MAESTRO Investment Consulting

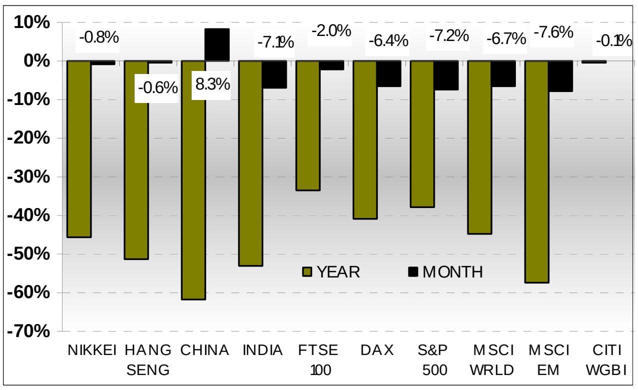
INTERMEZZO

Investment Letter | 8th Edition | December 2008

November in perspective – global markets

November proved to be another topsy-turvy month in global investment markets. Although we were hoping it wouldn't be necessary, halfway through the month, when markets were looking particularly precarious, we decided to again chronicle the month day by day, as we did in September and October. You can therefore find more detail on November's market behaviour in Appendix 1. As in October, the severity of the monthly returns is hidden by the large rise in markets during the last week of the month. By 20 November the US equity market was down 22.3% for the month, but thanks to a 19.1% gain in the last week it ended the month down "only" 7.2%. The pattern is similar to the behaviour during October, when by the 27th of the month the US market had declined by 27.2%, but a 14.1% rise during the last week reduced the loss to 16.6%. If nothing else it goes to show just how volatile and nervous global markets are at present; of course this has significantly complicated the investment environment throughout the second half of this year. When all was said and done, despite the strong bounce in the last week equity markets still registered declines, although none was as severe as the October losses. China actually posted a gain of 8.3% but the MSCI World index fell 6.7% and the MSCI Emerging market index 7.6%. The *annual* returns to end-November are now uncomfortably large – refer to Chart 1 for the details – and range between -30.0% and -60.0%. The dollar weakened marginally (-0.1%) against the euro but this didn't help commodity prices. Precious metal prices ended higher (gold rose 11.5%) but oil fell 21.7% and all major commodity indices registered significant declines. The US bond market in particular was very firm, thanks to a "flight to safety" into US government bonds; the yield on the US 10-year bond declined below 3.0% for the first time in more than fifty years.

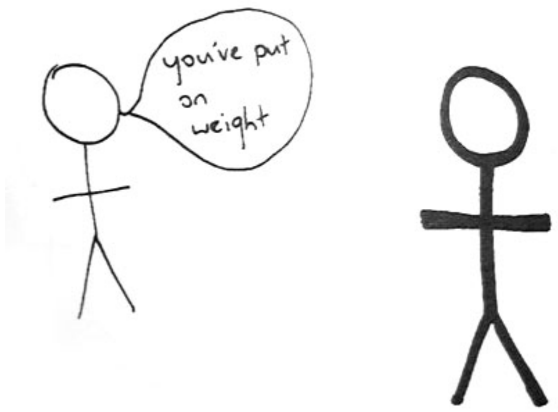
Chart 1: Global market returns to 30 November 2008



What's on our radar screen?

We remain focussed on the changing economic landscape and list below a couple of developments in this regard – you will find more significant events detailed in Appendix 1:

- *The Chinese economy:* inflation in China slowed further in October to an annual rate of 4.0%. The main reason for the decline was a drop in food prices. Non-food inflation is now only 1.6%, down from 2.0% in September. This gives the authorities more scope to cut interest rates further, which they subsequently did, cutting rates by four times their usual degree. On 26 November China cut rates by 1.08% to 5.58%. China's rate of increase in industrial production dropped to its lowest level in seven years - it rose "only" 8.2% in October. China also announced a two-year $586bn stimulus package targeting infrastructure and social welfare, in an effort to prevent growth from slowing further.
- *The SA economy:* Standard and Poor's downgraded SA's credit rating from "stable" to negative, as did another credit rating agency, Fitch. Other emerging markets that were downgraded were Russia, South Korea and Mexico. Hungary, Bulgaria, Kazakhstan and Romania had their ratings cut. The reason given for the changes was the "profound deterioration in the global outlook and the continuing difficulties in raising money in the capital markets."

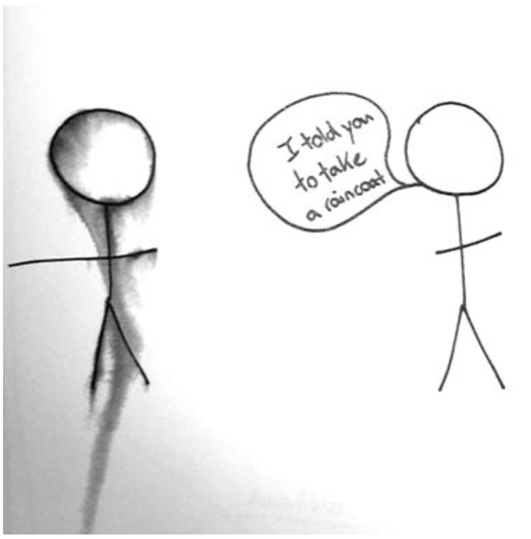


- *The global economy*: bad news on the global economy is coming in thick and fast. Japan confirmed that it is recession, as did Germany, whose growth declined 0.5% in the September quarter after the June quarter's 0.4% decline. The Eurozone also slipped into recession with that economy shrinking by 0.2% in the September quarter after a similar drop in the June quarter. And in a very belated response the National Bureau of Economic Research (NBER) the government agency charged with declaring and dating official US recessions, declared that the US is also officially in recession. The recession officially began in December 2007.
- *Deflation*: we will return to this topic many times in the coming months, but there is a very real danger that the global economy is moving rapidly into a vicious cycle

of deflation. History holds plenty of evidence of the devastating and long-term economic consequences of deflation. We will say more about it next year, but its worth noting that the Eurozone inflation dropped from 3.2% to 2.1% in October, the fastest decline since the European Monetary Union was established a decade ago. And in the US inflation declined 1.0% in October, its largest monthly decline since record-keeping began in 1947. The annual inflation rate is 3.7%. Core inflation i.e. inflation excluding food and energy prices, declined 0.1%, its first decline in 25 years. Core annual inflation declined to 2.2%.

A few snippets on the auto industry

Firstly, let me update you on the VW debacle – refer to Appendix 3 in the November edition of *Intermezzo*. Porsche released its results for the year to end-July. It made \$8.7bn from trading VW options and also benefited to the extent of another \$1.3bn from the increase in the underlying value of its stake in VW. This helped its pre-tax profit 46% to \$10.8bn. What makes this so ludicrous is that it comes as a time when the global auto industry is on its knees and struggling for survival. Ironically, VW, the very company that Porsche is stalking, was one of the first companies to opt for the cash bail-out offered by the ECB. And subsequent to its results, in the light of the substantial deterioration in economic conditions, Porsche and VW have announced significant production cutbacks.



