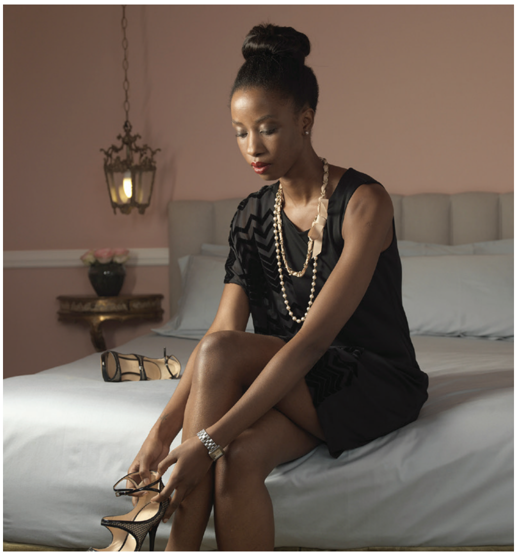
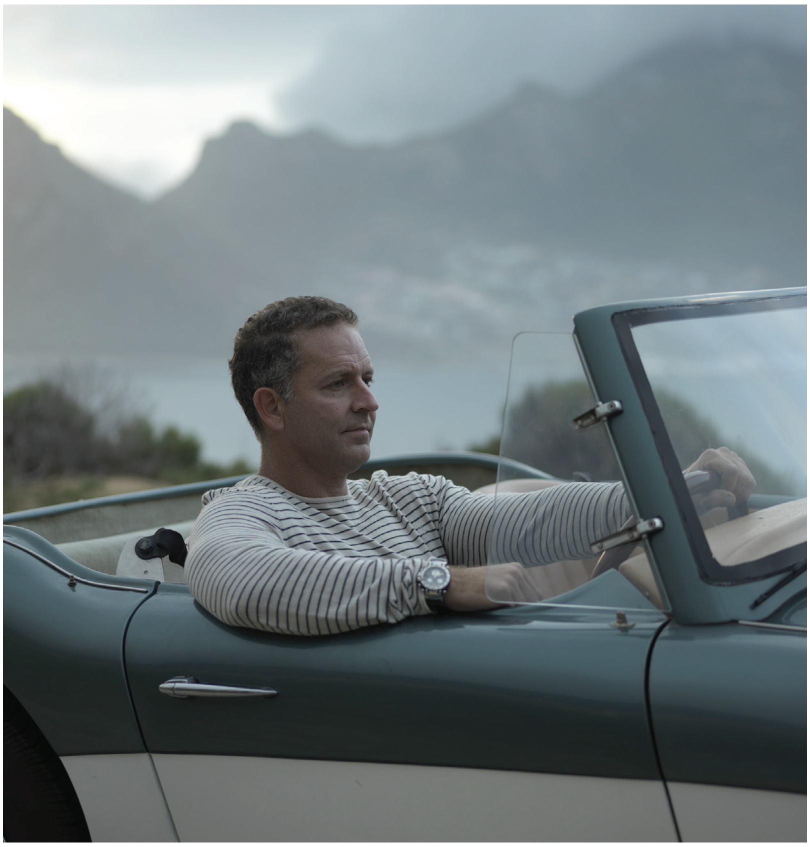
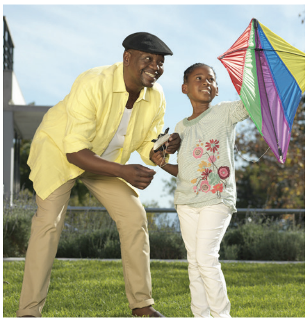
PRIVATE CLIENT SECURITIES

PROSPERITY







IN THIS CLIENT **NEWSLETTER**

- Business review and outlook
- Local and global economy
- Local equities we favour
- Global equities we favour

OLD MUTUAL WEALTH

BUSINESS REVIEW AND OUTLOOK

BITTERSWEET EMERGING MARKET PICTURE

Emerging markets were set for recovery from oversold positions and the past month has seen a good recovery. Emerging market currencies continued to strengthen on the back of positive capital flows. Relatively benign election results in Ukraine, India and South Africa have helped sentiment.

Just as the concern about the Ukrainian crisis was fading, the Thai army declared martial law. The nature of the global socio-political landscape is that hotspots are likely to come and go on a continuous basis. From an economic perspective, these events are fairly muted so far with no significant impact on the markets.

Locally, the prolonged mining strikes have weighed negatively on South Africa's economy with a decline in seasonally-adjusted GDP reported for the first quarter. Even though inflation is breaching the 6% level, the Reserve Bank has not raised interest rates given the weak economy. However, our local exchange set a new record above the 50 000 level. We highlighted the reasons for the disconnect between the South African economy and our stock exchange in last month's newsletter.

INVESTORS MUST ENSURE THEY'RE DIVERSIFIED

With many developed equity markets reaching new highs, it may be natural to question the wisdom of investing new money. However, considering the alternatives, there still appears to be better value in equities. Globally, cash and bonds do not present compelling value apart from being "dry powder" for buying into the dips of the equity market. Locally, fixed income investments are fairly valued. Investors will do well to consider their objectives and whether they are appropriately diversified across asset classes at this stage.

DEMOGRAPHIC TRENDS USEFUL TO INVESTING

Looking beyond current market dynamics to the long term, we find insight in global demographic trends. Why do demographic trends matter? Because they influence what people want to consume, their ability to earn an income and how much they have to spend. We live in a consumption-led global economy with nearly 90% of consumption taking place in countries where the only growth age segment is 40 years plus. This has implications for investment decisions, not just in developed markets, but also in developing markets, especially China. Even with moderate GDP growth, the growth in personal consumption expenditure in China is likely to be impressive over the coming decades. This bodes well for companies such as Naspers with its exposure to China's newly-minted and tech-savvy consumers.

