



Monthly Investor Confidence Index

February 2011

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EXPECTATION GAP WIDENS BETWEEN INSTITUTIONAL INVESTORS AND FINANCIAL ADVISORS

Institutional investors and financial planners greatly differ in their opinions of the current market valuation and expected equity returns over the next 12 months, according to the latest South African Investor Confidence Index. The findings of a survey conducted in February by the Institute of Behavioural Finance (IBF), which form the basis of the index, reveal that the structural gap between the two groups' confidence levels is widening. It is almost at the highest level since the survey was initiated in 2007.

Institutional investors, namely the managers of large pools of money such as pension funds and unit trusts, "have increased concerns about the level of equity market valuations," says Theo Vorster, chairman of the IBF. "Some 74 percent of the institutional participants think the market is expensive, and the remaining 26 percent see the market as neutral. None thinks the market is cheap."

This view is further emphasised by institutional investors' expectations for low returns from local equities. Almost two-thirds of the respondents expect near zero returns over one-, three- and six-month periods and a low 4 percent return over the next 12 months. This confirms the majority of institutional investors anticipate the market to move sideways during most of 2011.

"This decline in confidence is not as widely shared by financial advisors who predominantly guide and manage the funds of private clients," say Vorster. Half of the advisors surveyed view the market as being fairly priced and a few see the market as cheap.

"This more positive sentiment is reflected in the advisors' higher expected returns from equities," he says. "They anticipate that markets will trade higher over all the periods tested."

While institutional investors remain cautious regarding market valuations, the survey shows they are not overly pessimistic about market volatility. Almost three quarters of the institutional respondents expect the market to rebound the day after a 3 percent selloff.

The latest Crash Confidence Index supports this view, with two-thirds of institutional respondents believing there is less than a 10 percent chance of a catastrophic market correction occurring. "It is surprising the financial advisors are slightly less confident about a market rebound and the Crash Confidence Index," says Vorster.

"Based on the survey results, it seems positive news is needed for local equities to outperform, be it economic or, probably more importantly, earnings surprises on the upside," he says. "After the strong outperformance in equities since March 2009, it may be concluded that investors would want to see confirmation of the earnings recovery before pricing in further positive news."

On the other hand, bad earnings news could result in lower valuations, as the market is already pricing in a strong earnings recovery.

Gerda van der Linde, executive director at the Institute of Behavioral Finance, believes the structural gap between the market valuation confidence and expected return confidence of institutional investors and financial advisors is due to availability and confirmation biases.

"The confidence levels of financial advisors and their clients can be attributed to the most recent, available and prominent information on the markets communicated through the media," says Van Der Linde. "With daily reminders that the JSE is testing previous highs, it is normal for advisors and

investors to be biased in the direction of this positive confirmation regarding market returns. The more often the information is repeated the more intuition leads one to believe the market will continue on its winning streak.”

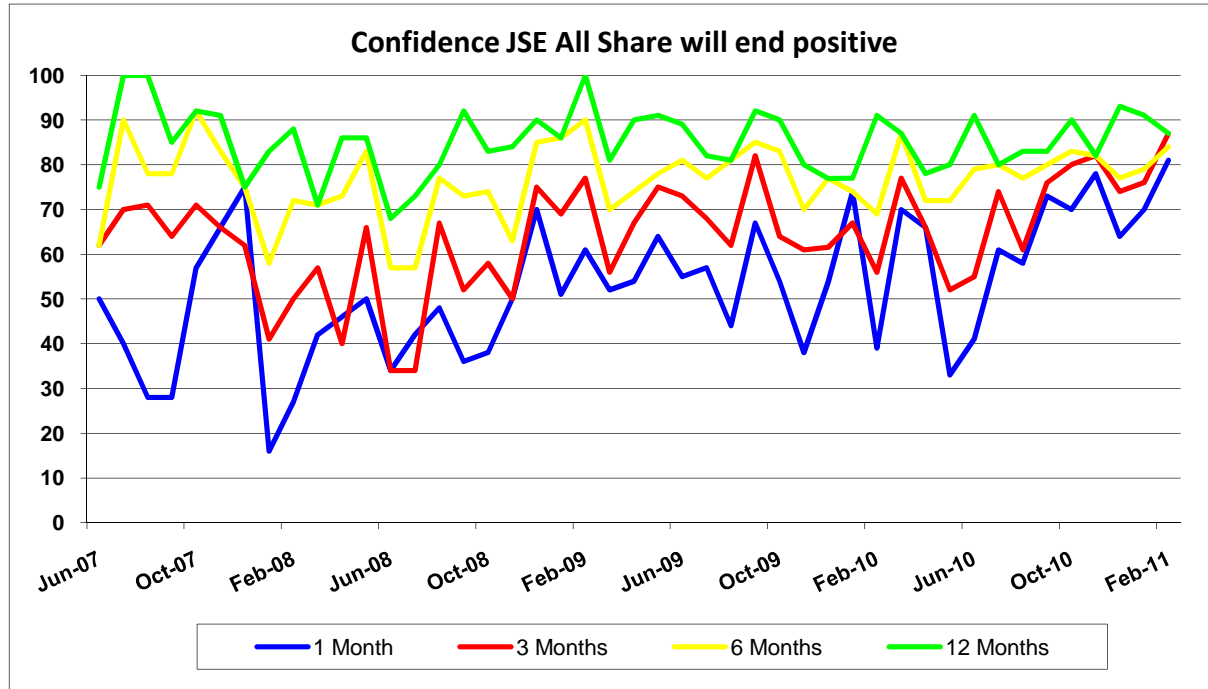
She says behavioral finance studies have found that investors tend to be myopic and overly fixated on recent occurrences while they tend to ignore the longer-term picture. “This must be a warning bell for investors not to become too confident and overestimate their ability to forecast events. With strong returns reported by most funds for the previous year, investors may be tempted to invest more money into the hottest performing funds and ignore their risk tolerance and risk capacity.”