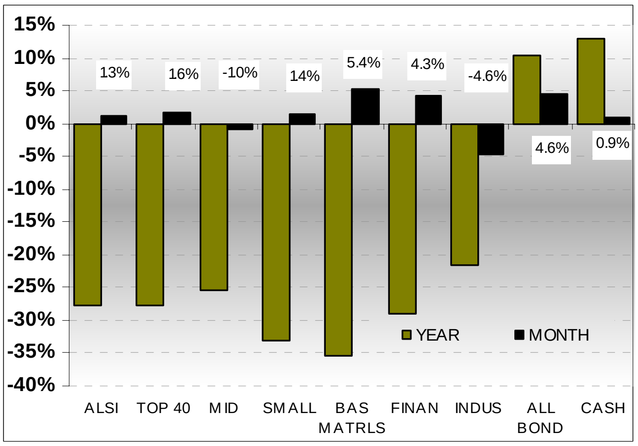
Elsewhere US automakers in particular are on the skids, with car sales down between 20% and 25%. GM is burning cash at a rate of \$7bn a quarter (and Ford at \$8bn) and issued a statement during the month to the effect that it would run out of money early next year. GM's lost \$2.5bn during the September, bringing its combined losses over the past four years to \$70bn! This is all rather embarrassing for GM, to say the least, at is "celebrates" its 100th anniversary.

At the time of writing, GM's price is close to a 62-year low and is currently valued at only 2% of Toyota's market cap, despite the latter having fallen sharply as well. All three US automakers are currently pleading their case for a government bailout package – they must wonder why, if the financial industry can get \$700bn and more, they get a measly \$25bn. Their initial request did not go down too well with Congress when it was revealed that the CEOs flew to Washington in their respective private jets (*Ed:* they really don't get it, do they?)

November in perspective – local markets

Similar to global markets, the JSE was spared the ignominy of further material losses by an enormous rally in the last week of November, driven by the materials index in general and Billiton in particular. By the 20th of the month the All share index had declined 15.1% but a 17.4% rally from that point onwards resulted in the index posting a positive return of 1.3% for November. The basic materials index gained 5.4% on the month, thanks to some extent to a 53.3% rally in Billiton following news that it has abandoned its hostile takeover of Rio Tinto. Financials were also firm, up 4.3%, which seems rather counterintuitive given the prevailing financial crisis. Industrial shares endured quite a bit of pain, ending down 4.6% while the All Bond index mirrored global bond returns by posting a gain of 4.6%. The gold (+17.9%) and platinum (+16.3%) indices were amongst the largest gainers during the month, while on the downside the household goods (-25.3%) and construction and materials (-21.3%) brought up the rear. The rand recovered off its intra-month lows of R10.75, but still ended 2.1% lower at R10.07 to the dollar; it has lost 32.5% of its value in the past year.

Chart 2: Local market returns to 30 November 2008



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.

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Table 1: Returns of funds under Maestro's care

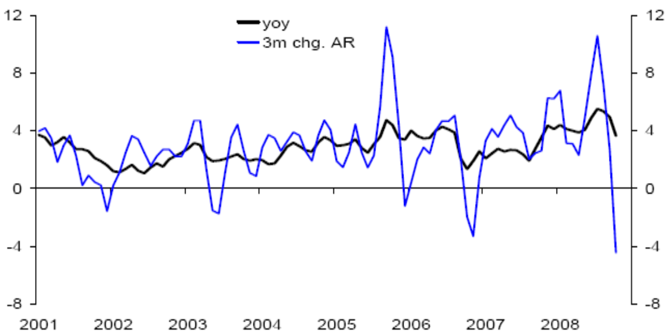
	Period ended	Month	Year to date	Year
Maestro Equity Fund	Nov	**-3.3%**	**-28.1%**	**-29.5%**
Maestro equity benchmark **	Nov	-0.2%	-21.9%	-25.2%
JSE All Share Index	Nov	1.3%	-24.4%	-27.7%
Maestro Long Short Equity Fund	Oct	**-15.4%**	**-27.1%**	**-29.2%**
JSE All Share Index	Oct	-11.7%	-25.3%	-30.9%
JSE Financial and Indus 30 index	Oct	-7.4%	-19.1%	-24.4%
Central Park Global Balanced Fund ($)	Oct	**-7.0%***	**-19.3%***	**-22.8%***
Benchmark***	Oct	-9.4%	-20.0%	-21.4%

* Estimate for October
** 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index
*** 40% MSCI World Index, 20% each in Citi World Government Bond Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills

Chart of the month

There are so many scary charts to show at the moment, it is hard to know which one to choose. Many of you would have seen a lot of them, so perhaps we should look at an indicator that may well come to play a more significant role than any other on the outlook for the global economy in the year ahead, namely inflation. Or should that be deflation? Chart 3 shows both the annual rate of US inflation (the black line) and the annualised rate of change over the *past three months* (the blue line). You can see that although the annual rate is still positive, more recently inflation has fallen sharply and is already negative. We think this trend will continue for some time.

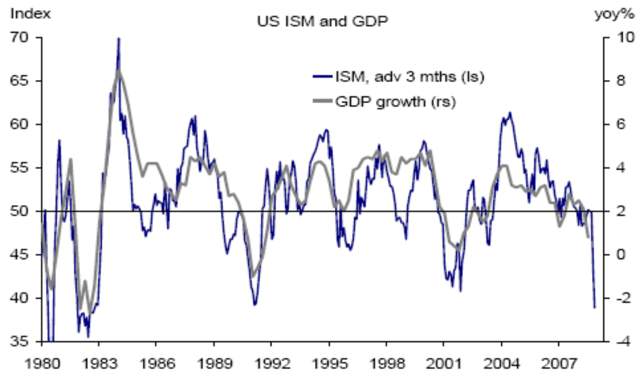
Chart 3: US headline inflation (%) - watch closely now



Source: Deutsche Bank

And while we're on the US economy, it is worth repeating that the **US is now officially in a recession**, despite the fact that they have not yet had two consecutive declines of economic growth; third quarter growth was -0.5% from the second quarter's 2.8%. We are told that the recession began in December 2007 already - regular readers will know we have long held the belief that the US recession started early this year. To be honest, we think this recession will be like no other – probably longer and deeper too, thanks to the huge excesses (leverage) that have built up in not only the US but the world in general, over the past number of years. For example, look at Chart 4, which depicts the ISM Manufacturing index (the blue line), advanced by 3 months. It has a very close historic relationship with US economic growth (GDP) which is why we follow these indicators so closely. Just look at the chart – you can draw your own conclusions. This recession is going to be bad – really bad.

