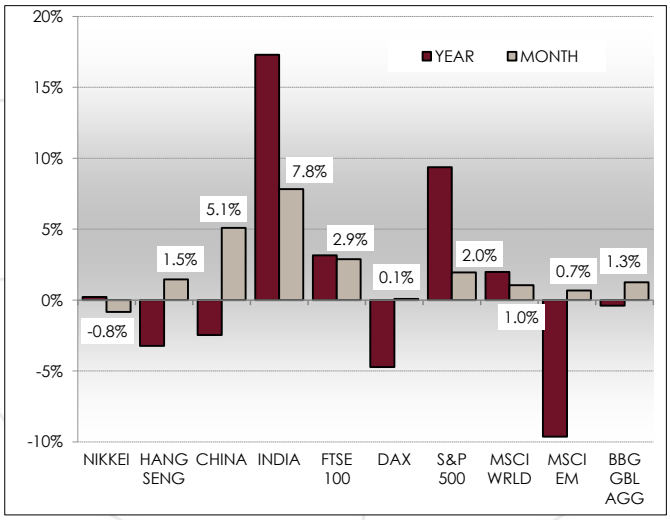
March in perspective – global markets

Notwithstanding the strong start to the year in January and February, markets continued to rise during March. Global investors have reason to reflect on the first quarter of 2019 with satisfaction. Early in February we said that we would watch market behaviour during February and March for an indication that January's big bounce was sustainable; it is now fair to say that most markets have retained their January gains and, better still, have built on them to bring a very profitable quarter to an end.

Chart 1: Global returns to 31 March 2019



For the most of this year so far, developed (as opposed to emerging) equity markets have led the gains. This was the case during March, too. The MSCI World index rose 1.1% and the MSCI Emerging Market index 0.7%, bringing their quarterly gains to 11.9% and 9.6% respectively. The Indian equity market rose 7.8% and the Chinese market 5.1%, but the Russian market rose only 0.8% while the Brazilian market lost 0.2%. The US equity market rose 2.0%, although the S&P Mid and Small cap indices fell 0.7% and 3.5% respectively. The Hong Kong equity market rose 1.5% but the German market rose only 0.1%. The Turkish equity market lost 10.3% during March. For the year so far – and thus also the quarterly returns – the Chinese equity market rose 23.9%, the tech-heavy NASDAQ rose 16.5%, the Swiss market 12.4% and the US market 13.6% - all in all very robust returns.

Lion's Head in the Mother City, Cape Town

The global bond market also rose strongly; interest rates declined in the face of concern about the slowing global economy and concern that central banks such as the US Federal Reserve had raised interest rates too aggressively in recent months. The Bloomberg Global Aggregate Bond index rose 1.3%, bringing its quarterly gain to 2.2%. The trade-weighted dollar rose 1.2%, putting the commodity price complex under pressure. The Bloomberg Commodity index lost 0.4% despite oil rising 1.8%. Oil gained 27.3% during the quarter.

"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

Dolos illusion, Hong Kong

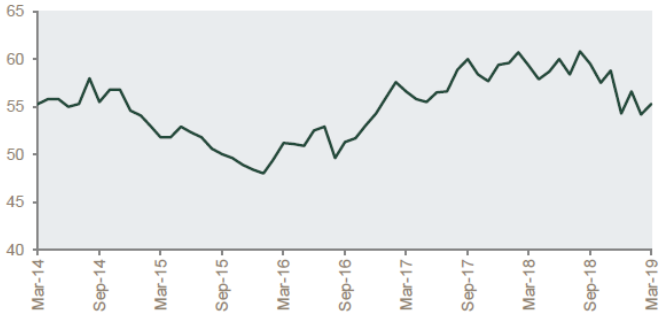
Instagram handle: @droneofficial

What's on our radar screen?

Here are a few items we are keeping an eye on:

- *The SA economy:* The SA economic continues to splutter along at a very low rate, woefully insufficient to meet the citizens' needs or make any meaningful impact on the huge unemployment in the country. Consumers were dealt a double blow during the month with a huge increase in fuel prices and electricity prices – the latter occurring despite Eskom's inability to deliver a constant supply of electricity. Inflation remains relatively moderate, with prices rising at an annual rate of 4.1% in March. The second-round effects of the huge fuel and electricity price increases will eventually feed into the headline inflation rate, cushioned by a firmer rand in recent weeks and declining consumer demand. Ironically, we are well into the territory where inflation is low, but for all the wrong reasons, such as decimated consumer demand. Annual wage increases in the government sector will not help undermine the systemic rise in prices either.
- *The US economy*: Data emanating out of the US continues to be mixed; there is no doubt the economy has slowed in recent months. February durable goods orders were weak, declining 1.6%. January's increase over December was revised down from 0.4% to 0.1%. March motor vehicle sales declined between 5% and 6%. February retail sales declined 0.2% month-on-month, but January's sales were revised upwards from 1.1% to 1.7%, to the largest monthly gain since October 2001, going some way to explaining the awful December number of -2.2%. On the other hand the March ISM Purchasing Manager's Index (PMI) was higher than expected, at 55.3, from 54.4 in February – refer to Chart 2. Any data point higher than 50 represents expansion, or below 50 contraction; the further away from the 50 mark, the greater the expansion or contraction. The readings for the PMI sub-components of employment (from 52.3 to 57.5), and new orders (from 55.5 to 57.4) were also very positive.

