INTERMEZZO

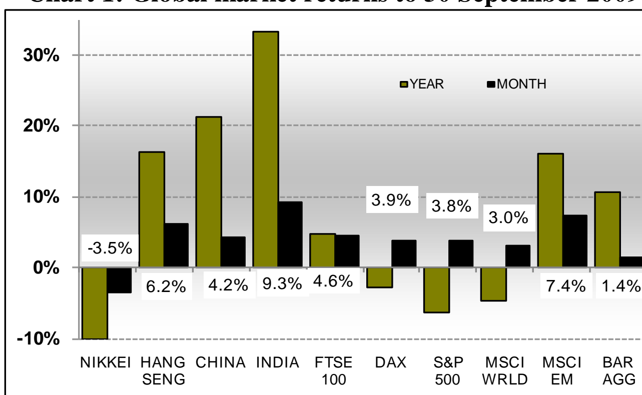
MAESTRO

Investment Letter | 9th Edition | October 2009

September in perspective – global markets

The past month proved to be another profitable one for most investors around the world, especially equity investors and those in emerging markets. The dollar declined 1.8% against the euro and was generally weak against most other currencies, which set the tone for firmer emerging market returns and some strength in the gold price. The latter rose 4.2% to end September at $995.75, well off its highs around $1030 reached during the month. The MSCI Emerging market index rose 7.4% - thanks to strong performances in India (9.3%) and Russia (17.6%) and Brazil (15.1%). China rose 4.2% but remember it declined 21.8% in August. The MSCI World index rose 3.8% with respectable returns in the UK, US and Hong Kong. More importantly, because the annual return to September 2009 now excludes the return of September 2008, which was very bad (the MSCI World and Emerging indices declined 12.2% and 17.8% respectively in that month) but now includes this September's good return, *the annual returns on equity markets suddenly look a lot better*. For example, the annual return to end-August 2009 in Hong Kong was -7.2% but to end-September 2009 it is 16.3%. Similarly in the UK the respective annual returns to August and September are -12.9% and 4.7% while the MSCI Emerging market returns are -11.0% and 16.2%! That's a huge turnaround in just one month, but of course the low base and good September returns are the primary reasons for the turnaround. Chart 1 below reflects more returns and Chart 4 at the end of this report depicts selected MSCI Emerging Market returns.

Chart 1: Global market returns to 30 September 2009



What's on our radar screen?

We remain focussed on the changing economic landscape and list below a couple of developments in this regard:

- *The SA economy:* there is quite a lot of news worth reporting on the SA economy. Firstly Deputy President Kgalema Motlanthe dropped a bombshell whilst addressing the Congress of SA Trade Unions he indicated that government revenue collection would fall about R70bn short of initial estimates, thereby raising the possibility of a much higher budget deficit than expected. The main reason for the shortfall was the global economic slowdown and its effect on the local economy. His announcement came on the same day that the Reserve Bank (SARB) kept interest rates unchanged. The SARB forecast that inflation will return to its target range of 3% - 6% during the second quarter of 2010. The rate decision followed the release of relatively good news on the annual rate of inflation, which declined from 6.7% to 6.4% in August. Food inflation, which only a year ago was 18.8%, declined to 6.8%. On a more sobering note annual producer price inflation (PPI) in August declined to -4.0%; deflationary conditions continue to persist at the factory level. Despite sharp rises in the price of electricity, PPI was kept under wraps by deflation in a number of sectors; deflation for imported goods, for example, declined to -17.8%. And finally SA retail sales for July improved marginally, rising at an annual rate of 6.7% from 3.6% in June.
- *The rand:* although strictly speaking not a matter of pure economics, many investors have watched in disbelief at the recent strength of the rand – it has risen 36.2% since the end of February. Of greater concern to us is the effect that this strength is having on the SA manufacturing sector. We came across a good example of one company's sensitivity to the rand during the month. Although it is perhaps not a "typical" example – we know Sasol's earnings are extremely sensitive to the rand – but the numbers are nevertheless quite astonishing. In a recent investor presentation Sasol provided the following guidance on their sensitivity to the rand and oil price: assuming a Brent oil price of $70 per barrel and a rand dollar exchange rate of R8.00, Sasol estimates that a 10c change in the rand will affect earnings by about R765m. A $1 per barrel change in the oil price will affect earnings by R570m.