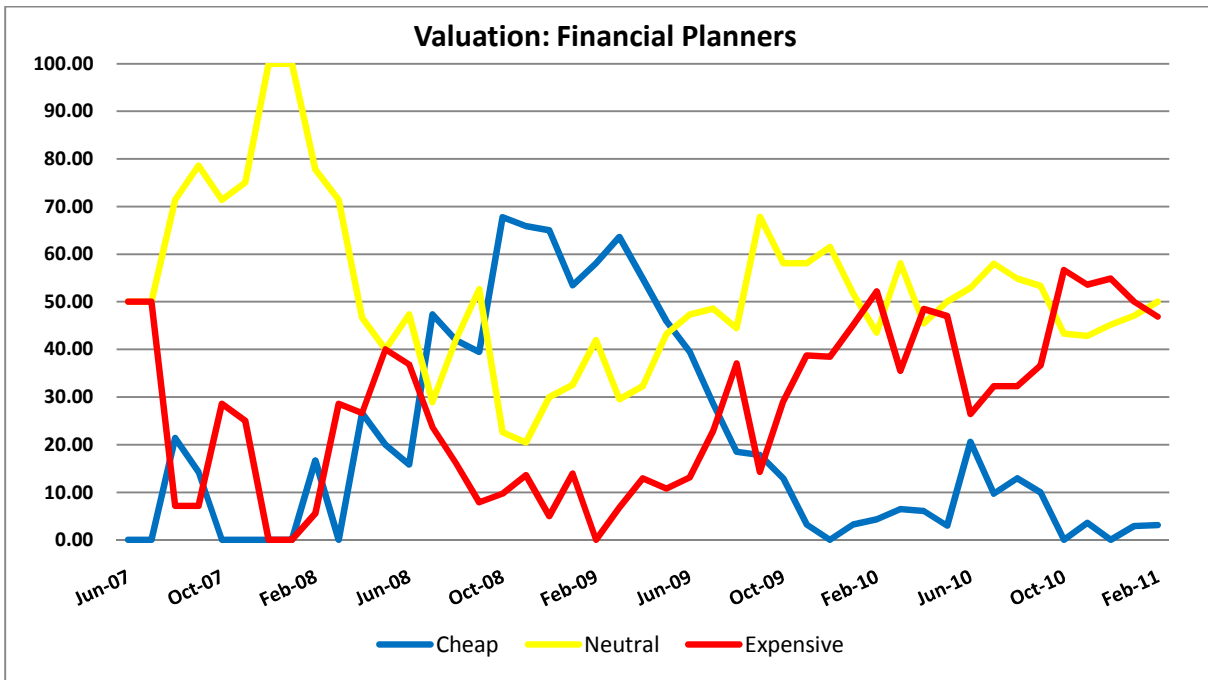
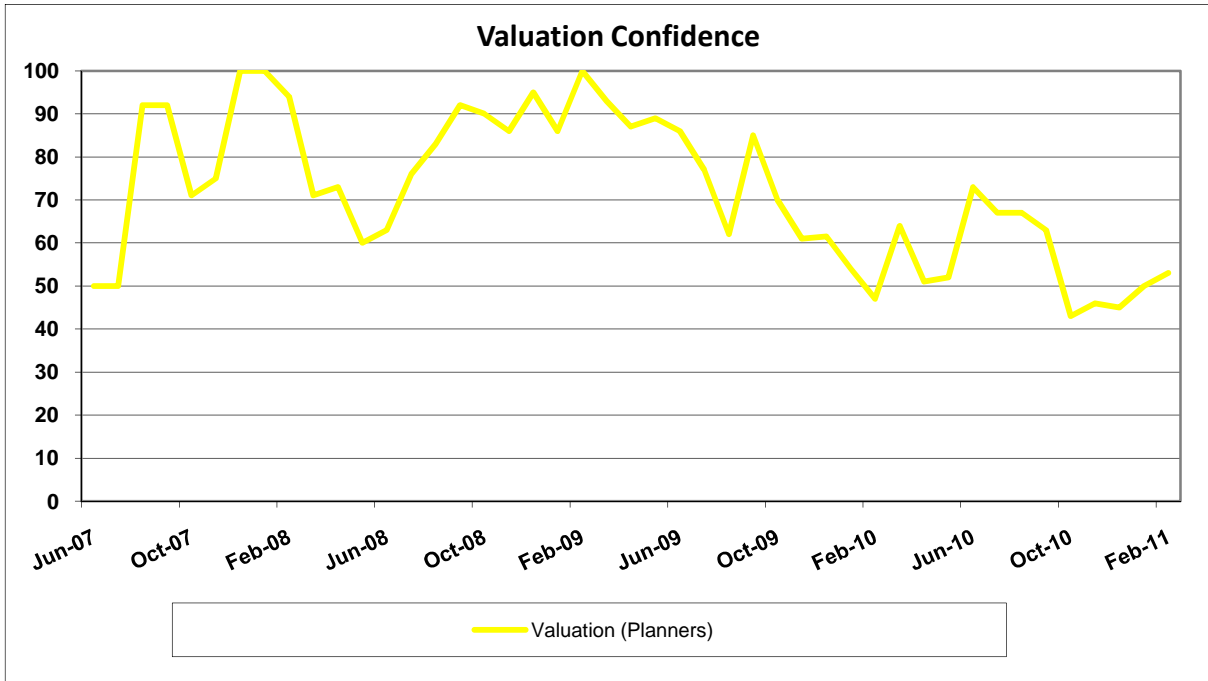
Leading investment commentators recently wrote that it is regarded as wise to build broadly diversified portfolios during a period of comparative calm – now, for instance – to prepare for the next downturn. This may assist investors to control and possibly lessen the impact of risk in the market on their investment portfolios, but not eliminate it.

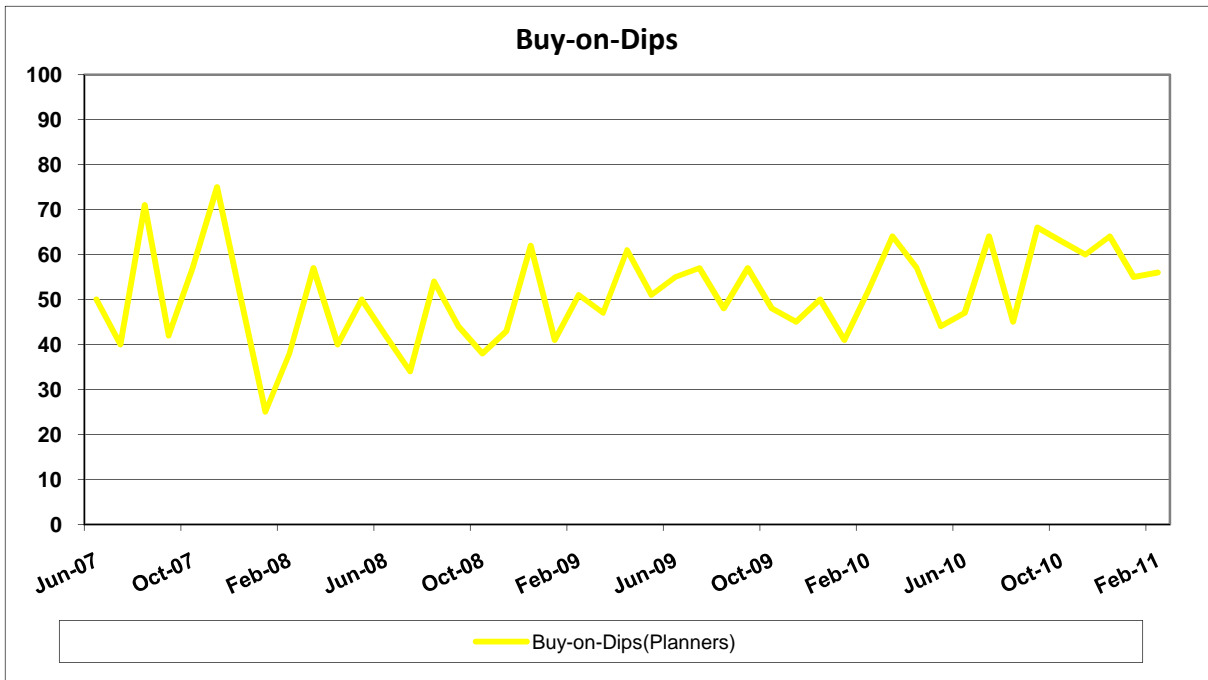
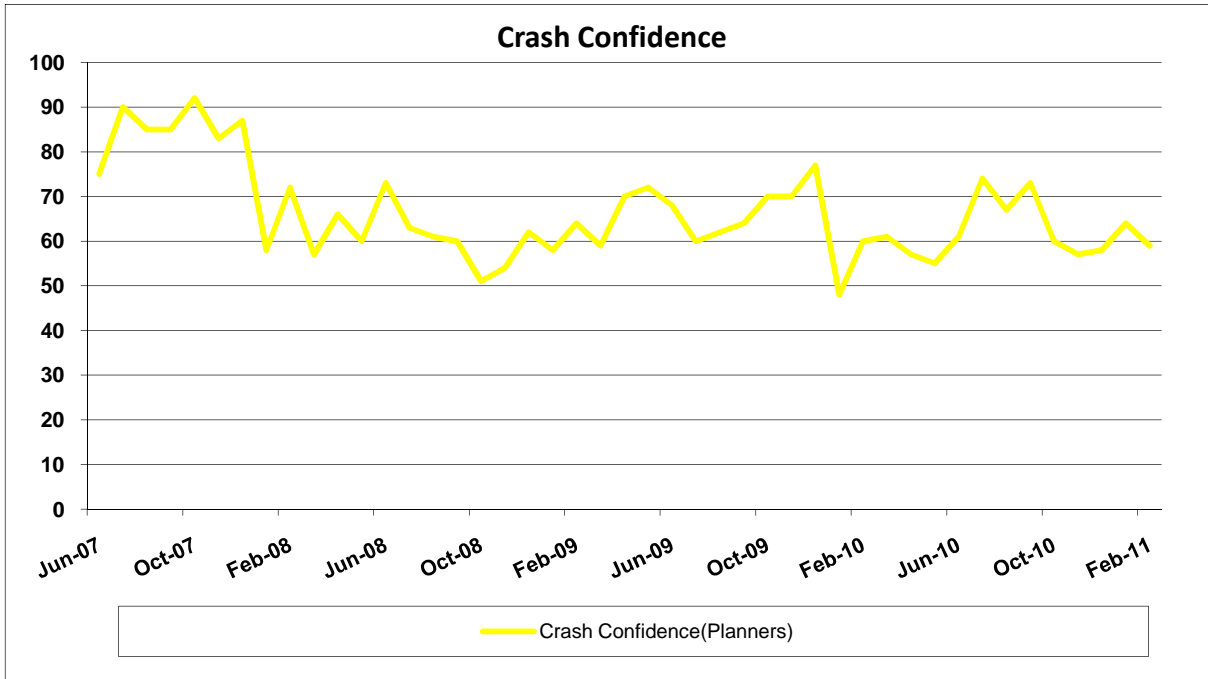
“With substantial amounts of money remaining in money market accounts whilst the JSE has almost reversed the fall from its previous high, playing too safe may have proved to be risky as well,” says Van Der Linde.

