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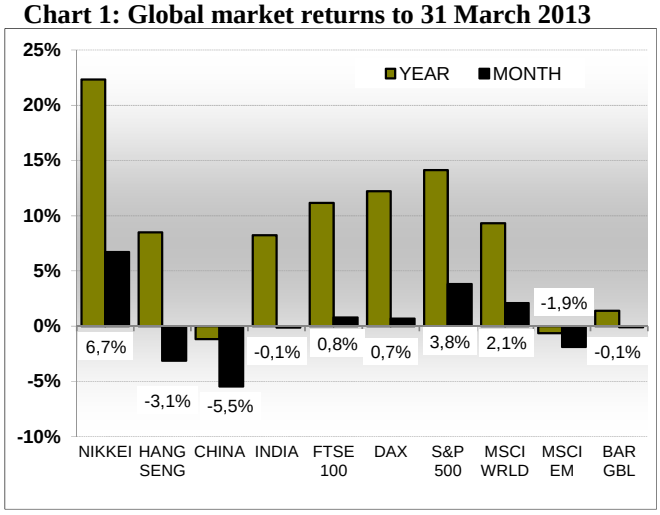
Investment Letter | 13th Edition | April 2013

March in perspective – global markets

The inexorable march of equity markets in developed countries continued through the first quarter. Not even the remarkable events in Cyprus could affect sentiment for more than a day or two. Emerging markets were less fortunate, as investor concerns about specific problems in those countries weighed on emerging currencies and markets. The MSCI World index rose 2.1% in March while the MSCI Emerging market index declined 1.9%. The respective *quarterly* returns for these two indices were 7.2% and -1.9% while in the *year* to end-March the World index rose 9.3% while the Emerging market index fell 0.6%. So within a relatively short period of time investors have voted with their feet and left emerging markets for the "safety" of developed markets. Back to the monthly returns, the conscious effort on the part of Japanese policy makers to weaken the yen (it declined 1.9% on the month and is down 17.3% in the past six months) boosted exporters listed on the Japanese equity market, helping that market to rise 6.7% in March (it has risen 39.7% during the past six months). The US equity market's gain of 3.8% was also noticeable, as was the 4.6% and 4.1% increases in the US mid and small cap indices. Turning to emerging markets, China declined 5.5%, effectively losing all its year-to-date gains, Russia lost 5.2%, Brazil 1.9% and India 0.1%. The JSE All share index i.e. the SA equity market, lost 1.0% in dollar terms, bringing to 5.2% its year-to-date loss.

Chart 1: Global market returns to 31 March 2013



What's on our radar screen?

Here are a couple of items we are keeping a close eye on:

- *The SA economy:* The trade deficit for February shrank to R9.5bn from unexpectedly high January deficit of R24.5bn. Exports rose by R9bn and imports declined by R6bn, resulting in the significant improvement. Imports of consumer goods are up only 2.7% in the past year while exports of motor vehicles now account for a third of the annual increase of 10.8% in exports. The SA Reserve Bank (SARB) kept its policy interest rate unchanged at 5.0%, noting that "further accommodation remains constrained by the upside risks to the inflation outlook". The SARB raised its inflation expectations slightly; it now expects inflation to average 5.3% and 5.9% during 2013 and 2014 respectively and to end 2014 around 5.2% (although it will get a lot higher before then). Annual consumer inflation rose to 5.9%, pushed higher by medical aid contributions. A small decline in monthly food prices eased the blow marginally, in the absence of which inflation would have breached the 6.0% mark. Annual core inflation i.e. excluding food and energy costs, rose significantly from 4.7% to 5.3%.