Source: Ingram Pinn, FT.com

- *The Chinese economy:* Evidence that the Chinese economy, at least in some sectors, is still in rude health came in the form of a 90.0% annual increase in passenger car sales in August. Admittedly August 2008 was a low base, having been distorted by the effects of the Olympic Games and the onset of the global credit crisis, when sales declined 6.2%, registering the first actual decline in three years. But car sales have been recovering ever since, assisted in part by tax incentives

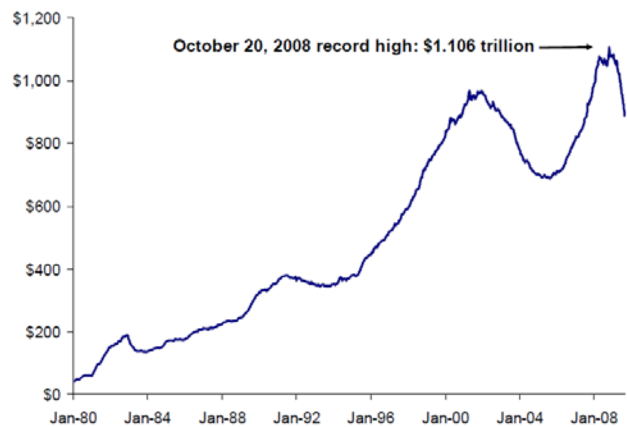
similar to those of the "cash for clunkers" program in the US. At this rate China is on track to overcome the US as the world's largest car market in absolute (car sale) terms. No less than 858 300 passenger vehicles were sold in China during August alone. As an aside, Ferrari reported that first half sales declined by 8.0% in the six months to June – it sold 3 226 cars, generating some $1.3bn of revenue in the process. Turning back to the Chinese economy, the annual inflation to August was -1.2% i.e. deflation of 1.2%. The annual rise to end-August in industrial production and retail sales was 12.3% and 15.4% - nothing wrong with that type of growth right now.

- *The US economy:* as usual there is a host of US data to report. We will save a summary of the data for the Quarterly Report but at this stage two features are worth highlighting. Firstly, despite better than expected economic data during the past few months, recent US data, especially that which relates to the health of the consumer, was disappointing. Secondly, the labour situation remains problematic. We are aware that unemployment data is a lagging indicator i.e. it reports conditions of the labour market some time after the event. However, conditions in that market are so severe they can simply not be ignored. Consider the following: non-farm payroll data, i.e. the number of jobs in the US economy excluding the agricultural sector (the latter being so volatile that it undermines the integrity of the data) declined by 263 000 in September, worse than the expected loss of 150 000. Admittedly, this is smaller than the monthly job losses in excess of 500 000 experienced earlier in the year, but the fact remains that in a time of improving economic conditions, jobs are still being lost. The current employment cycle has become the worst cycle in the past 50 years, having wiped out 85% of the jobs created during the last employment expansion cycle of 2003 - 2007. The broadest measure of unemployment (the so-called U6 definition) is now 17.0%. In September a record 54.3% of the unemployed moved into "permanently laid off" status, the average duration of unemployment moved close to a record, at 17.3 weeks and well over one third of those unemployed have been that way for more than six months. And it gets worse; the government agency responsible for compiling the data, the Bureau for Labour Statistics (BLS) released their preliminary estimate for the benchmark revision to the data covering the period from April 2008 to March 2009. Whereas the average revision over the past ten years was 0.2%, this year it is likely to be 0.6%. That may not sound like a lot but it equates to a loss of another 824 000 jobs. You will now understand why we remain concerned about the state of the US consumer and his or her ability to drive the global economy into a *sustainable* recovery mode.

Chart of the month

We are very conscious of the fact that many investors, local and global, have not fully participated in the recent record rallies on global equity markets. Many, including Maestro's offshore fund to some extent, have retained high levels of liquidity. Nowhere is this more evident than in the levels of money market funds in the US.

