INTERMEZZO

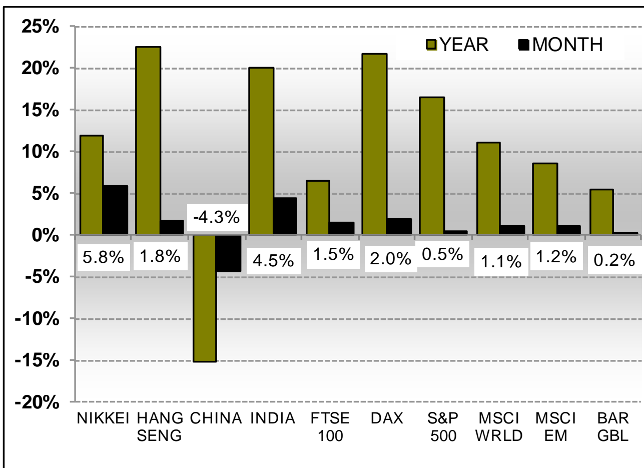
MAESTRO

Investment Letter | 12th Edition | December 2012

November in perspective – global markets

Despite the prevalent risks, markets continue chugging upwards, adding to their impressive year-to-date gains. Apart from the rough patch midway through the year, risk assets have been firmly on the front foot throughout the year. Key highlights during November included the US election and another last minute agreement by Eurozone finance ministers and the IMF to overhaul Greece's bailout program. After spending a record-breaking $6 billion on the election - more than the entire GDP of Malawi - US voters opted for more of the same, in terms of senate, congressional and presidential representation. After the conclusion of the election, concerns about the Fiscal Cliff rose to the forefront of investors' minds and markets declined for a few days before resuming their uptrend. With less than four weeks away the cliff, we wonder how long markets will afford the US congress leeway as they leisurely debate a deal on an issue so critical to the US and global economy.

Chart 1: Global market returns to 30 November 2012



Despite these concerns the MSCI World index added 1.1%, slightly ahead of the MSCI Emerging market's gain of 1.2%. The Japanese Nikkei was the standout performer during the month, rising 5.8% on the back of a 3.2% decline in the yen. The Japanese currency has been weak throughout the month as investors pre-empt the country's December 16 vote to elect a government that wants even bolder (read: additional quantitative easing and debt) action from the Bank of Japan to bolster the economy. A closer look at other Asian markets reveals that November's returns mirrored their year-to-date gains; markets that have performed well for the year continued to perform well in November. India rose 4.5% (25.1% year-to-date), Hong Kong 1.8% (19.5%), Indonesia -1.7% (1.9%) and China -4.3% (-10.0%).The remaining BRIC nations, Russia and Brazil, fared slightly better during the month, eking out gains of 0.1% and 0.3% respectively. Developed markets, particularly European ones, had a profitable month. The US equity market rose 0.5%, Germany 2.0% and the UK 1.5%. The S&P Midcap index rose 2.0% and the Small cap index 0.9%, both higher than the US large cap (S&P500's) 0.5%.

Commodities had a reasonable month on the back of a slightly weaker dollar and the weak prior month. Recall that September was a strong month within the commodity universe after the announcement of additional quantitative easing by the US Federal Reserve. Since then, commodities have struggled to maintain any trend, often oscillating between large declines to large gains. November was a positive month for precious metals with gold rising 0.4%, silver 6.2%, platinum 2.7% and palladium 13.0%. Base metals also had a positive month; aluminium rose 8.8%, nickel 5.9% and copper 1.7%. The net effect was a 1.2 % gain in the CRB commodity index during November. On the currency front, the dollar was weak, declining 0.4% and 3.2% against the euro and yen respectively, but it rose 0.5% against the pound. The rand continued to disappoint, falling 2.1% against the dollar, 1.6% against the pound and 2.5% against the euro. The weak current account deficit coupled with the negative sentiment following the widespread strikes contributed to the rand's continued weakness.

Econopic 1: Great blue heron with fish

What's on our radar screen?

