~ FEBRUARY 2012 ~

SYGNALS

KEY INDICATORS

		1 Month	3 Months	6 Months	1 Year	2 Years	3 Years	5 Years
J203T	FTSE/JSE All Share Index	1.7%	4.9%	12.3%	9.6%	16.4%	26.2%	8.9%
J200T	FTSE/JSE Top 40 Index	1.5%	4.1%	12.0%	8.2%	15.8%	25.7%	8.5%
J210T	FTSE/JSE Resources 20 Index	-2.5%	0.1%	8.4%	-6.0%	9.2%	19.1%	6.0%
J211T	FTSE/JSE Industrials 25 index	4.0%	5.1%	13.4%	21.0%	23.9%	32.4%	13.7%
J212T	FTSE/JSE Financials 15 Index	4.6%	13.6%	18.1%	20.9%	15.6%	29.3%	4.7%
J403T	FTSE/JSE SWIX Index	2.8%	6.0%	12.5%	13.6%	17.3%	26.8%	9.2%
J303T	FTSE/JSE CAPI Index	1.8%	4.9%	12.4%	10.4%	16.8%	26.7%	9.5%
ALBI	BESA All Bond Index	0.2%	3.0%	3.6%	13.6%	11.8%	10.1%	8.6%
STeFI	STeFI Index	0.4%	1.4%	2.8%	5.7%	6.2%	6.9%	8.5%
	MSCI World Index in SA Rands	0.6%	1.3%	15.7%	5.5%	7.8%	11.0%	0.0%
	Rand/US Dollar Exchange Rate	-4.1%	-8.0%	6.8%	7.3%	-1.4%	-9.5%	0.6%
	Rand/Euro Exchange Rate	-2.4%	-8.9%	-1.0%	3.5%	-2.6%	-7.7%	0.8%
	Headline CPI	0.6%	1.0%	2.1%	6.3%	4.9%	5.4%	6.8%
	Core CPI	0.3%	0.7%	1.1%	4.7%	4.0%	4.7%	5.3%

"We must show that Greeks, when they are called on to choose between the bad and the worst, choose the bad to avoid the worst."

Greek Finance Minister Evangelos Venizelos, appealing for support before the parliamentary budget vote, 10 February 2012

Greece once again dominated the headlines as it raced to secure approval for a second bail-out before its next bond repayment of €14.5 billion falls due on 20th March. Oil prices rose on tensions between Iran and the West and ongoing violence in Syria. The South African budget was dubbed a "Robin Hood" budget by the media as it once again took disproportionately from the wealthy.

GREECE ON A SLIPPERY SLOPE

The upward momentum of January continued into February as global economic data surprised on the upside and the probability of Greece defaulting was largely discounted by the markets.

Signs of an improvement in the US, UK and German manufacturing and services sectors in January provided a welcomed boost to sentiment. Manufacturing PMIs in the UK and Germany rose above the 50 level, a benchmark signalling expansion. However French, Spanish, Italian, Greek and Irish manufacturing activity contracted once again.

Belgium became the first eurozone country to officially enter a recession with its GDP shrinking by 0.1% and 0.2% in the third and fourth quarters of 2011 respectively.

The Bank of England announced plans for a further £50 billion of asset purchases, increasing the total amount spent on quantitative easing to £325 billion. The Bank of Japan followed suit with a US$130 billion asset-buying programme as Japan's fourth quarter 2011 GDP number showed a 0.6% GDP contraction, the fourth contraction in the last five quarters.

China's manufacturing sector growth also disappointed as inflation rose to 4.5%, driven by consumer spending during the Lunar New Year holiday season and higher food prices. Both exports and imports fell the most since the depths of the global financial crisis, leaving China with a trade surplus of US$27.3 billion.

On the upside, the US unemployment rate fell in January to 8.3%, the lowest it is has been since February 2009. A broader measure of unemployment, which includes job seekers as well as those stuck in part-time jobs, fell to 15.1%.

All central banks kept their benchmark interest rates unchanged.

On the political front Russia and China vetoed a draft UN resolution calling on Syrian President Bashar al-Assad to step down, and demanded that the UN rules out military intervention.

Growing tensions over Iran's nuclear programme led to the US freezing Iranian assets under US jurisdiction. Iran continued to threaten military action and halted oil sales to British and French companies, a largely symbolic gesture as the European buyers had already cut purchases from Iran. Despite the aggressive rhetoric, however, Iran indicated it may be willing to return to the negotiating table.