Chart 2: US Manufacturing PMI



Source: EFG

"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

- *Developed economies*: PMIs reported across the Eurozone continue to be disappointing and have renewed concern about the slowing economy there. The German, French and Italian PMIs are all still firmly in contractionary mode, at 44.1 (this reading for Germany was the second lowest since 2009; the new orders sub-index fell to a new post-crisis low of 40.1), 49.7, and 47.4 respectively. The Eurozone PMI came in at 47.5, also in contractionary mode. The services PMI reading for Germany and the Eurozone was 54.9 and 52.7 respectively. With manufacturing data like this, you will appreciate the concern that the EU may be sliding into a recession during the coming months, particularly in the event of a poorly-managed Brexit. The Swiss PMI is not much better, with the March reading of 50.3 barely above the 50 growth contraction divide. Annual inflation in Switzerland is now only 0.7%.
- *Emerging economies*: You would surely have seen by now that Turkey is in the news again for all the wrong reasons. Their equity market fell 10.3% during March and their lira was under huge pressure – it declined 5.6% against the dollar last month and has lost 29.2% during the past year. Annual inflation to March was 19.7%, with food and non-alcoholic prices rising nearly 30% from the year before. The Chinese manufacturing PMI rose from 49.2 to 50.5 (so back into expansionary mode), with the new orders (50.6 to 51.60 and new export orders (45.2 to 47.1) at encouraging levels – both sub-component readings are at six-month highs. The non-manufacturing (i.e. service) PMI also rose, from 54.3 to 54.8. At its latest policy committee meeting, the Reserve Bank of India (RBI) cut its benchmark interest rate by 0.25% to 6.0%. This was the second consecutive rate cut in a move aimed at boosting domestic growth.

Beijing bridge design for 2022 Olympics

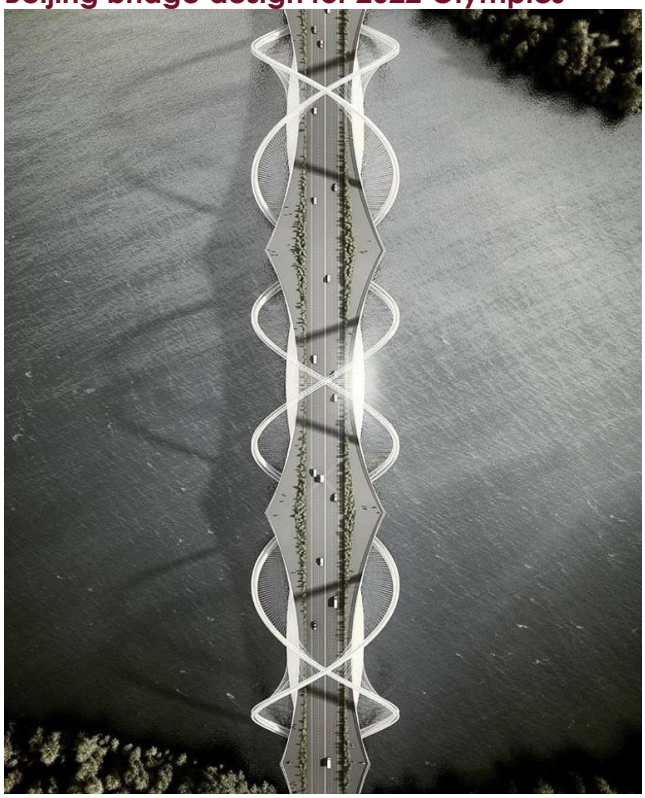


Chart of the month

A quick graphic tour of the world

While the following selection of charts is by no means comprehensive, it succinctly presents the extent to which the global economy is slowing. The charts are useful because they place recent events into the context of the past decade.

To start with, it is clear that world trade volumes have been slowing since early 2018. The Baltic Dry index, a shipping benchmark for dry goods such as iron ore and coal, has rapidly followed suit.

