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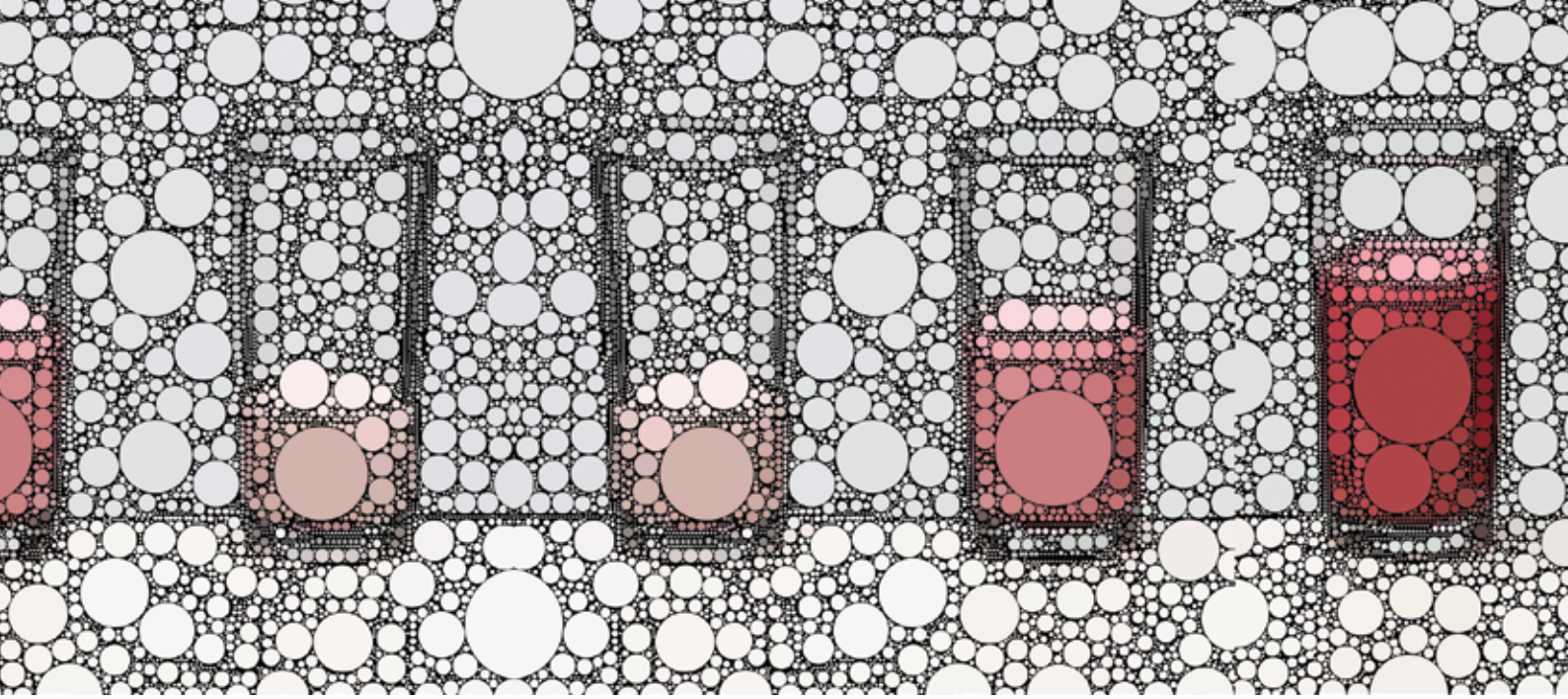
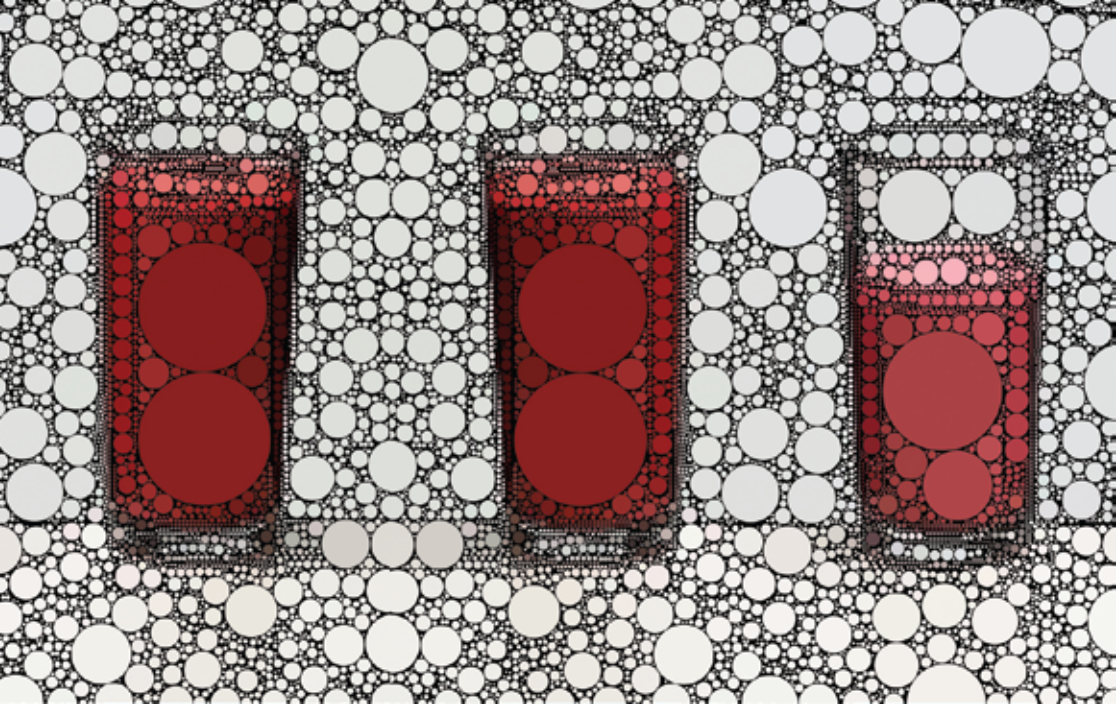




The contradiction between the economy and market

Abdul Davids - Head of Research

After an eventful year marked by widespread labour unrest, slower economic growth, rising domestic inflation and significant rand weakness, the South African economy finds itself in a precarious state.

GDP growth relative to other emerging market and African countries is anaemic, revenues from mineral exports and corporate taxes are under pressure and the growth rate in social grant spending exceeds that of fixed capital formation spending.

The contradiction between the economy and market

In addition, recent electricity price increases have been very negative for South African consumers and further hikes are on the horizon.

As a result, local consumers and businesses face major challenges and, as a country, South Africa is increasingly becoming less competitive. The local manufacturing sector is contracting as firms struggle to compete globally, partly due to cost pressures from increasing electricity and fuel prices and high real wage demands.

Yet, against this weak economic backdrop, the FTSE/JSE All Share Index sets new highs almost every day. This is largely due to foreigners investing in our equity market (specifically industrial and retail stocks) as they seem to regard South Africa as their gateway into Africa. This contradictory situation of a deteriorating local economic environment and stubbornly bullish sentiment towards certain industrial and retail stocks is unsustainable.

South Africa's economic woes

Platinum industry troubles weigh on GDP

South African platinum production has declined to multi-year lows due to the current challenges in the local platinum industry. In contrast to the gold mining sector (where South Africa is no longer the dominant global producer), the local platinum industry still controls over 80% of global platinum resources and is therefore a price setter in the global market. Yet, despite this, platinum group metals (PGMs) prices continue to languish at levels well below their pre-2008 highs.

