

Dear Investor

26 August 2010

Oh dear. It seems like the big bad wolf has arrived in the US housing market. In one of the most shocking weeks for market and economy followers in the US, it seems as if the roof has caved in with home sales plunging more than ever. Yes, the big bad wolf has now blown down all the straw and stick houses of QE and low interest rates. So where will all the little pigs run to now? The brickhouse? Is that what they call US Treasuries now? Read on for our take on this week's market and economy developments.

Regards  
Murray

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## View

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Incoming macro data continues to disappoint to no end with a disproportionately large emphasis likely to be placed on Fed Governor Bernanke's testimony at Jackson Hole tomorrow. Week-to-date the US has witnessed some of the worst housing statistics in history, clearly emphasizing that despite gigantic stimulus over a 3 year period, there seems to be no light yet at the end of the tunnel.

Inventories of unsold new homes reached its lowest level since September 1968 (210k), pushing Months' Supply back towards double digits, while existing family home sales experienced its biggest one-month drop in history, with inventories rising to just shy of 4mio, its highest level since 1999, while the supply of unsold single-family homes reached its highest level since 1982.

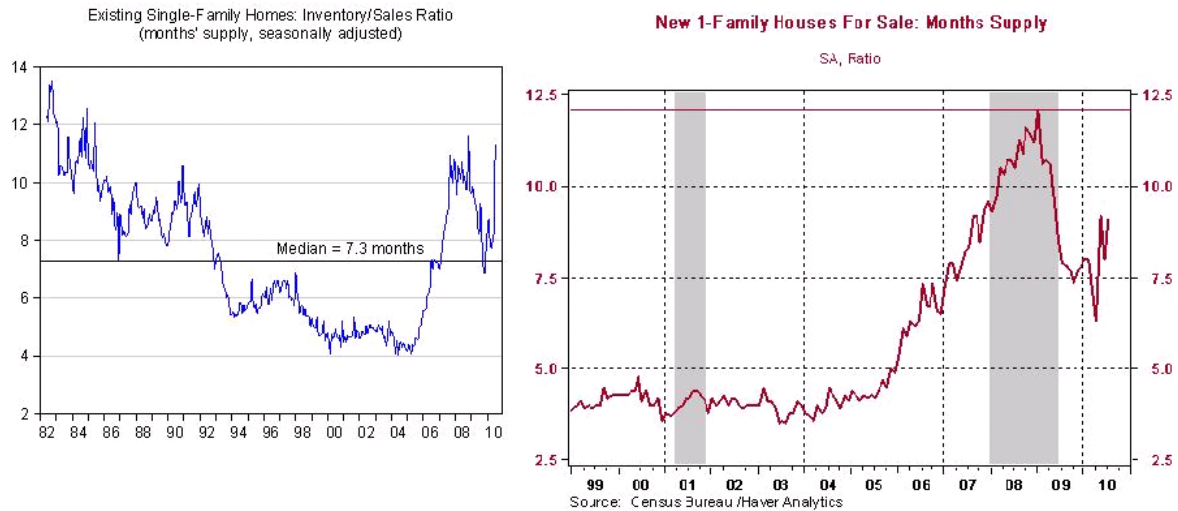
Clearly a new strategy is required.

If we further compare these notes to a point raised by one of our close friends in the macro business, based in Austria, clearly the outlook for risk seems to be on the increase. The latest Congressional Budget Office's (CBO) estimate of the impact of the American Recovery and Reinvestment Act (ARRA) on the US economy indicated that 3.1% of 2Q10 US GDP was a function of ARRA (i.e. government stimulus), indicating that the economy would probably be contracting right now without stimulus.

Ireland's woes also appear on the increase, while despite a successful auction, Portuguese spreads have risen dramatically, and so has Greece's.

Are we thus setting up for a tough end to the year as stimulus starts to fizzle out?

**Figure 1: 3 years after the first government stimulus (the ECB injected €95bn into the banking market to try improve liquidity post the first warning signs of the pending credit crisis – New Century Financial filing for bankruptcy, Bear Stearns' hedge funds collapse, BNP liquidity issues), the US housing market is in some sense in an even worse state than when it all started...**



## Fixed Income

There is no doubt the SARB's MPC will be taking notes of the developments highlighted above. And clearly macro developments have led to large-scale capitulation on the sell side recently. We count official calls for interest rate cuts to be running somewhere around 15 analysts now (while acknowledging that we are not subscribed to all sell side houses' research). When we take in consideration that at the July meeting 8/26 analysts were calling for a cut, it would appear that consensus now at last seems to be siding with the market that a cut is probably more of a necessity than a nice-to-have.