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

- *The SA economy*: South Africa grew at an annualized rate of only 1.2% during the third quarter (Q3) or 2.3% from the third quarter last year i.e. year-on-year. This 1.2% compares to the (upwardly revised) Q2 growth rate of 3.4%. The largest culprit was, not surprisingly, the mining sector, which contracted 12.7%, although we note that growth was weak across the board. What

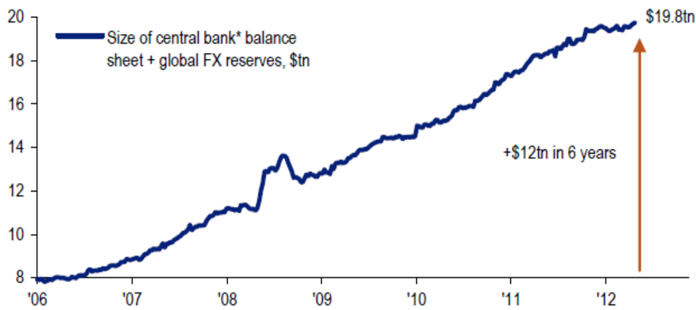
is more concerning is that most of the effects of the recent strike action fall into the fourth quarter; their effects are not recorded in these weak Q3 growth rates. Inflation for the year to October rose 5.6%, up from September's 5.5%, causing the SA Reserve Bank to maintain interest rates at their current levels. They increased their 2013 inflation forecast marginally to 5.5% but kept their 2014 forecast at 5.0%.

- *The US economy*: US Q3 GDP was revised upwards from 2.0% to 2.7% although most of it came in the form of an increase in inventories. Government outlays also rose sharply on the back of a 12.9% increase in defence spending, which is unlikely to be repeated in the current quarter. Merrill Lynch, with one of the more bearish views on the US economy, believes the US will grow only 1.0% in both Q4 2012 and Q1 2013 and at a rate of only 1.5% for all of 2013.
- *Emerging economies*: **Brazil**, once the role model for emerging markets and BRICs, posted Q3 growth rate of only 0.6%, setting it on course for a growth rate of only 1.0% for 2102. Apart from 2009, when Brazil's economy shrank 0.3% in the midst of the financial crisis, the country is heading for its slowest growth in a decade. The Brazilian economy grew 2.7% in 2011 and 7.5% in 2010. The **Indian economy** grew at 5.3% in Q2, down from 5.5% in Q2. The manufacturing sector grew only 0.8%. The latest 5.3% growth rate is the third successive quarter of growth below 6.0%.

Chart of the month

As the year draws to an end, let's remind ourselves of the extent to which central banks have inflated money supply to keep the global economy afloat – Chart 2 shows how the ECB, the Fed, and the Banks of Japan and England have increased the size of their combined balance sheets, in so doing creating massive liquidity and keeping interest rates in the developed world artificially low.

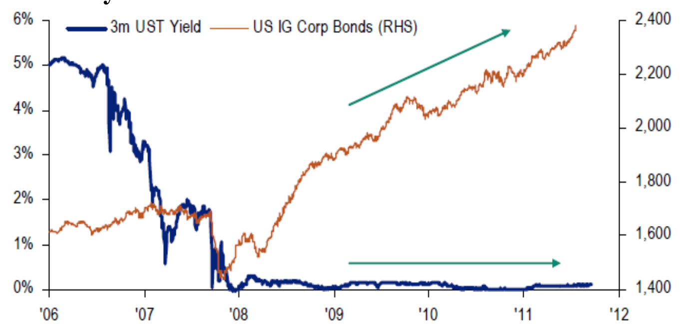
Chart 2: Central bank liquidity – up, up and away!



Source: Merrill Lynch

And seeing it's the Silly Season, let's also take a look at the next bubble in the making, namely the "high yield" (some would call it "junk") bond market. With interest rates having been distorted to such low levels (and we think they will remain like that for a long time to come) investors have desperately sought out any investment that will pay at least some form of interest, even if it places their capital at risk - refer to Henny Sender's comments, below. This has lead to a huge increase in the flow of funds into high yield and investment grade bonds. Chart 3 depicts the flows into investment grade (IG) corporate (not sovereign) bonds. The flow into high yield (junk) bonds has been ever greater. Watch this space ... all good things come to an end.

