INTUITION

(n: immediate insight; receive knowledge by direct perception)

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HARVARD HOUSE GROUP

Empowering knowledge and insight exclusively from the Harvard House Group of companies

INTUITION
Market Insight from the Harvard House Group

ALL ABUZZ IN THE LISTED PROPERTY SECTOR

Nigel Porter

The listed property sector is a hive of activity at present. One normally assumes that market activity will enter a lull as the December holiday season approaches. Far from it. Mergers, acquisitions and new listings are rife, and point to a sector alive with activity and in huge demand from investors. Existing clients only stand to benefit.

A tussle is brewing over the UK's prime shopping centres

London: Capital Shopping Centres (Capshop) has announced that it has reached agreement with the Peel Group to buy The Trafford Centre near Manchester. The Trafford Centre is one of the UK's most successful retail and leisure destinations, attracting 35 million customers annually, with 1.9 million square feet of retail catering and leisure space. In order to fund this acquisition Capshop will place 62.3 million new shares with institutional investors, representing up to 9.9% of the existing shares in issue.

Post the acquisition, Capshop will own 14 UK shopping centres including 10 out of the top 25 centres, and 4 out of the top 6 out of town shopping centres. This is a formidable portfolio that we would argue cannot be replicated through development. That makes Capshop an attractive long term investment.

The Trafford Centre in Manchester, England.

The attraction of Capshop is perfectly illustrated by the following news. At much the same time, the Simon Group of America has written to the board of directors of Capshop expressing its intention to make a bid for 100% of Capshop. The Simon Group has asked the directors not to proceed with the acquisition of the Trafford Centre, pending the opening of negotiations to buy 100% of Capshop. However, the directors of Capshop declined this request and have proceeded to issue 62.3 million new shares in order to have the funds available to buy the Trafford Centre. At the time of writing, and ahead of a key shareholder vote on the issue, Simon has made an indicative offer to all shareholders of Capshop to buy their shares at a price of 425p per share (equivalent to 4500 SAc).

When Liberty International split into Capital and Counties and Capital Shopping Centres respectively, financial analysts made the comment that either one of them could be ripe for a takeover bid. That prediction would appear to be very much on the cards. There is much uncertainty as to how the final act will play out, or whether the Simon Group will actually follow through with its intended offer. What is clear is that investors are recognizing the uniqueness and attractiveness of Capshop's portfolio of properties.

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Hyprop gobbles up rival Attfund Retail

Johannesburg: Hyprop has reached agreement with Attfund Retail (a large, but unlisted property fund) to acquire 100 % of the shares in Attfund Retail, with the purpose of acquiring its portfolio of properties and listed securities. The purchase price will be R8.9 billion which will be paid through a combination of issuing 112 million new shares at R54 each, with the balance in cash.

Through this transaction, Hyprop will not only acquire the direct shopping centres and office blocks currently owned by Attfund Retail, but it will also acquire almost 9 million units in Sycom, and 2.6 million units in Acucap. It is interesting to note that Hyprop already owns over 75 million units in Sycom. This transaction will take their holding to over 84 million units or 41% of the company. Acucap in turn 18.3 % of Sycom, so the battle for control of Sycom is hotting up. A further point to note is that Redefine now owns 45.7 % of Hyprop. So consolidation and control are the order of the day.

Canal Walk in Cape Town is part of Hyprop's retail portfolio

Merger of equals: Capital ties up with Pangbourne

Johannessburg: Capital Properties (not to be confused with Capshop) has announced its intention to make a firm bid to acquire all the outstanding shares that it does not already own in Pangbourne Properties. If it succeeds, then Capital will become the third largest property company on the JSE after Growthpoint, and Redefine. Pangbourne will be delisted, and clients who own shares in that company will receive new shares in Capital in exchange for their shares in Pangbourne.

The rationale behind the tie-up is quite simple. Both funds are controlled by the same ultimate management team, being Des De Beer and his colleagues at Resilient. Both Capital and Pangbourne are both focused on industrial properties. Having two funds with the same focus and with the same management team has always raised questions, and this deal was not a question of "if", but rather one of "when." We expect shareholders to vote in favour and for the transaction to be consummated in March.

OFFSHORE FUND RAISES CASH FOR EXPANSION

Bucharest: New European Property Investments (NEPI) has held a rights issue, in terms of which existing shareholders could apply for 24.2 new shares for every 100 shares held at 2600 cents per share. The shares have been trading above 3000 cents for the past four months, so the rights offer price was attractive. We have subscribed for the full allocation of rights for all those clients who had sufficient funds to pay for them. NEPI is using the money to further expand its property portfolio in Romania, through the acquisition of additional office and retail space in the heart of Bucharest. Despite the woes being faced in Western Europe, we remain very upbeat on NEPI as an under-appreciated share in an attractive segment of the market.

