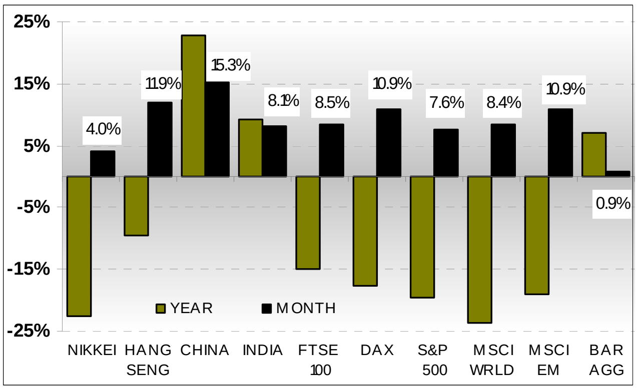
MAESTRO
INTERMEZZO
Investment Letter | 9th Edition | August 2009

July in perspective – global markets

Phew! Those of us who, during June, thought the recent rally was coming to an end were in for a rude, but pleasant surprise. Global equity markets rallied strongly in July, fuelled largely by corporate results that were better than expected. Putting aside, for a moment, the issue of whether the results were real or just a function of the wonderfully creative accounting companies, and banks in particular, have available to them, global investors took heart and pushed markets up to virtually their pre-Lehman collapse levels – please refer to Chart 1 in this regard. To place the recent gains in perspective, at the time of writing the US market is up 50.6% from its March low, the German market 52.3% and Hong Kong 83.5%. For its part, the JSE All share index has risen 36.9% from its March trough. With respect to the gains in July alone, the MSCI World index rose 8.4%, led by gains in Germany of 10.9% and Hong Kong 11.9%. Japan rose “only” 4.0% and the US market rose 7.6%. The MSCI Emerging market index rose 10.9%, with strong gains in China of 15.3% and India 8.1%. You may be interested to know that the Chinese equity market has risen 102.9% off its November 2008 trough and the MSCI Emerging market index is up 103.3% over the same period. Other emerging markets rose even more in July - please refer to the usual table of emerging market returns at the end of this edition. For their part most other asset classes played second fiddle to equities, with marginal movements in the currency and commodity markets.

Chart 1: Global market returns to 31 July 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:* last month we highlighted our concern that the SA economy slowing more than expected. We were not alone in that respect: Deutsche Bank has lowered their 2009 growth rate for SA. They now expect the SA economy to “grow” -1.3% this year but still see a recovery next year; their GDP forecast for 2010 is 2.8%. They have forecast a decline in inflation to 6.0% in the third quarter before it begins to rise again. Their rand dollar exchange rate for the year end is R9.50. On a separate note, SA retail sales declined 4.2% in the year to end-May, up slightly from the record decline in April of 6.9%; retail sales constitute about 14% of the SA economy.
- *SA rating upgrade:* on 16 July Moody’s upgraded SA’s foreign rating from Baa1 to A3. Only two other countries, Chile and China, have been upgraded so far this year. In the comment that accompanied the upgrade, Moody’s noted the build-up in SA foreign currency reserves, its astute debt management and the net foreign asset position of SA’s banks, which had enabled the country to weather the global crisis relatively well. The strength of the local banking system was also highlighted as a positive feature of the economic landscape. Of course there is little room for complacency though. With the economy under pressure, government revenues are shrinking, too. Finance Minister Pravin Gordhan warned at the beginning of July that revenue collection could fall short by as much as R50bn-R60bn this year; this current Budget targeted total revenue for this fiscal year at R659bn.
- *The US economy:* as usual there is a lot to report on the US economy. We continue to monitor it as the engine of the global economy. Its worth repeating here that as excited as we get about what is happening in China and India, the US economy remains, by virtue of its size and sheer economic muscle and spending power, the primary engine of the global economy. That may not be the case in ten years’ time, but it true today. Similarly, the US consumer still holds the keys to global spending, which is why we focus so much attention on the US economy and its consumers. Speaking of growth, the first estimate of second quarter “growth” in the US economy has just been released. The US economy shrank by 1.0%, not far off expectations. The surprise came in the revision to the first quarter numbers, which were revised from –5.5% to –6.4%; remember growth in the last quarter of 2008 was –6.3%. Another key area of focus was consumer spending, which declined 1.2%, more than expected.
- *The Chinese economy:* second quarter economic growth came in at 7.9% on an annualised basis, evidence that the Chinese economy is still benefiting substantially from the $585bn stimulus package announced last year. Urban fixed asset management surged 35.3% from a year ago in June and industrial production rose 10.7%. In addition China’s foreign exchange reserves rose $178bn in the second quarter to a record amount of $2.132 trillion, the first time reserves exceed $2tr ever. Passenger car sales rose 48% in June; the fourth consecutive month that more than 1.1m vehicles were sold. The total number of vehicles

sold in the first half of 2009 in China was 6.1m. By way of comparison total light vehicle sales in the US in the first half of this year were 4.8m. The increase in economic activity so far this year came as Chinese banks advanced $1 084bn of new loans in the first six months of 2009, up 201% year-on-year and equal to 150% of all of 2008's lending.