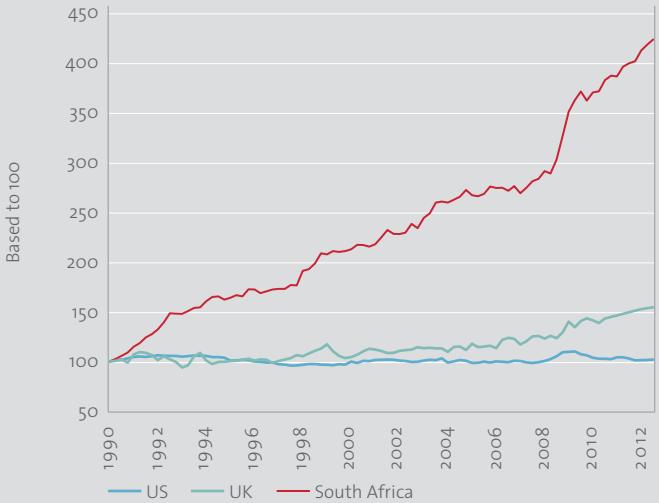
The combination of declining PGMs' production and softer prices contributed to a steep fall in PGMs' export revenues over the last 12 months. The mining sector's troubles also added to the country's record trade deficit of R21.2 billion in October. With export earnings declining and no significant domestic savings, South Africa will have to increasingly rely on foreign investments to fund future economic growth.

Declining industrial competitiveness

The chart on the left shows unit labour costs for South Africa compared to the US and UK. The large cumulative effect of sustained wage increases on labour costs is evident. In most developing countries, it is natural to see unit labour costs increasing above those of developed countries as short-term skills shortages in developing countries place upward pressure on wages. These labour cost rises are generally offset by productivity increases, resulting in unit costs being contained.

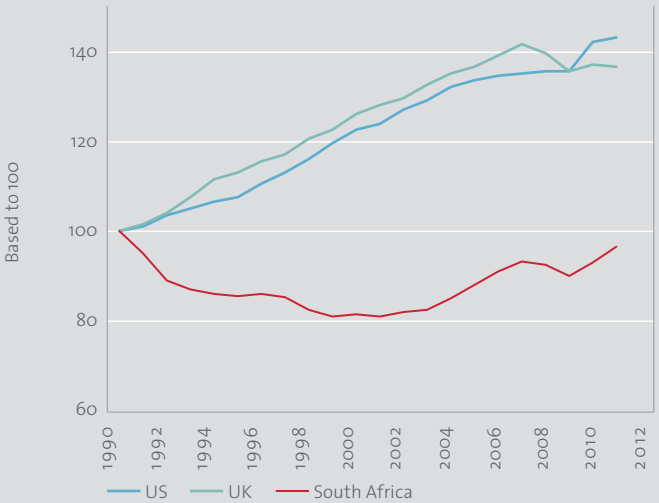
However, structural deficiencies in our local labour market have inhibited any productivity gains. As a result, South Africa's relative competitiveness has deteriorated significantly

Total manufacturing unit labour costs



Source: Bloomberg, Organisation for Economic Co-operation and Development and Kagiso Asset Management research

Labour productivity*



*Defined as GDP (in 2011 US$ terms) per person employed

Source: BCA Research and Kagiso Asset Management research

and labour unions' unwillingness to link wage increases to productivity measures ensures that the status quo is maintained.

Rampant electricity hikes

The chart on the bottom left shows the country's overall spending on electricity as a percentage of total GDP. Electricity prices rose moderately in the early 2000s while relative expenditure declined slightly. However, over the last five years Eskom introduced a sustained programme of significant electricity price hikes that contributed to record revenues for the state utility. South Africa's status as a source of cheap electricity and an attractive investment destination for heavy industries has therefore been compromised. Consequently, a large portion of the country's manufacturing base, from textiles to resource-beneficiation, has relocated to other emerging markets such as China. This has led to substantial losses in local jobs.

Changes in fiscal focus

The loss in manufacturing capacity has placed a strain on government revenues from corporates. As a result, the tax burden on individuals has increased. Faced with high unemployment (South Africa's unemployment rate of 25.5% is substantially worse than most other emerging markets), government's response since 2002 has been to increase spending on social grants and to boost the number of state employees.

In order to fund the rise in social grant spending and the rapidly growing government wage bill, government cut spending on capital investment, Gross Fixed Capital Formation, and allowed the budget deficit to increase. This underinvestment further inhibits future growth potential in the economy.

Debt refinancing

The increase in government's borrowing requirements coincides with a period of record-low bond yields. This has enabled it to issue new debt and to refinance existing debt at favourable rates.

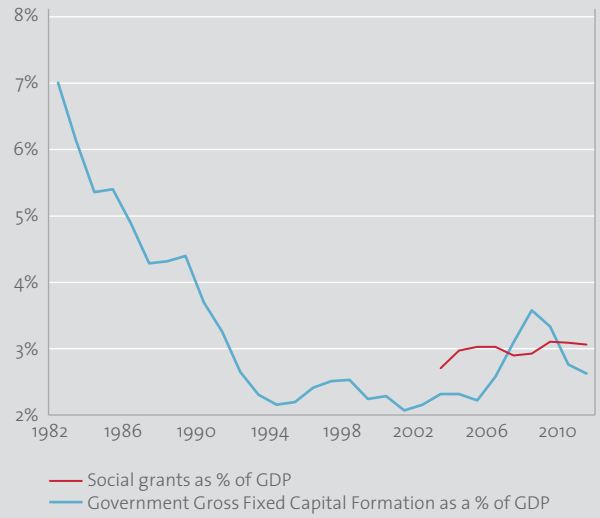
The coordinated monetary response to slow growth in developed markets has driven global bond yields to record lows. South Africa and other emerging markets have benefitted accordingly. The chart on the next page shows the average credit rating, as assigned by the three major credit ratings agencies, compared to five-year sovereign bond spreads.

Norway and Sweden have the best credit rating of AAA and therefore also enjoy the lowest borrowing costs relative to other countries. South Africa's position remains superior to some of the weaker Eurozone countries and other emerging markets such as Turkey. South Africa's inclusion into the JP Morgan Global Government Bond Index has also attracted substantial interest from foreign bond investors. However, recent credit

Electricity spend as a percentage of GDP

Source: I-Net Bridge and Kagiso Asset Management research

Government expenditure allocations



Source: South African Reserve Bank, Rencap and Kagiso Asset Management research

The contradiction between the economy and market

downgrades by two of the ratings agencies (in response to the weakening domestic fundamentals outlined) could result in a reversal in the country's relative positioning.

Caution: the stock market is too high

In contrast to the weak economic backdrop, the local equity market is achieving all-time highs on an almost daily basis. The monetary policies in developed markets have resulted in multi-decade low interest rates and a related decline in yields for developed market bonds and treasuries.

Faced with these low yields, fund managers in developed markets have increasingly sought out emerging markets as havens for better yields and earnings growth. South Africa, regarded as one of the more investable emerging markets with well-developed equity and bond markets, naturally features as an attractive investment destination. Foreign investors have been very selective in their local investment choices, steering away from resources and favouring industrial and retail stocks with high earnings yields and exposure to African growth.

