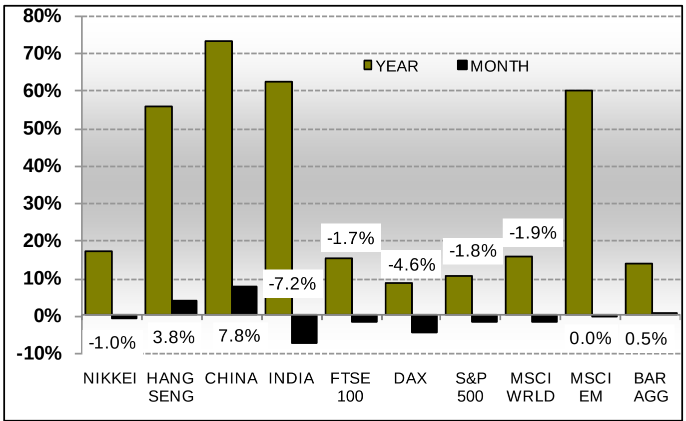
MAESTRO
INTERMEZZO
Investment Letter | 9th Edition | November 2009

October in perspective – global markets

It had to happen, not so? Apart for a brief pause in June, when some markets posted marginal declines, global equity markets have been on an uninterrupted rampage since March. But that has come to an end, as is clear from Chart 1. Tell tale signs of increased risk aversion is evident when one considers that the US mid and small cap indices declined 4.6% and 5.8% respectively and the Nasdaq fell 3.6%. Yet the declines were not uniform; China managed a gain of 7.8% but India was down 7.2%. The MSCI World index fell 1.9% although the MSCI Emerging market index remained unchanged on the month. More disconcertingly, despite the dollar weakening only 0.9%, commodity prices rose sharply in October. Gold rose 4.4%, oil up 13.0%, palladium rose 10.2% and two widely followed commodity indices, the CRB and S&P GSCI indices, rose 4.2% and 15.1%, the latter pushed higher by sharply higher soft commodity (food) prices.

Chart 1: Global market returns to 31 October 2009



A feature worth pointing out is the extent of the turnaround in the *annual* returns of global equity markets and emerging markets in particular. We alluded to this aspect last month, but the phenomenon is so amazing – none of us have ever seen anything like this in our lifetime – it is worth "savouring the moment". With many emerging markets having troughed in October last year, thereby creating a very low base, and with the huge gains experienced since then, the turnaround in annual returns has to be seen to be believed. Table 1 contains some relevant details.

What's on our radar screen?

We remain focussed on the changing economic landscape and list below a couple of developments in this regard:

- *The SA economy*: interest rates were left on hold in September despite good news on the inflation front. The annual inflation rate declined to 6.1% from 6.4% in August. For all intents and purposes, SA's inflation rate has re-entered the official target range of 3% to 6%. Private sector credit extension declined from an annual rate of 2.3% in August to 1.5% in September, showing just how "tough" it is out there, at both the manufacturing and retail level. Retail sales in August declined 7.0% year-on-year and industrial production declined 15.0% compared to July's 13.5% decline. The Minister of Finance also tabled his Medium Term Budget Policy Statement (MTBPS) in which exchange controls for individuals and corporates were relaxed further and a few spending cutbacks announced. The forecast Budget deficit was increased substantially, not entirely unexpected given the economic slowdown and the effects of reduced government revenue (estimated to be in the vicinity of R74bn). The Budget deficit for the 2009/10 fiscal year is now projected to be 7.6%, which sadly undoes a lot of the achievement of the past decade of disciplined and prudent fiscal management. In the MTBPS the Treasury forecast a decline of 1.9% in GDP in 2009 and a recovery to 1.5% and 2.7% in 2010 and 2011 respectively.
- *The Chinese economy:* As though we needed confirmation of its health, the Chinese economy grew at 8.9% during the September quarter, largely in line with expectations. The annual inflation rate to September was -0.8% from -1.2% in August. Retail sales rose 15.5% and industrial production 13.9%.

