

Global Markets



Commodity-Linker Exchange Traded Notes (ETNs)

Issued by The Standard Bank of South Africa Ltd through Blue Access

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Blue Access

In order to meet investor demand for access to new markets, Standard Bank introduces Blue Access. Blue Access, through the Bank's ZAR 60 billion Domestic Medium Term Note (DMTN) Programme, creates the platform for listing exchange traded notes (ETNs) on numerous underlying local and foreign assets. This provides investors with a cost-effective opportunity to invest in hard-to-reach markets through a local exchange.

Blue Access provides two effective avenues of investment:

- **Private access** – An exchange traded, customised, privately placed note, suitable for institutional investors
- **Public access** – An exchange traded public listed note, suitable for institutional and retail investors

The aim of the Blue Access listing platform is to increase the ability of South African (SA) investors, retail and institutional alike, to trade freely in products such as commodity futures, African stock markets, international equity and credit indices, bonds and currencies.

The first suite of ETNs to be issued from the Blue Access platform is Commodity-Linker ETNs.

What are Commodity-Linker ETNs?

Commodity-Linker ETNs are JSE-listed instruments that track the performance of an underlying commodity. These ETNs provide investors with a vehicle to access a market previously inaccessible to both individual and institutional SA investors. Standard Bank, the first bank in SA to launch ETNs that track commodities, is the issuer and market maker of the notes and will therefore facilitate the buying and selling of ETN positions thus ensuring the liquidity. Commodity-Linker ETNs will constitute senior unsecured unsubordinated obligations of Standard Bank.



Commodities as an asset class

In recent years, offshore investors have viewed commodities as a distinct asset class and investment tool with the potential to generate excess profit or portfolio returns. In SA, however, a position in commodity markets was largely restricted to the hedging of physical demand or producer exposures.

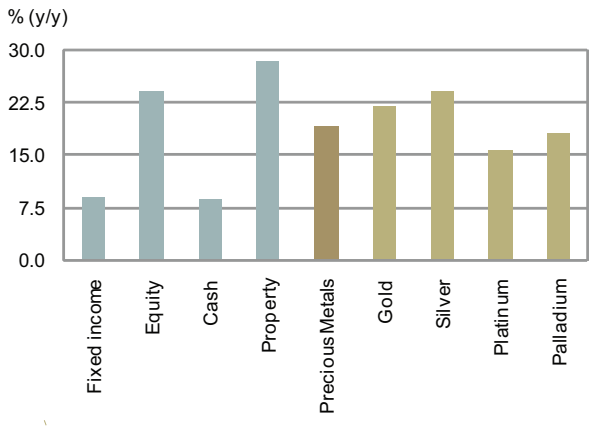
While exploring commodities as an independent asset class¹, Standard Bank’s research team noted that the motivation for the increased interest in commodities was due to the distinct advantages they offered over the markets of traditional asset classes, including local equities, fixed income, property and cash equivalents. These advantages include the following:

- **Commodity markets generally move in the opposite direction to fixed-income securities and equities.** This gives commodities the advantage of providing diversification benefits within investment portfolios.
- **Commodity markets are thought to offer protection against inflation.** While it has been shown that commodities are far from a perfect hedge against inflation, the inflation protection they provide is superior to that of other conventional asset classes.
- **Commodity markets trade globally.** This offers an advantage in terms of liquidity, as investors can take up or unwind positions at most times to optimise trading. It also enhances the speed at which information can be priced within commodity markets.

Precious metals as an asset class

Standard Bank’s research team continued to explore precious metals, including gold, silver, platinum and palladium, and their advantages and ability to perform as an independent asset **class**¹. A set of five criteria was used to determine that precious metals, compared to the existing commonly traded asset classes, indeed qualify as an asset class of their own. In addition, an historical analysis showed that investing in precious metals would result in positive returns that were comparable to those of the traditional asset classes. Precious metals have also been proven to be sufficiently uncorrelated to the traditional asset classes, hence would provide significant diversification benefits when included in an investment portfolio. The graph alongside depicts the results of a buy-and-hold (passive) investment in precious metals, compared to investments positions in traditional asset classes. As can be seen, precious metals ranked third among the other asset classes.

Average annual returns from June 2003 to June 2010



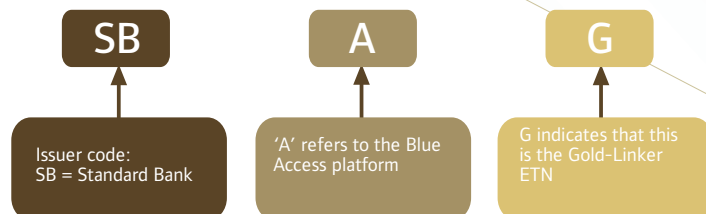
¹ Please refer to the appendices for the Standard Bank Research Publication

ETNs on precious metals

What are ETNs on precious metals?

The first suite of Commodity-Linker ETNs consists of separate ETNs created on four precious metals, namely Gold-Linker, Silver-Linker, Platinum-Linker and Palladium-Linker. These ETNs afford investors the opportunity to access the commodity market and gain exposure to precious metals as an asset class.

