INTERMEZZO

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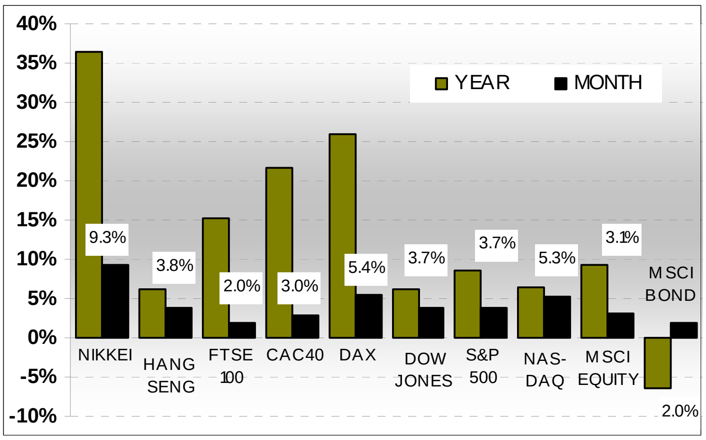
Investment Consulting

Investment Letter | 5th Edition | December 2005

Introduction
With due respect to the Northern Hemisphere readers, many of our clients are preparing for their summer holiday; many will print this and take it with them to read on the beach. So with your permission this edition will be a bit longer and less formal as we enjoy a well-earned rest and another beautiful African summer. But lets start with the "formal stuff".

November in perspective – global markets
The markets seemed to know no limits during November and if the start of the current month is anything to go by, will end the year with the proverbial bang. However, if one looks a bit closer, there have been great differences across the returns. Chart 1 illustrates this point clearly: Japan has risen very strongly (36.5%) so far this year, way above any other developed market. Rising to a five-year high, it gained 9.3% during November alone, in sharp contrast to Hong Kong, for example. European markets have also registered good relative gains, while US markets have lagged substantially. Bond markets have had a poor year too. On the other hand, emerging markets have had a superb year. India, South Africa, South Korea and Turkey all registered monthly dollar gains in excess of 10%, with the year to date gains in Brazil, Mexico, Russia (up 62.5%), South Korea and Turkey all exceeding 40%.

Chart 1: Global market returns to 30 November 2005



A quick review of global economic growth…
The past month saw the release of a host of data regarding the state of health of the global economy. The US third quarter growth rate was revised up from 3.8% to 4.3% and subsequent data indicates that the US economy remains in good condition despite the sustained rise in interest rates. Across the Atlantic, the European Central Bank (ECB) raised interest rates by 0.25% for the first time in five years. While the increase drew criticism from many quarters the ECB must be sufficiently confident that their action will not stifle economic growth, despite it being lower than most other regions. The historic South Africa growth rates were revised upwards. 2004 growth was revised from 3.7% to 4.5%. Growth during the first two quarters of 2005 was revised up to 4.6% (from 3.5%) and 5.4% (4.8%) respectively, while third quarter growth came in at 4.2%. It is not inconceivable that we could end up with a 2005growth rate close to 5.0%.

All of this data would be less surprising were it not for the sharp rise in energy prices that has occurred in 2005. Certainly, the past few weeks have seen the latter fall sharply (in excess of 20% in some cases) from their hurricane-induced peaks, but prices are still significantly higher than at the beginning of the year.

… And a closer look at commodity prices
2005 will go down as a year of extremes in many areas of the investment world, particularly within the commodity complex. Much controversy and debate exists as to the sustainability of China's growth rate, but it has proved to be a major "disruptive influence" on global commodity prices. Consider the following:

- the gold price is at an 23-year high
- the silver price is at an 18-year high
- the platinum price recently touched a 25-year high
- the copper price is at an all time high
- the aluminium price is at a 16-year high
- the zinc price is at a 15-year high
- the sugar price is at a 9-year high…

I think you get the picture. The point is that while a couple of unique circumstances are driving certain prices higher, it is fair to say that global growth must still be relatively strong to have sustained these rises. Why else would central banks be hiking interest rates? The record prices also reflect to some extent the huge under-investment in the resource sector over the past two decades. This supply constraint is unlikely to be resolved in the next year, which may help explain why commodities seem to have moved to a higher *range* of prices. And that bodes well for the South African economy, and also, I should point out, a stronger rand. Just imagine if the rand strengthened to, say, R6.00. After all, that's only 5% stronger than the prevailing rate at the time of writing. Don't you think the Reserve Bank would then cut interest rates? I suggest that *that* scenario is not priced into the financial and industrial sectors of the SA equity market at present.

