SYGNALS

KEY INDICATORS

		1 Month	3 Months	6 Months	1 Year	2 Years	3 Years	5 Years
J203T	FTSE/JSE All Share Index	3.2%	10.3%	18.3%	26.7%	14.0%	15.6%	9.4%
J200T	FTSE/JSE Top 40 Index	2.8%	10.9%	19.3%	26.1%	13.5%	14.7%	8.8%
J210T	FTSE/JSE Resources 20 Index	2.9%	7.1%	10.4%	3.1%	-1.9%	2.6%	0.9%
J211T	FTSE/JSE Industrials 25 index	1.9%	13.2%	26.6%	44.5%	26.4%	26.5%	17.4%
J212T	FTSE/JSE Financials 15 Index	6.6%	11.2%	17.1%	37.8%	21.2%	19.0%	9.8%
J403T	FTSE/JSE SWIX Index	4.3%	10.1%	18.1%	29.1%	16.0%	17.6%	10.6%
J303T	FTSE/JSE CAPI Index	3.1%	10.3%	18.3%	26.7%	14.3%	16.0%	10.1%
ALBI	BESA All Bond Index	2.3%	2.6%	7.7%	16.0%	12.4%	13.2%	10.9%
STeFI	STeFI Index	0.4%	1.3%	2.7%	5.5%	5.6%	6.1%	7.8%
	MSCI World Index in SA Rands	-3.8%	3.6%	12.8%	20.6%	17.8%	11.5%	3.0%
	Rand/US Dollar Exchange Rate	-5.6%	1.1%	3.2%	4.1%	12.6%	4.3%	4.3%
	Rand/Euro Exchange Rate	-4.3%	3.6%	7.1%	5.7%	11.9%	1.8%	2.1%
	Headline CPI	0.2%	1.8%	2.6%	5.6%	5.9%	5.1%	6.3%
	Core CPI	0.2%	0.6%	2.1%	4.9%	4.6%	4.3%	5.5%

"The ANC will continue to provide strong economic leadership and steer our economy boldly, and we do have a plan to grow the economy and create jobs. Central to that plan is our overarching National Development Plan which clearly identifies our challenges but also our opportunities to transform the economy, and build a thriving developmental state. The destination we are heading towards is a mixed economy, where the state, private capital, co-operative and other forms of social ownership complement each other in an integrated way to eliminate poverty and foster shared economic growth."

President Jacob Zuma, ANC National Conference, Mangaung, December 2012

A spectacular year for equity markets came to an end with a whimper as US politicians raced to resolve the fiscal cliff issue, and the US hit its debt ceiling once again. The US Federal Reserve announced an increase to the quantitative easing programme, while the new government in Japan pledged a relaxation of monetary policy to boost growth. In South Africa, the ANC election results, and in particular the political rejection of the concept of nationalisation, brought more investor confidence to the table.

WILL THEY OR WON'T THEY?

December started on an up note as Greece announced that it would buy back €10 billion worth of bonds through a Dutch auction mechanism in an effort to cut its ballooning debt and obtain the next instalment of aid. The auction allowed Greece to assess the level of demand for the proposal before setting a final price for the deal. The eventual outcome involved Greece repurchasing an effective €31.8 billion worth of bonds maturing from 2023 to 2042 at an average of about 33.8% of their book value, using a €10 billion loan from the EU bailout fund for the purpose.

The ECB agreed to accept Greek government bonds as collateral for loans to Greek banks once again, making it easier for the banks to continue operating, while the S&P upped Greece's credit rating from default to B- on the back of fiscal progress the country has made.

The positive sentiment was also fuelled by rumours of an extension of the quantitative easing programme implemented by the US Fed in September 2012. This became a fact with an announcement that the Fed will up the amount of money it "prints" each month to US$85 billion. The programme will continue until unemployment falls below 6.5% or inflation rises above 2.5%.

The optimism led to a sharp fall in the gold price which ended the month at US$1 675 an ounce, down from US$1 715 seen at the end of November. Overall the gold price gained 6.4% in 2012, its 12th straight annual gain. Brent crude oil ended the year virtually flat at US$109.89 a barrel.

By mid-month, however, investors became increasingly concerned about the weaker than expected European economic data, including Germany's slipping manufacturing PMI figures and the Bundesbank's growth forecast downgrades, and about the lack of progress in the US's fiscal cliff negotiations.

The fiscal cliff refers to a combination of the expiry of tax cuts introduced by George W Bush, and the poison pill provisions of the debt ceiling deal signed in August 2011 involving across-the-board spending cuts unless Congress passed a US$1.2 billion deficit reduction bill by the end of 2012. The impact has been projected as potentially reducing US GDP growth by up to 4% in 2013, taking the country back into recession.

A risk-on and off trading environment prevailed through the rest of the month as the Republican/Democrat negotiations dragged on. With no concrete deal in sight, the markets ended the year on a downbeat note. A compromise deal was reached just after midnight on the 1st of January 2013.

