



Today's highlights

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Talking point: One GDP reading doesn't make a winter (or a recession)

Even as the IMF upped its GDP growth forecast for the current year from 4.2% to 4.4%, so the UK delivered a shock with the release of an unexpected 0.5% decline in GDP in the last quarter of 2010. Forecasts in the market had been for the economy to grow by 0.4%, from 0.7% in the previous quarter. While the very cold weather of recent months has been blamed for much of the decline, it seems that the harsh austerity measures introduced by the Conservative-LibDem ruling alliance may have had a little impact – statistics officials in the UK point out that the number would have been 0% if weather had been normal.

One GDP reading doesn't make a winter of discontent, still less a new recession (two successive quarterly negative readings are needed for that). However, the pressure will now be on the UK government and other European governments who have slashed spending in order to reduce budget deficits. The next few quarters will tell whether economies can still grow while adopting austerity programmes.

Market highlights

US equities closed higher overnight on good consumer confidence numbers and hopes that the State of the Nation speech by President Obama this week will bring new tax breaks. This positive news offset some poor earnings results earlier in the day.

The JSE finished weaker again yesterday, as new worries about the world economy emerged on a decline in UK GDP in the previous quarter. Mining counters bore the brunt of the selling.

Bonds continued to firm yesterday, while the rand suffered from a renewed bout of risk aversion after the release of weak GDP data out of the UK.

Commodities fell overnight, amid new global growth worries and rising stock levels in many commodity categories.

Key indicators in a nutshell – Tuesday 25 January 2011

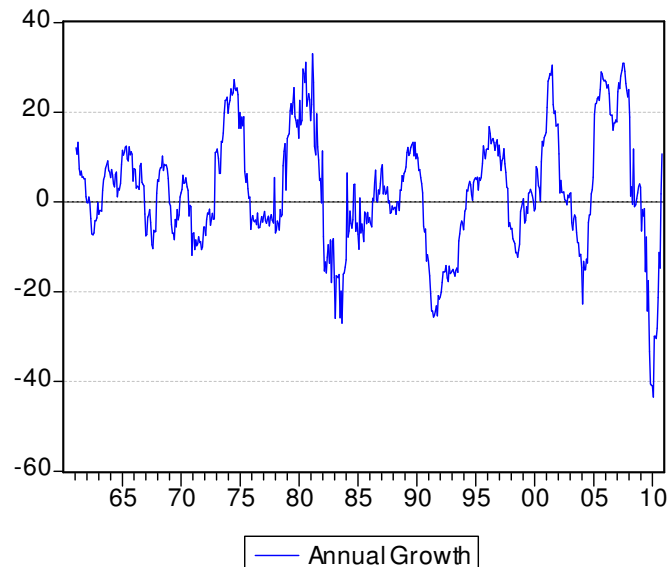
Key indicators	Last price	1 Day	1 Month	1 Quarter	Year date to	1 Year
JSE All Share	31656.63	-0.67%	-1.19%	5.68%	-1.44%	16.97%
S&P 500	1291.18	0.03%	2.74%	9.20%	2.67%	18.27%
Nikkei	10464.42	1.15%	1.80%	11.48%	2.30%	-1.19%
Rand/US \$	7.05	-0.76%	-4.50%	0.26%	-6.06%	8.30%
Rand/GB Pound	11.13	0.28%	-6.68%	-0.03%	-7.42%	10.28%
US\$/Euro	1.37	-0.31%	-4.12%	0.68%	-2.19%	3.31%
Gold \$/oz.	1333.84	-0.05%	-3.70%	0.65%	-6.16%	21.89%

Daily ideas

Earnings: The trend is your friend – but which trend?

JSE All share index earnings are highly cyclical. And the cycle is one of high peaks and deep troughs in the growth rate of earnings, as the illustration of the cycle of inflation adjusted or real earnings growth for the JSE since 1961 shows.