The relentless nature of change
I had the opportunity of travelling abroad recently. During that time I was again struck by just fast the world is changing. I know that is self evident, but let me illustrate my point through a couple of examples.

Firstly, once or perhaps twice during the life time of an investment manager an opportunity comes along to make a really good investment (read: *lots of money*). We all dream of having bought Intel at its IPO on October 13, 1971 (current market cap $165bn), or Microsoft at its IPO on the Nasdaq on March 13, 1986 (current market cap $298bn). Yes, that's only 21 years ago – what were you doing in 1986? Sure, they have declined from their peaks, but it would still have been a great investment for many years. And so we dream of prices that posted dramatic and *sustained* increases over many years. And we long for another opportunity like that to come our way.

But when it happens right in front of our eyes, we don't even see it! Oh yes, I hear you say. Where? In August 2004 a company listed amidst great controversy. We had all heard of the company, many of us had read a great deal about it, but how many of us actually bought the share? I for one didn't. I mean, who in their right mind would buy a company on a price earnings (PE) ratio of 150 times? Of course I refer to Google. Today Google has a market cap of $120bn – not bad for a company that is not even eight years old. And many are of the opinion that Google has not even begun to scratch the surface in terms of monetizing its intellectual property and unique skills. So what's my point?

Well, firstly, note how much shorter it has taken for one company to dominate its "space". It took Intel 27 years to reach a market cap of $100bn. Microsoft took 14 years. Google came "from nowhere" to leader of the global web in less than eight years; from $85 to $418 in just more than a year (that's a 391% price gain in just over a year). Secondly, how many of us even really understand the Google model? What does it have that enables it to so dominate the global search engine market?

The scary aspect is that while many of us don't even really know our way around the internet properly, those in the know are already talking of "Web 2.0". Not that a second version exists, its just that there seems to be a new way emerging of doing things on the web; a new web world driven by free software (how much do you pay to use Google's search engine, or to see what your house looks like on Google Earth?), enabling millions of smaller companies and entrepreneurs to take on bigger companies at a fraction of the cost and "time to market". That's change.

Table 1: The Largest Companies

Rank	Company	Market value at peak ($bn)	Date of peak	Change since high
1	Microsoft	615	Dec 1999	-55%
2	General Electric	594	Aug 2000	-40%
3	Cisco Systems	548	Mar 2000	-80%
4	Intel	502	Aug 2000	-73%
5	Exxon Mobil	410	Feb 2005	-13%
6	NTT DoCoMo	397	Feb 2000	-79%
7	Vodafone	361	Mar 2000	-54%
8	NTT	348	May 1987	-76%
9	Wal-Mart	310	Dec 1999	-37%
10	Pfizer	308	Jul 2000	-48%

Shaded area: has been the world's largest company at one stage in past 20 years
Source: Financial Times

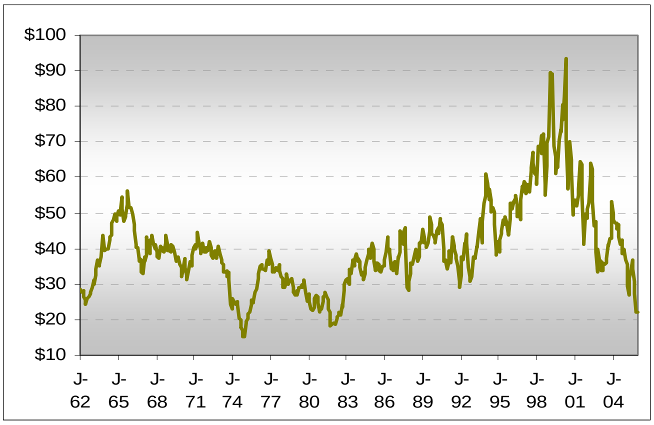
Table 1 reflects more symptoms of change. One can only wonders where Google will be in ten year's time – or should that be five years?

Incidentally, if you are looking for something to read this holiday, how about *The Google Story*, by David Vise and Mark Malseed, widely available, dare I say it, on the internet. Speaking of books, the book that won this year's Financial Times Goldman Sachs Business Book of the Year award was *The World is Flat*, by Thomas Friedman, a New York Times columnist. The book's premise is that, at the beginning of this century, the world entered a new phase of globalisation, based on disruptive social, political and technological events - "flatteners" as Friedman calls them.

From what I have read it sounds quite interesting, but two aspects fascinated me more than most. Firstly, Friedman is rather annoyed by the award, seeing that he did not set out to write a "business book". And secondly, the audio version of the book became the top-selling "podcast" album on Apple's iTunes audio downloading site this month. What's so amazing about that? Well, when Friedman started the book in March 2004, podcasting didn't even exist. Besides, who really invented podcasting? Nobody – its just one of those applications that emerged from the global network. That's change.