INVESTORS CHEER NEW ARRIVAL TO JSE

Cape Town: Vividend Income Fund is a newly listed company in the property sector. Whereas most of the other listed funds have a focus on large properties, Vividend has found its niche in smaller properties that have a value between R30 million and R100 million. The company has found that in this segment, properties are too expensive for private investors, whilst they are also too small for the larger funds that we know so well. It raised over R500 million through its listing to take advantage of perfect conditions for building a smaller, yet quality portfolio. The company was listed at 500 cents per share on 18 November 2010, and gives a fresh option to clients who need an income from their investments. We have met with management, and they are confidently forecasting a dividend yield of 11% on the issue price within 24 months of listing.

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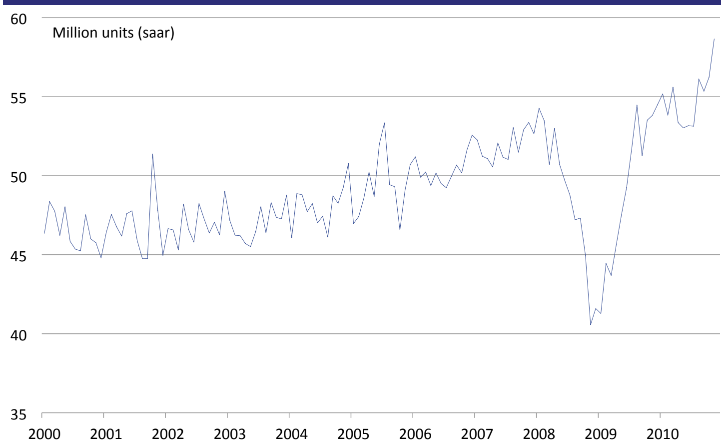
PLATINUM: GLOBAL VEHICLE SALES SOAR

Michael Porter

What a difference a year makes! How many times have you heard that expression, yet it is always amazing to look back and see how quickly conditions can change given the right environment. During the height of the Financial Crisis, one of the industries most hard hit by the fallout was the auto industry. Trading conditions got so tough that General Motors filed for bankruptcy, and other household names were not far behind. Governments responded. Being large employers, they could see a veritable tsunami of retrenchments looming should car sales collapse. The short term answer was to offer all manner of incentives to encourage people to buy new cars. So called "scrappage schemes" (where cash was offered to those willing to trade in an old banger for something a lot more shiny and new) sprang up across Europe and the US. These schemes worked, but skeptics were quick to pronounce that their only benefit would be to bring forward sales – not necessarily create long-lasting demand. Predictions were for a surge in sales in response to the schemes, followed soon thereafter by a total collapse.

We now have the benefit of hindsight on global vehicle sales for the last eighteen months, and what a show it has been. At the worst point of the Financial Crisis, global car sales plummeted to just over 40 million units (on an annual basis.) Eighteen months later, that number has literally soared to 59 million units (annualized) – a gain of almost 50%. What is even more notable is that the US is no longer the world's largest car market. That position now belongs to China. In November,

GLOBAL AUTO SALES



Mercedes is battling to keep up with demand.

US car sales were running at 12 million units p.a. In contrast, Chinese car sales were running at 16 million units p.a. We have long highlighted the potential for China, and this is now becoming apparent for all to see. What's more, car ownership in the US is approximately 850 cars per 1000 people. The same ratio in China is a mere 50 cars per 1000 people. It appears that Chinese sales can still accelerate much further.

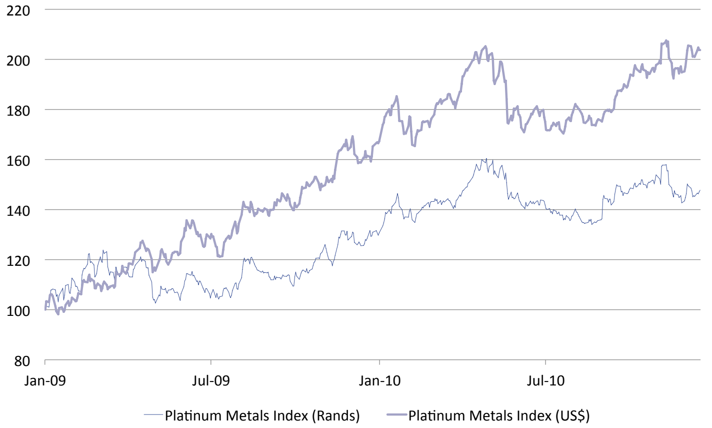
What has all this got to do with us? The good news is that all these cars have exhausts, and all exhaust systems need either platinum (used mainly in diesel cars) or palladium (petrol cars) to clean the fumes and reduce harmful emissions. Indeed, autocatalyst demand already accounts for 40% and 57% of all platinum and palladium demand respectively. This is being driven higher all the time by ever tighter emission standards in the developed world, and increasingly stringent standards in new, emerging countries such as China and India. What's more, the US and Europe have recently introduced legislation that makes it compulsory for extra heavy vehicles (mining and farming equipment for example) to also have autocatalysts fitted. Taken together, this all points to sustained demand for both metals over the new few years.

