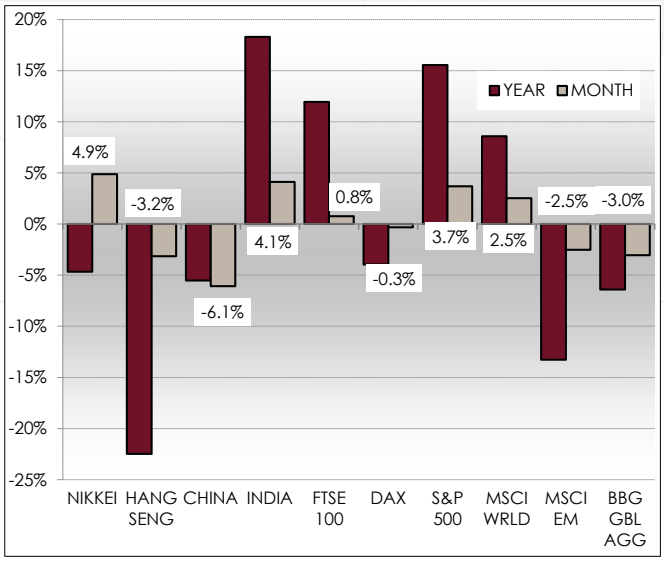
March in perspective – global markets

There is a sense of over-riding sadness and despair as I begin writing this edition. The photos of the massacre at Bucha, in Ukraine, have just come to light. I have no doubt there are more such instances of cold-blooded murder and evil in many places in that country that the rest of the world has yet to see. The devastation unleashed on Ukraine by Russia, completely unprovoked, and the heinous crimes against innocent people, orchestrated by a despotic lunatic, is at times hard to take on board, let alone observe. Like me, I am sure you wonder how, in this age of supposed intelligence and global camaraderie, we could even arrive at what is now a living hell for so many innocent Ukrainians, while the world looks on, aghast, with little material help or support for those suffering. It is the worst nightmare that has just become reality.

Chart 1: Global returns to 31 March 2022



With no disrespect to those who have lost everything, even their lives, investors will know that when there is such extreme socio-political dislocation, there is always loss evident across investment markets. As is often the case, the headline index movements during March belie the significant underlying volatility experienced during the month. For example, the US equity market ended March up 3.7%, but was down 4.7% at the intra-month trough. The German equity market ended down 0.3%, but was 11.3% lower at its intra-month trough. The MSCI World index rose 2.5%, while the MSCI Emerging Market index lost 2.5%; developing countries always suffer more during times of economic distress.

Movements of sovereign equity markets were large and extreme, as were the movements in certain commodity markets, particularly those where Russian or Ukraine feature highly as significant providers of those commodities. Oil is an obvious affected commodity, with the price of Brent crude oil rising 9.7%, though it had been up as much as 42.5% intra-month. Palladium is another affected metal; it declined 2.8% on the month although it did rise 23.2% in January. The price of nickel rose 33.0% - that alone hides a tumultuous month (you can read more about it in the March edition of *Intermezzo*, by clicking here); its price has risen 99.3% during the past year.

As though the Russian invasion of Ukraine wasn't enough, the Chinese authorities are waging their own war on the Covid-19 virus. Many large cities have gone into full lockdown mode. That will have a devastating effect on Chinese growth at the very time that it was slowing in any event. The Chinese equity market lost 6.1% during March, and the Hong Kong market lost 3.2%.

Another "war" so to speak that is being waged is against inflation. Even prior to the Russian invasion of Ukraine, global supply chain problems, caused by the Covid pandemic and exacerbated by unexpectedly strong underlying demand, together with a sharply higher oil price,

were having a direct and large impact on inflation. Sharply higher inflation rates around the world have cast doubt over the status of the inflationary surge, which was initially thought to be "transitory". Not surprisingly, this caught the attention of central banks around the world who are now undoing the loose monetary policy implemented during the pandemic, and replacing it with tighter policy in the form of higher interest rates. This had a dramatic effect on global bond markets, which posted one of their worst monthly returns on record. The Bloomberg Global Aggregated Bond index lost 3.1% in March, and has lost 6.2% so far this year.

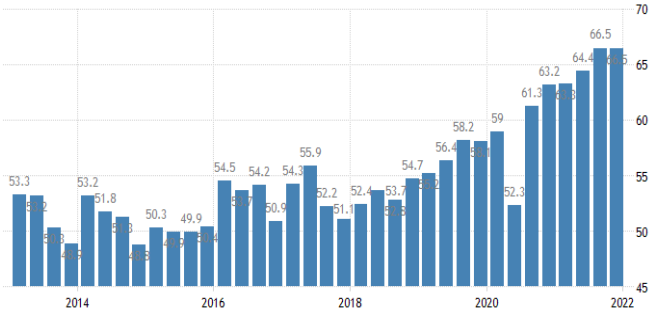
There are many other unusual market movements to report, such as the 14.8% rise in the Turkish equity market, or the 6.1% rise in the Brazilian equity market, bringing its year-to-date gain to 14.4%. Add to that the appreciation of the Brazilian *real* of 17.4% over the same period, and one lands up with a 34.3% return from Brazilian equities in dollar terms so far this year. This places the SA equity market's 19.9% year-to-date i.e. three-month return in dollar terms into perspective. The common feature is that both markets, and economies for that matter, are reliant on commodity exports for their well-being. With commodity prices firm, particularly base metals such as iron ore, which has risen 25.1% so far this year, it is unsurprising to see strong gains from these two respective markets. The 9.0% gain in the Russian equity market is also worth noting, but given the sanctions against that country and the world's attempts to isolate it from global capital markets, one wonders how authentic or relevant that market is. The Russian RTS index is down 30.9% so far this year and down 36.0% during the past year, despite the strong oil price (up 67.5% during the past year), which is a key driver of that index.

What's on our radar screen?

Here is a summary of the things we have been keeping an eye on:

- *The SA economy:* Evidence of the moribund SA economy continues to grow. The manufacturing sector grew just 0.2% in the year to February, with output declining by 1.1% from the previous month. The trade *surplus* widened to R10.6bn due to ongoing strength in commodity prices; commodities constitute a large portion of SA's exports. It is worth recalling that the trade *deficit* troughed in 2013 at R241.0bn, at which stage it constituted 5.8% of GDP.

Chart 2: SA youth unemployment rate (%)



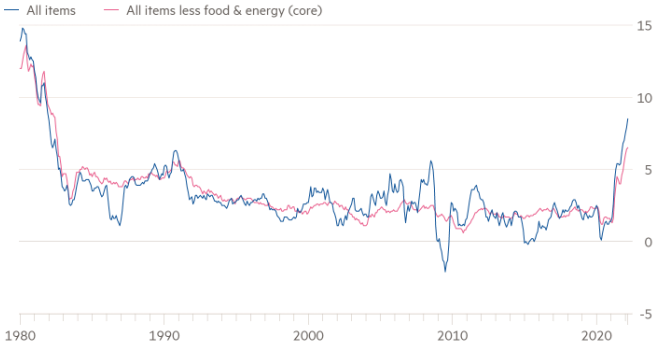
Source: Tradingeconomics.com

South Africa's unemployment rate rose to 35.3% in the December quarter (Q4), up slightly from 34.9% during Q3 of 2021. Youth

unemployment rose to an astonishing rate of 65.5%. This rate has risen steadily since Q4 of 2018, when it was 51.1% - refer to Chart 2. If one includes those who are discouraged and given up looking for a job, the unemployment rate rises to 46.2%. In case the numbers are lost on you, let's put it in simple terms: of the country's citizens capable of working, so excluding scholars and children, *nearly one in two people in this country are unemployed*. So much for all the talk about of job creation and youth employment on the part of government. The manufacturing sector shed 85 000 jobs during the December quarter, and the construction sector 25 000. Headline inflation rose from 5.7% in February to 5.9% in March, with prices rising 1.0% on a month-on-month basis. Core inflation rose 4.2%. The transport component of headline inflation rose 15.7% during the past year, a component of which, namely fuel prices, rose no less than 33.2% - and we know there are more price hikes to come in the coming months. Food prices rose 6.2% in the past year, down from 6.4% in February.