Attention soon shifted to Greece which continued to drag its heels over approving a severe austerity package demanded by the EU, IMF and ECB troika as a condition for releasing another instalment of the €130 billion bail-out. The troika also demanded that Greece reaches agreement with its private bondholders, largely European banks, to write off part of its debt and exchange current bonds for new ones with more lenient repayment terms. Although the banks have in principle agreed to a 53.5% loss and an artificially low coupon on the "replacement" bonds, the precise level of that low coupon became a point of contention. The final condition involved binding assurances from Greece that the elections announced for April 2012 would not trigger a reversal in commitments.

Greece has repeatedly frustrated the EU by failing to implement the reforms it had promised in exchange for its first bail-out of €110 billion in 2010. Apart from missing targets for reducing its budget deficit, Greece has delayed cutting the size of its public sector and privatising state assets. It has however raised VAT and cut pensions, salaries and public services. Unfortunately its high interest payments on external debt mean that the overall budget deficit is projected to come in at 4.7% of GDP in 2012. If austerity crimps growth and squeezes tax revenues, the budget deficit will be forced even higher, requiring a fresh round of belt-tightening or more bail-out cash.

After days of protests in Athens and other major cities the Greek parliament finally approved the austerity bill. However the initial approval was deemed insufficient in terms of details.

On a positive note, the markets hardly reacted to the news as a Greek default had by now been largely discounted by investors. This was further re-affirmed by a muted reaction when the rating agency Moody's cut the credit ratings of Italy, Spain, Portugal, Slovenia, Slovakia and Malta and put France, Britain and Austria on warning. The negative outlook means that there is a one-in-three chance of a downgrade in the next 18 months. Moody's also put 17 global and 114 European banks on review for a downgrade, citing the "prolonged" impact of the euro crisis, more fragile funding conditions, increased regulation and tougher economic conditions. By month-end it also cut the senior debt and deposit ratings of five South African banks, citing the difficulty the government would have in extending systemic support to all the institutions should they need financial help. The banks include Standard Bank, Absa, FNB, Nedbank and Investec.

There was more positive news. Successful debt auctions in Portugal, Italy, the Netherlands, Spain and Belgium helped to calm concerns about liquidity. China announced that it was considering increasing its participation in the European rescue fund without linking its help to trade relaxation conditions. The Chinese central bank also loosened its monetary policy by cutting the reserve ratio for banks by half a point to 20.5%. And finally a flood of positive US economic data continued, including falling jobless claims, improving consumer confidence and more promising housing market figures.

After squabbling over the details, the EU finally approved a further bail-out of €130 billion for Greece. Under the new bail-out terms, Greece promised to reduce its debt from the existing 160% of GDP to 120.5% by 2020. Private bondholders agreed to a 53.5% loss on the nominal value of their bonds, the equivalent of an overall loss of about 75%. €107 billion of debt will be written off as banks and insurers swap their current bonds for longer-dated securities issued by both Greece and the EFSF that pay a lower coupon. That coupon was set at 2.0% until 2015, 3.0% for the following five years and 4.3% until 2042. The new bonds will be governed by English law which offers more legal protection should Greece default. Although the ECB is not subject to a haircut, it agreed to give up its profits from Greek bonds bought at a discount in favour of the government in Athens. A permanent European team will monitor Greece's implementation of the austerity measures.

For the numbers to work, 88% of bondholders need to agree to the debt swap — a tall order given than more than €30 billion is held by hedge funds, asset managers and other private entities who, unlike the large European banks, are not inclined to succumb to government pressure. Recognising this, the Greek government announced it would pass a law that attaches collective action clauses to Greek bonds, a step that forces everyone to accept the terms of the deal. This sparked an interesting debate as to whether this move constitutes a "default" and whether this would automatically trigger credit default swaps on Greek debt to pay out.

In exchange for leniency, Greece has committed to over €13 billion in spending cuts to be achieved by 2015. The draconian measures include pension cuts totalling €3.3 billion, a 22% reduction in the minimum wage and the loss of 150 000 public sector jobs. Athens will also continue to sell state assets with a target of €50 billion "in the medium term".

Unfortunately the whole bail-out package is predicated on the idea that Greece will return to growth next year with the economy forecast to expand by 2.5% in 2014 and 2015. Back in the real world, this is a country where manufacturing output fell by 15.5% in December 2011, industrial output by 11.3% and where unemployment rose to 20.9%. The economy shrunk by 6.8% in 2011. And yet virtually nothing of the €130 billion will go towards stimulating economic growth. A giant debt refinancing package is regrettably no substitute for a stimulus plan.

Doubts about Greece's ability to carry out the tough austerity measures deepened with the leak of an official report from the EU, ECB and the IMF that said that if changes were not made, Greek debt could remain at 160% of GDP in 2020. It also suggested that more help would be needed in future, estimated at US$66 billion from 2015 to 2020.