Afro-pic 1: Zebras crossing

- *US economy:* Whereas the US economic data during February and March was generally better than expected, the data in April so far has been quite disappointing. This is very relevant because we are also probably due to start seeing the effects of the recent haggling over the US budget (the so-called sequester), which saw the US government mandated to make certain cutbacks in expenditure, which are bound to have a negative impact on their economy. The usual "non-farm payroll" data i.e. the US labour market data, was released a few days ago. It showed that job creation had slowed much more than expected and more significantly, although the official unemployment rate declined from 7.7% to 7.6%, it only did so because so many people gave up looking for work. This phenomenon, called the labour participation rate, fell to its lowest level (63.3%) since 1979. The jury is still definitely out as to how strong the US economic recovery will be. We are not inclined to give it the benefit of the doubt at this stage and still see growth

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for the year around only 2.0%; but let's acknowledge that there is growth, nonetheless, which is more than is happening in the Eurozone.

- *Emerging market economies:* **Chinese** inflation declined from 3.2% in February to 2.1% in March while produce inflation (PPI) posted a decline of 1.9% in March from -1.6% in February. **Indian** inflation rose from 10.8% in February to 10.9% in March, while in **Russia** inflation rose to 7.3% in February from 7.1% in January. **Turkey's** inflation in the year to February was 7.0%.

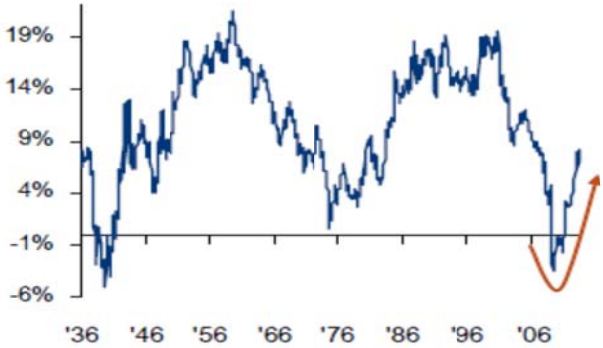
Afro-pic 2: White-tailed eagles

Global chart of the month

As you can see from Chart 2, momentum in large cap US shares is on the increase. Despite the inherent risk in global equity markets, we still believe equities will deliver superior returns over the next 12 to 18 months. The February US labour data (268 000 jobs were created) and housing data (rising 10.0% year-on-year in January) help explain the fact that underlying economic fundamentals within the US continue to improve. An improving macro-economic backdrop and accommodative central bank policies should lead US equities even higher. This will act as a strong tail wind for global equity markets. The fact that other asset classes look overvalued adds further conviction to our belief.

Equity markets recently touched new all-time highs despite global concerns about an imminent market correction. The consensus view is that 2013 corporate earnings will see global equity earnings rise by a solid 10.0%, which supports current valuation levels. The expansion of central banks' balance sheets has been unprecedented, with liquidity jumping from $8 trillion to $21 trillion over the past six years. Despite this, investors remain underweight in equities.

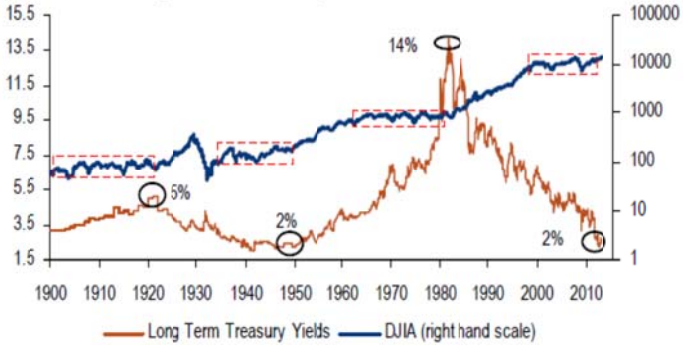
Chart 2: US large cap equity 10-year rolling returns
Expressed on an annualized basis



Source: Merrill Lynch

It is widely believed that secular equity bull markets have historically coincided with an inflection point in bond yields - refer to Chart 3. Perhaps for the late comers to the party, the US 10-year bond yield needs to find a solid floor at 2.0%. Only time will tell.