- *US economy:* The focus of all global investors at present is primarily on one aspect, namely inflation, and mostly US inflation for that matter. It remains the poster child of the world in terms of the peak it may rise to, as well as the remedial action the US Federal Reserve (the Fed) will implement. US Headline inflation rose to 8.5% in March, from 7.9% in February, its highest rate since 1981 (Chart 3). Core inflation i.e. excluding food and energy prices, rose to 6.5% (6.4% in February).

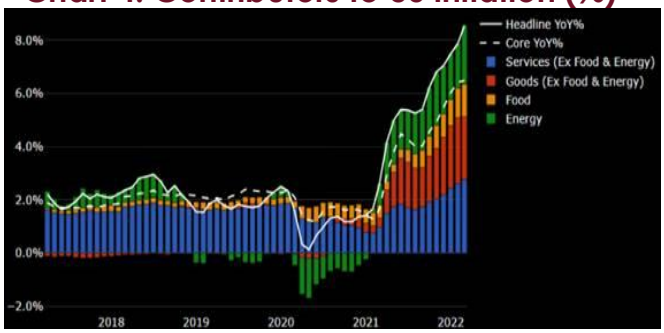
Chart 3: US headline and core inflation (%)



Source: FT.com

Chart 4 provides a useful breakdown of the major factors driving prices higher. Unsurprisingly, energy costs have been a major contributor in this regard.

Chart 4: Contributors to US inflation (%)



Source: Baader Bank

Recent high levels of US inflation make the Fed's official interest rate of "between 0.25% and 0.5%" look rather stupid, but of course markets are discounting the extent of future interest rate hikes by the Fed. This can be seen in the sharp rise in the yield (interest rate) of the 10-year government bond. Its upward trajectory has caused more than a few jitters in global equity markets. Apart from global supply constraints (caused by, inter alia, unexpectedly strong demand and pandemic-induced bottlenecks), and uncertainty caused by Russia's invasion of Ukraine, the sharp rise in US bond yields has

been the single largest handbrake on global equity markets in recent months. Chart 5 depicts just how sharply the US 10-year bond yield has risen since its trough of close to 0.5% in mid-2020.

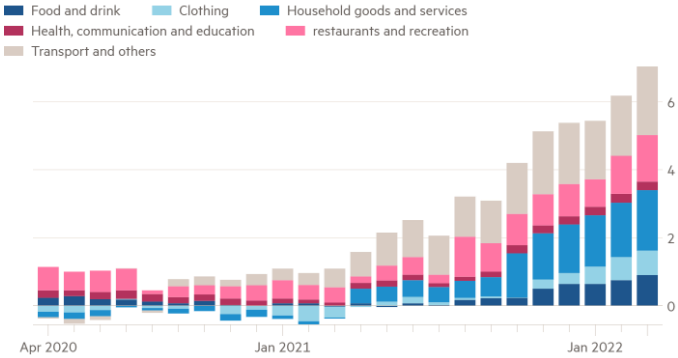
Chart 5: US 10-year bond yield (%)

Source: Tradingeconomics.com

Despite this singular focus on inflation, other metrics are being keenly watched to establish what pressures are building up in the economy which may or may not increase inflation even further. In many respects though, the US economy remains in reasonable shape; this is certainly true of the labour market, which is rapidly turning into a remarkable case of there being insufficient workers to fill an increasing number of job vacancies. Some 431 000 new jobs were created during March, and there were material (95 000) upward revisions to January and February's totals. The unemployment rate declined from 3.8% to 3.6%, while average hourly earnings rose 5.6% during the past year. The quantum of this increase points to pricing (inflationary) pressures building up in the economy.

- *Developed economies*: Norway's central bank increased interest rates by 0.25% to 0.75%. The March inflation reading in that country showed that prices increased at an annual rate of 4.5%, up from 3.7% in February. Inflation in the UK rose to a 30-year high of 7.0% in March, from 6.2% in February and *ten times higher* than the March 2021 rate of just 0.71%. Transport fuel rose at an annual rate of 30.7% during the past year, reflecting the surge in energy prices following Russia's invasion of Ukraine. Chart 6 provides a breakdown of the major factors constituting the UK inflation basket.

Chart 6: Contributors to UK inflation (%)



Source: FT.com

The central bank of New Zealand raised their official interest rate by 0.5% to 1.5%. At its previous meeting on February 23, the bank raised rates by 0.25% but warned that higher rates were on their way. New Zealand's inflation rate rose to 5.9% during Q4 of 2021.

- *Emerging economies*: Mexico's central bank increased the interest rate by 0.5% to 6.5%, following similar hikes in December and February. Mexico's inflation rate rose to 7.5% in March, from 7.3% in February. The bank also increased its core inflation forecasts for 2022 and 2023. In the same region, the central banks of Chile and Colombia continued their tightening cycle. Chile's central bank raised its rate by 1.5% to 7.0%, while the central bank of Colombia raised its rate 1.0% to 5.0%. The

Chile bank forecast a 2022 growth economic rate of only 1.0% to 2.0%, while it forecast a contraction in 2023 of between 0.25% and 0.75%. It forecast an average 2022 inflation rate of 5.6%. Headline inflation in Chile came in at 9.0% in March, from 7.7% in February, while core inflation was 7.4%. Colombia's March headline inflation rate was 8.4%, with core inflation coming in at 6.9%.

Turkey's headline inflation rate accelerated from 54.4% in March to 61.1% in March, registering a 5.5% monthly jump. The transport component rose by 25.8% month-on-month and 192.0% on an annual basis! About one fifth of March's inflation increase came from food, which has risen 70.3% during the past year.

Finally, turning to China, headline inflation rose to 1.5% in March, having remained at 0.9% during the prior two months. After having risen 4.0% in Q4 of 2021, the Chinese economy grew 4.8% in Q1, which was more than expected. It rose 1.3% on a quarter-on-quarter basis. Retail sale declined on an annual basis by 3.5% in March, and unemployment rose to 5.8%, its highest level since May 2020. These indicators are starting to reflect the drastic lockdown measures the Chinese authorities have imposed in recent weeks. At the time of writing, some 40 cities, responsible for about 45% of China's GDP, are under partial or complete lockdown. So these data are likely to get worse before getting better. On a more positive note, industrial production and fixed asset investment rose 5.0% and 9.3% respectively during the March quarter, when compared to a year earlier. The current property crisis in China is acting as a brake on the economy, with housing starts (-20%), steel (-6.0%) and cement (-12%) down sharply during the first quarter compared to a year ago. In response, the authorities lowered the reserve ratio requirement (RRR) by 0.25% in an attempt to inject liquidity into the system.

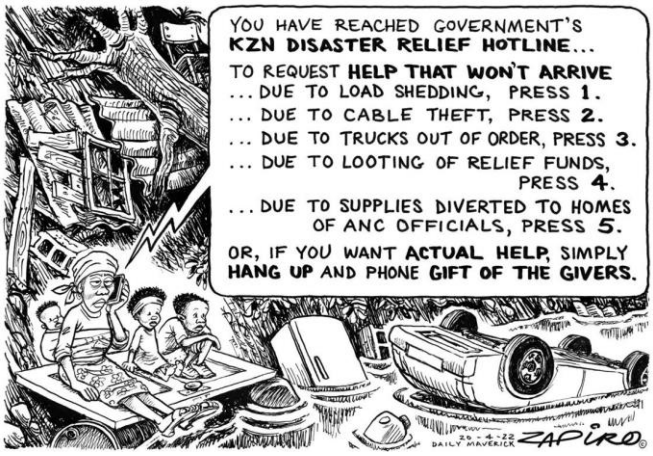
The world is changing – investors take note

During the course of many discussions with clients the conversation inevitably turns to how profoundly the world (for that, read "global investment environment") is changing, and how rapid that change is occurring. The changes are material and will alter the way nations engage with each other in the years to come. The world as we knew it only five years ago, just doesn't exist anymore. Investment managers and investors alike need to take urgent note of these changes and their subsequent consequences. It is fair to say we are living through an historic inflection point in world history, which is already having profound and long-lasting changes on investment markets around the world.