Once again there was little immediate reaction to the deal. However, as the days went by markets drifted lower as concerns about the implementation of the Greek bail-out lingered and the eurozone economic data disappointed.

The European Commission warned that the eurozone is heading into its second recession in just three years, while predicting that the wider EU will stagnate. Economic output in the 17 euro nations is now projected to contract by 0.3% in 2012, while the 27-nation EU, which generates a fifth of global output, should come in flat.

But the US data, and in particular buoyant US consumer confidence figures, lifted spirits. This indicator is noted because consumer spending accounts for more than two-thirds of US economic activity.

S&P's became the first rating agency to cut Greece's credit rating to selective default as a consequence of the collective-action clauses added to its sovereign debt. Moody's and Fitch are expected to follow suit once Greece proceeds with the debt restructuring. All will then reassess the country's ratings when new bonds are issued as part of the debt exchange.

Portugal passed the third review of its €78bn bail-out programme by the EU and the IMF, but the official outlook for economic growth in 2012 was cut further to a 3.3% decline in GDP.

The month ended with the G20 summit where finance chiefs won a commitment from the EU to review the size of its €500 billion permanent rescue fund due to come into operation in July. The G20 has pressed the Europeans to expand it to €1 trillion. Germany has been reluctant to commit to a larger firewall, arguing that this would discourage problematic nations from sticking to austerity measures. For their part, cash-rich countries like China and Japan have indicated that they would not contribute additional resources to the IMF until Europe agreed to do more to buffer its economies.

The news that the ECB had allotted €529.5 billion to 800 European banks in another three-year operation and that the US growth figure for the fourth quarter of 2011 has been revised upward to 3.0% provided the final boost to sentiment.

A ROBIN HOOD BUDGET TARGETS THE RICH

The news that Nelson Mandela's image would appear on new bank notes was marred by market uncertainty created by a preceding press release which proclaimed that President Jacob Zuma would make an announcement of "national importance".

The economic data continued to paint a picture of a steady recovery. Manufacturing activity rose in January to its highest level in six months, with the PMI up at 53.2, driven by seasonally adjusted new sales orders. Retail figures for December 2011 surged as consumers spent liberally during the festive season. And even the unemployment rate eased to 23.9% in the fourth quarter of 2011, down from 25.0% in the third quarter. The expanded definition of unemployment, which includes people who have stopped looking for work, fell to 35.4%.

But the outlook for 2012 is more uncertain with the business confidence index dropping to a 20-month low in January.

The consumer price index rose by 6.3% year-on-year in January, up from 6.1% in December. Headline CPI inflation is projected to average 6.2% in 2012. Producer inflation, which represents domestic output, slowed to 8.9% year-on-year in January from 9.8% in December.

The ANC research team on nationalisation submitted its report to the ruling party. The report is reliably understood to discourage asset grabbing as it is unconstitutional, and the purchase of stakes in mines as the government cannot afford it. However, it recommends an upwards revision of royalties and tax regimes, more beneficiation of raw materials and the introduction of higher taxes on exporters of unbeneficiated materials.

President Zuma's state of the nation address ahead of the budget speech prioritised job creation. Five major infrastructure programmes, as well as projects focusing on health and basic education infrastructure, information and communication technologies and regional integration were identified. The projects include expansion of rail transport in Mpumalanga to connect coal mines to power stations, and the enhancement of the Durban-Free State-Gauteng logistics and industrial corridor through Transnet's R300 billion capital expenditure programme.

The same theme permeated the 2011/12 Budget. The focus was largely on the economy, job creation and infrastructure spend. There was no clarity on retirement fund reform, while the national health insurance scheme is to be phased in over 14 years. Further re-distributive measures include a hike in capital gains tax and a 50% increase in the tax on dividends to 15%.

Some interesting points mentioned included the fact that a series of discussion papers will be released this year on promoting household savings and reforming the retirement industry. Reform of the tax treatment of contributions to retirement funds is planned for 2014. Once again the financial services industry was criticised for the high costs of savings products. The "treating customers fairly" initiative is to be accelerated.

Although hailed as a balanced budget, its success will largely depend on the government's ability to keep costs, such as public service wage increases, which have been assumed at 5%, and borrowing down. This point was also raised by Moody's in their assessment that the risks point to the downside.

The economic forecast highlights include:

- The economy grew by an estimated 3.1% in 2011 with growth in the fourth quarter coming in at an annualised 3.2%, up from 1.7% growth in the third quarter. GDP growth is expected to slow to 2.7% in 2012 before accelerating to 3.6% in 2013 and 4.2% in 2014.

- Unemployment, at 23.9%, has stabilised. The economy is projected to add 850 000 new jobs over the next three years, with 80% of these in the private sector, lowering the unemployment rate to about 23% in 2014.