Table 1: What goes down ... the effects of a low base

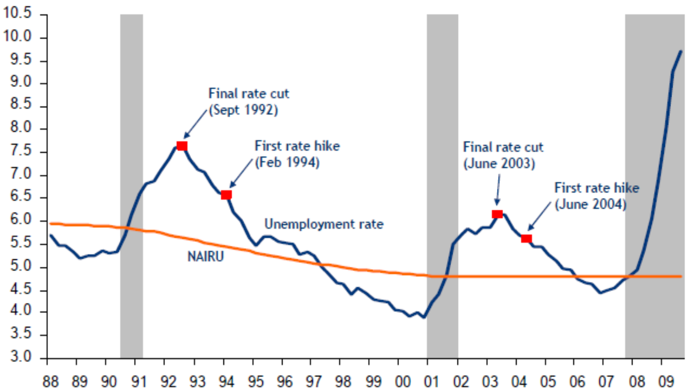
Market	**Annual returns (%) to end ...**			
	Oct 08	**Aug 09**	**Sept 09**	**Oct 09**
India (BSE Sensitive)	-50.7	7.8	33.2	62.4
China (Shanghai Comp)	*-71.0*	*11.3*	*21.2*	*73.3*
Hong Kong (Hang Seng)	-55.5	-7.2	16.3	55.7
South Africa (All Share)	-30.9	-6.8	7.7	29.2
Russia (RTS)	-65.2	-35.2	3.5	74.4
MSCI Emerging markets	***-57.4***	***-11.0***	***16.2***	***60.3***
MSCI World index	***-43.1***	***-18.8***	***-4.7***	***15.6***
Germany (Dax)	-37.8	-14.9	-2.7	8.6
UK (FTSE100)	-34.9	-12.9	4.7	15.2
US (S&P500)	-35.8	-17.8	-6.3	10.4
Japan (Nikkei 225)	-48.8	-19.7	-10.0	17.0

- *The US economy:* The initial estimate of third quarter economic growth was 3.5%, marginally better than expected. Last month we commented in some length about the US unemployment rate and the loss of jobs, there. During October the US continued to lose jobs, although at a slower rate, but I point out that *they are still losing jobs every month* – 190 000 jobs were lost in October, bringing the total number of jobs lost since this recession began to 7.3m. That means the unemployment rate is still rising – it hit 10.2% in October, the highest rate in 26 years. More importantly the broad definition of inflation, the so-called U6 rate, rose from 17.0% to 17.5%. So nearly one fifth of America's working population is out of work. Over and above the jobs data, much of the US economic data in the past month was below expectation. There are clear signs that the economy is recovering but perhaps a bit slower than most expected. That explains some of the weakness we saw in the US equity market last month, which was also the cause of equity weakness in most other developed countries.

Chart of the month

Maestro holds the view that the Federal Reserve will keep interest rates very low for a long time – possibly through all of 2010. US rates might only rise early in 2011. If this proves to be correct it will have a direct bearing on the dollar (which we believe will continue to be weak) and thus also the rand (we maintain our view that the rand will remain firm, at least until mid-2010) and the gold price (which should also remain firm as investors seek out assets that will protect them against a declining dollar). Chart 2 depicts the historic precedent in terms of the Fed's move on interest rates relative to unemployment. The shaded portions in the chart depict periods of US recession. Note that the Fed tends to wait until unemployment is in a firm downtrend before raising rates. If this holds true for the current recession it underwrites our view that US rates will remain close to zero for a long time yet. That means "free" or very cheap money will continue to wash around the world, looking for some form of yield, or simply assume more risk in the hope of obtaining *some* return. This is likely to remain an abnormal and disruptive force that will distort markets, particularly financial ones as the money is unlikely to find its way into the real economy until the situation normalises.

