NORTHSTAR
ASSET MANAGEMENT

Client Letter 18 October 2011

Quarter End: 30th September 2011

Dear Investor

This past quarter financial markets were very volatile as they were buffeted by external and politically driven factors. In the USA, politicians' partisan grandstanding over raising that country's debt ceiling, in part, resulted in the Standard and Poor's credit rating agency downgrading US sovereign debt, for the first time in almost 100 years, from its premium AAA risk rating. If that wasn't enough to roil the markets, the debt problems of peripheral European countries remained unresolved and are a continuing source of uncertainty and concern to the markets. Economic growth, or even economic traction, which would be a balm to worried participants, was little evident, leaving investors and markets fretting that this may result in a double-dip recession.

Investors gave expression to their qualms by retreating from more risky assets and currencies. Share prices reversed gains from earlier in the year. Asian stock markets, reflecting uncertainty over China's on-going economic growth, experienced their largest quarterly decline in ten years, and those of Germany and France fell by over 25% in the period. Investors sought the perceived safe haven of bonds including, ironically, the same US Treasury bonds which had recently had their creditworthiness downgraded by Standard & Poor's, and whose yields were driven to record low levels.

Fleeing risk, investors flocked to gold and currencies such as the Japanese Yen and Swiss Franc, which were propelled to record highs, and the yield on the Swiss two year government bonds turned negative – investors were paying the Swiss government to lend it money.

This is Alice in Wonderland territory for the markets which had gone through the looking glass. These abnormalities are not sustainable, albeit that they may always get worse before they get better. One does not try to buy hurricane insurance in the middle of the storm; investors were overpaying for the perceived protection of low risk assets.

As our clients well know, we prefer to invest away from the herd, and when the gold price spiked in the last quarter, we took the opportunity to take profits in selling all our clients' exposure to Harmony and significantly trimming back exposure to AngloGold Ashanti. In our view, the gold price, which has doubled in the past two years, and quadrupled in the past 6 years, was crossing the line from investment to speculation. We would suggest that the 'easy money' in that trade has been made and that talk of a near-term gold price of US$3,000 or $5,000 may be just that.

In the depth of the August stockmarket lows, we rotated the proceeds of the gold sales and began building positions in Impala Platinum and Anglo American, both of which had been severely punished by the market and were well below half their 2007 prices and had respectively fallen by around 30% and 25% in 2011 alone.

The South African markets were not exempt from the global turmoil and our benchmark, the Johannesburg Securities Exchange (JSE) All Share Index (ALSI), ended September with a year-to-date loss of -7.6%. Fortunately, our previously discussed risk-averse positioning of our clients' portfolios resulted in Northstar's clients not having to participate in any measure in those losses.

It is our great privilege to be entrusted with the responsibility of managing our clients' capital and it is most rewarding for us on an on-going basis to add value or, as now, to avoid losses and so considerably benefit our clients' wealth.

Yours sincerely

Alexander Otten

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The most widely tracked stockmarket index, the US's Standard and Poor's index of the 500 largest listed companies in the US (S&P 500) recently crossed the 1,100 point mark. A few years ago they used to print souvenir baseball caps each time the index crossed a 'psychological' barrier of a round thousand points. But no more.

After crossing the 1,100 mark for the first time in March of 1998, the S&P has crossed it over 100 times in subsequent days and has pivoted around this level with a high of 1,576 (Oct 2007) and a low of 666 (March 2009). US investors who remained in the market for the duration will have not much more than a few additional grey hairs to show for their tenacity.

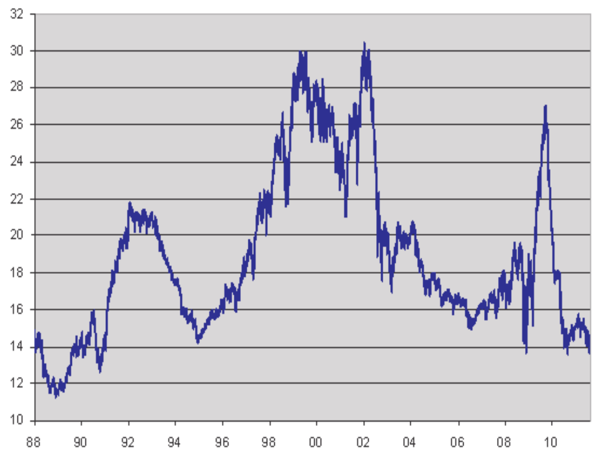
S&P 500 Index - weekly chart - 1997 to 2011

Source: Northstar Asset Management

Stocks have endured a lost decade, but that far from tells the full story. While stock prices may be unchanged over this period, the companies have grown and evolved. As a result, each time the market crossed the 1,100 hurdle, investors were paying a lower price for each unit of earnings generated by the companies, ie: P/E ratio.

The p/e ratio, when the S&P 500 first crossed the 1,100 mark, was 22 and went on to peak at 32 in early 2000, after a period in which stock prices had appreciated twice as quickly as did company earnings. Excepting spikes attributable to post-crash economic shocks in 2002 and 2009, since its zenith in 2000, the p/e ratio of the S&P has declined fairly consistently and when the index again crossed the 1,100 mark in August of 2011, investors were paying just 12.4 times each unit of S&P earnings, the lowest multiple in twenty one years.