Chart 3: US investment grade bonds inflows and 3-month yields



Source: Merrill Lynch

Some quotes to chew on

A view on the current state of South Africa

Prof Gerrit Olivier, professor of political science at the University of Pretoria, wrote a piece in the Business Day recently, entitled *Something is rotten in the state of contemporary SA.* That rings a true bell in the minds and hearts of many South Africans, but it is the concluding section which I would like to share with you. Olivier touches on a rare SA attribute which is frequently not accorded sufficient strength and status in the ability of South Africans to change, namely the "self-correcting mechanisms and forces", brought about by "common interests, cutting across historical divisions of ethnicity, race and culture". Read on: "The cover story of The Economist announces "South Africa's sad decline". A disturbing indictment indeed, but a true statement. President Jacob Zuma vainly stated that this government would rule until "Christ comes back". Rest assured, however, something must give and the chickens will come home to roost much sooner. This is so because the ruling party is in shambles and on the way towards self-destruction. But let us also not overlook the collateral propensity for self-correction of South African civil society. This propensity is a powerful force and may in the end be our saving grace in the face of one-party totalitarianism and progressive national decay. A positive development in the new South Africa is that the deep divisions in our society caused by apartheid are progressively being ameliorated by common interests and alliances, cutting across historical

divisions of ethnicity, race and culture. These cross-cutting cleavages bring about self-correcting mechanisms in the form of checks and balances and countervailing forces, which the government cannot simply ignore forever. These forces are already at work; the public mood is one of general dissatisfaction, questioning the incompetence of the present government, knowing that the country deserves better. At the same time the forces of left-wing extremism and anarchy set loose by the government's failure to lead are also at work. The recent and current labour unrest in South Africa could be a foretaste of this horrible scenario and the question is whether civil society will have the resourcefulness and resilience to deal with it. Let us hope so. South Africa is a proud nation with high self-esteem, high ideals and high aspirations. It deserves better than what we get from the present leaderless, wayward government. Our propensity towards self-correction helped us to get rid of apartheid, to make a fresh beginning. Likewise, changes for the better can again take place in South Africa, in spite of the regime."

Econopic 2: An Alligator in Florida

A wonderfully poignant and simple quote of the fiscal cliff

What is so important about the fiscal cliff? This wonderful quote by *UBS Chief Investment Officer Alexander Friedman* puts it into proper perspective. "We should not delude ourselves: this (the fiscal cliff) is a real risk and it is binary in its effect. Let me put it to you this way... if you and I had dinner and then I offered to give you a ride home and said there might be a 10% - 20% chance I would crash the car, would you come with me? I doubt it. My point is, as long as there is a small but real risk that the fiscal cliff could materialize, I would wait until the risk is gone before I get more aggressive on the investment positioning." We could not have put it more eloquently.

Econopic 3: Monk with dogs in Myanmar

We are not alone in being worried about SA's future

This is not the time and place to share our full outlook on the economic and political future of South Africa, although we record here that 2012 provided more than sufficient evidence to prove that government is failing its citizens in virtually every respect other than tax collection. The clouds over our future have become a lot darker and more uncertain, with many of the long-term failings of government now coming to the fore i.e. the chickens are coming home to roost in droves. However, it is also worth recording here that we do not share the gloom expressed by many, that there is no hope or future. My response to the doomsday prophets, which should not be construed as burying our heads in the sand pretending there are not problems, is the following:

- For as long as I have been an investment professional (and that's nearly 28 years now) I have had some investors and those that have already emigrated in particular, tell me this country is "going down the tubes". Yet during that time the All share index has risen an astonishing 6 640% in absolute terms or about 28.1% per annum – despite several crashes, terrorist attacks, changes of government, etc. And as I write the All share index has just breached another all-time high. Poor local investors ☺.
- Despite their negative comments, many of these people have made a significant amount of money in their own right through their entrepreneurial activity. So perhaps this country, its markets and its economy are not as bad as they make it out to be.
- In addition, SA is not alone in having its fair share of problems. The world is a mess right now so we are in good company; the grass is certainly not greener on the other side. And yes, the US equity market is up about 13.0% so far this year and the German market 28.0%.

- And finally, I have seen more money lost through procrastination and waiting for the markets to decline after a strong rise, than I have seen lost through bad investment decisions.

