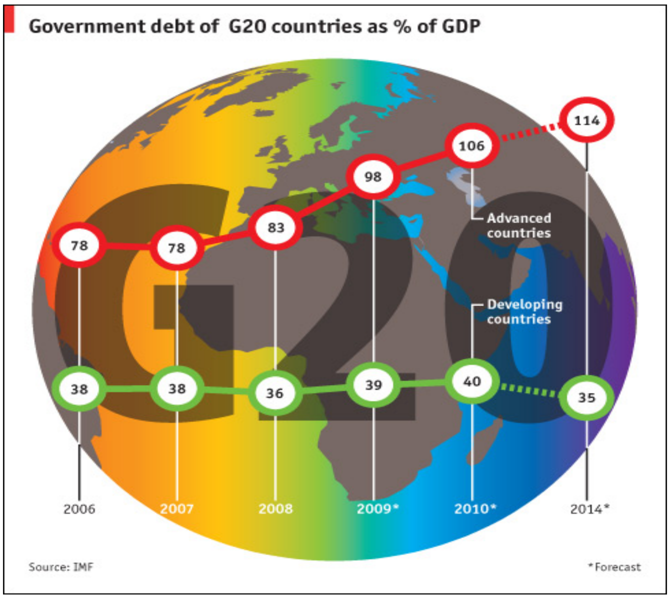
- Subsequent to the lows reached in March 2009, global risk aversion dissipated with stocks posting a massive rally; since that point, the Dow has returned close to 60%.
- Figure 3 exhibits annual returns over the past half century of the Dow Jones, as well as, the Standard and Poors 500; highlighting the severity of the 2008 outcome.

Figure 3



- A similar picture is evident if we consider the emerging market basket.
- The Morgan Stanley Emerging Market index reached its all time highs in October 2007 and then lost 60% of its value in the following year. From the March 2009 lows, this index has generated a staggering 108% return.
- The spectacular comeback posted by risky assets has unfortunately come at a heavy cost.
- The stimulus measures of governments across the globe have meant massive increases in national debt.
- The Economist[1] writes that advanced economies, which aggressively stimulated demand, are forecast to experience weak economic growth into 2010 in stark contrast with the G20's developing nations that are said to be on track for strong growth after some 'gentle' fiscal stimulus. It also notes that the IMF forecasts that gross government debt among advanced economies will continue to rise until 2014, reaching 114% of GDP, compared to just 35% for developing nations as shown in figure 4.

Figure 4



[1]www.economist.com

Advantage economic and market commentary (continued)

- Another issue highlighted is that rating agencies are becoming increasingly twitchy as rich countries like the US and UK are fearful of losing their hallowed triple A status.
- The UK Telegraph[2] has recently reported that Fitch Ratings has given its bluntest warning to the UK and France about losing their AAA rating.
- Specifically the UK, Spain and France must articulate credible fiscal consolidation programmes over the coming year, given the budgetary challenges they face in stabilising public debt. Furthermore, failure to do so would greatly intensify pressure on their sovereign ratings.
- Spain has already begun to feel some pain with its credit outlook cut to negative from stable Standard and Poor's ratings agency during December.
- Again the issue highlighted by Standard and Poor's was that strong policy action needed to be put in place to reduce Spain's sizable fiscal and economic imbalances.
- During the final month of the year, news from Greece pulled down equity markets.
- The three major credit agencies downgraded this nation's sovereign rating.
- Standard and Poor's and Fitch Ratings lowered its rating of Greek debt from A- to BBB+, while Moody's Investor Services cut this to A2 from A1.
- Within the 16 member Eurozone bloc, Greece has the highest debt ratio, forecasted to reach 125% of GDP in 2010. During December, the country was formally put under European Union supervision as its public deficit reached 12.7% of GDP, more than four times the Union's permitted level.
- In as much as global nations have emerged from the recession, the steps taken to ensure this recovery have come at a high cost, particularly for advanced economies.
- In order to retain credibility nations have to reign in its spending.
- The tricky issue is the timing of this exit in stimulus. Closing the taps too soon may threaten the economic recovery, leading to a double dip recession, while waiting too long can have a devastating effect on public finances.
- Unfortunately moving from easy/loose fiscal policy to tight fiscal policy requires some very tough and painful decisions.
- Government has to widen its revenue base while limiting its expenditure. This could mean dramatically rising taxes and a lowering of government spending. It is also likely that the artificially low interest rates would need to start rising.
- All these measures are generally negative for economic growth and employment - the key drivers for financial market performance.