The cycle has been particularly vicious lately. After a surge in earnings growth after 2004, which was sustained until 2008, the growth cycle turned very negative in 2009-2010. Real earnings at the bottom of the trough in late 2009 were some 40% lower than a year before. This represented the deepest trough in the JSE earnings cycle since 1960. Real JSE earnings growth turned positive again late in 2010 and consensus forecasts would have them grow by about 25% in 2011.

The JSE Real Earnings Cycle (Year on year growth in inflation adjusted earnings per Index Share)

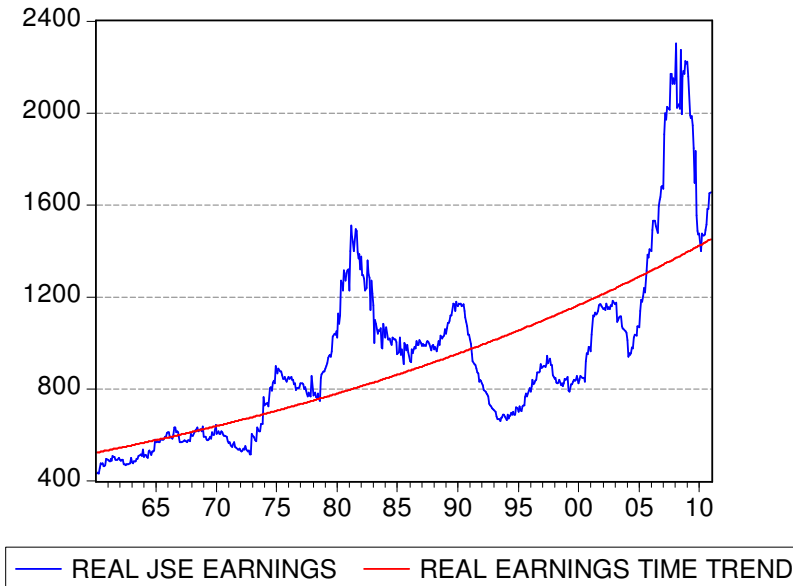
Source: I-Net Bridge and Investec Wealth and Investment

Clearly if one is to hope to assign a value to a share or an index one needs to be able to see beyond current earnings, which may be temporarily high or temporarily low. One needs to look through the cycle to what may be described as cyclically adjusted or *normalised* earnings. If actual earnings are well below normalised earnings then this would strongly encourage the sense that market valuations have significant upside as strong earnings growth materialises. Vice versa if current earnings are considered well above normalised earnings because of a period of strong growth, the expectation would be for earnings growth to slow down as earnings normalised.

The issue then is to determine how JSE earnings currently stack up against their normalised levels. One prominent SA fund manager regards the current level of JSE real earnings as above their normalised trend levels. This judgment is taken to imply an overvalued market and one likely to realise unsatisfactory returns as earnings growth slows down and reverts to trend.

We by contrast regard the reported level of real earnings as still well below their normalised or cyclically adjusted levels. Coupled with strong growth in real earnings expected over the next 24 months, this suggests to us that very promising returns can be expected from the JSE as market participants come to recognise the underlying strength of JSE real earnings.

The difference in views comes from different ways of measuring the underlying trend. As far as we can ascertain, the negative view of the market is derived from comparing current real earnings with trend earnings, calculated by estimating a simple time trend linking 1960 real earnings with their levels in 2010. By this calculation JSE real earnings are indeed below their long term trend.

JSE real earnings compared to a simple time trend

Source: I-Net Bridge and Investec Wealth and Investment

We would argue that such a method used to establish the long term trend in real earnings is misleadingly naive. It implies that the economic fundamentals of the JSE are unchanged between 1960 and 2010. Surely this is not the case. The globalisation of the sources of JSE earnings has transformed the character of the JSE since 1995 and especially over the past 10 years. The JSE has become much more a play on the global economy than on the SA economy given the increasingly global scope of an Anglo American, BHP Billiton, SABMiller or Richemont. We calculate that only about 25% of the earnings of the JSE can be attributed to the SA operations of JSE listed companies. More important, when calculating the earnings potential of the JSE, such developments are of recent origin.