One over-riding change is that the era of globalization, and all the benefits it brought, many of which were not that apparent to the lay

person, has come to an end. Most of the change will be felt and become apparent when prices start escalating more than expected. Another profound change is that the entire global supply chain, which brought enormous efficiencies to everyone, and which was inherently deflationary, has been shaken to the core. While the end result is not too clear yet, you can rest assured that the net result will be inflationary. Not surprisingly then, global attention is keenly focussed on inflation, which has risen strongly around the world; its rate of acceleration having been increased even further as a result of Russia's invasion of Ukraine.

In recent weeks, a lot has been written on these topics. I would like to share extracts from three articles with you, as they describe some of the changes far better than I could. Our thinking is largely reflected in these articles.



Change: China is investable, but not core

The first article is by *Julius Bär Group Chief Investment Officer Yves Bonzon*. On 30 March he wrote as follows:

"From diversification benefit to confiscation risk
It would be hard to overstate the geopolitical, economic, and financial ramifications of the Russian invasion of Ukraine on 24 February 2022. The war itself is already a large enough shock, but the strong rallying of Western governments and their corporate sectors behind measures intended to punish Russia's government is completely unprecedented. Not only are Europe and its allies implementing sanctions that may cause substantial damage to themselves, but private companies are voluntarily pulling out of the Russian market, irrespective of restrictions. This signals a strong shift in US and European geopolitical and economic strategies going forward, allocating major resources to ensure independence from countries outside their sphere of influence. This includes further 'weaponisation' of financial, trade, and business relations as well as the diversification and onshoring of key resources – most critically, in the areas of energy, food, defence, and technology. These swords of Damocles hang dangerously over the Chinese economy and its capital markets. Indeed, not only is the Middle Kingdom arguably the biggest winner of the globalisation and 'financialisation' trends of the neoliberal era, but the stakes of a strategic confrontation with the US have just become much higher, as, besides the increased risk of an escalation with regards to Taiwan, the extent of China's support of the Russian invasion remains uncertain.

"China – no longer a core asset
It is unclear how China's relations with the West will evolve in the coming months and years, but we already know that investor capital is at risk not only of derating due to increased regulation by the Chinese government but also of impairment as a consequence of Western sanctions should diplomatic relations turn sour. This has a major impact on the role of China as an asset class in investors' portfolios, for any strategic diversification comes at the cost of having the investment's value marked down hard by

Western politicians and regulators. In light of this, we have decided to update our Secular Outlook and put an end to our five-year-old call on Chinese equities rising to core asset class status. Going forward, we do not see the asset class as occupying a stand-alone, dedicated allocation within our strategic grids. Instead, we believe its investment case is best described as belonging to the larger Asia-excluding-Japan complex. In short, the Chinese equity market remains investable but does not warrant a specific strategic allocation due to expected higher returns or better diversification characteristics. This, however, does not exclude the possibility that future tactical or thematic opportunities could be taken within the Chinese market".

Change: Ukraine war heralds a new regime

The second article is also by *Julius Bär Group Chief Investment Officer Yves Bonzon*. On 14 April he wrote the following:

"The end of the Peace Dividend

Russia's decision to attack Ukraine on 24 February 2022 has ushered in a new era with a radically different investment environment than the one that characterised the last four decades. After the advent of neoliberalism in the early 1980s, economic and financial criteria largely dominated the choices of our governments. This was particularly true as of 1990, following the collapse of the Soviet Union. By the end of 2019, we envisioned the transition to state-sponsored capitalism under the political pressure to address record inequality in the West and the challenges of climate change. The Covid-19 pandemic already accelerated this transition. The war in Ukraine has plunged us into a new era where political criteria now largely prevail over economic criteria.

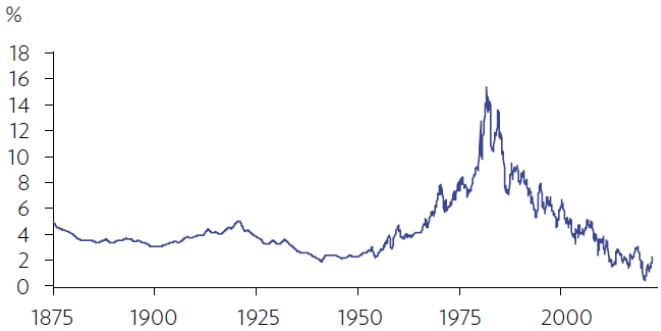
"During the last 30 years, the West benefited from peace. This allowed us to optimise our economies by delegating capital-intensive, low valued-added or environmentally damaging activities to other countries. The most successful example is Europe. It outsourced its defence and technology to the US, its energy supply to Russia, and its manufacturing to China. The result was an era with an abundance of labour, capital, raw materials, goods, and services. In this context of abundant supply, central banks only had to intervene when there was an external shock to demand, as in March 2020 (Covid-19) or in 2008 (the Great Financial Crisis). This world vanished on 24 February 2022. Since then, the US and Europe have become aware of their dependence on countries whose regimes may prove hostile to liberalism and democracy. The reaction function of central banks has therefore changed. On 16 March, the US Federal Reserve raised interest rates for the first time amid an external shock. Given that the economy is facing a supply shock – rather than a demand shock – the central bank needs to normalise its monetary policy despite the uncertainty about the consequences of the war in Ukraine, especially regarding the supply of key commodities, including energy and food.

"Political considerations take precedence over economic considerations.

Since the beginning of my career in 1986, I have always consciously ignored political aspects. They did not play an important role in the investment process, as the world was governed by economic and financial logic. Today, this is no longer the case. Paradoxically, in a world governed by political imperatives, one must tactically ignore them, as one cannot predict them, but take them into account strategically. In recent events, we were certainly surprised by the Russian president's gamble. However, above all, it is the speed and scope of Western sanctions that astonished us. In a context of increasing bifurcation between the US and China (whose position on Ukraine is ambiguous), the question now arises of the risk of sanctions by the governments and regulatory authorities of the countries in which we invest. In the case of Russia, it is the sanctions that have caused the bulk of the mark-to-market losses observed since the start of the conflict, more than the conflict itself. The financial system is now directly involved, and we are facing a radically different investment environment.

"The shift to strategic political rather than economic priorities will lead to many activities being relocated to the developed countries. Supply chains will be redesigned, and the rise in fossil fuel prices and the security of their sources will accelerate the move towards renewable energy. The great era of globalisation with its optimised allocation of resources and capital is giving way to much stronger local investment. Living standards, especially in Europe, will be affected. Governments will have to alleviate the cost-of-living shock through wider, systematic transfers to the poorest households. The interest-rate market has begun to discount the medium-term effects of these structural shifts. For the first time, we can say with relative certainty that long-term yields bottomed out in March 2020 (0.31% on 10-year US Treasury bonds). The great secular bull market in bonds is well and truly over.

Chart 7: 10-year US Treasury bond yield (%)



Source: Julius Bär

"Market Outlook

Nevertheless, we believe that the recovery in yields will be gradual, as in the last secular bear market in bonds (1950–1981). There are many reasons for this: record debt, technological progress, and the cyclical effects of changes in the price of financial and real estate assets. Beyond the very short term, we will lose money on bonds in real terms, but not in nominal terms, as was the case recently. This environment will be structurally favourable for equities, which are set to benefit from higher nominal economic growth than in the last 20 years.