Conclusion

- Risky assets rallied magnificently as investors poured funds into high yielding assets.
- In South Africa, the Monetary Policy Committee followed its global counterparts, cutting the prime rate down to 10.5% as inflation eventually fell to within the target band.
- The Treasury also embarked on expansionary fiscal policy in light of the economic recession, pushing the budget deficit to 7.6% of GDP.
- Extraordinary stimulus measures have left developed nations in a more precarious position as the IMF forecasts their national debt levels to rise to 114% of GDP by 2014 while this is seen at 35% for emerging markets.
- Over the next few years advanced nations must engage in a very difficult adjustment process to bring down debt levels; tax levels could rise dramatically while government expenditure is curbed significantly.

Azola Lowan, CFA
Senior Research Analyst
Advantage Asset Managers

[2] www.telegraph.co.uk

Contact details:
Tel +27 11 575 4450 Fax +27 11 576 4450 Website www.advantage.am e-mail info@advantage.am
The Gabba, 2nd Floor, The Campus, 57 Sloane Street, Bryanston, Johannesburg, 2191
PO Box 330, Gallo Manor, 2052

Performance report - December 2009

Fulcrum	1 Month	3 Months	6 Months	12 Months	36 Months*	60 Months*
Fulcrum Aggressive	2.99%	6.19%	17.18%	19.91%	7.03%	15.27%
Benchmark	2.59%	6.01%	17.93%	18.96%	6.13%	15.34%
Fulcrum Balanced	2.88%	5.88%	16.35%	18.11%	7.26%	15.22%
Benchmark	2.40%	5.58%	16.68%	17.27%	6.32%	15.53%

*Annualised

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

Market indices

	1 Month	% Change at 3 months	% Change at 12 months	% Change at 36 months	% Change at 60 months
CPI*	0.00%	0.37%	4.79%	8.29%	6.70%
R/$ Exchange rate	1.12%	2.97%	23.73%	-1.45%	-5.04%
All Share index	2.92%	11.44%	32.13%	6.53%	20.25%
Shareholder Weighted index (SWIX)	3.86%	8.96%	29.91%	6.30%	19.37%
Financials	2.90%	6.52%	28.03%	-0.88%	12.25%
Industrials	3.36%	8.46%	30.51%	8.86%	19.91%
Resources	2.54%	16.70%	35.40%	7.82%	25.36%
MSCI World index (All countries)**	1.54%	1.79%	4.10%	-6.60%	6.34%
Citigroup Composite index	-5.15%	-3.78%	-16.96%	8.76%	9.28%
ALBI	1.20%	1.08%	-0.99%	6.47%	7.12%
STeFI	0.61%	1.85%	9.13%	10.05%	8.93%