Chart 2: Patience is a virtue – the Fed waits for labour



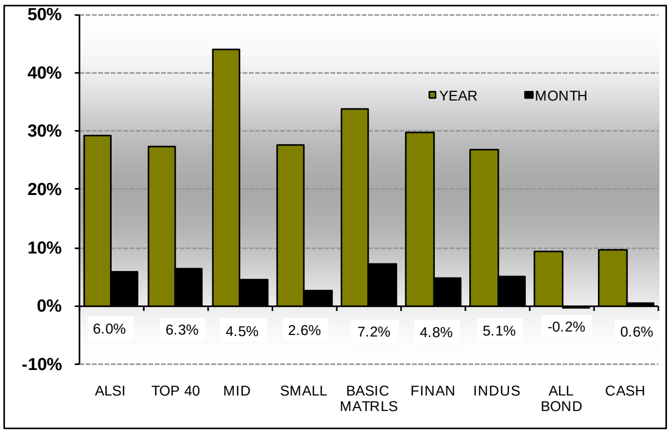
Source: Merrill Lynch

A few quotes to chew on

In the annals of double-edged compliments, Warren Buffet's description of his planned $27bn acquisition of Burlington North Sante Fe as an "all-in wager of the economic future of the US" ranks highly. If the best expression of the future of the ES economy is a railway operator dating back to the mid -1800s, the growth investors might be advised to look instead to China, India or Brazil. *John Gapper, Financial Times columnist.*

Our $6.7bn bullion buy reflects the power of an economy that lays claim to the fifth largest foreign reserves in the world and that has the resilience to reach 9% economic growth in a year's time. *Pranab Mukherjee, Indian Finance Minister.*

Chart 3: Local market returns to 31 October 2009



October in perspective – local markets

October was a very strange month in the markets. You really needed to own three stocks (Anglo up 22.3%, SAB Miller 15.9% and Old Mutual 15.3%) to have registered decent gains. The All share index rose 6.0%, but for the most part gains were more muted than this return leads one to believe. Ironically these three shares are neatly spread across the basic materials, financial and industrial indices, so each major sector return looks good on paper, but it hides the reality that it was tough generating a respectable return in October. Anglo rose 22.3% but Billiton rose "only" 5.8%. Firstrand rose 7.8% but Standard Bank only 1.1%. The rand declined 3.2%, but that didn't prevent pure rand-hedge Arcelor Mittal from falling 11.3%, or Sasol for that matter, rising only 4.7% despite a 13.0% rise in the oil price. Why did Dawn decline 12.5% but Iliad, which is largely similar in nature, rise 10.1%? These, and other similar questions, left us scratching our heads a bit. Be that as it may, in contrast to September, large caps (6.3%) outperformed their small cap (2.6%) brethren. The All bond index declined 0.2%, continuing its awful showing so far this year. Despite its annual return of 9.3%, its year-to-date return is -2.3% - all the gains in the annual return were made in November and December last year. Chart 3 lists the usual returns for the SA investment markets.

The shape of things to come

We have frequently highlighted the speed at which the world is changing. Due to the financial crises last year and the economic turmoil in which the world now finds itself, the world as we knew it only two years ago no longer exists. It is our humble view that in a couple of years time a New World Order will exist in the which will be unrecognizable from the one that prevailed just a few years ago. In order to focus on this phenomenon, we highlight some of the events indicative of this process of change.

India's $6.7bn purchase of 200 tonnes of gold, equivalent to 8% of annual world production, from the International Monetary Fund (IMF) put the proverbial cat amongst the pigeons and caught the market by surprise. It also pushed the gold price to record levels, despite a stronger dollar on the day (at the time of writing bullion is flirting with the $1110 level). India's purchase takes its bullion holding to 6.2% of its foreign reserves, down from 20.0% in 1994 but up from 3.6% in 2004. By comparison, China holds more physical gold, at 1 054 tonnes, but it constitutes only 2.0% of its reserves. The point I wish to emphasize here is not so much India's specific purchase of gold as much as the fact that *many governments are increasing their purchases of hard assets*. Many of you would know that two of Maestro's Big Picture themes are "*Security of supply*" and "*The value of the dollar*", which speaks to the fact that there are insufficient supplies of commodities to satisfy long-term demand and secondly that the long-term value of the dollar will continue to be questioned. By buying hard assets, governments are playing to both themes; they are diversifying their exposure away from the dollar and US Treasuries (bonds) and into hard assets, which they must believe will better retain their value in coming years. It might be a bit simplistic, but ask this question of yourself: will the supply of gold (or any other commodity for that matter) rise as fast as the supply of dollars? You already know India's answer.

