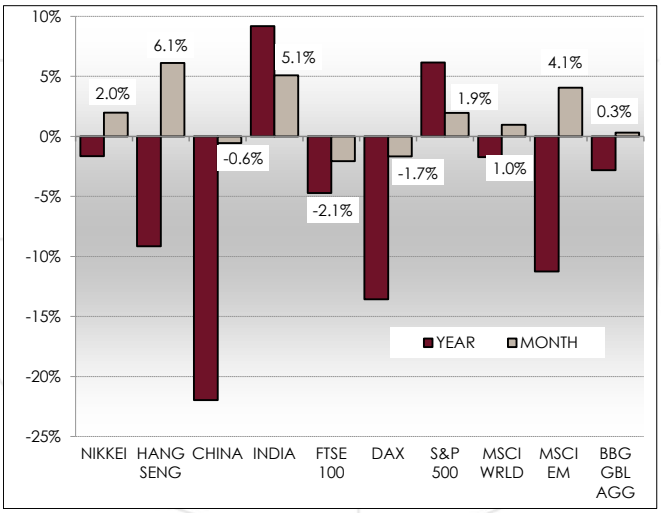
November in perspective – global markets

November was characterized by a slight recovery in the Hong Kong market, which prior to November had declined 16.5% so far this year. Emerging markets also posted decent returns, and selected emerging market currencies posted a recovery of sorts. As for global equity markets, the MSCI World index rose 1.0%, although its year-to-date return remains negative, at -3.0%. The MSCI Emerging market index rose 4.1%, which looks good but the index is still down 14.1% for the year-to-date. Notable features last month were the Hong Kong equity market, which gained 6.1%, the Turkish market rose 5.8%, India 5.1%, Indonesia 3.9%, Brazil 2.4%, and Japan 2.0%.

Chart 1: Global returns to 30 Nov 2018



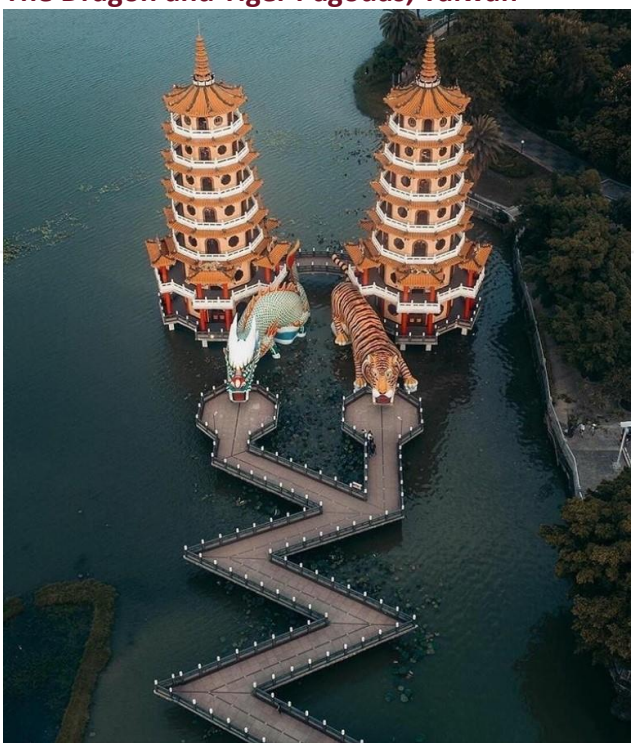
The global bond market rallied towards the end of the month, ending November up 0.3%, bringing its year-to-date return to -3.2%. The dollar strengthened 0.9% and has risen 6.4% so far this year. One of the main topics of focus during the month was the oil price, which declined sharply during the month. It ended 21.5% lower on the month, but was down by more than that from its intra-month low. The palladium price continued to gain, as it has done all year – its price has risen 15.8% during the past year. The price of copper rose 2.2%, but the iron ore price declined 13.4% on the month. Coal lost 4.1%, the Baltic Dry index fell 17.4%, and soft commodity (agricultural) prices ended the month with mixed fortunes.

What's on our radar screen?