We started the second quarter with a neutral equity position... In the fixed income space, we currently have a neutral duration and are overweight in credit, diversified between investment-grade bonds, high-yield bonds, emerging market hard-currency bonds, and subordinated bank debt. On the other hand, we significantly reduced our Chinese assets, first by exiting renminbi government bonds and then by strategically reducing our allocation to Chinese equities in favour of Asian equities outside Japan.

"ESG in times of war

In his famous 1970 essay Milton Friedman proclaimed that a company's social responsibility is to increase its profits. While already controversial at the time, some market pundits recently declared the dogma as dead for good on its 50th anniversary. Indeed, the extent to which the corporate world has moved away from Friedman's shareholder doctrine has just been underscored again by the latest round of self-sanctioning related to the war in Ukraine. More than ever, companies are expected to take a moral stand on a wide range of societal and political issues. The unprecedented exodus of companies from Russia is a valuable lesson on environmental, social, and governance (ESG) investing. In fact, ESG measures have not proven helpful in identifying the erupting confrontation. Prior to the outbreak of the war, average ESG ratings for companies with extensive operations in Russia were higher than those of their peers without such exposure. Weeks later, most of the companies in the former group saw their market values collapse in record time. While the Ukraine war as a single event should not be considered as a universal litmus test for the usefulness of ESG, the demonstrated inability of ESG ratings to flag looming tail risks is certainly not a selling point and relentlessly exposes some of the flaws in the system.

"In essence, investors face a triple whammy when it comes to ESG, having to first reach consensus on what to measure, second on how to measure it, and last on how to weigh performance on individual ESG aspects to obtain an overall rating. To make matters worse, there appears to be substantial elasticity in the system. For instance, voices have been heard advocating for arms producers to be reclassified as sustainable provided that the supplies are made available for the defence of the Ukrainian population. Again, this shows that ESG can be a subjective concept, not to say one that is considerably bendable depending on the context and intended use. Recently, the US Securities and Exchange Commission released a long-awaited proposal on climate-related disclosures to promote transparency for investors. Nevertheless, we expect the lack of market consensus on ESG topics to persist, as key aspects, especially in the social and governance spheres, are difficult to quantify.

"Most importantly, investors need to grasp that ESG is not about achieving a systematic outperformance. By definition, an investment portfolio based on a constrained investment universe will, at best, achieve the risk-return profile of an investment portfolio that can access an unconstrained universe. In fact, the merits of

ESG lie elsewhere in our view, namely that it can be a useful tool for investors to express their values in portfolios and hence derive additional non-monetary benefits from investment activity".

Change: Changing global supply chains

The third article was written on 26 March by *Harriet Agnew of the Financial Times*, and deals with some aspects of the global supply chain. This is a complex, multi-facetted issue, but the article lays bare some of the profound changes at hand.

"Investors bet Ukraine war will prompt companies to bring production onshore

Big investors are betting that the war in Ukraine will prompt companies to pull production closer to home in a significant reshaping of global supply chains.

"For decades, broad investment themes have gelled around the idea that cheap offshore manufacturing and slick global supply chains can hold down costs for companies and foster low inflation. But the war, with its impact on commodities supplies on top of revulsion at doing business with Russia, has accelerated a rethink.

"'The Russian invasion of Ukraine has put an end to the globalisation we have experienced over the last three decades,' Larry Fink, chief executive of BlackRock, the world's largest asset manager, wrote in his annual letter to shareholders this week. 'A large-scale reorientation of supply chains will inherently be inflationary,' he added.

"Fink is not alone in raising this issue in recent days. Howard Marks, co-founder of distressed debt investor Oaktree Capital Management, also warned in a Financial Times article this week that the pendulum of globalisation is swinging back towards local sourcing. Offshoring 'makes countries and companies dependent on their positive relations with foreign nations and the efficiency of our transportation system', he said.

"The past three decades marked a period of rampant globalisation as companies slashed costs by moving large parts of their production offshore and using cheap labour. That has helped to keep price pressures low and helped enable central banks to hold down interest rates, boosting investment in risky assets. But this is now creaking.

"'The Ukraine war is part of a pattern of supply chain disruptions getting more frequent and more severe,' said Dan Swan, co-lead of McKinsey's operations practice, pointing to the trade war between the US and China, the blockage of the Suez Canal last year, and the coronavirus pandemic.

"All of these have focused attention on supply chain sovereignty and domestic production facilities. Surging demand for semiconductors during the pandemic exposed how the US and Europe's share of global semiconductor

production had decreased from roughly 80% in 1990 to only 20% in 2020 and has prompted big investments in US semiconductor production.

"At the same time the war in Ukraine has highlighted the dangers of Europe's dependence on Russian energy exports, particularly natural gas. Prices for gas in Europe, used in everything from heavy industry to heating homes, surged to record highs in recent weeks on concerns that Russia could reduce supplies in response to western sanctions. This has ramped up pressure to accelerate investments in renewable energy.

"Germany on Friday vowed to all but wean itself off Russian gas by mid-2024 and said it aimed to become 'virtually independent' of Russian oil by the end of this year. The US has already blocked Russian oil imports, while the UK expects to do so by the end of 2022 — factors that have helped send crude oil prices surging well above $100 a barrel.

"'The three mega trends that have helped companies to generate tremendous profits over the last 30 years, namely the trend on long-term nominal interest rates, the trend on corporate tax rates and globalisation, are reversing simultaneously," said Thomas Friedberger, deputy chief executive at Tikehau Capital, a €34.3bn alternative asset manager.

"'We need to learn to invest again in an inflationary environment,' he said. 'It's injecting dispersion into asset prices, compressing multiples and putting pressure on corporate profits. It can only be overcome by asset managers positioning themselves to take advantage of these mega trends: energy transition, cyber security and digitalisation. It's going to be a much trickier environment for investors.'

"It all also opens up opportunities for fund managers, however. 'There will be a lot of opportunities for stock pickers because there will be a lot of fragmentation within sectors,' said Monica Defend, head of the Amundi Institute. She pointed to the energy and defence sectors where there is both a political and economic need to pursue 'strategic autonomy'.

"Virginie Maisonneuve, global CIO equity at Allianz Global Investors, said the shift would drive innovation, for instance in linking renewable energy with artificial intelligence to enhance efficiency. 'While on the surface it looks very inflationary, it's sector by sector and you have to look at it with the overall costs and the policies that go with them, which include fiscal policies or special advantageous policies,' she said. The use of AI, for example, could push down costs.

"Tikehau's Friedberger said that, ultimately, de-globalisation represented an opportunity to build a more sustainable economic model. 'This very globalised economic model where companies and governments and economists were looking for infinite short-term growth at any cost to justify high levels of debt and high levels of valuations doesn't work,' he said. 'It has an impact on climate, on biodiversity, on social inequalities. The

fact that those crises force us to try and build a more sustainable economic model is definitely not necessarily bad news for the world.'

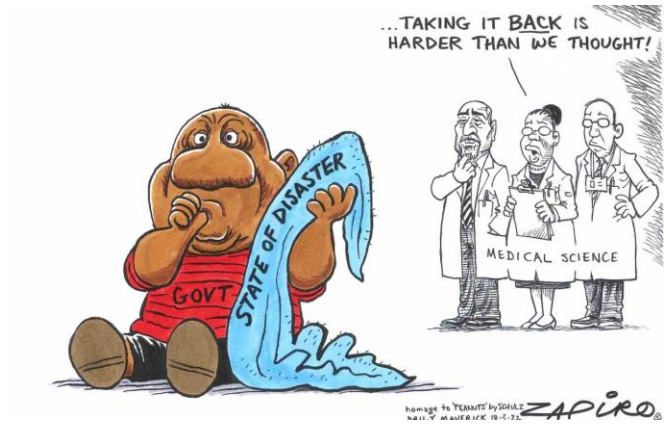
Quotes of the month

Only 2m more Bitcoins to be mined?