S&P 500 Index - price / earnings multiple (p/e ratio) - 1988 to 2011



Source: Northstar Asset Management

The weak dollar has boosted corporate profits in the US and the S&P's current return on shareholder equity is the highest since 2001. If companies' guidance and analysts' forecasts are correct (we reserve our judgment) then the S&P is currently trading at just 10.4 times next year's earnings and equal to the historic low reached in the aftermath of the 1987 stockmarket crash. This implies that stocks are either very cheap, or the market is convinced that companies' and analysts' forecasts are wrong.

The p/e ratio is used as a crude assessment of risk. And, this is what interests us. When the ratio was peaking, the possibility of significant permanent loss of capital was high. At current levels that probability is significantly reduced. Indeed, were the stockmarket to rerate to a long-term average p/e ratio, share prices could overnight appreciate by over 50% and still be merely averagely priced.

This somewhat simplified analysis reflects part of our thinking when we make investments on behalf of our clients. It illustrates the emphasis we place on our aversion of downside risk rather than single focus on possible upside gain. From our experience, if we are able to curtail the risk of permanent loss of capital, many of the potential upside gains look after themselves.

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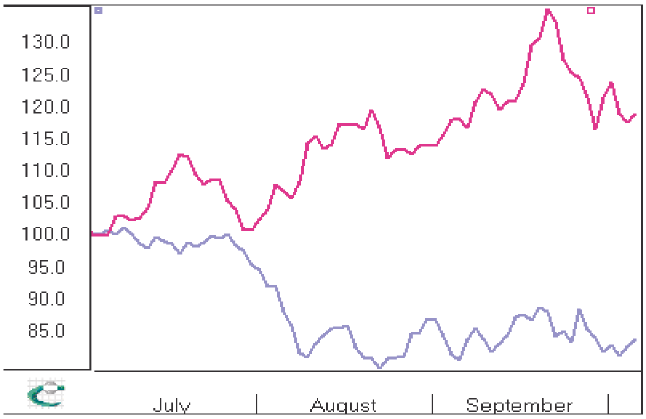
In the past quarter we took advantage of market anomalies to do what we are most comfortable doing. Selling that which the market deemed fashionable and was buying; and buying shunned shares which the market was selling.

In so doing we were able to lock in share prices which were at a premium to the gold producers', Harmony Gold and AngloGold Ashanti, intrinsic value and, on the other leg of the trade, acquire positions in Impala Platinum and Anglo American Plc. at a discount to their respective intrinsic value.

As mentioned in our Client Letter, in the last quarter the political uncertainty spooked investors and they responded with a binary 'risk-on / risk-off' reaction. In the latter they flocked into 'safe-haven' assets such as gold and the Swiss franc. Both of which spiralled on a virtuous cycle to unrealistically high levels.

AngloGold Ashanti Ltd. vs. Anglo American Plc – relative share price in 3rd quarter 2011

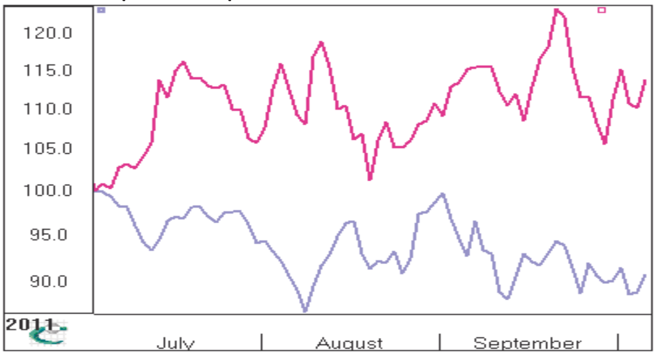


Source: Northstar Asset Management

To be frank, we are not great fans of Anglo American. Its management has destroyed several billions of rand of shareholder value and its commodity mix is, in our view, not necessarily the most exciting. Despite this, we began to build a position in this company in our clients' portfolios simply because the company's share prices reached levels which were exceptionally cheap relative to the company's intrinsic value based on normalised earnings.

By our analysis, when we were buying Anglo American for our clients, its share price, relative to the rand price of its underlying commodity basket, was at a similar, exceptionally low ratio to which it fell when the markets crashed following the financial crises of 2008.

Harmony Gold Ltd. vs. Impala Platinum Ltd. – relative share price in 3rd quarter 2011



Source: Northstar Asset Management

Impala platinum is another company which rattled investors' nerves in the quarter when it was announced that Zimbabwe was pursuing its policy of 'indigenisation' whereby all foreign companies are required to have a minimum 51% local shareholding.

Although the bulk of Impala's activities take place in South Africa, it has vast platinum reserves in Zimbabwe. It is, by far, the largest single generator of foreign reserves for that country. At its current share prices one is acquiring the Zimbabwe operations at 'no cost' and, more importantly, investors are buying the company's shares at a comforting markdown to Impala's normalised earnings value.

We know that share prices are more volatile than is a company's intrinsic value and, while the price of Anglo American and Impala shares may decline further, at current prices there is already a reassuring safety-net in terms of the discount in the price paid relative to the respective companies' intrinsic value.

Indeed, we would be pleased were their share price to further decline as we be able to increase our clients' exposure to these companies at even more attractive prices.