With that by way of a very long introduction, I was struck by a quote of *former SA President Thabo Mbeki* about the current state of politics in SA; "I, for one, am not certain about where our country and nation will be tomorrow, and what I should do in this regard, to respond to what is obviously a dangerous and unacceptable situation of directionless and unguided national drift".

Its 2007 again, thanks to the Fed
In an unsettling article, *Financial Times columnist Henny Sender* drew parallels between 2007 just prior to the Great Financial Crisis and the current markets, raising the role of the Fed in the creation of a false investment environment. Here is an edited version of her article. "Financial conditions are as loose today as they were in 2007, Ben Bernanke noted in a speech he gave in New York on November 20. The Federal Reserve chairman had good reason for that observation. Thanks to the Fed, there are so many ways in which it seems it is 2007 once again. But to what extent is that a good thing? Mr Bernanke's speech was hardly upbeat; it was all about the necessity for Washington to come to grips with issues surrounding the fiscal cliff, the package of tax increases and spending cuts due to take effect from January unless a deal is reached. But neither in the speech nor in the questioning after was there much discussion about the downside of the current Fed policy. There are several downsides, quite apart from the fact that the Fed's policies cannot continue indefinitely and their efficacy diminishes with each round of easing. At this point, after so much credit spread tightening, there is far more potential downside than upside... Other drawbacks, of course, are that households cannot earn anything on their savings, pension funds are badly underfunded and insurers cannot generate enough investment income. The real beneficiaries of easy money are speculators. Meanwhile, from a narrow financial markets point of view, yet another downside is the fact that market prices have lost any real meaning. Prices suggest that the world is a safer place but is it really? Probably not. The world is much more frightening today than it was in 2008. Growth in most parts of the world is far slower, while Europe looks to be in recession. Joblessness is a challenge in many parts of the globe. The geopolitical situation is far less stable. Governments are cash strapped and have far less room to support either their economies or their banks. Yet prices don't reflect risk at all. Should Philippine government debt really be yielding 3.6 per cent? In 2008, it cost 800 basis points to buy protection against a Philippine default. In June, the price was 220bp. It is now a mere 100bp. In 2007, senior staff at the New York Fed compiled a list of all the indicators, suggesting the prices of many financial assets were no longer rational, and presented that list to their colleagues in Washington. Among the indicators they cited was a Middle Eastern telecoms group whose initial public offer was close to 700 times oversubscribed. Their concerns were dismissed. This time, Mr Bernanke's Fed is even more complicit.

Econopic 4: A peacock tree frog

The Maestro Music Fund – still working hard at it
Some of you are aware that a few years we investigated the possibility of launching a Music Fund. For a few reasons, the main one being that we simply have insufficient funds under our management to launch such a Fund, we put the venture on hold. But it remains a dream of mine, if it is ever possible, to launch such a fund. Many of you might think this bizarre, but I was reminded of at least one of the reasons behind us looking to start up such a fund when reading the weekly "Lunch with the FT" section which covers interviews with celebrities and interesting people. The closing section of an interview *with world-renowned violinist [Maxim Vengerov](#)* ended as follows: 'While I am settling the bill, I can't resist asking what impact Vengerov's lay-off (he suffered an injury to his shoulder) has had on his exchequer: does he get paid less now per concert than before the hiatus in his career? There's a long, studied pause before he lets loose another big smile and, in quasi-confidential tone, says: 'More'. When I express mild surprise, he seems eager to justify himself. Referring to the instrument he plays, he explains that 'Heifetz sold the 1727 "Ex-Kreutzer" Stradivarius in 1956 for $24,000, but he was earning $8,000 for three New York Philharmonic concerts. He could afford my violin. In half a century the price grew to just under $1m. Life is more expensive now."