Another of the Big Picture themes we have in Maestro at the moment is what we have termed *Regulation Strangulation*. At the heart of the issue is the fact that regulation is increasing by the day, raising costs of doing business with seemingly little benefit, and taking up more of all of our time every turn we take. Just think of FICA, travelling through airports, dealing with any financial institutions, etc. The scary aspect of this theme is that we don't think the process has really got going – the regulatory environment is going to get much harsher in the coming years. While this topic begs a day's discussion in itself a public forum such as *Intermezzo* is hardly the place for us to embark on a detailed discussion about our concerns about regulation. We are fortunate to count among our readers a number of regulators, including some at the Financial Services Board. I am thus very conscious of the need to tread a very careful line. However, we owe it to our clients to raise concerns and risks when we see them arise, and in this respect they need to know that we, for a number of reasons, are growing increasingly concerned about the regulatory environment in South Africa. In the past month alone we have had three specific reasons to be more concerned than ever about this aspect of our profession and business. Our frustration is increased by the fact that there is little we can do about it – we are largely relegated to the role of "takers" in this regard. But eventually the costs and consequences of regulation will filter up to clients – it is important that you are aware of this risk, which is likely to continue increasing in significance.

And now for something a bit more cheery. Can you believe it is 20 years ago that we watched the *Berlin Wall come down*? Where were you on that historic day? Talk about the shape of things to come! Who could ever have imagined the huge global changes that were to occur subsequently, of which the collapse of the Berlin Wall on 9 November 1989 was but the tip of the iceberg, albeit a very symbolic one?

In many respects one senses that the world is at a similar point; perhaps not politically but certainly ideologically.

MAESTRO
INTERMEZZO
Investment Letter | 9th Edition | November 2009

Hard questions are being asked of capitalism and the West. The West is in trouble, deeply indebted; short of ideas and long of demographic challenges. Asia, in many respects not least of which are financial ones, has less liabilities but more assets, lots of young people and an increasingly wealthy population. Another of Maestro's Big Picture themes is *The inexorable shift in power from the West to the East* as well as *"Coming of Age" – emerging markets' role in the future*. It is through these themes that we try and capture moments such as these and deploy them in our thinking and investment actions for the benefit of clients.

For the record

Table 2 lists the latest returns of the mutual funds under Maestro's care. You can find more detail, including the latest Maestro Equity Fund Summary, by visiting our website at www.maestroinvestment.co.za. Returns include income and are presented after fees have been charged.

Table 2: Returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Fund	Oct	**0.9%**	**23.7%**	**22.6%**
Maestro equity benchmark *	Oct	5.8%	25.1%	26.2%
JSE All Share Index	Oct	6.0%	25.7%	29.2%
Maestro Long Short Equity Fund	Sept	**2.5%**	**13.7%**	**-8.1%**
JSE All Share Index	Sept	0.2%	18.6%	7.7%
JSE Financial and Indus 30 index	Sept	-0.1%	19.1%	9.8%
Central Park Global Balanced Fund ($)	Sept	**1.5%**	**9.6%**	**5.1%**
Benchmark**	Sept	2.1%	13.4%	2.3%
Sector average ***	Sept	2.4%	20.2%	1.3%

* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index
** 40% MSCI World Index, 20% each in Barclays US Aggregate Bond Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills
*** Lipper Global Mixed Asset Balanced sector ($)

As usual we also list, below, the returns of the equity portfolios under our management. Given the huge gains in the equity market since mid-March, the absolute numbers have improved dramatically. One would never say, looking at the returns of both the market and the portfolios under our management, that we have just experienced the most dramatic financial crisis we are ever likely to face in our lifetimes. Investors who withdrew their cash from the market at any point in the past six months ran the risk of incurring a significant opportunity cost, proving how costly a strategy of "timing the market" can be. We are committed advocates of the philosophy of "time in the markets" and the returns listed below, by and large, bear testimony to the appropriateness of this approach.