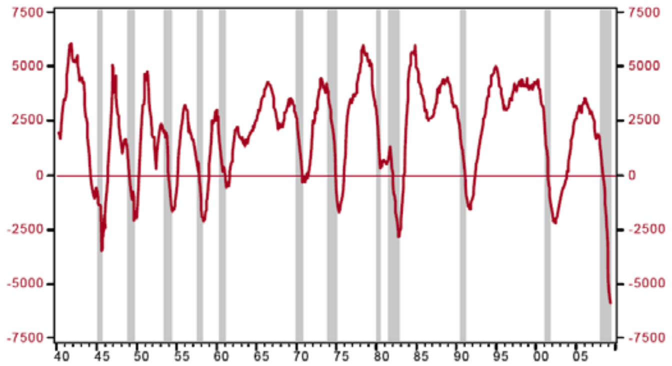
- *A change in guard at the SA Reserve Bank (SARB):* for those who may have missed it, the current SARB Governor, Tito Mboweni, will not be renewing his contract at the end of this year. He is to be replaced by Gill Marcus, a well-known figure in both business and political circles, who will begin her term on 9 November. She is currently the chairwoman of Absa Bank and has in the past also served in the capacity of deputy governor of the SARB. Much speculation exists as to whether Tito was "pushed" – the SA labour unions have long wanted to get rid of him – but if Marcus's track record is anything to go by, she is unlikely to be a push-over. She will likely stamp her authority and independence on the SARB very quickly; we see no reason to expect a radical departure from the prevailing monetary policy framework in SA.

Chart of the month

We continually draw your attention to the financial position of the US consumer and remind you that he constitutes 18% of the global economy. Given that his aggregate "balance sheet" has lost a combined $16 trillion over the past two years due to declining house and equity prices, our cautious view on global investment markets is formed by our belief that he will not recover from this knock overnight. In addition there are good reasons to believe that the huge spending binge that he undertook during the last 25 years will not be repeated. One reason is simply a question of demographics – he is getting older and has purchased most of his requirements (and then some) and will increasingly be focussed on income and not growth from his investments. Another reason for us to regard his future with some suspicion is the fact that more and more consumers are being retrenched. Indeed, the very reason for the market rally in July, namely "good" corporate earnings, is the same reason for our caution: companies were unable to increase their "top line" (sales) but rather achieved greater profitability by reducing costs, including laying off workers. The broad definition of US unemployment is now north of 16% and the latest narrow definition is heading to 10%. We suspect it will eventually move north of or get close to 11%, which, remember, is politically unpalatable. So we watch the US employment situation very closely. Chart 2 places the job losses in this recession into perspective. We have simply never seen anything like it since the 1940s. In other words the current US consumer's "spending power" is simply not what it used to be.

Chart 2: Historic cumulative job losses in the US

The shaded portions represent recessions

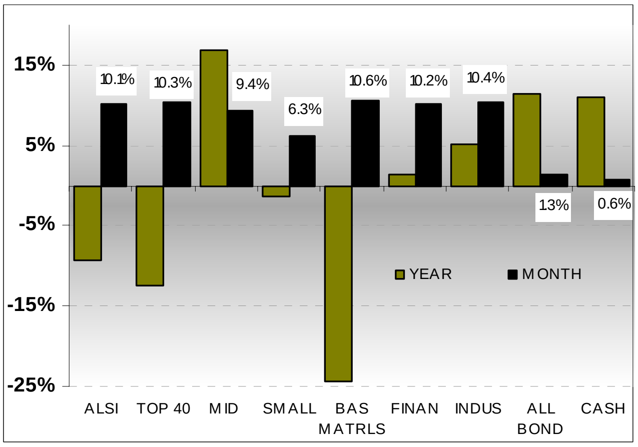


Source: Merrill Lynch

July in perspective – local markets

The rand eased marginally during July, which means that the strong gains on international equity market flowed right through to the SA equity market. You will see from the Chart below that all of the major indices posted returns around the 10% level, with the only "laggard" being the small cap index, which ended July 6.3% higher. The best returns were generated by the general financial sector, up 20.2%, personal goods 17.8% and life insurance 16.1%.

