



Monthly Investor Confidence

May 2011

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Key Insights (Media release)

Signs of returning confidence in local markets

Confidence in the local equity markets is returning as stronger earnings coupled with perceived lower market risks emerge, says Theo Vorster, chairman of the Institute of Behavioral Finance (IBFSA).

“The latest South African Investor Confidence Index indicates a significant change in attitude among the institutional investors and financial advisors who participated in May in the IBFSA’s survey, on which the index is based,” says Vorster. “The same surveyed participants indicated low levels of confidence in the equity market during previous months.”

None of the institutional participants believes markets are undervalued, however, they remain uncertain about the very short-term outlook for equities one month into the future. “This is confirmed by very low consensus between the participants on the expected return for this period,” he explains.

Institutional investor confidence has substantially improved for the three, six and 12-month measurement periods, with their estimated returns up by more than 2.5% from their April estimates over each of these periods. “Such a positive movement of the same magnitude was last measured during the World Soccer Cup in June 2010,” he says.

“For the first time in nearly 24 months, institutional investors and financial planners almost reached consensus on expected returns 12 months into the future,” says Vorster. “With their views differing by a mere 0.5%, a collective return of 5.2% is expected.”

“In line with the increased optimism about market movements, investors were also more optimistic about how far the market would bounce back a day after a 3% drop, says Gerda van der Linde, IBFSA executive director. Respondents on average expect a 0.85% recovery the following day.

She notes that it is interesting to compare the latest results for the Crash Confidence Index with the May 2008 results, as local markets have been testing the May 2008 highs since February this year. While institutional investors believed there was a 7.73% probability of a crash back then, they currently imply a 15.8% probability.

“This could reveal that institutional investors have a more realistic expectation of market potential this time around,” explains Van der Linde.

Since January 2011 the Valuation Confidence Index, which indicates perceptions of market value, has shown a steady increase in responders who believe the market offers fair value. Only 2% of the total respondents think the market is cheap, while 50% still believe it is too expensive.

“With lingering concerns about market value, combined with global economic conditions and developments that are difficult to interpret and/or forecast, the cautious approach by equity investors could remain for some time,” says Van Der Linde. “However, with the JSE All Share Index regularly moving above 32 000 since early this year it may not be a surprise to see confidence in the markets returning slowly in the minds of investors.”

She continues, "When all is considered, the equity market has recovered all losses since the lows in 2009. Investors who parked their investments in fixed interest type investments have missed the recovery.

"Investors need to trust that equities deliver higher returns than fixed interest investments over time, despite higher risk and volatility."

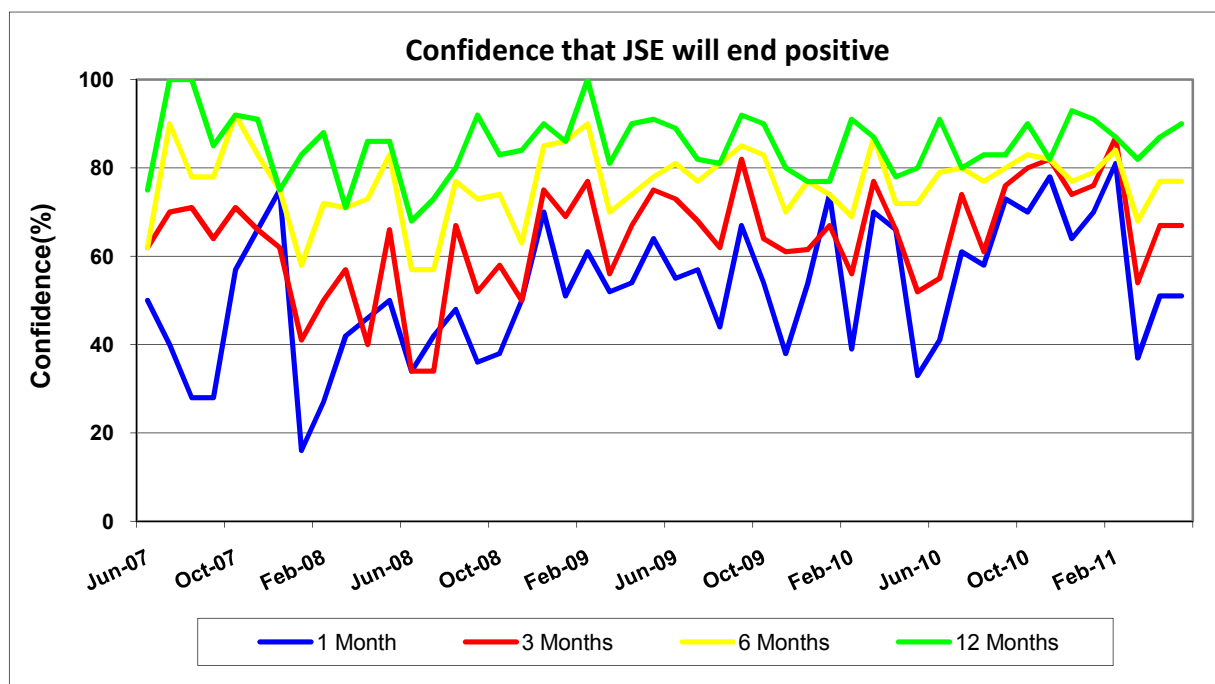
On the down side, Van der Linde says it appears as if loss aversion is still keeping investors out of equity markets. "This is not a surprise as research results in behavioral finance show investors to be highly loss averse if they experienced a loss in the recent past."

