NORTHSTAR
ASSET MANAGEMENT

**Client Letter** 17 July 2012

**Quarter End: 30th June 2012** 

Dear Investor

Our job is to worry, so that our clients don't need to. Investing, for us, is to navigate the financial markets constantly on the lookout for potential hazards, and to steer around those which are avoidable, or to prepare and protect against those which are unavoidable. As referred to in our Market Report, this approach, underpinned by our investment analysis, has enabled us to protect and grow our clients' wealth over the long term, in both up and down market cycles.

The global backdrop shows that the US economic recovery is underwhelming, China's growth rate is slowing and Europe continues to experience economic turmoil which keeps spilling over into world's financial markets. Europe's woes, and its inability to proactively address these, are the main source of current global economic instability. Just as these problems affect other nations' economies, so too do they impact on the prospects of the companies in which we invest our clients' capital and may give rise to heightened uncertainty, volatility and risk. And, opportunity.

We do not anticipate that these matters will be resolved anytime soon. Nor do we profess to have any foreknowledge of how the future will ultimately play out. Rather than trying to predict the unpredictable, in uncertain times such as these, we continue to focus our efforts where they count; on analysing and estimating companies' normalised future earnings and hence their worth. It is the associated stream of future earnings which we buy, when we invest in a share on behalf of our clients and, ultimately, everything else is secondary.

Our preferred companies are usually temporarily out of favour with the market because of perceived poor near-term prospects. Notwithstanding, these are sound companies offering superior fundamental value, taking into account associated long-term risk and return.

As has been the case for some time we remain reluctant to assume unnecessary risk in our clients' portfolios. In view of this, those few portfolio changes that we have made are the recycling of profits realised from the sale of more fully valued shares, and rotated into the purchase of inexpensively valued ones. In keeping with our cautious approach, any investments which we make are done on an incremental basis. Should the share prices of our recent purchases decline in the near term, it then provides us pleasing opportunity to continue building our clients' positions at even more compelling valuations.

It remains our great privilege to keep safe and grow our clients' wealth and we look forward to continuing to do so in the years ahead.

Yours sincerely

Alexander Otten

**Alexander Otten**

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In chess, the term 'Zugzwang' describes a situation in which one player cannot skip a turn, but whatever move he makes will put him in a worse situation.

Angela Merkel must feel a bit like this. Germany is having a very good European crisis. The weak Euro increases their competitiveness and as a consequence, the German economy is at full employment and attracting skilled workers from those countries having a bad crisis. Additionally, despite record-low interest rates, and as a result of the 'flight to safety', Germany is experiencing mammoth investment inflows.

Irrespective of how the European crisis may be resolved, Germany will be worse off. If it does too little, the profligate periphery European nations leave the European Union (EU), and Germany will not only lose markets but the Euro currency will appreciate markedly, thereby hurting German exports and its economy.

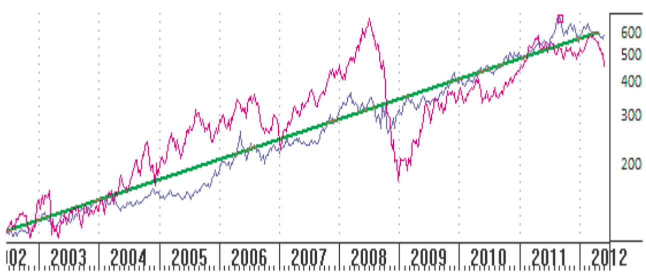
If Germany does too much, their taxpayers will become, at least, partially responsible for the debt of imprudent states and entities over which they have limited influence. Merkel will be seen as having sold out her electorate which will impact her chance of re-election. A fact not lost on her political opponents, nor on the CSU, her governing coalition partners.

We expect that Germany will do just enough to keep the Euro alive (and preferably weak); and no more. Whether this will be enough to hold the EU together is yet to be seen. The ongoing cost to Germany will be to recycle the benefits it accrues from a weak and intact EU, to the periphery countries through aid and loans.

While this might be seen as a short term solution, it is no panacea. This arrangement will result in ever increasing political and economic tensions and resentment, from both sides.

In tackling the deflationary effects of the ongoing deleveraging of the global economic system, central bankers have encouraged their currencies to depreciate. Some have been more successful than others. Those less successful, such as the Japanese and Swiss, have resorted to massive dumping of their respective currencies to prevent them from over-appreciating in value relative to the more successful depreciators such as the US and UK central banks.

Oil price (per barrel) and spot Gold (per fine ounce) both in US$ - 2002 to present




Source: Northstar Asset Management

The Swiss Central bank is on record saying that, should their currency appreciate further, their intervention and selling of the Swiss Franc will be in "unlimited" quantities.

With major currencies beggaring their neighbour in an attempt to gain the advantage of weakening the most, it is not always clear to see just how much fiat currencies have declined in value.