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Econopic 5: Lotus leaf in Japan

The Maestro Art Fund – still working hard at it

In similar vein, some of you have heard us expressing regret that we have also not been able to make progress towards launching an Art Fund, for similar reasons that prevented us from launching a Music Fund. In the light of the latter then, the following comment from *Georgina Adam, editor-at-large of The Art Newspaper*, is relevant. "'A perfect storm between supply and demand" is how Nicholas Maclean of London and New York dealership Eykyn Maclean described the roof-raising sales of postwar and contemporary art in New York this week (16 November). The action started at Sotheby's on Tuesday with a rollicking $375m, the highest total the firm has ever racked up. Leading the pack of winners was Rothko's "No.1 (Royal Red and Blue)" (1954) – see above - which made $75.1m, well over its upper estimate of $50m (pre-sale estimates don't include commission; results do). A perfect little Pollock "drip" painting, "Number 4, 1951" (1951), set a new world record for the painter at $40.4m. The major winners were Warhol, pop art and abstract expressionist works, with names such as Kline, De Kooning and Bacon being hotly contested. Then at Christie's the following night, the roof was raised even further when the firm turned in another record sale, this time soaring to $412.2m... It was the firm's highest result ever in the postwar and contemporary category, and the second highest in its history (an impressionist and modern sale from 2006 still holds the record, at $491m). Warhol, Kline, Basquiat and Lichtenstein again dominated the upper reaches of the sale, with new records established for Kline ($40.4m) and Basquiat ($26.4m); the top lot was Warhol's 1961 "Statue of Liberty", which made $43.7m. The catalogue featured red-and-green 3D glasses to view it with. 'The market has expanded massively, there are far more people in the higher income brackets and the number of international buyers has increased dramatically,' said Maclean. 'And new buyers are tending to favour postwar and contemporary over the modern field, as primary works are also returning to the market more quickly. Artists such as Warhol, De Kooning and Rothko are seen as safe bets and have consistently commanded yet higher prices.' Koons was another winner at Christie's, with his colourful sculpture "Tulips" (1995-2004) making a new record at $33.7m, which also propelled him into being the world's second most expensive living artist at auction, after Gerhard Richter.

For the record

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

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

	Period ended	Month	Year to date	Year
Maestro Equity Prescient Fund	**Nov**	**2.0%**	**20.9%**	**20.8%**
JSE All Share Index	*Nov*	*2.7%*	*22.8%*	*19.8%*
Retirement Funds				
Maestro Growth Fund	**Nov**	**1.7%**	**17.5%**	**17.2%**
Fund Benchmark	*Nov*	*2.1%*	*18.6%*	*17.1%*
Maestro Balanced Fund	**Nov**	**1.6%**	**16.1%**	**15.9%**
Fund Benchmark	*Nov*	*1.8%*	*16.8%*	*15.6%*
Maestro Cautious Fund	**Nov**	**1.2%**	**13.5%**	**14.0%**
Fund Benchmark	*Nov*	*1.2%*	*12.8%*	*12.4%*
Central Park Global Balanced Fund ($)	**Oct**	**0.2%**	**7.3%**	**1.3%**
*Benchmark**	*Oct*	*-0.4%*	*6.2%*	*4.5%*
*Sector average ***	*Oct*	*-0.2%*	*6.5%*	*3.3%*

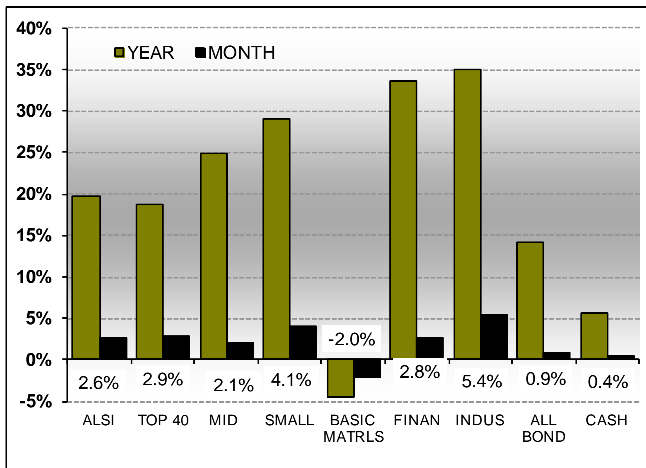
* 40% MSCI World Index, 20% each in Barclays US Aggregate Bond Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills
** Lipper Global Mixed Asset Balanced sector ($)