Chart 3: Secular equity bull markets have coincided with an inflection point in bond yields



Source: Merrill Lynch

A few quotes to chew on

An admonition for shareholders

It is well known, at least amongst Maestro clients, that we do not hold Anglo in high regard i.e. it has never been one of our preferred mining houses. Over time it is fair to say this view has been correct. Our preference for Billiton over Anglos has worked well for clients. That said, *outgoing Anglo CEO, Cynthia Carroll*, recently directed some salient comment at shareholders, which we would all do well to heed. It is worth highlighting that all the major mining houses have recently written down billions of dollars in failed investments and are all in the process of changing CEOs. This applies to Anglo, Billiton, Rio Tinto and Xstrata. Referring to shareholders' demands for greater cash returns, Carroll said there was a "disconnect" between mining companies and investors, adding that the latter need to understand better "what it really takes to deliver projects.

It's not an industry where you can react overnight to something that happened yesterday. The (industry) context has changed (and) maybe the shareholder base must also change. It will need more time and patience. Some (shareholders are) under severe pressure and want a return tomorrow. They're going to be hard-pressed to get them because it's not going to happen that way. We have to be ruthless in terms of what (costs) we've got to cut but we have to be mindful that we're in a long-term industry."

Afro-pic 3: A buffalo bull eyeing Wall Street's new peaks

A word of warning on the North Korean situation
In a recent report *Merrill Lynch Chief Investment Strategist Michael Hartnett*, had the following to say: "The geopolitical situation in North Korea also bears watching. Although thus far it's difficult to see much impact on asset prices, the fact remains that there are $11.4 trillion of US Treasuries outstanding on the planet, and 25% of them are currently owned in countries that surround North Korea. The potential for geopolitical risks is clear to see should the 'crisis' worsen".

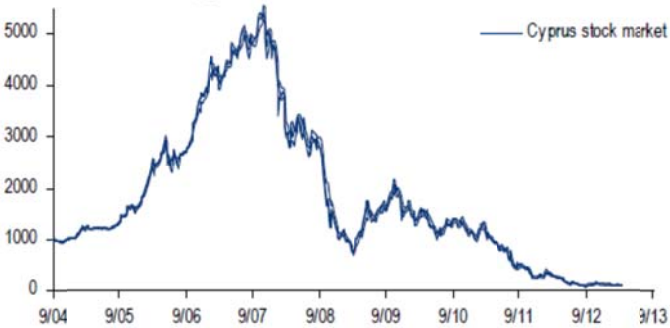
The end of the Iron Age
I wonder what your reaction was to the passing of Baroness Margaret Thatcher. Whatever it was, we know for certain that they don't make leaders like that anymore! We thought the following observations from *Jim Reid, the Deutsche Bank Market Commentator and economic historian*, were rather prescient. "We try to stay fairly neutral politically in this job but with the death of Mrs Thatcher yesterday it was interesting to hear the debate about some of her policies in the early 1980s. In closing down many of Britain's uncompetitive industries her policies led to much social disruption and high unemployment. However some might argue that this was creative destruction at its purest and her policies turned around years of competitive decline in the UK albeit at a high social cost. In addition there was a deliberate policy of high interest rates to tame inflation which added to the short-term economic/social problems. If you compared that to today, the Western World and the UK in particular have perhaps been interfering in the creative destruction process and are keeping more entities alive than the free market would naturally allow. These policies are arguably minimising social disruption (even if it doesn't always feel like that) but are also arguably leading to a sub-optimal and inefficient resource allocation in various economies. Indeed the UK today is in an odd position where it's flirting with a 'triple-dip' but that unemployment is at pretty low levels. So was the early 80s in Britain a case study of creative destruction and is the UK now a case study of a zombie economy? It's a tough debate as to which is the better route as you have appreciate that you are playing with individuals and communities lives. It takes a very brave politician to venture down the huge restructuring route which is part of the reason that Mrs Thatcher splits opinion. However in a world of consensual and compromising politics she should be remembered for her decisiveness and aggressive policy choices whether you agreed with them or not. I did re-watch her final PM speech on you tube yesterday from 1991 and her disdainful comments on the ECB were quite entertaining."