There is another relatively recent and very important force acting on earnings. This is the move from the deflation of metal and commodity prices in the eighties and nineties to the inflation of commodity and metal prices that began in the late nineties with the surge in global demand, emanating from China in particular. This deflation depressed JSE Resource company earnings from their highs in the late seventies and early eighties for about 20 years. Gold mining, which was such a major contributor to JSE earnings in the seventies had become insignificant by the turn of the century. It has not revived despite the extraordinary increase in the price of gold.

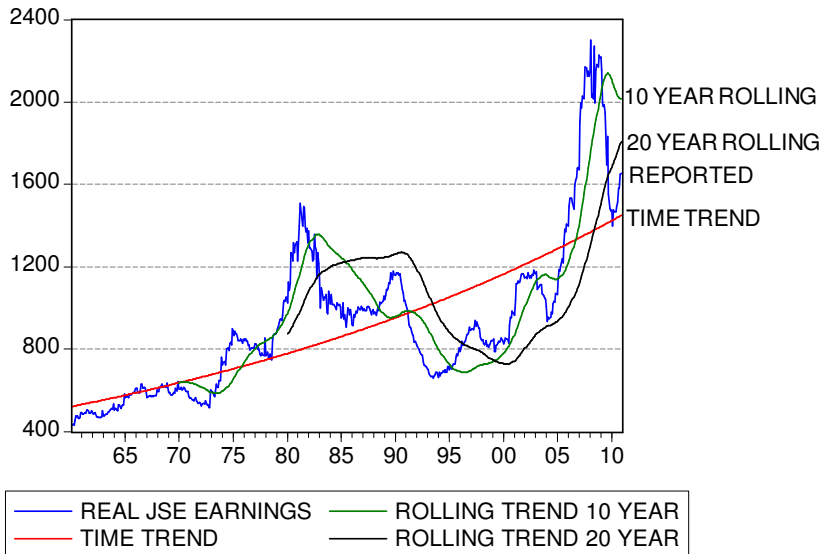
A simple very long term time trend of the kind shown above surely cannot capture all this structural change. In other words, there is much more than a very regular JSE earnings cycle at work over the long run. The future of real JSE earnings will be decided by the pace of the global economy and especially the influence this has on commodity prices.

The question to be considered is whether the surge in real JSE earnings represents a permanent move in earnings potential to a higher sustainable level, or a temporary development that will be reversed, reverting earnings to their very long term trend.

Time, not statistical analysis, will give the answers. But statistical analysis can do more than simply run a trend through a very long series of numbers over time. Our measure of normalised earnings attempts to adjust for potential changes in the structure. It does so by estimating a time trend for an initial period, 10 or 20 years, and thereafter re-estimating the trend. In this way we establish a rolling rather than a fixed trend as the estimate catches up with the realities.

The differences in results as we show can be very significant. By our calculation, reported JSE real earnings are still well below normalised or cyclically adjusted real earnings rather than above them as implied by the simple time trend, thus implying considerable scope for further growth and for a much higher level of sustainable real earnings.

Reported, rolling and time trend earnings



Source: I-Net Bridge and Investec Wealth and Investment

When these different measures of earnings are translated into price to earnings multiples the differences are also marked. The JSE traded at about 17 times reported earnings at year end 2010; at 19 times simple time trend earnings; and only about 14 times our estimate of ten year rolling earnings.

The average price over reported earnings multiple for the JSE has been 13.8 times since January 2000 with a recent high of 17.5 times and a low of 8.2 times in early 2003. By contrast the JSE price to our rolling estimate of earnings (measured over 10 years) has averaged 14.5 times with a high of 21.6 times in early 2006 and a low of 8.5 in early 2009.