The main issues of contention between the two parties are taxation and social spending. US President Barack Obama wanted to raise taxes for all families earning more than US$250 000 p.a. The Republicans are, on principle, opposed to any hikes in tax rates. They also want to see meaningful cuts in social spending such as the Medicare health care programme - an anathema to the Democrats. The parties eventually settled on the tax break expiry above a salary threshold of US$400 000 for individuals and US$450 000 for couples. The spending cuts have been delayed for two months.

The agreement effectively scrapped income tax increases for more than 99% of US households on a permanent basis. However, it did not eliminate the 2% payroll tax increase which will affect 77% of households and is expected to cut US$125 billion out of the economy in 2013. The elimination of the payroll tax cut, coupled with higher income taxes on the wealthy, is expected to reduce growth in the first quarter to just 1%, down from 3.1% in the third quarter of 2012.

In addition to the above standoff, the US Treasury was also forced to announce that it was making plans to take "extraordinary measures" to help finance the government going into 2013 because the US had reached its debt ceiling of US$16.4 trillion by 31 December 2012. The negotiations over the debt ceiling are likely to become part and parcel of the fiscal cliff discussions going into the first quarter of 2013. The US Congress must act as early as mid-February to prevent a default.

In the US the IMS manufacturing PMI fell below the key 50 level to 49.5 in November, after two months of expansion. But most other economic data trended upwards, with the unemployment rate dropping to 7.7%, stronger retail sales and tentative signs of a continuing recovery in the housing market.

China also produced a raft of positive economic figures. Official manufacturing PMI rose to a seven-month high of 50.6 in November after 12 consecutive months of contraction. Industrial output and retail sales growth accelerated and inflation came in at a manageable 2%. The momentum seems to have continued into December with the flash HSBC/Markit manufacturing PMI rising to 51.5, a 14-month high.

The eurozone fared much worse, with manufacturing activity contracting for a ninth consecutive month in November, and unemployment at an all time high. 2013 is not expected to be much better with the ECB projecting that the eurozone will remain in a recession, contracting by 0.3%.

The Spanish government, although ending the year without having asked for a bail out, indicated that it has not ruled out seeking aid once the impact on funding costs are better understood. As it stands Spain managed to raise €97.1 billion in the bond market in 2012 as the yield on their 10-year bonds dropped from 7.8% in July to 5.3% after the ECB pledged to do "whatever it takes" to defend the euro in July. It needs to sell a further €111 billion of bonds in 2013, a number which may well be beyond market appetite.

In Italy, Prime Minister Mario Monti indicated that he is ready to step down. Praised for having pushed through significant reforms to the economy, this is not good news.

On a positive note, the EU finance ministers agreed to formally make the ECB the bloc's top banking supervisor. Many details are missing but the agreement does include key concessions that guarantee the UK's influence in the EU banking policy and protect London's status as a global financial centre.

SOUTH AFRICA

December brought a significant shift in terms of the longer-term political and economic landscape in South Africa. The ANC re-elected President Jacob Zuma as its leader, effectively ensuring his position as head of state of Africa's biggest economy for the next seven years. More significantly, however, it also elected businessman Cyril Ramaphosa as his deputy, seeking to repair the damaged image of Zuma's administration. Ramaphosa is seen as broadly favourable to business and investment, and capable of bringing business and labour together.

In yet another significant development, the ANC's national conference also resolved that wholesale nationalisation is "off the table" and that the state must capture an equitable share of mineral resources through the tax system.

Labour and land reform policies remain largely unchanged, although the conference agreed to regulate labour brokers, rather than banning them outright.

All the outcomes were positively received by investors, with the rand strengthening against the US dollar in response. In fact, the stock market hit fresh lifetime highs in December, breaking through the key 39 000 level for the first time in its history.

On the economic front the seasonally adjusted manufacturing PMI rose to 49.5 in November from 47.1 in October, but remained below the key 50 level for a third straight month. Consumer inflation came in at 5.6% year-on-year in November, broadly in line with expectations. On a positive note the trade deficit fell to R7.9 billion in November from the shocking R21.2 billion level reached in October, as imports fell by 9.8% month-on-month, while exports increased by 8.4%. This has brought the cumulative deficit for the year to R112.7 billion, the largest absolute figure on record, compared with R18.4 billion for the same period in 2011.

South Africa's poor corruption record has once again affected its global reputation. South Africa dropped to 69 out of 176 countries (64th in 2011) in Transparency International's latest Corruption Perceptions Index 2012. It is a far cry from the 43rd place of 2007. Two thirds of the 176 countries ranked in the 2012 index scored below 50, on a scale from 0 (perceived to be highly corrupt) to 100 (perceived to be very clean). South Africa's score out of 100 was just 43.