From *Julius Bär* comes the following comment on Bitcoin: "Over the weekend, the Bitcoin1 network has reached a major milestone as the 19th million coin was mined. With the total supply of Bitcoins capped at 21m, this only leaves 2m more to be mined. As supply growth constantly decelerates due to a pre-programmed halving of the block rewards, the next of which will likely occur in 2024, the last coin will most likely be only mined in 2140.

"Many supporters see this pre-programmed supply scarcity as a key factor underpinning Bitcoin's store of value function. While this is conceptually sound and is also the case for other scarce real assets such as prime property, it does not hold for currencies. The Swiss franc is a case in point. While it is widely considered a store of value, the growth of currency in circulation has accelerated from 6% per year between 2000 and 2010 to more than 20% per year since then. Nevertheless, the franc has appreciated significantly versus almost all major currencies over that period. The picture looks of course different from the perspective of investors in some emerging market countries, who might be facing structurally high levels of inflation, structurally weak currencies, and little trust in local authorities. In such countries, the case for Bitcoin or other digital assets may be much clearer than for example in Switzerland.

"Bitcoin's supply scarcity also allows us to draw parallels to gold, not least because the demand for Bitcoin does not depend on economic activity. While we share the view that conceptually Bitcoin could become a form of 'digital gold' at some point in the future, practically it currently does not demonstrate the same safe-haven characteristics. Most importantly, thus far Bitcoin has not served as a store of value in times of risk aversion in financial markets as it often suffered much more than equities. For now, Bitcoin remains very much a 'risk-on' asset. However, we believe this could change as investor adoption and sophistication grows over time. In short, we believe Bitcoin's potential long-term bull case relates much more to growing demand than constrained supply."



At the time of writing the above comment (6 April), the total market capitalization was given as $2.17trn, which represented 1.38% of financial assets. The top five coins by market cap were Bitcoin at $854bn, Ethereum $399bn, Tether $82.4bn, Binance Coin $73.4bn and USD Coin, at $51.3bn.

Charts of the month

Earlier in our market comment we referred to the intra-month volatility of equity markets. It is hard to appreciate this if you don't follow markets on a daily basis. However, Baader Bank produced a chart (refer to Chart 8) that placed that volatility into perspective. Despite the significant decline in prices, at times during the month of March it

seemed like one was in a bull market. Baader Bank wrote the following on 30 March, which places the strong two-week market gain into the perspective of a bigger picture market decline.

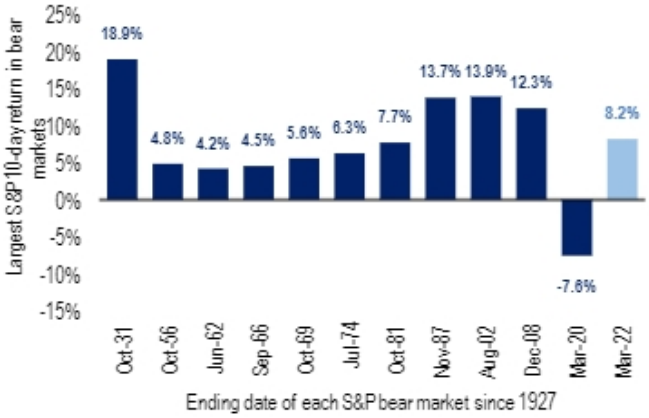
"The 11% surge in US stocks in the past two weeks has the hallmarks of a bear-market rally that might give way to deeper losses. That's the conclusion of analysts at Bank of America (BoA), who say warning signs are flashing for a market that has climbed 'despite clearly weaker fundamentals,' including a Federal Reserve bent on raising rates sharply this year to battle persistent inflation.

"The strategists caution that the sell-off that took the S&P500 12% off its January record is not over and sharp rallies are typical of volatility in bear markets, with some of the biggest on record occurring in the throes of the dot-com meltdown and the global financial crisis. A closely watched Treasury market metric flashed a recession warning Tuesday, adding to worries a restrictive Fed will damage the economy. 'The worsening macro backdrop and market-unfriendly Fed make sustained U.S. equity gains unlikely,' BoA wrote. The Fed isn't likely to come to the market's rescue at any point and, in fact, the central bank is welcoming of tighter financial conditions to aid its battle against inflation. 'In practice, this means lower risk assets.'

"For now, investors aren't heeding any warnings. The S&P500 jumped 1.2% Tuesday for its 9th gain in 11 sessions, even as the yield on two-year Treasuries popped above the 10-year rate for the first time since 2019. But 10-day stretches of big gains have been common in bear markets. There were four that exceeded the 10-day rally of 10% through Monday in 11 bear markets since 1927, the BofA strategists wrote".

Chart 8: 10-day S&P500 bear market returns

Largest 10-day returns during bear markets since 1927

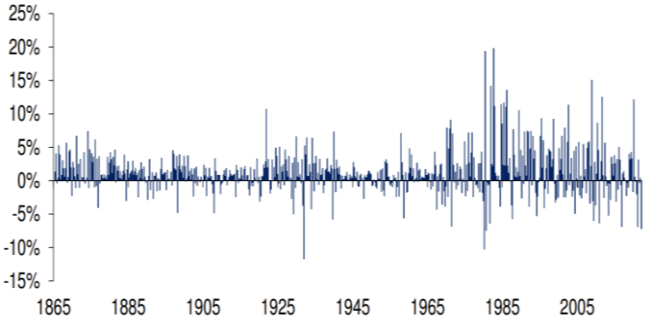


Source: Baader Bank

A torrid March quarter for global bond investors

I have already alluded to the terrible returns global bonds produced in the first quarter of this year. Chart 9 depicts the quarterly returns from 10-year US bonds since the US Civil War, from which it can be seen that US 10-year bonds have only seen a worst total return quarter in the early 1980s and in Q4 1931 after passing the peak of the Depression-based rally.

Chart 9: US 10-year bonds quarterly returns



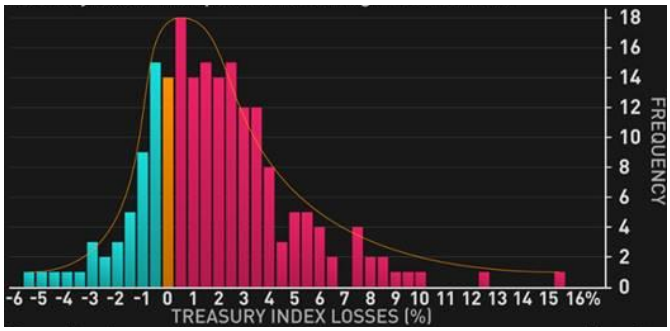
Source: Deutsche Bank

More on the bad bond market in Q1

Chart 10 depicts the same story, but in a different way. It depicts US Treasury losses as a normal distribution. Bloomberg's Treasury Index incurred a loss of 5.9% since the start of the year, the worst return in nearly 50 years. That represented a 2.5

standard deviation move to the left – in itself an extreme probability in a normal distribution.