Unfortunately, the local platinum industry has had a relatively torrid year. Anglo Platinum is one of the few shares in the Top 40 Index to be down for the year to date. The platinum price in dollars has been rangebound for most of the year, although recently, the price has climbed along with other commodities. Unfortunately, all of this benefit has been outweighed by the strong Rand. The chart on the next page highlights the discrepancy between a basket of prices (platinum, palladium and rhodium) in Rands and in Dollars.

Looking forward, the immediate profitability of the sector depends heavily on the direction of the Rand, which remains as unpredictable as ever. Longer term however, there appears to be a growing possibility of a shortage in both platinum and palladium. South African mines are struggling to expand, given the pressures of the Rand, safety issues, rampant electricity costs and inflexible labour unions. Despite forecasts of growing production, total production from all South African mines combined is lower now than it was five years ago.

Static supply and growing demand imply only one outcome – higher prices. This, together with a weak dollar and growing demand for real assets such as precious metals, all point to a rosy future. Despite the poor performance over 2010, we remain platinum bulls and will continue to add platinum shares to portfolios to take advantage of what we see as an increasingly bright future.

PGM BASKET PRICES IN ZAR AND USD



STANDARD BANK: THE HALO IS SLIPPING

Michael Porter

Long standing clients will know that we have always held Standard Bank in high esteem. History will show that it has endured periods of lacklustre performance, the last ending when Nedcor made a cheeky, hostile bid for the company back in 2000. Ten years ago, Nedbank was the flavor of the month, the darling of every investor's eye. It could do no wrong. Standard Bank was the opposite, and suddenly found itself fighting for survival as Nedcor launched its attack in what could only be described as a "David vs Goliath" story.

Standard Bank won the battle. It fended off the bid, for which shareholders must be grateful. The bid acted as a catalyst for management, and they set about making changes. Standard Bank was transformed from a lumbering giant into a large, but nimble bank, that set about conquering both the African continent in particular, and emerging markets in general.

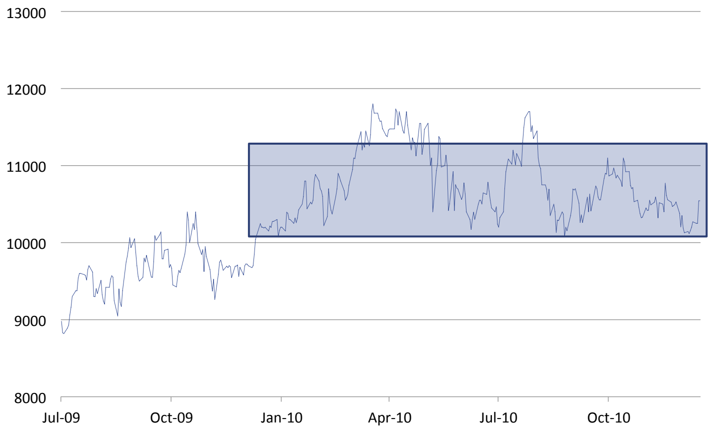
For years that strategy has paid off well, with Standard outgrowing its local rivals. However, more recently, this expansion has begun to take its toll. It was the hardest hit of the local banks by the Financial Crisis, as its global operations suffered weak volumes and low levels of activity. To add insult to injury, the African operations are growing, but costs are higher, and it is taking time to expand the suite of services to really capitalize on the potential on offer throughout Africa. (As an aside, Willie and I recently attended an African conference, and we came away with the distinct impression that Africa holds enormous potential and lucrative profits for those who can tame her.)

On top of weak international operations, all of our local banks are also contending with a weaker local economy than previously expected. Despite interest rates being at their lowest level in over thirty five years, demand for new loans remains stubbornly weak. There are encouraging signs that consumers are starting to borrow again, but corporates remain on the sidelines. Most of our big companies have plenty of cash and are not in expansion mode. This implies that there is no need to borrow money. All the banks thought that conditions would be better by now. They were wrong, and this includes Standard.

