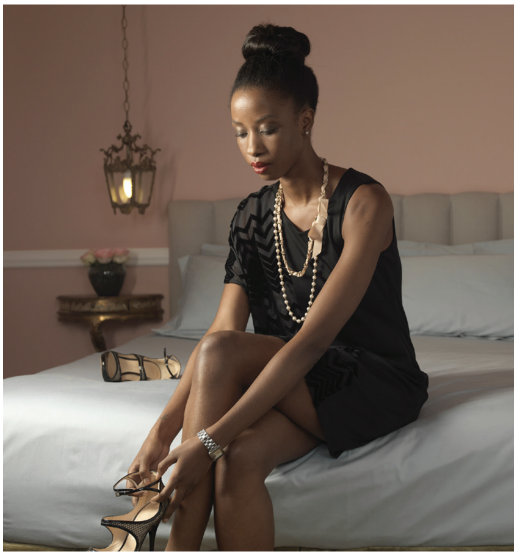
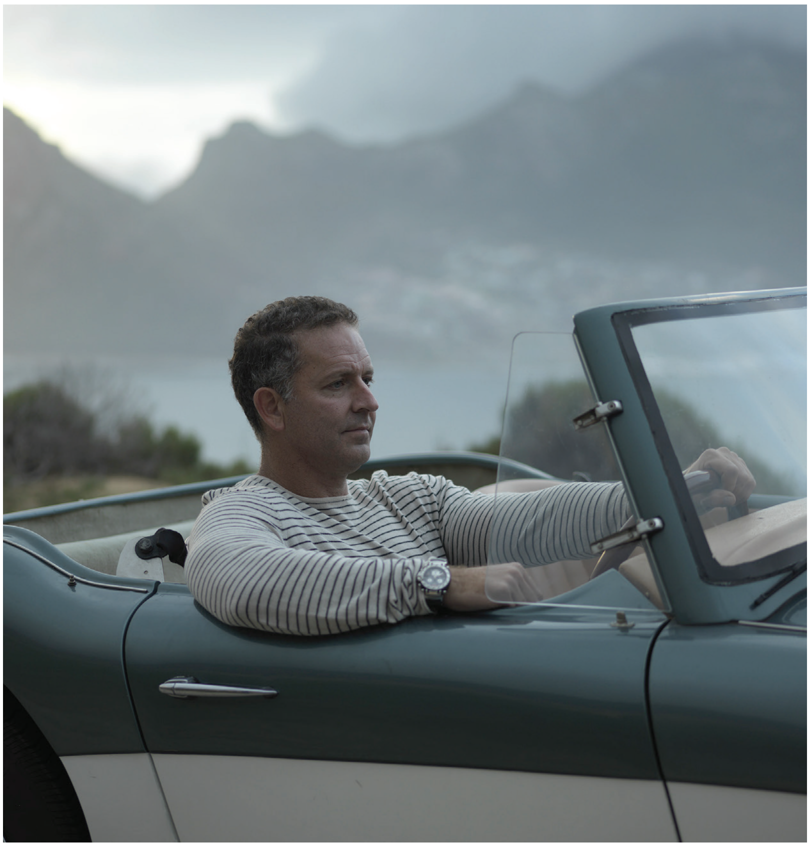
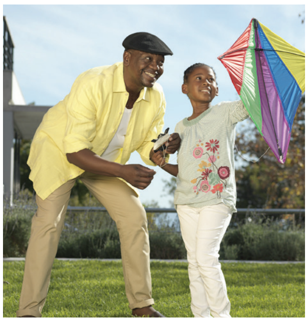
PRIVATE CLIENT SECURITIES

PROSPERITY







IN THIS CLIENT **NEWSLETTER**

- Business review and outlook
- Local and global economy
- Local equities we favour
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OLD MUTUAL WEALTH

BUSINESS REVIEW AND OUTLOOK

ASSET PRICES HOLDING UP

At the halfway mark, 2014 has been rewarding for investors in the local and global equity market. Some market commentators are questioning the basis for US equity valuations, calling it a bubble and warning of an imminent market correction. While we are not in the business of predicting the future, our view is that there is a firm basis for current valuations. Monetary policy in the developed world remains focused on keeping interest rates lower for longer and stimulating real economic growth. These accommodative measures are positive for equities.