At this stage I would like to have shared a bit on the woes of General Motors (GM), an unfolding story of a company that has shown a total inability to adapt to the changing world. Space precludes me from doing so, but there will be plenty of opportunity to deal with this drama next year. Both GM management and staff (unions) have displayed incredible intransigence and an introspection that is an indictment of everything positive about the "American story". How can such an "icon" of corporate America miss such an obvious feature, namely the power of change, in the modern world? Little wonder that the share price has returned all the way back to 1982 levels – refer to Chart 2.

Chart 2: GM share price – all the way to 1982 levels



One final comment of the changing environment is the increasingly diminished effect of politics and more specifically politicians. It seems to me that investors have decided, rightly or wrongly, that the global economy and the factors that influence it are more important than politics and politicians. One doesn't have look too far to see that the public at large has little faith in politicians, who in turn have little credibility and even less integrity. US President Bush as a good example of how increasingly irrelevant politicians are becoming. His popularity is declining rapidly, his policies are arguably falling apart at the seams (thanks in part to the ongoing failure of US policy towards Iraq) and he could conceivably earn the reputation of being the worst US President in history on many accounts. Yet the US economy is thriving and US consumers remain confident and financially secure. Let me put it another way: who do you has been the more powerful person in the US and the global economy for that matter, in the past four or five years. President Bush or Fed Chairman Alan Greenspan?

But Bush is not alone. The political morass in Germany has not stopped that equity market from doing very well this year. Even as the debilitating result of the elections was being announced and as the weeks of coalition negotiations dragged on, the German market moved to record levels. But perhaps the most glaring example of how little store investors place in politicians these days can be found in our own back yard. On the day that the "until recently-Deputy President" Jacob Zuma, who remains extremely popular amongst the broad populace, was charged with rape, the rand rose to a three-month high. Had that happened in the late nineties, the rand would have fallen 5% or 10%. That's change. It's important to focus on matters such as these. They are becoming increasingly influential in shaping the world around us in general, and the investment environment in particular.

Chart of the month - Part 1

We have commented a number of times through the year on the so-called "property bubble" in the US and UK in particular and the extent to which it has supported economic well-being in developed countries. Note how the role of property in the US (Chart 4) has usurped the role of financial assets (Chart 3) in the "household" balance sheet. While both were coming off extreme bases, we should not underestimate the effects of property in the past few years. Neither should we ignore the consequences in the event of a down turn in first world property prices.

Chart 3: Financial assets as a % of total household assets

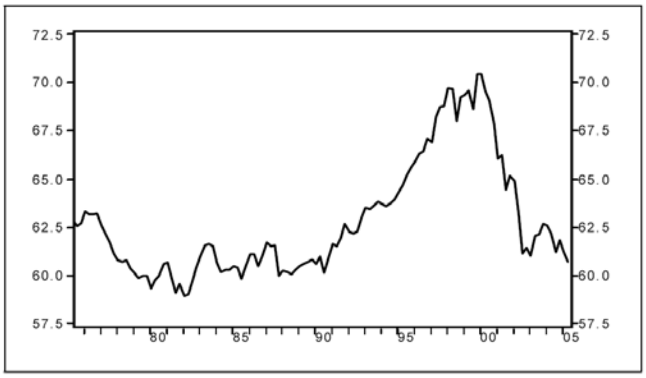
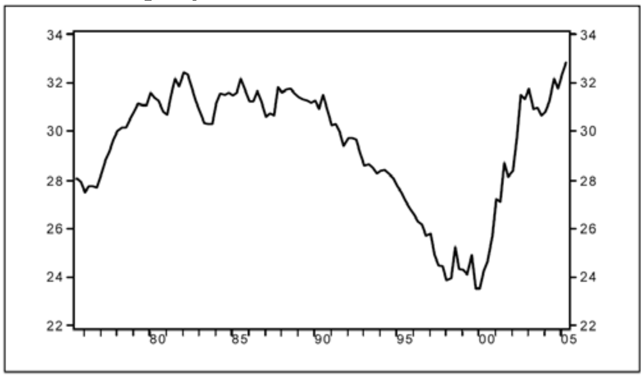


Chart 4: Property assets as a % of total household assets



Source: Merrill Lynch

November in perspective – local markets

The South African landscape produced a mixed picture. In general all major indices ended higher, although the month was characterised by a very strong market in the first half, then saw prices correct sharply in the latter half as the rampant rand retarded resources shares in particular. If you don't think the rand was that strong, recall that the dollar gained 1.7% and 2.9% against the euro and yen respectively yet the rand itself gained 3.8% against the dollar during November. The platinum index gained 12.7% despite the firm rand, and the pharmaceutical and life assurance sectors about 7.3% each. The beverage sector lost 7.6%. It is interesting to note from Chart 5 that during November the resource index surpassed the small cap index as the top performer over the past year.

