GRINDROD BANK

GRINDROD ASSET MANAGEMENT
INVESTMENT REVIEW – JANUARY 2010

"It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price."
Warren Buffett

ECONOMIC OUTLOOK

Economic woes in Europe have dominated headlines since the start of the year. Greece's socialist government has allowed public debt to soar to more than 100% of GDP, while Spain, Portugal and Ireland are facing record public sector deficits in 2009. Adding to economic woes in these countries is the fact that unemployment is soaring (unemployment has topped 10% in the Eurozone as a whole and is just shy of 20% in Spain) (chart 1). At this stage it remains unclear whether or not any of these countries will need to be bailed out by the European Union, but the cost of insuring against debt default in Greece has risen sharply.

In the US, the housing market appears to have run out of steam (chart 2), as the tax credit for first-time home buyers ends in April this year. Despite this, the FOMC noted at the conclusion of their January meeting that the pace of economic recovery was likely to be "moderate" for a time rather than "weak", as described at previous meetings. They did remain committed to holding rates "exceptionally low" for "an extended period" to support the economy.

Index	Jan%	12m%	YTD %
Dow Jones	-3.5	25.8	-3.5
S&P 500	-3.7	30.0	-3.7
FTSE 100	-4.1	25.0	-4.1
EuroStoxx50	-6.4	24.1	-6.4
Nikkei 225	-3.3	27.6	-3.3
Hang Seng	-8.1	51.5	-8.1
Australia	-5.9	32.2	-5.9

Source: I-Net Bridge

As the pace of economic recovery has gathered momentum in China, authorities have become increasingly concerned about limiting the likelihood of creating new asset bubbles (over-inflated markets that will eventually correct sharply). To this end, the People's Bank of China raised the amount banks have to hold in reserve by 0.5%, which in turn should lead to a reduction in bank lending as liquidity is drained from the banking system. India followed suit and surprisingly hiked the reserve requirement by 0.75%, although they did keep official interest rates unchanged.

While we continue to enjoy evidence that the economic recovery is gathering momentum (particularly in developed economies like China and India), the extent of the recovery on a global scale is likely to be quite muted in 2010 and until such time as new jobs are created in developed economies, we are unlikely to return to the economic growth rates enjoyed between 2003 and 2007. The threat of over-regulation is also a real one and likely to curb growth in the future.

MARKET OUTLOOK

Despite a number of upbeat and consensus-beating earnings reports in the US, market participants tended to focus on the problems unfolding in Europe and the fact that authorities in both China and India have taken steps to temper economic growth. As a result, equity and commodity prices fell sharply during January and the Euro lost ground to the US dollar (chart 3) and Sterling. Equity market losses were heaviest in Europe and those markets with close links to China, like Hong Kong (chart 4) and Australia. As a result of the improving earnings outlook and lower prices, value is slowly returning to global equity markets, although the situation in the PIGS countries (Portugal, Ireland, Greece and Spain) suggests that risks remain high.

Despite the fact that public finances in most economies are stretched and significant new bond issuance is expected this year, bond markets performed well in January (chart 5) as investors went in search of safe-havens for their money. The US dollar, which was trading close to $1.50/Euro towards the end of last year, is now below $1.40/Euro, highlighting the flight to quality that characterised the first trading month of the new year.

Index	Jan%	12m%	YTD%
All Share	-3.5	33.2	-3.5
Resources	-6.4	30.2	-6.4
Financials	1.2	39.4	1.2
Industrials	-2.7	33.1	-2.7
Property	-0.3	15.1	-0.3
Bond	0.3	1.7	0.3
Cash	0.6	8.7	0.6

Source: I-Net Bridge

With commodity prices falling (Chart 6) and investors looking for less risky assets, South Africa's equity market followed global markets lower. Price declines were highest among the Resources stocks, while Financials managed a small gain over the course of the month. Value is now returning to South Africa's equity market and the forward price:earnings ratio has dipped below 12 times. Investors are unlikely to rush in and buy the market aggressively, particularly commodity stocks, where China's efforts to slow growth and prevent asset bubbles will be closely watched to gauge the potential impact on commodity prices.