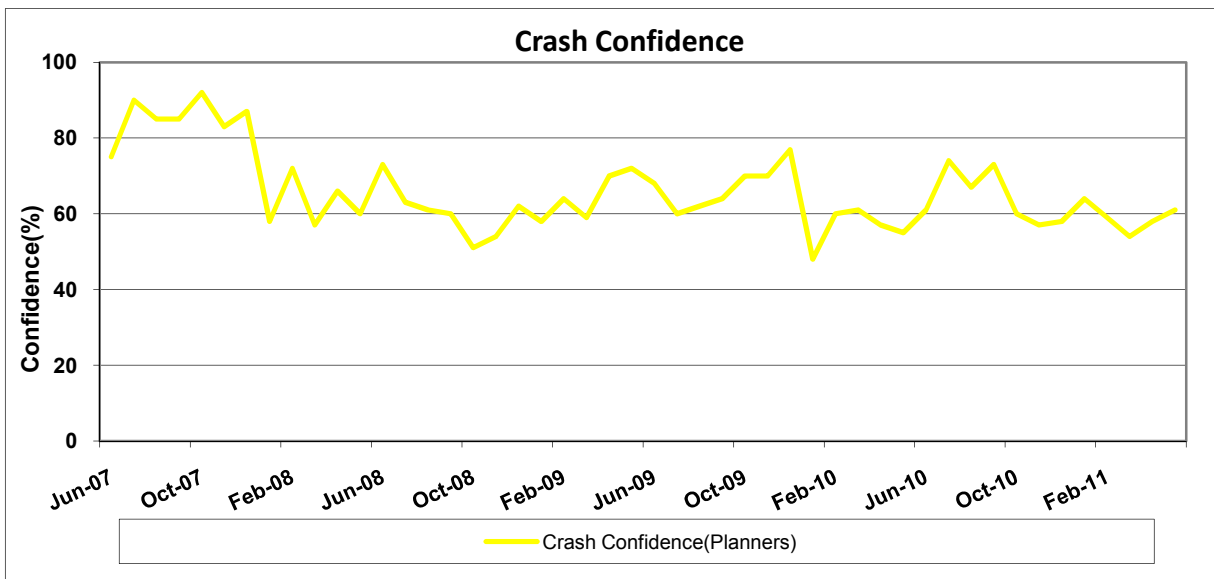
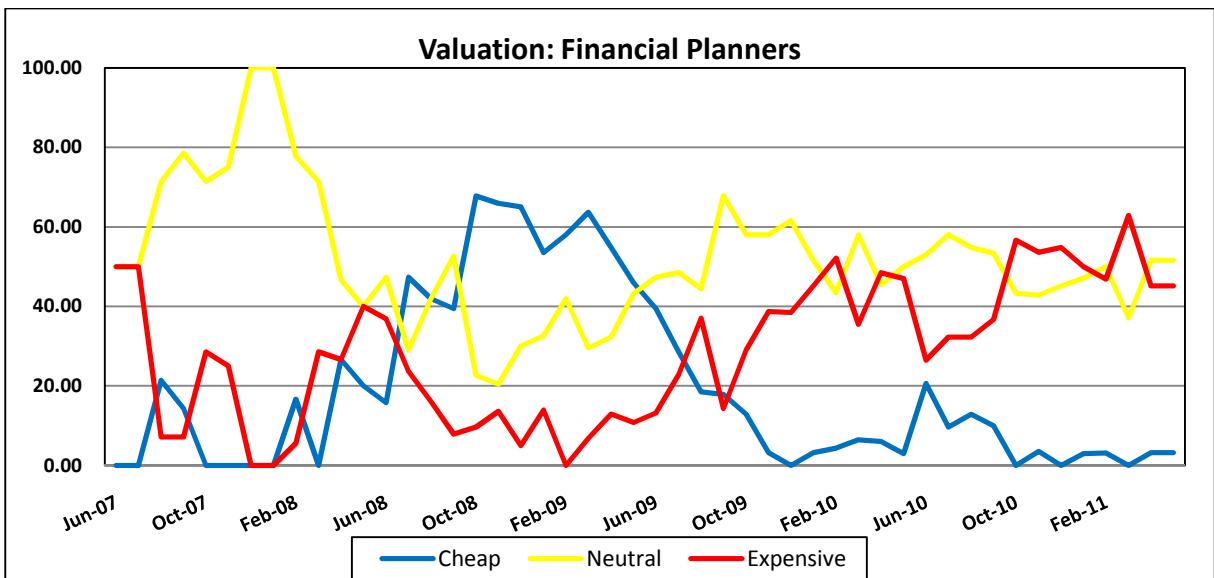
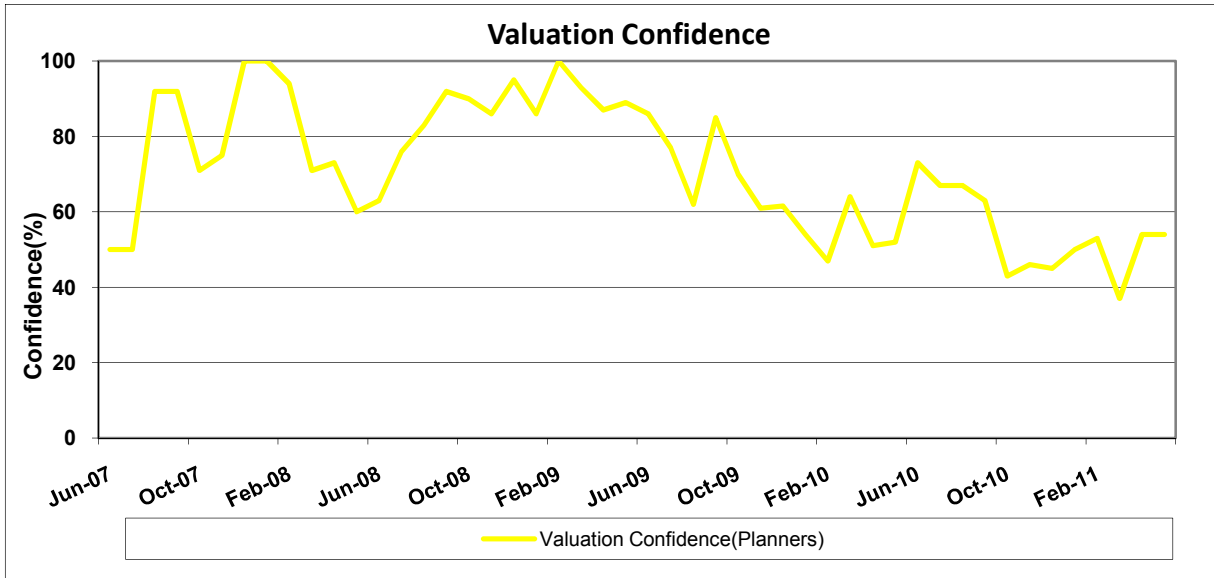
"The only way to overcome investor paralysis caused by loss aversion is to phase investments into the market over an extended period," she says.