Table 3: Maestro annual returns to 30 Sept 2009 (%)

SA equity returns	6m *	1 yr	2 yrs	3 yrs	5 yrs	7 yrs
Maestro long-term equity portfolios	*28.5*	*6.3*	*-5.4*	*9.9*	*22.9*	*24.1*
Maestro Equity Fund	*27.5*	*3.1*	*-4.7*	*7.8*	*N/A*	*N/A*
Maestro equity benchmark **	29.7	7.8	-4.0	6.8	19.1	18.6
JSE All Share Index	25.4	7.7	-6.0	6.7	19.5	18.3

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

The State of the Nation – internal affairs

You will recall from last month's *Intermezzo* that I committed myself to giving other Maestro team members more "air time" in so doing provide you with an opportunity of getting to know them better. I have asked our team to write a short paragraph on *any topic whatsoever* on the occasion on their anniversary. Sue Joubert celebrated her 9th anniversary with Maestro in September; here, then, is Sue's contribution, which she has called *"My time at Maestro"*.

The most enjoyable highlight of my time at Maestro has been the privilege of getting to know the Maestro clients. Quite honestly we have been blessed with the most amazing people as clients. They have really embraced Maestro and allowed us to get "under the skin" of their families and their affairs. Some of these people we now count as close friends and engage with them when looking for advice on a range of topics from keeping positive in the ever- changing South African arena, to bringing up children and facing the many challenges that life throws all of us.

An equal highlight has been getting to know the various (and there have not been many) colleagues over the years. Maestro is a small team and we get to know each other and our families well. We know the following: some people are grumpy on a Monday morning; never leave biscuits or chocolates unattended in the kitchen; we all like wine and clear up your own mess or you will get sent to purgatory! I also know that these people will always go the extra mile for our clients and for one another.

Some very memorable moments (good and bad) over the years include:

- *Sitting in the office and watching in horror as a plane flew into the first of the Twin Towers and knowing that the world had changed.*
- *South Africa losing the bid to host the Olympics – the office was depressed for days!*
- *South Africa winning the Bid to host the World Cup in 2010.*
- *Lehman Brother's collapse and the resulting uncertainty as once again we realized that the world as we knew it had changed.*

MAESTRO
INTERMEZZO
Investment Letter | 9th Edition | November 2009

- *The death of a much admired and respected client and the resulting sadness and grief on the faces of all the team. It felt as if we had lost a member of our family.*

This is my overriding memory of my time at Maestro – actually it's all about relationships.

Why we love this job – Example 1
Those of you who know us well will be aware that all of us in the Maestro team are very passionate about what we do and believe firmly in the benefits of long-term investment. At times though, we get too familiar with the latter and are guilty of not sharing enough about this important topic. So, in the coming *Intermezzo* editions we plan to share some of our passion and reasons for our firm beliefs with you.

We recently had the privilege of setting up a retirement fund, from scratch, for a young media company in Cape Town. In less than four months we have put in place the ability for this company's staff to provide for their retirement and obtain, at the same time, benefits such as life cover and disability insurance at a very competitive rate. We have a compelling solution in this regard, but I want here to focus on the investment aspect of saving for retirement.
I had the daunting task of, within 30 minutes, trying to persuade the employees, whose average age is probably not more than 26, why they should take a portion of their valuable salary (and who doesn't remember how precious your salary was at that age?) and invest it for their retirement. Apart from feeling very old, it was a daunting challenge. So I called on what Albert Einstein once described as the "most powerful force on earth", **the power of compounding**. There was no rocket science to what I presented; anyone of the audience (and probably all of you) could have presented this simple example. But in the hustle and bustle of life and in its sheer simplicity, we forget about one of the more important aspects of life, namely to plan for retirement. This was the example I presented:

Mr Really Clever invests R1 000 a year towards his retirement, starting at the age of 21, but then stops investing at age 40. In total he therefore invests R20 000. Can you afford R1 000 a year towards your retirement? How much do you spend on the movies and, say, magazines in a year? Perhaps the more appropriate question to ask is: can you afford *not* to invest R1 000 a year towards your retirement?

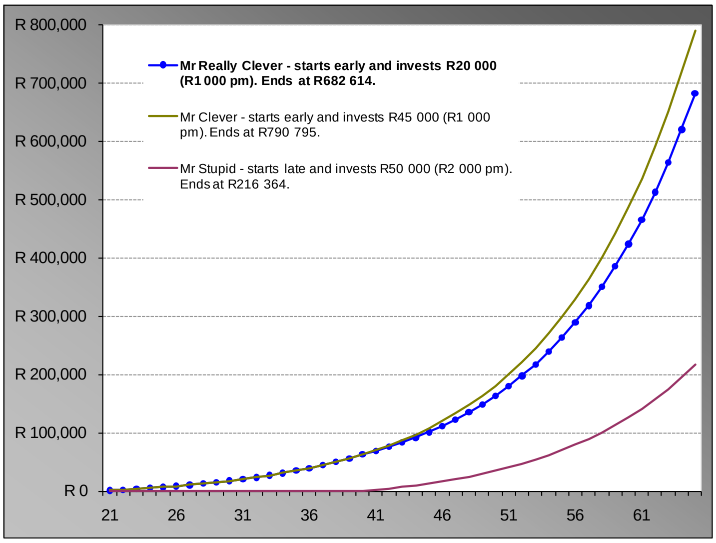
Enter Mr Clever; he does the same, but continues to invest R1 000 a year until he is 65, which means he has invested a total of R45 000 towards his retirement.

Then along comes Mr Really Stupid, who says: "No, I would rather save more for my retirement when I earn a bit more". So he starts investing for his retirement when he turns 40, but to compensate for lost time, he invests R2 000 a year. In total he therefore he would have invested R50 000 when he reaches age 65.

OK, all well and good, you say. Now let's see what happens. Let's start by assuming that the compound annual return on investment is 10% - not too demanding. Although not directly comparable, you may be interested to know that the 40-year compound annual return of the SA equity market to December 2008 was 16.7%; the assumption of a 10% return is thus a relatively conservative one. At the end of year 1 Mr Really Clever has R1 100 (R1 000 plus 10%). Then he adds his next R1 000 (taking his total to R2 100) on which he earns 10%, taking it to R2 310 (R2 100 plus 10%). As so he continues through to the age of 40, when his retirement "fund" stands at the grand total of R63 002. Of course the same holds true for Mr Clever, except that continues to invest R1 000 for another 25 years, until the assumed retirement age of 65.

At this stage, you would think that Mr Clever's retirement will be much larger than Mr Really Clever. Well, it is more, but not by as much you think. At the end of their 65th year Mr Clever's fund totals R790 795; not bad for an investment of only R45 000 over 25 years. Mr Really Clever's retirement fund totals R682 614 - amazing if you think he only saved R20 000 and has not set aside a cent for retirement for the past 25 years! But where does that leave Mr Really Stupid? For all his hard work and double contribution (R50 000) his retirement fund at age 65 is ... only R216 364. Oops! Probably not enough, don't you think? And hardly a function of the fact that he saved twice as much each month towards his retirement. Chart 4 shows the graphic depiction of our simple little story.