Key Insights

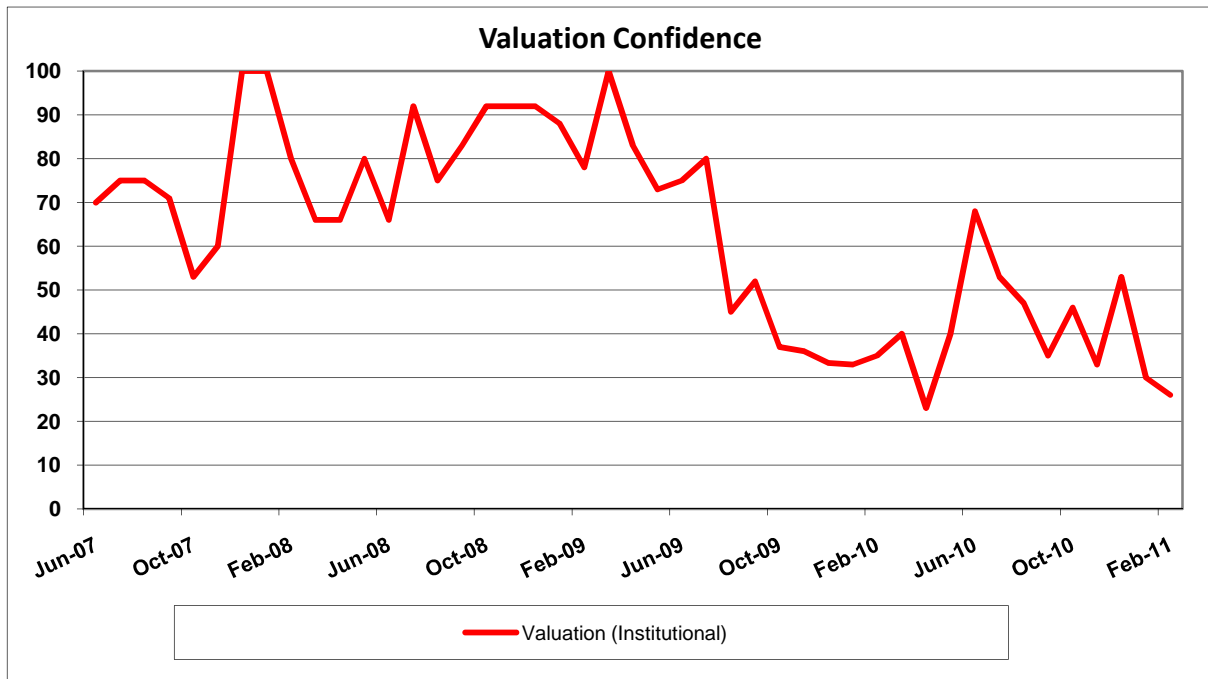
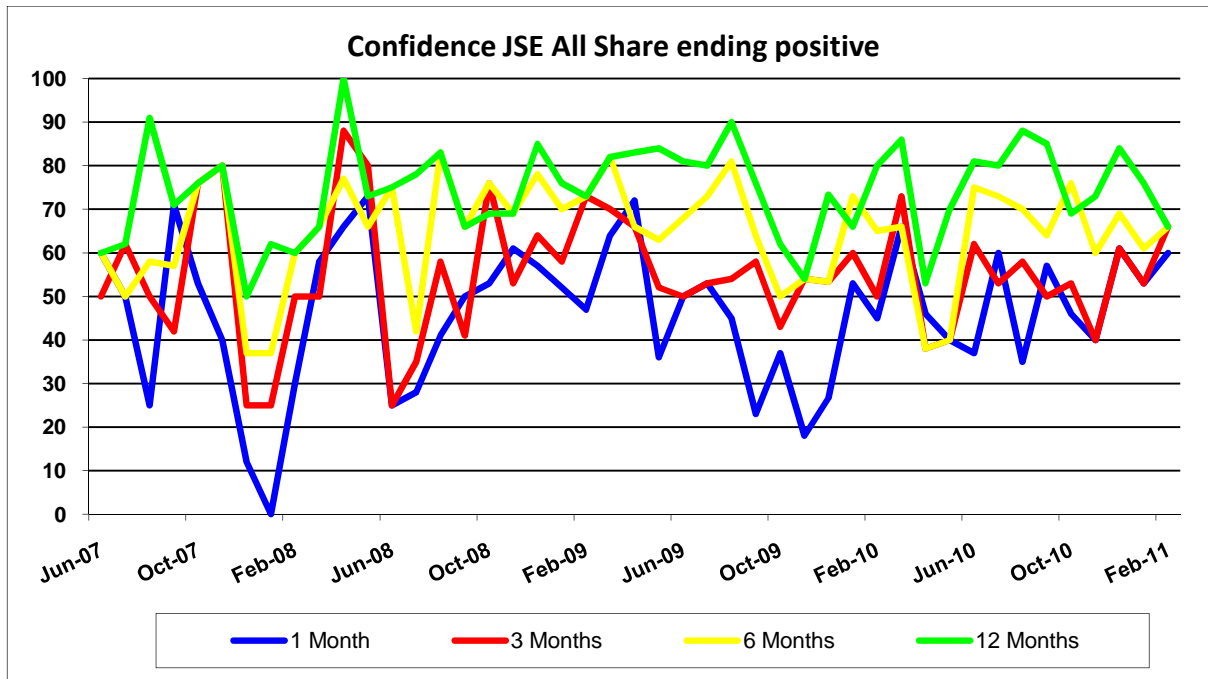
Financial Planners