How to identify Standard Bank's precious metal Commodity-Linker ETNs



JSE trading codes

Gold: SBAG1

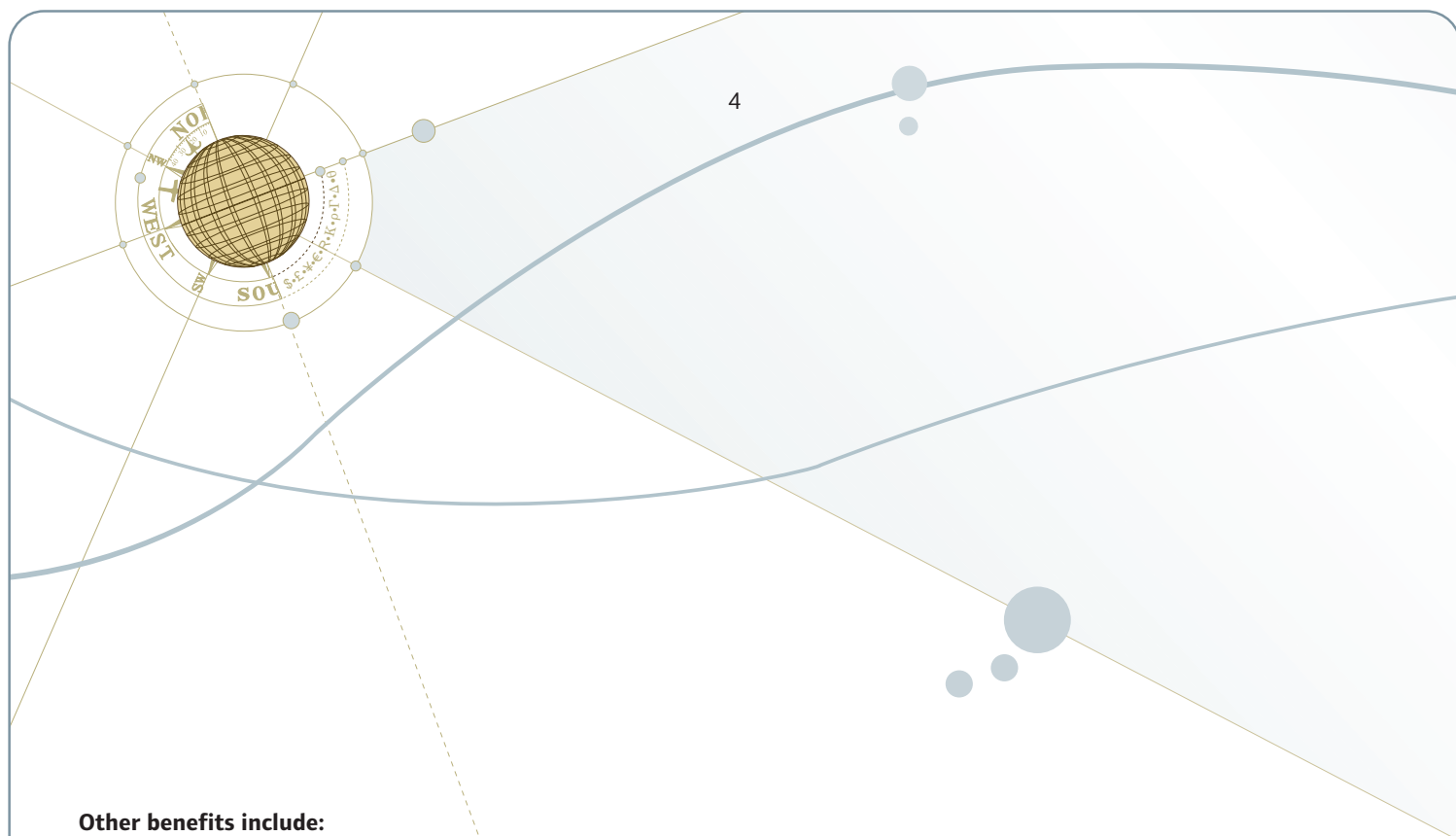
Silver: SBAS1

Platinum: SBAPL1

Palladium: SBAPD1

Advantages

Instead of owning, storing and insuring physical gold, silver, platinum and palladium, investors can enter the precious metals market by purchasing Commodity-Linkers. In addition, the commodities market can now be accessed via another avenue than the traditional USD commodity futures. The ETNs therefore provide investors with exposure to the performance of the precious metals without the necessity of trading the underlying commodity futures. The inconvenience of margin calls, which is particular to futures trading, can be avoided.



4

Other benefits include:

- No gearing on instrument
- Passive long-term investment that has 'equity'-like characteristics
- Liquid: Standard Bank agrees to provide buy/sell prices and market-related spreads
- Transparent: Investment returns are determined from the relevant underlying near-dated futures contract, which is a transparent contract with reliable information and statistics
- Cost-effective mechanism for managing your commodity investment
- No hidden expenses

Possible risks:

- Returns not guaranteed; returns generated from the positive performance of the underlying commodity total return index
- No principal protection
- Currency risk to the extent that the underlying precious metals market trades in US Dollars and the ETNs trade in Rands
- Standard Bank issuer risk (Issuer rating of AA-)

What does buying an ETN actually mean?

Purchasing a Commodity-Linker ETN provides investors with exposure to the performance of the underlying commodity price. In order to track the underlying commodity price, a total return index is created which links to the particular commodity. The index is composed of the performance of the underlying near-dated precious metal USD futures price converted into ZAR. The near-dated futures are used as they are typically the most liquid contracts and are a very close proxy of the spot price.

Each precious metal Commodity-Linker gives the investor exposure to a portion of an ounce of the precious metal concerned. This amount varies daily in line with changing underlying commodity values.

Consider the below trade example

If an investor purchases a Gold-Linker for R100 and the exchange rate is R7.25, the investment is converted into a USD amount, i.e. \$13.79 ($R100 \div R7.25$). If the gold near-dated future is trading at \$1190.30, the initial investment of R100 will give the investor exposure to 0.012 of an ounce of gold, i.e. $\$13.79/\1190.30 . Hence 100 ETNs will give the investor exposure to 1.2 ounces of Gold.

The following table was constructed on 03 August 2010 on the assumption that the USD/ZAR exchange rate was R7.2865 and the cost of one ETN is R100.

ETN units	Metal ounce (oz)
100	1.153 oz of Gold
100	0.859 oz of Platinum
100	73.984 oz of Silver
100	2.686 oz of Palladium
86.73	1 oz of Gold
116.38	1 oz of Platinum
1.35	1 oz of Silver
37.23	1 oz of Palladium