Chart 4: Local market returns to 31 October 2009



MAESTRO
INTERMEZZO
Investment Letter | 9th Edition | November 2009

The difference, of course, is time. And that, dear friends, is what I shared with my young audience at the media group. The message is simple – **you have to start early**! And then time itself, through the wonderful power of compounding, will work its wonder on your investment.

This is the message we at Maestro need and want to share with all those who walk alongside us through life. I would encourage all parents to share this with their children and or grandchildren. Pass the message on – it will not cost you anything but the benefits are life-saving, to say the least. If you don't believe me, go and do the numbers yourself. Now let me ask my question again: can you afford *not* to invest for your retirement? Although it is never too late to start, let time (and the power of compounding) work its wonders and **start investing early**!

File 13 – things almost worth remembering

There have been a couple of times in the past when I have been embarrassed to be associated with capitalism. It has happened more times than usual during the past two years, which not surprisingly coincides with the worst global credit crisis in our life time. When I read the following, I felt my ideological framework being challenged once more. What does it do for you? In a recent regulatory filing Goldman Sachs disclosed that it made more than $100m (R750m) *per day* in profits on 36 of the 65 trading days during the third quarter. During the second quarter, there were 46 days when they made more than $100m in profit. What makes these statistics even more remarkable is that this is occurring at a time when the US government (USA taxpayers, actually!) is supporting the banking system now more than ever, and is throwing free money at anything that moves in an effort to resuscitate their economy. It's hard to understand the benefits of a banking system such as this. For the record, Goldman Sachs has, in the nine months to September this year, set aside $16.7bn (yes, that's R125.3bn or 65% more than the total revenue shortfall of the SA government for their 2010 fiscal year; alternatively more than the entire market cap of Naspers, for just nine months' work) for "compensation and benefits" - that's "banker-speak" for bonuses . What makes this story even less palatable is that Goldman Sachs's CEO responds to this criticism by saying that he is just a banker, "doing God's work". You can read more about his interview by clicking here.

New research has shown that fake mobile phone handsets, made in China, are set to reach 13% of the legitimate global mobile phone market this year. Fake Chinese handset production is set to total 145m units in 2009, up 44% from 101m in 2008.

And finally, at our Investment Forums last month we showed a video, *Moving Windmills*, that had a profound impact on us and which we thought held an important challenge for all who watched it, particularly as Africans. It is hard not to be inspired by people such as William Kamkwamba. For those of you who would like to watch it either for the first time or again you can watch it by clicking here. I urge you to watch it. Alternatively, the website is:

http://www.sevenfund.org/cinema/videos/moving-windmills.html.

"That's what I'm planning to do …"

Table 4: MSCI Emerging Market October returns (%)

	Oct'09	YTD
Argentina	7.6	57.7
Poland	6.6	29.7
China	6.4	54.3
Malaysia	4.6	45.8
Russia	4.5	89.6
Egypt	4.1	47.6
Hong Kong	2.5	54.6
Brazil	2.4	102.1
Israel	1.7	35.4
Philippines	1.6	48.9
LatAm	**1.4**	**80.1**
EMEA	**1.3**	**51.9**
Hungary	1.3	70.1
Chile	0.8	59.2
Morocco	0.7	-0.6
MSCI EM Small Cap	**0.6**	**87.6**
Mexico	0.4	36.5
Australia	0.0	62.0
MSCI EM	**0.0**	**61.2**
AP ex Japan	**-0.4**	**58.6**
Singapore	-0.9	52.1
EM Asia	**-1.0**	**58.1**
South Africa	-1.5	38.7
MSCI DM	**-1.8**	**20.2**
Turkey	-2.5	71.8
Japan	-2.5	4.8
Pakistan	-3.1	78.5
Indonesia	-3.8	102.7
Peru	-4.0	61.8
Taiwan	-4.1	55.4
India	-4.1	78.8
Czech	-4.2	23.0
Korea	-6.3	55.2
Thailand	-6.4	57.5
Colombia	-9.1	63.9

Source Merrill Lynch

MAESTRO

INTERMEZZO

Investment Letter | 9th Edition | November 2009