LOCAL AND GLOBAL ECONOMY

US ECONOMY STABLE, BUT NOT READY FOR RATE HIKES

A solid labour market report for April points to a healthy rebound in the US, following the sharp weather-related slowdown in the first quarter. Headline CPI inflation kicked up to 2%, but underlying inflationary pressures remain subdued. The Fed is maintaining a dovish stance and will only hike rates when it believes the economy can absorb higher rates without slowing down. In the last twelve months the recovery in residential property sector has lost a lot of momentum as mortgage rates firmed about 1% on the back of tapering – an indication that the economy is not yet in a position to stomach higher rates. The first Fed rate hike should not happen before mid-2015.

EUROPE ECONOMY STILL WEAK, BUT EXPECTED TO IMPROVE

First quarter growth in Europe was barely positive and inflation remained stuck below 1%. The European Central Bank signalled that monetary policy was to be relaxed further at its June meeting. The region was still expected to register some positive growth in 2014 and foreign direct investment has picked up since 2012. Car sales also showed some further improvement in April. Eurosceptic and anti-austerity parties made dramatic gains in the EU elections as voters voiced their dissatisfaction with economic conditions, although markets did not react negatively to the election outcome.

CHINA CONTINUES TO TAKE STRAIN

China still appears to be slowing and the property market is taking strain, with prices under pressure in certain regions. Consumer spending and credit growth is subsiding, but is still in double digit territory. Following a hiccup early in the year Chinese exports have recovered. The 3% fall in the renminbi year to date should support exports.

SA ECONOMY FRAGILE, AGGRAVATED BY MINING STRIKES

The local economy shrank in the first quarter, largely due to the mining strikes and a struggling manufacturing sector. However, the rest of the economy continues to grow at less than 2%. Outside the public sector, wage increases are barely higher than inflation and household credit growth is falling behind inflation as unsecured lending grinds to a halt. Although inflation rose above 6%, the Monetary Policy Committee kept interest rates unchanged due to the weak economy. The Reserve Bank did warn that that we were still in a rate-hiking cycle. With investor sentiment towards emerging markets improving in recent months, the rand strengthened moderately. On a purchasing power parity basis the rand still appears to be somewhat undervalued at current levels. Manufacturing exports have picked up moderately and tourism continues to do well.

LOCAL EQUITIES WE FAVOUR

NASPERS

After a fairly shaky start, May has ended on a positive note. Naspers has been the biggest contributor to this solid performance after its Chinese subsidiary, Tencent, reported a stellar set of results. The reported earnings were ahead of already high expectations. Tencent's instant messaging service experienced robust growth with a user base that is now close to 400 million. The company is still at an early stage of monetising this user base. E-commerce is the other division that we expect will become a meaningful contributor. The division is currently loss making as Tencent is investing in infrastructure. Online retail's share of total retail is expanding at a very rapid rate. Gauging from the release of numbers from Alibaba (the largest online retailer in China), this is an attractive untapped opportunity for Tencent.

MEDICLINIC

Mediclinic looks set to become the next SA company to derive a larger part of their revenue from outside SA. The SA operation is performing well, however, the incremental improvement in the overall business is being driven by stronger profitability from the Swiss operation and aggressive expansion from other smaller hospital groups like the Dubai operation.

WOOLWORTHS

Woolworths has managed to recover most of the performance lost after the announcement of the acquisition of Australia's David Jones department store. We believe that this is due to the market gaining a better understanding of the transaction and the strategic fit, post the recent investor trip to Australia.

MTN

MTN's proactive approach in SA is certainly winning favour among investors. The company has recognised that SA is set to become a lot more competitive with lower call rates that will bring it in line with similar markets. We believe that the decision to cut call rates will allow the company to at least maintain its market share in SA. MTN remains a firm favourite with investors seeking exposure to emerging market mobile telecoms.

GLOBAL EQUITIES WE FAVOUR

EBAY

eBay has had a solid first quarter and a good start to the year. Its marketplace portal benefitted from the stronger retail environment in the US. PayPal, the payment portal, continued to gain traction, driven by increasing consumer adoption and expanded merchant coverage. eBay's acquisition of PayPal has certainly been a rewarding move as these two businesses complement each other very well. We are bullish on the prospects for online retailing and payments, especially considering the global trend towards mobile transacting.

APPLE

The appetite for Apple has continued to improve after the very strong results in April. Apple's recent hires have the market speculating about the next product launch. Apple has appointed a number of senior medical technology executives from the biotech community. We have suspected for some time that the next "cool" device to be released from Apple will not be another entertainment gadget but a medical monitoring or fitness device. Apple does sell certain medical monitoring devices, but are yet to release a mass market device. We believe that Apple will transform the industry in a similar way it redefined the MP3 player with the launch of the iPod. Apple has registered the iWatch name in a number of markets and this could be the device that Apple uses to attach a number of medical additions. Another key area of development is in "smart homes" where Apple is pioneering an integrated approach to networking various devices.

HEALTHCARE

While Pfizer failed in its bid to take over AstraZeneca and GlaxoSmithKline is under scrutiny for alleged bribery by some of its employees in China, the healthcare and pharmaceutical sector remain squarely in our sights for all the right reasons. Strong balance sheets and cash flows coupled with high returns on equity and capital make this sector attractive, especially when seen in the context of favourable demographic trends and improved living and healthcare standards globally. The key is not to overpay for these companies and to ensure that one buys into sustainable growth prospects.

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