

APRIL

SYGNALS

2010

MONTHLY UPDATE



KEY INDICATORS

		1 Month	3 Months	6 Months	1 Year	2 Years	3 Years	5 Years
J203T	FTSE/JSE All Share Index	-0.1%	8.2%	9.8%	41.8%	-0.6%	3.4%	21.2%
J210T	FTSE/JSE Resources 20 Index	-1.6%	7.3%	9.0%	37.9%	-11.1%	3.2%	23.8%
J211T	FTSE/JSE Industrials 25 index	1.1%	8.0%	8.8%	43.9%	7.4%	6.4%	22.1%
J212T	FTSE/JSE Financials 15 Index	0.4%	8.7%	11.8%	45.6%	8.4%	-2.5%	14.0%
J403T	FTSE/JSE SWIX Index	0.6%	8.6%	10.4%	40.7%	1.9%	3.1%	20.8%
J303T	FTSE/JSE CAPI Index	0.3%	8.5%	10.1%	42.6%	1.4%	4.2%	21.7%
ALBI	BESA All Bond Index	1.3%	5.5%	7.1%	9.3%	12.1%	7.4%	8.0%
STeFI	STeFI Index	0.6%	1.7%	3.6%	7.9%	9.8%	9.9%	8.9%
	MSCI World Index in SA Rands	1.3%	4.5%	3.7%	20.5%	-9.3%	-4.7%	8.0%
	Rand/US Dollar Exchange Rate	1.2%	-3.1%	-5.5%	-12.5%	-1.1%	1.6%	4.0%
	Rand/Euro Exchange Rate	-0.2%	-7.1%	-14.6%	-12.1%	-8.7%	0.6%	4.6%
	Headline CPI	0.8%	1.7%	2.0%	5.1%	6.8%	7.8%	6.1%
	Core CPI	1.2%	2.2%	2.5%	5.4%	7.0%	6.6%	4.8%
	PPI	0.3%	2.0%	3.6%	3.7%	4.5%	6.9%	7.5%

April brought an abundance of shocking headlines. Tragic news of a plane crash in Russia which killed the political, military and secular elite of Poland, was quickly followed by clouds of Icelandic volcanic ash closing off European air space, a surprise announcement of the SEC filing a civil suit against Goldman Sachs and finally a major oil spill threatening the coastline of Louisiana and the Gulf of Mexico.

Poland mourned the deaths of President Lech Kaczyński and 95 other dignitaries in a plane crash while on their way to a commemoration service at Katyn in Russia. This is particularly poignant as Katyn is the burial ground of 23 000 members of Polish pre-war elite murdered by the Soviets after invading Poland under the Hitler-Stalin pact of 1939. Until 1990 the Soviet Union blamed the murders on the Nazis. As appalling as the event was, it will have little economic impact. Unlike other European countries, Poland boasted economic growth of 1.7% in 2009.

A five day shutdown of European airspace cost airline carriers US\$3.3bn, an impact more severe than the aftermath of the September 11 terrorist attack. Interestingly, although over 50 volcanoes erupt each year, flights are normally easily diverted around ash clouds.

On another sober note the International Monetary Fund warned that with debt levels in leading economies set to reach 115% of GDP by 2014, compared with 80% before the financial crisis, the risk of sovereign default is now the greatest threat to global economic growth.

DEBT DEFAULT FEARS DRIVE EQUITY MARKETS

The month started on an up note as strong economic data from China, Japan and South Korea reassured investors. In the US improvements in the services sector and a stable unemployment rate of 9.7%, pushed the Dow Jones Industrial Average towards the psychological benchmark of 11 000 for the first time in 18 months. Even the wobbly US housing market showed a rare sign of strength with pending home sales up 2.8% in February.

Unfortunately disputes over the rescue of Greece continued, with Germany fighting for unsubsidised market-related interest rates should Greece call for the emergency loans. Greece's borrowing costs rose to a record high amid concerns that the rescue package agreed in March may unravel. To add to the problem Fitch cut Greece's credit rating two levels to BBB-, one rung above speculative grade.