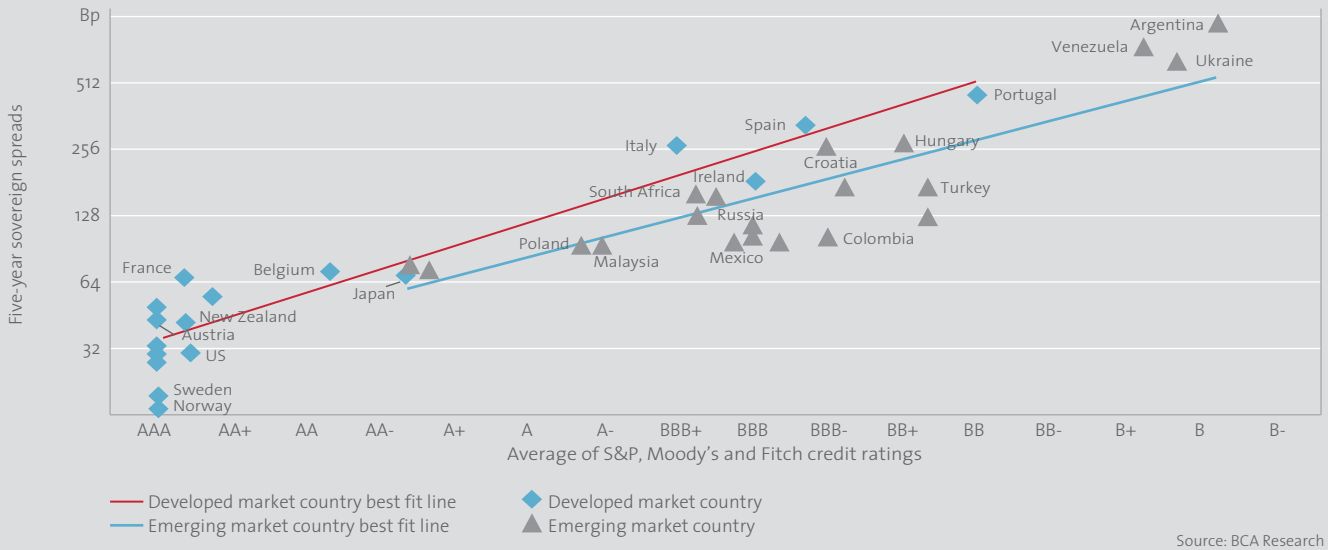
Opportunities amid gathering clouds

The contradiction between a deteriorating local economic environment and indiscriminate bullish sentiment towards certain industrial and retail stocks is unsustainable.

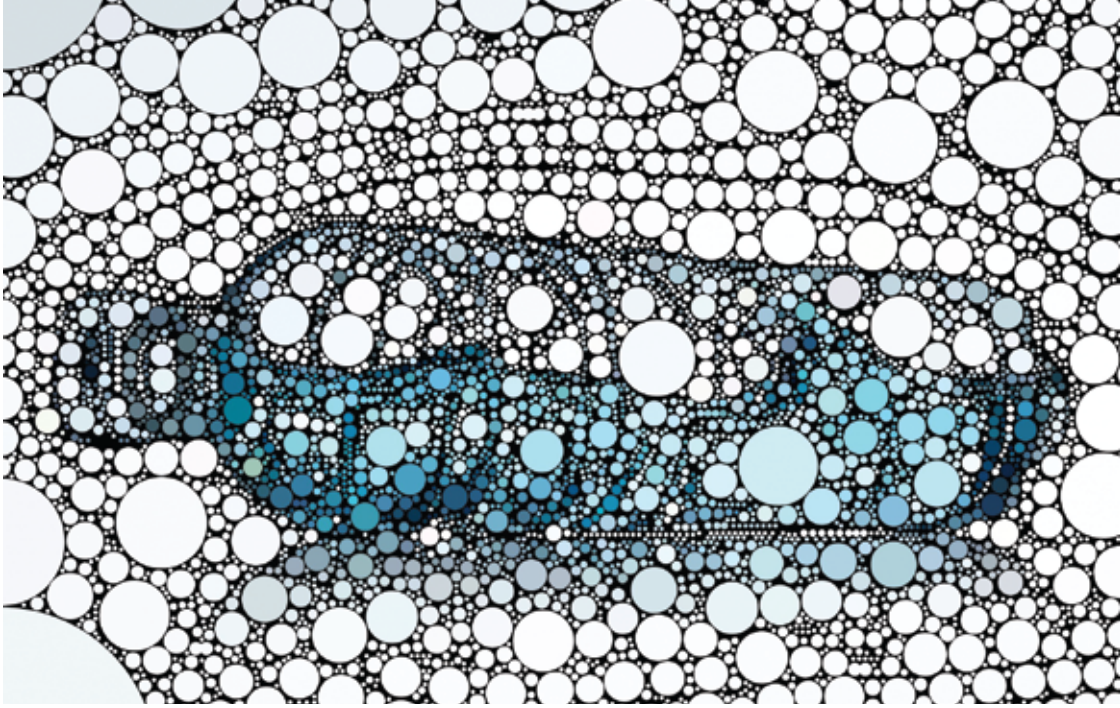
South Africa's current economic realities will eventually filter through to domestic companies' earnings in the form of lower revenues and pressures on input costs. This will result in lower growth from record high earnings levels. Dividend yields may then decline, especially as many companies have aggressively increased payout ratios. The country's attractiveness relative to other emerging markets will therefore diminish. History has shown that a change in sentiment by foreign investors can have a devastating impact on share prices.

However, within this scenario we see significant potential for a recovery in our resources sector from very depressed production levels. With 75% of the world's platinum production and 40% of the world's palladium production, South African resources companies have natural competitive advantages. We therefore continue to favour the resources sector and remain cautious about the prospects for industrials. UP

Country credit ratings



Source: BCA Research



Packaging companies adapt to survive

Ross Heyns - Equity Analyst

Over the last decade, local packaging companies have significantly underperformed other consumer-focused listed companies as they have failed to earn adequate returns on their substantial asset bases.

This has largely been due to an increasingly concentrated and globalised client base that has placed significant pricing pressure on the packaging companies.

Packaging companies adapt to survive

In addition, a number of structural shifts have taken place in the global and local packaging industry, including the move to lighter pack types. These changes have prompted companies to focus strongly on innovation, with consequent additional capital commitments.

In these challenging conditions, companies such as Nampak and Mpact have had to adapt to the changing environment. They have rationalised their portfolios of assets to focus on areas where they have sufficient market power to engage meaningfully with their customers. Both companies have also increased their exposure to growing markets and niche products.

South African packaging sector

The South African packaging industry generates about R45 billion in revenues each year and made up 1.5% of GDP in 2011. When looking at the sector, it is useful to separate the market into four main packaging categories: **paper, plastic, metal** and **glass**.

Historical performance

In early 2009, the market capitalisation of the five listed packaging companies in South Africa was roughly the same as it was in 2002. This stagnation is dramatically different compared to the threefold increase in the market capitalisation of the broader Industrials Index over the period (see chart).

Although these packaging shares performed better over the last three years, they have still substantially lagged other domestic industrials over the longer term. As a result, packaging companies now present a cheaper option to gain exposure to the defensive qualities of consumer-orientated industrial companies than for example retailers and food producers.

Innovation

Innovation has become an increasingly important theme in packaging. By providing customers with more effective ways to distribute and display their products, packaging companies are able to gain a more favourable position in pricing discussions.

Those that are able to add value by reducing the cost of transporting products and the cost of the packaging itself, or that can provide a new way of marketing products, have a distinct competitive advantage. Packaging companies are therefore constantly re-designing packs to reduce their weight while maintaining the strength and barrier properties (to maintain food quality and retain durability during transportation). This is known as **light-weighting**.

Other innovations that assist customers in marketing their products include indicators on the packaging that change colour depending on the temperature of the content, such as those found on beer cans.

Packaging sector versus Industrials Index

Source: I-Net Bridge

These and other structural changes have caused noticeable shifts in the market, resulting in a move away from metals and paper towards plastic packaging.