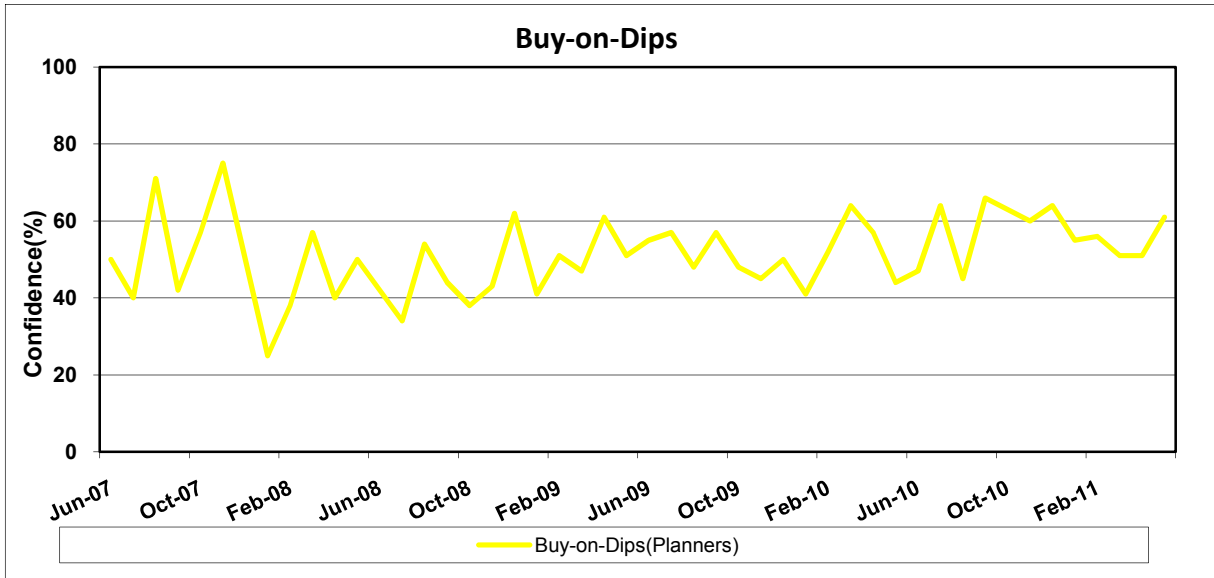
A phasing in approach also eases regret aversion in volatile markets. "Regret aversion causes procrastination, as investors fear the pain of being responsible for a wrong decision.

"Investors should not attempt to make up lost ground without the advice of a professional financial planner," says Van der Linde. "Whilst equity markets deliver superior returns over time, investors need a solid strategy linked to their individual goals based on their risk required, unique personal risk tolerance and risk capacity."

