NORTHSTAR
ASSET MANAGEMENT

Dear Investor

Whilst 2013 has been a tough year for investors on the JSE, it gives us great pleasure to inform our Northstar clients that we have had a solid six months and outperformed the market by a significant margin.

In April, the JSE fell 2.5%, in May it rose 8.5% and in June fell another 5.7%. These are significant moves over a short period of time and although unnerving, should be placed in the context of returns over longer time periods. Over the past decade, the JSE has returned almost 20% annually.

At Northstar, we understand that fluctuating markets unsettle our clients, but advise that share price movements are completely unpredictable or random in the short-term and moving prices do not indicate risk. Market gyrations merely reflect animal instincts. Real risk is losing capital over time and underperforming inflation – our goal is to keep our clients invested in assets that offer value, are incorrectly priced (cheap) and given time, will beat inflation, irrespective of how volatile they may prove to be! All the energies of our firm are directed towards this task.

In the past two months, we have briefly assessed hundreds of companies and conducted 12 'deep dives' (where we turn a company inside out – build financial models, go look at the operations and meet the management). This process of 'deep diving' occurs week in and week out as we refuse to invest in any business on a hope and a prayer.

Our intense investment process and hard work permeates beyond the borders of South Africa and we spend copious amounts of time analysing offshore companies too. Managing offshore portfolios is a further offering that we have made available to our clients.

Although 2013 market conditions are not without their challenges, we are enjoying applying our research process consistently and have absolute confidence that our hard work will continue to be reflected in our client's returns in the years ahead.

Yours sincerely

Adrian Clayton
and the Northstar Investment Team

NORTHSTAR ASSET MANAGEMENT (PTY) LTD.
4 Chester Drive Bishopscourt 7708 South Africa
Tel: 021- 797 8184 Fax: 021- 797 4706
email: info@northstar.co.za web address: www.northstar.co.za

Company registration number 1996/001423/07
Member of the Fund Managers Association of South Africa
Regulated by the Financial Services Board of South Africa
VAT registration number 429 01 666 46
Member of the Investment Analysts Society of South Africa
Authorised Financial Services Provider - License number: 601

It is not normal practice for us to dedicate the Northstar Quarterly Client report to our views and thoughts on economic matters, as we prefer to write about what we do each and every day – researching and analyzing companies and then informing our clients of our findings. However, the nature of market and economic dynamics this year has compelled us to reflect deeply and convey our views.

Geological data shows clear evidence that the earth has experienced dramatic climate change over its estimated 4 billion years of existence. It is theorised that these events have occurred as a result of tilts in the earth's axis and tectonic plate shifts, with some being rapid (which implies a period of 20 000 years) whereas others have taken hundreds of millions of years.

100 Million Years ago, during the Cretaceous World, subtropical conditions stretched from Antarctica to Alaska and herbivorous dinosaurs roamed the earth. The Ice Age changed this and as 'little' as two million years ago, much of Britain was covered by ice sheets and was inhabited by creatures such as mammoths and woolly rhinoceroses. Whilst we focus on animals that have become extinct through the ages, some - such as the tuatara (lizard found in New Zealand), the horseshoe crab, the duck-billed platypus and the coelacanth - have soldiered on.

Similarly, financial markets also endure events that redirect their flight paths, the vast majority of which are short lived and have little lasting effects, whilst others are highly impactful with long-term consequences. Being versatile ensures an ability to survive when change strikes.

Most market dislocations are invariably driven from changes in economic policy out of the United States and we need only look to the immediate past as proof of this. Consider the excessive consumer debt surge before the housing bubble burst in 2007, the epicentre being in the US and yet the effects of this reverberated across all markets. This proved to be a momentous economic crisis, but the extent to which some had predicted the United States turning into an economic lunar landscape has not materialized. Instead, US asset classes systematically re-valued or re-priced upwards, ascribable to progressive and positive monetary policy (reducing interest rates and printing money), which stabilized the tremors and prevented ongoing after-shocks.

Our attached graphs - the first reflecting the performance of the dollar over four decades and the second showing the powerful surge in the dollar since last year - may hold the key to market developments in the years to come.