By reference to rolling normalised earnings the JSE is now very fairly valued. However with strong growth in real earnings expected over the next 24 months it is our view that the JSE will deliver good returns as these real earnings materialise and normalise. **Brian Kantor**

Upcoming dividend dates and corporate actions

Share/security	Last day to trade	Ex-dividend	Record date	Pay date	Description	Per share amount/ result
Mobile	28 January	31 January	4 February	7 February	Unbundling	8.117 TRE in addition to every 100 MOB
Premium	28 January	31 January	4 February	7 February	Rights issue	20.5 PMMN per 100 PMM
SBR003	28 January	31 January	4 February	7 February	Interest	R1.60
Tradehold	28 January	31 January	4 February	7 February	Consolidation	1 new TDH per 10 old TDH
Foord Compass	4 February	7 February	11 February	14 February	Scrip Dividend	53.846c or 7.342 FCPD per 100
UCS	4 February	7 February	11 February	14 February	Cash Dividend	R0.05
Digicore NPLs	11 February	14 February	18 February	21 February	Rights take up	1 DGNN converts to 1 DGC at R3 a share
Massmart	11 February	14 February	18 February	21 February	Scheme of Arrangement	Proposed acquisition of 51% of MSM by WalMart
Trematon	11 February	14 February	18 February	21 February	Cash Dividend	R0.015
Winhold	11 February	14 February	18 February	21 February	Cash Dividend	R0.10
Dialogue	18 February	21 February	25 February	28 February	Capital reduction	R0.1238
Premium NPLs	18 February		25 February	28 February	Rights take up	1 PMMN converts to 1 PMM on take up at R15 per unit
RMB Holdings	25 February	28 February	4 March	7 March	Unbundling	1 Rand Merchant Insurance Holdings per RMH
Paracon	4 March	7 March	11 March	14 March	Cash Dividend	R0.10
Simeka Business Group	4 March	7 March	11 March	14 March	Name change	Morvest Business Group (MOR)
SBR002	4 March	7 March	11 March	15 March	Interest	R1.41
JOZI03	11 March	14 March		22 March	Interest	R14.83
Foschini Prefs	17 March	18 March	25 March	28 March	Cash Dividend	R0.065

Source: JSE

Company calendar – 26 January to 2 February

Wednesday 26 January	Country Bird interims Capital Shopping Centres EGM Barloworld AGM
Thursday 27 January	Adcock Ingram AGM Life Healthcare AGM Lonmin AGM and quarterly production
Friday 28 January	Zurich Insurance finals
Monday 30 January	Redefine AGM

Source: I-Net, Company updates

Economic calendar – 26 January to 2 February

Date	International	South Africa
Wednesday 26 January	US – December New home sales [16h00] US – FOMC meeting closes	
Thursday 27 January	Japan – December Trade balance Germany – January CPI prelim [09h00] EMU – January Business and consumer confidence [12h00] US – Initial jobless claims for previous week [14h30] US – December Durable goods sales [14h30] US – December Pending home sales [16h00]	December PPI [10h30]
Friday 28 January	Japan – December CPI Japan – December Unemployment Japan – December Retail sales EMU – December M3 [16h00] US – Q4 Real GDP advance [14h30] US – January Consumer sentiment [15h55]	
Monday 31 January	Japan – January PMI manufacturing Japan – December Industrial production prelim EMU – ECB monthly bulletin [17h00] US – December Personal income [14h30] US – January Chicago PMI [15h45]	December PSCE and money supply [08h00] December Trade balance [14h00] December Exchequer account [14h30]
Tuesday 1 February	China – January PMI Germany – January PMI manufacturing [10h55] Germany – December Unemployment [10h55] EMU – January PMI manufacturing [11h00] EMU – Dec/Jan Unemployment [12h00] UK – January PMI manufacturing [11h30] UK – December M4 money supply [11h30] US – January ISM manufacturing [16h00]	January Kagiso PMI [11h00] January New vehicle sales [11h00]
Wednesday 2 February	EMU – December PPI [12h00]	