Two quick notes on Cyprus
Much has been written about Cyprus. We remain fascinated and mildly concerned about the events there, particularly the fact that some politicians really seem to believe that their "new model" i.e. getting private investors and depositors to pay, is an effective means of dealing with failing banks and economies. That was stated in as many words by Mr Jeroen Dijsselbloem, who heads the Euro group of finance ministers, in an interview with the Financial Times and Reuters. In the interview he indicated that the initial plan hatched by policy makers was effectively "pushing back the risks" that sovereigns or EU authorities would be left to shoulder the burden of bank bailouts. He added that the relative market calm in recent months, coupled with the lack of market panic following the decision to force depositors to pay for the bailout of two large Cypriot banks, allowed the Eurozone to go after private money more aggressively when banks failed. The market reaction prompted a clarification statement later where Dijsselbloem said that Cyprus was a "specific case with exceptional challenges" and that bailout programmes do not have models or templates. But by then the earlier message had done the damage - equities and the Euro had already fallen sharply. However, both were to recover soon afterwards.

The second note on Cyprus has to do with their stock market. Have you wondered what effect, firstly the 2007/9

Great Financial Crisis and secondly the recent economic crisis there has had on their stock market? Wonder no more and allow me to put you out of your misery – the answer is not a happy one. Chart 4 related the sad facts: since the peak of their market in 2007 the Cyprus has fallen 98% - eina!

Chart 4: The Cyprus stock market

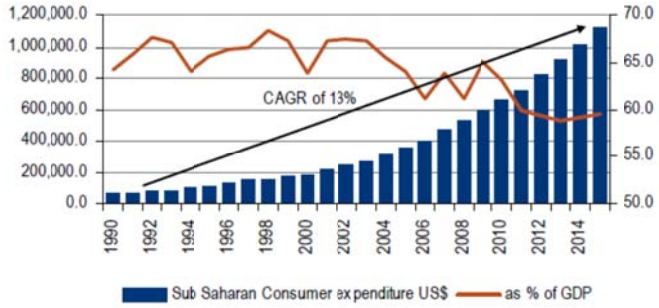


Source: Merrill Lynch

Local chart of the month

Sub-Saharan Africa has been overlooked by international investors for many years. However, in a world that is searching for areas of economic growth it was only a matter of time before Africa started to show up on investors' radar screens. The area remains characterized by countries with relatively small GDPs, data releases that are questionable and illiquid stock markets. These factors, by and large, keep investors at bay. However, as countries grow in economic status they start to become more attractive as investment destinations. The demographics tell a compelling story: a population of well over 700m and growing at over 2.0% per annum, increasing urbanization, strong GDP growth of 5.0% - 6.0% p.a. and above-average consumption growth.

Chart 5: Sub-Saharan consumption expenditure
Current US dollar prices



Source: Euromonitor (in Merrill Lynch)

South Africa remains the largest African country by GDP. The next four countries – Nigeria, Angola, Ghana and Kenya – are cumulatively the same size as South Africa in terms of GDP. Euromonitor forecasts a real compound annual growth rate in GDP of 6.8% for these four countries versus a rise of 3.5% p.a. for South Africa. Arguably of more importance is the compound growth in consumer expenditure over the last two decades rising 13% to just over $700m.

Chart 5 illustrates the fact that consumption expenditure is expected to grow at an annualized rate of approximately 11.4% p.a. over the next three years, which is only marginally lower than the 13.0% experienced over the past two decades. The primary drivers of this anticipated growth rate are the formal food and apparel retail market. A number of the companies in which Maestro is invested, particularly in the industrial sector, are well positioned to capitalize on this growth. They have established bases in South Africa and a growing distribution footprint into sub-Saharan Africa.

Afro-pic 4: Impala enjoying some African TLC

March in perspective – local investment markets

March proved to be a rewarding month in the SA equity market – at least for investors in the financial and industrial sectors, where the latter two indices rose 3.1% and 2.7% respectively. Like so many months before, it was a different story for investors in resource shares. The basic material sector declined 3.7%, following the 6.8% decline in February. The basic material sector has now declined 7.2% so far this year, despite the 7.5% decline in the rand over the same period - so much for these shares' "rand hedge nature". So far this year the financial and industrial indices have risen 5.9% and 6.3% respectively. The gold index is down 17.9% over the same period.

