

BLUE INK
investments

THRIVE

STRIVING TO PRESERVE CAPITAL AND CREATE WEALTH YEAR-ON-YEAR

MARKET REPORT

EQUITY MARKETS ON THE UP?

August is the last month of the summer holidays in Europe and the US. Historically, trading volumes are low from June to August, leading to the saying "sell in May and go away". This is a long-held stock market theory that markets rise through the winter, but as traders head for their holiday cottages and golf courses for the summer, market action dries up. Hence, May is seen as the time to sell and to go away until the fall, when everyone returns and markets theoretically start to rise again.

Clearly in the southern hemisphere however, the seasons are reversed with all of us working hard over our summer holidays but we do observe a similar pattern. On the JSE, the average daily trading volumes from January to May were 25% higher than the average volumes from June to August. The JSE peaked in May 2010 at roughly 28,200 points but currently, is approximately 1,000 points lower with some significant monthly swings in between. The question is what will happen after Labour Day in the US? Will markets discount bad news or focus on the positive?

The JSE All Share Index returned a negative 3.58% for August wiping out half of the gains we saw in July. Intra-month there were periods where the two-month returns showed no gain or loss, whilst the year-to-date figures showed a loss of 7.00% on the JSE. A sharp recovery on the All Share was experienced however, on the last two trading days of the month.

The Blue Ink funds produced the following performance to 31 August 2010

	1 month	3 months	6 months	12 months	2 years	3 years
Big Oak	-0.08%	1.42%	3.14%	11.68%	18.10%	13.59%
Blue Ink-ubator	1.97%	5.02%	9.18%	17.65%	38.49%	53.31%
Blue Sky	0.70%	2.13%	3.50%	7.33%	3.79%	2.44%
Evergreen	1.47%	4.00%	6.52%	12.95%	22.97%	31.59%
Redwood	0.83%	2.58%	4.59%	9.91%	12.28%	14.31%
ALSI	-3.58%	0.88%	3.19%	11.66%	4.08%	3.28%

Housing and unemployment numbers out of the US had the largest negative impact on markets for the month. Things started off well with markets rising from where they ended in July but then retracting as the US Non-Farm Payroll figures were published. This negative sentiment led the market into negative territory. US housing numbers saw the worst data in 20 years, based on new and existing home sales. Clearly with the housing market faltering and the 2008 credit / debt bubble still fresh in investors' minds, there was some real fear in the stock market.

Positive indicators included US GDP numbers which at 1.6% quarter-on-quarter annualised, came in better than consensus market expectations of 1.4%. The most shocking thing about this number is that one quarter ago the estimate was at 2.6%. Federal Reserve Chairman Ben Bernanke hosted a meeting of fellow bankers at Jackson Hole where he stated the US would do anything in its power to prevent a double dip. The markets latched on to these positive news items and subsequently there was a 3% rise in the last days of trading in August and another 3% on the first trading day of September.

One has to ask however, if this news justified the positive tone of the last week. These volatile swings can also be attributed to low trading volumes and less activity as mentioned above. The second week of September will hopefully give some clearer direction to stock markets globally. ■

Dear Clients



Hedge funds remain a hot topic of conversation and we were pleased to read the promising and positive comments from Deputy Executive Officer at the Financial Services Board, Bert Chanetsa. The FSB is acknowledging a growing understanding of the role hedge funds play in investments and he stated "*I personally feel that there is room in the investment funds space for hedge funds – they actually did assist during the crisis to preserve the value of capital and the value of investments.*" This feedback is really positive in light of the hedge funds regulatory framework being worked on by the FSB. We will keep you updated on the progress of the regulation of the South African hedge fund industry.

The Blue Ink funds performed well in a month where the ALSI was down 3.58%. The Blue Inkubator fund was our best performer, returning 1.97% for August, with performance being driven largely by our fixed income strategies which returned 3.58% against an ALBI return of 2.99% for the month.

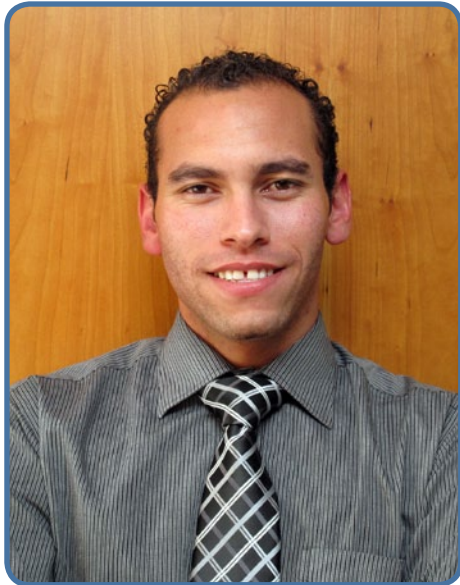
Grant Hogan, junior analyst at Blue Ink chats to us about a topic that remains in the headlines - government debt-to-GDP. And we feature Mark Le Roux this month who manages the Granite Fixed Interest Hedge Fund for Coronation Fund Managers.

Until next month!