Container ship

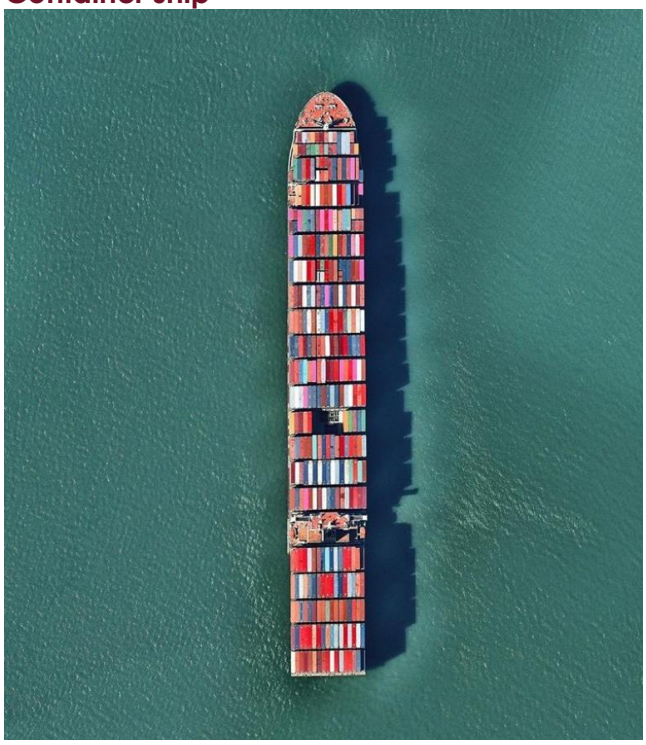
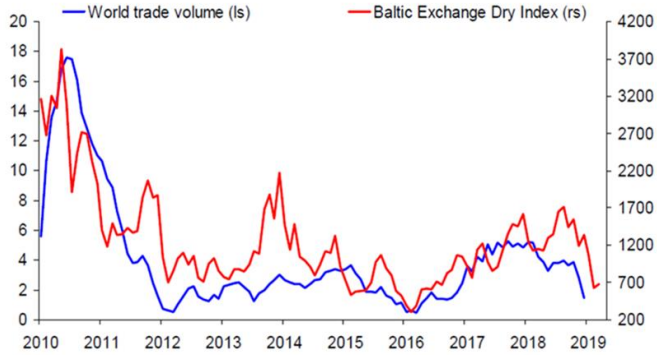


Chart 3: World trade and the Baltic Dry



Source: Deutsche Bank

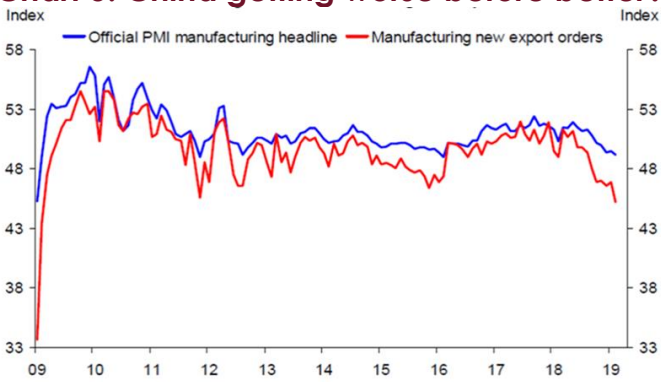
Chart 4 depicts the global manufacturing PMI sub-component of new export orders, pushed forward by 6 months, against the annual percentage change in the three month moving average of world trade volume. Once again, the direction is clear and the global PMI indicates that there is worse to come.

Chart 4: New export orders vs trade vols

Source: Deutsche Bank

China is clearly an important component in global trade and in this regard the message is not too encouraging. Chart 5 depicts similar data (manufacturing PMI against manufacturing new export orders) and the message is clear – the downturn in global trade is affecting China as well and there are few signs of improvement yet.

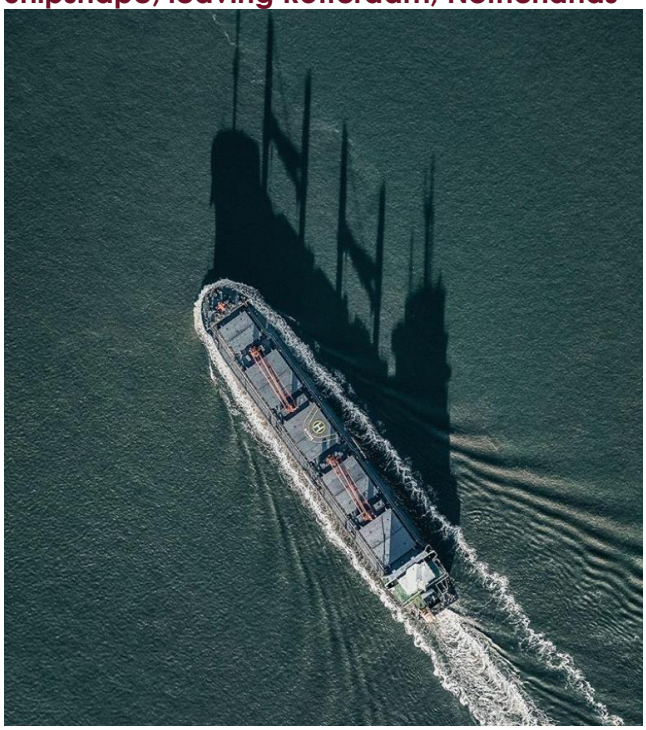
Chart 5: China getting worse before better?