A popular argument we have seen on why a pause would be the more appropriate outcome is that interest cuts to date justify the current low inflation prints – indicating that the SARB was indeed not reactionary, but proactive. Interesting then looking at both a basic Taylor Rule model, as well as the current MCI indicate that there is room to reduce rates by at least a further 50bp.

We have already in the past called for a more open mind to incoming global data, while also pointing out that time would probably be the only real true recalibrator of this ongoing balance sheet recession. Unfortunately, the lack of traction that policy actions appear to have offshore stands the risk of not only perpetuating deflationary risks but affect global sentiment to such an extent that it could start to impact emerging markets as well(lack of final demand).

A further issue is authorities' ongoing concern about the strength of the Rand.

It will therefore be very interesting to see how the MPC approaches this particular meeting. Clearly the short-term downside risks for inflation continues to build as oil, white maize and the Rand continues to surprise all and sundry on the pleasant side. Furthermore, the meaningful slowdown on the services side is now also starting to impress. While we remain highly concerned about high ULC coupled with low productivity, it would appear that this is a concern for somewhere further down the line at present.

The MPC appears to be faced with a situation where the US is very likely to announce further stimulus measures at some point soon (and let us hope this takes the form of infrastructure investment rather than further cash injections in an attempt to directly stimulate further demand), causing continued record low global interest rates, likely leading to further foreign inflows as record low developed market yields supports the carry trade.

The only likely solution here seems for the SARB to acknowledge that their inflation forecast is now heavily outdated and likely to surprise across 2010 and 2011 by at least one percentage point. So while they may not acknowledge that they would be cutting to weaken the Rand, a cut supported with a warning of more to come may see the Rand come under some pressure, an outcome much desired as they look to inject some life into the local economy.

## Global

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Did you know that the US 10-year note is currently at similar levels to that of January 2009, when the S&P 500 was trading at 800? Given all that we have written above it would be interesting to gather your take which one of the two is 'wrong' at this stage...

Interestingly, it would appear 2v10 flattening is starting, and if it is indeed the case, and as BNP correctly argues, the deleveraging this flattening compels will not be pain-free.

Another issue that has caught our attention is the 110bp 4-month rally witnessed in Australian government bond yields, this despite this country leading the 'hiking pack'.

Thus, my favourite macro commentator captured the essence of the issue again – this time by spotting a comment made by one of his favourites in return – as Dave Rosenberg correctly points out the following quote from the Lex Columnn:

*'For investors, the only thing worse than a low-yielding world is denying that it exists'*

## FX

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It is official, I have run out of acronyms for the Rand, and given the price action I truly hope so has the rest of the market. We have been bombarded with negative commentary on the unit for months on end now, and perhaps all we need is for the last bear to give up on the upside for it to crack.

However, over the past week again we have been faced with reports including HSBC bidding for Nedbank and Jacob Zuma 'asking' BRIC if he can join the club – didn't know that it was a function of signing an application form and Bob's your uncle (pardon the pun Mr. Mugabe) – but be that as it may, the Chinese visit is more than likely to bring at least one interesting FDI offspin in time to come (wouldn't it be great if the Sandtonites got their way with a fastlink down to Durban as a way to get their Michaelhoosians quicker to school?!)

Anyway... the SARB is now left with the unenviable task of 'doing something about the strength in the Rand'. I for one will be extremely interested to see how they are going to tackle this tough nut.

	High	Low	Average	Previous Close
R157	7.36	7.10	7.25	7.29
USDZAR	7.42	7.27	7.35	7.32
EURUSD	1.2736	1.2588	1.2668	1.2712
DJIA	10411	9939	10155	10416
S&P500	1092	1040	1064	1094
JSE ALSI	27491	26432	27076	27287
GOLD	1242	1210	1230	1232
BRENT	75.06	71.01	73.00	74.63

## Albert's Quote of the Week :

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The world is full of willing people, some willing to work, the rest willing to let them. - Robert Frost

Success is not final, failure is not fatal: it is the courage to continue that counts. - Sir Winston Churchill

## From the Atlantic Team

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