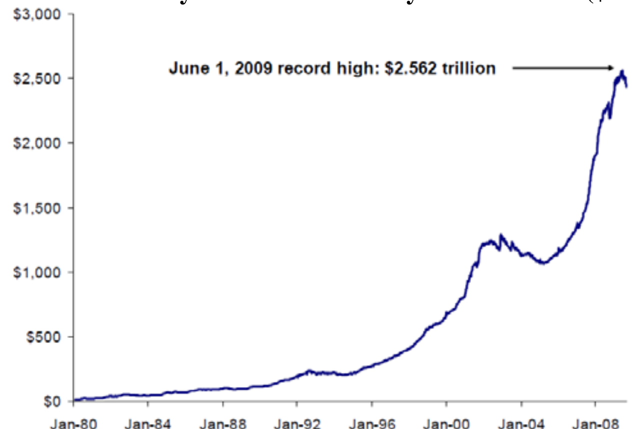
Chart 2: Weekly retail money market fund levels ($bn)



Source: Merrill Lynch

Note from these two charts below that although the level of retail money funds is off its October 2008 peak, both retail and institutional money funds remain at very high levels. This provides one reason to believe that equity markets are unlikely to experience a severe and brutal downturn like we experienced in the last quarter of 2008. There is simply so much money sitting on the sidelines – and it grows by its very nature – that investors are likely to begin committing new money to the market at the first sign of any material decline in markets. This is why, in all likelihood, markets have been so resilient in the face of still above-average risk levels inherent in the market.

Chart 3: Weekly institutional money market levels ($bn)



Source: Merrill Lynch

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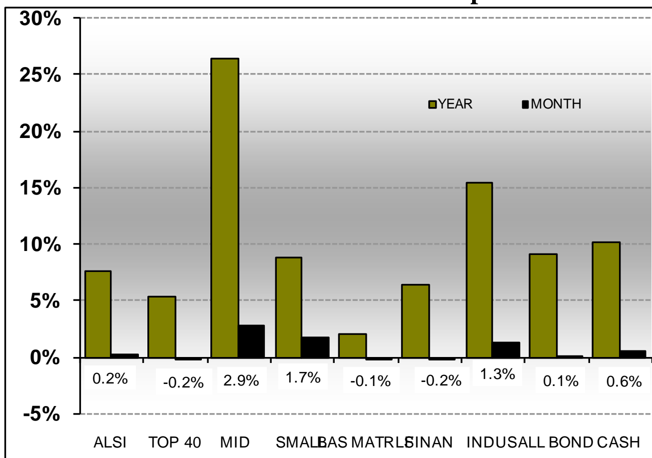
September in perspective – local markets
September proved to be a frustrating month in the SA equity market. As you have already seen from Chart 1, global equity markets enjoyed robust returns but, thanks largely to the strength in the rand, the SA equity market marked time. The All share index, All bond index and cash produced respective returns of 0.2%, 0.1% and 0.6% - not much to write home about. Mid (2.9%) and small (1.7%) caps did a bit better, while the firm rand took its toll on the basic materials sector, which ended down 0.1%. The retail sector produced a return in excess of 8.0% while on the downside the coal, and forestry and paper sector declined 16.1% and 8.6% respectively. Of course, if you add the 2.8% gain of the rand against the dollar, the SA equity market return in dollar terms of 3.0% was quite respectable. That said it was still some way off other emerging market returns, as Table 4 at the end of this report shows. It is worth pointing out, as can be seen in Chart 4, that every major sector of the SA equity market has now registered a positive return over the past year.

Chart 4: Local market returns to 30 September 2009



The shape of things to come
We have frequently highlighted the speed at which the world is changing. Due to the financial crises last year and the economic turmoil in which the world now finds itself, the world as we knew it only two years ago no longer exists. It is our humble view that in a couple of years time a New Order will exist in the world which will be unrecognizable from the one that prevailed two years ago. In order to focus on this phenomenon, we highlight some of the events indicative of this process of change in this section called “The shape of things to come”.

Unconfirmed reports have it that **the Bank of China** (BoC), not to be confused with China’s central bank, the People’s Bank of China (PBoC), **is planning to launch a fund of hedge funds** through its Geneva-based banking operation. This comes at a time when hedge fund of funds have seen a 40% decline in their assets under management, which peaked at $1.1 trillion in 2008. The planned launch also comes after a $500m investment into hedge funds by the China Investment Corporation (CIC), one of China’s sovereign investment funds and one of the largest in the world. It’s chairman Lou Jiwei was quoted as saying that the CIC planned to invest “many times” the $500m it invested in June.