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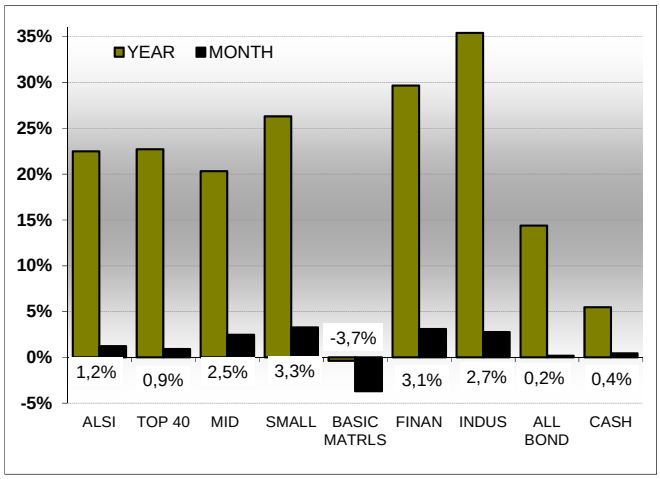
We noted how firm the US mid and small cap indices had been so far this year. It is worth pointing out that the same is true for the SA equity market, although the midcap sector flew into quite strong winds in January as the retailers, many of whom are to be found in this sector, were severely marked down. During March alone the mid and small cap indices rose 2.5% and 3.3% while for the year-to-date their respectively returns are 2.7% and 8.1% (yes, 8.1%). In stark contrast, large caps (the Top40 index) rose only 0.9% in March (it was carried by the financial and industrial large caps) and has risen 2.3% for the year-to-date. All in all these returns make for very interesting analysis, and highlight the extent to which the inner workings of the SA equity market have changed relative to last year. Despite pedestrian returns in popular sectors such as basic materials, a lot is happening within the market. Many sectors have already delivered very respectable returns so far this year. For the records, the best-performing sectors during March were the pharmaceuticals and biotechnology sector, which rose 14.5%, automobiles and parts up 13.5% and tobacco 9.4%. The worst were industrial metals, which declined 10.1%, platinum mining down 5.7% and mobile telecoms 5.6%.

Chart 6: Local market returns to 31 March 2013



Victor's anniversary article

Regular readers will know that on the occasion of their anniversary, each staff member is invited to contribute an article in *Intermezzo* on a topic of their choice. This month it is Victor's turn. For your information, Victor joined Maestro in January 2011 and currently has responsibility for a number of client relationships. He is a key member of the investment team and analyses certain companies and sectors. He also has responsibility for the smooth operation of our offshore unit trust, Central Park Global Balanced Fund. Victor holds an Honours degree in Finance from the University of Cape Town and is a Chartered Financial Analyst (CFA). Victor writes as follows:

It is hard to believe that another year has gone by already! It seems like just a few weeks back when I was celebrating my first anniversary at Maestro with an *Intermezzo* contribution on my two passions, football and investment markets. The year has certainly gone by quickly. I guess it is true what they say, time flies when one is having fun or is very busy☺.

Afro-pic 5: The African equivalent of Brothers-in-arms

As is customary at Maestro, with each anniversary comes an opportunity to write an article on any topic and share it with *Intermezzo's* readers. In keeping with last year's motivation, I have decided to share some thoughts on another topic that is dear to my heart, the African continent. Many will agree that the topic of the African growth story has received renewed attention over the past few years. Hardly a week goes by where we do not come across an advert or invitation to a 'Discussing Africa' conference or presentation. The media has certainly caught onto the hype with business channels screening numerous weekly shows on the topic and the print media publishing a plethora of articles on the subject. I can easily recall no less than three publications in The Economist in the recent past that largely focused on Africa. It is also worth noting that much of what is being said and written is positive, as evidenced by the caption on a recent The Economist cover, 'Aspiring Africa'. Perhaps the most telling sign that something of interest is taking place on the continent is the attention business executives and investors are giving to their African operations.