Plastic

Plastic packaging has become increasingly popular as it is lighter and therefore cheaper and easier to transport than glass and metals. Technological improvements have also allowed for thinner plastic packaging using less raw material. In addition, advances in digital printing have enhanced the actual packaging's ability to advertise the product.

The use of plastic has grown strongly in food, beverage and household goods. Soft drinks are increasingly sold in polyethylene terephthalate (PET) bottles rather than cans and numerous food items, such as tomato sauce and peanut butter, are now sold in plastic containers rather than glass.

Glass

The greater use of glass has been influenced by different market forces. Products packaged in glass have a premium image attached to them as they are thought to taste better and to be healthier. This is used to enhance the perceived quality of the product. In the South African beer market, this has resulted in non-returnable glass bottles taking a significant amount of market share from tin cans.

The growing beverage market and the aspirational quality of glass-packaged goods are expected to continue to contribute to growth in glass volumes. At the other end of the market, returnable glass is popular as a cost-effective packaging option. In South Africa, the vast majority of beer is sold in returnable glass bottles and an estimated 80% is consumed in townships, where price is an important demand driver.

Aluminium cans

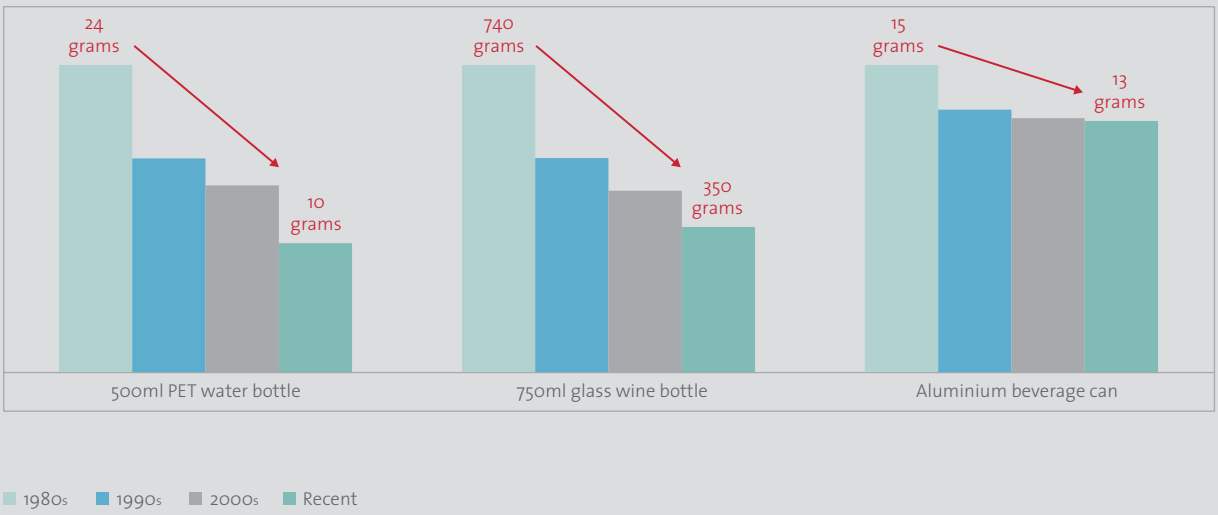
Globally, aluminium instead of tinplate is increasingly being used for beverage cans. This is because aluminium cans require less material and are therefore lighter and cheaper to transport. Aluminium has the added advantage of being more efficient to recycle than tin plate.

The decline in the price of aluminium since 2008 has made this an increasingly attractive option. Aluminium cans will soon become common in South Africa as Nampak recently agreed with its main customers to convert some of its tinplate canning capacity to aluminium, thereby aligning itself with the global standard.

Industry challenges

Packaging companies find themselves in an inherently difficult position. Their customers tend to be large multinational consumer goods companies that are able to exert considerable

Light-weighting of pack types



Source: Consol Glass, www.factsonpet.com, Aluminium Association and Kagiso Asset Management research

Packaging companies adapt to survive

pricing pressure. Essentially, packaging is a means to deliver a product to the end customer and consumer-focused companies generally want to do this as efficiently and effectively as possible.

It is therefore vital for packaging companies to focus on particular product areas where they have sufficient market scale as this will allow them to retain some market power when they negotiate with large multinational corporations. An alternative approach is to focus on smaller niche areas, where they are able to provide their customers with a unique solution that allows them to deliver their products more effectively or at a lower cost.

Nampak and Mpact

The local packaging market is characterised by a few large listed companies with numerous smaller private companies. Nampak is by far the largest packaging company in South Africa with a market capitalisation of R22 billion compared to Mpact at R3.2 billion[1], while the rest are substantially smaller. Both companies have large market shares in their respective focus areas and are less vulnerable to competitive forces than some of their smaller rivals.

Nampak enjoys a near monopoly position in the canning business and has a 20% share of the glass market, where Consol (now owned by private equity investors) is the only other player. It also has good market share in its rigid plastic and tissue businesses. Although the company's other businesses operate in a more competitive environment, Nampak has significantly restructured its paper and flexibles business to increase its focus on niche areas. It also has considerable exposure to sub-Saharan Africa, which presents a meaningful growth opportunity into markets with less domestic competition.

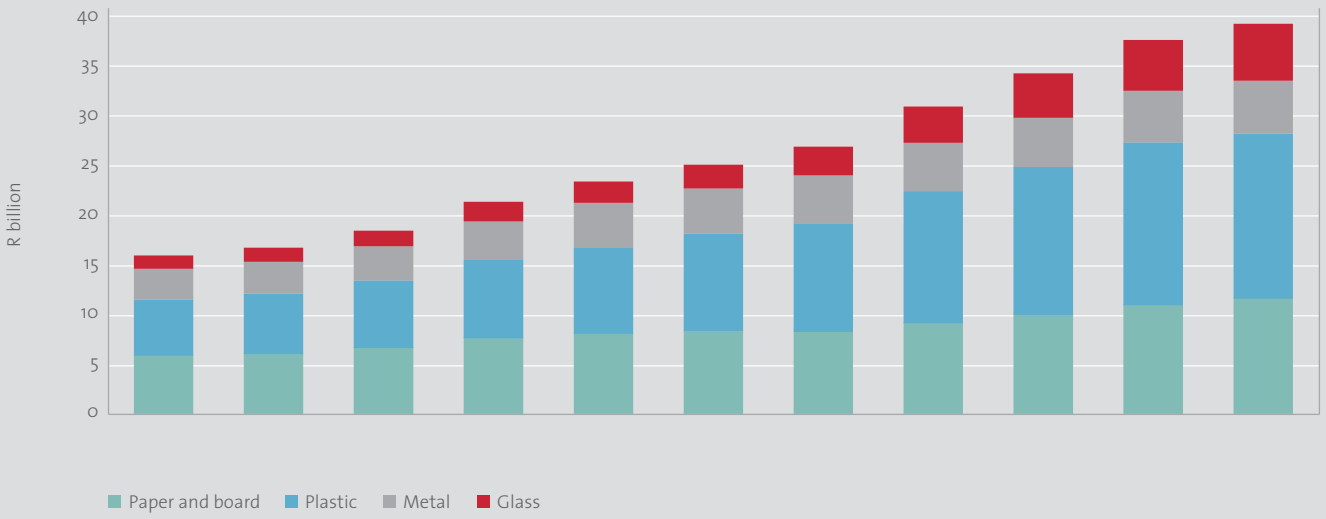
Mpact has sizeable scale in its rigid plastic and paper businesses and has the added advantage of vertical integration with its recycling operations. The company's paper operations tend to supply smaller customers who are less likely to pressure management on price. These benefits help to improve its competitive position.