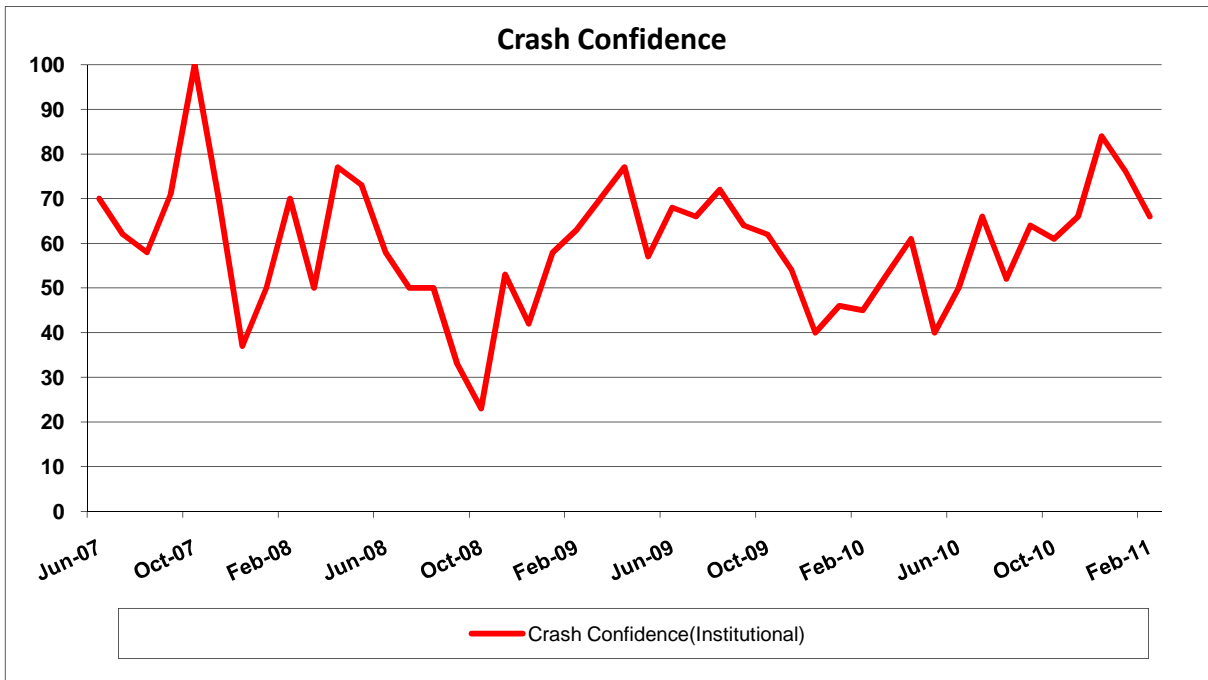
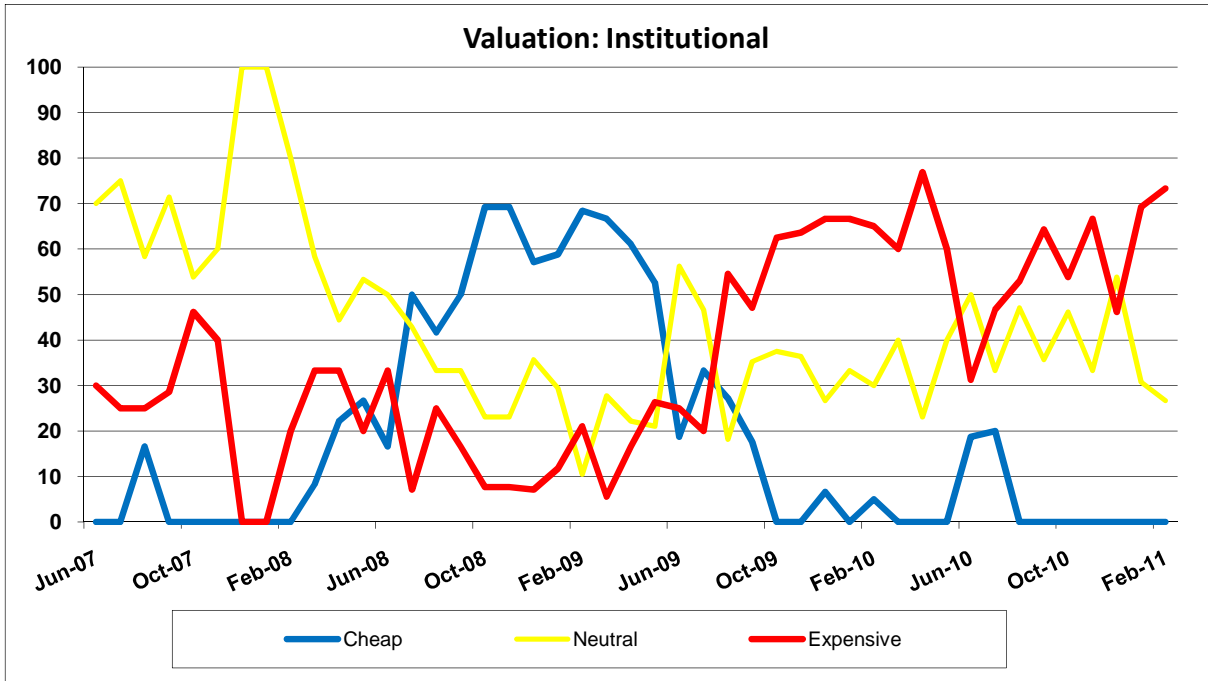