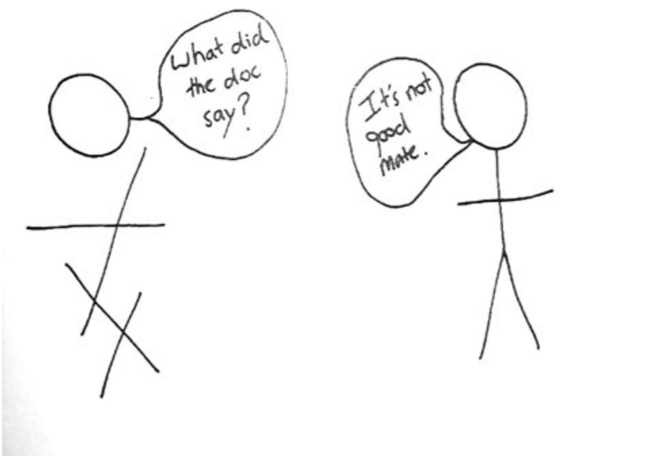
Chart 4: ISM manufacturing index and US growth
The shape of things to come



Quotable quotes

Those of us (myself especially) who have looked to the self-interest of lending institutions to protect shareholders equity are in a state of shocked disbelief. *Allan Greenspan*.
The crisis in the economy has come on us much more suddenly than anyone expected. We are facing a situation the world has not seen since the 1930s. *Lakshmi Mittal, CEO of Arcelor Mittal*.

Certainly we have a difficult situation in Europe in relation to steel demand. But one thing I know for sure – human civilization cannot survive without steel. *B Muthuraman, chairman of Tata Steel, the world's 5th largest steelmaker*.



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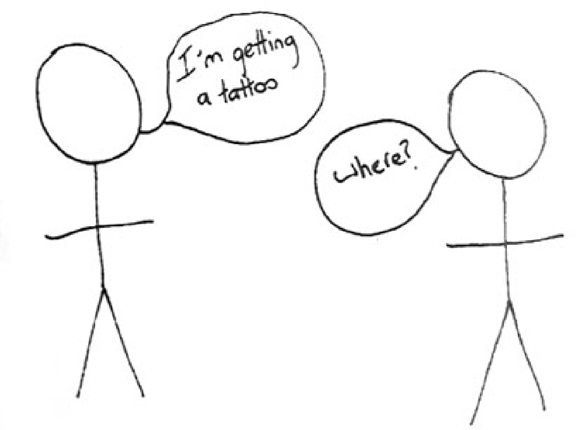
Excessively cheap money in the US was a driver of today's crisis. I am deeply concerned about whether we are now reinforcing this trend through measures being adopted in the US and elsewhere and whether we could find ourselves in five years facing the exact same crisis. *German chancellor Angela Merkel*.

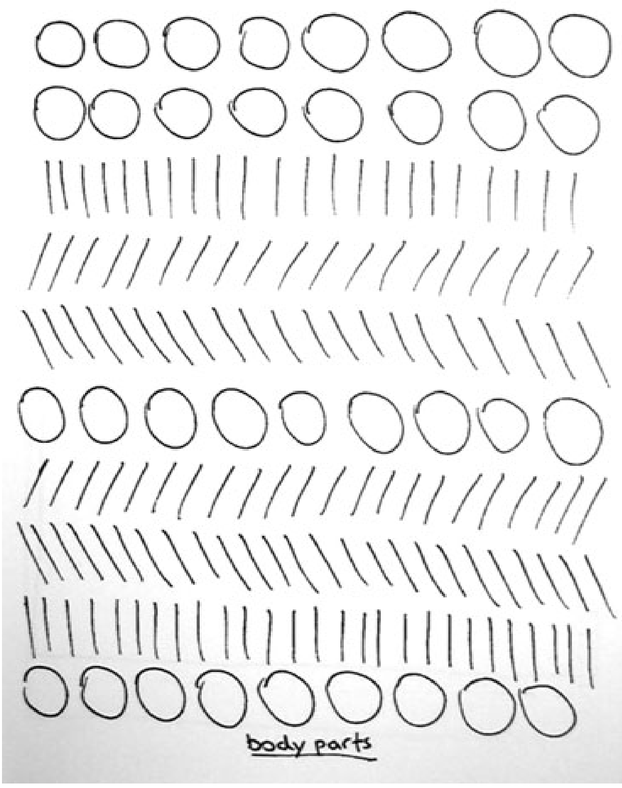
The function of economic forecasting is to make astrology look respectable. *John Kenneth Galbraith.*

File 13 – things almost worth remembering
On 20 November the average daily rate to charter a Capesize dry bulk carrier (ship) declined to $3 670. On June 5 it hit an all-time record of $233 988, making the decline from the peak an astonishing 98.4%.

And here's another bit of incredible news: in response to the recent food price hikes and in order to increase the security of food supply, South Korea recently bought a vast tract of land in Madagascar to grow food crops. The 1.3m hectares – half the size of Belgium and comprising nearly half of the arable land in Madagascar - have been leased for 99 years. The maize and palm oil crops will be developed over a period of 15 years and the produce will be shipped back to Korea. The labour will be supplied by … South Africa.

Have you ever wondered how much it costs to run a Formula 1 team? Well, wonder no more. The Honda Formula 1 team recorded the highest ever costs in the Formula 1 circus, burning through $221m last year. The biggest expense, not surprisingly, was the development and production of its 80 V8 engines, although staff expenses came in second at a cost of $53m. Its staff compliment is 667, which compares to the 557 of this year's F1 world champion McLaren team, whose expenses were "only" $189m. Boys and their toys, hey?





And finally…
Where does one begin to reflect on a year like the one just passed? As we head our respective ways for a much-needed break, within the Maestro office it is always a time for reflection on what the past year held. This year we leave with mixed emotions; anger (directly at ourselves for the opportunities we missed during the year), a sense of regret and disappointment (at our failure to not protect our clients' investments better), weariness and relief (for obvious reasons), edification (despite all the trauma we learnt more this year than most other years put together) and sadness (as we share in the unexpected loss of loved ones during the year in respect of two members of the Maestro family). There is also a sense of gratitude towards the many service providers, including those in London and Luxembourg, who have assisted us throughout the year.

