MAESTRO
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INTERMEZZO

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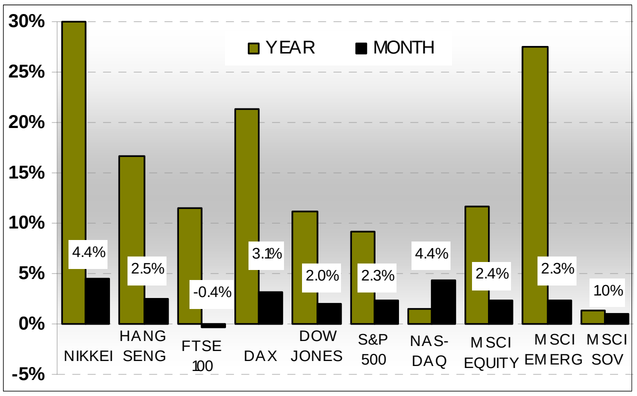
August in perspective – global markets

August is historically one of the weakest months on global equity markets, but this year it passed without incident, which comes as quite a relief given the rollercoaster ride experienced since May. A closer look at the monthly returns reveals that although most Western markets dozed off as investors enjoyed the summer holiday, a rewarding "stealth" rally actually occurred. That much is evident from the returns in Chart 1. Global "tech" shares rose sharply: the Nasdaq was up 4.4% with strong gains by Cisco and AMD each up 23%, HP 15% and Intel 9%. The strong monthly gain pushed the Nasdaq's annual return into positive territory – but it has only risen 1.5% in the past year. The MSCI World and Emerging markets index gained just over two percent each, although the annual returns at 11.7% and 27.0% respectively remain vastly different. On the currency front, the dollar was relatively weak, and the pound strong. The rand lost ground against all major currencies.

Chart 1: Global market returns to 31 August 2006



SA interest rates revisited

The SA Reserve Bank (SARB) is one of nearly two dozen banks around the world raising interest rates. At the time of its first surprise rate hike in May, I expressed the opinion that the rate hike was unwarranted; the SARB had "erred in its way", and had not considered the full effects of the new middle class that was emerging as a powerful force in the SA economy. Well, with three months having passed and another interest rate hike later, I need to acknowledge that with the benefit of hindsight, the rate hike by the SARB *was* appropriate. It is now clear, thanks to a weaker rand and higher oil price, that the rate of inflation is rising sharply and more importantly that, as an economy, we seem to be living "beyond our means". A key indicator in this regard is the extent to which the trade deficit has mushroomed in recent months. SA posted a July trade deficit i.e. it imported more goods than it exported, to the extent of R7.8bn. This will place enormous pressure on a number of areas in the economy, not least of which will be the rand. It is therefore not surprising that the rand declined 3.8% in August. And if that trend continues, we can soon get into a vicious cycle of a weaker rand adding further pressure on inflation, which in turn will exacerbate the deficit and weaken the rand even further, and round and round we go. It is a moot point whether higher interest rates are the ideal solution; for example, they will not have much effect on the level of oil imports or the price of oil. But higher rates may send a cautionary message to new borrowers, many of whom have never experienced the effects of rising interest rates, it will be a good thing. The purpose of raising this point now is firstly, to confess the "error of *my* ways" and secondly to highlight that from here on we need to keep a closer eye than usual on the path of the SA economy. It's vulnerability as an open economy is again becoming apparent. Interest rates will most surely be raised again and we cannot ignore the effects this will have. Watch this space; government has committed itself to R375bn of infrastructural spending (which is of necessity import-dependent) over the next few years, 2010 is a reality that cannot be delayed, and with a whole new stratum of consumers out there things are getting interesting.

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.

Table 1: Returns of funds under Maestro's care

	Month	Return	Year to date
Maestro Equity Fund	Aug	**4.9%**	**9.6%**
Maestro equity benchmark *		5.3%	19.3%
JSE All Share Index		5.4%	23.4%
Central Park Global Balanced Fund ($)	July	**-0.2%**	**4.5%**
Benchmark**		0.8%	4.8%