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

- *The SA economy:* South African retail sales during September declined 0.6% on a monthly basis, and have now risen by only 0.7% during the past year, down from an annual increase of 2.5% in August. The current account deficit grew to R177bn or 3.5% of GDP during the third quarter (Q3) from 3.4% of GDP during the second quarter (Q2). The economy grew at an annualized rate of 2.2% during Q3, from a downwardly revised -0.4% in Q2 and -2.6% in Q1. While it means the economy has exited a recession, the growth was largely a function of the low base created during the previous six months. With load-shedding back in everyday life in the country, and the disastrous effect it has on business, tourism, and sentiment, it is hard to see the economy picking up any steam during the next few months. The 2.2% growth in Q3 brings the annual growth rate for the economy during the September quarter to 1.1%.

The Dragon and Tiger Pagodas, Taiwan

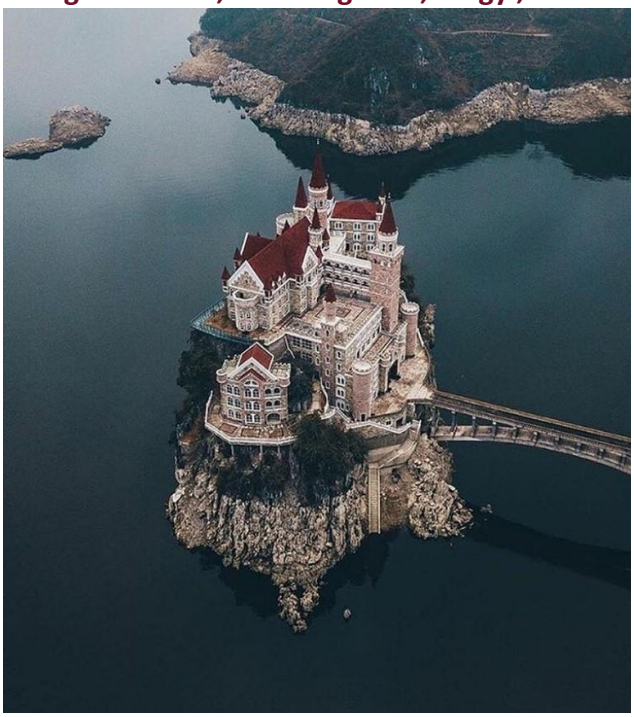


Instagram handle: @amazingworld.hd

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

- *The US economy*: The US economy grew at an annualized rate of 3.5% during Q3 relative to Q2. Downward revisions to consumer growth from the first estimate were offset by upward revisions to infrastructure spending and inventories. The annual rate of headline inflation in October rose from 2.3% to 2.5%, largely due to fuel oil and gasoline price increases. Core inflation declined from 2.2% to 2.1%. Given the dramatic decline in the oil price during November, it is likely that US headline inflation will decline below 2.0% next year. Annual retail sales increased from 4.2% to 4.6% in October, indicating that the consumer is still in good shape. Durable goods orders, excluding the volatile transport series, rose 0.1% month-on-month, following September's 0.6% decline. We continue to believe that the US economy is in good shape. Its rate of growth may slow slightly next year, but we do not subscribe to the popular belief that the US economy will slip into a recession during 2019.

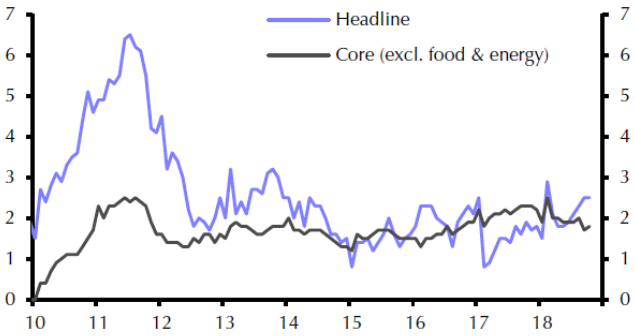
Jilongbao Castle, Wanfeng Lake, Xingyi, China



Instagram handle: @discover_passion

- *Developed economies*: The Swiss, German and Swedish economies all declined by 0.2% during Q3 when compared to Q2. While some of the slowdown can be ascribed to the automobile sector, which is experiencing its own unique set of challenges at present, it is nevertheless indicative of a general slowdown we have seen during Q3 across Europe. German annual inflation during October totalled 2.4%, while unemployment in the UK rose marginally to 4.1%. The Singapore economy grew at an annual rate of only 2.2% during Q3, which represented a sharp slowdown from Q2's 4.1%. The government revised down its 2019 growth projections to between 1.5% and 3.5% from between 3.0% and 3.5% previously. In Canada, economic growth slowed from an annualized rate of 2.9% in Q2 to 2.0% in Q3.

