NORTHSTAR

ASSET MANAGEMENT

Client Letter 23 April 2009

Quarter End: 31st March 2009

Dear Investor

Any one of the many tools used to value or price markets indicate that share markets are currently inexpensive. While they are not quite at the extreme cheap levels that were reached in the worst ever bear markets of the past, at present levels they are, in most cases, offering a comforting discount to their intrinsic value.

As we know, markets are driven by those most basic of human emotions; greed and fear. Due to genetic programming, the former is gradual whereas the latter is immediate. Just as we saw the pendulum reach an extreme in the good times (when we went defensive), so too might it now overshoot as investors belatedly bolt the stable door by hoarding cash in an effort to minimise further losses.

Under present market conditions, those exchanging shares for cash are doing the antithesis of what disciplined and successful investors do; buying low and selling high.

So overcrowded is the demand for cash and near cash assets, that government bonds in leading economies have near zero yields. While the pendulum might have further to swing before reverting to the mean once more, governments and central banks around the world are flooding economies with unprecedented levels of cash and this additional liquidity may well stabilise markets and quell investors' fear.

However appropriate these measures may currently be, we would be surprised if they did not result in the (not-entirely) unintended consequence of heightened inflation. This, combined with central bankers race to the bottom by depreciating their respective currencies, makes cash an extremely unattractive prospective investment when compared to real assets.

As long-term investors we spend little time attempting to predict short-term market movements, preferring instead to focus our energies on taking advantage of the current environment which is presenting opportunities which, for investors such as us, we have not seen for many a year.

Just as smooth seas don't make skilled sailors, so too do the stormy markets of late create opportunities for skilled investors. As always, over the next few years, investment returns will separate the wheat from the chaff.

Yours sincerely

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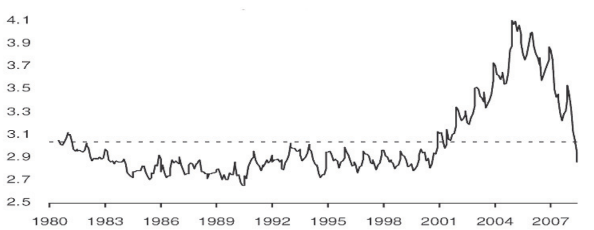
"Safe as houses". Or so the saying goes. This assumption suggests that investors in property are somehow immune from market price volatility, and was at the heart of the current global financial crises. Short and selective memories erased the several broad based declines in property prices that have occurred over the years. Throughout the 1930's, property prices in the US steadily declined by over a third before bottoming in 1941, long after the stock and bond markets had snapped back from Depression lows.

When they say that house prices don't fall, they neglect to mention that they don't rise by much either. US house prices, in the period 1890 to 2004, rose by all of 66% or just 0.4% pa after inflation. All the more remarkable then that between 1997 and 2005, they leapt by 52% or 6.2% pa after inflation.

Affordability of US single family homes as multiple of median annual income



Source: Credit Suisse Research

Spurred by low interest rates and abundant and innovative credit, buyers bought believing that house prices would only go up, and lenders lent believing they could never fall.

US House prices became so distorted that at their peak, a median income family in San Francisco could, at historic multiples, afford only 1.8% of the city's residential housing stock.

Then the impossible happened and prices began to fall. With average US single family house prices having peaked in 2005 at $241,000, they currently stand at $153,000. And they continue to fall; albeit at a decelerating rate of decline. As always, there is a risk of overshoot as forced sellers and surplus stock need to be cleared before prices can normalise.

Commercial real estate is suffering even greater declines. Investors who bought even the 'safest' commercial property companies, such as Liberty International, have suffered eye watering losses. Listed on both the London and Johannesburg stock exchanges, Liberty International's share price fell by nearly 80% before recovering to a loss of 'just' 66% at present.

Liberty International - share price over past 2 years to present.

Source: Northstar Asset Management

Adding to investors' troubles is the suspension of a powerful incentive for which many bought the share; the juicy annual dividend. Indeed, Liberty International is likely to be approaching existing shareholders to raise additional capital in order to avoid breaking banking covenants. So much for "as safe as houses".

While Northstar's clients owned neither Liberty International nor Anglo American (which recently also suspended its dividend for the first time in over 70 years and suffered a peak to trough share price decline of around 75%), they illustrate how even the most highly regarded companies are not immune to market cycles.

They also neatly define the companies we avoided when we explained that we sought for inclusion in our clients' portfolios those quality companies which had 'transparent and highly predictable future earnings'.

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Many of the companies held by our clients have seen their share prices marked down (albeit much less severely) in sympathy with the overall market. This is less concerning if the companies continue to hold, or increase, their earnings and dividend payments. In that case, any mark-down of the share price is no more than a temporary loss of capital which, in time, will be recouped, and more.

Companies such as Liberty International and Anglo American (and many others) destroy shareholder capital. Liberty, in order to raise capital to stave off insolvency, will issue a vast number of new shares at abnormally depressed prices and, in so doing, will dilute existing shareholders' equity stake in the company. In the case of Anglo American, not only did management employ debt and surplus capital to buy back large blocks of shares at near record high prices, but are now trying to extinguish debt by issuing around R15bn worth of shares to new investors (by way of a convertible bond), also at greatly depressed share prices.

For the past several years corporations and consumers enjoyed the 'wealth effect' created by cheap and abundant credit and appreciating asset prices. Just as leverage magnified the gains on the way up, so too is it amplifying the losses on the way down. The 1987 stockmarket crash, when worldwide losses were estimated to have been below $15 trillion, is but a blip when compared to the breadth of the wealth destruction taking place in the current cycle.

Since 2006, US households alone are estimated to have lost more than one quarter of their net worth or around US18 trillion. Globally, corporate and household losses are estimated to exceed US$100 trillion. Or, around 5 year's global GDP.

We have long held exposure to gold mining companies which we assessed were trading at prices below their intrinsic value. For a time they disappointed as rampant input costs hurt profit margins. In 2008, Harmony was one of the top performing shares on the JSE and together with Anglo Gold Ashanti have helped limit the downside in our clients' portfolios.

Rand gold price

Source: Northstar Asset Management

With the gold price presently trading at near record levels in most currencies, including the Rand, the share prices of SA gold miners are, once again, outperforming the Rand gold price.

While consensus inflation expectations are presently relatively benign, the consequences of successful global economic stimulus packages, and of central bankers beggaring their neighbours to depreciate their paper currencies, significantly increases the likelihood of a future inflationary, cash-devaluing environment.

We are of the view that it would be imprudent not to hold a portion of our clients' wealth in assets which would provide protection in the event of an inflationary shock. Should inflationary pressures elevate, these asset prices will be swift to adjust accordingly.

While financial markets appear to be indicating some optimism that a global economic recovery is taking hold, we are reluctant to subscribe to this view on faith alone. Once we see evidence of economic recovery gaining traction, only then will we reduce the defensive profile of our clients' portfolios. Over the past many quarters there have been several false dawns which have proved expensive to less wary investors.

The behaviour being displayed by financial markets is typically seen after substantial declines; when they need to accommodate the new 'normal' paradigm. This uncertainty may continue for a while as investors digest the much lower than expected earnings, and expectations, that are being reported by a wide range of companies.

Consequently, while we do not foresee a dramatic recovery in the near term, we do expect that, on a medium term view, our clients will comfortably outperform cash and bond investments.