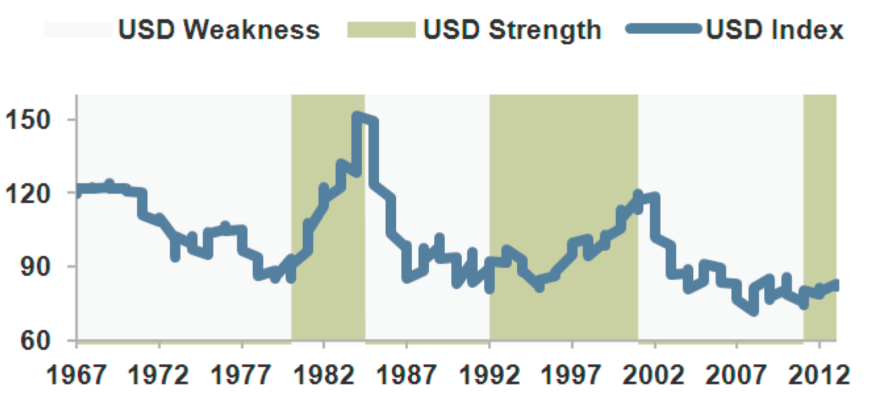

Figure 1. Dollar performance Source: Bloomberg & Northstar

The United States is the key driver of global interest rate policy and although certain smaller economies may have their own mini-cycles, the US drives the direction of interest rates for many followers. The linkage is capital and there tends to be a defined pool of money for which everyone is vying, whilst interest rate levels determine where investors want to invest their cash. Higher real interest rates attract savers, and if the US Federal Reserve raises rates, it forces other Central banks to follow. If they do not, capital leaves those countries.

With the slashing of US interest rates from a little below 7% in 2001 to 1% in 2005 and then again, post a rising cycle which lasted between 2005 and 2007, from 5.25% (2008) to almost 0% (2009), capital moved into emerging markets - higher yielding environments. Low interest rates drove a weak dollar for the past decade (2002 to 2012) and created a natural disincentive for investors to chase US assets. In addition, US assets were overpriced at the turn of the millennium. The game was on - emerging markets with higher growth prospects, cheaper assets and higher paying bank deposit rates attracted foreign flows. South Africa and our JSE was a major recipient of this cycle.

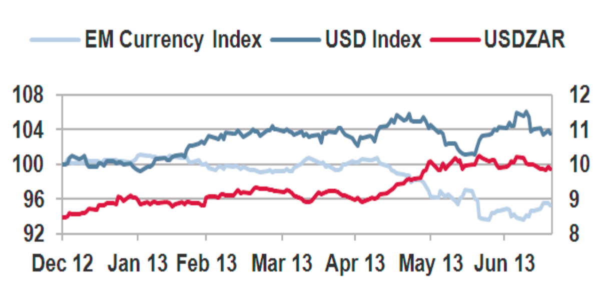

Figure 2. Recent dollar strength Source: Bloomberg & Northstar

The reason that the latest dollar resurgence is telling, is that it is being underpinned by legitimate fundamental factors, namely low levels of inflation (1.5% expected for 2013), improving GDP growth (2.5% expected for 2013) and improving employment levels together with the rising prices of houses. US net debt to GDP has also begun to level off and is projected to decline from 2014 - this is currently at about 75%. In addition, until eighteen months ago, US financial assets were grossly undervalued and it is only in the last couple of months that the market has really cottoned on to this.

Based on the rhetoric from the Federal Reserve, the US' improving economic fundamentals seem to be underpinned and consequently, US interest rates are set to escalate. From what we can gauge, these will be at 0.5% in 2014 and reach 1.5% in 2015 - current US rates are 0.25%.

Unfortunately, we do not have the latitude to expand on the consequences of a dollar directional change, but what we do know is that these are usually long cycles and are highly beneficial for companies with strong US franchises, such as US banks. On the other hand, emerging currencies weaken with such cycles and emerging market interest rates rise, although this cycle will probably be more muted than some of those in the past. The weakness of the rand in 2012 and 2013 is ascribable to exactly these factors mentioned above!

At Northstar, we are not attempting the role of economist and market prognostication is not an area on which we focus. However, we believe that ongoing strategies to mitigate risk for our clients is key to our success and a protracted change in the direction of the dollar could be an event for which we must prepare. The key components of our strategy thus far have been:

- Avoid risky, cyclical, expensive South African companies where domestic interest rates have acted as a tailwind over the past decade and could become a head wind going forward - South African retailers fall into this camp.

- Stay invested in world class companies.

- Factor in an extra margin of safety during our analysis - be penal when valuing companies.

- Inform our clients of the advantages of South African and offshore asset exposure.

- Research of both domestic and offshore companies - this we have been doing for years.

Adrian Clayton and the Northstar Investment Team