In the UK Prime Minister Gordon Brown called a General Election for the 6th May 2010. The pound weakened as polls continued to point to a hung parliament with neither Labour nor the Conservatives winning an outright majority. The Institute of Fiscal Studies criticised the three main parties for failing to disclose the scale of tax rises and public sector cuts required to tackle the financial crisis, as well as for making "misleading" claims that spending reductions could be met through efficiency savings.

On the other side of the globe Australia's central bank raised its interest rates in a fifth hike since October and flagged further increases ahead as the economy returns to strong growth.

Markets continued to rise, fuelled by more positive economic data from the US and rumours that agreement on a bailout for Greece had been reached. Rumours turned to fact when the EU announced that it had agreed to offer Greece a €30bn bailout in three-year loans at about 5% interest - cheaper than would be available to the country from private investors. The IMF committed another €15bn. The large scale of the bail-out package surprised markets, with the euro strengthening in response.

With concerns about Greece receding markets turned to first quarter corporate earnings reports. In the US the banking and IT sectors surprised on the upside. Banks profited handsomely from trading activities, whilst IT companies are starting to benefit from a steady rise in consumer and business spending.

News of China's first-quarter economic growth of 11.9% drove markets to a cyclical high, but the rally came to a sudden halt as the word spread that Greece had formally requested a rescue consultation with the EU, the European Central Bank and the IMF, and that the Securities and Exchange Commission had filed an unexpected civil suit against the Goldman Sachs Group.

Equities extended declines as a gauge of US consumer confidence trailed estimates and as calls for a regulatory probe of Goldman Sachs spread to Europe. The yen strengthened as investors sought the relative safety of Japan's currency.

Perceptions of Greece deteriorated further as Eurostat, the European statistics agency, raised its estimate of Greece's 2009 budget deficit to 13.6% of GDP, up from the previous 12.9%. Eurostat expressed "a reservation on the quality of the data reported by Greece". The agency also raised its estimate of the 2009 deficit for Ireland to 14.3% (from 11.7%), the largest for any country since the start of the euro in 1999.

Moody's delivered a further blow when it lowered its rating of Greek debt to A3 (still an investment grade rating). Adding to the country's woes, Greek civil servants went on strike to protest the austerity measures.

Towards month-end markets recovered some momentum as solid earnings from Apple sparked a rally in technology stocks, whilst higher commodity prices boosted energy and gold plays.

However, confidence was knocked when President Barack Obama took on Wall Street in a run up to pushing through regulation of the financial services industry, chastising it for "reckless risk taking" and "loosely monitored gambling".

Although harsh in tone, the aim of the speech was to gain Wall Street's backing for his reforms and to set out the main tenets of what he expects will be contained in the US Senate's Financial Reform Bill. These include an industry-backed resolution fund to bail-out systemically important companies, tougher rules on trading in derivatives, as well as the imposition of the Volcker rule, which will stop banks from owning proprietary trading businesses. With his poll numbers sagging, the choreographed confrontation seemed aimed at tapping the nation's anti-establishment mood.

Markets continued falling when Greece formally requested the IMF loan while denying rumours that it was contemplating restructuring its debt – a soft form of default. Germany, meanwhile, demanded further austerity measures before the EU's aid is granted. Germany's seemed reluctance to help would mean that Greece might not have access to a bailout package in time to make a new round of debt payments due on May 19. Sentiment plummeted further when S&P cut Greece's debt rating to BB+, junk status, warning that bondholders could face losses of up to 70% in a restructuring. Portugal had its credit rating cut two steps to A- on a negative outlook for its deficit. S&P's reduction of Greece's credit rating puts the nation's debt on par with bonds issued by Azerbaijan and Egypt.

Although they are under the most immediate pressure, Greece and Portugal are relatively small economies. The real problem is Spain which is five times larger. On the surface, Spain's debt, at 54% of GDP (compared to 120% for Greece and 80% for Portugal) appears manageable. However Spain has the highest twin deficit, or combined budget and current account deficits, of any country in the world except Iceland, a reflection of how dependent it is on increasingly fickle foreign investors for financing. With a budget deficit of 11.2% of GDP and a 20.1% unemployment rate, growth is likely to be feeble (S&P forecast an average of 0.7% a year until 2016). Spain has €225bn in debt coming due this year – an amount that is about the size of Greece's economy.