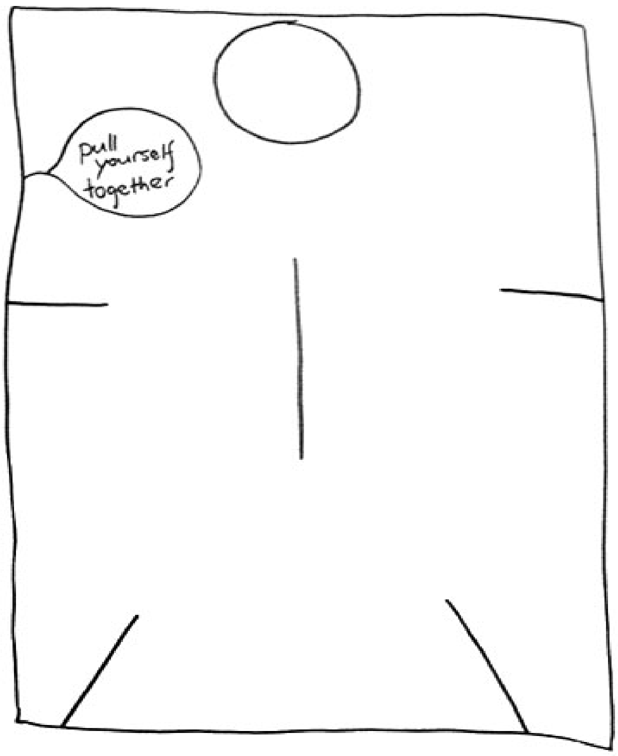
But this year, more than any other, the over-riding emotion is one of deep gratitude and humility, directed at our clients who have supported us throughout the year, at times also with words of encouragement and understanding. We are very conscious that many fellow-professionals no longer have jobs and many investment companies are shrinking, merging or even disappearing. That only serves to increase out gratitude towards our clients, who have stood with us throughout the year and endured all that the markets have thrown at us. *Thank you so much*. If and when you head for the summer break, may you come back refreshed and full of energy to tackle what will surely be another difficult year. Our desire for you is that you experience the joy of Christmas, and all that it means to you, in a new way, and that you are enriched by the times of family and togetherness that are so special this time of year. May the New Year bring with it a sense of perspective, excitement and contentment, as well as many opportunities for each of us to reach out and touch the lives of those that walk alongside us through the journey of life.

The Maestro office will be closed during Christmas and New Year. Most of you have our respective contact details and are more than welcome to contact us in the event of an emergency, at any time. “Hamba kakuhle” *(go well)* and see you in 2009.

Table 2: MSCI Emerging Market November returns (%)

	Nov-08	YTD
EM countries/regions		
Peru	11.5	-50.9
China	4.3	-56.5
South Africa	-0.2	-47.1
Philippines	-0.6	-53.2
Malaysia	-1.8	-46.6
Argentina	-2.6	-54.4
Chile	-2.9	-38.6
Mexico	-3.6	-46.4
Thailand	-4.2	-56.4
MSCI EM Small Cap	**-5.9**	**-63.8**
Morocco	-6.3	-16.4
LatAm	**-6.7**	**-53.9**
MSCI DM	**-6.7**	**-43.8**
Czech Rep	-6.8	-47.4
Asia	**-7.2**	**-58.7**
MSCI EM	**-7.6**	**-57.7**
Israel	-8.2	-33.4
Hungary	-8.7	-63.6
Brazil	-9.4	-58.0
EMEA	**-9.6**	**-58.5**
Turkey	-10.4	-65.5
India	-10.7	-68.1
Taiwan	-10.8	-51.1
Indonesia	-11.7	-65.8
Poland	-11.8	-58.1
Egypt	-14.5	-60.5
South Korea	-17.0	-63.2
Russia	-18.4	-72.0

Source: Merrill Lynch



Source of the stick men sketches unknown

Appendix 1 – Chronicles of chaos – Part 3
At the beginning of November I had hoped that a chronicle of the month's events would be unnecessary. However, by the middle of the month it was clear that November was turning into another landmark month, similar to September and October. Consequently, we continue the series of chronicles that describe the salient features of the ongoing market mayhem; if by any chance you missed them, you can read a daily account of September and October in the October and November editions of *Intermezzo* respectively.

Monday 3 November: The Reserve Bank of India cuts interest rates by 0.5% to 7.5%, the second cut in as many weeks. Their actions follow rate cuts in Japan and China the previous week. The cash reserve ratio banks have to hold at the central bank is also cut by 1.0% to 5.5%. The Indian equity market rises 5.6% on the news. With the Indian equity market down 51.6% for the first eleven months of 2008, the Financial Times reports that India's 10 wealthiest billionaires have lost an aggregate $200bn so far this year due to declining share prices. US manufacturing activity, as measured by the ISM manufacturing index, falls to a 26-year low. GM's October sales of cars and light trucks falls 45% and Ford's by 30%. European equity markets end flat, although Xstrata, which rose 36% last week alone, rises another 10.3%. VW falls 21.3% after the German stock exchange cuts its weighting in the Dax index to 10%. The Australian market ends 5.1% higher ahead of the Reserve Bank of Australia meeting the following day. America heads into the day on which they will choose a successor to George Bush and 3-month Libor declines to its lowest level since the collapse of Lehman Brothers on 15 September.
Tuesday, 4 November: Australia's central bank cuts rates by 0.75% to 5.25%, the lowest since March 2005. It has now cut rates 2.0% in the past two months. Tokyo rises 6.3% and India another 2.8%. Libor eases further to 2.71%, its 17th successive daily decline, in a clear sign that the massive risk aversion of recent days is abating. The oil price rises 10.5% to above $70 and gold 4.3% to $731 as the dollar declines by 2.5% against the euro. However, the Baltic Dry index declines 1.5% to a new 9-year low and is now only 5% above a 22-year low. The UK equity market ends 4.4% higher (Xstrata rises another 12.0%, bringing its 5-day gain to 83.9%), the Dax rises 5.0%, SA 2.4%, Brazil 5.2% and Argentina 6.1%. In an "Obama bounce" of note – Barack Obama won the election by a convincing margin - the US equity market rises 4.1%, led by financial and energy shares.
Wednesday, 5 November: Following strong US markets overnight, China rises 4.2%, Japan 4.5% to a 3-week high, Hong Kong 3.2% and Australia 2.9%. But reality sets in as European markets snap a six-day rally; the Dax ends down 2.1% and London 2.3%. All 30 stocks in the Dow Jones index fall and the S&P500 index ends the day 5.3% lower. Brazil ends 6.1% lower and the SA market loses 3.2%. The dollar declines 0.5% against the euro and the oil price heads sharply lower, down 7.1% to $65. Arcelor Mittal reduces output for the remainder of 2008 by 35%; CEO and major shareholder Lakshmi Mittal says "We are facing a situation the world has not seen since the 1930s." Three-month Libor falls for the 18th successive day, to 2.51%, its lowest level in almost four years.