November in perspective – local investment markets

The SA equity market continued to defy sceptics, registering its sixth successive monthly return in excess of 1.5%! Indeed, the market closed at an all-time high thanks to the industrial and financial sectors of the market. Within the industrials, it should come as no surprise that the rand-hedges led the way, just as they did last month. Resource shares failed to maintain previous months' momentum; they fell 2.1% in November, while industrials rose 5.4% and financials 2.8%. The top performing sectors were the personal goods sector (Richemont), which rose 21.6%, beverages up 8.3% and tobacco 7.2%. The worst performing sectors were fixed line telecoms (Telkom) down 15.3%, coal mining (Exxaro) 10.9% and non-life insurance 5.1%. Small caps outperformed their mid and large cap peers as

they rose 4.1% versus the 2.1% and 2.9% gains for the mid and large cap indices respectively. Despite the weaker rand, bonds rose 0.9% bringing the year-to-date return to 14.2%.

Chart 4: Local market returns to 30 November 2012



"State of the Nation"

Firstly allow me to introduce our newest staff member to you. **Kandi Hime** started in mid-November as the Personal Assistant to Andre Joubert. Kandi has 11 years work experience in both South Africa and London in various administrative and managerial roles.

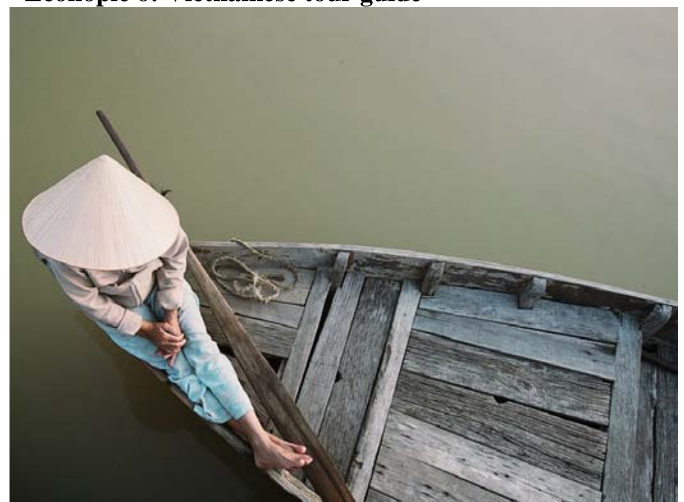
Secondly after working in our present offices for 12 years, the Maestro team is moving premises in mid-December. Please note that all our contact details, including our telephone number of 021 674 9220, will remain the same. Our postal address remains Box 1289, Cape Town, 8000 but our physical address will be the **3rd floor, Letterstedt House, Newlands on Main, Main Road, Newlands**. A map to the new offices will be posted on our website which can be accessed by clicking here.

Just a reminder too, that the Maestro office will be closing on 21 December and will reopen on 2 January. That said, as usual, you can get hold of any of our team in the event of an emergency during this period either by email or cellphone.

So what's with the pics?

I have no particular theme this month other than to share more remarkable photographs with you, some of which I may have shared before but all of which continue to capture one's attention and remind one of what a beautiful world we live in. In addition to the photographs of plants and animals, let us remind ourselves by looking at the two photographs of people who live extremely simple lives that it is they who also keep the world turning. I get demoralised when I look at our leaders and politicians, but when I consider the ordinary people with whom I have come into contact this year, it is they who give me hope, courage and the reason to continue making a difference when and where I can. We can all make a difference in the little things in life and around us; a difference to those who are less fortunate than we are. Only then will we surely experience a true sense of community and "ubuntu", which stretches across race, colour and creed, and which will go a long way to achieving the community that we desire. My hope is that this is your experience in the coming year, too. All photographs courtesy of the National Geographic Photo-of-the-day website Enjoy!

Econopic 6: Vietnamese tour guide



The Music Therapy Community Clinic

As is our habit at this time of the year, we bring to your attention the wonderful achievements of a very special team in Cape Town, namely the Music Therapy Community Clinic team. Rather than purchase gifts for our clients, we have for the past four years made a donation to the Music Therapy Community Clinic, who perform an invaluable service within very dysfunctional communities that struggle with unemployment, drug abuse and other, worse social problems. I would commend them to you for consideration, specifically if you are looking for worthy recipients in your philanthropic activities. I had the privilege of spending time at their offices during the year, and I was overwhelmed at the effort they make and the lengths to which they have to go simply to raise sufficient funds to keep going. As you will see from their comment at the end of this edition of *Intermezzo*, 2012 brought some new challenges to the Clinic, many of a financial nature; we hope that in some small way, you could help them through what is a very difficult time.