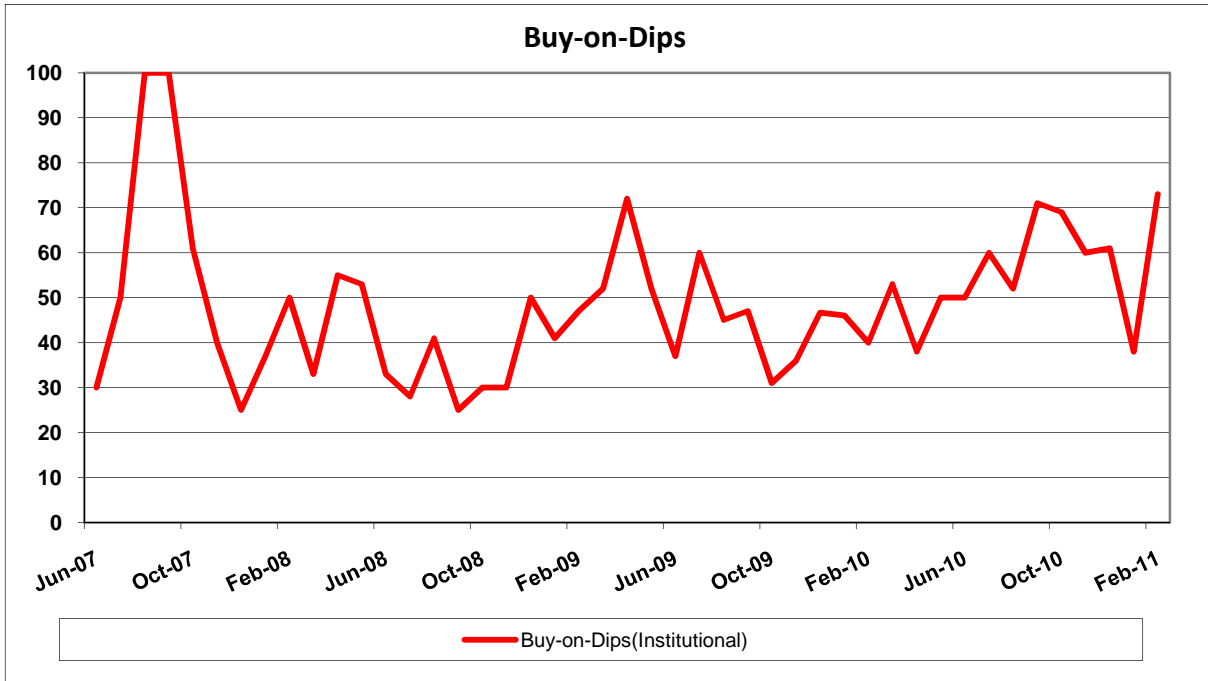




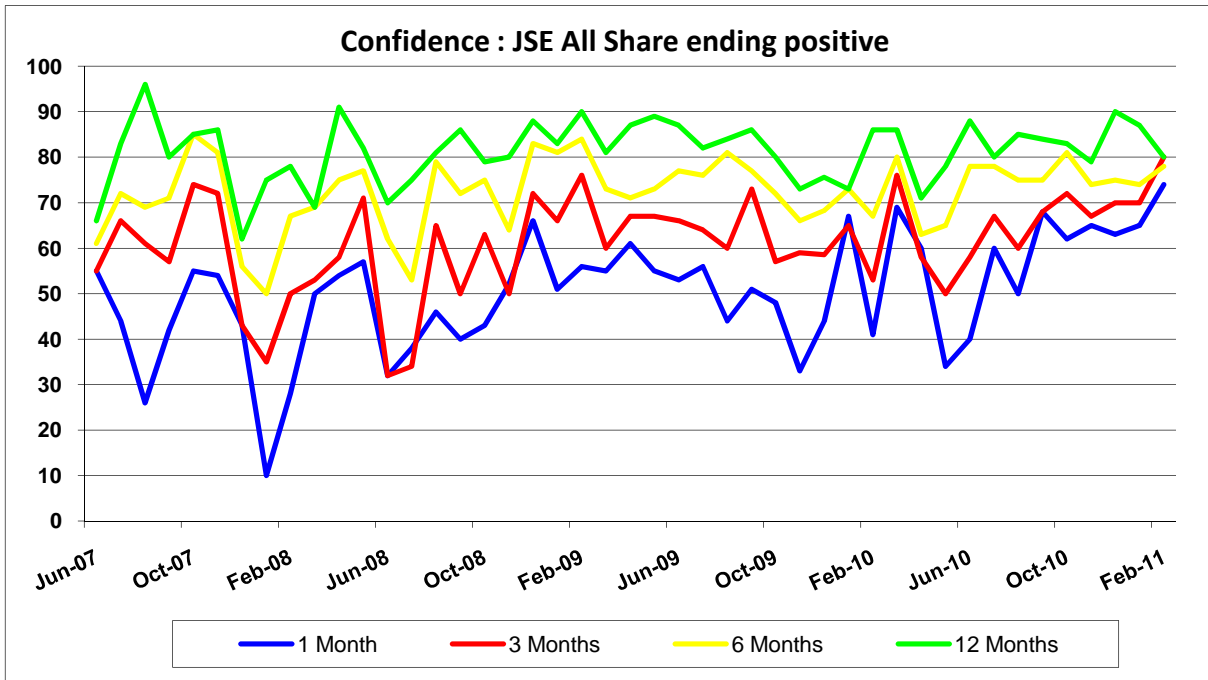
Institutional Investors

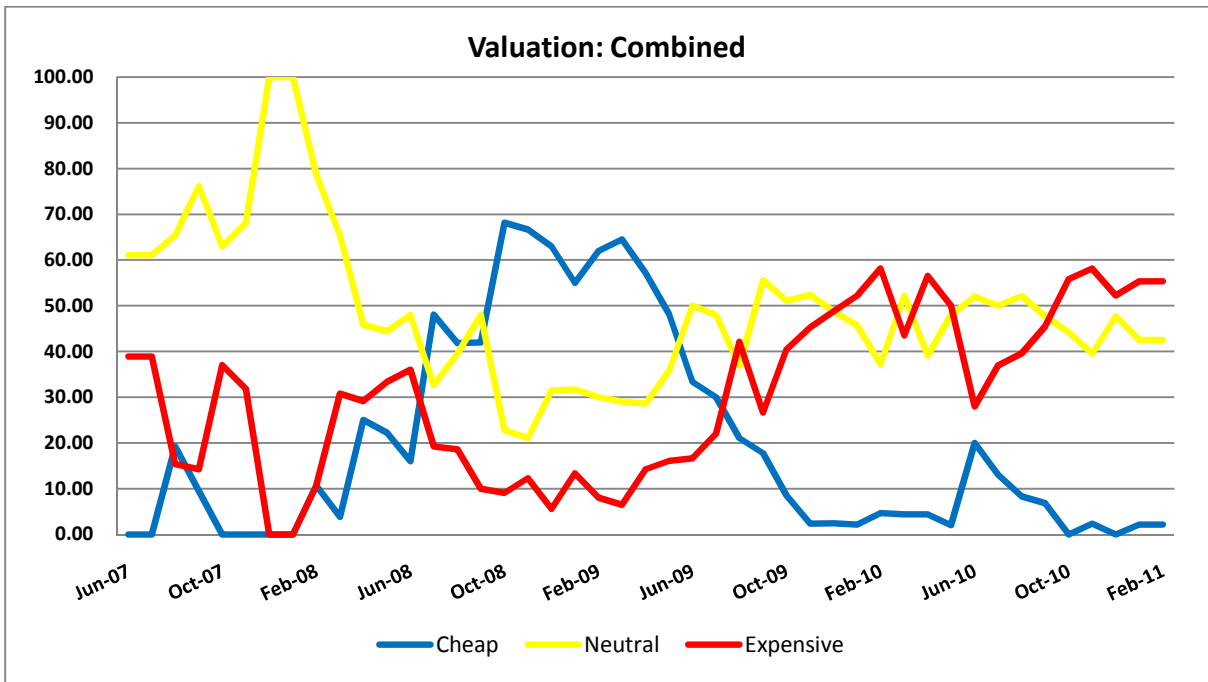
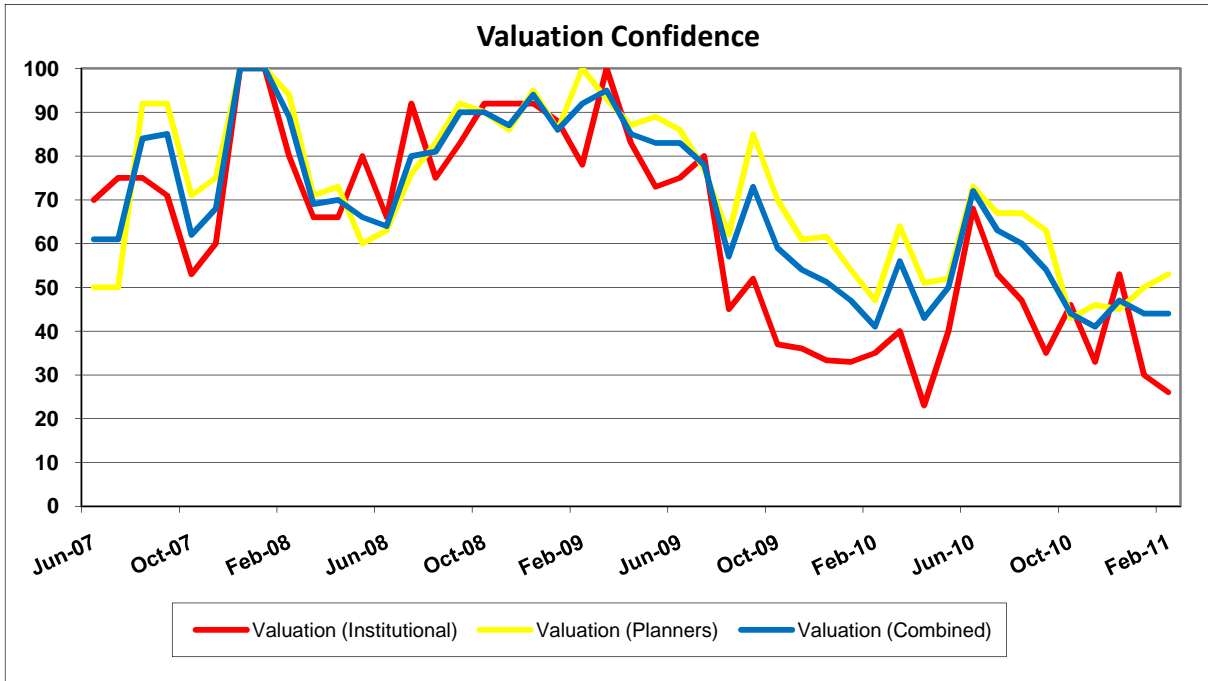