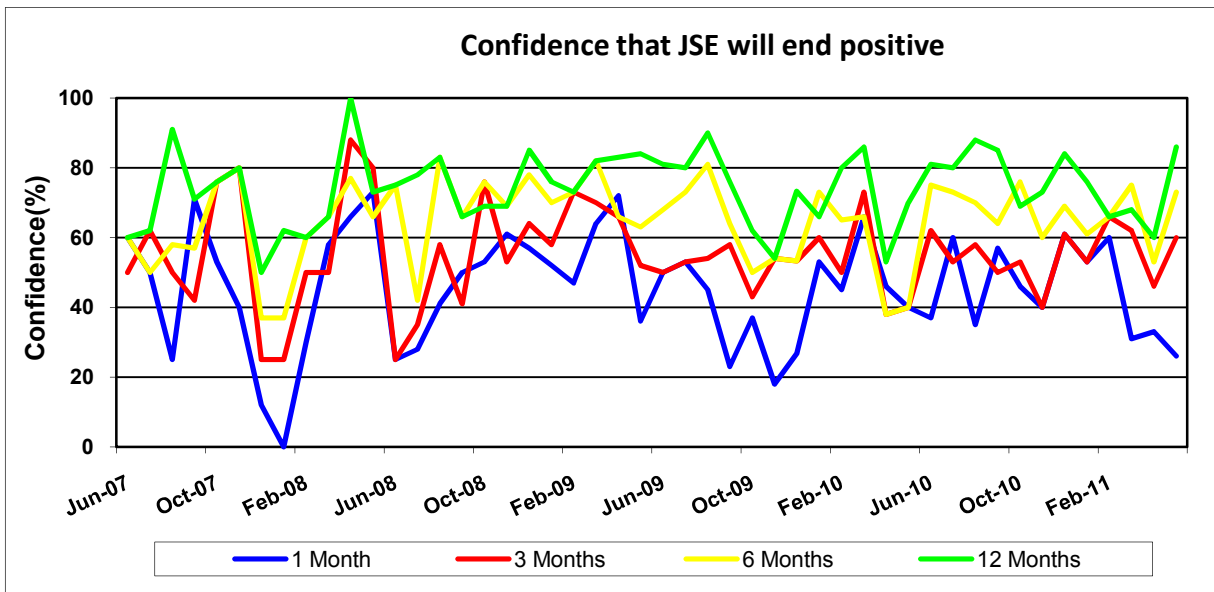
Financial Planners

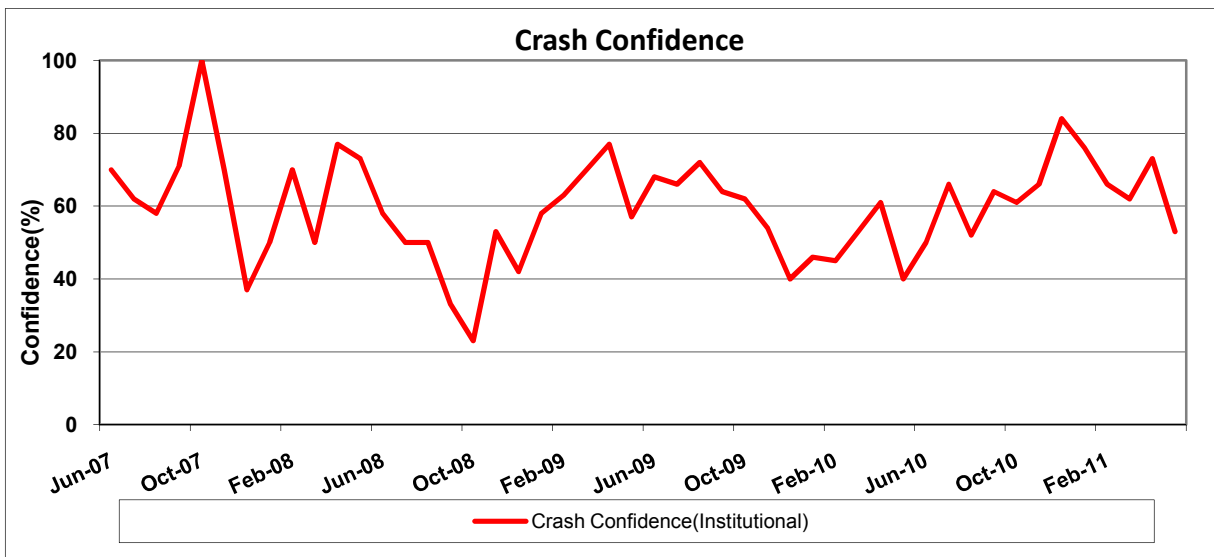
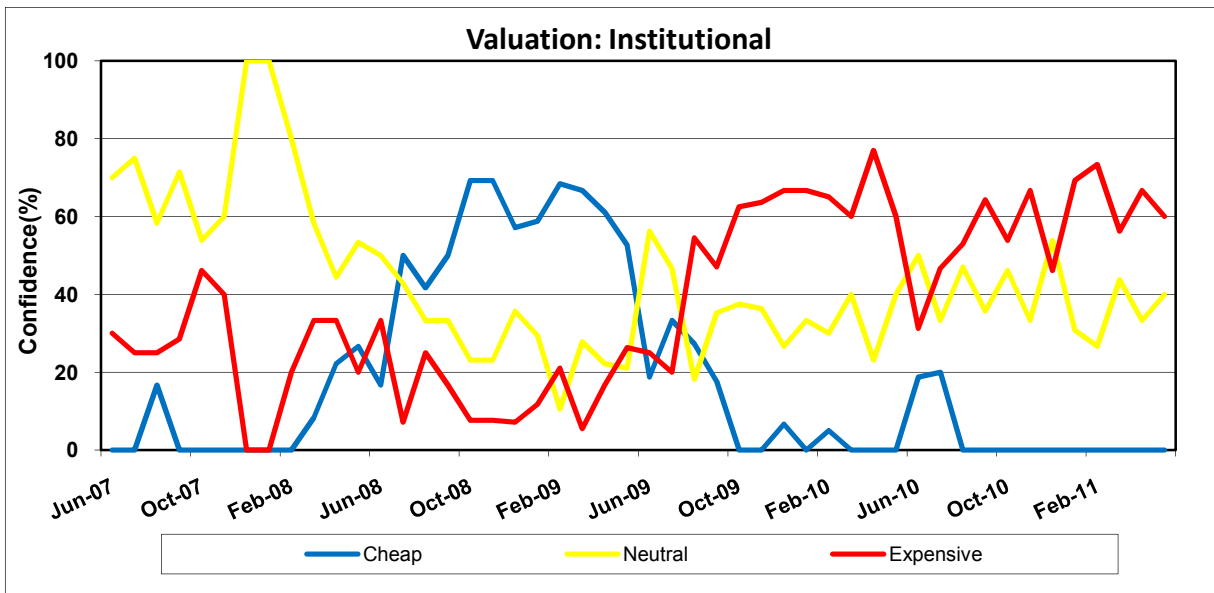
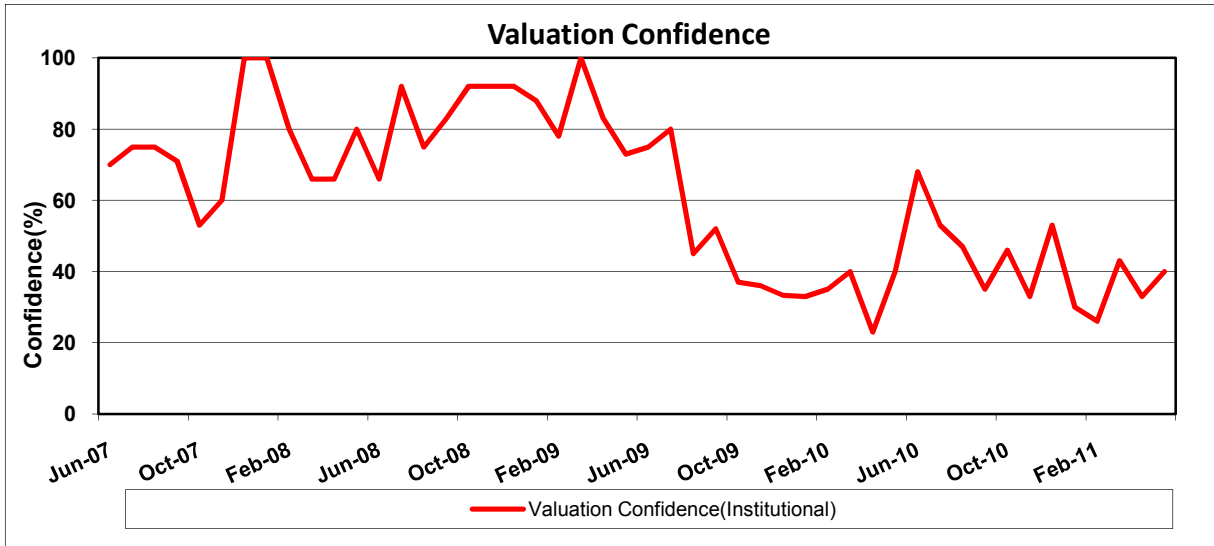


