Sanlam Investment Management

INVESTOR CONFIDENCE INDEX

FIFTEENTH PUBLISHED REPORT

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Despite news of a still-deteriorating global economy, doubts as to whether rescue plans would have the necessary impact, worldwide retrenchments and continued uncertainty about corporate earnings, South African investor confidence improved slightly in early February. However, on aggregate, a negative mood still persists among the financial advisers and investment professionals polled by Sanlam Investment Management (SIM) in its monthly Investor Confidence Index.

Although for only the second time since its inception, all four indices surveyed in the survey slightly improved during the same month, it was clear that investors were hesitant to be overly optimistic on market returns.

Local investors were more upbeat on the outlook for market returns, the value of the market, on the expected return on a day after a big decline in the market, as well as on the deemed probability of a severe market crash. Improvements among institutional investors, however, were not as unanimous, with some deterioration amongst this group with respect to the outlook for 12 month returns.

On a 12 month basis, institutional investors now expect the index level to rise by only 5.1 percent, whereas financial advisors expect the index to rise by 10.7 percent. In contrast to the institutional investors, financial advisors surveyed expect positive results from the market over a twelve month period. Should advisors be correct in their average expectation, the twelve month total return from equities, including dividends, would be in excess of fifteen percent nominal or nine percent real, assuming inflation returns to within the South African Reserve Bank’s target range.

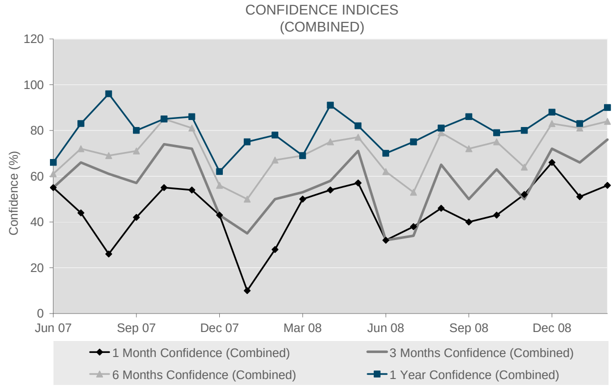
Investors’ hesitance to be overly optimistic on market returns, despite their optimism with respect to valuation, is likely to be a symptom of continued uncertainty about corporate earnings. The deteriorating global economic conditions and uncertainty about whether rescue plans will turn the tide, may have resulted in an inability to forecast write downs and the outlook for earnings developing into a chronic uncertainty. Without an anchor for earnings, confidence in valuations cannot be high and investors are likely to be loath to act on the value they think the market might be offering.

Frederick White
Head of Research and Process
Sanlam Investment Management

1. One-Year Confidence Index

Question: How much of a change in percentage terms do you expect in the JSE All-share Index during the following periods: one month, the next three months, the next six months and the next year?

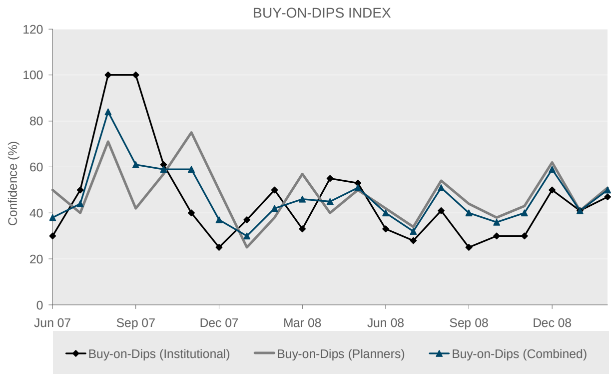
The index is calculated as the number of respondents giving a number strictly greater than zero for the “In one Year”. The index therefore reflects the percentage of the sample that expects the JSE All-Share Index to end positive over the next X months.



2. Buy-on-Dips Confidence Index

Question: If the All-Share were to drop by 3% tomorrow, what would you think the All-Share would do the day after tomorrow?

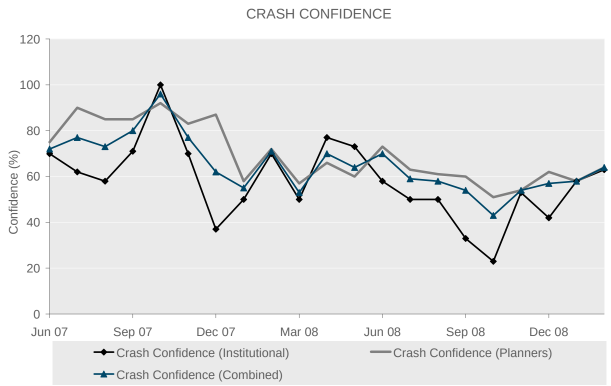
Three options are available namely Increase (%), Decrease (%) or stay the same. The Buy-on Dips Index is the number of respondents that choose an Increase as a percentage of the total number of respondents. The index therefore shows the percentage of the respondents expecting a rebound the next day should the market drop by 3% in one day.