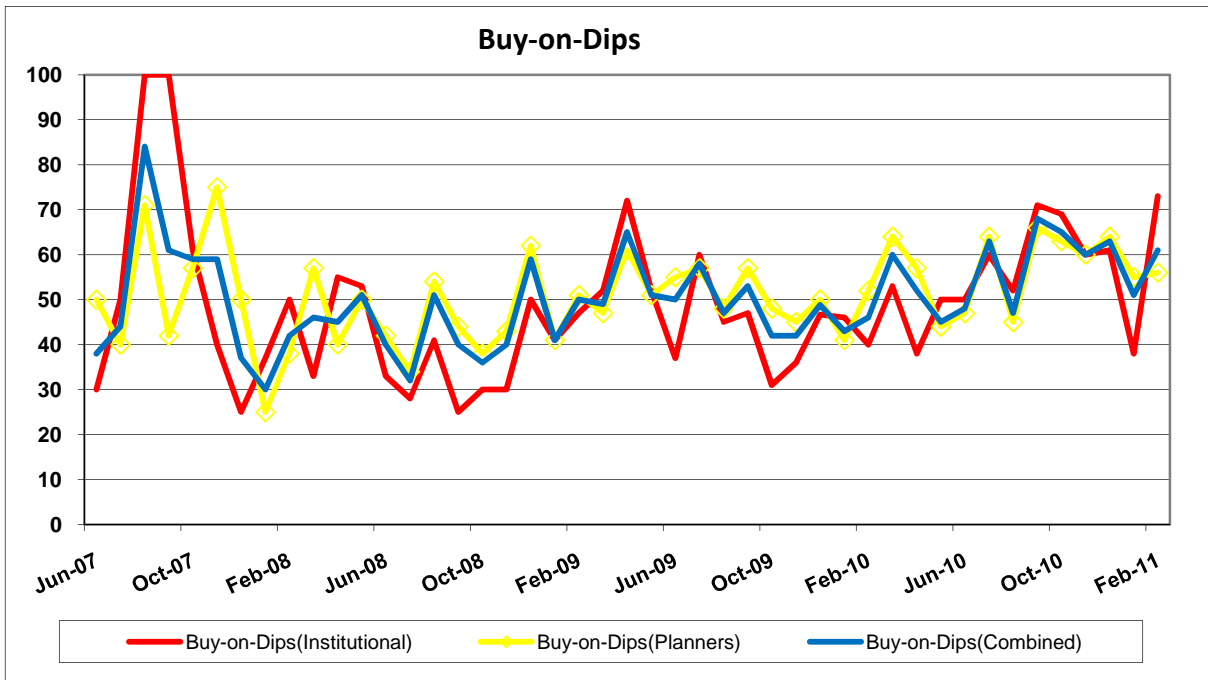
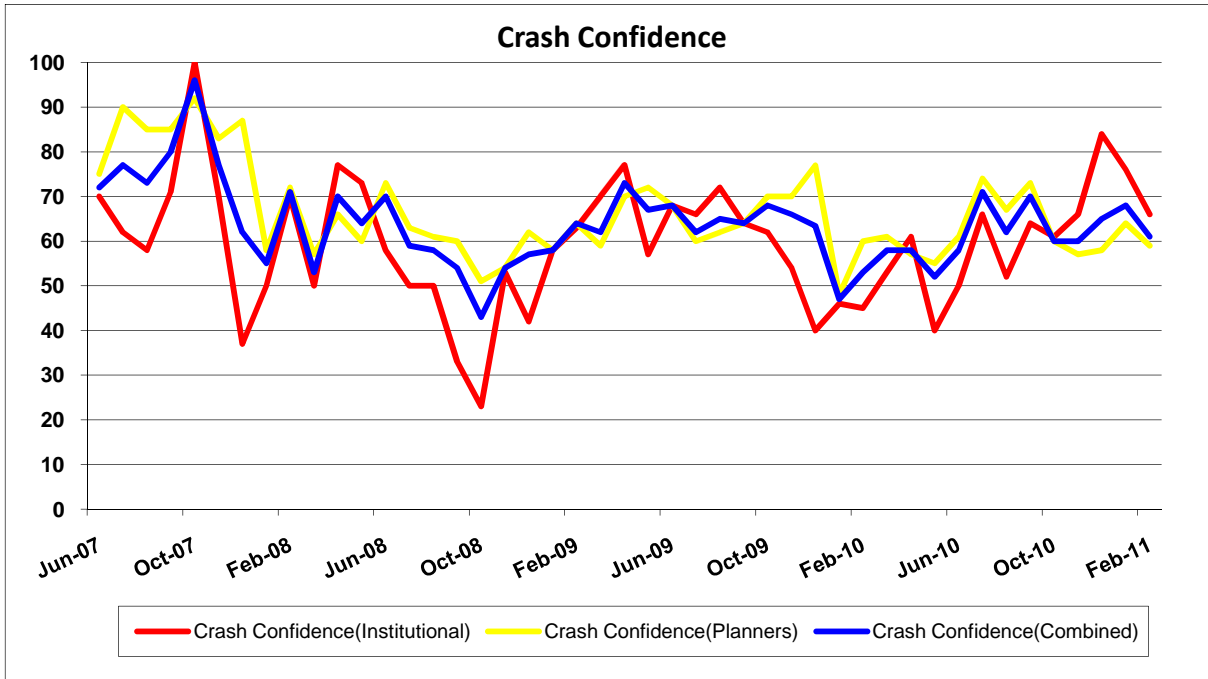