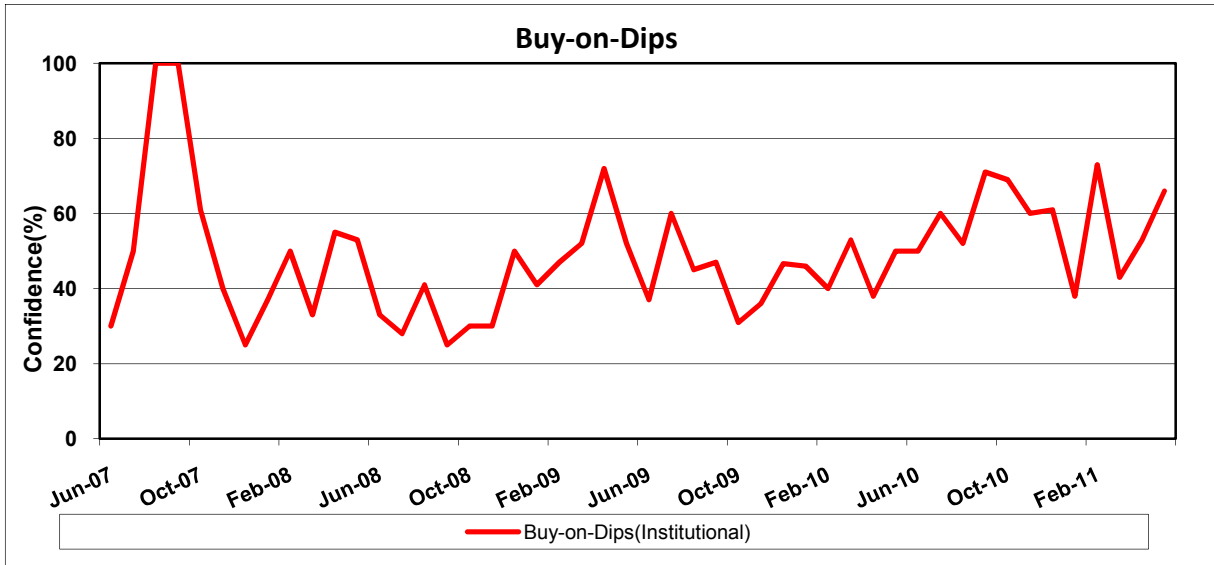




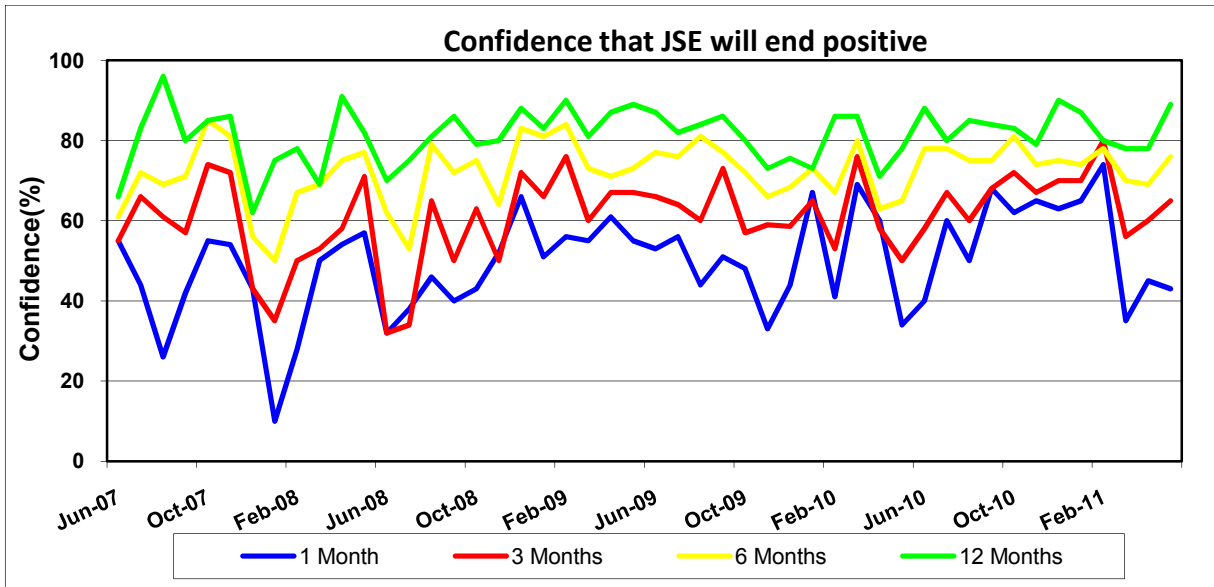
Institutional Investors