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

The performance Maestro achieved for its clients is listed in Table 2. The returns for the quarter to 30 June were very disappointing and pulled the 6-month returns lower. However, the *annual* return to June, and for longer periods, remains respectable. Our poor performance during the June quarter was caused by the relatively small exposure to resource shares (the Basic materials index rose 20.6% in the June quarter) and large exposure to financial and industrial shares (the latter indices *declined* 6.0% and 5.4% during the June quarter respectively). The portfolios are also biased in favour of mid and small caps, which *declined* 9.5% and 9.0% respectively. During the June quarter Maestro reduced the resource weighting of its portfolios in an effort to reduce the risk profile of the funds. But we failed to appreciate the effect of the weaker rand, which rose to R7.55 at one stage during the quarter, on the resource sector. With a larger cash component in the funds, we then also missed the recovery in late-May and June, all of which cost the portfolios relative performance. That said, we are of the humble opinion that our intentions were correct. Although our actions cost clients some relative performance, had developments turned out to be much worse, our actions would likely have saved our clients a lot of money. We used the analogy of a safety belt to explain the poor performance to our clients: you can elect to drive with or without a safety belt. However, if you have an accident, I know which position I (and most of Maestro's clients for that matter) would prefer to be in. At Maestro, we prefer to "drive with our seatbelts on".

Table 2: Maestro equity returns to 30 June 2006 (%)

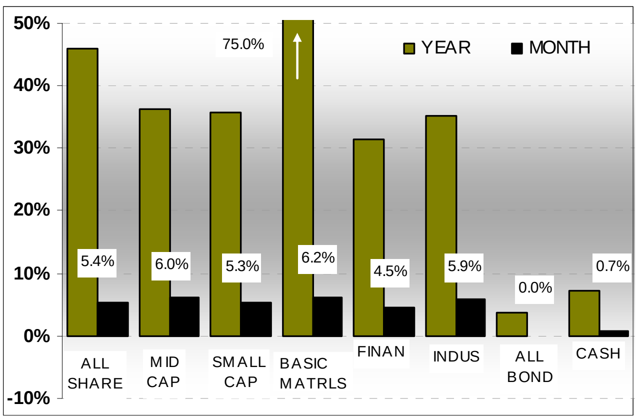
SA equity returns	6 months	1 year	2 years	3 years	4 years
Maestro average – ***short-term, actively traded portfolios***	***7.7***	***49.9***	***52.7***	***49.3***	***45.3***
Maestro average – ***long-term portfolios***	***9.5***	***44.3***	***46.9***	***42.4***	***29.3***
Maestro equity benchmark *	13.7	45.0	44.4	39.2	21.2
JSE All Share Index	18.8	53.7	48.7	40.3	22.5

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

August in perspective – local markets

There were three influences on the SA equity market that deserve mention. *Firstly*, SA companies, by and large, reported very good results. This was particularly true of some small and mid cap shares that had been badly mauled during the June quarter. Their results went a long way to supporting their respective share prices, and in explaining the 6.0% and 5.3% monthly returns from the mid and small cap indices respectively. The *second* influence was a raft of economic data indicating that the economy and its citizens were "living beyond their means", as discussed above. And *finally* and closely related, the rand declined 3.8% against a weak dollar, which in turn supported the resource sector, helping it to a 6.2% and 75.0% monthly and annual return respectively. Perhaps the most refreshing aspect during August, apart from the decent returns, was the absence of the volatility that has so plagued the market in the past three months.