Chart 5: Local market returns to 30 November 2005

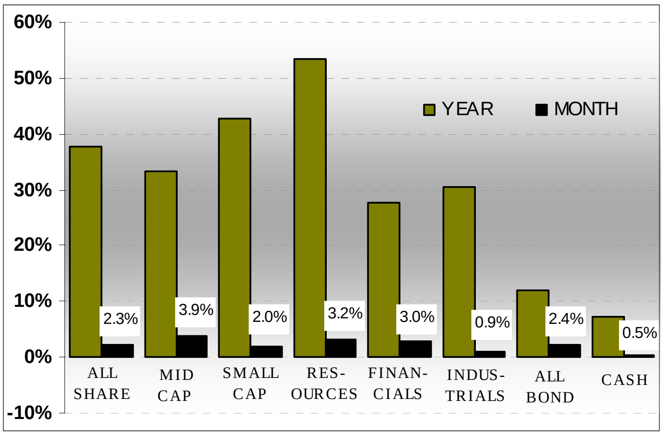
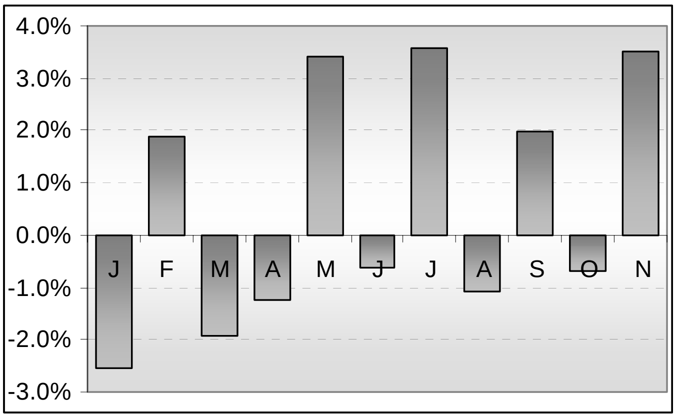


Chart of the month - Part 2

Time for a bit of fun, to illustrate a point of course. Chart 6 below lists the monthly returns so far this year of a well-known global equity market index. Which one is it? Note the interesting pattern – up down, up down – with no two consecutive months of positive returns. All rather predictable, but not very good at generating satisfactory returns. So far the year to date return on this index is only 3.1% - that should give you a clue in identifying it. The answer is at the end of this edition.

Chart 6: Which index do these 2005 returns represent?



For the record

The latest returns of the collective schemes (unit trusts) that Maestro manages are listed in Table 2, below. If you wish to find out more detail on the Funds, including the latest Maestro Equity Fund Summary, please visit our website at www.maestroinvestment.co.za. During the month the Maestro Equity Fund experienced inflows that had the effect of increasing the Fund's size to just short of R10m.

Table 2: Returns of mutual funds under Maestro's care

	Month	Return	Year to date
Maestro Equity Fund	Nov	**1.0%**	Not applicable
Maestro equity benchmark *		1.8%	29.2%
JSE All Share Index		2.3%	35.7%
Central Park Global Balanced Fund ($)	October	**-2.9%**	-2.9%
Benchmark**		-1.4%	1.0%

* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index
** 40% MSCI World Index, and 20% each in MSCI Sovereign Index, CFSB Hedge Index and 3-month US Treasury Bills

And finally…

We will be "closing" the Maestro office and heading for the summer sun on 10 December. However, as always I will keep half an eye on my emails and am always available on my phone should you need to get hold of me in the event of an emergency. Tracy (tracy@maestroinvestment.co.za) will be in the office for most of the period, with the exception of the period between Christmas and New Year, and I will be back at my desk in Cape Town on Monday, 9 January 2006.

All that remains is for me to wish *Intermezzo* readers around the world - one day time will allow me to profile the *Intermezzo* readership – the very best for the coming Festive Season. Your encouraging comments and support throughout the year have been greatly appreciated. Thank you. May the coming year be filled with good things and may this time be one of joy and rekindling of relationships with those closest to you.

Spot the index – the answer

Chart 6 represents the monthly returns of the S&P500 index.