Source: Deutsche Bank

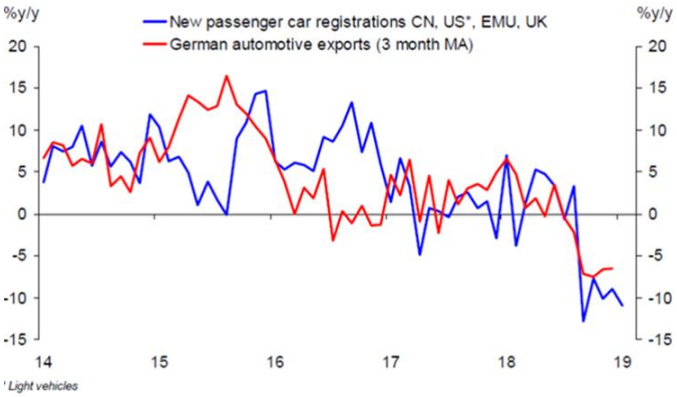
The auto industry is an important part of the German and indeed European economy. The industry's woes in recent years have been well documented, and the effects on, together with the fortunes of the remaining global auto industry, are illustrated in the chart below. As if this weren't enough, remember that the European car industry currently struggles under the threat of US tariffs by US President Trump.

Shipshape, leaving Rotterdam, Netherlands



Instagram handle: @abstractaerialart

Chart 6: German auto exports under pressure

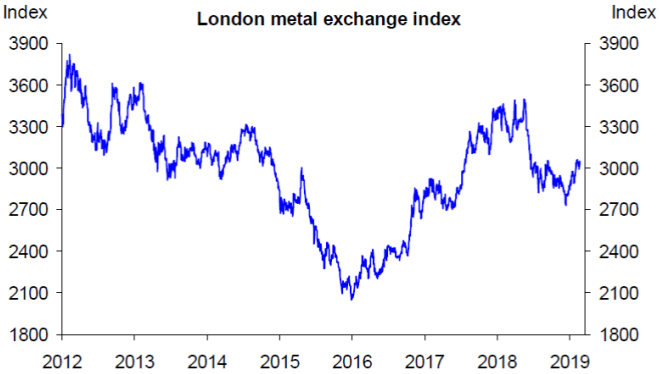


Source: Deutsche Bank

It is not all bad news though. Commodity prices have shown a small rebound in recent months, as can be seen from Chart 7. While this has typically been an early indicator of a turnaround, commodity prices are also very volatile and fickle, and one should bear this in mind.

Chart 7: LME index – a leading indicator

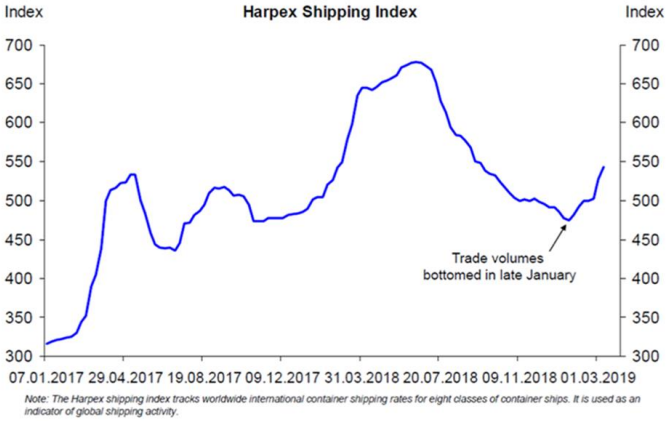
Copper, aluminium, lead, tin, zinc and nickel



Source: Deutsche Bank

In similar fashion we have seen an early rebound in the Harpex shipping index, and we will have to wait and see how sustainable this is.

Chart 8: Container shipping index



Source: Deutsche Bank

In short, the purposes of taking you on this graphic tour is to provide perspective on the state of the global economy. The obvious takeaway is that it is cyclical, providing a reasonable indication of where in the cycle we currently find ourselves. Secondly, the slowdown is not recent but has been developing slowly for the better part of last year. Finally, there are signs that the slowdown may have run its course although it is far too early to suggest that it is over. We will therefore remain vigilant and continue to watch the indicators for the direction and state of the global economy.

"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

A different take on the US China trade war

I have always had a high regard for Stephen Roach and have enjoyed his thinking and the way he writes. For many years Roach was the Chairman of Morgan Stanley Asia, and as such was in a privileged position to watch China "came of age", grow and transform at the most rapid pace we will surely ever see during our lifetime. He consequently writes with authority about China and has a keen understanding of the important but subtle nuances of the Chinese culture and their modus operandi. He is currently a faculty member of Yale University and is the author of Unbalanced: The co-dependency of America and China.

Given the relevance of the current US China trade war, I thought the following summary of a paper Roach presented at the 20th Annual China Development Forum would be worth sharing. I came across it in the daily digital version of the South China Morning Post, the English daily in Hong Kong.