- The 2011/12 budget deficit of 4.8% of GDP is expected to decrease to 4.6% in 2012/13 and 3% in 2014/15. Education, health and social assistance remain the largest categories of expenditure in the R1.1 trillion budget.

- The current account deficit is expected to widen from an estimated 3.3% of GDP in 2011 to 4.4% of GDP in 2014 as imports outpace exports on robust domestic demand.

- Headline CPI inflation is projected to increase from an average of 5% in 2011 to 6.2% in 2012. After temporarily rising above the upper limit of the 3-6% target, inflation is forecast to fall to 5.3% in 2013 and 5.1% in 2014.

GLOBAL SNAPSHOTS

Romania

After weeks of protests, Romania's prime minister Emil Boc resigned, the latest European leader to fall victim to a mood of public outrage over austerity measures and stagnant growth.

Romania suffered a sharp reversal of fortune as the global financial crisis hit and foreign lending tightened up. After the economy grew by 7.3% in 2008, it shrank by 6.6% in 2009. The country was forced to turn to the IMF, the World Bank and the EU for emergency loans of US$27 billion. These came with painful terms and conditions. Although the economy began to grow again, Boc's popularity suffered after he raised taxes and cut government wages.

According to the three lenders, however, unlike Hungary, Romania is "on track" in terms of goals for improving economic growth while maintaining fiscal and financial stability.

India

Despite being less dependent on exports than its Asian neighbours, India's economy is slowing down. The government forecasts GDP growth of 6.9% for the fiscal year to March, the slowest pace since the 2008 financial crisis.

The Indian economy has slowed as the eurozone crisis, combined with tight monetary policy and political paralysis at home, discouraged foreign investment. Unlike most of its Asian peers, India runs fiscal and current account deficits, leaving it reliant on notoriously fickle foreign investors for financing. Foreign flows are back for now, after net outflows in 2011, but the risk is on the downside.

Cyprus

The resort island of Cyprus, whose stricken economy is closely linked to Greece, is hoping that an offshore gas discovery will bail it out of trouble. In December 2011, the US firm Noble Energy announced that it had discovered gas reserves worth €100 billion beneath the seabed south of Cyprus.

Cypriot banks are heavily exposed to Greek sovereign debt, and its 7% of GDP budget deficit is well above the 3% limit set by the EU. But its overall debt level at 61% of GDP compares well to Greece's 160%. And unemployment among its 900 000 population is only 7%.

WORLD STAGE EVENTS EXPLAINED

Changes at the World Bank

Robert Zoellick, the head of the World Bank, is to step down in June 2012. Zoellick took over the reins in 2007 after a staff revolt pushed out Paul Wolfowitz. He moved quickly to return the institution's focus to alleviating poverty by dispensing development funding to the world's poorest nations.

Traditionally the presidents of the World Bank come from the US, while the IMF's managing directors come from Europe. The resignation of France's Dominique Strauss-Kahn as head of the IMF last year prompted calls for a replacement who would reflect the growing importance of emerging economies. However, the selection of French finance minister Christine Lagarde confirmed that the "gentleman's agreement" remains firmly in place.

The US pledged to name a replacement candidate within weeks, while rumours circulated that the Secretary of State Hillary Clinton was being considered for the post.

Telkom in trouble

The Competition Commission has levied a R4.5 billion administrative penalty against Telkom for contraventions of the Competition Act. The Commission found that Telkom abused its near-monopoly position in the provision of telecommunications network facilities by charging excessive prices for the basic infrastructure needed of its competitors, while keeping its own internet service charges low. More than 20 ISPs, including Internet Solutions, had complained about Telkom's conduct. If the Competition Tribunal accepts the Commission's calculations, the fine will be the largest yet levied in South Africa.

Why have the markets stabilized?

Stealthily and quietly the ECB did in fact unveil the "big bazooka" the markets have been waiting for. It just took a bit longer for the markets to understand the implications of what has happened. In December 2011, worried about the credit crunch developing in Europe, the ECB announced that it would lend European banks as much money as they wanted for a period of three years at a rock bottom price of 1%. This sparked a massive rally in global assets as European banks took up €498 billion in the first Long-Term Refinancing Operation (LTRO) in December. The second LTRO in February resulted in another set of loans of €529.5 billion.

The truth is that the LTROs, which require collateral, have badly eroded the capital structure of many banks, pushing a lot over the edge towards junk status. The longer it goes on the worse it gets. There are suspicions that many Spanish and Italian banks used the money to purchase their government's sovereign debt. The ECB admitted that they do not know what the money is used for but hope that some of that translates into consumer loans. Although this action stabilised the markets in the short-term, the longer term consequences look dire.

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Sygnia Asset Management Registration No. 2003/009329/07

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