The markets stabilised somewhat as Germany appeared to relax its opposition to the rescue package and the IMF pledged to increase aid to Greece to €110bn over the next three years. Despite the rhetoric, a Greek default is really not an option for Germany. According to Barclays Capital, Germany's financial institutions hold some US\$37bn in Greek bonds, an exposure which by far exceeds what Germany needs to lend to Greece as part of the initial EU plan. France is Greece's biggest creditor with US\$67bn. Italy holds US\$27bn in Greek paper, followed closely by Belgium, the Netherlands and Luxembourg. American banks held only about US\$17bn in Greek debt at the end of 2009.

The month ended with Louisiana fisherman and shrimpers suing BP, Transocean and Halliburton for environmental damage and personal injuries as oil edged toward the US's east coast and fears continued to grow that the leak from a seabed oil well could spiral out of control. Transocean owns the oil rig and Halliburton was responsible for capping the well. Downgrades of Goldman Sachs shares to a "sell" by a number of analysts pulled the US equity market down on the last day of trading.

IMF ISSUES REVISED GLOBAL GROWTH FORECASTS

The IMF's latest World Economic Outlook report describes the global recovery as slightly better than expected. After shrinking by 0.6% last year, the global economy is likely to expand by an upgraded 4.2% over 2010. Much of the revision can be attributed to a better outlook for the US. The IMF revised its US growth forecast for 2010 to 3.1%, whilst keeping the eurozone's growth unchanged at 1% for 2010 and 1.5% for 2011. Growth in Europe is highly divergent, with Germany and France heading the list at 1.2% and 1.5%, respectively.

The outlook for emerging economies is also brighter, with the overall growth forecast revised up to 6.3%. Developing Asia (including China and India) is expected to grow by 8.7% in 2010 and 2011, with China contributing 10%. Brazil's forecast has been lifted to 5.5%, while Japan is expected to expand by 1.9%.

On a negative note the IMF warned that sovereign debt worries will become more severe as the year progresses. Debt issues are likely to prove especially problematic in Europe, which has the highest debt ratios and the slowest expected growth rates. Sovereign debt strains may infect the banks and "prolong the collapse of credit".

US TURNS TO FINANCIAL REGULATION

The US economy has expanded for three quarters in a row helped along by consumer spending. The broadest measure of the overall economy grew at an inflation-adjusted annual rate of 3.2% in the first quarter of 2010, after expanding 5.6% in the fourth quarter of 2009 and 2.2% in the third quarter. However weak construction spending and high unemployment continue to pose a problem.

Although unemployment stabilised at 9.7% in March and the supply of new jobs is increasing, the increase is not enough to accommodate the rising numbers of people actively looking for jobs.

On a positive note US consumer sentiment is on an up with the personal consumption expenditures price index, regarded as the broadest measure of retail sales, increasing by 0.3% in February compared with January and consumer confidence figures rising to the highest level since September 2008. Overall consumer spending grew at an annual rate of 3.6% in the first quarter, a big gain from the 1.6% growth in the previous three months. And the personal savings rate, which jumped above 5% during the recession, has returned to its historical level of about 3%. The US retailers reported the strongest monthly sales growth in a decade in March with a 9.1% sales increase at stores open at least a year. Despite this inflation remains subdued, with the consumer price index slowing to an annualised 1.1% in March versus 1.3% in February.

However, housing remains a significant brake on the pace of the recovery. Sales of new and existing homes fell in January and February, the pace of housing starts has stayed sluggish, and the commercial real estate market is still shrinking.

CHINA MOVES TO SLOW DOWN THE PROPERTY MARKET

China's economic growth accelerated to the fastest pace in almost three years in the first quarter of 2010, with the GDP rising by 11.9% from a year earlier.

The consumer price index rose 2.4% in March year-on-year, and the producer price index was up 5.2%. These comparatively modest inflation figures give the government some leeway in making two crucial economic decisions that affect inflation, raising interest rates and revaluing China's currency. However cuts in interest rates are expected to be delayed as the events in Europe threaten the pace of recovery.