"The United States and China are likely to reach a trade deal, but this will hardly be the breakthrough that ends a deep-rooted conflict. Any deal is likely to focus primarily on multi-year narrowing of America's outsize bilateral merchandise trade deficit with China, which hit an astonishing $419bn in 2018, nearly half the total US trade gap.

But there is no bilateral fix for America's trade deficit with 102 countries last year. The multilateral imbalance stems from a profound shortfall of US domestic saving, which will only worsen in the years ahead due to chronic and widening federal budget deficits.

Arc de Triomphe, Paris

Instead of popping champagne corks when such a deal is reached, government officials and investors should think ahead to unresolved structural issues that remain – over technology, intellectual property rights, state-sponsored industrial policy and forced technology transfer through joint venture arrangements.

Consistent with the ominous warnings of US Vice-President Mike Pence and former US Treasury secretary Henry Paulson, such an outcome points to the distinct possibility of an economic cold war, with the US and China locked in a protracted clash over the competitive strategies of two very different economic models.

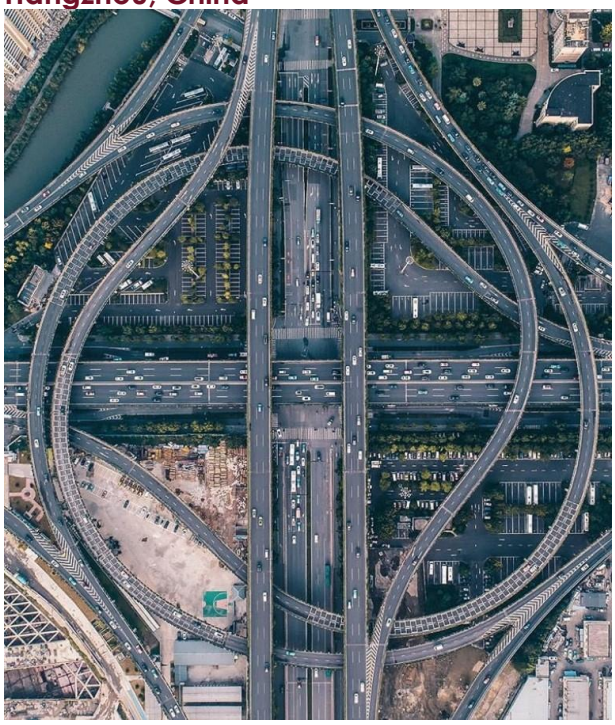
A year ago, the so-called Section 301 complaint of the US Trade Representative made the case for China as an existential threat to America's economic future. While my analysis suggests that the evidence behind these allegations is weak,

the US seems determined to push ahead on these fronts – many key to China's own longer-term economic strategy.

America does not have a monopoly on existential fears. China has deep-rooted concerns that the US is fixated on a "China containment" strategy. While Trump's tariffs underscore these concerns, they follow on the heels of the Obama administration's "Asia pivot" and Trans-Pacific Partnership ambitions – with the latter excluding China from its original 12-nation framework.

Inasmuch as I do not expect China to capitulate on its core economic strategy, there is a strong likelihood of a protracted struggle between two systems – call it "cold war 2.0". This, of course, would contrast with "cold war 1.0", more of a military struggle between the US and the former Soviet Union.

Hangzhou, China



Instagram handle: @twenty4sevendrones

Significantly, for the US, its economy is in much weaker shape to wage a cold war today than was the case during cold war 1.0 from 1947 to 1991. During that earlier period, real US gross domestic product growth averaged 3.5% per year. By contrast, since 2010, real US growth has slipped to 2.3%. Similarly, during the first cold war, productivity growth averaged 2.2%pa, while over the past nine years the pace has slowed to 1.1%.

America's domestic saving position is woefully deficient – a 2.5% net national saving rate since 2010 versus an 8.8% average during cold war 1.0. Such a profound shortfall raises serious questions about America's wherewithal to fund the investments in physical or human capital required for competitive revival.

Contrasting global perspectives of the US and China were evident from the beginning of the Trump administration. US President Donald Trump said in his January 2017 inaugural address, "Protection will lead to great prosperity and strength." Three days earlier, on January 17, Chinese President Xi Jinping gave the keynote address at the World Economic Forum in Davos, suggesting that China "should adapt to and guide economic globalisation".

Trump mistakenly believes that tariffs will "make America great again" by restoring US manufacturing jobs; however, with the manufacturing share of US employment down from 40% in the aftermath of the second world war to just 8.5% today – in large part due to technological and productivity enhancements – that is all but impossible to achieve.

By contrast, Xi's multilateralism draws on the efficiency enhancements of trade liberalisation, global value chains and, hopefully, renewed commitment to the rules-based governance of globalisation – principles that place greater emphasis on the collective growth opportunities for the world economy.

The last thing the global economy needs is a breakdown of the post-second-world-war order. Collectively, only the US and China are in a position to neutralise this risk. Yet they can do so only if both operate from a position of strength.