Preferred players

In a market where industrial stocks have become increasingly expensive, Nampak and Mpact present a relatively inexpensive way to gain exposure to the defensive qualities of consumer-focused companies. Within the packaging sector, our preference lies with these two large players as they have superior market power compared to their smaller peers. In addition, they have the capacity to adapt to structural shifts in the industry. The market appears to be aligning itself with this view, which is reflected in these companies' recent strong share price movements. UP

[1] (as at 21 December 2012)

South African packaging industry revenues



Source: BMi Research

Copper: a metal of all ages

Rubin Renecke - Equity Analyst

Copper is a very useful metal to humankind and has been extensively used in China's rapid development over the last decade.

This strong demand from China, coupled with constrained supply growth, has caused a period of significantly elevated copper prices, which has been positive for some of the JSE-listed miners. However, we incorporate lower prices in our valuations of these companies.

Copper: a metal of all ages

History

The name copper is derived from Cyprus, the Eastern Mediterranean island where the Romans first found their copper supplies. The metal, one of the oldest ever extracted, has been an essential material since prehistoric times. Together with its many alloys, it has played an important role in many societies - from the ancient Egyptians and Romans to modern-day cultures.

Applications

Copper is easily stretched, moulded and shaped. It is resistant to corrosion and it conducts heat and electricity efficiently. Copper is used in building construction, power generation and transmission, electronic product manufacturing and the production of industrial machinery and vehicles. The average car contains 1.5 kilometres of copper wire and the total amount of copper ranges from 20 kilograms in small cars to 45 kilograms in luxury and hybrid vehicles.

Geology

The metal is formed from the lava and minerals that occur during volcanic activity. It is mainly found in the sulphide minerals of Chalcopyrite ($CuFeS_2$) and Chalcocite (Cu_2S), and in oxides. A copper oxide deposit tends to sit on the surface of the much larger sulphide deposits underneath. Gold and silver are usually associated with copper ores and are recovered as by-products in the process of copper extraction.

Mining

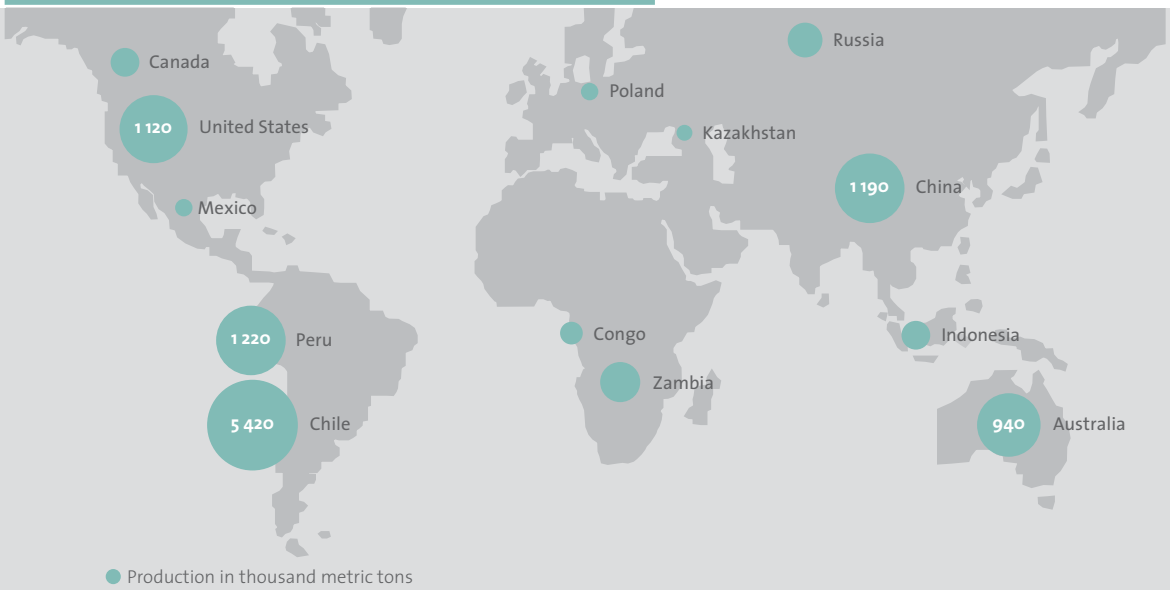
Copper is primarily mined through the open-pit method (90%), with the remaining 10% mined by underground techniques. The mining depth of open-pit copper mines varies, depending on the ore body, and can range from four metres to 1.2 kilometres. Copper is mined throughout the world, as can be seen in the map below. Chile has a large percentage of global reserves (at around 28%) and is the world's top producer, recording 34% of global mine production in 2011.

Two JSE-listed companies, BHP Billiton (BHP) and Anglo American (Anglo) have large exposures to copper mines in Chile. The majority of BHP's copper production comes from Chile and all of Anglo's production is in Chile. In 2011, BHP and Anglo produced around 1.4 million tons of copper in Chile - roughly 26% of the country's copper production. In the same year, BHP's and Anglo's share of global copper mine production was 7% and 4% respectively.

Beneficiation

Copper is generally extracted from ore in three steps: ore processing (beneficiation), smelting/leaching and refining. The refined metal is then sold to metal fabricators. Ore processing

Major copper producers



Source: United States Geographical Survey, Mineral Commodity Summary 2012

is done at the mine site, while smelting and refining are carried out at the smelter site.

Mines produce two primary products: copper concentrate and copper cathode. When a copper deposit produces concentrates (usually in mining sulphide ore deposits), initial beneficiation is done at the mine site and the concentrate is then shipped to the smelter. In the case of cathodes (usually in mining oxide ore deposits), the processing is done at the mine site itself. Miners and smelters are not usually integrated operations and are often independent buyers and sellers of services.

Supply and demand

Globally mined **copper supply** amounted to 16 million tons in 2011, while recycled copper added another 3.5 million tons, bringing total global supply to 19.5 million tons. Copper is one of the most widely recycled of all metals. Recycled copper scrap as a source of supply has been growing faster than copper demand over the last 20 years. Some 20% of annual copper demand is now satisfied by recycled material.

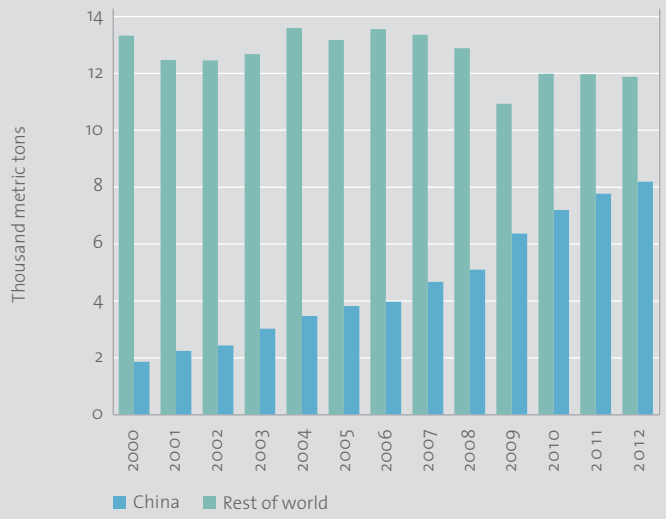
Mined copper supply has struggled to keep up with demand over the last few years due to a number of factors such as declining grades, increasing mining complexity and labour unrest.

Additionally, new supply has been slow to market following the Global Financial Crisis, which resulted in delays in and the postponement of copper projects.

This underperformance of mine supply and lack of new supply, coupled with particularly strong demand from China, has resulted in the copper price increasing to levels well above the marginal cost of production. Sustained higher copper prices have revived previously delayed projects and also incentivised many new projects. Based on committed new projects over the next three years, global mined copper production capacity is set to rise by 27% or 4.5 million tons.