Putting all these factors together points to the fact that Standard Bank is facing pressure from all sides: a weak domestic economy, low levels of borrowing, and declining profitability in its international operations due to high costs and weak demand for its services. To top it all, the Bank has been forced to retrench 3,000 employees across the Group, which has not only turned into a public relations disaster, but will also impact heavily on this year's profits. It has been a bleak year, and one that Standard bank will gladly like to see slip into history.

Unfortunately, whilst the outlook for 2011 should be better, new rules for the global banking system will continue to impact on the Group, and there is a growing probability that the Bank may be forced to cut its dividend when it releases results in March 2011 – previously an unthinkable option. Given all these factors, investors are right to question whether the Bank has once again lost its way. We do believe that the road ahead for Standard will be harder for a while. But the Bank retains a fabulous franchise, and it continues to lay the foundation for its African expansion. Expansion and dominance in new territories does not come cheaply, but perseverance can pay off handsomely for those willing to last the entire journey. Look no further than SABMiller to see what can be achieved through slow, steady expansion into high growth markets.

STANDARD BANK



In the short term, Standard Bank faces headwinds. The share price has tracked sideways for the better part of this year, and in our opinion, it will continue to do so whilst investors digest the steady stream of bad news. In this regard, we have taken the opportunity to trim holdings where clients were overweight, and reinvest in alternative bank shares that offer more promise over 2011. But our view on the long term potential of Standard Bank remains unchanged. If the shares fall in the new year in reaction to poor results, we will be first in the queue to snap them up.

RMB HOLDINGS: DIVIDING THE FAMILY SILVER

Michael Porter

During December, RMB Holdings, the holding company for some of South Africa's most well known financial brands (FNB, Rand Merchant Bank, Discovery, Outsurance & Momentum) announced that it was to split itself into two distinct companies. Following its initiative to merge Momentum and Metropolitan Life to create the country's third largest insurance company, RMB Holdings has gone a step further to unlock value for its shareholders.

The first company to be created out of this transaction will be called RMI Holdings (Rand Merchant Insurance Holdings), and will be a holding company for a suite of insurance assets including 25% of the newly created Metropolitan/Momemtum life company (renamed MMI Holdings), 25% of Discovery, and 90% of Outsurance. We would argue that Discovery and Outsurance are South Africa's two most innovative and consequently, fastest growing insurance companies. Investors will now have a focused insurance investment through which they can tap into the future potential of both Discovery and Outsurance. Traditionally, we have always had a rather negative attitude on the insurance industry, given their general contempt for their clients. But both Discovery and Outsurance offer exciting growth prospects, and may well be worth considering in their new guise. The second company will have only one investment, being the current investment in FirstRand (which includes FNB, Wesbank, and Rand Merchant Bank.) The transaction is complicated slightly by the fact that RMB Holdings will increase its stakes in both FirstRand and MMI Holdings by buying additional shares in both companies from Remgro. In turn, Remgro will end up holding a larger slice of both companies created from the split of RMB Holdings. RMB Holdings is also taking the opportunity to increase its empowerment shareholding by selling 5% of its shares to the Royal Bafokeng Nation.

At the end of the day, the transaction makes sense for all parties. We have always invested in RMB Holdings as opposed to FirstRand for the very reason that the initial founders of RMB Holdings and FirstRand (GT Ferreira, Laurie Dippenaar and Paul Harris) held their wealth through RMB Holdings, and therefore would look always look after their own wealth when deciding the future. This strategy has borne fruit. We do not expect major resistance from shareholders for this transaction, and expect it to be finalized by March 2011. More news and the impact on portfolios will be communicated in due course.

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2011: A QUICK LOOK INTO THE FUTURE

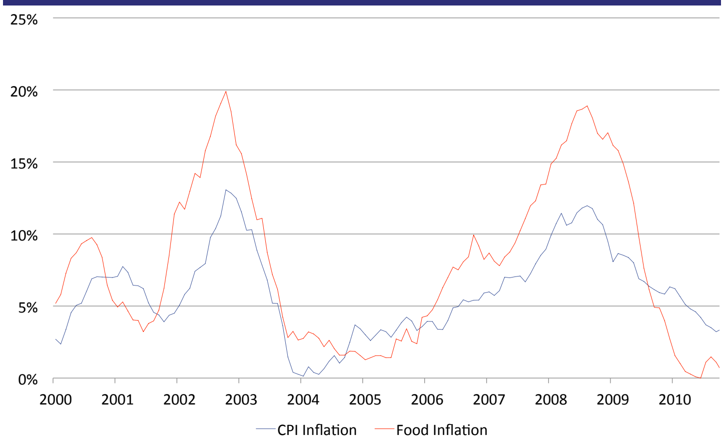
I am sure that I am not the only one to marvel (or should that be despair) at how quickly the years seem to come and go. It hardly seems possible that 2011 is just a few days away. Looking back at the year just past, one trend that stood out was the extreme volatility across all financial markets. Whether it was the JSE, currencies or government bonds, prices and markets gyrated in all directions. In our opinion, this is the surest sign that the majority of investors are very uncertain of the future. Instead of thinking rationally, investors are reacting to each individual piece of news.