Geopolitical risks remain in the headlines. As investors we know there will always be "hot spots" and we need to monitor these risks, but be judicious in our reactions. The current turmoil in the Middle East is extremely unfortunate, but it is a continuation of a long trend in this strife-torn region of the world.

Emerging market economies are still not showing convincing signs of recovery, but the risks appear to be better understood and managed compared to a year ago. We do not expect the stellar returns of the first half to repeat in the second half, but we also do not expect asset prices to collapse.

TWO MORE SENIOR APPOINTMENTS

We are delighted with two new appointments in our business, effective 1 July. Anil Thakersee has joined us as Chief Investment Officer and Avien Pillay heads up our research efforts. Anil previously managed equities in the Macro Solutions boutique of Old Mutual Investment Group and Avien held an equities research position with a leading global investment manager. Both individuals have over 15 years' investment experience which will certainly stand us in good stead for the future.

LOCAL AND GLOBAL ECONOMY

US, EUROPE AND THE EAST

As expected the US Fed reduced quantitative easing by a further $10 billion at their June meeting, but signalled that a fed funds rate hike was unlikely before mid-2015. Their 2014 economic growth forecast was reduced somewhat, but the Fed was confident that the recovery was still on track and likely to gain momentum in 2015. A highly accommodative monetary policy, fewer fiscal headwinds, an improving labour market, slightly better global growth, firming asset prices and households that are more comfortable with their debt exposures were all seen as developments supporting growth into 2015. Janet Yellen dismissed the recent rise in CPI inflation as mostly noise.

In Europe, inflation has remained uncomfortably low at less than 1% and the IMF highlighted the deflation risks in the region. The ECB relaxed policy further at their June meeting, cutting interest rates to 15bps and introducing a negative deposit rate for cash balances held at the ECB. Mario Draghi, President of the ECB, also signalled that additional monetary stimulus was likely. A further rise in car sales and reasonable sentiment survey results suggested that the region was still in a recovery mode, albeit very muted.

In China, the authorities introduced a range of mini-stimulus measures over the past month in an attempt to prevent growth from falling well below the official forecast of 7.5%. The property sector still appears vulnerable and there are ongoing concerns about the shadow banks. The Indian elections were won by the BJP party and financial markets reacted very positively, anticipating a fast tracking of structural reforms that would boost economic growth.

BALANCING ACT FOR SA ECONOMY

Locally the SARB left the repo rate unchanged, despite inflation creeping out of the official target range. A weak economy, reasonably anchored inflation expectations, a steadier rand and limited second-round inflation effects from the earlier rand collapse were the main reasons for leaving rates unchanged. However, the SARB did reiterate that we were still in a rate tightening cycle. Given the depressed outlook for the local economy we believe the tightening cycle (i.e. moving towards a normalised positive real repo rate) is likely to be slow.

Local growth forecasts were revised down by the SARB, the World Bank and the rating agencies. Growth is now expected to average less than 2% in 2014. Standard & Poor's reduced the country's foreign currency credit rating by one notch to the lowest investment grade rating, mainly due to the poor growth prospects and the dysfunctional labour market. The downgrade was widely expected and financial markets took it in their stride. The JSE rose to new record highs towards the end of the month and the rand held steady, even appreciating moderately. Long bond yields continued to trade in a range of 8% to 8.5%.

The five-month long platinum strike ended in the last week of June. A pick-up in platinum production should help to accelerate local economic growth somewhat in the second half of 2014 and assist in narrowing the still-wide foreign trade deficit.