If both the US and China address their own economic issues and imbalances, they can better resolve the issues that have come between them. For China, that means continuing to focus on rebalancing and structural change by putting its vast reservoir of surplus savings to work in tackling domestic challenges. For the US, that means addressing its chronic shortfall of domestic saving and putting new increments of saving to work in rebuilding the infrastructure, manufacturing capacity and human capital.

Contrary to the view of the Trump administration, trade wars have no winners – especially between two co-dependent economies that rely so heavily on each other. Trump's argument that the US has the upper hand in a trade war because China is already hurting could be a serious miscalculation.

Yes, the Chinese economy is weakening and likely to slow further in the months ahead. But in light of recent policy stimulus actions, both monetary and fiscal, that weakening could run its course by mid-year. On the other hand, the sharp plunge in the US stock market in December 2018, in conjunction with a significant weakening in global trade, point to a test of US economic resilience in the months ahead.

Notwithstanding a probable superficial deal between the US and China, it is hard to be optimistic that a meaningful breakthrough is at hand. Nothing short of bold, courageous and strategic vision by leaders of both nations is required to restore trust and rebuild the relationship.

Court illusion, China

Instagram handle: @seven7panda

Quotes to chew on

Too many jobs, too few people

No, you aren't seeing things. "Too many jobs, too few people" is a problem every country would like to have. Believe it or not, that is where the US now finds itself. In previous editions of *Intermezzo* we have drawn your attention to the fact that there are now more job vacancies in the US than there are people looking for work.

"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

This was confirmed recently in the comment that accompanied the first quarter sales report of Sika, a Swiss company involved in the building industry, providing solutions focussed on bonding. Commenting on their growth in the US market, they said "The Americas region recorded growth of 4.8% (previous year: 12.2%). Numerous major construction projects have been delayed in the United States *due to the ongoing shortage of skilled labour* (our italics)." We suspect this is going to be an ongoing feature of the US economy for many months to come, if not years.

For the record

Table 1 lists the latest returns of the mutual and retirement funds under Maestro's care. Returns include income and are presented *after* fees have been charged. Fund Summaries for each respective fund listed in the table, as well as all the historic returns, are available on our website.

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

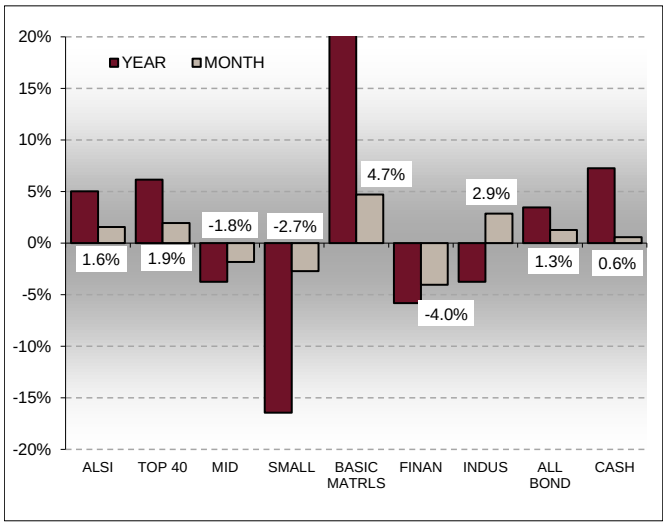
	Period ended	Month	Year to date	Year
Maestro Equity Prescient Fund	**Mar**	**0.0%**	**5.9%**	**-0.7%**
JSE All Share Index	*Mar*	*1.6%*	*8.0%*	*5.0%*
Maestro Growth Fund	**Mar**	**2.0%**	**8.1%**	**6.6%**
Fund Benchmark	*Mar*	*1.6%*	*6.6%*	*7.0%*
Maestro Balanced Fund	**Mar**	**1.6%**	**5.0%**	**2.9%**
Fund Benchmark	*Mar*	*1.5%*	*5.9%*	*7.3%*
Maestro Cautious Fund	**Mar**	**0.6%**	**0.5%**	**3.8%**
Fund Benchmark	*Mar*	*1.1%*	*4.2%*	*5.7%*
Central Park Global Balanced Fund ($)	**Feb**	**4.0%**	**13.7%**	**-6.9%**
*Benchmark**	*Feb*	*1.5%*	*6.8%*	*-0.9%*
*Sector average **	*Feb*	*1.7%*	*6.5%*	*-1.7%*
Maestro Global Balanced Fund	**Mar**	**4.3%**	**19.5%**	**15.1%**
*Benchmark**	*Mar*	*3.7%*	*8.3%*	*24.0%*
*Sector average***	*Mar*	*3.7%*	*9.9%*	*21.5%*

* 60% MSCI World Index and 40% Bloomberg Global Aggregate Bond Index
** Morningstar USD Moderate Allocation ($)
*** Morningstar ASISA Global Multi Asset Flexible Category

March in perspective – local markets

Turning to South Africa, the rand lost 2.5% against the dollar, which helped the Basic Materials index to a monthly gain of 4.7%. The Industrial index rose 2.9% but the Financials index lost 4.0%. The All Share index rose 1.6% during March, bringing its quarterly gain to 8.0%. The Basic Materials and Industrial indices rose 18.0% and 7.4% during the quarter respectively, while the Financials index lost 0.5%. The All Bond index rose 1.3%, supported by the global bond markets, bringing its quarterly gain to 3.8%.