Chart 10: Treasury losses the highest since 1973

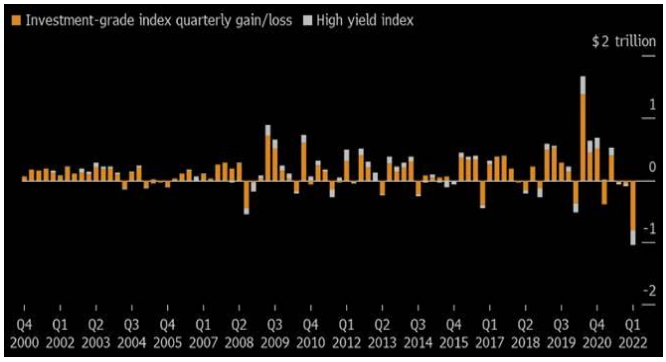


Source: Baader Bank

Not much better in the corporate bond market

Corporate bond market returns were not much better than government bond returns during Q1, as shown in Chart 11. The dollar value of the world's corporate bond market shrank by about $1tn for the first time on record during Q1 as war, inflation and concerns of an economic slowdown hit investors from all angles. The losses – the worst since the global financial crisis for high-grade bonds and since the early pandemic turmoil for junk bonds – are accentuated by the market's growing size in recent years as companies raised new debt at low rates.

Chart 11: Global credit indices shed $1tn in Q1



Source: Baader Bank

Q1 2022: Bad for bonds, great for the rand

The March quarter was an awful one for global bonds, but a great one for emerging currencies, and the rand in particular. As it happens, the rand was the second best performing emerging market currency in the world in 2022, as the chart below shows.

Chart 12: Emerging market currency returns

1 January to 24 March 2022

Source: Ninety One

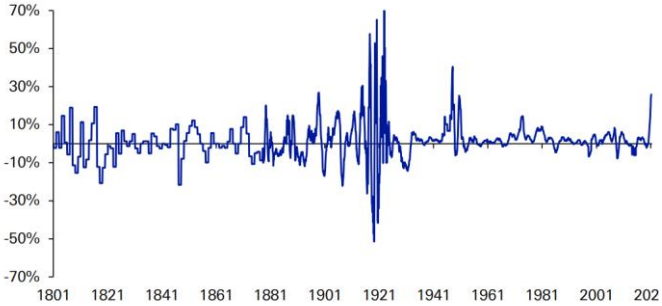
Inflation, inflation, inflation – all around

All investors' eyes are on inflation at present. Major developed economies such as the US grab the most attention, but it would be wrong to think only the US has an "inflation problem". Truth be told, rising inflation is now a problem in most countries around the world, especially in Europe, where energy prices have gone ballistic, especially since the Russian invasion of Ukraine.

Let us consider Germany, for example. German producer price inflation (PPI) rose at an annual rate of 30.9% in March (Chart 13), from February's 25.9% rise. The detail in the data is quite alarming. The figures reflect the effects of the war in Ukraine for the first time, with energy prices remaining the biggest contributor (reflecting an 83.8% annual increase), comprising distribution of natural gas (144.8%), electricity (85.1%), and mineral oil products (61.3%). Excluding energy, the annual

increase in producer prices would have been "only" 14%. Other significant price increases were seen for intermediate goods (23.3%), comprising metals (39.7%), fertilisers and nitrogen compounds (+87.2%), and wooden containers (68.8%); non-durable consumer goods (9.6%); and food (12.2%). The monthly increase in producer prices was 4.9%. The annual increase of 30.9% was the highest since World War II; let's remind ourselves that only a year ago, German producer price inflation was under 2.0%!

Chart 13: German annual PPI (%)



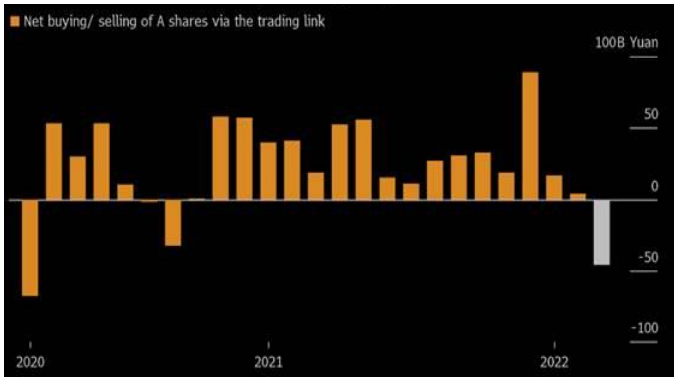
Source: Deutsche Bank

Foreigner investors are starting to leave China

China has not been kind to foreign investors – and that is putting it mildly. Maestro's 2021 returns were poor, largely because, with the benefit of hindsight, we had too many of our assets invested in Chinese companies. We sold them down during the second quarter of 2021, but that hasn't stopped Chinese markets from declining even further. Even at the time of writing, Chinese markets remain weak and investor-unfriendly. Whether or not China has become "un-investable" for foreign investors will be decided in the years to come, but for now it seems most foreigners are heading for the exits.

As Chart 14 shows, March saw a rare monthly outflow by foreign investors of "A" shares i.e. shares listed on mainland Chinese bourses. Global funds offloaded $7.1bn (45bn yuan) of China A shares as regulatory jitters, Covid lockdowns and geopolitical risk dampened sentiment. It marked the first monthly withdrawal by overseas investors since September 2020 and the largest outflow in two years.

Chart 14: Foreign investors leaving China



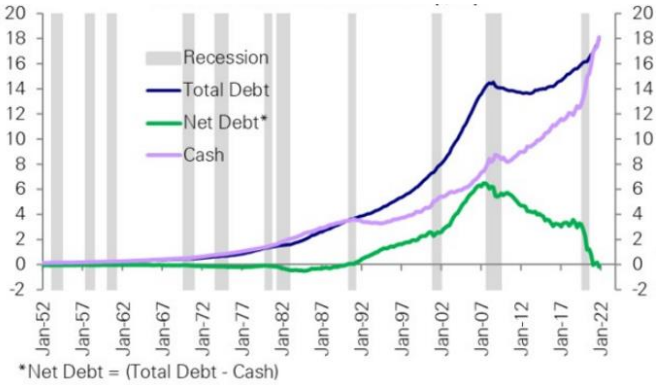
Source: Baader Bank

Good news: the US has plenty left in the tank

Let us turn to some good news now. I recall how, in years past, we highlighted the US consumer as over-indebted, facing a situation of ever-increasing debt. That said, it has never stopped the US consumer from spending an even greater amount. To be honest, most global investors owe more than a polite "thank you" to the US consumer; on a number of occasions in the past the US consumer has come to the rescue of the global economy, by enthusiastically exercising his and her innate propensity to spend.

Chart 15 shows that US household cash exceeds debt for the first time in three decades. Ironically, it seems as though the generous fiscal (government) transfers (subsidies, grants, etc) made during the Covid pandemic enabled the consumer to restore their balance sheet.

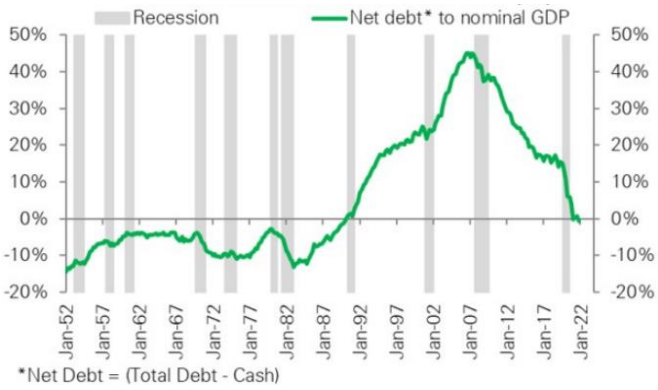
Chart 15: US Household debt and cash ($tn)



Source: Deutsche Bank

As the world economy heads into a precarious phase, brought on by the pandemic, supply chain bottlenecks, Russia's invasion of Ukraine and the resultant issues such as higher energy prices and inflation, global investors might again have to rely on US consumers' insatiable appetite to spend, and then spend some more. The good news is that US consumers are in a great position to do so – better than at any time during the past three decades. Here's hoping nothing else comes along, like a downturn in sentiment, or some geo-political issue, to deter him and her from spending.