Source: Financial Times, Ingram Pinn, 8 November 2008

Thursday, 6 November: Following on from the very weak market in the US last night, Asian markets head lower; Japan closes down 6.5%, China 2.5%, Hong Kong 7.1%, India 3.8% and Russia 6.3%. The SA market closes 3.9% lower and Brazil 3.7%. The Bank of England (BoE) cuts rates by more than expected, leaving many shocked by the extent of the cut. It cut rates by 1.5% to 3.0%, their lowest level in 54 years. The European Central Bank (ECB) also cuts rates, but by a more sedate 0.5%, to 3.25%. The Czech and Swiss central banks also cut rates. The UK equity market fails to respond to the large cut though, ending the day down 5.7%, led lower by financials and property developers. Similarly, the Dax ends down 6.8% and Paris 6.4%. Commodity prices also fall heavily, with oil edging below $60 to a 19-month low. In response to the rate cuts, sterling initially loses over 1% but manages to end the day marginally higher at 1.5944 to the dollar; the euro and Swiss franc are punished though, ending down 1.2% and 1.5% against the dollar at 1.2801 and 1.1738 respectively. The yield on the US 10-year Treasury (bond) rises to 3.73%. The US equity market ends another 5.0% lower as gloom once again sets in to global equity markets - so much for the "Obama bounce." On the corporate front, Toyota reports a 69% drop in second quarter earnings as US automakers head to Washington to lobby government for a bailout package – Ford (-5.3% on the day) and GM (-13.7%) have lost a combined $24bn in the past three months on the back of the worst slump in US auto sales in 25 years. UK-listed MAN Group, one of the largest listed hedge fund managers, falls 31% after it reports a 44% drop in performance fees and a 24% drop in half-year pre-tax profits. And two years after abolishing its absolute monarchy Bhutan crowns 28-year old and Oxford-educated heir to the throne Jigme Khesar Namgyel Wangchuck as its Dragon King.

Friday, 7 November: Asia starts the day off on a weak note with Japan down 3.6% but manages to gather itself towards the close. Hong Kong ends 3.3% higher, India 2.4% and China 1.8%. The markets are nervous ahead of the release of US employment data, which has historically caused great volatility in the market. When the data is released it is worse than expected; the US unemployment rate comes in at a 14-year high of 6.5% as the economy sheds 240 000 jobs in October, bringing to 1.2m the number of jobs that have been shed this year so far. Yet despite the poor jobs data, the UK and German equity markets manage to register respective gains of 2.2% and 2.6%. The SA market ends down 0.5% and the US market ends the day up 2.9% and so brings to a close a week characterised by huge swings and sentiment, poor economic data and massive daily and intra-day volatility. Finally, GM warns that it is likely to run out of cash by the first quarter of 2009. In stark contrast and as though to rub salt into the wounds of all those who bet against the VW share price, Porsche announces results which show that it made a cool $8.7bn out of trading VW options during the year to end-July and booked another $1.25bn from the increase in the value of its VW holding. Although Porsche did not release details of CEOs Wendelin Wiedeking package, it is widely believed he earned about $100m in the past year, making him one of the highest paid CEOs in the world. Auto industry executives are reportedly "not amused" (*Ed:* can't say I blame them!)

Monday, 10 November: China announces a $586bn two-year fiscal stimulus plan, equivalent to 15% of their GDP, in an effort to prevent the economy from slowing further. This lights a candle under Asian equity markets; the Chinese markets gains 7.3%, India 5.7% and Russia 6.8%. Hong Kong rises 3.5% and Japan 5.8% as resource companies around the world post strong gains. The SA market gains 5.1% with Anglo and Billiton rising 13.3% and 10.5% respectively. European gains are more muted; the Dax gains 1.8% and London 0.9% as the US gets off to a weak start and eventually ends 2.2% lower. On the corporate front the bad news comes in thick and fast: Circuit City files for bankruptcy protection and concerns are raised about GM's future yet again, as its share price declines 23% to a 62-year low. AIG, which last month received an $85bn rescue injection from the US government, confirms that it is in discussions for yet another capital injection - this time for $150bn. At the same time it announces an astonishing third quarter loss of $24.5bn! And not to be outdone, Fannie Mae, the now-nationalised mortgage finance group that together with Freddie Mac guarantees or owns more than half of US mortgages, announces a third quarter loss of $29bn! And in a sign of the mayhem prevailing in the shipping industry at present (remember the huge declines in the Baltic Dry index since it peaked on 5 May?) New York-listed Genco Shipping announces that it is walking away from the $53m deposit it had placed to buy six new vessels. Hellenic Carriers walks away from a $7m deposit and pays an additional $1m penalty as it cancels a contract to buy a dry-bulk carrier. "Mama Africa," Miriam Makeba, dies after collapsing on stage during a concert in Italy. Aged 76, Makeba lived in exile for 30 years before returning to South Africa in 1990. She was a legendary singer, mixing jazz with blues, and in 1966 became the only African woman to have ever won a Grammy award.

Source: Financial Times, Ingram Pinn, 12 November 2008

Tuesday, 11 November: Ninety years ago this day the First World War came to an end; Remembrance Day is honoured around the world by friend and foe alike. The sombre mood is reflected on the world's equity markets. It's all doom and gloom again today. The Chinese fiscal package-induced lift proves short-lived and gives way to fears about the global recession. Japan ends down 3.0%, Hong Kong loses 4.8%, China 1.7% and India a bruising 6.6%. The SA market ends down 4.5% and Australia 3.6%. Oil heads through $60 again to a 20-month low and other commodity prices decline sharply. In a trend reminiscent of recent months, the very shares which led the charge yesterday, namely the resource shares, lead the market lower with large declines. Banks and oil producers are also very weak. London ends 3.8% lower and Germany 5.2%. In the US GM falls another 12.5% and Ford loses 9.8% while AIG, which rose 8.1% yesterday on the announcement of another government bailout, falls 6.6%. And Citigroup loses 2.2% to $10.96 – remember that price. We are going to revisit it in the next few days. US equity markets are getting increasingly concerned that the US Treasury, which now has access to the $700bn TARP plan eventually put in place by Congress after causing a week from hell in the markets in October, has yet to buy a single "toxic asset" from any bank. The purchase of toxic assets from banks was the main reason for the TARP, but to date the Treasury has spend just over $250bn of the funds buying *equity* of troubled banks and $40bn in additional assistance for AIG. Clearly, the TARP is not evolving as planned (*Ed:* welcome to the real world). On the currency markets sterling falls to a 12-year low against a basket of currencies, after news that UK home sales fell to their lowest level in 30 years and house prices declined for the 15th consecutive month. And the Russian authorities signal to the markets that they are abandoning their defence of the rouble – it was previously managed against a basket comprising 55% dollars and 45% euros. It is believed that their efforts to manage the rouble in the face of unprecedented capital outflows in recent months has cost Russia more than $100bn and led to its foreign exchange reserves declining to below $500bn.