Chart 9: Local returns to 31 March 2019



So who are you going to vote for?

Next month South Africans head to the poles. Electioneering is now in full swing and, sadly, hard to avoid. Most intelligent voters would have been influenced by the recent rolling blackouts across the country, as the country's electricity utility Eskom struggled to deliver the most basic supply of electricity. For our foreign readers, suffice is to say that Eskom is completely insolvent, and bankrupt from a financial, management, and competence point of view. Despite this, Eskom's only shareholder, the ANC-led government, refuses to admit there is a lasting problem, and

continues to roll out vague promises about an improvement, as well as throw more money (which they don't have) at the problem, or worse still, heap even more debt on Eskom.

Hippos bathing in the sun

Of course, if that was the only bad news, we should all be relieved. Sadly though, Eskom is only the tip of the iceberg. Virtually every State-owned enterprise (SoE) is in a similar or worse position: bankrupt, unable to deliver the most basic of service or product, and wracked with rampant corruption and having been plundered on an unimaginable scale. For the past 25 years the ANC-led government has presided over the slow disintegration of the country's infrastructure and SoEs. They have spent the billions earmarked for investment and maintenance on bloated cadre-filled workforces and salary bills that bear no relation to productivity. They have watched, overwhelmed by a total lack of understanding and absolute indifference, as the State's machinery meant to support its citizens has collapsed, in slow motion, into a state of utter disrepair. We are rapidly reaching a point where even what is left, will be irredeemable.

If you think I am exaggerating, I could give you many examples emanating out of Eskom. But just to show you that Eskom is not the only SoE in total disarray, let's consider some of the statistics that emerged recently when the Passenger Rail Agency of SA (Prasa) released its Annual Report. Remember, Prasa was a reasonable enterprise when the new government inherited it in 1994; its mandate is simply to transport SA passengers.

Here are a few statistics drawn from the Annual Report:

- 13% of all scheduled trains are cancelled
- 68% of trains operated on any given day run late. The average delay during 2018 was 30 minutes.
- 50% of all of them run without all their coaches
- Working through the above statistics, effectively means that 138 trains out of every 1 000 achieve their proper objective
- The availability of train sets decreased from 288 in 2014 to only 200 at the end of 2018. At the time of writing this had deteriorated to only 174, of which only 50% were correctly configured with 12 coaches
- Metrorail currently transports only 700 000 passengers per week day, compared to the 2.6m passengers transported in 2013
- During that time the number of employees increased from 12 000 to 17 000 and the wage bill rose from R3.9bn to R5.4bn. That works out to an average annual salary of R347 060
- Just for good measure, Prasa reported that passengers are increasingly refusing

to pay for their trips. Management reported that the fare collection systems in Cape Town and Gauteng had "basically collapsed" during the first quarter of 2019

- Government has committed R173bn to overhaul the operations – most of this capital remains unspent
- Prasa reported a loss before interest of R1.9bn (2017: loss of R1.6bn), mainly due to the decrease in fare revenue to less than R1.8bn. Its biggest source of income is an R5.9bn operating subsidy funded by taxpayers. The R968m of interest earned on the R63bn capital earmarked for capital expenditure reduced the loss after tax to R925m.
- Prasa's balance sheet shows that its liabilities exceeded assets by R882m and that net equity is a startling negative R840m. The individual items that make up the assets and liabilities indicate that things are far worse than the balance sheet suggests. One of the items listed as an "asset" is a prepayment of more than R1.9bn in respect of the disastrous 2013 agreement to acquire Spanish locomotives which did not fit the railway tracks despite a redesign by Prasa's chief engineer at the time – he lied about his engineering qualifications and the locomotives were deemed dangerous. This "asset" is still the subject of court cases. How terrible the agreement was can also be seen in the condition that the supplier would have accepted the currency risk up to an exchange rate of R10.40 (the current rate is around R14.10), with Prasa taking responsibility for any subsequent worsening in the exchange rate.
- Liabilities include possible claims from commuters injured in accidents to the value of R1.2bn and a long list of contingent liabilities of R979m arising from claims from suppliers. Trade creditors amounted to R6.1 billion – remember this is a balance sheet "sustained" by negative shareholder equity of R840m!
- As if that is not bad enough (*Ed*: could it get any worse?!) the Auditor-general issued a qualified report on the financial statements, noting that the statements were "presented late, incomplete and lacked proper and complete supporting documentation". The Auditor reported 10 pages worth of shortcomings, including the lack of information to substantiate fixed assets or income. He noted irregular expenditure of R23.4bn! He also mentioned material misstatements in the preparation of the financial reports.