One of the landmark events for financial markets during 2010 was the announcement of "QE2." When we think of the QE2, the majority of us remember the magnificent cruise liner, undoubtedly the finest ship of the day. Today QE2 refers to the policy of the US Federal Reserve of printing money hand over fist. In the short term, this policy has been good for stock markets. Money has been sloshing around the world, looking for a suitable home. With cash offering such poor returns, shares have been the natural beneficiary, and markets have risen accordingly. Looking ahead into 2011, this becomes our "Global risk: No 1." If the economic data improves during the course of 2011, the Federal Reserve will be under pressure not only to stop QE2, but also to begin the process of normalizing interest rates by raising them to more sustainable levels. Such action could see money being drained from the system. Having benefitted from the flood of money, shares could suffer when the tide goes out.

Whereas the above risk is linked to improving economies, our "Global risk: No 2" is linked to a further deterioration across Europe. At the other end of the scale, there is a growing risk that following bailouts in both Greece and Ireland, that the rot spreads to Portugal and Spain, and possibly even Italy. In each case, the potential size of the problem gets bigger and bigger, to the point where it will simply not be possible for Germany and France (the core of Europe) to continue to fund the bailouts. In such a scenario, the dominoes will fall and the Euro will fight for its very survival. That would have implications for the world as a whole. This is not our mainstream forecast, but stranger things have happened!

Looking closer to home, we see reason for both optimism and pessimism. Reasons to be optimistic include record low interest rates, real growth in incomes (salaries are rising faster than inflation), a recovery in the residential property market, and strong growth overseas that is creating demand for some of our exports. On the flipside, businesses have no need to invest in new capacity as there is plenty of slack available, manufacturing is weak, and we have a growing concern that inflation might rear its ugly head sooner than expected. This might force the Reserve Bank to hike interest rates in the latter part of next year, much earlier than is currently predicted.

CPI INFLATION



When all is said and done, investing always boils down to valuations. In this regard, we do not believe that local shares are cheap, although they are not overly expensive either. However, we do think that markets are pricing in strong profit growth for 2011, which may be harder to achieve if our economy remains more sluggish than expected. At the time of writing, the JSE had delivered returns for the year of almost 17% (capital appreciation and dividends.) That is a strong performance relative to inflation of less than 4%, and reaffirms the rationale behind investing in shares in the first place.

Whilst our prediction for a sideways trend in 2010 failed to materialize, we do feel that the JSE is ripe for a period of consolidation that allows the economic fundamentals to catch up with the current level of share prices. If this scenario does come to pass, then our relentless focus on dividends and income will stand our clients in good stead.

INSIGHT SEMINAR: KZN MIDLANDS

It is hard to believe that another year has come and gone so quickly. We are now looking ahead to 2011 and planning our seminars for next year. Given that the start of the year is always full of good intentions, we have decided to open the season with a focus on the art of savings and investment for the long haul. Markets are so volatile and there is so much news in the modern age that we tend to forget the basics that will ensure a successful investment or happy retirement.

These functions continue to draw a lot of support, for which we are very grateful. All clients are welcome, and please invite friends along if you feel they may benefit from the evening.

	Natal Midlands
Topic:	The art of long term saving
Date:	25th January 2011
Venue:	Cowan House Dining Room
Address:	11 Dennis Shepstone Drive, Hilton
Time:	5.30pm for 6pm
RSVP:	Cynthia Hirsch on 033 330 2164 or cynthiah@hhgroup.co.za

For more information on the range of products and services offered by Harvard House Investment Management and its associated companies (including Harvard House, Chartered Accountants), or for any financial advice, please contact the Company at:

Harvard House
3 Harvard Street
Howick 3290
South Africa

PO Box 235
Howick 3290
South Africa

Tel: +27 (0) 33 330 2164
Fax: +27 (0) 33 330 2617
E-mail: admin@hhgroup.co.za
Website: www.hhgroup.co.za