



# INTERMEZZO

MAESTRO

Investment Consulting

Investment Letter

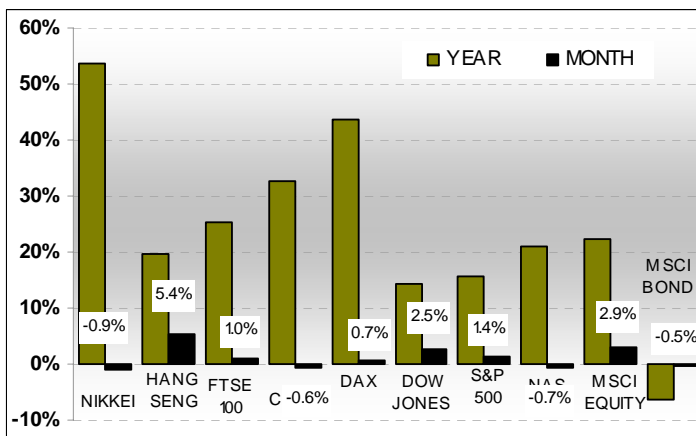
6th Edition

May 2006

## April in perspective – global markets

The past month proved to be another rewarding one for global equity investors but a gloomy one for bond investors yet again. Comments by Governor Bernanke that the Fed may pause in its rate increases at some stage were all investors needed to take equities higher. Most markets are trading around six-year highs, which is significant in that they have just about, with the notable exception of the tech-dominated Nasdaq, recovered all of the ground lost since the Millennium (Y2K) meltdown. Commodity prices continued rising sharply, which in turn spurred emerging markets to new records. The MSCI World index gained 2.9% during April, while the MSCI Emerging Market index rose 6.8%. *En passant* there was a sense of *déjà vu* on the last day of the month: Microsoft tumbled 11% on the back of poor results, undermining the day's overall market gain, just as Google tumble 7% on the last day of February, also taking the overall market a lot lower.

Chart 1: Global market returns to 30 April 2006



## What's on the radar screen?

*Firstly* one development that may not have caught your eye is **the collapse of the emissions market**. This is a relatively new market, established by the EU to encourage a cleaner environment and to act as an incentive to reach the Kyoto Protocol targets. If companies – typically utilities and industrial energy users – emit more carbon dioxide than they are allowed to, they have to buy additional permits, which are traded on the European Climate Exchange. If they emit less than the permissible amount, they are allowed to sell their permits. The carbon trading market had operated effectively until now but all but collapsed last month. December 2006 CO<sub>2</sub> futures reached a record of EUR31 in mid-April but ended the month down 62% at EUR11.5 per tonne. December 2008 CO<sub>2</sub> prices ended “only” 44% lower. Eina!

*Secondly*, note **the extent of the increase in US corporate earnings**, which explains why global equity markets remain so resilient in the face of record commodity and energy prices and rising interest rates. With the majority of S&P500 companies having reported, earnings are about 13% higher, more than the 11% expected and the 11<sup>th</sup> consecutive quarter of double-digit increases. Ultimately, earnings drive share prices. This, together with the fact that the Fed must be close to the top of this interest rate cycle, makes it easy to see why global equity investors are in such a buoyant mood.

Table 1: Emerging markets: April MSCI dollar returns

	April	YTD
MSCI EM	6.8	19.1
<b>Latam</b>	<b>7.3</b>	<b>23.3</b>
Argentina	19.8	52.9
Brazil	8.8	30.7
Chile	1.5	8.7
Colombia	-2.4	14.3
Mexico	5.1	12.4
Peru	16.1	27.2
<b>Asia</b>	<b>6.9</b>	<b>16.5</b>
China	4.8	27.2
India	3.5	25.3
Indonesia	14.0	43.1
South Korea	6.8	11.0
Taiwan	10.0	12.9
Thailand	8.2	14.6
<b>EMEA</b>	<b>6.3</b>	<b>21.3</b>
Czech	0.3	11.3
Hungary	11.2	19.7
Israel	3.7	-0.2
Poland	15.7	23.0
Russia	11.6	43.2
South Africa	3.3	21.2
Turkey	4.8	11.4

*Thirdly*, in their unstoppable march towards becoming the world's largest economy (forecast to occur in about 2030) **China grew at a rate of 10.2%** in the first quarter. No wonder the commodity world and emerging markets are riding high – refer to Table 1. We have recently examined this phenomenon in detail so it is nice to see it playing such a major role in the global

economy. Time does not permit me to share the extent of the commodity price gains, but believe me we are now in a full-blown upturn in a commodity cycle of note!