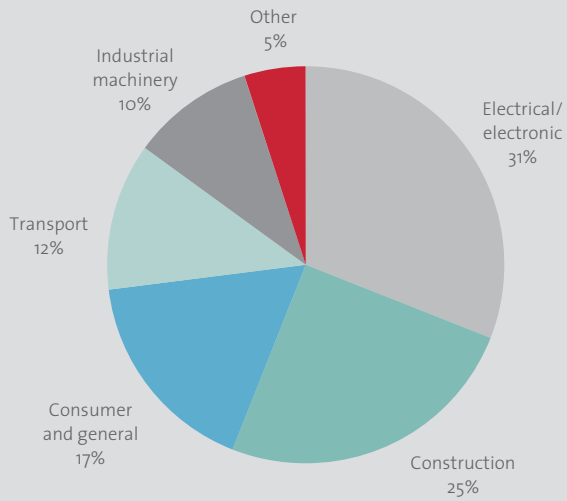
China has been the main driver of **copper demand** over the last decade (see chart). China's infrastructure and property boom over the period has fuelled demand for the metal, causing supply shortages. In 2000, the country's share of global copper demand was 11%. This share increased to 39% in 2011. China and Europe make up about 56% of global copper demand. Going forward, Europe's depressed industrial activity will have a negative impact on copper demand and China's slowdown in GDP growth - in particular in infrastructure and housing activity - will slow the rate of growth in copper demand.

Chinese and world copper demand



Source: Citigroup and Kagiso Asset Management research

Industrial consumption of copper (2011)



Source: CRU (Commodities Research Unit), London Metal Exchange

Copper: a metal of all ages

Pricing

As with other commodities, the copper price is determined by the interaction of supply and demand. However, pricing is also influenced by the dynamics of copper trading on the various metals exchanges, such as the London Metal Exchange.

The use of copper as a financing mechanism, particularly by the Chinese, is a recent phenomenon that has created artificial demand. Chinese banks are either unwilling to lend to property developers in the current market, or they charge high interest rates. As an alternative, property developers have applied to banks (and other institutions) for trade finance to buy copper at much cheaper lending rates and have then used the copper obtained as collateral to borrow domestically. This has resulted in artificially high copper prices.

The chart shows the historical copper price and the recent price volatility. Between 1976 and 2003, copper traded between US$1 500 and US$3 500 per ton. At the start of 2004, the copper price started to increase rapidly as Chinese demand accelerated. In the second half of 2008, the copper price was negatively affected by the Global Financial Crisis and reached a low of US$2 770 per ton before rebounding to its all-time high of US$10 148 per ton in February 2011.

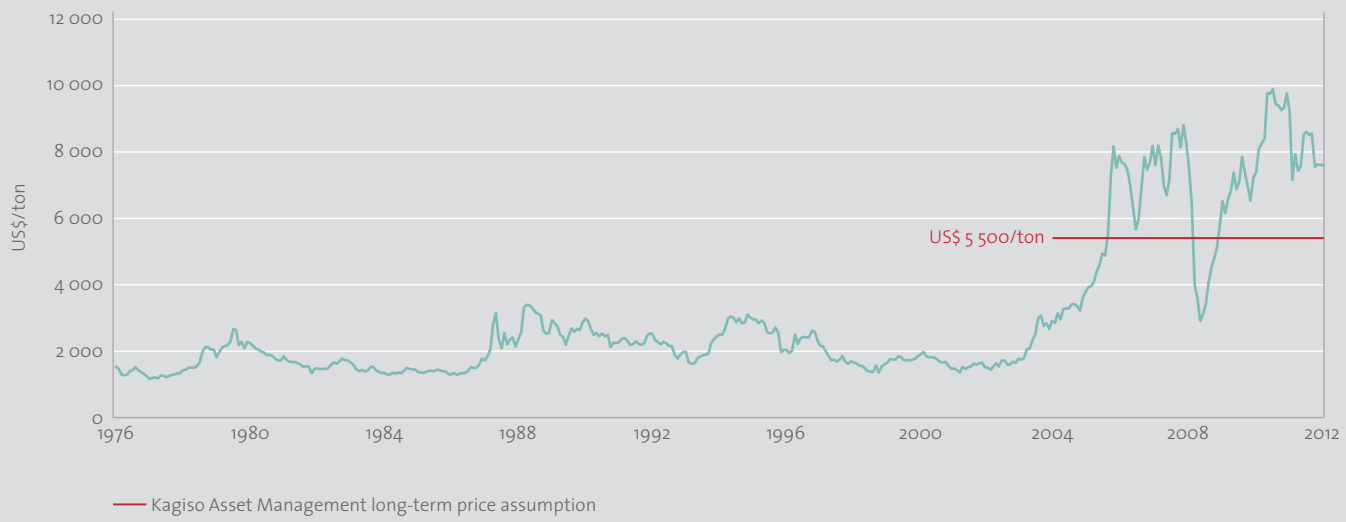
Substitutes

The level of the copper price also drives the substitution decision. There are a number of substitute products available to manufacturers when the copper price is too steep. Aluminium is a substitute for copper in power cables, electrical equipment, automobile radiators and cooling and refrigeration tubes. Titanium and steel are substitutes in heat exchangers and optic fibre is a substitute in telecommunications applications. Plastic is a substitute in water pipes, drain pipes and in plumbing fixtures. This substitution potential places a ceiling on the copper price. The rate of substitution is estimated at around 400 000 to 500 000 tons per year or 1.7% to 2% of demand per year.

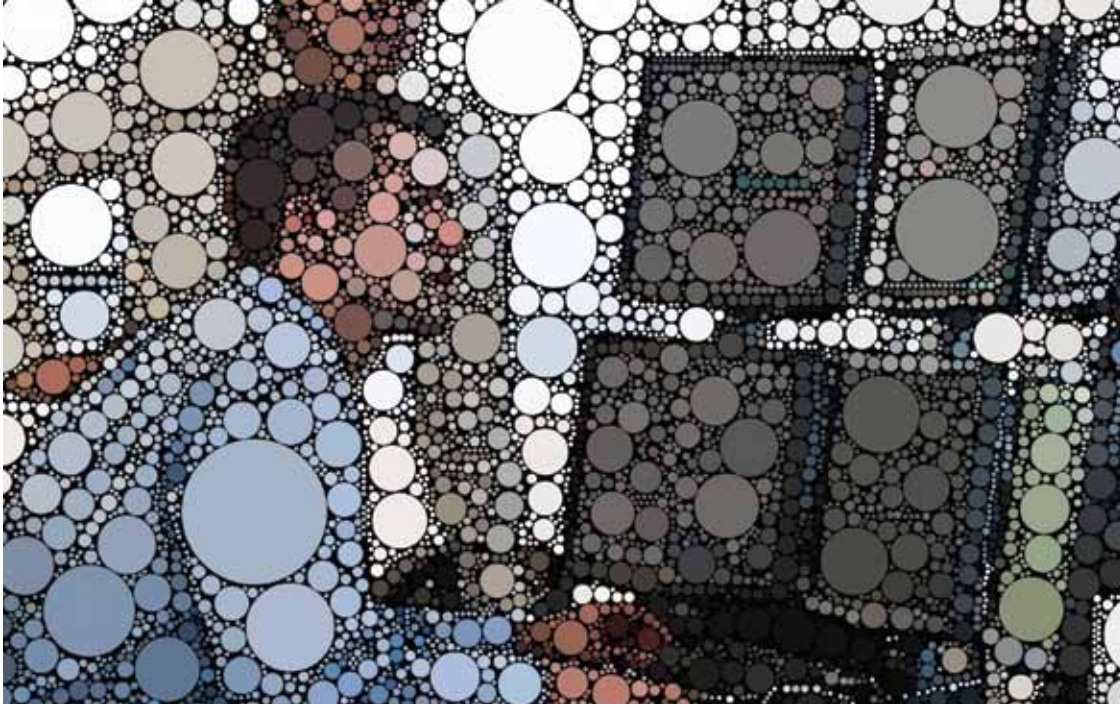
Long-term view tilted towards the downside