Wednesday, 12 November: General equity market weakness continues around the world. Things are starting to get really ugly – a bit like the movie we saw in October! The Man Group in the UK, the largest listed manager of hedge funds in the world and a leader in this arena plunged 23% to a 5-year low. The shares have now halved in the past week. There is further general weakness in financial shares across the world. Raiffeisen International and Erste Bank, both held in Central Park Global Balanced Fund, fall 15% on the back of concern about their exposure to Eastern European economies. The Russian equity market falls 12.5% three hours into trade before trading is halted for the rest of the day. In the US, Treasury secretary Paulson announces that they are revisiting the original intentions of TARP and hints that they will not use the funds to buy banks' toxic assets as originally planned. Commodity prices and credit markets fall on the news and the US equity market ends down 5.2%. The financial sector is particularly weak, falling to a 12-year low. The S&P500 is now 852 and bearing down on its lows for the year. On currency markets sterling falls below 1.50 to the dollar as BoE Governor Mervyn King gives a bleak assessment of the economy – he says the UK faced its deepest recession since the 1990s and puts a 20% probability of deflation taking hold. On the corporate front US automakers continue to lobby for a government bailout package as another unique gathering takes place on Capitol Hill. Five hedge fund managers receive personal invitations (*Ed:* yeah, right) to give testimony to the House oversight committee hearing on hedge fund regulation and more specifically the role that they may have played in the current financial crisis and the risk they pose to the broader economy. What makes this collection of five men so unique is a single characteristic: they all earned more than $1bn last year. For the record they are James Simons of Renaissance Technologies, Philip Falcone of Harbinger Capital Partners, George Soros of Soros Fund Management, John Paulson of Paulson & Co (no relation to US Treasury Secretary Hank Paulson) who earned no less than $3.7bn last year and Ken Griffin ($1.5bn) of Citadel Investment Group. It is unlikely that we will ever again see such "human earning power" present in one room. Now let's call a spade a spade: taking nothing away from these able men's abilities or their professional standing, does it not strike you as odd that five people can earn more than $8.2bn *in one year*? That's R82bn or the equivalent of Richemont's entire market cap, the 10th largest company on the JSE – *and that in just one year!* What message does that give to those less fortunate than us? Or to many poor countries struggling to repay debt incurred over many years of unfair trade regimes? Or to the thousands of home owners who have had their houses repossessed due to reckless bank lending (and a bit of irresponsibility on their part)? It is instances like these that lead to the strong belief I have of the US being a land of such excess. And it is issues such as this that are giving rise to the tough questions that are and will still be asked about capitalism and free markets. I don't have all the answers, but there are many questions that arise from instances like this that will need to be answered before the world can fully recover from the 2008 global financial crisis. And finally, in a cameo that epitomizes the current financial malaise, the Karachi stock exchange opens as usual but not a single share changes hands i.e. there is absolutely no turnover. This compares to the average daily volume of 300m shares in the first eight months of 2007.

Source: Financial Times, Ingram Pinn, 13 November 2008

Thursday, 13 November: More pain in Asia today (they always catch the fall-out from bad US sessions) as Japan ends down 5.3% and Hong Kong 5.2%. China bucks the trend and rises 3.7%. SA ends 2.9% lower. In the European session Germany announces that its economy has slipped into recession. Third quarter economic growth declined 0.5% after the second quarter's 0.4% decline. And in China the rate of increase in industrial production dropped to its lowest level in seven years - it rose "only" 8.2% in October – vindicating concerns about the slowing Chinese economy, and all that that means! The German equity market closes 0.6% higher despite the bad economic news, led by the turn in the US market, while the UK market ends down only 0.3%. Standard Charter loses 8.2% amidst concerns about its capital adequacy and a possible rights issue, taking the UK banks index to a five-year low; it has lost 56% so far this year. The US market opens very weak (-3.8%), hitting a new intraday low for the year (S&P500 at 819) but just as everyone is about to slit their wrists, the market turns around and surges to close at 912 to post a gain of 6.9%! (*Ed:* who ever said life wasn't full of surprises?) For the purist technical analysts who read *Intermezzo* the S&P500 formed a perfect "key reversal," leading to great excitement, albeit ephemeral in nature, amongst those who have a more-than-healthy respect for technical analysis (Maestro includes itself amongst the latter). Oil moves below $55 and takes other commodities down with it, leading to a 3% decline in the CRB Commodity index, its lowest close in five years.

Friday, 14 November: Markets close firmer in Asia after the big bounce in US markets but investors remain sceptical about the sustainability of any equity rally. The Japanese market ends up 2.7%, Hong Kong 2.4%, China 3.1% and SA 1.7%. The Eurozone slips into recession, with that economy shrinking by 0.2% in the September quarter after a similar drop in the June quarter. The German market manages a gain of only 0.7% and the UK 1.5%. But shocking US economic data punctures the US market; retail sales drop 2.8%, the fourth consecutive monthly decline and the greatest decline in 23 years. The US market drops 6.8%. After having declined for 23 consecutive days Libor begins to rise again, posting its second consecutive rise. And finally, Adolf Merckle, patriarch of the large German family that controls Heidelberg Cement and reported to be Germany's fifth wealthiest man, approaches the government for a bridging loan after having suffered a "large three-figure million euro" loss betting against the VW share price. For more background on the VW debacle, I refer you to our discussion of the VW debacle in Appendix 3 of the November edition of *Intermezzo*. So ends another weak week on global markets (the US declined 6.2% on the week and the MSCI World index 6.4%) although one should note that amidst all the weakness, the Chinese market posted a weekly gain of 13.7%. Leaders of the G20 countries head to Washington for an emergency economic summit.

Monday, 17 November: Asia opens mixed after the weak US close on Friday. Japan closes 0.7% lower after having reported that it, too, is now officially in recession, while China continues to rise, ending the day 2.2% higher. News early in the day that Citigroup plans to lay off 52 000 employees heightens concern about the well-being of the bank and the banking sector in general. Equity markets around the world take fright, with Germany ending 3.3% lower, the UK 2.3%, the US 2.6% and South Africa 2.7%. Bank shares lead the UK declines with HBOS down 13.9%, Royal Bank of Scotland 12.4%, Lloyds TSB 10.2% and Standard Charter 7.0%. Libor continues to rise and despite much jaw-boning at the weekend G20 meeting nothing substantial emerges in terms of a co-ordinated plan to resuscitate global economies or markets. Heidelberg Cement shares dive 21.9% on the fear that the Merckle family might have to sell a portion of the business to provide the family with liquidity following the loss on the VW bet that went pear-shaped. Across the world, bank shares continue to slide amidst increasing concern about further write-downs and capital inadequacy. Citigroup shares, which have already lost more than 75% of their value so far this year, end 6.6% down, having broken the $10 mark on Wednesday, 12 November. Basic material shares are also weak. In the currency markets sterling recovers 2.4% to 1.4994, off its 6-year low against the dollar and all-time low against the euro. The "cherry-on-the-top" story today comes in the form of pirates hijacking a Saudi super-tanker off the coast of Somalia with a fully laden cargo of oil worth $100m. And here we were, thinking things just couldn't get worse!