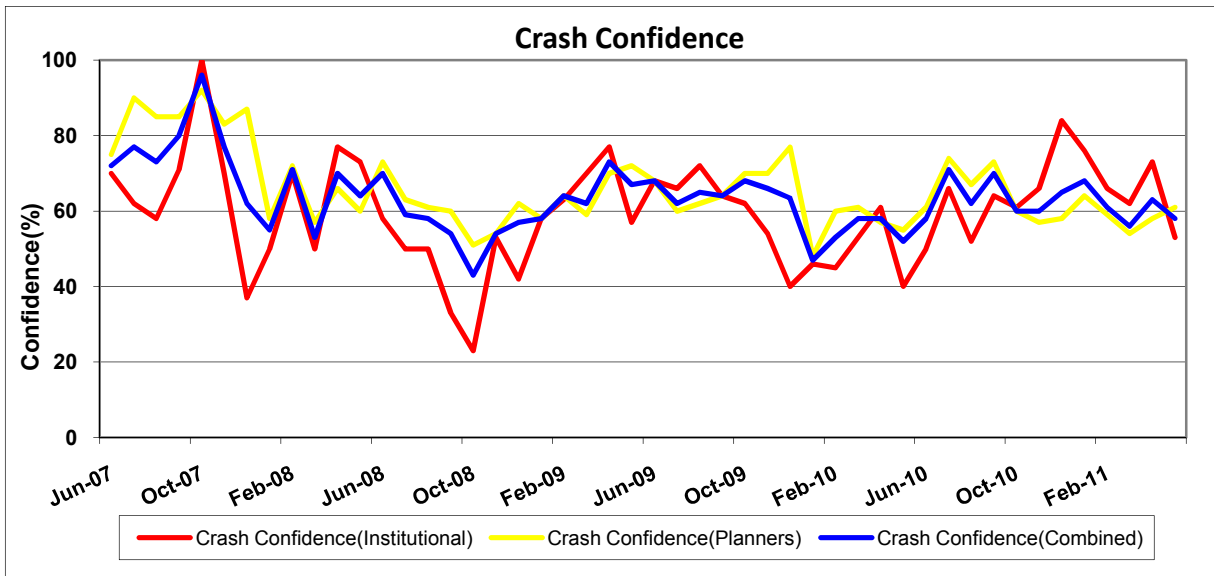
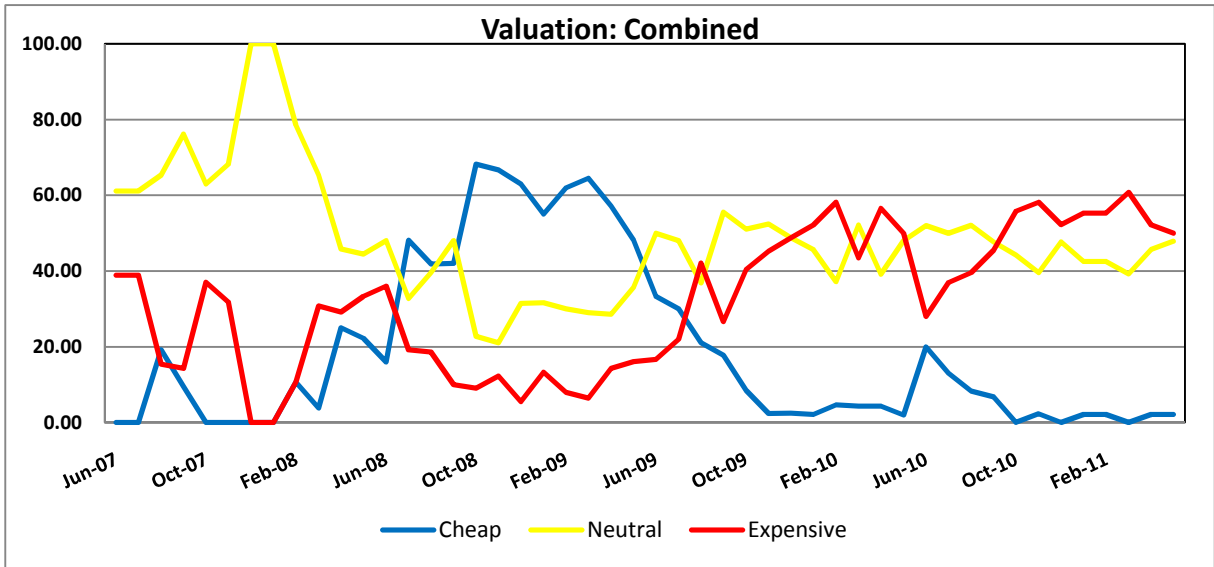
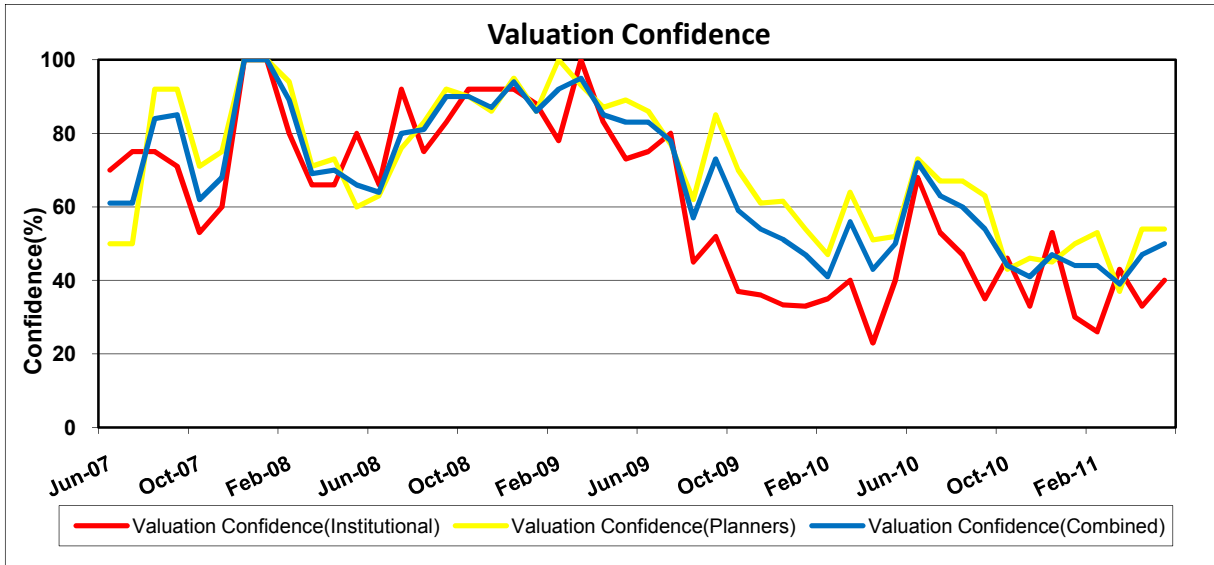