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

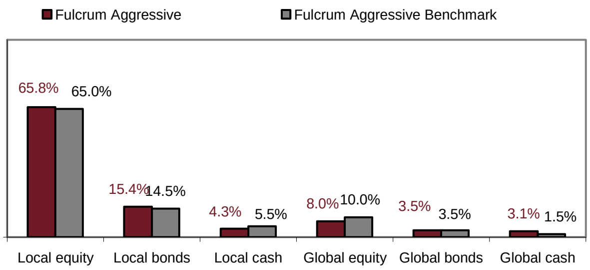
Advantage Fulcrum Aggressive

December 2009

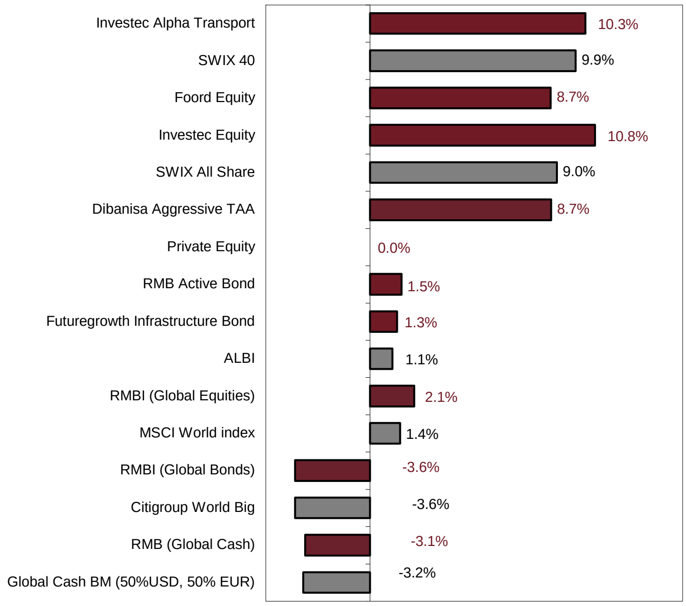
Portfolio mandate

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 so as 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 changing the portfolio's exposure to mispriced assets. The asset mix and risk profile is dynamically managed relative to a market index composite with a high strategic weight to equities.

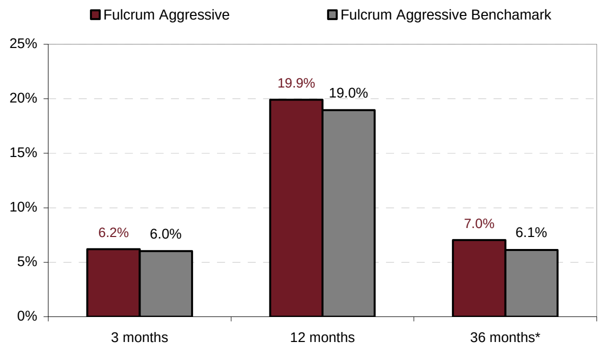
Asset allocation as at 31 December 2009



Manager performances: quarter ending 31 December 2009

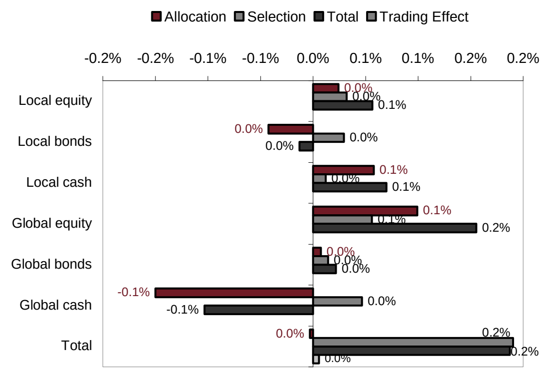


Fund performances: 31 December 2009



* Annualised

Fulcrum Aggressive



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

Contact details:
Tel +27 11 575 4450 Fax +27 11 576 4450 Website www.advantage.am e-mail info@advantage.am
The Gabba, 2nd Floor, The Campus, 57 Sloane Street, Bryanston, Johannesburg, 2191
PO Box 330, Gallo Manor, 2052