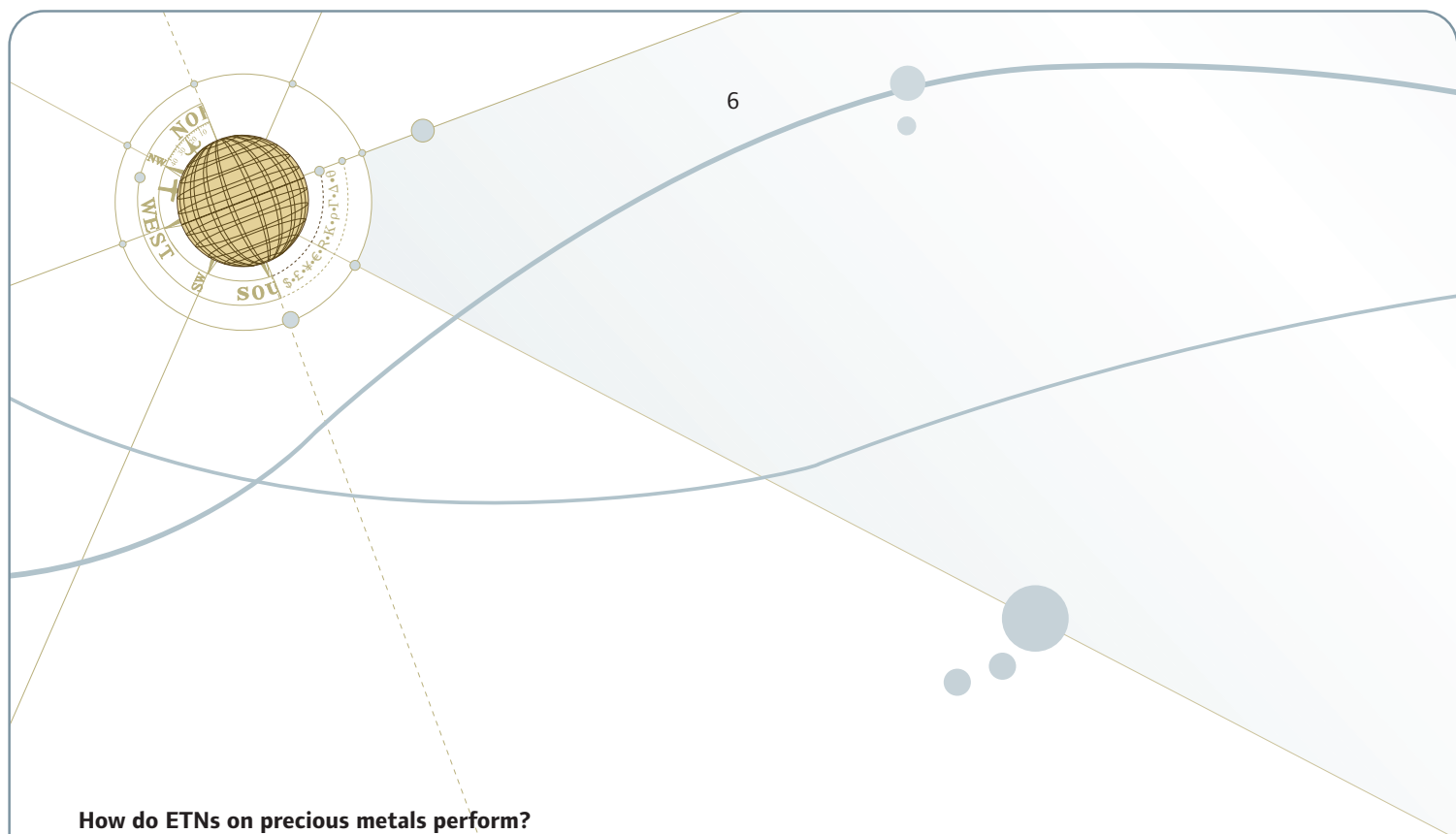
What is a total return index?

A total return index is an unleveraged commodity index that represents the returns that would be earned by holding only passive long positions in near-dated commodity futures contracts. The position in the futures must be fully collateralised to be unleveraged, meaning that a portion of the investment will be used for margin purposes and the rest will earn interest in a deposit. This interest is calculated using the USD overnight Libor rate, less 0.125%.

These futures positions will need to be rolled over into more distant contracts as the near-dated contracts approach maturity. This is done in a pre-defined, transparent manner and the trader has no discretion in this regard. The rolling mechanism will begin 30 days prior to the expiry of any futures contract, with the position being rolled over a five-day period to reflect an average roll return. All liquid futures contracts are pre-determined at the beginning of the year to ensure that only sufficiently liquid futures contracts are used.

How will investment return be generated?

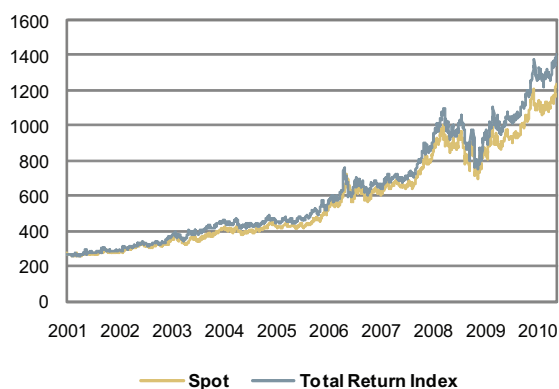
The return the investor earns is derived from four sources. Firstly, the investor will earn the USD deposit rate that accrues daily on the collateralised cash value of the investment. This reflects expected inflation plus a real rate of return. The second component of the return is the performance of the underlying expected future price of the commodity. This is measured by the change in the near-dated futures USD contract price. Thirdly, the return is also adjusted for the change in the USD/ZAR exchange rate which could have a positive or negative impact on the return over the investment horizon. Lastly, the investor will earn the roll-and-rebalancing yield which results from rolling the current future into a more distant future (due to the approaching maturity of the near-dated contract) whilst remaining fully invested. This component could be positive or negative, depending on whether the far-dated future is cheaper or more expensive than the near-dated future being sold.



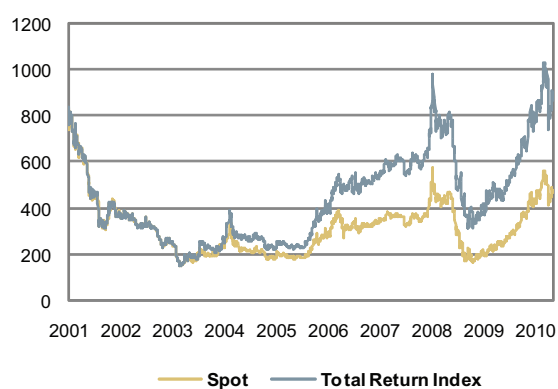
How do ETNs on precious metals perform?

We explored the back-testing **results²** of a similar total return rolled futures position in precious metals, compared to spot. It was assumed that the futures positions were rolled quarterly, and the historical overnight USD Libor rate was used to calculate the interest component. As shown in the graphs below, not only would the total return futures positions have provided direct exposure to the performance of four precious metals, but they are also seen to outperform the underlying spot metal positions. This proves that the total return futures positions would have been a preferable investment to holding the relevant physical bullion.