And in another China-related development, **Standard Bank**, one of South Africa’s largest banks, **raised a $1bn loan facility with four Chinese banks.** It seems that a new region for funding is now opening for SA banks and institutions; more evidence of our Big Picture theme of “Coming of Age” of emerging markets.

Source: Ingram Pinn, FT.com

And in similar vein **China issued its first renminbi sovereign bond** in September. At $879m the bond is hardly earth-shattering, but it marks a significant step towards the internationalization of the renminbi; remember China’s currency is not convertible i.e. it is not a free-floating, exchangeable currency. China has often voiced unhappiness about the dollar’s role as the global reserve currency, but no progress will ever be made in the direction of China’s currency until it is fully convertible. The issue of the Chinese sovereign bond thus marks another small step, of which there have already been a few, towards the currency’s convertibility and thus progress towards a global currency.

Whilst on the topic of **China’s unhappiness about the dollar as the world’s reserve currency**, we have noted previously that China has suggested the International Monetary Fund (IMF’s) Special Drawing Rights (SDRs) as an alternative global currency. Although such an event is unlikely in the near to medium term it is worth noting the following in order to understand the logic behind China’s suggestion. At present the SDRs are a basket unit consisting of four currencies, which will be re-weighted in 2010: a 44% weighting of dollars, a 34% euro weighting and 11% each in sterling and yen. At present these four regions constituted only 28% of global exports. China is keen for the SDRs to more accurately reflect the rising importance of

emerging markets, specifically their increased role in the export market. David Marsh of London and Oxford Capital Markets has suggested the basket be increased from four to ten currencies. The effect would be to halve the share of the existing four currencies. The renminbi and euro would then constituted the two largest weightings with about 20% each, with the dollar at 16%, the yen 9% and the rouble and sterling 5% each. On paper at least that seems to be more representative of the real world, the obvious catch being that all of this remains theoretical until such time as the renminbi is fully convertible into other currencies – hence the importance of the earlier point highlighting the steps China is taking towards renminbi convertibility.

The world's second largest luxury group **Richemont** issued a five-month **trading update** in September. What was arguably the most significant aspect of the update was the manner in which sales had developed in differing parts of the world: sales in the US and Europe declined by 36% and 22% respectively. In Japan sales were 7% lower but in Asia (including China) sales *rose* 5%. A fair reflection of the world order at present, or just another sign of the times?

Perhaps the most notable and significant event, for me at least, in terms of the "New World Order", was the award of the 2016 Olympic Games to Rio de Janeiro in Brazil. In itself, the award was a remarkable achievement; but the real significant event was the elimination of pre-race favourite Chicago in the first round of voting; this, despite flying in Chicago's most famous son, Barack Obama, to sway the judges at the eleventh hour. One of Maestro's key Big Picture themes is "The Coming of Age", which refers to the fact that the coming decade is likely to be dominated by the "development" of emerging markets, which are expected to grow faster and, well, emerge, faster than developed markets. But back to the 2016 Olympics: the awarding of the Games to Rio and its significance for both Brazil and the developed world, was perhaps best summed up by Brazilian President Luiz Inácio Lula da Silva, who had personally invested a lot of political capital in Rio's bid. After bursting into tears once the award was made, he went on to say "we are not a second rate country, we are a first-rate country and this is what this victory means." The decade of Emerging markets has surely dawned.

For the record

Table 1 lists the latest returns of the mutual funds under Maestro's care. You can find more detail, including the latest Maestro Equity Fund Summary, by visiting our website at www.maestroinvestment.co.za. Returns include income and are presented after fees have been charged.

Table 1: Returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Fund	Sept	**2.0%**	**22.7%**	**3.1%**
Maestro equity benchmark *	Sept	-0.2%	18.2%	7.7%
JSE All Share Index	Sept	0.2%	18.6%	7.7%
Maestro Long Short Equity Fund	Aug	**3.0%**	**11.0%**	**-14.8%**
JSE All Share Index	Aug	3.2%	18.3%	-6.8%
JSE Financial and Indus 30 index	Aug	4.1%	19.2%	3.6%
Central Park Global Balanced Fund ($)	Aug	**0.9%**	**8.1%**	**-3.3%**
Benchmark**	Aug	2.5%	11.1%	-5.8%
Sector average ***	Aug	2.5%	17.4%	-8.2%

* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index
** 40% MSCI World Index, 20% each in Barclays US Aggregate Bond Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills
*** Lipper Global Mixed Asset Balanced sector ($)

The State of the Nation – internal affairs

I have great pleasure in announcing a new addition to the Maestro team: **Luke Sparks** joined Maestro mid-September with a view to helping Vicki with the increasing admin load and providing additional support and capacity to our team in general. Luke completed his Bachelor of Business Science Honours degree last year at the University of Cape Town and has completed his first level (of three) of the CFA (Chartered Financial Analyst) certification. On a personal note, I have known Luke's family for many years and have watched Luke grow up over the past ten or so years. So, apart from making me feel very old (!) it was a very special moment for me to have welcomed him on board our team.

Vicki (Sabor) celebrated her second year with our team during September. Upon that occasion it dawned on me that some of you might not know all our team members that well. So in an effort to give them more "air time" and to give you a glimpse into "what makes them tick" I have asked our team to write a short paragraph on any topic whatsoever on the occasion on their anniversary. Herewith, then, Vicki's contribution:

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When I first heard that we had been requested to write a paragraph for Intermezzo on our anniversary, I was so relieved that my anniversary with Maestro had come and gone and that I would have a whole year to think about what I would contribute. However, André had a different view and decided that I should be the first to contribute. While working out at the gym this morning, I caught a glimpse of the early morning sun shining on the mountain on another perfect day in Africa and my Maestro contribution came clearly to mind. Something that I know for sure - being back in Africa after 14 years abroad is the best life-changing decision I've made. Armed with two small suitcases, I left South Africa as a young 22 year-old single girl to join my boyfriend who had left Cape Town to broaden his horizons as a Physiotherapist in West Palm Beach, Florida. At almost 40, I have recently returned to Cape Town as a married woman with two small children and 14 years of valuable investment experience and I couldn't be happier with our decision.

One hot October afternoon in Florida, I suddenly realised that my children were growing up in a city that was so hot they could not walk anywhere without shoes for fear of either being bitten by fire ants or scorching their feet on pavements where one could literally fry an egg. In addition they could never kick a ball outdoors on the lawn, had never seen a mountain or slept with a window open to breathe in some fresh air. With these thoughts so clear in my mind, I immediately phoned my husband David and enquired whether he had ever considered returning to South Africa. It was as simple as that – 7 months later we returned to Cape Town.

My children are enjoying a healthy outdoor life, are being educated at some of the best public schools (far superior to the private education they were receiving in America) and have formed deep and meaningful relationships with loved ones and peers alike. I was blessed to have found a little piece of heaven at Maestro away from the stress, "noise" and red-tape of the busy corporate environment in which I was involved for so many years and we, as a family, constantly pinch ourselves to realise that things have worked out so well. Despite the negativity that surrounds us all in South Africa, we consider ourselves blessed to live here and have never once regretted our decision to come "home".

Something I know for sure!

File 13 – things almost worth remembering

The following data places the recent global equity market rally in perspective: Deutsche Bank recently analyzed the US equity market returns since 1928 and established that the most common gain during any six month period was between 2.5% and 5.0%. That places the more than 62.2% gain in the US market (at the time of writing) in perspective. Even greater returns have been registered by other markets recently, as Table 2 shows – the Table was lifted from our *Market Commentary – June 2009* document.

Table 2: Up, up and away … the record rally

	Movement from March trough to recent peak (%)	Decline from 2007 peak to recent (2008/9) trough (%)
Nikkei 225 (Japan)	50.2	-61.3
Hang Seng (Hong Kong)	91.3	-63.8
Dax (Germany)	49.9	-54.6
FTSE 100 (London)	39.2	-47.8
S&P500 (US)	51.7	-56.4
S&P Financial index *	135.4	-82.8
S&P Mid cap index	63.0	-55.9
S&P Small cap index	69.3	-58.9
MSCI World index	***56.9***	***-59.1***
India *	112.3	-71.2
China (Shanghai Composite index)	103.4	-71.1
Russia RTS	137.0	-79.9
MSCI Emerging market index	***90.3***	***-66.1***
CSFB Tremont Hedge index	9.9	-19.7
JSE All Share index	41.6	-46.4
JSE Mid cap index	47.3	-41.8
JSE Small cap index	28.4	-47.3
Brent (Oil)	106.2	-75.0
Gold	39.3	N/A
Euro dollar	15.7	-22.1
Rand dollar	47.4	-36.4

* the Exchange traded fund (ETF) equivalent

About nine months ago we reported in "File 13" on the antics of one Muntadir al-Zeidi, the Iraqi journalist who became an overnight hero in the Arab world after hurling both of his shoes at former US President George Bush. You may recall that he was sentenced to three years in prison for that deed, but his sentence was later commuted to one year. We can now bring closure to this episode by reporting that in September the intrepid journalist was released early.