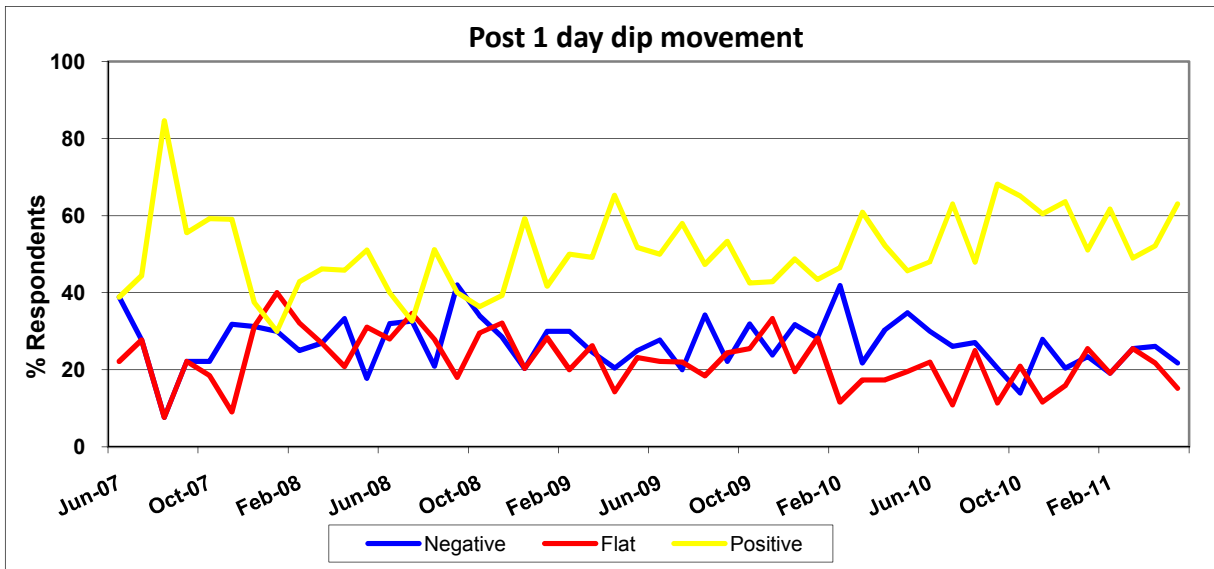
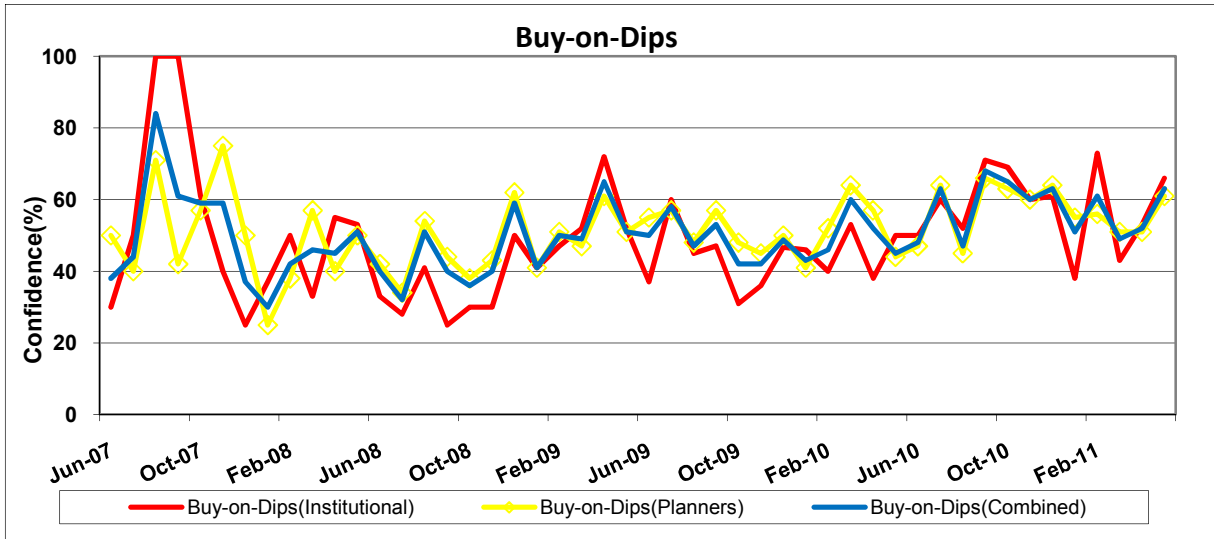