Sources: Bloomberg, StatsSA, SA Reserve Bank, NAAAMSA

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Key market indicators – Monday 25 January 2011

Indices	Last price	1 Day	1 Month	1 Quarter	Year to date	1 Year
JSE All Share	31656.63	-0.67%	-1.19%	5.68%	-1.44%	16.97%
JSE Fini 15	8145.27	-0.42%	0.51%	2.48%	-0.32%	10.00%
JSE Indi 25	26145.72	-0.21%	-2.47%	4.46%	-2.41%	25.79%
JSE Mining	36745.88	-1.33%	-1.27%	8.35%	-1.21%	10.36%
JSE Resi 20	55921.56	-1.24%	-0.47%	8.97%	-0.68%	11.86%
S&P 500	1291.18	0.03%	2.74%	9.20%	2.67%	18.27%
DJI	11977.19	-0.03%	3.49%	7.65%	3.45%	17.74%
NASDAQ	2719.25	0.06%	2.01%	8.63%	2.50%	23.31%
Nikkei	10464.42	1.15%	1.80%	11.48%	2.30%	-1.19%
Hang Seng	23788.83	-0.05%	4.18%	2.69%	3.27%	14.78%
FTSE 100	5917.71	-0.44%	-1.52%	4.81%	-0.89%	11.59%
CAC 40	4019.62	-0.34%	3.06%	5.34%	5.65%	5.20%
DAX	7059.01	-0.12%	0.02%	7.48%	2.09%	23.94%
ASX-ORD	4909.00	0.43%	0.84%	3.99%	1.28%	2.87%
JSE All Share (in US\$)	4492.98	-1.42%	-5.63%	5.95%	-7.41%	26.68%
MS EM Index	1135.92	-0.07%	0.81%	3.37%	-1.34%	17.85%
MS World Index	1310.93	-0.10%	2.86%	7.99%	2.41%	14.00%

Currencies	Last price	1 Day	1 Month	1 Quarter	Year to date	1 Year
Rand/US \$	7.05	-0.76%	-4.50%	0.26%	-6.06%	8.30%
Rand/GB Pound	11.13	0.28%	-6.68%	-0.03%	-7.42%	10.28%
Rand/Euro	9.64	-1.07%	-8.40%	0.97%	-8.25%	11.88%
Rand/Aus \$	7.01	-0.54%	-3.56%	-1.97%	-3.60%	-1.81%
Yen/ US \$	82.26	0.34%	0.75%	-0.69%	-1.40%	9.21%
Swiss Franc/US \$	0.94	0.75%	2.10%	5.05%	-0.83%	10.52%
US \$/Euro	1.37	-0.31%	-4.12%	0.68%	-2.19%	3.31%
US \$/GB Pound	1.58	1.05%	-2.37%	-0.26%	-1.30%	1.83%
US \$/Aus \$	0.99	0.25%	0.85%	-2.25%	2.78%	-9.12%
Nominal Effective Exchange Rate (2000 = 100)	75.96	-0.41%	6.21%	0.16%	6.98%	-6.46%

dailyview

Commodities	Last price	1 Day	1 Month	1 Quarter	Year to date	1 Year
Gold \$/oz.	1333.84	-0.05%	-3.70%	0.65%	-6.16%	21.89%
Platinum/oz.	1787.5	-1.54%	3.62%	6.46%	0.99%	15.36%
Brent Crude \$/bbl	94.78	-1.86%	1.66%	15.64%	0.03%	32.30%

Fixed income	Closing yield %
SA R157	7.75
US 2 YEAR	0.63
US 10 YEAR	3.39
UK 2 YEAR	0.73
UK 10 YEAR	3.61
EURO 2 YEAR	1.26
EURO 10 YEAR	3.14

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