Chart 3: Local market returns to 31 July 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 of 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".

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Two of our "Big Picture" themes are "The Lost Decade" and "The Shift of power from West to East". The first speaks to the decline of the US in terms of its economic might prior to the credit crisis and the extent to which it will become entangled in internal issues, including the financing and eventual repayment of its vast private and public debt. The second is self-explanatory. Daily we find examples of how previously subservient economies, which traditionally played second fiddle to G7 countries, are establishing and developing their economic and political clout. Nowhere was this clearer than during a press conference on US Secretary of State Hillary Clinton's recent visit to India in order to "encourage" India to embrace a low-carbon future. Isn't it a bit rich – such a mission coming from the world's largest polluter? Be that as it may, the response by Jairam Ramesh, India's environmental minister to Clinton's call was the following: "there is simply no case for the pressure that we, who have been among the lowest emissions per capita, face to actually reduce emissions. And as if this pressure was not enough, we also face the threat of carbon tariffs on our exports to countries such as yours. We look upon you suspiciously because you have not fulfilled what developed countries pledged to fulfil. The demands of the developed world constitute a crisis of credibility".

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	July	**8.1%**	**15.9%**	**-9.3%**
Maestro equity benchmark *	July	10.6%	14.4%	-5.6%
JSE All Share Index	July	10.1%	14.6%	-9.4%
Maestro Long Short Equity Fund	June	**3.3%**	**2.3%**	**-18.4%**
JSE All Share Index	June	-3.1%	4.1%	-24.9%
JSE Financial and Indus 30 index	June	2.0%	3.3%	-5.7%
Central Park Global Balanced Fund ($)	June	**-0.14%**	**4.1%**	**-10.7%**
Benchmark**	June	-0.04%	4.2%	-14.1%
Sector average ***	June	1.10%	9.7%	-18.7%

* 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 ($)

Table 2 lists the returns on the equity component of the assets under Maestro's management. So far this year Maestro's clients are enjoying equity returns (7.3%) that are above the market (4.1%) and our internal benchmark (3.4%) but we take nothing for granted and working hard to put even more distance between ourselves and the market. What it not evident from the Table is our belief that *these returns were achieved with significantly less risk than that which is inherent in the equity market*. We spend a lot of time on risk, the bed-fellow of return; risk management forms a large part of our investment activities although it is hard to quantify in a simple table.

Table 2: Maestro annual returns to 30 June 2008 (%)

SA equity returns	6m *	1 yr	2 yrs	3 yrs	5 yrs	7 yrs
Maestro long-term equity portfolios	*7.3*	*-19.6*	*-9.4*	*9.2*	*22.9*	*20.2*
Maestro Equity Fund	*7.3*	*-20.2*	*-8.6*	*5.2*	*N/A*	*N/A*
Maestro equity benchmark **	3.4	-17.5	-8.0	5.1	19.3	14.0
JSE All Share Index	4.1	-24.9	-9.0	4.2	20.2	14.3

* 6-month returns are un-annualised
** 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index

Note, too, that we are publishing our seven-year returns for the first time. When one considers all that the world has thrown at investors since June 2002 (the base period for the seven-year return) the quantum of returns – more than 20% per annum for each of the past seven years – is impressive. I should add that equity returns from developed markets over the same period, look decidedly worse. By way of example, the seven-year compound annual return of the US equity market is -1.1%, Germany 1.3%, London -1.3% and Japan -0.9%. Who ever said South Africa is not the land of milk and honey?!

File 13 – things almost worth remembering

We thought you may be interested – we hold MTN shares across just about all our equity portfolios – that Bharti Airtel, the Indian mobile giant in discussions with MTN regarding a "merger of equals" added 8.5m subscribers in the first quarter of this year, bringing to 105.22m its total subscriber base. India's mobile market is the fastest growing in the world, adding more than 10m per month. There are presently 415m mobile subscribers in India.

Changing topics slightly, in previous editions of *Intermezzo* we have drawn your attention to the German soap opera, wherein two families are battling it out for control of their grandfather's legacy. Of course I am talking about the titanic and bizarre battle between VW and Porsche. What makes the soap opera so intriguing is that is contains elements of almost all the major factors behind the global credit crisis, being greed, egos, leverage, to mention but a few. To many, ourselves included, the battle represents the ugly face of Capitalism.