INTERMEZZO

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Final year-end greetings and wishes

Thank you very much for the time you have taken each month to read through the publication and literally spend "a short break", which is what *Intermezzo* means, with me each month.

The year is nearly up and I beg your indulgence for a few words of a personal nature. Last year I commented that "the Maestro team is functioning as a cohesive and capable team, from an administrative and investment point of view, better than we ever have in the past." Although global investment markets have been characterized by a lot of risk and uncertainty during the past year, unlike 2010 we have managed to successfully negotiate the risks. Investors in general and our clients in particular have enjoyed credible returns this year. Our relative performance in 2012 has improved significantly when compared to last year's returns. In addition we welcomed a number of new clients into the Maestro family during the past year and it has been a real blessing for our whole team to get to know these friends and their respective families, and to begin to serve them. Thank you to all of you who fall into this category – the journey has only just begun ☺.

So it is with an extraordinary sense of gratitude that I, on behalf of the whole Maestro team, thank you for your support throughout the year, for your friendship and kindness and for the manner in which you have "walked through the investment landscape of 2012" with us.

All that remains is for me to wish you a wonderful summer holiday (at least to our Southern hemisphere readers☺) and a meaningful break. Travel safely wherever you go and may the coming New Year be a blessed one for you and those dearest to you.

Table 2: MSCI returns to 30 November 2012 (%)

	YTD	MTD
ACWI	**11.1**	**1.1**
DM	**11.2**	**1.1**
Asia Pacific	**6.7**	**1.8**
Australia	13.2	0.3
Hong Kong	23.4	2.9
Japan	0.6	2.4
New Zealand	20.7	1.4
Singapore	23.1	1.6
GEM	**9.9**	**1.2**
EM Asia	**14.2**	**2.8**
China	13.5	1.9
India	24.0	4.4
Indonesia	0.8	-3.4
Korea	14.3	2.6
Malaysia	6.7	-3.1
Philippines	40.0	5.4
Taiwan	12.4	7.2
Thailand	23.4	1.5
EMEA	**9.1**	**-0.6**
Czech	-7.4	-7.9
Egypt	33.5	-14.7
Hungary	22.4	-3.8
Morocco	-13.4	3.7
Poland	21.7	5.5
Russia	3.2	-0.5
South Africa	4.5	-1.0
Turkey	50.1	0.3
LATAM	**-0.6**	**-1.8**
Brazil	-9.9	-3.1
Chile	1.4	-3.3
Colombia	22.2	-1.5
Mexico	22.1	1.6
Peru	8.9	-0.8

Source: Merrill Lynch

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Music is the thing that binds all of humanity. No matter what our place of origin, our ethnicity or our financial standing....we are all drawn together by this one indefinable entity.

Working within some of the most marginalised communities in the Cape Peninsula, the Music Therapy Community Clinic seeks to find unique ways to heal children and youth ravaged by poverty, gang violence, abuse and HIV and AIDS by using professional music therapy interventions and providing positive alternatives through its after school music programmes.

However, 2012 has been challenging on many fronts. The organisation, like so many NGOs throughout South Africa continues to suffer from the global economic downturn and the redirection of funding away from South Africa to the economically deprived regions of West Africa. In addition, the Western Cape is seen as the 'wealthy province' by funders within South Africa and obtaining funding for an organisation that does not have a national footprint has proved to be increasingly difficult.

This being said, the Music Therapy Community Clinic is the only organisation of its kind on the African continent. Yes, there are individuals providing music therapy to private clients – but our organisation is the only one that provides a *free* community focused service to children and youth deprived of many of the traditional interventions enjoyed by many young people in more affluent societies.

We believe – and we hope that you do too – that it is crucial for our work to continue and for the young voices to be given expression so that they may strive to take their rightful place in the world.