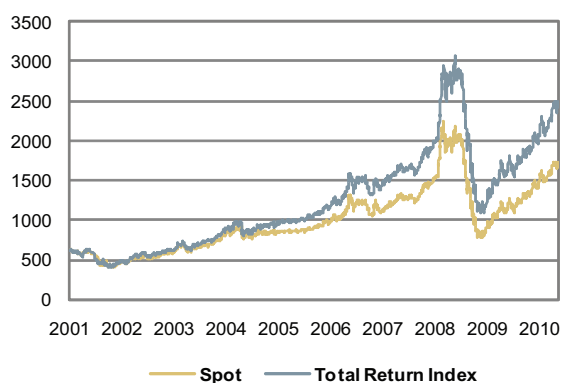
Gold



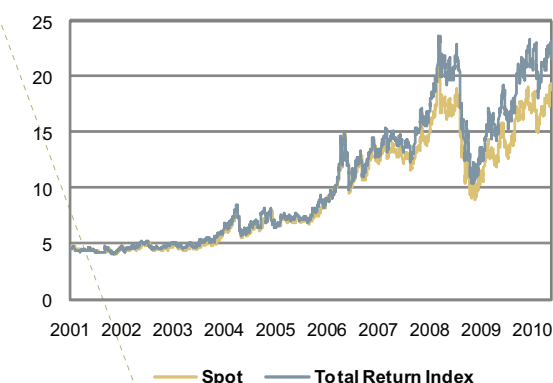
Palladium



Platinum



Silver



² Please refer to appendices for the further back-testing results

Commodity-Linker ETN specifications

Issuer and issuer credit rating

The ETNs are issued by Standard Bank off its Blue Access platform or ZAR 60 Billion Domestic Medium Term Note (DMTN) programme. Standard Bank's credit rating is AA-. This is the credit risk the investor is exposed to when purchasing a Commodity-Linker.

ETN purchase price

Each Commodity-Linker ETN will be issued at a price of R100.

Listing

Commodity-Linker ETNs are listed on the JSE's ETN sub-sector.

Trading in Commodity-Linker ETNs

Commodity-Linker ETNs can be bought and sold through any JSE-approved member.

Exchange Control Rulings applicable

Commodity-Linker ETNs are defined as inward-listed securities and as such are governed by Section H of the South African Reserve Bank (SARB) Exchange Control Rulings. Section H concludes that all individual and corporate SA investors can invest in Commodity-Linker ETNs with no impact on their foreign allocation limits. Institutional investors are not required to obtain prior approval from the SARB to trade but are required to report trades as part of their foreign allowance limits.

Liquidity and secondary market

Standard Bank acts as the market maker and provides live intraday buy-and-sell prices on the JSE's equity trading platform between 09:10 and 16:49 (live prices are not provided in the opening and closing auction period).

Trading times

JSE trading times are 09:10 to 16:49.



Cost of trading

An annual discount rate of 0.50 percent is charged. Standard Bank also charges market related spreads between buy and sell prices.

Term

These notes have a fixed term of 10 years. Investors wishing to sell their notes prior to maturity can do so in the secondary market.

Redemption

If the ETN is held until maturity the investor will receive the amount invested, multiplied by the performance of the total return index, multiplied by the change in the exchange rate, less the accrued costs.

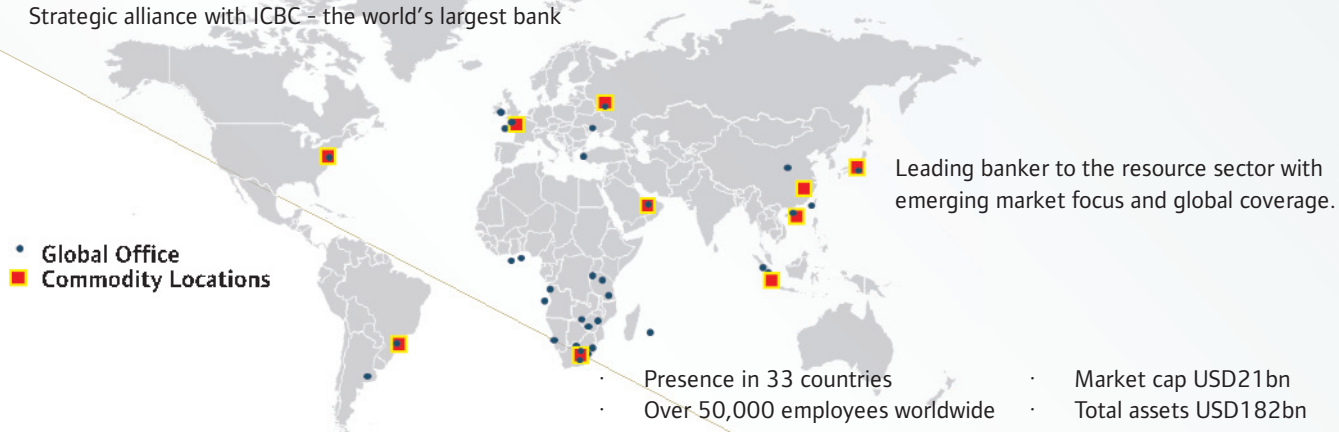
Standard Bank – a leading commodity house

Standard Bank is a leading commodity trading house with product and service offerings on each of the following commodities:

- **Base metals:** Copper, aluminium, nickel, zinc, lead, tin and steel
- **Precious metals:** Gold, silver, platinum, palladium and rhodium
- **Energy:** Crude oil and related products, natural gas, coal and carbon credits
- **Agriculture:** Corn, wheat, soybeans, sugar and fertiliser

Standard Bank is a key player on all global bullion markets and the largest international gold trader on the Tokyo Commodities Exchange. Standard Bank is also a member of the London Bullion Market Association, **Chair of the London Platinum and Palladium Fix**, a member of the London Platinum and Palladium Market, and a member firm of the New York Mercantile and Dubai Commodities Exchanges.

