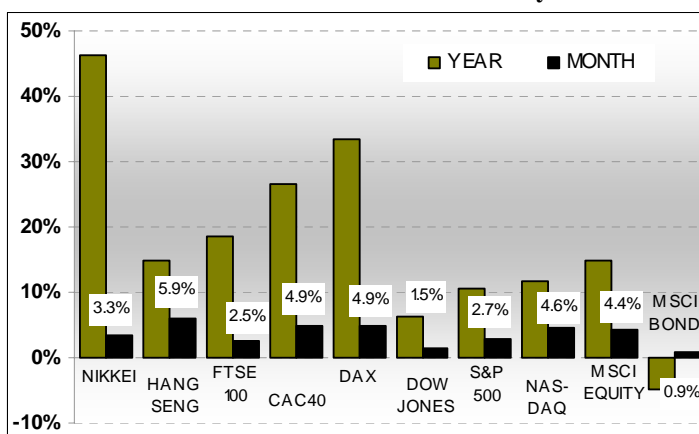




## January in perspective – global markets

Yebo! For the benefit of our non-South African readers, that means something like “wow, yes, for sure, absolutely” – all thrown into one. And that is the best way to describe what was a truly remarkable start to the year. There seemed to be no stopping global equity markets. As in 2005 European, Asian and Emerging markets led US ones, which continued to lag. Some Asian markets closed at their highest level in a decade. In general, small cap companies outperformed large caps. Oil and commodity prices continued rising sharply, fuelled by the feeling that the global economy was in good shape and was likely to continue growing through the year, despite interest rate increases in the US and Europe.

Chart 1: Global market returns to 31 January 2006



## Economic smorgasbord

Recent data worth highlighting include the following:

- *Chinese economic growth*: again surprised on the upside. Growth during the fourth quarter of 2005 rose to 9.9% (off the higher base remember). The year-on-year rate was also 9.9%, down from 10.1% in 2004, resulting in China becoming the fourth largest economy in the world, after the US, Japan and Germany (and ahead of France and the UK). Maestro remains as upbeat as ever regarding the effects of this juggernaut on the global economy. One need look no further than commodity prices to see one of the direct effects of this growth.
- *Emerging markets* have been another constant theme of Maestro over the past few years. Data released by the International Institute of Finance (IIF) showed that net private capital flows to emerging markets rose to \$358bn in 2005, exceeding the preceding record of \$324bn in 1996. The IIF forecast 2006 flows at \$320bn. Rising commodity prices, improving fiscal discipline resulting in declining debt-to-GDP ratios, and the rebuilding of reserves are all contributing to a healthier

attitude by global investors towards these markets. Of course nothing lasts forever, but a clearer understanding of the factors behind the recent rise should assist in trying to determine the future direction of global emerging markets.

- We have touched on the topic of *Exchange Traded Funds* (ETF) in the past, highlighting them as an efficient and effective financial instrument. The most popular ETF in SA is the Satrix40, which tracks the Top40 Index. The ETF consists of a basket of shares held in exactly the same proportion as the underlying index (in this case the JSE Top40 Index). They trade just like shares, effectively tracking the underlying index. They are more flexible and often cheaper than mutual funds (unit trusts) and their popularity is rising as more people, particularly investment professionals, come to appreciate their advantages. At the end of 2005 there were 453 ETFs globally, representing assets under the management of \$417bn, some 35% higher than the \$310bn under management in 2004, when there were 336 ETFs. There are 204 ETFs in the US with \$304bn under management, and 165 in Europe with \$54.9bn under management. An interesting statistic is the fact that in the US, which is traditionally rather inwardly focussed, ETFs that provide international exposure saw their assets grow 97%, while those focussed on the US grew only 18%. This underlines the fact that investors are increasingly turning to ETFs to gain international exposure. They are also frequently used to gain exposure to specific sectors.

## What's happening in the SA equity market

I have found myself saying the following a number of times during my discussions with friends and colleagues in recent days, so permit me to offer my opinion on the current SA equity market. For the benefit of those who are not close to our market, the All Share Index has risen 58.7% in the year to end-January, 32.1% of which came in the last six months. The respective returns for the resource and platinum indices are 84.2% and 43.4%, and 127.7% and 76.8%. I refer you to Chart 2 for the returns on other major indices. Notice how large the returns have been, this after a wonderful year in 2004 as well. What is happening? Why is our market so strong?