LOCAL EQUITIES WE FAVOUR

SASOL OFFERS GOOD LONG-TERM PROSPECTS

The Brent oil price reacted to a worsening military and political situation in Iraq and ended the quarter 5% stronger at just over $113 per barrel. Iraq only makes up 3.5% of global production but it has been responsible for nearly 30% of the growth in output between 2005 and 2013. It is the second biggest OPEC producer after Saudi Arabia. Sasol is South Africa's biggest direct beneficiary of a higher oil price. We have exposure to Sasol because we believe that the company's current investment projects will be value accretive over the long term. Oil price and currency volatility also come into play when considering Sasol's share price, but our investment case is based on the longer-term prospects of this well-managed company.

NASPERS'S RESULTS REVEAL FURTHER INTERNET INVESTMENTS

Naspers continues to back its winners and the most recent results reveal that it increased its investment in a number of subsidiaries including a R1.9 billion investment in Indian Flipkart Private Limited. Naspers is developing the Indian portal with joint venture partner Tencent. The results also show that India recorded the highest growth rate of internet users among the major markets. Like a number of other emerging markets, India seems to be moving directly to mobile internet access and skipping the fixed-line phase. Currently, smart phones make up about 20% of total global mobile handsets and this figure was close to 5% a few years ago. This is good news for Naspers, which has invested early in a number of mobile internet assets.

At a 32 forward price earnings (PE) ratio, Naspers looks expensive, however Naspers does expense (as opposed to capitalise) the massive development spend amount in the year in which it is incurred. This is a very conservative practice and is not very common. To further expand their presence in the emerging markets, Naspers has materially increased the development spend over the last few years. In the most recent results, the development spend was close to 90% of its earnings. If we capitalise the development spend (like most of the peers), the forward PE drops to a more reasonable 19 times earnings. At this stage, a number of Naspers's large e-commerce assets are in the development phase. However, we believe that the valuation will unwind very quickly when these businesses reach critical mass.

GOLD IS BACK IN THE SPOT LIGHT

Despite the comments from the Fed about growth being on track, there seems to be concern about growth and disinflation or deflation and this has resulted in renewed interest in gold. The market is now anticipating a more expansionary stance by the central banks relative to its expectations. Monetary expansion is generally positive for precious metals. AngloGold Ashanti has been the biggest winner for the month.

GLOBAL EQUITIES WE FAVOUR

FEDEX GUIDES FOR A STRONG 2015

The company's $1.7 billion cost-reduction plan that was initiated in October 2012 continues to produce dividends. As part of its global cost-reduction plan, the company is retiring older, less fuel-efficient planes and shedding 5 000 older vehicles. FedEx's most recent results show that it experienced a strong fourth quarter. The ground shipments division experienced volume growth of 8% which was driven by growth in e-commerce. The company also provided a bullish 2015 outlook.

BP SIGNS A 20-YEAR LNG DEAL WITH CHINA

BP and the China National Offshore Oil Corporation (CNOOC) have signed a 20-year deal for BP to supply up to 1.5 million tones of liquefied natural gas (LNG) per year. CNOOC is the third largest importer of LNG in the world. This deal is very positive for BP as it is one of the first oil majors to benefit from China's commitment to improving its air quality.

GOOGLE'S QUEST FOR INFORMATION

Google has acquired satellite start-up, Skybox. Skybox makes and launches satellites. This move will allow Google to improve the accuracy of its mapping service and expand internet services to remote locations that are not covered currently. Google already operates Project Loon, a network of high-altitude balloons designed to give internet access to remote places. This acquisition is one of the many steps Google has taken to stay ahead of competition and expand its offering.

VW SUBSIDIARY PORSCHE IS THE TOP BRAND FOR A SECOND YEAR

The JD Power survey has revealed that Porsche recorded the least number of faults among the 86 000 entrant survey. This is the second year in a row that Porsche has occupied the top spot and a triumph for VW. We believe that this benefit will be felt across its many brands given the high level of collaboration between its brands.

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