## For the record

The latest returns of the mutual funds that Maestro manages are listed in Table 2. You can find more detail, including the latest [Maestro Equity Fund Summary](#), by visiting our website at [www.maestroinvestment.co.za](http://www.maestroinvestment.co.za).

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

	Month	Return	Year to date
<b>Maestro Equity Fund</b>	Apr	<b>2.1%</b>	<b>12.2%</b>
Maestro equity benchmark *		3.2%	15.6%
JSE All Share Index		4.3%	18.1%
<b>Central Park Global Balanced Fund (\$)</b>	Mar	<b>1.8%</b>	<b>7.5%</b>
Benchmark**		1.1%	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

While on the subject of returns Table 3 lists the returns of the equity portfolios under Maestro management. A couple of comments are necessary: *firstly* remember that the short-term, actively traded portfolios have a different risk profile and tax status, so their returns are not directly comparable to those of the long-term portfolios. *Secondly* it is interesting to see that despite the dramatic annual gain in the Resource index (97.8%) the Maestro equity benchmark, which has a lower resource weighting than the All Share index, has performed better than the latter over the longer periods.

**Table 3: Maestro equity returns to 31 March 2006 (%)**

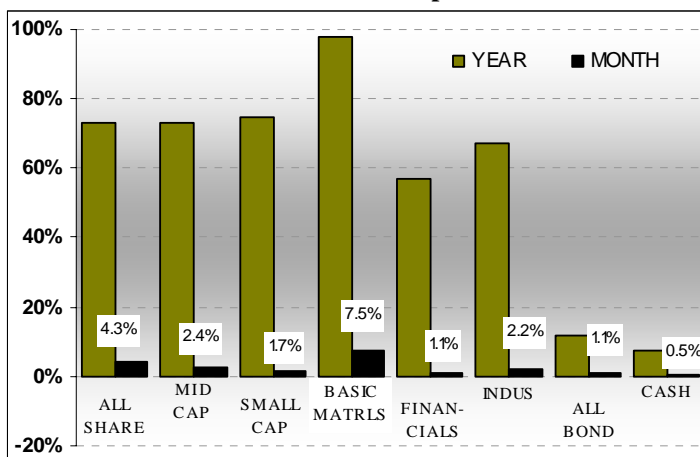
SA equity returns	6 months	1 year	2 years	3 years	4 years
Maestro average – short-term, actively traded portfolios	31.1	68.8	61.5	62.0	50.5
Maestro average – long-term portfolios	26.0	60.0	50.0	51.2	30.8
Maestro equity benchmark *	20.8	51.8	42.2	44.2	20.5
JSE All Share Index	22.2	57.1	41.7	42.5	20.4

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

### March in perspective – local markets

Taking their cue from global equity and rising commodity markets, the SA equity market put in another impressive performance during April. Although the monthly return of the All Share index in absolute terms may not be that large, remember that the base off which the monthly returns are being measured is very high. April 2005 (which has now fallen out of the “annual” base) was a very poor month – the All Share declined 5.4%, which has resulted in the annual returns to end-April 2006 being nothing less than spectacular. **The All Share, large, mid and small cap indices now all boast annual returns in excess of 70%.** The resource index is up an astonishing 97.8%. Notable monthly declines were seen in all the property sectors, while the platinum sector rose only 0.1%. Going back to April 2005, you may recall that China announced it was introducing administrative restraints on certain industries, the steel and property sectors in particular, in an effort to curb over-investment. Ironically, one year later almost to the day, China announced that its interest rates were to rise by 0.27% to 8.25%. Although there was a ripple through global equity markets this time around the effect was not nearly as severe as last year.