- Standard Bank has 10 commodity sales trading offices providing 24 hour market coverage and service
- Strategic alliance with ICBC – the world’s largest bank



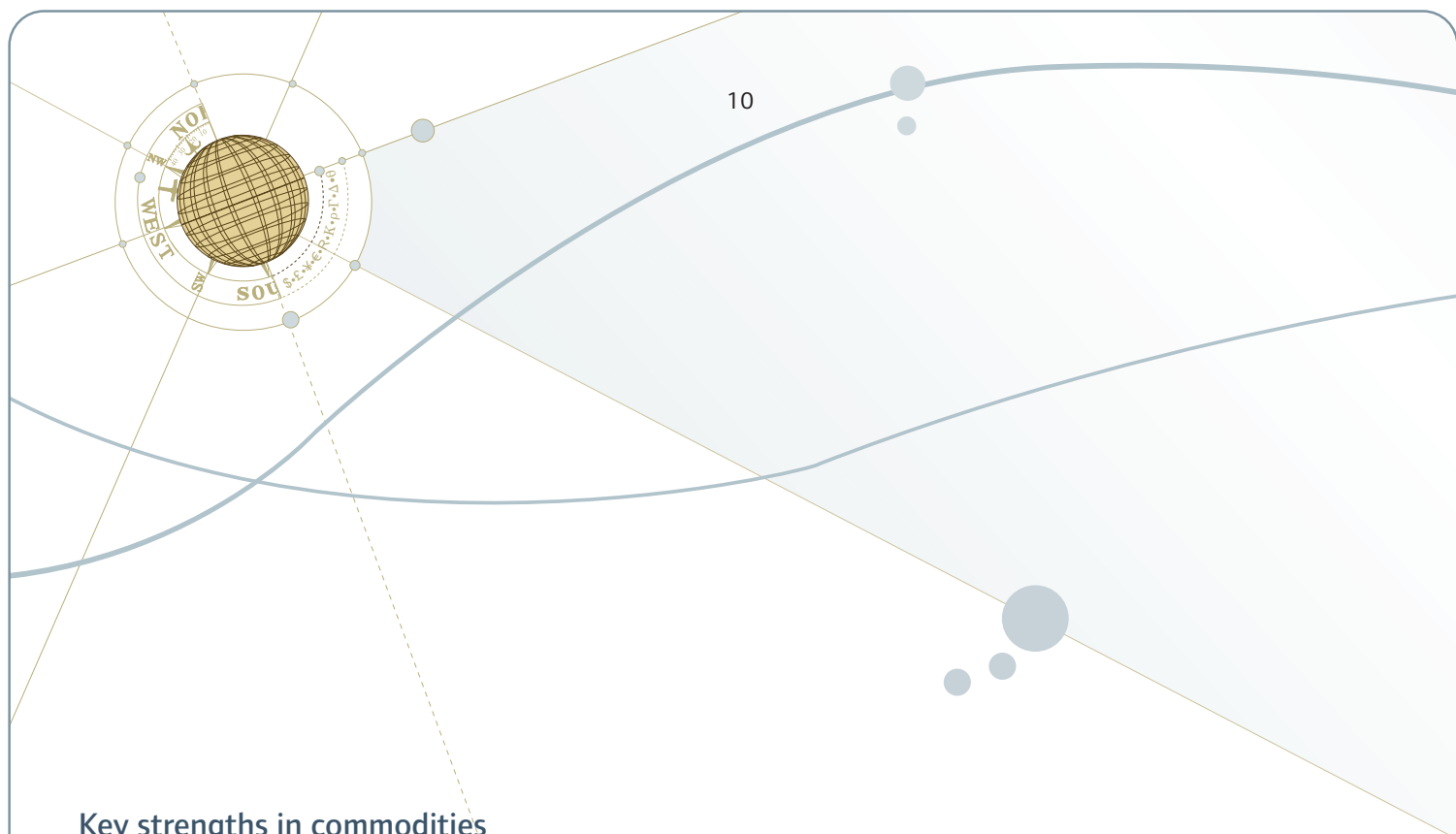
Standard Bank is an active issuer of and/or market maker in the following commodity exchange traded products:

- Standard Bank commodity reference warrants
- Safex commodity futures
- Customised commodity ETNs listed on the JSE’s Bond Exchange

Standard Bank’s research team offers commentary on the metals markets on a daily, weekly and monthly basis. This commentary includes technical analysis and discussions of trading strategies.

Contact Standard Bank’s research team to find out more:

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Key strengths in commodities

- Well diversified global business with local focus
- Strong Emerging Market credentials, with a network of offices in many emerging markets
- Chinese representation and capabilities across all products
- Strong presence in both precious and base metals trading
- Global physical metals distribution franchise
- Diversified client base that includes producers, consumers, hedge funds, banks and financial institutions
- Specialist inventory financing team
- Structuring team that is capable of producing tailored solutions for clients

Contact details

For product information:

Contact Standard Bank's Global Structuring Group on 011 378 7110 or ETNS@standardbank.co.za

Visit us at www.standardbank.co.za/commoditylinkers

To register for trade:

Contact your JSE-approved stockbroker.

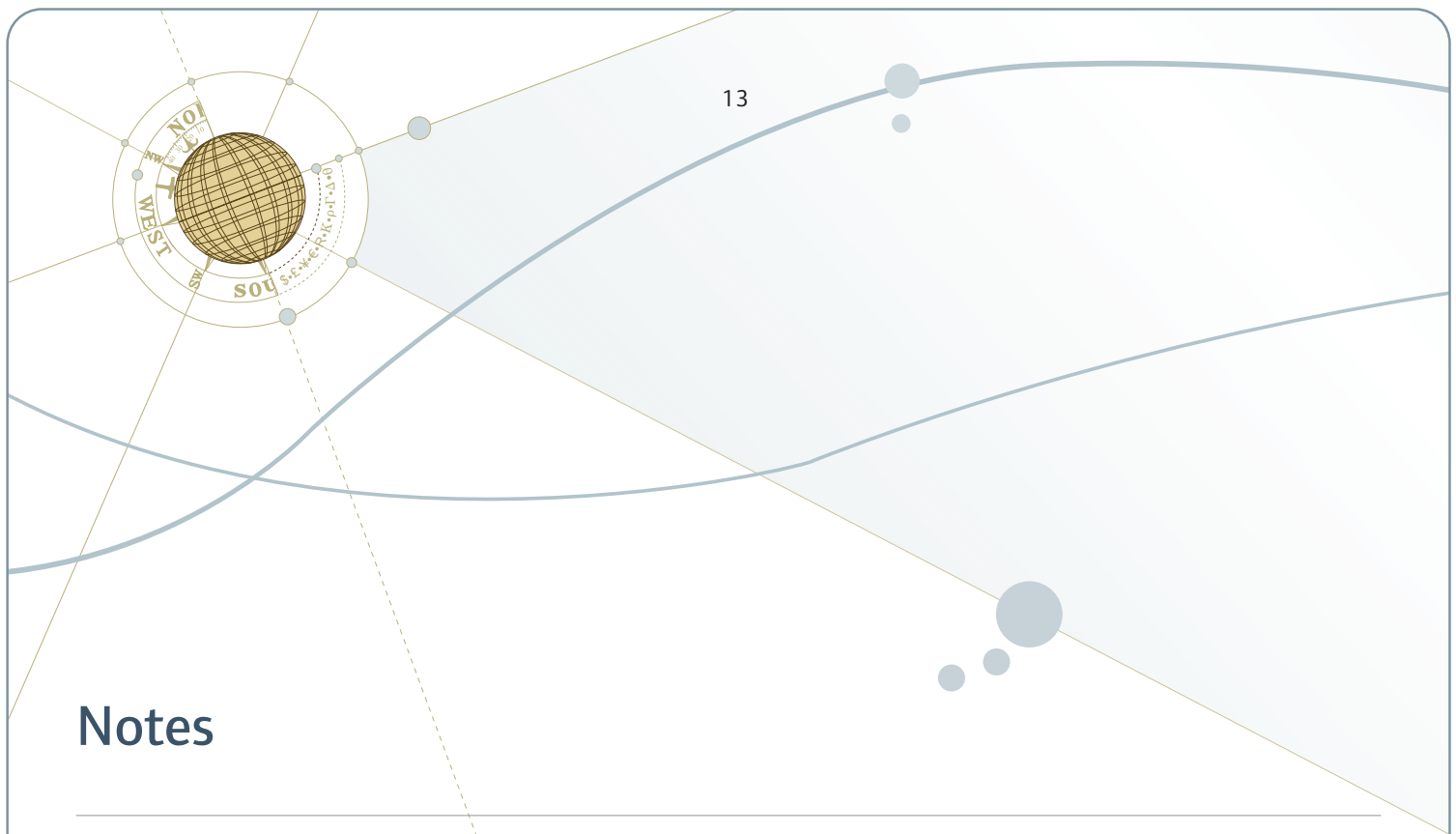
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Appendices