Exports are recovering, climbing 29% in the first quarter from a year earlier, with their value topping the level of the same period in 2008, before the crisis hit. Industrial companies' profits are also up, more than doubling in the first quarter from a year earlier,

Unfortunately China appears to have little success in reining in the property boom, despite efforts to limit borrowing and to ban some state-owned corporations from the land market altogether. Investment in property leaped 35.1% in the first quarter compared to a year earlier, the fastest growth rate in more than two years. Residential and commercial real-estate prices in 70 cities climbed 11.7% in March from a year earlier, the most since data began in 2005.

UK HEADS FOR A HUNG PARLIAMENT

The UK economy grew by a less than forecast 0.2% in the first three months of the year, underlining the fragility of the recovery. January's cold weather held back manufacturing and consumer spending. The news came as the Bank of England held interest rates steady at 0.5% at its last meeting before the election, and voted to maintain its stock of asset purchases under quantitative easing at £200bn. This is despite the fact that inflation climbed by 0.6% in March and is now 3.4% higher than a year ago. Lower interest rates have helped to support the housing market which recorded a 1.1% increase in house prices in March and a 6.9% rise year-on-year. However, consumer confidence fell in March by the most since July 2008 as the forthcoming election fuelled doubts about the economy.

In a pre-election blow to Labour, the IMF cut its 2011 UK growth forecast to 2.5% (from 2.7%) whilst maintaining its 1.3% prediction for 2010. The UK government's own forecast is 3.3%. The IMF expects the unemployment rate to rise to 8.3% in 2010, from its current level of 8%, before falling back to 7.9% in 2011. In a similar vein the Bank for International Settlements warned that the UK will need "drastic" austerity measures to prevent public debt exploding out of control. Interest payments on the UK's public debt will double from 5% of GDP to 10% within a decade under the Bank's "baseline scenario" before spiralling upwards to 27% by 2040, by far the highest among the OECD nations.

The economy lies at the heart of the general election campaign. After a series of televised debates, the polls indicate that neither the Labour nor the Conservative Party will win enough seats to control Parliament. Both are struggling to convince voters they are best placed to narrow Britain's budget deficit while cementing its recovery from the recession.

SOUTH AFRICA'S ELECTRICITY SUPPLY ON AN UP

April started with the news that the World Bank has approved Eskom's request for a US\$3.75bn loan to finance the coal-powered Medupi Power Station in the Limpopo Province, and some wind and concentrated solar power projects. Facing criticism from environmental groups, the World Bank defended the loan on the basis that poverty could not be reduced without the availability of electricity.

More good news followed as ICASA surprised the telecommunications industry with an announcement that cellphone operators would have to further reduce their interconnection fees to 65c by July. The reduction will come three months after the interconnection fee was cut to 89c from R1.25.

The economy is slowly picking up. Business confidence in March showed its first year-on-year increase since September 2007. Although lower than expected, manufacturing production increased by 2.7% year-on-year in February compared to a revised 3.5% growth in January. South Africa recorded a smaller than expected budget deficit for the financial year to March, with tax revenue exceeding forecasts. The shortfall amounted to 6.8% of GDP in fiscal 2009-10, well below the 7.3% level predicted by the Treasury in its February budget. South Africa recorded a surprise trade surplus of R457.8 million in March after a R5.7bn deficit in February.

On a negative note retail sales contracted by 1.1% year-on-year in February, from a revised 1.5% decline in January, disappointing widespread expectation that February would signal a strong consumer recovery.

Inflation (CPI) fell to an annualised 5.1% from 5.7% in February on lower food prices and a stronger Rand which has held prices of imported goods at bay. Inflation is expected to trend downwards until at least the third quarter of 2010. PPI, representing domestic output, quickened to 3.7% year-on-year in March from 3.5% in February, although it slowed to 0.3% from 0.4% on a monthly basis. Factory gate inflation is likely to translate into pressure on consumer prices down the line.