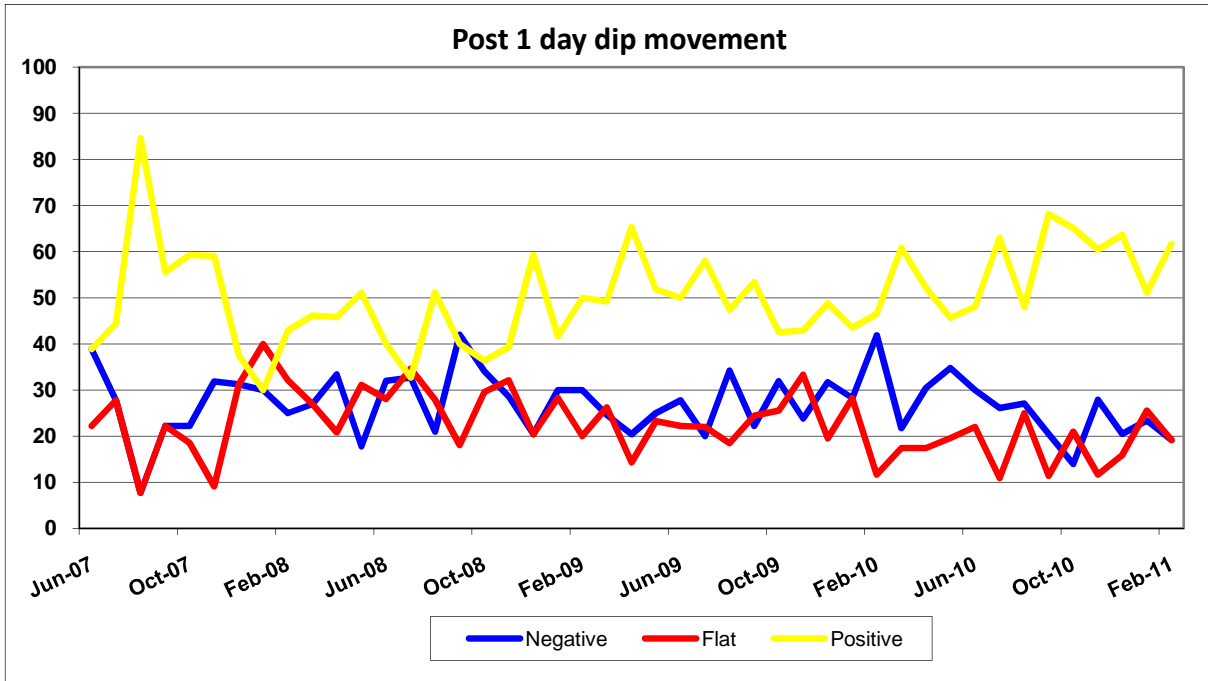


Combined Index

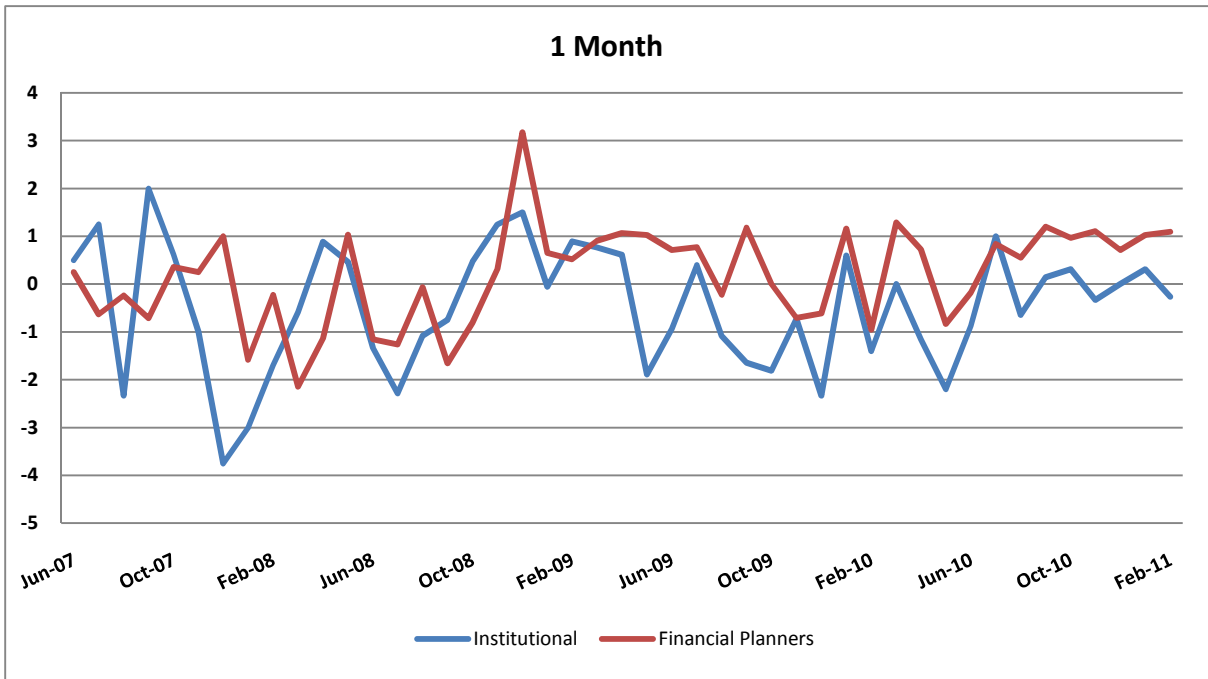


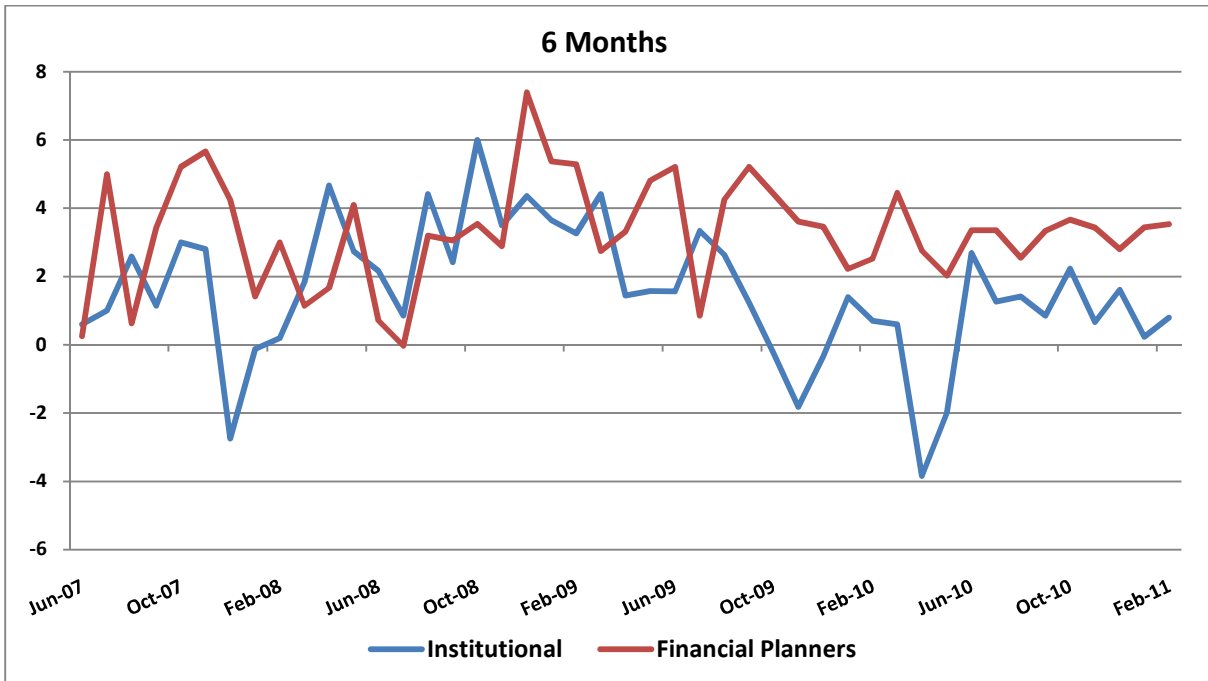
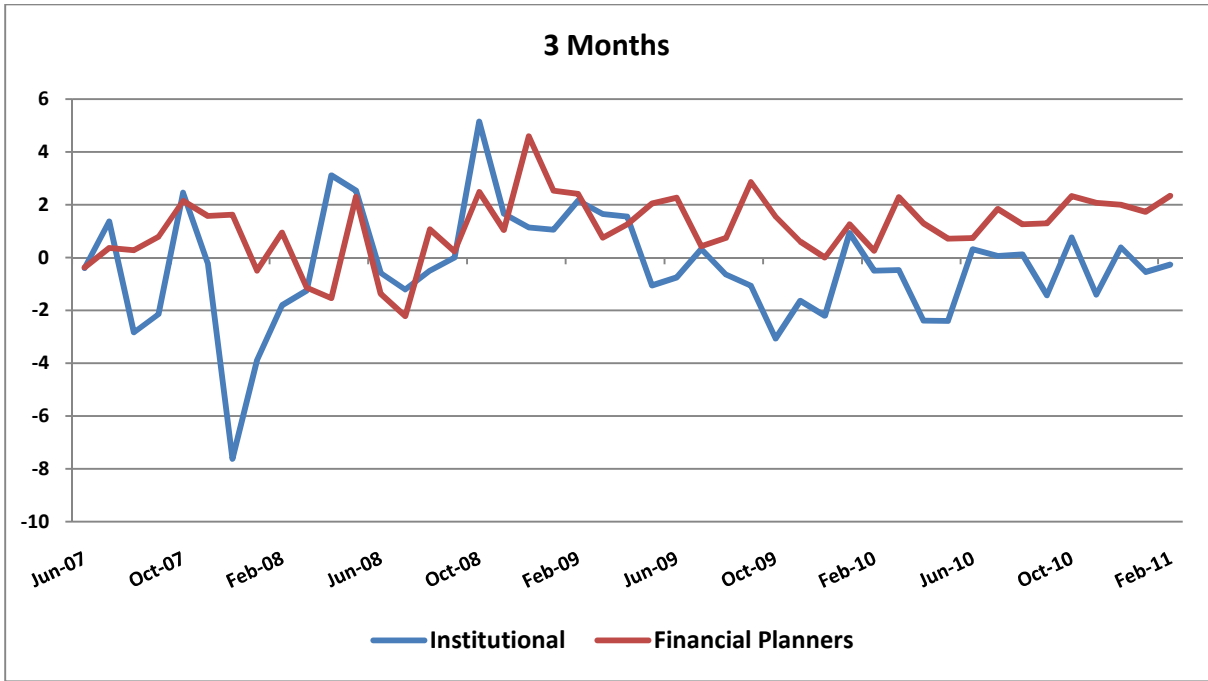


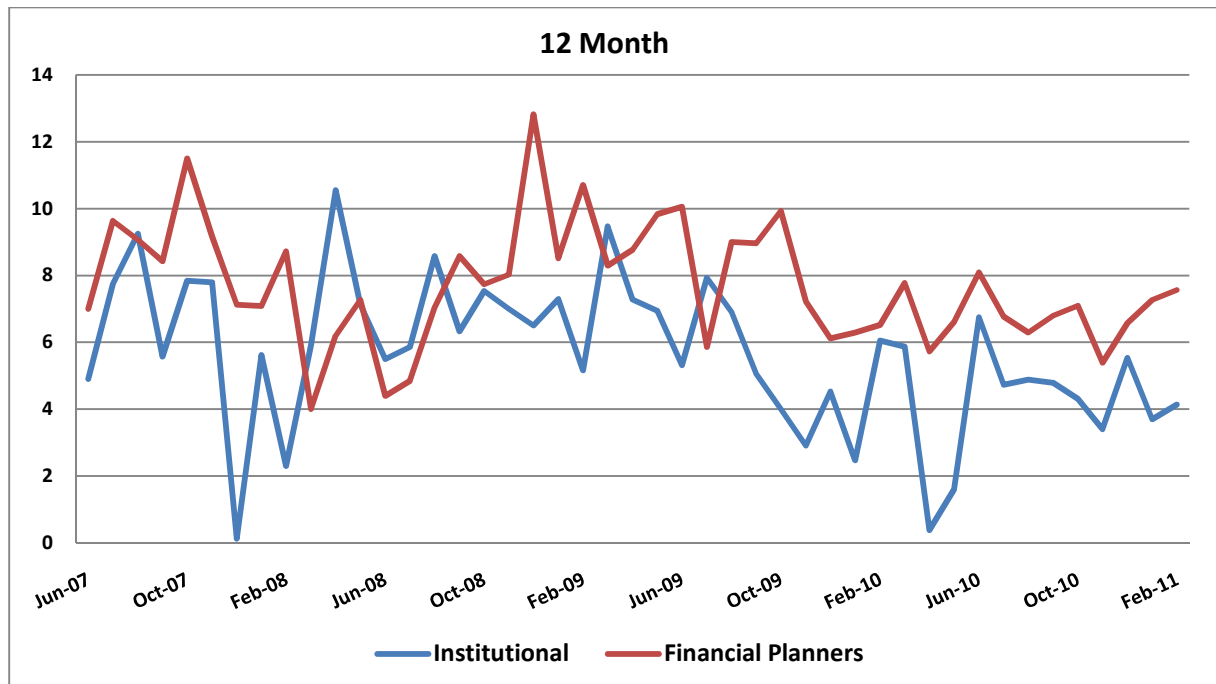




Average expected return







Survey Method

Confidence in the share market is much harder to pin down than consumer confidence, since the judgments people make about the share market are among the most involved of any that they must make. People interested in the stock market often tend to 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 share market watch the numbers every day, and many popular magazines, television, and radio shows follow the share market closely. Thus, there is likely to be more complexity to people’s views about the share market than there is about their decisions whether to save more now or whether to buy a new sofa, which consumer confidence indexes emphasize.

It should also be recognized 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. Indices of share market confidence can therefore only play a supportive role in trying to understand market events.

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 percent, as a percent of respondents who report holding a certain view.

Data

A questionnaire is sent the second Monday of every month to a sample of investment professionals. These include economists and portfolio managers from 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 for the "In 1 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.