Standard Bank Research Publication
Statistical Back Testing

FICC Research

Commodities

Precious metals as an asset class



July 2010

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What qualifies as an asset class?

Broadly speaking, an asset class is simply a grouping of assets that possess similar characteristics. Defining asset classes is a key input in the investment decision-making process, and can ultimately affect the performance, in terms of return and risk, of an investment portfolio. Before embarking on any strategic asset allocation exercise, it is important to understand how the investable universe can be most favourably divided in order to reap the benefits of portfolio optimisation.

In order to make a case for defining any particular asset or group of assets as an asset class, it is necessary to elaborate on the definition of an asset class and present some criteria which might be applied in our determination. The following are the most commonly used conditions in defining asset classes:

- **Assets within an asset class should be homogenous.** They should be subject to the same laws and regulations, and perform similarly under varying market conditions.
- **Asset classes should be constructed in such a way so as to reap the benefits of diversification.** Returns and risk profiles of asset classes should *not* behave similarly under a given set of market conditions. This characteristic is best described and analysed through the use of statistical correlation. Expected correlations among assets classes should *not* be extremely high. A conventional rule-of-thumb is that correlations among assets classes should *not* exceed 0.95, with negative correlations being the most desirable.
- **There should be no overlap between asset classes.** A particular asset should be uniquely assigned to only one asset class. This is to realise the diversification benefits mentioned in the previous point.
- **The market of an asset class should have the ability**

to absorb a significant proportion of an investor's portfolio. The asset class should possess sufficient liquidity to allow significant investment without prompting a marked move in asset class prices. Large-scale participation in an asset class should also be possible without incurring high transaction costs.

- **Asset classes should provide an opportunity for generating positive returns.** It should be possible to significantly enhance the performance of a portfolio through actively taking positions in the asset class, based on the investor's strategy and particular market view.

What makes commodities an asset class?

Traditional asset classes have included local equities, fixed income, property and cash equivalents. Positions in commodity markets were largely restricted to hedging of physical demand or producer exposures (with the notable exception of gold). However, for a long time now investors have viewed commodities as a distinct asset class, with the possibility of generating excess portfolio returns by actively taking positions in commodities.

A primary motivation for the increased interest in commodities has been the distinct advantages they offer over the markets of traditional asset classes:

- **Commodity markets trade globally.** This offers a distinct advantage in terms of liquidity, as investors can take up or unwind positions at most times, enhancing the optimality of their trades. This also enhances the speed at which information can be priced, within commodity markets.
- **Commodity markets generally move in the opposite direction to fixed income securities and equities.** This gives commodities a distinct advantage in providing diversification benefits within investment portfolios.
- **Commodity markets are thought to offer protection**

against inflation. While it has been shown that commodities are far from a perfect hedge against inflation, the inflation protection they provide is superior to that of the other conventional asset classes.

Do precious metals qualify as an asset class?

After discussing the emergence of commodities, in general, as an asset class, we turn our attention to a group of precious metals (gold, silver, platinum and palladium) in par-

Table 1: Asset class criteria

Criterion	Precious Metals
Homogeneity within asset class	✓
Mutually exclusive	✓
Diversifying	✓
Liquidity	✓
Non-zero positive returns	✓

Source: Global Markets Research

ticular. Using the criterion expressed in the first section, we can come to the conclusion that **this group of precious metals may be defined as an asset class** (see Table 1).

Gold, silver, platinum and palladium are largely traded on the New York Mercantile Exchange (COMEX division of NYMEX) and the Tokyo Commodities Exchange (TOCOM), and thus are subject to similar regulations regarding standardisation and trading practices. In addition, as we will see, the risk return profile of these metals is fairly similar. Hence, the first asset class criterion of **homogeneity** is met. **Mutual exclusivity** is assured since the precious metals considered are not classified under any of the other traditional asset classes.

Table 2: Correlations across asset classes

(June 2004 to June 2010)

	Fixed income	Equity	Cash	Property	Precious Metals
Fixed income	1.00	-0.08	-0.08	0.59	-0.62
Equity	-0.08	1.00	-0.92	0.68	0.49
Cash	-0.08	-0.92	1.00	-0.72	-0.45
Property	0.59	0.68	-0.72	1.00	-0.11
Precious Metals	-0.62	0.49	-0.45	-0.11	0.74

Sources: Global Markets Research, Bloomberg, JSE, I-Net

In terms of opportunity for **diversification**, we look to the correlations of this precious metals group (an equal weighting of gold, silver, platinum and palladium) with other con-

ventional asset classes (see explanation of data used in next section).