Bond yields declined during January as speculation mounted that the Reserve Bank may cut interest rates again before the end of the year. Although rates were left unchanged at the January meeting, Governor Marcus did indicate that the decision was not unanimous and that there were calls from certain members of the committee to cut rates at the meeting. Although listed property stocks lost some ground during January, the forward yield of the sector remains below the yield on long bonds and investors should be cautious when investing in the sector.

Chart 1 - EUROZONE UNEMPLOYMENT

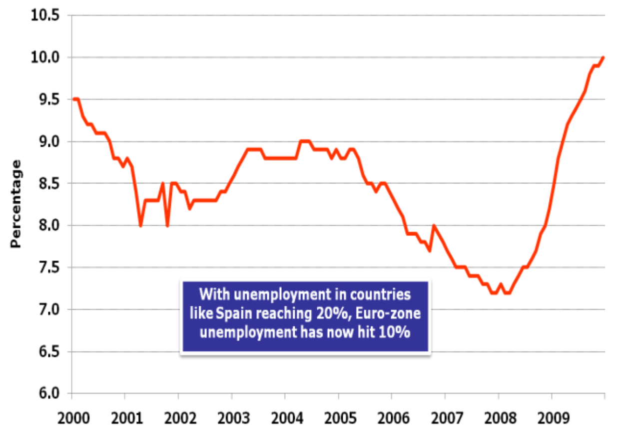

Chart 2 - US NEW HOME SALES

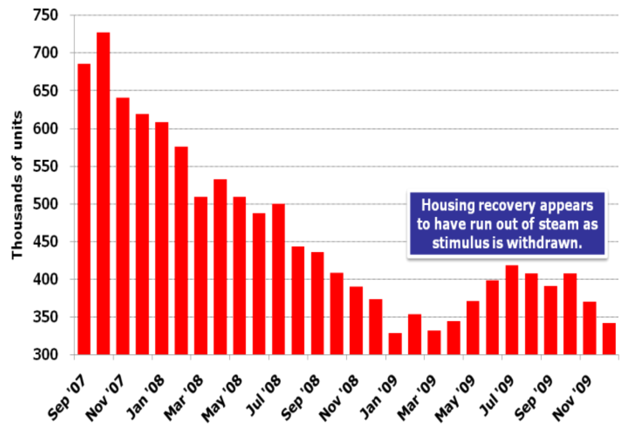

Chart 3 - US$/EURO EXCHANGE RATE

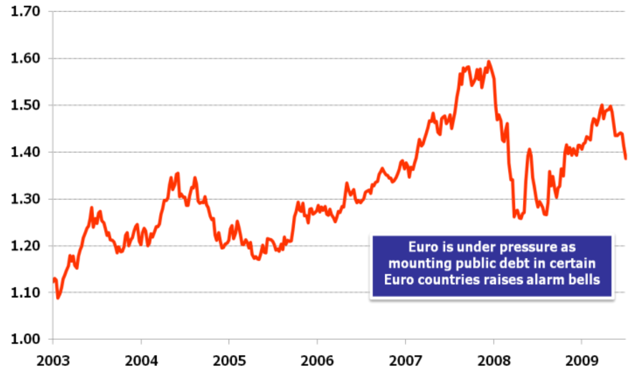

Chart 4 - HANG SENG INDEX

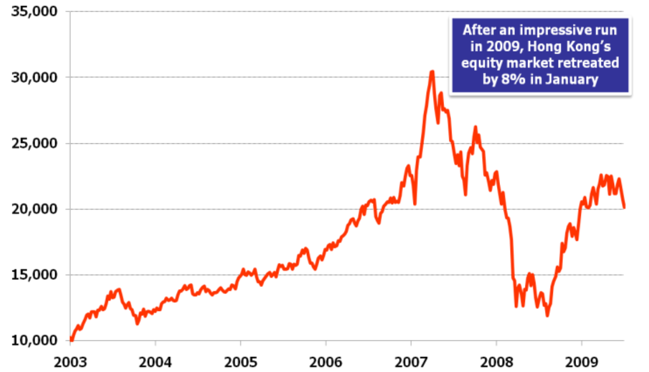

Chart 5 - JP MORGAN GLOBAL GOVT BOND INDEX YIELD

Chart 6 - ECONOMIST COMMODITIES INDEX