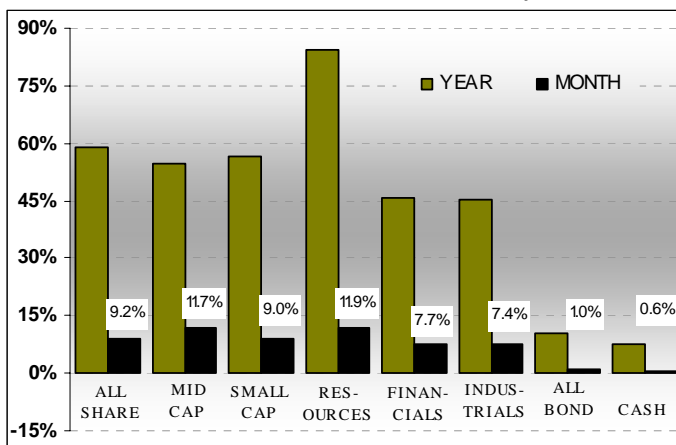
Although it doesn't represent the whole story, I suspect the major players in our market are foreign. True, the “man-in-the-street” is increasingly active in the market, but the volumes of trade are such that the bulk of trade must be institutional. After all, we recently had two consecutive days when trade on the JSE exceeded R9bn per day. That's not the “small man”. We know that emerging markets have produced stellar returns over the past year. Ironically, many

are now in greater shape than developed countries. If you cast your mind back to the first and second emerging market (and LTCM) crisis in 1997 and 1998 – this is a common comparison that is made with recent market movements - emerging markets and countries' finances were in terrible shape. Fiscal indiscipline and profligate government spending was the order of the day, as were budget and trade deficits. Debt levels were rising steadily. Their equity markets were expensive. Today, many of these countries have got their fiscal houses in order. Debt has been and continues to be repaid. Fiscal discipline is common, as are budget and trade surpluses and with the odd exception, valuation levels are not expensive. Ironically, many developed countries (the US and EU being prime examples) now run massive budget and trade deficits. Government spending is all but out of control and policy-making is in disarray. How the times have changed.

Moreover, investors have underestimated the effects on commodity prices of the quantum of demand created by continuous, above-average growth in the likes of China and India, for example. Neither commodity producers in general nor oil companies in particular have invested in capacity in the past decade or more, resulting in the demand translating directly into higher prices. Emerging markets have been the prime beneficiaries.

Given that the SA market scores well on both accounts – great fiscal management and adequate exposure to resources – it is not surprising to see foreigners piling into our market. Add to this the fact that emerging market funds are significantly under-invested in South African, and the results are there for all to see. How long will it last? Of course that is the proverbial million-dollar question which I will not try and answer here, other than to say that given the momentum and substance behind the buying, I don't think it is about to end abruptly. Certainly recent price rises have been "irrationally exuberant", but my point here is to draw your thoughts to the *structural* nature of this event. The major risks, and thus signs of a change in sentiment to watch out for, are when global growth begins to slow and/or commodity prices begin to fall. The SA market could then decline quite sharply; not only will prices decline as foreigner investors leave, but the rand will almost certainly decline as well. I would encourage you to consider these thoughts as we watch prices move ever onward.

**Chart 2: Local market returns to 31 January 2006**



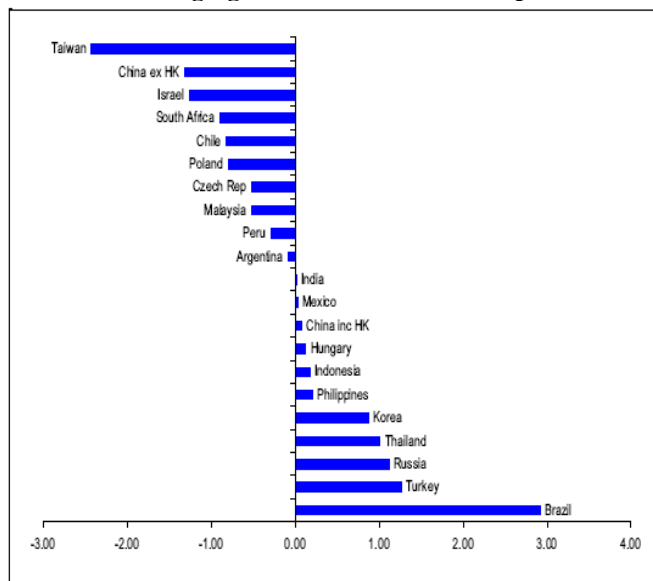
**December in perspective – local markets**

Similar to other emerging markets, the SA equity market posted further strong gains, bringing its rise over the past three months to 20.6%. Given strong commodity prices, including that of gold, resource shares stole the limelight with the gold index posting a gain of 24.2% for the month, despite the 3.5% gain in the rand. The platinum index was up 12.4%, and similar to the overseas trend, the mid cap index posted a rise of 11.7%, bringing its three-month gain to 25.0%. The strong gains in recent months have left investors wondering how long it can continue, but with global emerging market investors under-exposed to South Africa, a favourable Budget on 15 February expected, the country's finances in good shape and a reasonably valued market, it is hard to see just where the gains will run out of steam. Watch this space...

**Chart of the month**

Having touched on emerging markets earlier, Chart 3 depicts the exposure of emerging market funds relative to their respective benchmarks. Taiwan, China, Israel and South African comprise those markets where funds are the most under-exposed, while Brazil, Turkey and Russia are the most over-represented. Not surprisingly, the latter markets were amongst the highest gainers in 2005. And many of them have kicked off 2006 in like fashion. During January alone, dollar returns from the likes of Brazil, up some 25.1%, Russia 18.7% and Turkey 14.3% are truly impressive.