Fulcrum

advantage
asset managers

fulcrum

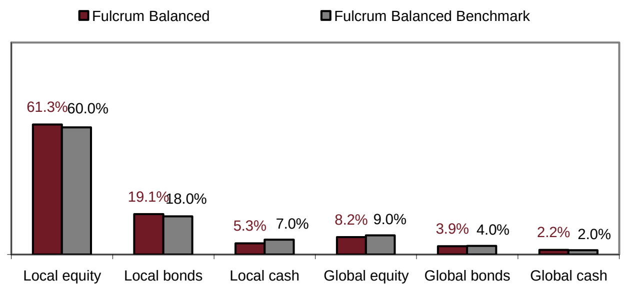
Advantage Fulcrum Balanced

December 2009

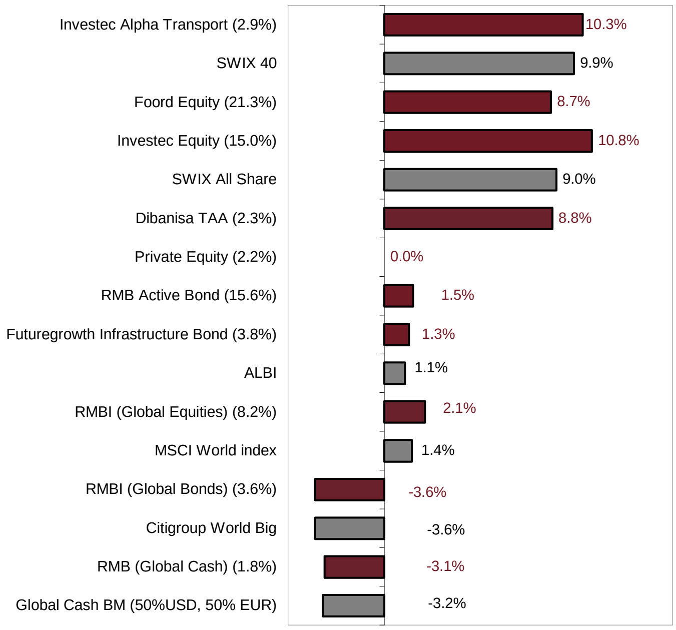
Portfolio mandate

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 so as 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 changing the portfolio's exposure to mispriced assets.The asset mix and risk profile is dynamically managed relative to a market index composite.

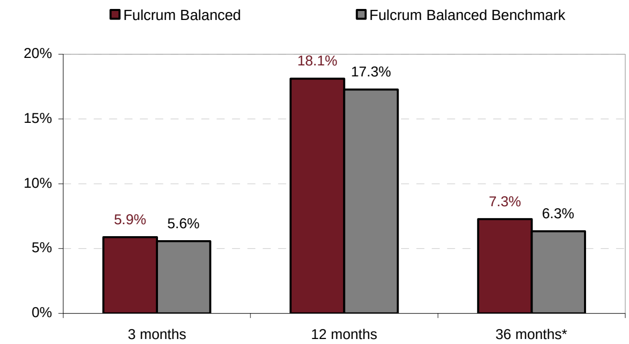
Asset allocation as at 31 December 2009



Manager performances: quarter ending 31 December 2009

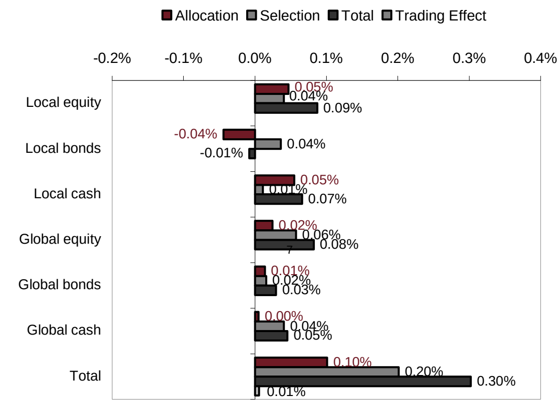


Fund performances: 31 December 2009



* Annualised

Fulcrum Balanced



Contact details:
Tel +27 11 575 4450 Fax +27 11 576 4450 Website www.advantage.am e-mail info@advantage.am
The Gabba, 2nd Floor, The Campus, 57 Sloane Street, Bryanston, Johannesburg, 2191
PO Box 330, Gallo Manor, 2052

Fulcrum

advantage
asset managers

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.

Contact details:
Tel +27 11 575 4450
Fax +27 11 576 4450
Website www.advantage.am
e-mail info@advantage.am