Esmarie Strydom
CEO, Blue Ink Investments

A Perspective on Government Debt-to-GDP

Grant Hogan - Junior Analyst, Blue Ink Investments



As the dust settles from the 2008 financial crisis, escalating government debt in advanced countries presents a new risk for the global economy. While this has prompted calls for stimulus withdrawals, falling output and not withdrawing stimulus remain most countries' top priority. Accordingly, achieving economic growth to break the debt spiral is crucial; however markets must remain confident in the capacity of major economies to settle their debt obligations in order for this to happen.

Public debt levels increased sharply during and after the financial crisis of 2008. Moody's estimates that sovereign debt jumped from 62 percent of world GDP in 2007 to 85 percent in 2009. Over the same period, the average fiscal deficit in the G20 rose from 1 percent of GDP to 7.9 percent. These trends were much more pronounced in advanced countries due to sharper output declines, a more severe banking crisis, and highly developed social safety nets. Since 2007, debt in seven out of the nine advanced G20 countries increased by more than 10 percent of GDP. By contrast, debt-to-GDP ratios declined or are little changed in eight of the ten emerging economies in the G20.

.....
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Though markets are nervous about holding the sovereign debt of the smaller Euro

area members, these countries' problems should prove manageable assuming the European economy continues to recover and neighbouring countries provide funding support. Among the major economies however, Japan offers the greatest source for worry in the medium term.

The bigger story is the effect of the recession on tax receipts and the automatic increase of spending on unemployment and other safety nets. For example, total expenditures in the United States grew from a historical average of 20.7 percent of GDP to 24.7 percent in 2009, while tax receipts fell to 14.8 percent of GDP from an average of 18.1 percent. EU tax revenue is predicted to decline to 29.2 percent of GDP, down from 30.9 percent in 2009.

To fund this shortfall governments have aggressively tapped capital markets to finance their respective spending objectives. By raising the supply of sovereign bonds, governments can push bond prices down and yields (which, by definition, move inversely to price) higher. Higher public debt can also raise expectations of tax increases and inflation in the future, undermining business and consumer confidence. With no consumer demand, producers will not manufacture goods and this in turn could lead to slower economic growth, falling tax receipts and as a consequence put further pressure on a country's debt levels.

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Debt levels however are not the sole determinant of yields. Monetary policy, perceived currency risk, inflation expectations, and risk appetite, which vanished during the financial crisis, also play an important role. As the recovery strengthens and investors turn from government bonds to riskier assets, the yield on government securities will rise.

Perhaps the most important factor in determining government bond yields and thus the impact of higher debt is investor confidence in the country's governance. Added to this is the integrity and quality of its administration, to overcome spiralling debt

levels in the medium to long term together with the independence of its central bank, and its political cohesion. Common sense and academic research suggests that countries with poor governance borrow at a substantial premium; think of Greece!

Confidence in the sovereign debt of several small Euro area economies is obviously wavering. Let's continue with the example of Greece - Greek credit default swaps, that is the cost the borrower pays to insure himself against a \$1,000,000 default on Greek debt, was close to \$400,000 earlier this year. Though well below that of Greece, the cost of credit default swaps for Ireland, Portugal, Spain, and Italy have all been rising since March. Greece's 2010 deficit is expected to reach an EU-high of 125 percent in 2010. As many commentators have underlined, the most vulnerable Euro area members must adjust to the crisis without the option of devaluing their currency or exercising an independent monetary policy. While these countries do benefit from the relative stability of the euro-zone, they would likely have to pay even higher yields if they were not a member. Nevertheless, they will face more painful and protracted adjustments in wages and government spending.



Given that strong economic growth is the best long term debt reduction strategy and that the global recovery is still dependent on government support, policy makers, particularly those in the advanced economies worst-hit by the crisis, must maintain stimulus efforts in the short term. Market confidence that debts will be managed in these large countries is reassuring for now. Nevertheless, this cannot induce complacency; investor sentiments can change quickly, especially if smaller more exposed economies run into trouble. Again, the example of market reaction to Greek debt concerns and later market reaction to Portugal, Ireland, Italy, Greece and Spain (PIGS) speak exactly to this point. Any high-public-debt economy is a more exposed one and effective plans to restrain spending and/or increase taxes

as soon as a robust recovery is established must be made. In addition, monetary policy should respond quickly to signs of inflationary pressure. It is a case of countries trying to borrow themselves out of debt, a debt either this or the next generation will have to settle.

History shows that confidence in governance critically affects how investors react to debt concerns. In the case of South Africa, the government's latest wage offer to striking public sector workers will lead to increased state borrowing and may put the country's debt book under pressure.

“.....
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.....”

The lessons learned from Europe's debt crisis are still fresh in the minds of South African authorities who want to press on with plans to slow down borrowing and cut the country's large budget deficit. However

government's improved offer of a 7.5 percent wage increase - double the inflation rate of 3.7 percent and an R800 (\$108.5) housing allowance puts a damper on those plans. The state's wage bill already makes up a third of its entire spending and almost half of the tax revenue it collects. Salaries already consume 40% of all tax revenue collected and increasing the salary bill would have a negative impact on our country's finances. Simply put, government will be borrowing money to pay wages and debt service costs. This is not only unsustainable but will require future generations to pay for current spending. ■

FUND MANAGER PROFILE: MARK LE ROUX - CORONATION FUND MANAGERS



CORONATION 
FUND MANAGERS

How long has Coronation been investing in the hedge fund industry?