**Chart 3: Emerging market fund relative exposure**



Source: Merrill Lynch; EmerginPortfolio.com

**For the record**

The latest returns of the collective schemes (unit trusts) that Maestro manages are listed in Table 1. 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](http://www.maestroinvestment.co.za).

**Table 1: Returns of mutual funds under Maestro's care**

	Month	Return	Year to date
<b>Maestro Equity Fund</b>	Jan	<b>8.6%</b>	Not applicable
Maestro equity benchmark *		7.9%	7.9%
JSE All Share Index		9.2%	9.2%
<b>Central Park Global Balanced Fund (\$)</b>	Dec	<b>N/A</b>	N/A
Benchmark**		1.5%	3.7%

\* 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

Talking of returns, Table 2 lists *the returns of the long-term equity portfolios* under Maestro's management. *For the first time, we are able to list the compound annual returns over a four-year period.* As I often contend, returns in themselves do not represent the full picture. How those returns were achieved, in particular what risk was assumed in order to achieve those returns, is also a critical factor. The latter is very hard to depict, a bit like an insurance policy – you never appreciate its value until you need it. Nevertheless, Maestro's equity portfolios are generally conservative by nature. For virtually the entire periods under review the portfolios have had a resource weighting lower than that of the All Share Index, and have had no direct gold exposure. Portfolios consist of about 25 counters, with the ten largest constituting between 55% and 60% of the portfolio.

**Table 2: Maestro equity returns to 31 Dec 2005 (%)**

SA equity returns	6 months	1 Year	2 Years	3 years	4 years
<b>Maestro average</b>	<b>31.8</b>	<b>41.2</b>	<b>41.9</b>	<b>38.5</b>	<b>26.7</b>
Maestro equity benchmark *	27.5	40.2	37.9	30.0	17.8
JSE All Share Index	28.4	46.6	35.6	28.8	18.3

\* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index

A final look at the results of Maestro's efforts can be found in Table 3, which lists *the returns achieved on the short-term (equity) trading portfolios* that Maestro manages for selected clients. Although at the outset it is easy to compare the returns listed in Tables 2 and 3, this is a good example of comparing apples and bananas. The assets that produced the returns listed in Table 3 were exposed to more risk than those underlying the returns in Table 2. Investment decisions taken on the trading assets are often based on different criteria than the long-term equity portfolios. The returns in the two tables are thus not directly comparable.

**Table 3: Returns on trading portfolios to 31 Dec 05 (%)**

SA equity returns	6 months	1 Year	2 Years	3 years	4 years
<b>Maestro average</b>	<b>39.1</b>	<b>39.2</b>	<b>51.3</b>	<b>52.7</b>	<b>45.7</b>
Maestro equity benchmark *	27.5	40.2	37.9	30.0	17.8
JSE All Share Index	28.4	46.6	35.6	28.8	18.3

\* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index

Before leaving the topic of returns, consider for a moment the meaning of the data in the table, even just the market data. The All Share Index has produced a compound return of 28.8% per annum for each of the last three years. That is quite remarkable! And rather unsustainable too, of course. And it gets better. The mid and small cap indices respective compound annual returns over the same 3-year period were 36.0% and 51.3% *per annum*.

**File 13: Information you needn't retain**

Last month I highlighted the \$343m trading error by Mizuho Securities that caused a minor wobble on the Tokyo Stock Exchange (TSE). With the Japanese market having risen 46.2% in the last year alone, driven to some extent by huge foreign interest in that market, the underlying operations and efficiency of the TSE have not surprisingly attracted a fair amount of attention. Indeed, one of the major problems in December's trading fiasco was the inability of the TSE to accommodate the trader's request to cancel his errant order. So it is not surprising to learn that the TSE is urgently installing additional capacity to deal with the increased volumes. Trading on the TSE has been halted a couple of times in January with the TSE simply unable to cope with more than 4.5m transactions a day. On a good day's trade, up to 8m orders can be placed, but not all are executed.

What you ask, in the relevance of this? Well, firstly, this is "File 13" remember, so "intrigue" is more relevant than significance. But that aside, consider the changing nature of the world, and the digital trading environment in Japan in particular. Could the rest of the world's financial markets be heading in the same direction? One of the major factors behind the increase in volumes on the TSE is the ubiquitous nature of day trading and share ownership in Japan. Trading via web-enabled mobile phones reached \$121.7bn in 2005 through the five major online brokerages alone. Individual shareholders as a percentage of the Japanese population have risen from 21% in 1996 to 28% in 2005. The number of internet dealing accounts has risen from 3.5m in 2002 to 6.9m in 2005. Last year individuals accounted for about 50% of market turnover by value, of which 70% was transacted through the internet. These figures uncover an interesting state of affairs that is worth watching, not only as a possible guide to the future manner of share trading, but also as insight into the Japanese market that continues to attract local and foreign investors, with the commensurate increase in price levels.

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