And now, something for all South Africans to relish, as well as for Maestro's global friends, specifically our rugby-loving readers from the UK and Ireland. The following Table was sent to me by a client – what did I say about the Age of Emerging markets having dawned? As my 11-year old daughter always says, "When you're hot, you're hot!"

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Table 3: Telling it like it is

Year	World Cup	Tri-Nations	B&I Lions	Super Rugby	7s	Ranked 1
1987	New Zealand		New Zealand			
1988	New Zealand		New Zealand			
1989	New Zealand		Lions			
1990	New Zealand		Lions			
1991	Australia		Lions			
1992	Australia		Lions			
1993	Australia		New Zealand			
1994	Australia		New Zealand			
1995	South Africa		New Zealand			
1996	South Africa	New Zealand	New Zealand	New Zealand		
1997	South Africa	New Zealand	Lions	New Zealand		
1998	South Africa	South Africa	Lions	New Zealand		
1999	Australia	New Zealand	Lions	New Zealand		
2000	Australia	Australia	Lions	New Zealand	New Zealand	
2001	Australia	Australia	Australia	Australia	New Zealand	
2002	Australia	New Zealand	Australia	New Zealand	New Zealand	
2003	England	New Zealand	Australia	New Zealand	New Zealand	England
2004	England	South Africa	Australia	Australia	New Zealand	New Zealand
2005	England	New Zealand	New Zealand	New Zealand	New Zealand	New Zealand
2006	England	New Zealand	New Zealand	New Zealand	Fiji	New Zealand
2007	South Africa	New Zealand	New Zealand	South Africa	New Zealand	New Zealand
2008	South Africa	New Zealand	New Zealand	New Zealand	New Zealand	New Zealand
2009	South Africa	South Africa	South Africa	South Africa	South Africa	South Africa

The May 2007 edition of *Intermezzo* included a picture of the initial stages of the Cape Town Stadium for the FIFA 2010 World Cup final. At the time of writing there are only 241 days before the first kick-off, so I thought it appropriate to include two updated photos. The May photo is included at the end of this edition for comparative purposes.

Table 4: MSCI Emerging Market September returns (%)

	3Q09	Sept'09	YTD
Peru	43.8	18.1	68.5
Hungary	42.0	7.3	68.0
Indonesia	36.5	11.7	110.8
Korea	34.4	12.1	65.6
Colombia	34.2	16.3	80.4
Pakistan	32.6	6.5	84.2
Turkey	32.2	3.1	76.2
Australia	31.5	11.3	61.9
Poland	31.4	-2.2	21.6
Brazil	26.7	15.1	97.3
Russia	26.5	15.0	81.4
Argentina	25.9	3.7	46.5
LatAm	**24.0**	**12.0**	**77.6**
MSCI EM Small Cap	**22.2**	**7.9**	**86.5**
AP ex Japan	**21.6**	**9.4**	**59.2**
Egypt	21.5	1.3	41.7
Czech	20.3	-0.8	28.4
MSCI EM	**20.1**	**8.9**	**61.2**
Taiwan	19.8	12.7	62.0
EMEA	**19.6**	**5.4**	**50.0**
India	19.0	10.9	86.5
EM Asia	**18.7**	**9.0**	**59.7**
Thailand	18.5	11.9	68.3
Singapore	18.0	5.8	53.4
Mexico	17.6	1.6	36.1
MSCI DM	**16.9**	**3.8**	**22.5**
Philippines	14.1	-0.2	46.6
Malaysia	13.8	3.8	39.4
Hong Kong	13.7	7.8	50.7
South Africa	13.6	2.6	40.9
Israel	9.8	0.2	33.2
China	7.3	4.2	45.0
Japan	5.8	-2.3	7.5
Chile	5.5	7.4	58.0
Morocco	-7.1	-1.1	-1.3

Source Merrill Lynch

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