FRANCE

France's Constitutional Council took the unprecedented decision to reject the 75% income tax rate to be introduced in 2013 on incomes in excess of €1 million euros per year on the grounds it failed to respect constitutional promises of "equality before public burdens." Although a political embarrassment, the ruling is only a temporary reprieve as the government immediately indicated that it would redraft the tax rate proposal to answer the Council's concerns.

Fitch affirmed its triple-A rating for France but said there was no room for slippage. S&P's and Moody's have both stripped Europe's second largest economy of its AAA badge due to concerns over strained public finances and stalled growth.

SYRIA

The conflict in Syria continued with no resolution. International sanctions introduced to pressure President Bashar al-Assad to step down, have badly damaged the economy. It is estimated that the economy will shrink by a fifth in 2012 and all of Syria's foreign reserves could be depleted by the end of next year as the government spends billions on financing the war, public sector wages and fuel subsidies.

JAPAN

Japan saw a change of political leadership as the Liberal Democratic Party, led by Shinzo Abe, won the December elections, beating Prime Minister Yoshihiko Noda and his Democratic Party. Abe campaigned on a promise to spend heavily on public works and pressure the Bank of Japan to launch aggressive monetary easing measures to boost growth. He has also vowed to work on improving the relationship with China through dialogue.

The election results came just as the Bank of Japan confirmed that the economy shrank by an annualised 3.5% in the three months to September, after a 0.1% decline in the previous three-month period, meeting the textbook definition of a recession. The Bank also expanded its asset-buying and lending programme for the third time in the past four months.

WHAT TO LOOK OUT FOR IN 2013

Similarly to the preceding year, 2013 will be a year of uncertainty as political decisions override fundamental economics.

In the US the fiscal cliff, and in particular US$110 billion of spending cuts, and the debt ceiling issue remain largely unresolved and will likely dominate the headlines in the first quarter of the year. We expect that the fiscal cliff debate will eventually result in a compromise solution of some spending cuts acceptable to both parties in exchange for the Republicans agreeing to raise the debt ceiling. The uncertainty is, however, likely to keep the markets on edge, with the gold price acting as a barometer of sentiment swings.

Despite the compromises, the 2% increase in the payroll tax and the spending cuts to come will act as a drag on the US economic growth in 2013. This means that the US will make limited progress in reducing unemployment in 2013, ensuring that quantitative easing programme is likely to remain in place. This should act to underpin the equity markets during this period of uncertainty.

The problems in the eurozone are far from over as it will remain in a recession for the greater part of 2013. Politicians will continue to grapple with the question of how to practically impose the central banking regulator concept on individual countries' banking systems. Germany's Chancellor Angela Merkel is unlikely to deviate from the path of demanding fiscal responsibility from debtor nations as she faces national elections in the autumn. Therefore it is unlikely that the eurozone will move towards greater fiscal integration in the near future. The visible economic slowdown in Germany and France is likely to spread into 2013. The prospects of more bail-out funds for Greece and a potential rescue package for Spain continue to loom. Italy is looking more politically fragile than it did in 2012.

All indicators point to China having stabilised with some internal demand driven recovery continuing into 2013. However China is unlikely to return to the double-digit growth in the short term. This is not good news for commodity prices. The only exception is gold which will react counter-cyclically to the appetite for risk.

In South Africa risks are also on the downside. Growth forecasts were repeatedly cut as the country faced an unprecedented level of labour-related violence. Labour relations will continue to be difficult in 2013, starting with the unresolved question of the striking farm workers, while the government struggles to maintain control of the budget. Much of its success will depend on its ability to curb public sector wage increases and public spending. With the country's sovereign credit rating facing further downgrades by Fitch, and the ballooning current account deficit, the rand may well come under more pressure. However, the extension of the US quantitative easing programme should provide an underpin to the downside. Nonetheless, more than ever, the rand remains highly vulnerable to any reversal in foreign inflows. Despite the domestic uncertainty, the equity and bond markets will continue to take their cue from the international arena.

Overall, the equity markets are positioned to continue on an upward trajectory for as long as excess liquidity creates a risk-oriented investment environment. However, the same environment is highly susceptible to sentiment swings and market shocks. Political manoeuvring is no substitute for real economic growth, and hence, on a balance of probabilities, 2013 is unlikely to deliver the same returns as we have seen in 2012. Diversification and risk management remain key to a successful investment strategy.

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Directors: S. Mkhwanazi* | S. Peile | M. Wierzycka | W van der Merwe | *non-executive directors
CAPE TOWN I 7th Floor I The Foundry I Cardiff Street I Green Point I 8001
T +21 446 4940 I F +21 446 4950 I W www.sygnia.co.za I E info@sygnia.co.za
JOHANNESBURG I 9th Floor I 15 Alice Lane I Sandton I 2196
T +11 290 9360 I F +11 290 9365 I W www.sygnia.co.za I E info@sygnia.co.za

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