The copper price currently trades at about a 40% premium to its marginal cost of production. We believe the combination of slowing copper demand and increased supply is likely to tip the market balance into surplus. In an oversupplied market, the marginal cost of production should be the clearing price for copper. We therefore set our long- term copper price at our estimate of the marginal cost of production of US$5 500 per ton and believe it has significant downside from current levels. This price decline will have a meaningful impact on the earnings of BHP and Anglo, which we incorporate into our valuation of the two companies. UP

Nominal monthly average copper price



Source: I-Net Bridge and Kagiso Asset Management research



From open outcry to electronic trading

Satish Gosai - Head of Trading

Equity trading in South Africa has evolved significantly over the last few decades, from the days of the open outcry trading floor to the current advanced electronic methods of execution. This evolution mirrored rapid technological developments on global exchanges.

The main share trading platforms for equity trading are stock markets, which play an important role in the economy. The principal purpose of such platforms is to enable companies to raise capital when necessary in order to expand.

From open outcry to electronic trading

In addition, trading platforms create a central location for share ownership to change hands efficiently, transparently and at relatively low cost.

The JSE Securities Exchange (JSE)

Early days

The JSE was first established in 1887 by London businessman, Benjamin Minors Wollan. The main aim of the exchange, which was set up in a miner's tent in central Johannesburg, was to facilitate the rapidly growing trade that was sparked by the discovery of gold on the Witwatersrand in 1886.

This discovery transformed the South African economy into a resource-dominated market and attracted significant foreign interest. Big mining companies were needed to deal with the technical challenges involved in recovering gold from the deep level rock face. In turn, these companies (such as Anglo American and De Beers) needed large amounts of money and were therefore looking for a central facility to access capital.[1]

Key developments

Between 1887 and 1995, there was little change on the JSE except the substantial growth in its aggregate market capitalisations and the types of companies that listed on the exchange (mainly mining companies in the early days). Then, after using an open outcry trading platform for more than 100 years, major changes were introduced between 1996 and 2002.

Before 1996, shareholders were issued with paper certificates, which served as proof of their stake in a company. When ownership changed, these certificates exchanged hands. The move to an automated trading system in 1996, which involved using a more technologically advanced screen-based trading system, was the first step towards the current environment.

The JSE and the banking sector launched an electronic settlement system in 1996. This system ensured that the change in share ownership occurred electronically, removing the need for a paper-based share certificate. Through a process called dematerialisation, all existing paper certificates were converted to electronic ownership records by the end of 2002.

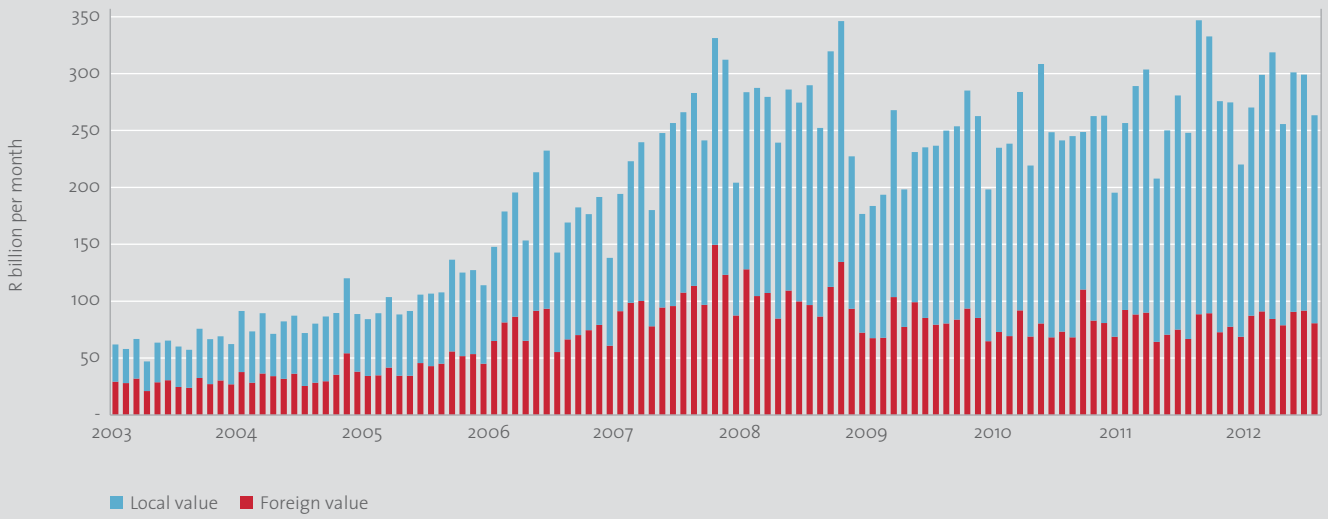
The JSE then demutualised in 2005 and became a public unlisted company. One year later, it listed on the main board of its own exchange.[2]

The JSE today

With a history spanning 125 years, the JSE has consistently been ranked as one of the top exchanges in the world. Its advanced Broker Dealer Accounting System fully integrates administration processes between brokers, share custodians and dealers. This enables real time monitoring, ensuring

[1] www.nationsencyclopedia.com, www.goldinsouthafrica.com
[2] www.jse.co.za

Trade activity on the JSE



Source: Citigroup, JP Morgan and Kagiso Asset Management research

effective surveillance of market activity. The JSE's robust systems have led to the exchange being ranked first for three consecutive years, out of 144 countries surveyed for securities market regulation, by the World Economic Forum.

The role of the stockbroker

Trade execution using the JSE automated trading system is limited to registered members of the exchange. This limitation creates the need for a stockbroker to act as an intermediary between counterparties participating on the exchange. In addition to implementing client instructions, brokers provide investment research to their clients as a way of competing for business. The JSE has introduced a stringent set of regulations for stockbrokers, including specific requirements around training and experience.

JSE trade activity

Over R10 billion worth of equity trades are executed on the JSE on a typical day. Over a third of this amount is from foreign investors (see chart on opposite page). Although the percentage of locally-listed companies owned by foreigners has risen over the past few years, foreign trading activity has remained relatively stable. The existence of dual-listed stocks (stocks that are listed on both the JSE and another international exchange) has substantially increased local volumes. In fact, the traded volume in dual-listed stocks on the JSE reduces by up to 50% when the London Stock Exchange is closed.

The total market capitalisation of the JSE has increased significantly over the past decade, rising from R1.4 trillion in 2002 to just over R7.4 trillion at the end of December 2012. Liquidity on the exchange remains at relatively high levels with an average of four billion shares changing ownership every month.[1]

Recent developments

The global and local trading environments have had to keep pace with technological developments. Increased computing power and trade automation programmes have resulted in various advanced methods of trade execution.