Tuesday, 18 November: Amidst ongoing concern about the US auto industry, the banking industry in general and the future of TARP, losses continue to mount in global equity markets. The Japanese market ends 2.3% lower and China loses 6.3%. Europe recovers partially with London up 1.9% and Germany 0.5%. SA ended 0.7% lower (saved by a weak rand at R10.30) and Argentina and Brazil fall 4.4% and 4.5% respectively. Once again bank shares dominate trade in the UK with HBOS down 15.4%, Lloyds TSB 12.0% and Royal Bank of Scotland 6.7%. The US market manages a 1.0% gain (thanks to another late-day surge) but in unconvincing fashion; it traded down more than 3.0% at one stage to a low of 848 on the S&P500. It ended the day having traded in range of 4.7%. Citigroup shares drop 6.0% to $8.36 and the yield on the US 10-year bond declines to 3.6%. In the UK inflation fell for the first time in 15 months to an annual rate of 4.5% from September's peak rate of 5.2%, and in the US PPI fell 2.8% after a 0.4% decline in September. China overtook Japan as the largest holder of US debt; its holdings of US Treasury bills, notes and bonds rose from $541bn to $585bn in September. Japan's holdings declined from $586bn to $573bn. The third largest holder is the UK, with $338bn.

Wednesday, 19 November: Asian markets end the day marginally lower but China surprises once more with a 6.1% gain. European markets are less convinced, as concerns about the depth of a global recession and deep deflation take hold. US October inflation falls 1% (the year-on-year gain is 3.7%), the largest monthly decline since record-keeping began in 1947 and core inflation i.e. excluding food and energy prices posts a decline as well – the first in 25 years – but is still 2.2% higher on an annual basis. This data sinks any hope of positive equity returns on the day, as the UK market ends down 4.8% at 4 006, having briefly flirted with its October low just below 4 000. The Dax ends down 4.9%, dragged lower by the second profit warning in as many months from chemical giant BASF (it cites a "massive decline in demand"), which ends the day 13.7% lower. Most material (resource) and financial shares end the day with large double-digit losses. The SA market ends up 0.1% but is again "saved" by a weak rand (now at R10.57) as another wave of global risk aversion drives it lower. In the US things begin really badly and never really recover. The market ends the day down 6.1% at a new 5 ½-year low of 806. Investors continue to stress about the state of the US auto industry, as they should; Ford ends the day down another 20.0%. Since its 2008 peak in April this year, Ford is down 85.1% and GM is 90.4% of its 2008 peak reached in February. Financials lead the broader market lower as Citigroup loses 23.4% to end the day at $6.40. Now that the US Treasury has officially abandoned plans to use the TARP to buy banks' toxic debt, the credit market is under severe strain. Most sub-prime indices are trading at all-time lows due to forced selling and capitulation – the Markit triple-A rated sub-prime mortgage derivative index (what a mouthful!!), called the ABX index, has fallen 20% this month alone and is now at an all-time low i.e. at levels lower than when the sub-prime crisis first emerged and when markets were in full-blown panic mode in October. And other credit spreads are now also at their widest level ever. Whereas the Treasury was meant to assist this market, its recent tactics and pronouncements have sown more fear and uncertainty than ever before. Sales of gold coins hit a 10-year high; the World Gold Council says that investors bought 232 tonnes of gold worth $6.5bn in the third quarter, a 121% increase over a year ago and the greatest quarterly rise since the mid-1990s.

Thursday, 20 November: After a dismal day on US markets yesterday, a sense of panic begins to sweep through markets again. Gold rises 2.1% to $748. The Japanese equity market falls 6.9%, Hong Kong 4.0%, India 3.7% and Russia 7.4%. The Swiss National Bank (their central bank) surprises the market with a 1.0% cut in interest rates to a level of only 0.5%, its third cut in two months. The London market ends down 3.3% and Germany 3.1%. The SA market ends 5.0% lower, led by the resource index, down 10.6% Industry data reveals that investors withdrew $40bn from hedge funds during October; this, on top of the $115bn aggregate losses hedge funds suffered last month. As a result of the "flight to safety" US bond prices rally sharply; the 10-year bond registers the largest daily gain since October 1987, ending the day at a yield of 3.16%. At one stage it traded below 3.0%. The 30-year bond traded at an all-time low (yield) of 3.73% and the 2-year bond traded below 1% - it got as low as 0.96% at one stage – its lowest level ever since its creation in 1976. There were some reports that certain US Treasury bills were even quoted at 0.0%! But the strength in the US (government) bond market has not extended to the corporate bond market. Prices there remain very depressed and are still moving lower. Some AAA-rated commercial paper (bonds) is now trading at or below 70 cents in the dollar. The US ends down 6.7% after another nightmare session. The S&P500 ends at 752 – the lowest level since 1997! As oil heads below $50 the US energy sector closes down 11.2% and the financial sector down 10.5%. Citigroup is still under enormous pressure, losing another 26.6% to $4.71, despite news that its largest individual shareholder, Saudi Price Alwaleed Bin Talal, has agreed to invest $300m into the bank. It has now lost more than 50% of its value in the last four trading sessions. On the US economic data front, unemployment claims rise to their highest level since 1982 and oil dips below the $50 mark. The world's shipping industry remains in a crisis, as a result of falling shipping rates. Contract holders are cancelling contracts to build new ships and charter others faster than Somali pirates can hijack them! Iceland, the country that has effectively imploded as a result of the global credit crisis, finally secures a $10bn loan to stave off economic collapse. The loan is the equivalent size of the entire economy. Icelanders – all 300 000 of them - now face an economy forecast to shrink more than 10% next year, interest rates of 18% (also forecast to rise further) and a tripling in unemployment. Government indebtedness has quadrupled as it pumped $19bn into its banking sector to recapitalise it – most of this money has been borrowed from abroad.

Friday, 21 November: Despite a shocking session on US markets overnight, Asia ends higher and sets the tone for the European session of trade. Japan ends up 2.7%, Hong Kong 2.9%, India 5.4% and SA 1.4%. China ends down 0.7 %. But the overwhelming negative news on all fronts catches up with European markets; the UK and Germany post declines of 2.4% and 2.2% respectively. In the US, the market provided yet another display of inexplicable trading behaviour: the market opened weak once more, headed down to a 12-year low of 740 on the S&P500, before hurtling up 6.3% to end the week 8.4% down. Citigroup declines 20.0% to $3.77 (it traded as low as $3.05 intraday), bringing its weekly decline to 57.6%. Its price behaviour is anything if not volatile, with gains of up to 17% and losses of more than 24% on the day - who said investing is for "sissies"? And this, from what was only a couple of years ago the world's largest bank, boasting a market cap of $270bn. Its market cap is now less than $30bn! Despite the Citigroup mess, the *weekly* losses reflect some of the real trauma of the past week on global equity markets: the UK market is down 10.7% on the week, the Pan-European Eurofirst 300 index is off 11.5% and the Dax 12.4%. Russia is down 12.7% on the week and oil broke through the $50 level and is down 14.1% to its lowest level since May 2005. Gold gained sharply though to end the week 7.5% higher at $796. The SA market lost 6.9% during the week. US 10-year Treasuries are trading at a 5½-year low around 3.17% - an indication of the flight to quality - while credit spreads remain close to record levels (that's bad by the way). Many respectable shares posted large double-digit losses on the week as the reality of the extent of the global economic slowdowns begins to hit home. This week alone more than 80 000 job losses were announced; UK companies have cut more than 30 000 jobs in the past two weeks. Things are bad – really bad.