**Chart 2: Local market returns 30 April 2006**

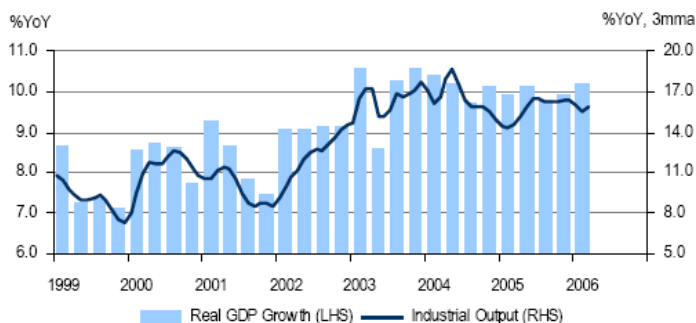


### Chart of the month

“Two for the price of one” this month: given the 10.2% increase in Chinese Q1 06 GDP, it would be useful to again view recent Chinese GDP. This type of growth is not a transitory event. It is no fluke. If anything, the rate of growth has been rising slowly since 1999 as seen in Chart 3.

**Chart 3: The “Power of the Panda”**

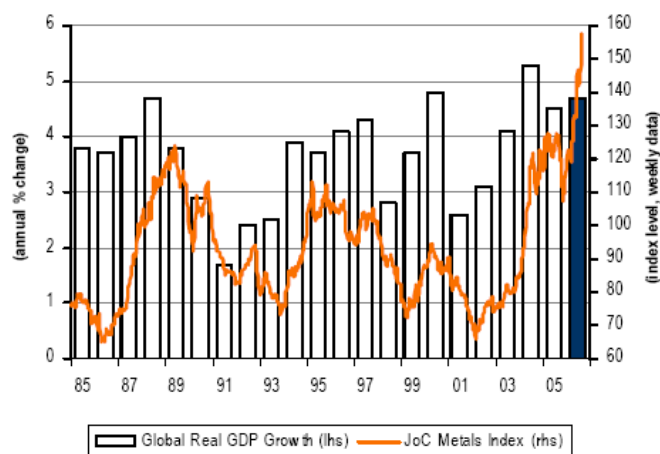
Chinese economic growth and industrial output



Source: Merrill Lynch

Then seeing that commodity prices are so dominating the headlines these days, I found Chart 4 very informative. It shows global economic growth since 1985 versus a widely followed metals index. Note how the current increase in metal prices compares to previous cycles and to historic global growth. While we have previously discussed some of the factors behind this dramatic cycle, the more important issue is how long the current increases will continue. The answer will have a direct bearing on the future of the SA equity market, the rand and other emerging markets.

**Chart 4: Metal prices versus global growth**



Source: Merrill Lynch

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

On 26 April, 1956 the Ideal-X, an oil tanker with a steel frame welded above its deck loaded 58 aluminium containers in New Jersey and set off for Texas, where trucks took the metal boxes and carried them to their destinations. The significance of Ideal-X's voyage is that it is regarded as the first container voyage. The container has revolutionized global trade and accelerated globalisation in a manner unimaginable in 1956. Today some 86m containers are moved annually, with that figure forecast to rise 50% by 2011. We have commented on the Baltic Exchange Dry index in the past and highlighted the importance of global trade as a source of numerous investment opportunities, so you will understand the relevance of this “50<sup>th</sup> anniversary”.

Not only did the advent of the container dramatically improve the efficiency of freight costs, it also revolutionized the global economy, enabling manufacturers to separate the production process from the point of sale. One only needs to think of how developed market operators have relocated manufacturing operations to lower cost environments such as China, and consider the effects this has had on, say global inflation, to realise how significant containerisation has been to the modern world. Those who are interested in the history of containers can read more in Marc Levinson's *The Box: how the shipping container made the world smaller and the world economy bigger* (Princeton University Press).

Finally, in previous editions of *Intermezzo* we noted the upcoming silver exchange traded fund (ETF) and the effect that the build up to its launch has had on the silver price. Well, the iShares Silver Trust was launched on 28 April, and had after only four days of trade accumulated 40m ounces of silver, driving the silver price to a 23-year high in the process. Not that it was such a smooth ride though. During April the price of silver declined dramatically at one stage, posting a 20% decline in four days (15% on one day!), before recovering close to recent record levels. Certain listed silver mines have had an equally rough ride, largely due to the developments in Bolivia, where threats of nationalization have created great uncertainty within the mining and refining communities. The bumpy ride is not only indicative of the lateness of the commodity cycle, but also a timely reminder of the risks inherent in commodity investing in general.

#### On the lighter side

I have written more than enough in this edition but still have plenty of space to fill – always a writer's nightmare! So, to celebrate the 50<sup>th</sup> anniversary of the container, I include the following pictures to brighten up your day. Let's place them under the heading "Tell me again why I was fired"? Enjoy!



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