The Reserve Bank indicated that interest rates were likely to stay steady for some time, dampening speculation of another cut next month. The Bank kept its latest growth forecast for 2010 unchanged at 2.6%, rising to 3.5% next year. This contrasts with the latest estimate from the Bureau for Economic Research, which raised its estimate for 2010 to 3.4% from 2.7% previously. However it is consistent with the IMF's prediction that the economy will grow by 2.6% in 2010 and 3.6% in 2011. The IMF warned that although the rebound in world trade is supporting recovery, growth will be tempered by high unemployment, tight credit conditions, and the recent strength of the rand.

WORLD STAGE EVENTS EXPLAINED

Goldman Sachs on the Rack

The SEC filed a civil fraud suit against Goldman Sachs alleging that in early 2007, as the US housing market teetered, it sold a Collateralised Debt Obligation instrument (a CDO), known as Abacus 2007-AC1, linked to sub-prime mortgages without disclosing that a hedge fund, Paulson & Co, helped to pick the underlying mortgage bonds and then bet against

the vehicle on a view that the housing bubble would burst. In Abacus marketing materials Goldmans told investors that the bonds would be chosen by an independent manager, ACA Management LLC. It appears that although ACA did sign off on the securities, it was pressurised to accept the majority of Paulson's selections. The SEC also alleges that Goldman Sachs misled ACA into believing that Paulson planned to buy the CDO's lowest-ranked slices, while in fact the bank knew that the fund planned bets against more senior pieces. By betting against that Abacus investment, Paulson reaped US\$1bn in profit, according to the SEC, while the investors sold the CDO by Goldmans lost US\$1bn.

Goldmans has vowed to fight the SEC. But the allegations have left many on Wall Street wondering how far the investigation might spread inside Goldmans and perhaps beyond.

Pressure on Goldmans mounted as calls for an enquiry into the bank's role in the mortgage market spread to the UK and Germany. Politicians have started to call on their governments to cut ties with Goldmans, which has long been one of the top financial advisers to the European policy makers and of government bond issues in Britain, Germany and many other European countries. In the UK the FSA announced a formal investigation as the Royal Bank of Scotland, the taxpayer-backed bank, was the biggest victim of the alleged fraud, losing US\$841m. The EU is already probing Goldmans' role in arranging swaps for Greece that may have masked the country's budget deficit.

The stakes are high. The SEC, battered by its failure to identify several major frauds in recent years, is eager to re-establish its credibility as an enforcer. But in choosing such a difficult battlefield, it also risks losing a case at a time when it is trying to re-establish its reputation.

Independently of the SEC the Senate Permanent Subcommittee on Investigations which is heading hearings into banks' role in the financial crisis, interrogated Goldman Sachs' executives on client disclosure. In preparation, the Subcommittee released a series of damaging internal emails showing that the firm anticipated making a lot of money by betting against the mortgage market. Goldmans responded with documents indicating the firm lost money on mortgages in 2008. Although the SEC has accused Goldmans of defrauding investors in one particular transaction, the Subcommittee implied that the bank devised many deals meant to profit from the collapse of the home mortgage market and sold those to their clients without disclosing that Goldmans was taking an opposite view. Goldmans defended their actions as "market making" activities rather than proprietary trading and their short positions as company-wide "risk management".

April ended with Federal prosecutors opening an investigation into trading at Goldman Sachs, raising the possibility of criminal charges. While the investigation is still in a preliminary stage, the move could escalate the legal troubles swirling around Goldmans. Several analysts downgraded Goldmans to a sell.

The vaunted Wall Street bank has lost US\$21bn in market value since the SEC announcement came out.

World Cup Update

Grant Thornton published its economic impact study on South Africa hosting the World Cup. The tournament is expected to inject R93bn into the economy, contributing 0.5% to the GDP when taking into account government infrastructure spend, organising spend and the arrival of an estimated 373 000 foreign visitors in South Africa.

While the new estimate in arrivals is a significant drop from Grant Thornton's 2008 prediction of 483 000 foreign visitors, the updated study shows that fans will stay longer, watch a greater number of matches and spend more than previously expected.

The report is far more upbeat than recent predictions in the tourism industry, which have put the number of visitors between 150 000 and 350 000. These numbers compare favourably with the World Cup in Japan and South Korea in 2002, which received 250 000 visitors each.