Chart 16: US Household debt to GDP (%)



Source: Deutsche Bank

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**	**2.7%**	**3.2%**	**19.4%**
JSE All Share Index	*Mar*	*0.0%*	*3.8%*	*18.6%*
Morningstar sector ave	*Mar*	*0.9%*	*4.1%*	*17.8%*
Maestro Growth Fund	**Mar**	**0.2%**	**-1.9%**	**6.0%**
Fund Benchmark	*Mar*	*-0.4%*	*1.3%*	*14.2%*
Morningstar sector ave	*Mar*	*-0.5%*	*-1.2%*	*10.8%*
Maestro Balanced Fund	**Mar**	**0.0%**	**-1.9%**	**5.7%**
Fund Benchmark	*Mar*	*-0.4%*	*1.0%*	*12.7%*
Morningstar sector ave	*Mar*	*-0.3%*	*-1.1%*	*10.0%*
Maestro Global Balanced Fund	**Mar**	**-5.5%**	**-18.8%**	**-16.4%**
Benchmark	*Mar*	*-5.2%*	*-13.9%*	*1.4%*
*Sector average **	*Mar*	*-3.9%*	*-12.7%*	*0.6%*

* Morningstar Global Multi Asset Flexible Category

Notwithstanding the returns listed in Table 1, our longer-term returns for our investment solutions are listed in the table below. All returns are for periods to 31 March, and are taken from Morningstar's unit trust survey. Returns are shown on a net basis after all fees have been deducted.

Table 2: The Maestro Equity Prescient Fund

Morningstar (ASISA) South Africa Equity General - March 2022						
	3 mths	6 mths	1 year	3 years	5 years	10 years
Maestro Equity Prescient Fund	***3.2%***	***15.0%***	***19.3%***	***12.0%***	***5.2%***	***7.4%***
Maestro Equity Fund benchmark	-0.6%	13.9%	13.0%	11.8%	9.6%	12.4%
SA Peer Group Average	4.1%	13.7%	17.8%	11.5%	8.0%	9.5%
Maestro position within Group	97	63	55	60	101	56
Number of participants	168	167	166	146	120	66
Quartile	3rd	2nd	2nd	2nd	4th	4th

Table 3: The Maestro Growth Fund

Morningstar (ASISA) South Africa Multi-Asset High Equity - March 2022						
	3 mths	6 mths	1 year	3 years	5 years	10 years
Maestro Growth Fund	***-1.9%***	***4.2%***	***6.0%***	***7.3%***	***5.8%***	***7.5%***
Maestro Growth Fund benchmark	1.3%	12.2%	14.2%	12.0%	10.5%	11.0%
SA Peer Group Average	-1.2%	6.0%	10.8%	8.9%	7.2%	8.5%
Maestro position within Group	156	174	190	157	132	54
Number of participants	205	205	205	187	156	69
Quartile	4th	4th	4th	4th	4th	4th

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

Table 4: The Maestro Balanced Fund

Morningstar (ASISA) South Africa Multi-Asset Medium Equity - March 2022						
	3 mths	6 mths	1 year	3 years	5 years	10 years
Maestro Balanced Fund	***-1.9%***	***4.1%***	***5.7%***	***7.2%***	***5.2%***	***7.1%***
Maestro Balanced Fund benchmark	1.0%	10.4%	12.7%	11.1%	10.0%	10.4%
SA Peer Group Average	-1.1%	5.5%	10.0%	8.3%	7.0%	8.1%
Maestro position within Group	75	80	94	76	68	34
Number of participants	97	97	97	91	73	38
Quartile	4th	4th	4th	4th	4th	4th

Table 5: Maestro Global Balanced Fund

Morningstar (ASISA) Global Multi-Asset Flexible - March 2022						
	3 mths	6 mths	1 Year	3 Years	5 Years	10 years
Maestro Global Balanced Fund	***-18.8%***	***-12.3%***	***-16.4%***	***1.8%***	***N/A****	***N/A****
Global Balanced Fund benchmark	-13.8%	-4.6%	1.4%	8.6%	8.9%	12.5%
SA Peer Group Average	-12.7%	-4.8%	0.6%	7.6%	8.2%	11.5%
Maestro position within Group	44	44	43	28	N/A	N/A
Number of participants	45	45	44	30	22	13
Quartile	4th	4th	4th	4th	N/A	N/A

Obituary: Mimi Reinhard, 1915 - 2022

I am sure many of us have seen the movie Schindler's List. At the time it felt as though it took place so long ago. Who would ever have imagine that, in April 2022, we would again be staring at human tragedy *déjà vu* in a similar European region? There is a surreal air of about Russia's invasion of Ukraine, about the horror of war beaming into our living room or office; as though humanity has not learned anything from the two Great Wars. In the light of this, I felt the obituary of Mimi Reinhard, who recently died at the remarkable age of 107, was not only of interest, but also significant.

Around 1953, Mimi Reinhard was walking in Vienna when she was accosted by a figure she almost didn't recognize. She recalled: "We were passing a coffee house where there was a group of people sitting. This large man ran across and hugged and started kissing me, saying: 'Mimi, Mimi . . . '." His identity dawned on her. Nine years earlier, she had met him while she was enslaved as a secretary in Płaszów concentration camp – an encounter that would save her life and those of over 1 000 others. The man was Oskar Schindler. His companions in the café were a tiny segment of the 1,200 or so *Schindlerjuden* – Schindler's Jews – that the German industrialist had exhausted all his charm, connections and wealth to save from the death camps.

Reinhard, who has died in Israel at 107 years old, was another of them. Back in Płaszów in 1944, with the Red Army bearing down and the Holocaust entering a murderous fever pitch, Schindler had found a way to rescue some of the camp's prisoners from inevitable deportation to the gas chambers. A combination of charisma, bribes and luck had allowed him to convince both German officials and the camp's commandant, the cruel and capricious Amon Göth, that the prisoners who worked in Schindler's enamelware factory were indispensable to the war effort. They simply had to be withdrawn safely to the west, to a factory in Czechoslovakia.

Such a request entailed a mountain of bureaucracy. Schindler's handwritten list of "essential workers" needed to be replicated many times and meticulously, a job that fell to Reinhard. She had been given her administrative position owing to perfect German and impeccable shorthand, but her typing was basic. She would later recall, "I never learned to type . . . I typed with two fingers only." So, using just her index fingers, Reinhard diligently pecked out the lists of the saved: their numbers, names, birth dates, nationalities, and occupations.

It was a chance to escape. She would later speak modestly of her role: "I typed in my name and the names of my friends . . . They told me to type, so I typed." She became number 279 on the women's list of *Schindlerjuden*, her occupation listed as *Schreibkraft* – typist. Born on January 15 1915, in the Austrian city of Wiener Neustadt, Mimi Reinhard was originally named Carmen Koppel – her father Emil was a businessman whose opera enthusiasm led him to name his daughter after Bizet's heroine. She never took to it, and her father, sticking stubbornly to his theme, conceded to a switch to Mimi, from Puccini's *La Bohème*.

Before she became one of the millions caught up in the Holocaust, Reinhard was a student of philology at the University of Vienna. But it was a decision to master shorthand, which she called, "The only practical thing in my life that I learned", that would one day put her in a position to encounter Schindler and, ultimately, save her life and those of the other *Schindlerjuden*.

Reinhard experienced an eventful enough life even before the camp and typewriter, in the 10 years or so after her studies in Vienna. She married, had a son named Sasha, and settled down in Krakow. After the Nazi invasion of Poland, Sasha was smuggled to relatives in Hungary. Her first husband, Joseph Weitmann, was killed trying to escape the Krakow Ghetto; Reinhard herself was deported from the ghetto to Płaszów in 1942.