As is evident from Table 2, including precious metals in a portfolio should offer significant diversification benefits. **Precious metals are poorly correlated with all asset classes** — the strongest correlation with equity is only 0.49 (this is most likely due to the dominant position commodities command in the SA economy). All other asset class returns are negatively correlated with precious metals, with the fixed income and cash classes displaying a fairly strong negative correlation. This indicates that most portfolios, regardless of their allocation amongst the traditional asset classes, could achieve an improvement in risk and return characteristics through the inclusion of precious metals. In short, the correlation of precious metals with the other asset classes is considerably below the 0.95 threshold that would disqualify it from being defined as a separate asset class.

As will be discussed further in the next section, even a naïve approach to investing in precious metals can yield **positive**

Table 3: Nominal value of average daily open interest (2009)

(US\$ millions)

	COMEX	TOCOM	Total
Gold	47,622.40	2,886.51	50,508.91
Silver	7,925.26	12.64	7,937.90
Platinum	1,500.74	690.68	2,191.42
Palladium	463.14	20.20	483.34

Sources: Global Markets Research, Bloomberg

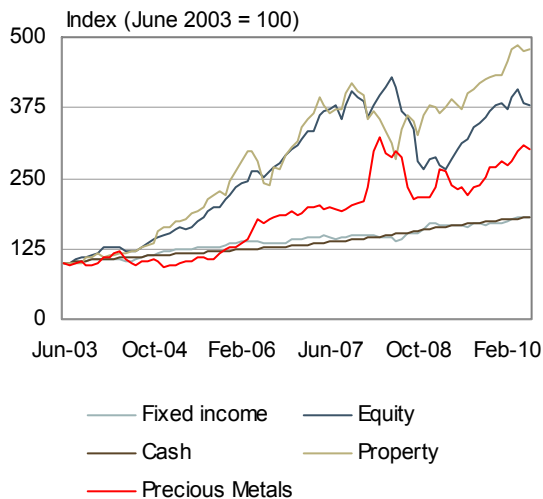
Note: Calculated using 2009 average for London PM fix

returns. A simple buy-and-hold strategy (of an equally weighted position) over the investment period considered would have generated an average return of 19.27% y/y. This might not seem excessive, but **given the high volatility of commodities, the opportunity exists for investors to considerably improve on this average return through an active management of their positions.**

In terms of **liquidity**, the markets for precious metals differ considerably (see Table 3). However, **all the markets for precious metals compare favourably to other financial markets in terms of liquidity.** The liquidity of each market (i.e. gold, silver, platinum and palladium) is more than sufficient to absorb most investments **without markedly affecting prices.** Also the depth of these markets ensures that **most trades can be processed without inhibitive transactions costs.**

Precious metals vs. other SA asset classes?

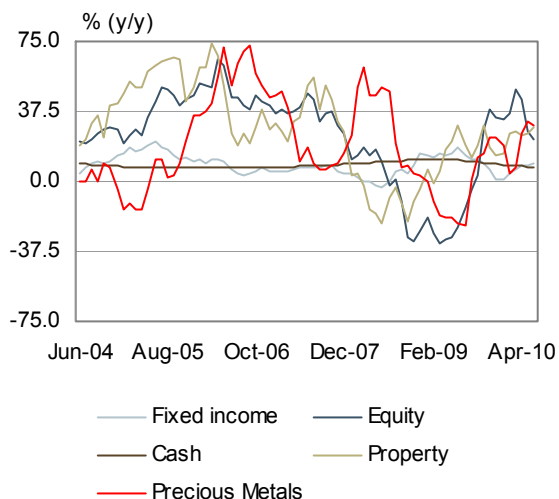
Figure 1: South African asset class performance



Sources: Bloomberg, JSE, I-Net

We compared the performance of precious metals, in ZAR terms, to SA's other conventional asset classes — *local equity*, *fixed income*, *cash equivalents* and *property*. These asset classes are represented by the *JSE All Share total return index*, the *ALBI total return index*, the *12-month Stefi* and the *SA Listed Property total return index* respectively.

Figure 2: South African asset class performance

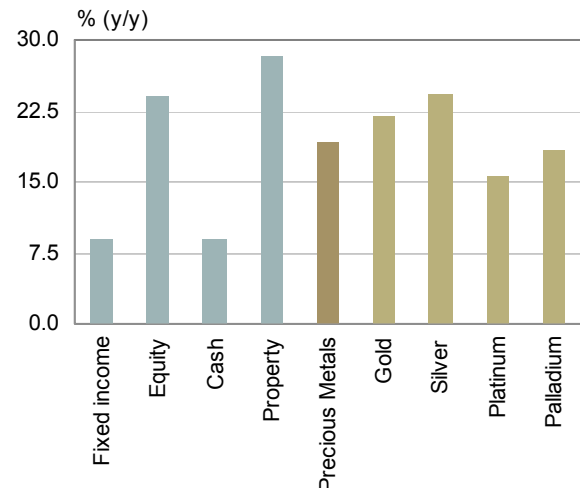


Sources: Global Markets Research, Bloomberg, JSE, I-Net

Our analysis considers investments in spot (and not futures) gold, silver, platinum and palladium, as well as an equally weighted holding of all four of these metals. All positions were ZAR-denominated. That is, similar to purchasing equities or fixed income securities in rand, one would purchase these metals at a rand price.

A returns analysis (Figures 1 and 2) highlights the diversification benefits of precious metals. The returns on precious metals are, for the most part, counter-cyclical to those of

Figure 3: Average returns

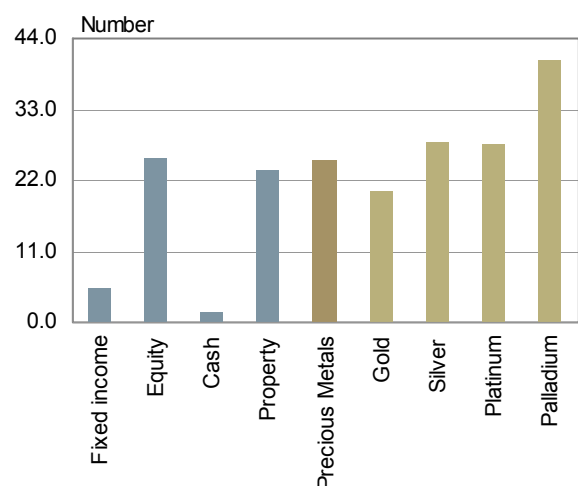


Sources: Global Markets Research, Bloomberg, JSE, I-Net

fixed income and property. That is to say, precious metal returns increase when those of local fixed income and property decrease, making it an effective diversification tool in a portfolio.