Some will remember the doleful cover of The Economist magazine over a decade ago with the inscription 'Hopeless Continent' and the image of an African man carrying what appeared to be a bazooka on his shoulder. Few argued with the description or foresaw that a decade later the publication would regret ever printing such an article and recant. How times have changed since then. Afro-optimism is probably at

its highest level ever and rather than being viewed as hopeless, many now look at Africa as the next beacon of hope. Most of the enthusiasm is justified. It is a matter of fact that many of the continent's economies are enjoying their best years since they won independence from their colonial powers. Africa is the world's fastest growing continent with average GDP of 6% per annum. Six of the world's ten fastest growing economies over the past decade were from the continent and this helped average real income per person increase by over 30% during that period.

Afro-pic 6: Impala ewe receiving her daily grooming

Ironically, part of Africa's recent success is a result of the Great Financial Crisis of 2007/8 and the subsequent over-indebtedness of developed economies, which has condemned most western nations to sluggish growth for the foreseeable future. In search for growth and returns, global investors have turned to frontier and emerging market economies, which has assisted foreign direct investment (FDI) into Africa to increase from $37bn in 2006 to $46bn in 2012. The increased investment on the continent has brought about many goods and services that used to be scarce, such as telecommunications. It is estimated that there are now three phones for every four people on the continent, a statistic that is comparable to that of India. Remarkably, about a third of Kenya's GDP now passes through M-Pesa, the country's mobile money service. When you consider that eight out of every ten people on the continent do not have a bank account, it is safe to assume that the trend in Kenya is likely to be replicated in other African countries. The increase in FDI is only part of the story and frankly, to lay much of Africa's success on the demise of developed economies would be an injustice to the continent's people. Several factors have conspired to bring about the change in perception on how the continent is viewed, not least of which is the reduction in the number of war-torn regions across the continent.

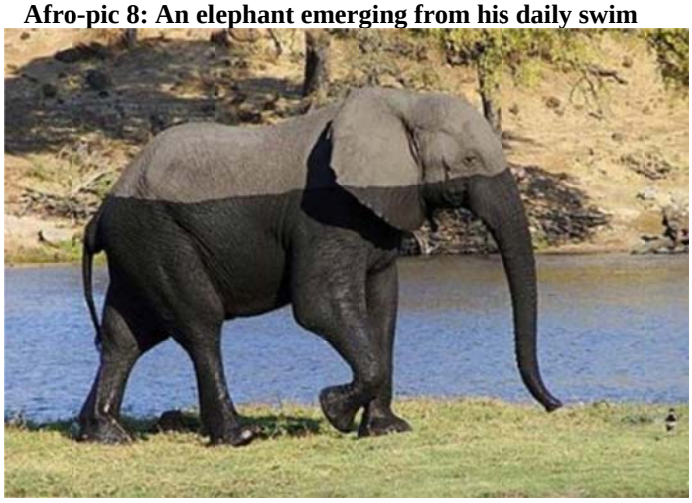
I am of the view that the most significant change on the continent over the past decade is that wars and civil dissension have declined dramatically. There are still incidences that occasionally flare up (the Central African Republic being a case in point) but overall the continent's conflicts are less severe and do not last as long as they used to. A clear example of this can be seen by looking at previous crisis zones such as Liberia, Angola, Chad and Sierra Leon, all of which are enjoying a period of peace, certainly more than they have in decades. Closely linked to this development is the advent of democracy across many countries. It is startling to note that in early 1980 only three African countries had democratically elected governments, currently there are over 25 countries across the continent that enjoy some form of democracy. Sceptics will be quick to point out that much of the continent's elections are flawed with vote rigging, violent clashes and intimidation of one form or the other, all of which are accurate assessments. Yet, the point remains, that in itself is an improvement on the perennial civil wars and the countless *coups d'état* of prior decades.