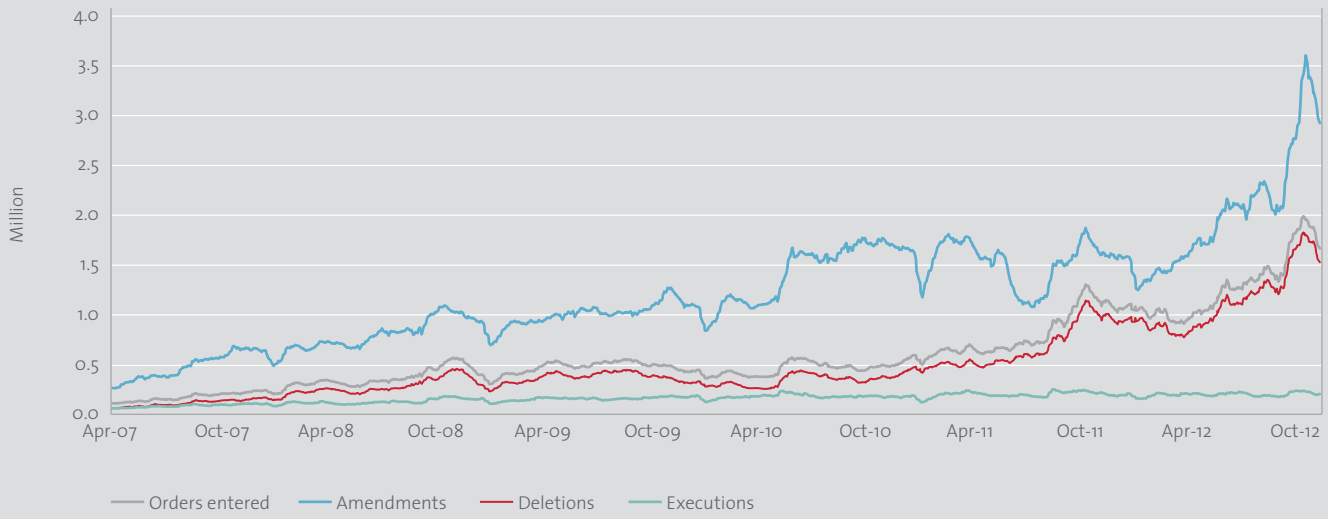
Use of algorithms

The use of algorithms, which are designed to execute trades without human intervention, has increased significantly. Combining both historic and live market information, trading algorithms are able to implement changes and adjustments to orders faster and more efficiently than human traders. The JSE's market trade history shows that order amendments have increased considerably, while the actual number of trade executions remains fairly constant (see chart).

An algorithm can be customised to suit a trader's desired strategy. More commonly used algorithms include targeting

[1] I-Net Bridge and Bloomberg

Daily JSE order activity



Source: Investec Securities and JSE Securities Exchange

From open outcry to electronic trading

a percentage of traded volume and the volume-weighted average trade price. Other more complex algorithms are able to keep orders hidden from the trading order book, aggressively searching for liquidity or adjusting market participation depending on price movements. One such algorithm, commonly referred to as an Iceberg, displays relatively small volumes on the market order book, concealing the larger part of the order from other market participants. It will trade aggressively at desired prices if or when an opportunity arises.

Dark pools

The need for faster execution and lower trade costs has seen the development of alternate trading venues such as 'dark pools', which are widely used in global markets. Dark pools are essentially private trading platforms that are independent of the primary stock exchange and aim to provide liquidity for large trade orders. Importantly, they maintain the anonymity of those transacting and the total size of the order. Trade prices are only publicly displayed after trades are complete. In the local market, dark pools play a less significant role than in global markets. In 2010, the JSE launched an anonymous trading platform named 'Block X', specifically designed for large trade orders that require such anonymity.

Dangers of electronic trading

While electronic trading results in faster and more strategic execution, there are some important associated risks. Since trading algorithms base their execution on historic and live market information, unusual market events can result in unfavourable trades. The so-called 'Flash Crash', which occurred in the US on 6 May 2010, is an example of this. On that day, the Dow Jones Industrial Average Index fell by approximately 9% and recovered 20 minutes later as the implementation of just a single large trade order and the lack of market liquidity triggered a significant number of active electronic trade orders, thereby causing a market sell-off.

Kagiso Asset Management's trading evolution

Trading on any exchange has direct costs such as brokerage payable, exchange and administration costs, and various indirect costs. The indirect costs can be divided into market impact cost, opportunity cost and time delay cost. 'Implementation shortfall', which takes both direct and indirect costs into account, is a closely-watched measure in today's trading environment.

In order to optimise brokerage spend, we use a combination of algorithm trading, execution-only brokers and focused trade allocations to brokers who provide research. Indirect costs are minimised through technologically advanced in-house trading systems, designed to significantly reduce time delay and opportunity costs. The application of certain algorithm trading strategies attempts to minimise the implementation shortfall measure, thereby reducing the total cost of the trade. We are continuously evolving our trading function to take advantage of opportunities to improve trading efficiency for our clients. UP

Kagiso Asset Management Funds

Performance to 31 December 2012	1 year	3 years[1]	5 years[1]	Since launch[1]	Launch	TER[2]
Collective Investment Scheme Funds[3]						
Equity funds						
Equity Alpha Fund	16.1%	14.2%	9.5%	22.1%	26-Apr-04	1.48%
Domestic Equity General Funds Mean	21.2%	13.9%	7.8%	17.3%		
Outperformance	-5.1%	0.3%	1.7%	4.8%		
Islamic Equity Fund	11.0%	11.8%	-	16.0%	13-Jul-09	1.32%
Domestic Equity General Funds Mean	21.2%	13.9%		18.2%		
Outperformance	-10.2%	-2.1%		-2.2%		
Asset allocation funds						
Balanced Fund	13.1%	-	-	10.7%	3-May-11	1.58%
Domestic AA Prudential Variable Equity Funds Mean	15.6%			11.5%		
Outperformance	-2.5%			-0.8%		
Islamic Balanced Fund	9.5%	-	-	4.4%	3-May-11	1.59%
Domestic AA Prudential Variable Equity Funds Mean	15.6%			11.5%		
Outperformance	-6.1%			-7.1%		
Protector Fund	8.4%	6.1%	5.7%	11.2%	11-Dec-02	1.59 %
CPI + 5%[4]	10.6%	10.1%	11.4%	10.7%		
Outperformance	-2.2%	-4.0%	-5.7%	0.5%		
Stable Fund	7.2%	-	-	8.2%	3-May-11	1.56%
Return on large deposits*	5.3%			5.4%		
Outperformance	1.9%			2.8%		
Institutional Funds[5]						
Equity funds						
Managed Equity Fund	20.2%	15.5%	10.8%	14.6%	1-Sep-06	
FTSE/JSE SWIX All Share Index	29.1%	17.6%	10.6%	14.1%		
Outperformance	-8.9%	-2.1%	0.2%	0.5%		
Core Equity Fund	25.1%	16.4%	11.0%	20.1%	1-Nov-04	
FTSE/JSE SWIX All Share Index	29.1%	17.6%	10.6%	19.7%		
Outperformance	-4.0%	-1.2%	0.4%	0.4%		
Asset allocation funds						
Domestic Balanced Fund[6]	10.3%	11.9%	9.2%	9.0%	1-May-07	
Peer Median[7]	17.1%	15.3%	10.3%	10.0%		
Outperformance	-6.8%	-3.4%	-1.2%	-1.0%		

[1]Annualised; [2]TER (total expense ratio) = % of average NAV of portfolio incurred as charges, levies and fees in the management of the portfolio for the rolling 12-month period to 31 December 2012; [3]Source: Morningstar; net of all costs incurred within the fund; [4]CPI for December 2012 is an estimate; [5]Source: Kagiso Asset Management; gross of management fees; [6]Domestic Balanced Fund and benchmark returns to 30 November 2012; [7]Median return of Alexander Forbes SA Manager Watch: BIV Survey; * Return on deposits of R5 million plus 2% (on an after-tax basis at an assumed 25% tax rate).

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