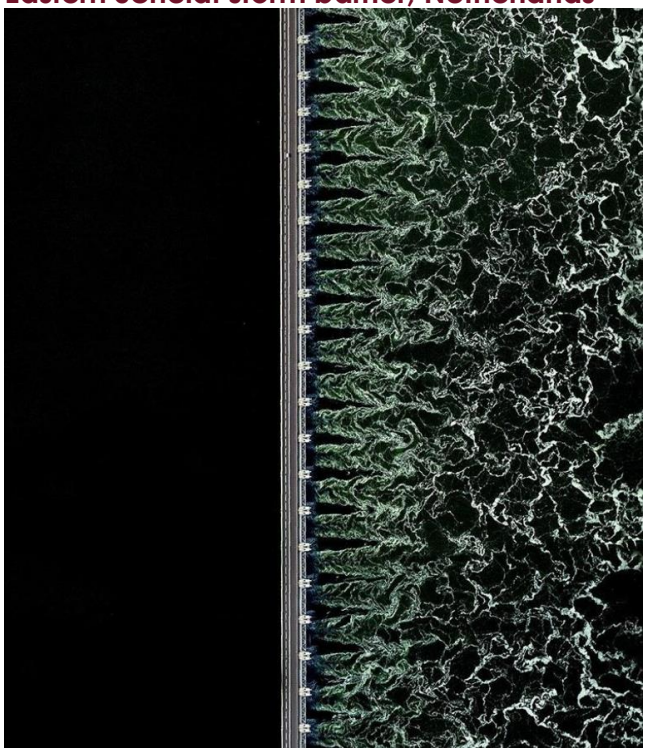
Al Maha Oasis, United Arab Emirates

Instagram handle: @droneofficial

Prasa Chairperson Khanyisile Kweyama states that Prasa is "almost broken and is fraught with a myriad of issues and challenges ranging from its failure to deliver on its primary mandate, investigations arising out of allegations of mal-administration and corruption, poor internal controls and the slow roll-out of the capital program meant to transform rail travel". She admits that the business is broken and near total collapse. Talk about an understatement.

After having read this you can decide whether or not I am exaggerating. Remember this is only one SoE – there are plenty more in a similar, or worse, state. This is where our taxes are going and how they are being "spent". I ask my question again: so who are you going to vote for?

Eastern Scheldt storm barrier, Netherlands



Instagram handle: @dailyoverview

File 13 – Information almost worth knowing

Investors are at risk of losing sight of the Big Picture by getting caught up in the details and getting confused by everyday noise. By way of example, the market cap (size) of Visa and MasterCard has reached just over $500bn in total. A bit more surprising is the market cap of European banks versus these two stocks: 26 European banks have the same market cap as these two US stocks. For explanatory sake, assuming this current ratio was 1, this ratio has declined by 21% per annum since 2008, bringing the total decline in the relative market cap of European banks against MasterCard and Visa to an astonishing 93% since 2008. For the record, Visa is one of the larger holdings in our global equity portfolios.

How big is big?

The market has been salivating for some time now over the listing of the Saudi Arabian national oil company, Saudi Aramco. In what must be regarded as a trial run, the company recently issued $12bn of bonds for the first time – it had originally only planned to sell $10bn.

There were a couple of interesting aspects about the issue:

- Demand for the issue was said to exceed $100bn
- The actual pricing of the bonds was done at an interest rate (yield) lower i.e. better than the actual yield on the Saudi Arabian sovereign bond. It is highly unusual to have this occur
- The duration of the bonds was spread between 3 and 30 years. The 10-year bond was issued at a rate of 1.05% higher than the comparable 10-year US bond (around 3.5%), which was 0.12% lower than the comparable sovereign bond yield

- The company recently publicized its profits, ahead of a potential listing. It made an astonishing $111bn in profits last year. To place that in perspective, Apple's profit last year was "only" 59.4bn, and ExxonMobil, the US oil giant, made $20.8bn
- Saudi Aramco produces and sells 10m barrels of oil each day

So think of these things when next you fill up your take with petrol, and pay for it in rand terms.

So what's with the pics?

In recent months, I have become a great fan of Instagram, which is unsurprising, given my fondness for photographs and things visual. Instagram doesn't lend itself to sharing much of the beautiful photos that appear on it from users around the globe, other than on the Instagram platform itself.

Camel in the United Arab Emirates

Instagram handle: @abstractaerialart

That said, I have created folders compiled along thematic lines. The photos that appear in this edition – taken from my Aerial folder – have all been lifted from Instagram. Inevitably, using this approach, some quality is lost along the way, but I hope the photographs are of sufficient quality for you to still enjoy them.

Tyre sorting, Kwinana Beach, Australia

Instagram handle: @dailyoverview