Afro-pic 7: Cheetah family

With peace, or some form of it, often come investment, human development, increased life expectancy, optimism and aspiration among locals. All of these contribute to some interesting forecasts of where Africa will be in the next few years; consumer spending is expected to double over the next decade with the emerging consumer contributing significantly to that growth. The average income per person in three out of four African states is forecast to grow above $1 000 per annum while trends such as urbanisation and declining child mortality are adding to the optimism. Africa's growing population promises an increase in labourers in the next few decades as the ratio of workers relative to children and the elderly increases, a phenomenon often referred to as a 'demographic dividend'. With all the above, it's no wonder business leaders are paying close

attention to the continent and why investors are willing to back seemingly credible African growth strategies. Some African governments are taking advantage of this change in perception by investors and making the proverbial hay while the sun shines. In September of 2012, the Zambian government issued ten-year Eurobonds (bonds backed by the Zambian government but denominated in euros) mainly to American and European investors at a yield of 5.4%. Remarkably, the initial plan was to raise $500m but the auction drew $12bn in orders. In the end $750m was raised, underscoring investors' appetite for African assets. At present, fourteen sub-Saharan governments have issued foreign denominated bonds and the list includes Ivory Coast, a country that has defaulted on its debt twice in the last decade, yet its long-term dollar bonds are trading at a yield of less than 8%.

Afro-pic 8: An elephant emerging from his daily swim



The continent certainly has made great strides over the past two decades; however, one cannot be oblivious to the fact that as a continent we still have a long way to go. While headline statistics are encouraging, there are still large parts of the continent (particularly the central region) where hunger and poverty are rife. Even in countries where economic growth has been robust, like Angola and Ethiopia, the majority of the population still live on less than $1.50 a day. If the continent is to build on the foundations of the past decades, more schools and hospitals still need to be built and governments must deal with the bureaucracies that serve as a deterrent to additional investment. The continent currently attracts only 1% of global investment and contributes less than 4% to world GDP despite being home to over 13% of the world's population. The corruption pandemic is often cited as one of the continent's greatest challenges, and rightly so. Estimates suggest that up to $8bn is siphoned out of the Nigerian economy every year due to crookedness; sadly, the story is no different in many other African countries. These are all funds that could be directed to infrastructure projects that would help to ensure a better future for the young and aspiring generation. One of the consequences of corruption is the uneven spread of wealth, an additional challenge the continent contends with. As the US president often says when referring to America, "the country does well, when the middle class does well." The same can be said of the African continent that when leaders are more interested in the well-being of the masses rather than enriching a connected few, that will expedite sustainable wealth creation and reduce inequality. Singapore is often quoted as a template in this regard; the country grew its GDP per capital from $460 to $62 000 in four decades, a truly remarkable achievement.

Another hurdle the continent will have to overcome in the coming years is the lack of diversification within its economies. Almost a third of Africa's GDP growth comes directly from commodities. This is unlikely to be sustained; commodity prices are cyclical and soft commodities are subject to unpredictable weather. With the vast mineral wealth on the continent, it will come as no surprise that many booming African nations share China as their largest trading partner, a relationship that cynics are uncomfortable with. In the long-term, the over-reliance on commodities will need to be addressed and perhaps be replaced by increased domestic demand.

So, a decade from now, how will we evaluate the African continent? Will the sceptics be proved right once again, after conflicts have flared up and incompetent governments have erased the fragile gains of the last two decades? Or will the aspirations of a billion people on the continent be closer to being realised? Needless to say, I am bullish on the continent's prospects and believe we are on the cusp of some interesting developments. However, I will add the proviso that it will take time; as the old adage goes, 'there is no hurry in Africa'. Sadly, this will probably be the reality. Destructive practices like bribery, fraud and violence take generations to expunge, so the road ahead will likely see many setbacks but the consolation, judging from the past decade, is that we are on the right track. In addition to that, I would go as far as to say that many of Africa's challenges can be corrected by having the right leaders. How else would you explain the anomaly that the continent with the most arable land has to import food or that the continent with the richest mineral wealth has the poorest people? The challenge of inept leadership can be rectified in time, while the difficulties facing other global regions, such as Europe and America, are much more complex.