3. Crash Confidence Index

Question: What do you think is the possibility of a catastrophic market crash (like 28 October 1928) occurring during the next six months?

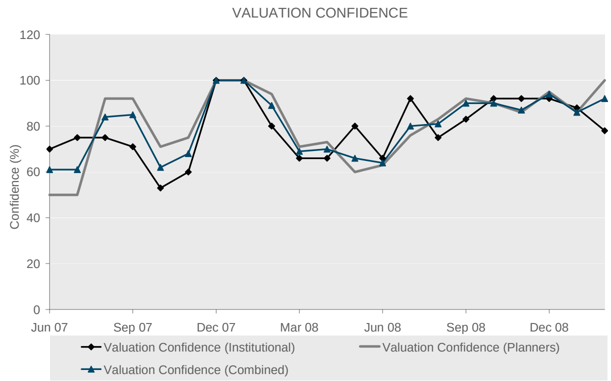
An answer of between 0% and 100% may be given, with 0% meaning it will not happen and 100% it is sure to happen. The index is the percentage of respondents who think that the probability is less than 10%. Therefore shows the percentage of respondents who attach little probability to a stock market crash in the next 6 months.



4. Valuation Confidence Index

Question: Stock prices in South Africa, when compared with measures of true fundamental value, are too low, too high, or just right?

The valuation index is the number of respondents who choose too low or just right as a percentage of the total number of respondents. It therefore reflects the number of respondents who think that the market is not too high.



Report methodology

Confidence in the equity market is more complicated to ascertain than consumer confidence, since thejudgments people make about the share market are multi-dimensional and influenced by a number of complex motivations. One of the complications is that people who are interested in the stock market often view themselves as "playing a game" against other share market investors, trying to guess when shares will do well before others do, so that they can profit from this knowledge. Many people who follow the financial markets will watch the numbers every day, and their observations and conclusions may be coloured by the many divergent business reports that appear in the media. Thus, there is likely to be more complexity to people's views about the share market than there is about their decisions about, for example, whether to save more or to buy a new car, which consumer confidence indices emphasise. It should also be recognised that investor confidence is only one of many forces on the market. Share prices are of course determined by supply and demand, and there are numerous factors that affect these: fundamental factors, legal, tax-related, demographic, technological, international, as well as other psychological factors related to attention, regret, anchoring, and availability.

If investor confidence is such a complex construct, is it at all possible to measure it? Research conducted by the Yale International Centre for Finance at Yale University in the USA has certainly shown that it can be measured, but the measurement must reflect the multi-dimensional nature of the construct. For this reason the confidence index is not expressed in just one figure, but the "index" actually consists of a collection of indices.

It must further be noted that the indices of investor confidence that we have derived do not all move in the same direction through time, or even approximately so. Forming a simple average of the different indices to produce one overall share market confidence index would thus be arbitrary. Instead, we report here different investor confidence indices. Each is measured in %, as a % of respondents who report holding a certain view.

Sample

The Sanlam Investment Management Investor Confidence Index is conducted monthly among abroad group of investment professionals, these include economists and portfolio managers from institutions as well as financial planners whose main focus is investments. The number of respondents is between 80 and 120 each month. Responses are submitted by a consistent set of investors to a consistent set of questions which makes comparisons between different time periods possible and accurate.

Data

A questionnaire is send the second Monday of every month to a sample of investment professionals. These include economists and portfolio managers form institutions as well as financial planners whose main focus is investments. Respondents need to answer 4 questions only by indicating in what direction and by what percentage they think the market will change. The questions are shown below as well as an indication of how the index is calculated.

1. One-Year Confidence Index

Question: How much of a change in percentage terms do you expect in the JSE All-share Index during the following periods: one month, the next three months, the next six months and the next year?

The index is calculated as the number of respondents giving a number strictly greater than zero. The index therefore reflects the percentage of the sample that expects the JSE All-Share Index to end positive over the next 1, 3, 6 and 12 months.

2. Buy-on-Dips Confidence Index

Question: If the All-Share were to drop by 3% tomorrow, what would you think the All-Share would do the day after tomorrow?

Three options are available namely Increase (%), Decrease (%) or stay the same. The Buy-on Dips Index is the number of respondents that choose an Increase as a percentage of the total number of respondents. The index therefore shows the percentage of the respondents expecting a rebound the next day should the market drop by 3% in one day.

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