Over our sample period (Figure 3) precious metals have underperformed local equity and property. It did, however,

Figure 4: Standard deviation of returns



Sources: Global Markets Research, Bloomberg, JSE, I-Net

significantly outperform cash and bonds. This implies that **when employing a buy and hold strategy with precious metals, i.e. not actively managing the investment, the average return on precious metals ranks third among the asset classes.** Given the differences in returns among

the various component of the precious metals group, it is

Table 4: Correlations across asset classes

(June 2004 to June 2010)

	Gold	Silver	Platinum	Palladium	Precious Metals
Fixed income	-0.44	-0.45	-0.72	-0.55	-0.62
Equity	-0.08	0.50	0.48	0.62	0.49
Cash	0.03	-0.50	-0.38	-0.55	-0.45
Property	-0.40	0.01	-0.18	0.04	-0.11

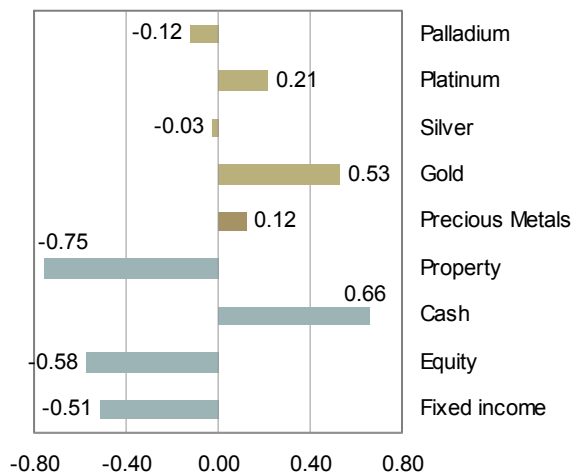
Sources: Global Markets Research, Bloomberg, JSE, I-Net

easy to see that an alternative weighting (perhaps biased towards gold and silver) could improve on these returns.

Figure 4 shows the volatility across the asset classes. Based on standard deviations, **precious metals are riskier than the fixed income and cash equivalents, as one would expect, yet are comparably in terms of risk with local equity and property.** Again, there are considerable differences among the precious metals considered when it comes to risk. Thus, an investor could tailor a combination of metals that is best suited to their tolerance for risk and

Figure 5: Correlations with consumer inflation

(June 2004 to June 2010)



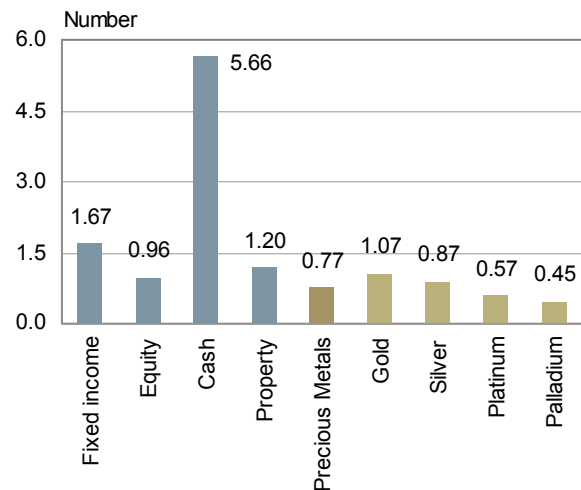
Sources: Global Markets Research, Bloomberg, JSE, I-Net

potentially optimises their portfolio's risk/return profile.

Even in terms of correlations with the other asset classes, the precious metals differ amongst themselves (see Table 4 overleaf). So while, **the diversification benefits of including gold, silver, platinum and palladium in a portfolio are undeniable**, it is advisable for each investor to consider their allocation among the various precious metals within the

context of their existing portfolio distribution.

Figure 6: Sharpe ratios



Sources: Global Markets Research, Bloomberg, JSE, I-Net

Investing in commodities is also associated with hedging against inflation. While the extent to which this can be achieved is limited, correlations with SA consumer inflation (Figure 5) reveal that among the conventional asset classes, precious metals offer the greatest opportunity for doing so. Other than cash, precious metals are the only asset class to display a positive correlation with inflation. As evident in our previous metrics, this correlation also varies among the precious metals. An investor who is particularly concerned about hedging against inflation, might tilt their allocation towards gold and platinum.

Looking from a Sharpe ratio perspective (Figure 6), the precious metals group underperforms all the asset classes. This implies that **an investment in precious metal outside of a portfolio may not reap as many benefits as if used within a balanced portfolio.** However, it is worth noting that gold compares favourably against equities in terms of reward for risk.

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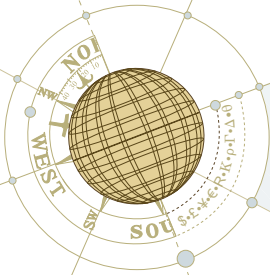
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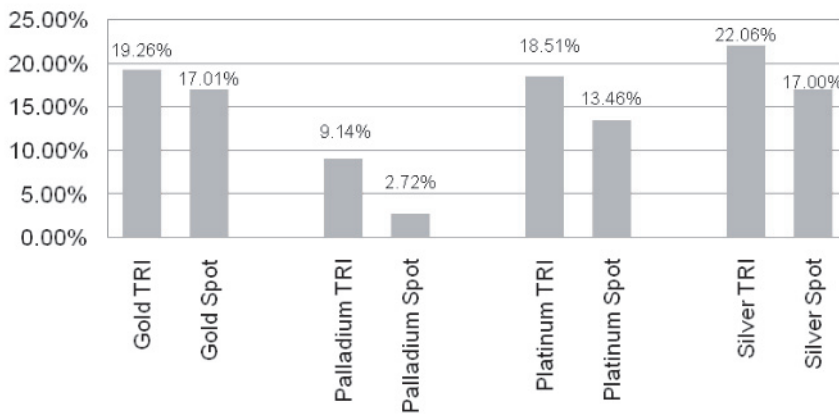
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Statistical back-testing results

The following graphs look at the average annual returns in both USD and ZAR from 2001 to 2009 of a total return rolled futures position in the precious metals compared to a spot metals position.

USD Returns



ZAR Returns

