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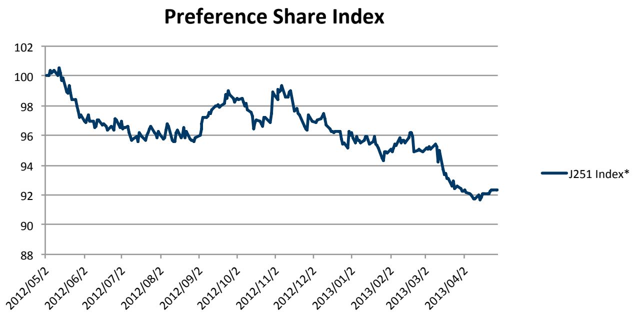
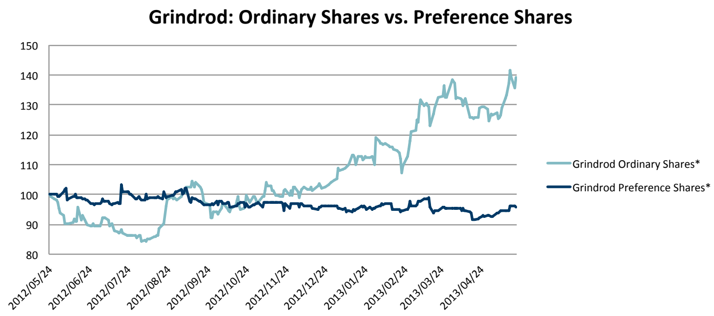
Dear Investor

MARKET UPDATE: UNLOVED LISTED PREFERENCE SHARES SHOWING VALUE.

Preference share yields continue to climb as their share prices continue to weaken (refer preference share index). For the first time ever, the rolling 12 month total return (capital and div) of the Diversified Preference Share Fund has dipped into negative territory (GDPSF -1.36%, Index – 1.28%). This weakness is difficult to understand as there is now tax clarity (post a benign 2013 budget speech) and, all the while, most other fixed income yields are moving lower and spreads tightening generally. Markets globally have been chasing yield assets and this contrarian behavior of the asset class is confusing. The J251 is now yielding over 7.45% - an attractive rate not even taking the tax efficiencies into account. Some weakness in certain sectors is easier to understand such as the weakness in the micro lenders but this makes up only a small part of the preference share market. Whilst there have been rumblings of further new issuances coming to market there are no imminent listings which have been announced so supply side shocks are unlikely in the near term.



*Source, I-Net Bridge, performance based to 100.



*Source, I-Net Bridge, performance based to 100.

It is worth noting that some of the preference shares which are experiencing price weakness, take for instance Grindrod Limited, are otherwise enjoying healthy support in the bond and equity markets - refer below chart showing Grindrod Limited's Ordinary shares vs. Prefs. Grindrod Limited (via its Bank subsidiary) also had a healthy debut showing in the bond market in October 2012 raising R500m. In the majority of cases, the credit risk of the issuers is looking suitably robust.

The only material risk (or perhaps opportunity) facing the index, as far as we can see, is the classification of the Bank prefs from a BASEL III perspective. The terms of these prefs will most likely need to be adjusted which is likely to result in higher yields or the Banks' redeeming them. We believe there is more upside opportunity than down side risk in this change.

We believe the recent weakness in the asset class can most likely be attributed to:

- The historically low interest rate environment – yields from cash, and cash proxies, are generally low. Conversely risky asset classes such as equity and listed property ran hard last year and investors might have been looking to switch.
- The poor liquidity of the asset class means that only a handful of large sellers can move the market as a whole.
- Possibly the most likely reason is the classic (and disappointing) investor behavior to sell when markets move lower instead of buying in depressed markets and selling in rich markets. This means that an already weak market is suppressed further.

In conclusion, we feel the asset class is oversold and investors looking for yield in this low yield environment would do well to capitalize on this weakness. "You got to be greedy when others are fearful and you got to be fearful when others are greedy" Warren Buffett.

Regards

Gareth Stobie
Head: Capital Markets Grindrod Bank Limited