Chart 4: Recent price history of Porsche (€)

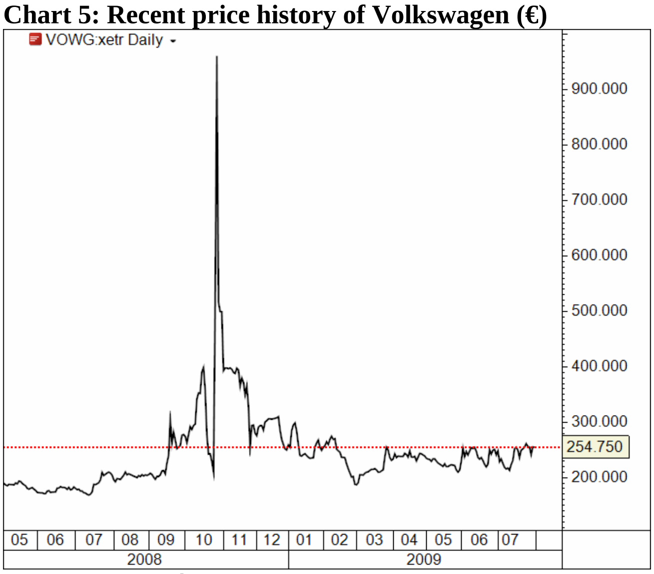
Source: Saxo Bank

The bizarre tale of Porsche's stealth takeover of VW has taken so many twists and turns in recent months that I have actually refrained from commenting on it. Literally, every time I have wanted to put "pen to paper" events have rendered the latest news obsolete. One day it was announced that agreement had been reached for a merger, only to be followed a few days later by the announcement that this would not be the case. Porsche was going to take over VW, but that changed a day later to VW now taking over Porsche – and so it went on. All of this takes place against a backdrop of the worst crisis in history ever for the global automobile industry. In respect of Porsche at least, it was easy to forget that they actually made cars – in reality Porsche had become one of the largest hedge funds in the world. But things went badly wrong when the global crisis unfolded; suddenly the €9bn debt Porsche had incurred in its battle to buy more of VW didn't look that clever. Having being turned away by the German government Porsche was left with little option by to begin direct talks with VW. But this was never going to be a smooth ride as long as Porsche CEO Wendelin Wiedeking was around.

Source: Unknown

Without going into all the details – and there are plenty, which make for fascinating "soapie drama" – Wiedeking finally got the boot. But not before he was paid €50m for his "efforts" – this being on top of the €150m he earned in the past two years. But perhaps we should feel sorry for him; Herr Wiedeking's lawyer reminded the public that he was actually entitled to a total of between €170m and €260m. His arch-enemy and VW Chairman, Ferdinand Piëch, was reported to have offered him €140m initially but this was negotiated down to €50m by the management board. Wiedeking has committed himself to taking half of the €50m and using it to establish a charitable trust for Porsche employees, but that has only outraged the Berlin government ever further. As one German politician pointed out "the modest sum of €25m would still be enough to pay all German members of parliament for one year or buy 250 Porsche 911s". That sort of puts it into perspective. And let's not forget the hundreds of millions of euros investors lost when hedge funds shorted the VW share, on sound valuation bases, during the raid on VW's shares, or the fact that Porsche manipulated the market so blatantly right under the German regulator's nose – refer to Chart 5. You may also recall the tragic death of the German industrialist Adolf Merckle, who took his life after the family group he had built up over decades nearly folded under the losses suffered when betting against the surging VW share. Wiedeking's departure brings to an end a horrible saga that brought out the worst in the capitalist system – is it no wonder that people and governments alike are taking such a hard look at capitalism?

Chart 5: Recent price history of Volkswagen (€)



Source: Saxo Bank

Table 3: MSCI Emerging Market July returns (%)

	July'09	YTD
Pol	26.4	17.0
Indo	23.0	90.1
Tur	20.8	61.0
Cze	19.4	27.4
Kor	18.5	46.0
Hun	17.2	38.6
Phil	16.3	49.5
Per	16.3	36.2
Sing	15.5	50.2
HK	13.8	50.8
MSCI EM Small Cap	**12.3**	**71.3**
Asia	**12.3**	**51.0**
AP ex Jap	**12.0**	**46.6**
Isr	11.9	35.7
Col	11.7	50.0
MSCI EM	**10.9**	**48.8**
China	10.8	49.7
Aust	10.2	35.8
Taiw	10.2	49.1
Mex	10.1	27.5
Mal	10.0	34.8
Egy	9.9	28.2
EMEA	**9.4**	**37.1**
LatAm	**8.7**	**55.6**
India	8.6	70.2
Bra	8.4	68.9
MSCI DM	**8.4**	**13.5**
Arg	7.7	25.3
Rus	7.3	54.0
Pak	5.3	46.3
S.Afr	5.1	30.3
Jap	4.2	5.9
Thai	3.9	47.6
Chil	2.8	54.0
Mor	-6.7	-0.9

Source Merrill Lynch