Chart 2: Local market returns 31 August 2006

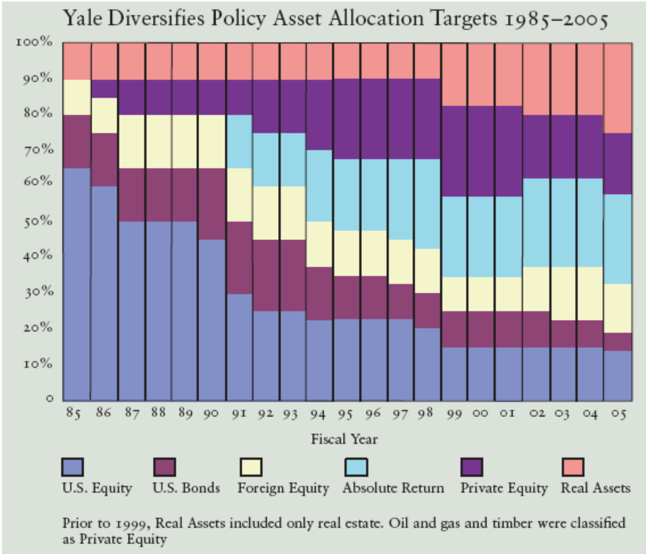


Private equity in action

Private equity and merger and acquisition activity has dominated headlines this year and had a profound effect on many listed companies. One of the dominant participants in the private equity market are US public pension funds which, with their long-term horizon and little need for trading in and out of investments, are ideally suited to private equity. But there are other large funds that have been at it for many years, such as the Yale Endowment Fund. Having been alerted to it by an article in the Financial Times I hope you find the following information as interesting as I did. Like so many US institutions, Yale University is blessed with a large Endowment Fund, valued in June 2005 at $15.2bn, up from $4bn ten years ago. The following information is worth highlighting:

- The Fund's allocation to domestic (US) securities has declined dramatically over the past twenty years. In 1985 80% of the portfolio was committed to US securities. In 2005 this portion had declined to only 20% - refer to Chart 3 in this regard.

Chart 3: Yale Endowment Fund asset allocation (%)



Source: Yale Endowment Fund June 2005 update; Yale University

- The Fund is explicitly committed to alternative investments, listing examples such as venture capital, leveraged buyouts, oil and gas, timber and real estate.
- The Fund's asset allocation at June 2005 was domestic equity 14.1%, absolute return 25.7%, fixed income 4.9%, foreign equity 14.7%, private equity 14.8%, real assets (real estate, oil, gas and timberland) 25.0% and cash 1.9%.
- With regard to private equity, the Fund generated a return of 39.5% *per annum* over the past ten years (including a return of 168.5% in 2000) and an *annual* return of 31.0% since 1973.
- A couple of examples of venture capital investments include: in the 1970's and 1980's investments were made in the start-up companies of Amgen, Compaq, Dell, Genentech and Oracle. The 1990's saw investments in (start-ups) Amazon, Cisco, Juniper Networks, Red Hat and Yahoo. Google is specifically mentioned: the Fund's $300 000 investment in Google yielded a $75m profit when Google listed in 2004. The return would have been much higher – more like $335m at Google's current price - had the Fund retained its holding after the listing; perhaps this is an example of the discipline that has yielded these impressive returns.

The cynic in me notes that only successes are mentioned by the Fund. However, the failures are also included in the investment returns, which speak volumes for themselves and bear testimony to a remarkable investment team. Those who are interested in reading more about the Fund and its achievements, including its investment activity in South African through the apartheid years (refer to page 42 of the Report), can access the latest Report by clicking here.

File 13: The law of large numbers

For the benefit of *Intermezzo's* non-SA readers, the SA cellular telephony market is dominated by two players, MTN and Vodacom. MTN, the only cellphone company listed in SA, recently reported interim results for the six months to 30 June. MTN's total subscriber base is 24.4m, with 9.6m of these in Nigeria. The SA subscriber base is 10.4m, an increase of 2% or about 200 000 subscribers since December 2005. The point of this exercise is to illustrate the "law of large numbers", in this instance to illustrate the sheet size of a country such as India. The Telecom Regulatory Authority of India recently reported its July data. *In July alone*, India added 5.3m new subscribers, bringing its total subscriber base to 111.2m. No wonder everybody is beating a hasty path to Mumbai!

Table of the month

Whilst on the topic of emerging markets, Table 3 lists the dollar returns of the major emerging markets, using the MSCI indices as yardsticks. In the table, the acronym EMEA refers to **E**urope, the **M**iddle **E**ast and **A**frica.

Table 3: MSCI Emerging Market returns to August ($)

	August	YTD
MSCI EM	**2.8**	**10.0**
LatAm	**1.5**	**15.2**
Argentina	-2.7	26.5
Brazil	-0.4	17.1
Chile	3.3	2.5
Colombia	7.0	-3.5
Mexico	4.8	14.6
Peru	1.4	28.8
Asia	**3.0**	**8.5**
China	2.0	27.9
India	10.7	19.6
Indonesia	7.2	34.8
South Korea	2.0	2.4
Taiwan	1.7	-1.2
Thailand	0.0	3.5
EMEA	**3.6**	**8.9**
Czech	0.6	11.5
Hungary	-0.3	2.3
Israel	5.5	-11.3
Poland	-6.1	15.2
Russia	5.6	42.7
South Africa	2.7	-1.6
Turkey	3.7	-17.3

Source: Merrill Lynch, MSCI