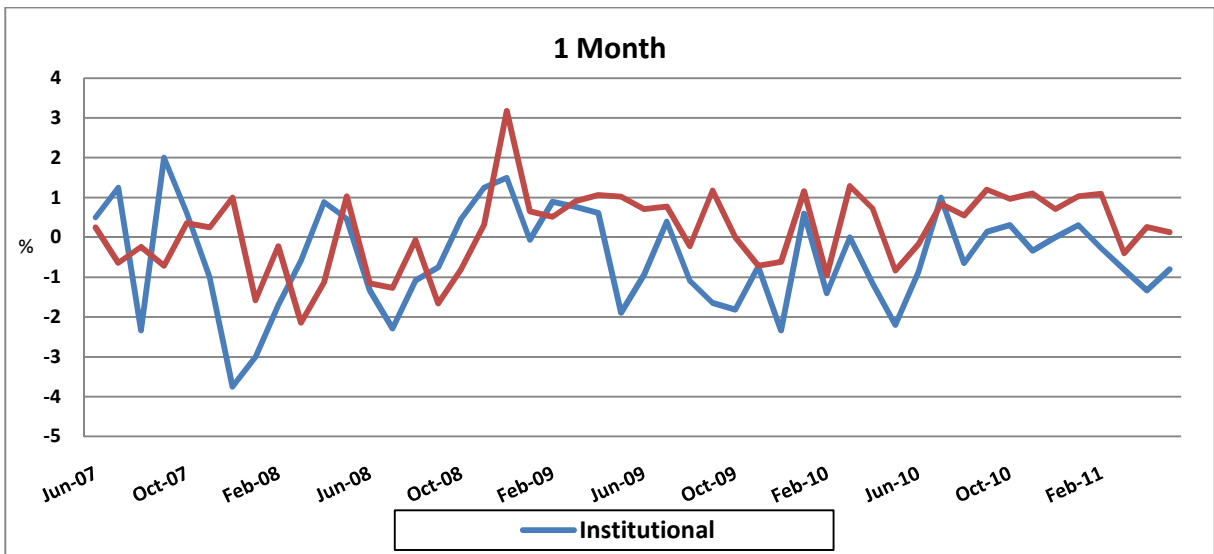
Combined Index

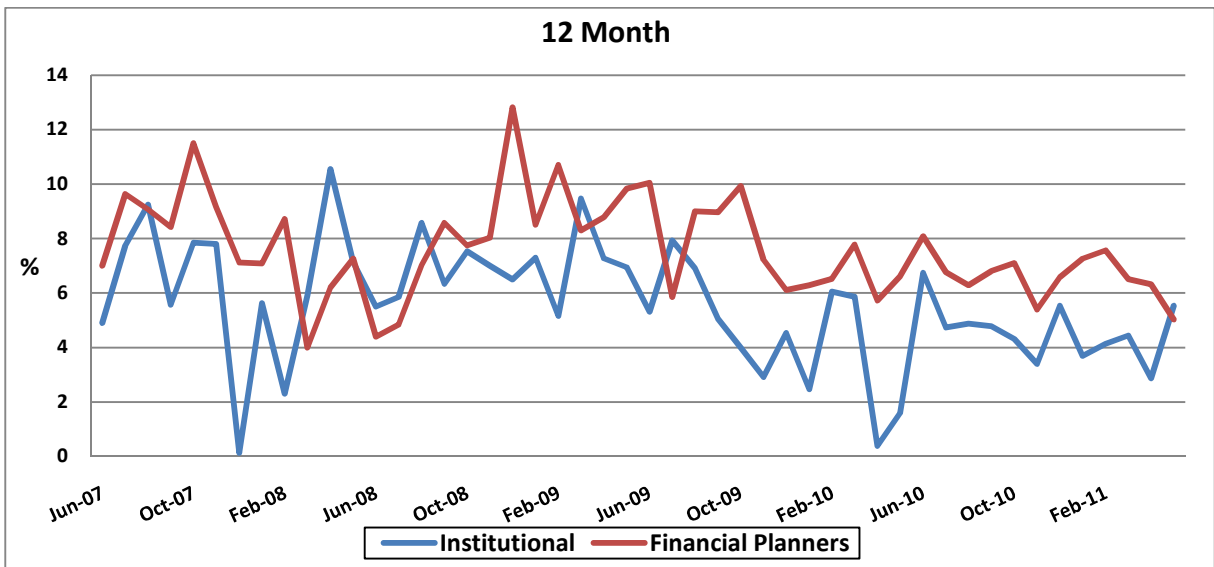
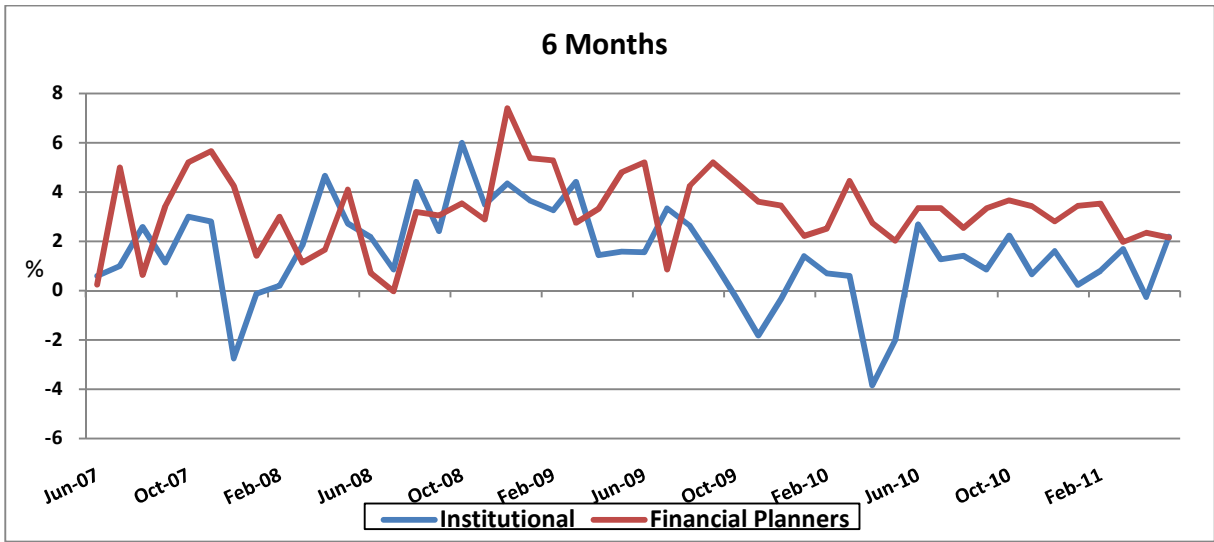
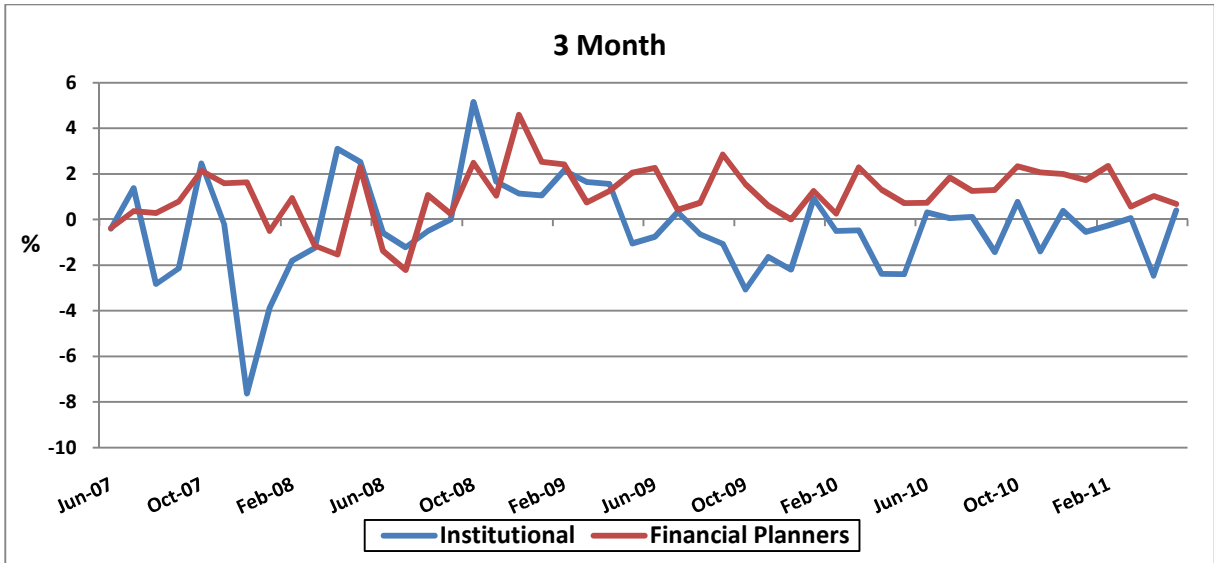






Average expected return





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.