Monday, 24 November: Another week, another day … with Japan closed Asian markets end the day flat. But news of the US government bailout of Citigroup lifts European markets in emphatic style. The UK market rises 9.8% - *its largest one day percentage gain ever* – led by financial and mining shares. The daily gains are simply enormous: Anglo rises 22.8%, Billiton, 22.9% and Kazahkmys 27.8% while Prudential rises 20.4% and Barclays 10.0%. The German market rises even more, ending the day 10.3% - *its third largest rise in history ever* - despite the fact that the Ifo business confidence index falls for the sixth consecutive month to levels last seen in February 1993. The SA market ends 5.1% higher, led by a resource charge of note; the resource and gold indices close 10.3% and 17.7% higher. Billiton rises 13.1% and Anglo 9.8% despite the fact that the rand firms 3.7% to R10.10. But the news of the day belongs to Citigroup, which came within an eighth of a polony skin from collapsing last week; the US government agreed to guarantee R306bn of its domestic assets and injected $20bn in new capital into the bank. The share leapt 57.7% although intra-day it rose 113.1% from Friday's low – just in case you thought prices weren't volatile enough these days!! The change in sentiment is palpable and helps the US market rise 6.4% on the day – making its two-day rally the largest since October 1987. Banks and financial shares are the obvious beneficiaries. And here's a titbit of information to show you just how volatile the markets are: in October the US equity market rose or fell by at least 3% 13 times, more than half the 23 trading days in October. During this time it included six moves of 5% or more. So far in November, the market has risen or fallen by at least 3% on 10 of the 16 trading days so far this month, which have included movements in excess of 5% no less than eight times! Two further "signs of the times" emerge during the day, indicating how bad market conditions are: Standard Charter announces a $2.7bn rights issue to boost its capital; the new shares are priced at a 48.7% discount to the last traded price – Standard Charter ends down 6.0% on the day (when the rest of the market rose 9.8% remember). And Anheuser-Busch InBev announces an $8bn rights issue, priced at a jaw-dropping 70% discount to its prevailing share price! And for the record, existing US house sales decline 3.1% over the month to the lowest level in 40 years and the average house price declines 11.3% over the past year.

Source: Financial Times, Ingram Pinn, 24 November 2008

Tuesday, 25 November: Following yesterday's large gains the market runs out of a bit of steam, despite news that the US Fed will initiate two further rescue programs totalling $800bn, one of $600bn for mortgage-backed securities and another of $200bn for consumer asset-backed securities (for example small business, car and student loans). The UK, German and US markets end up less than 1.0% but the SA equity market gains another 6.7%. The reason? Billiton walks away from its hostile bid for Rio Tinto. Rio plunges 36.7% on the London market, while Billiton gains 7.3%. However, on the JSE Billiton rises 19.7% (it was up over 27% at one stage intraday) and Anglo 13.7%, resulting in the resource index gaining 12.2% on the day. (*Ed:* Wait a moment. Weren't all global equity markets heading lower at a rapid rate last week i.e. just two days ago? Just checking – I thought I had perhaps missed something.) The SA economic growth rate slowed from 5.2% in the second quarter to only 0.2% in the third, the main culprits being a sharp slowdown in retail sales, mining and manufacturing. And in Europe several car manufacturers announce production cuts, including Porsche, which abandons its sales targets and plans to shut production for seven days in the coming months (*Ed:* why don't they just short the VW share, seeing that they made so many billion dollars from manipulating it on the way up?) The Porsche share price falls 5.8% on the news while VW price plunges 22.7%. The dollar continues it weak trend of the past few days, to close near 1.30 to the euro and the oil price gives up its 10.0% gain of the previous day, to end around $51. Gold manages to hold above the $800 level.

Wednesday, 26 November: Today proves to be one of great contradictions but also one full of evidence of the slowing global economy. Japan closes 1.3% lower and China ends 0.5% higher. After the market's close, China's central bank cuts interest rates more than four times the usual amount, by 1.08% to 5.58%, which is the largest cut in more than a decade. Europe pays scant attention to the news though, with the German market flat and London down 0.8%. Apart from the Chinese rate cut, the US trading session holds the most surprises: firstly, US durable good orders declined 6.2% in October and personal spending declined 1.0%. The equity market ignores the data and closes up 3.5% but the really telling movement occurs in the US bond market. The US 10-year bond closes below 3.0% *to its lowest level in 50 years.* In Mumbai a devastating terrorist attack on three main business hotels claims numerous lives; the attackers take a number of people hostage.

Thursday, 27 November: The Chinese equity market reacted to the dramatic rate cut by rising over 6.0% intraday, but eased back to close only 1.1% higher. Japan rises 2.0% and Hong Kong 1.4%. London ends up 1.8% and Germany 2.3% but commodity shares remain weak. The Baltic Dry index loses more ground to 733, a fresh 22-year low; that, after it peaked at 11 793 on 5 May this year. The US markets are closed for Thanksgiving Day but that doesn't stop the SA equity market from rising another 4.0%, led yet again by the resource sector. Billiton continues to lead the charge, rising 8.9%, bringing its five-day gain to no less than 53.3%. The SA resource and gold indices both end up more than 7.0% on the day. Mumbai continues to battle the terrorists that are still holed up in one hotel.

Friday, 28 November: The sun rises on the last trading day in the month. In similar fashion to last month, although to a lesser extent, we have seen global equity markets decline sharply in the first three weeks of the month only to stage a rally in the last week and remove the edge off the severe intra-month declines. Before getting into the detail, note the *weekly gains* in the following markets: the US 12.0%, Germany 13.1%, London 13.4%, Russia 13.5%, Hong Kong 9.7% and South Africa an astonishing 17.4%! With respect to the detail, trading around the world's markets was thin due to "Black Friday," the day in which Americans traditionally "spend their hearts out". US markets were open for only half the day but nevertheless maintained their momentum of the previous few days. Asian markets were generally firmer, the German market was flat, London ended up 1.5% and the US 1.0%. The SA market, having posted a rally over the past four trading days of close to 18% ends marginally lower. Eurozone unemployment rises to 7.7%, the highest in almost two years as the number of unemployed jump the most in 15 years. India counts the cost of the devastating terrorist attack; the official death toll rises above 200 and more than 400 are injured.