Coronation Fund Managers has been a pioneer SA asset manager in the absolute return fund space including hedge funds since the late 1990's. The Granite Fixed Interest Hedge Fund was launched in October 2002 which, at the time, we believe was the first fixed interest hedge fund offered to external investors in South Africa.

Where did you gain your investment/hedge fund experience and how long have you been in the industry?

My investment career started on the fixed income trading desk at Old Mutual in July 1991. I started managing fixed income

portfolios in 1994. In my 19-year career I believe I have gained valuable experience and learned many a hard lesson at Old Mutual, African Harvest, Decillion and for the past 5 years, at Coronation. The Coronation Granite Fixed Interest Hedge Fund was launched 8 years ago at Decillion, and bought across to Coronation in 2005.

What motivates you about the hedge fund industry?

I love the constant change in the markets and that every day is different in this industry that also sees much innovation taking place. While there is constant change in the markets, it however is interesting to see (learning from history) how markets can make the same mistakes over and again.

Finally, it doesn't matter where you come from or what your background is, the market is a great leveller and we all compete in this industry on equal terms to generate the maximum risk-adjusted returns for our clients.

What is the Coronation strategy or motto for investing?

Coronation Fund Managers is a single philosophy investment house that focuses solely on the long-term. We use proprietary research to support our valuation-driven approach to investing.

What does Coronation do to differentiate the Granite Fixed Income Hedge Fund from other fixed income funds?

Firstly, Granite is a low heart-rate, conservative portfolio. We aim to produce a return of 1% per month, which we have managed to achieve over the past 8 years since inception. Risk management is key to our investment process. We believe if

we manage the risk, the returns will follow. We employ six distinctive strategies in the portfolio: directional trading, credit opportunities, relative value trades, arbitrage trades, quantitatively driven strategies as well as yield curve trades.

Would you invest your own money in the hedge fund industry?

Yes, and I do.

How do you view hedge fund regulation?

Hedge funds are a growing alternative asset class - with that inevitably comes regulation.

How does the SA hedge fund industry compare with offshore peers?

The South African hedge fund industry is very young. However, we compare very well with the more developed markets. This was recently evidenced by how well the South African industry has come out of the global financial crisis. If ever there was the "100-year flood" that was it and the majority of the funds came through it pretty well.

What advice do you have for investors?

When you invest, make sure that you invest with someone who has integrity and that you trust. Irrelevant of the size of your investment, investors should be treated equally.

Similar to investing in other asset classes, diversification remains key when investing in alternative asset classes. Therefore, investing in a fund of funds is an ideal way of gaining exposure to an asset class such as hedge funds.

Finally, if something seems too good to be true, it probably is. ■

WHO'S WHO AT BLUE INK



Roshnee Naidoo Executive Assistant Blue Ink Investments

Tell us about your position at Blue Ink Investments.

I am the Executive Assistant to Esmarie Strydom, our CEO at Blue Ink Investments.

Run us through some of your responsibilities and tasks.

I provide administrative and secretarial support to Esmarie and play a pivotal role

in ensuring that her hectic work schedule is run as smoothly as possible.

What are the challenges you face?

It is extremely challenging to work more often than not, in a different location to Esmarie.

Tell us about your past experience and jobs.

I have a long, rewarding and close working relationship with Esmarie spanning more than 12 years. We worked together at Transnet Pension Fund Administrators and then moved to Fifth Quadrant before joining Blue Ink Investments. Prior to working at Transnet, I worked at FNB Card Division for seven years.

What have been your key lessons in life?

To put God first, before all else. To be thankful and grateful to God for my daily blessings. To stay positive, which I believe is an act of one's will, despite the circumstances around me.

What is your philosophy?

If you don't stand up for something, you will fall for anything. Your life is your own and nobody has the power to take away your convictions. It is when you relinquish

your beliefs, compromise your values, and don't listen to what you know is right, that you lose yourself.

What is your greatest achievement?

Raising two boys and 21 years of marriage!

If you were president of South Africa for a day, what would you do?

Firstly, I would ensure that discipline and the freedom of religion be brought back to the schools. Secondly, I would reinstate capital punishment. That may seem callous, but because miscreants have nothing to lose, they are careless and heartless with innocent lives.

If you could meet one famous person, who would it be?

Jesse Duplantis - for those of you who don't know him, he is a famous and dynamic evangelist.

What are your activities outside of work?

My life revolves around my family and church. We are all actively involved in church activities. I'm an avid reader. ■

CASUAL DAY FUN



Blue Ink joined in the spirit of Casual Day and purchased stickers from Paarl School in Brackenfell, who cater for children with physical and learning disabilities. The school receives 40% of the income from the sale of the Casual Day stickers and the remainder goes directly to Casual Day for distribution to all the institutions that benefit from this initiative.



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