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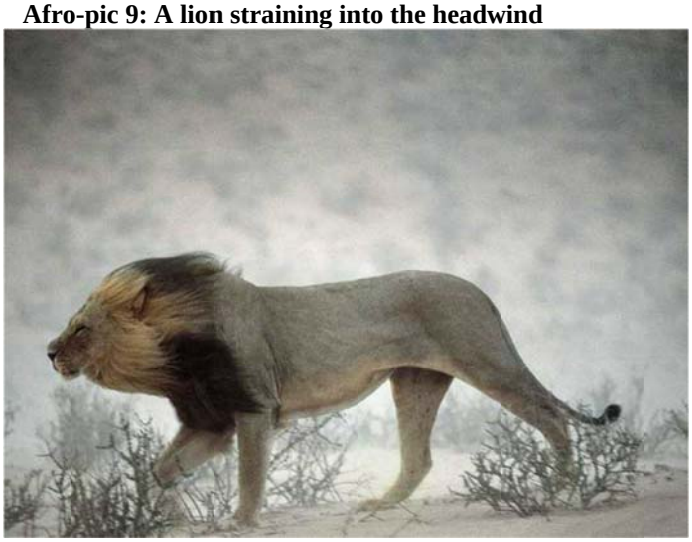
Afro-pic 9: A lion straining into the headwind



For the record

Table 1 below lists the latest returns of the mutual and retirement funds under Maestro's care. You can find more detail on our website at www.maestroinvestment.co.za. Returns include income and are presented *after* fees have been charged. Fund Summaries for each respective fund listed in the table are available on our website.

Table 1: The returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Prescient Fund	**Mar**	**1.1%**	**0.3%**	**14.5%**
JSE All Share Index	*Mar*	*1.2%*	*2.5%*	*22.5%*
Retirement Funds				
Maestro Growth Fund	**Mar**	**0.9%**	**1.3%**	**14.0%**
Fund Benchmark	*Mar*	*1.1%*	*2.9%*	*19.6%*
Maestro Balanced Fund	**Mar**	**0.8%**	**1.5%**	**13.5%**
Fund Benchmark	*Mar*	*1.0%*	*2.8%*	*17.8%*
Maestro Cautious Fund	**Mar**	**0.6%**	**0.9%**	**11.7%**
Fund Benchmark	*Mar*	*0.6%*	*1.6%*	*13.1%*
Central Park Global Balanced Fund ($)	**Feb**	**-2.1%**	**-1.0%**	**-0.7%**
*Benchmark**	*Feb*	*-0.2%*	*2.1%*	*4.8%*
*Sector average ***	*Feb*	*-0.5%*	*2.0%*	*2.3%*

* 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 ($)

So what's with the pics?

What with Victor's inspiring and thought provoking article on Africa, I simply couldn't resist taking another look at the extraordinary beauty that the continent holds. I hope you enjoy the photos, which, with the odd one from an anonymous source, were all obtained from National Geographic.

Table 2: MSCI returns to 31 March 2012 (%)

	YTD	MTD
ACWI	6.0	1.6
DM	7.2	2.1
Asia Pacific	8.8	2.0
Australia	7.8	-1.0
Hong Kong	3.1	-1.9
Japan	10.7	4.1
New Zealand	8.0	-0.2
Singapore	2.8	1.4
GEM	-1.9	-1.9
EM Asia	-1.6	-2.4
China	-4.5	-4.6
India	-2.7	0.0
Indonesia	13.2	0.6
Korea	-4.1	-4.4
Malaysia	-1.3	2.3
Philippines	17.9	0.8
Taiwan	-0.2	-0.8
Thailand	9.4	1.2
EMEA	-5.8	-2.0
Czech	-14.1	-4.8
Egypt	-10.8	-6.4
Hungary	-6.6	-10.3
Morocco	-3.0	-0.9
Poland	-11.5	-5.2
Russia	-3.2	-3.6
South Africa	-9.7	-2.3
Turkey	8.2	8.1
LATAM	0.5	-0.2
Brazil	-1.3	-1.4
Chile	4.1	-2.2
Colombia	-6.8	-3.4
Mexico	5.9	3.7
Peru	-2.7	5.2

Source: Merrill Lynch