Some indicators are to measure currencies against assets such as art, real estate or even global commodities such as oil and gold. Interestingly, despite oil's greater price volatility, the number of barrels of oil that it takes to purchase an ounce of gold has, over the past decade, remained relatively consistent around a mean of 16 barrels of oil per ounce of gold. (Currently 16.4)

What is evident from these 'price increases' is that much of what we are witnessing is actually the ongoing erosion of the value of money. In cash form money is no long-term store of wealth and is 'king' only for brief and infrequent intervals when there is turbulence in financial markets.

Over the past 65 years, the US dollar has lost 93% of its purchasing power. It, and other currencies, are likely to continue to devalue as a result of steps (such as the zero interest rate policy) taken to spur economic recovery from the 2008 credit crises.

It behoves us to be mindful of this when we assume the responsibility of protecting and growing our clients' real wealth.

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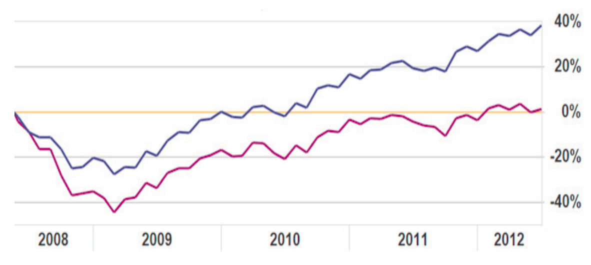
The Johannesburg Securities Exchange (JSE) All Share Index (ALSI) is currently 2% higher than it was at its pre-crash peak value in May 2008. In the same period Northstar's clients' portfolios have appreciated by almost 40% from their 2008 peak value.




Northstar client portfolio vs JSE All Share Index - peak 2008 value to present

Source: Northstar Asset Management

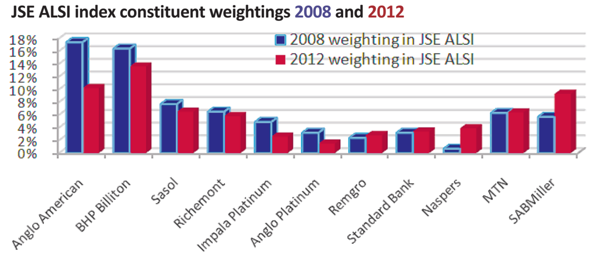
This outperformance has been a result of our being prepared to follow the conviction of our research and hold investment portfolios unique to Northstar's clients. It is only by being different that we are able to produce results which differ from the market's indices and our competitors.

As we commented after the 2008 crash, experience has taught us that the companies which lead the market into a crash are never the same as those which lead the market out of a crash. We saw this in 1998 when then over-hyped small companies and banks experienced share price meltdowns and again in 2001 when then in-vogue technology companies led markets into severe price falls. Small capitalisation companies, banks and technology companies have yet to recover theirpre-crash valuations.

In 2008 it was commodity companies which had led the charge up and they too have subsequently seen their share prices languish despite the stockmarket's recovery to its pre-crash peak level.

To understand how it can be that the JSE ALSI presently trades within a whisker of its all-time high, requires that we delve deeper into the constituent components of the stockmarket index.

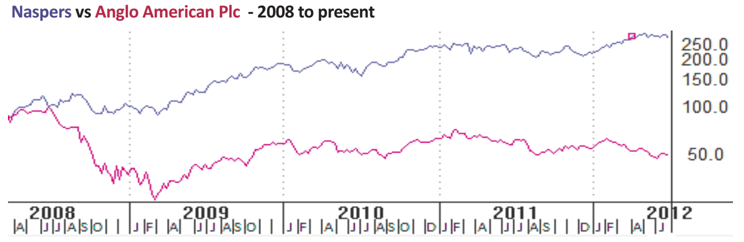
In 2008, Anglo American Plc constituted 17.4% of the JSE ALSI; today it is around 10%. BHP Billiton's weighting declined from 16.7% to today's 13.6%, and the platinum producers Implats and Amplats have seen their influence on the index decline from a respective 4.9% and 3.2% in 2008 to today's 2.6% and 1.5%.




JSE ALSI index constituent weightings 2008 and 2012

Source: Northstar Asset Management

As the influence of the resource companies on the ALSI declined, the respective weighting of successful non-resource companies such as Naspers, SABMiller and Sanlam increased. Since the pre-crash 2008 peak valuation, Anglo American share price has halved while Naspers has appreciated by 275%. At that time it cost 3.3 Naspers shares to buy one Anglo share. Today one Naspers share buys 1.5 Anglos shares; a 500% differential in price movement.




Naspers vs Anglo American Plc - 2008 to present

Source: Northstar Asset Management

Cyclical resource companies were at peak earnings in 2008, at which time our clients had all but no exposure to them. At current cycle-low earnings, our research indicates that some of these companies are trading at a discount to their intrinsic value as calculated on normalised earnings. They are becoming increasingly interesting on both an absolute and relative value basis.