Typing her name on to Schindler's list did not ensure her salvation. The train that was to carry her and other rescued Jews was diverted from Schindler's munitions factory in the Sudetenland, to Auschwitz. Her memory of the camp was "straight out of Dante's Inferno". Schindler had to shed his legendary charm to secure their safety, threatening the camp administrators that he would report them if his workers weren't released. It worked: "Schindler's Jews" left Auschwitz. One last miracle in a long and dangerous subterfuge.

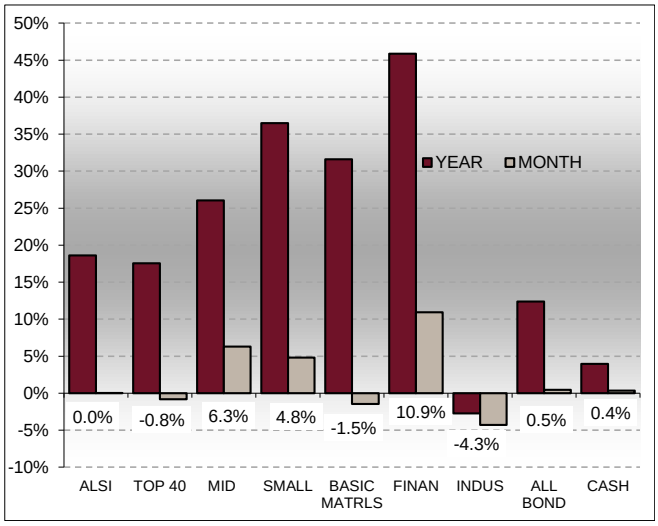
The *Schindlerjuden* were liberated in May 1945 and Reinhard was reunited with her son soon after. She spent half a century in New York and remarried before moving to Israel to be near her extended family, when her role in the escape plot became public. The story was immortalized in Steven Spielberg's Schindler's List, a cinema adaptation of Thomas Keneally's book Schindler's Ark. Reinhard did not feature as a character, but it was a long time before she felt able to watch the film. "It was still fresh in my mind," she said at the age of 92, "I did not want to relive it."

March in perspective – local markets

Turning to South African equity market returns during March, the All Share index ended the month just about where it started. The respective *declines* of 1.5% and 4.3% in the Basic Material, and Industrial indices, stand in contrast to the 10.9% *rise* in the Financial index. The Large, Mid,

and Small cap indices returned -0.8%, 6.3% and 4.8% respectively. The All Bond index rose 0.5% during March, despite the bloodbath on global bond markets. Add to that the 5.8% appreciation of the rand relative to the dollar, and the SA bond market proved to be one of the most profitable bond markets in the world in March.

Chart 17: Local returns to 31 March 2022



Global investment markets remain nervous, volatile and challenging. Rising inflation, significant supply chain issues, slowing Chinese growth, and the Russian war on Ukraine and civilization in general, and all the consequences of it – many of which are not yet apparent – all combine to create a very fickle environment. However, we retain our confidence in the long-term power of equity markets to generate wealth. Recent corrections in prices of many quality companies have restored value to many of the companies in which we have invested. We are hopeful of still achieving a positive return for 2022 as a whole, but we must draw your attention to the current risk implicit in the market, and the fact that it is off to one of the worst starts in history, meaning it will take something really special to regain lost ground during the next few months. Our focus will remain on quality companies with favourable prospects. We believe that investing in such entities, over the long term, will still yield favourable results.

Data that Dazzles

Another look at the US consumer

When is an annual income of R1.55m ($100 000) insufficient? Quite often, it would appear, and for a large swathe of the US population, too. In the face of sharply higher inflation, a recent survey by Pymnts.com and Lending Club found that half of Americans earning $100 000 were living from one salary cheque to the next. In December, "only" 42% of Americans were doing so (Chart 18). According to Lending Club, living pay cheque to pay cheque means "devoting all of one's income to expenses, having little or nothing left at the end of the month".

Chart 18: Americans living dangerously (%)

Source: Baader Bank

What a wonderful world

I am frequently asked, particularly by clients, what I think of the future and what my attitude towards markets is. In recent years my response has always been the same: we are living in such exciting times, I can't remember when last such profound change was happening, and so rapidly, too. For many, particularly those who remember a world without mobile phones and laptops, it can be a bit frightening, almost overwhelming. Supported by a belief in the adaptability of mankind however, I am excited by the new investment opportunities that these changes bring.

I recently heard of some news which epitomized the change I often refer to, and would like to share it with you. Here is an extract from a daily report from *Julius Bär*.

"The world just got one step closer to fulfilling the promise of offering personalized treatments for every patient based on an individual's unique DNA make-up. A team of roughly 100 scientists from the Telomere-to-Telomere (T2T) consortium has revealed that the complete human genome has, for the first time, been sequenced in its entirety. Due to technical difficulties, scientists have been struggling for two decades to decipher the remaining 8% of the human genome's three billion nucleotides since the Human Genome Project successfully sequenced 92% of it in 2003. This achievement has been facilitated by *rapidly declining genome sequencing costs, which have fallen from $50m per genome in 2003 to under $1000 per genome today* (my italics).

"With the groundbreaking findings published in the journal *Science*, the newly added sequences reveal layers of repetitive DNA added over time in the centromeric regions, which could pave the way for a deeper understanding of human evolution and further medical breakthroughs on the treatment, prevention, and cure of a host of diseases.

"Although individualized medicine is still out of reach for now due to the prohibitive costs associated with sequencing everyone's genomes, scientists can use the new insights to identify the links between genetic variations and some of humanity's most common and debilitating diseases. The development is certainly a triumph for scientific research and development.

"Given the immense potential that genome sequencing has on the treatment of present and future health threats, such as Alzheimer's, cancer, and pandemics, the long-term outlook of the Genomics theme remains bright".

Within our global equity portfolios, we express this view through investment into the likes of CSPC Pharma, HBM Healthcare Investments, Lonza, Siegfried, and Wuxi Biologics.

SARS Tax statistics

SA Revenue Services (SARS) recently released their 2021 Tax Statistics Report – all 332 pages of it. I always enjoy going through parts of it. It is a real tome though and can surely only excite those who love numbers and who are obsessed by fiscal policy.

Some of the data I found interesting included:

- Total tax revenue collected by SARS in the 2020/2021 tax year was R1 250bn.
- Tax collected from private individuals totaled 39.1% of total revenue.
- There are 7.6m registered taxpayers which earn more than the R70 000 income tax threshold.

- 161 868 taxpayers earn between R1m and R1.5m per annum. Collectively these taxpayers earn R193.9bn or 7.1% of total income earned by individuals. They paid 13.5% of all tax revenue paid by individuals.
- 120 751 taxpayers earn more than R1.5m. This cohort of taxpayers earn 13.3% of all income earned by individuals, and collectively they paid 32.7% of tax revenue collected from individuals.
- There are 7 040 taxpayers who earn more than R5m of taxable income. In 2010, only 1 578 individuals earned more than R5m of taxable income.
- Individuals and trusts paid a total of R8.4bn of Capital Gains Tax (CGT) or only 0.7% of total tax revenue. It might be in the report somewhere, but I couldn't find a separate entry that related to tax collected from trusts.
- You are more than welcome to read or peruse the document yourself. You can find a Highlights version by clicking here.

So what's with the pics?

The results of the Sony World Photography Awards competition were recently announced. I have chosen a selection from the entries to share, this time from the "Motion" category, but you are welcome to browse through more of them by clicking here.

You would also not have missed the Zapiro cartoons that focus largely around the President and his government's actions. They are increasingly so mind-boggling, and devoid of logic or intellect, that one can only laugh at them.

If we had to take him or his government's statements and actions seriously, we would all be crying, or would have slit our wrists a long time ago. So please join me in seeing the funny side to what we have to put up with from the ANC and government on a daily basis.