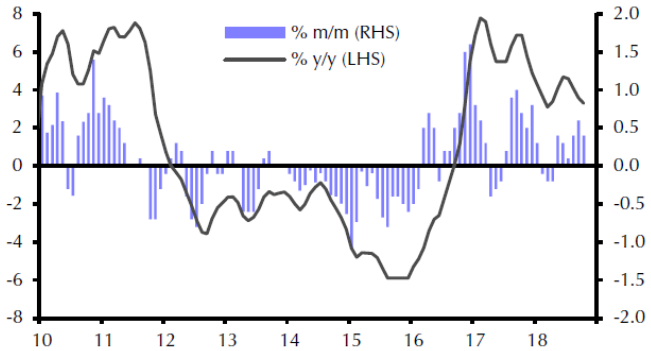
Chart 2: Chinese consumer inflation (%)



Source: Deutsche Bank

- *Emerging economies*: in China, annual headline inflation remain steady at 2.5% in October. Annual core inflation rose from a two-year low of 1.7% in September to 1.8% in October – refer to Chart 2. Producer inflation continues to subside, falling to 3.3% in October from September's 3.6% - refer to Chart 3. The decline in the oil price bodes well for a continuation of this declining trend in Chinese producer inflation.

Chart 3: Chinese producer inflation (%)



Source: Deutsche Bank

The Indian economy grew at an annual rate of 7.7% during Q3, slower than the 8.2% experienced during Q2. Net exports declined as did private consumption, although government spending and private investment were both strong, rising 10.9% and 12.5% respectively. India's fiscal deficit is under scrutiny, and Governments target of 3.3% of GDP is unlikely to be met. In a surprise move, the Reserve Bank of India (RBI) Governor, Urjit Patel, resigned on 11 December, in what was seen as a protest against government interference in RBI's workings and independence.

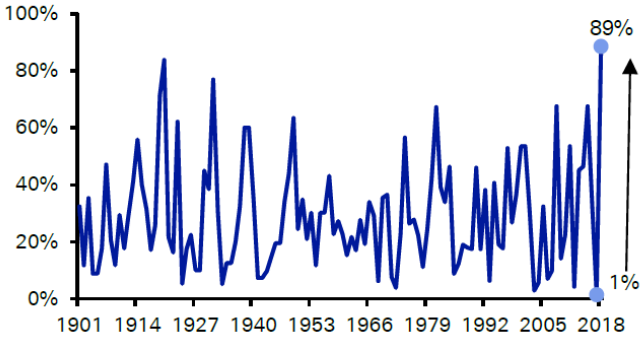
The Ancient City (Mueang Boran), Thailand

Instagram handle: @twenty4sevendrones

Chart of the month

We actually included Chart 4 in last month's *Intermezzo*, but as the month progressed came to really appreciate its message and value. So I have included it again, to bring home the point that this year so far, we have seen the most asset classes post negative returns since 1901 (and probably since record-keeping began). This comes right after a record-breaking 2017 when only 1% of asset classes monitored by Deutsche Bank's fixed income research team registered negative dollar declines. For the majority of investors, 2018 has been a tough year, and this chart simply underlines that point, showing how miserable a year it has been for virtually all investors.

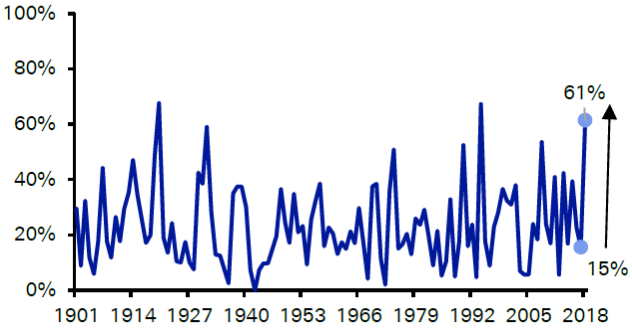
Chart 4: Assets with negative dollar returns



Source: Deutsche Bank

Chart 5 depicts the same data as in Chart 4, but in local currency terms. So while 89% of asset classes have posted declines in dollar terms so far this year, when measured in local currencies the number declines to 61%. The decline is measured off a base which saw 15% of asset classes post declines in local currency terms in 2017.

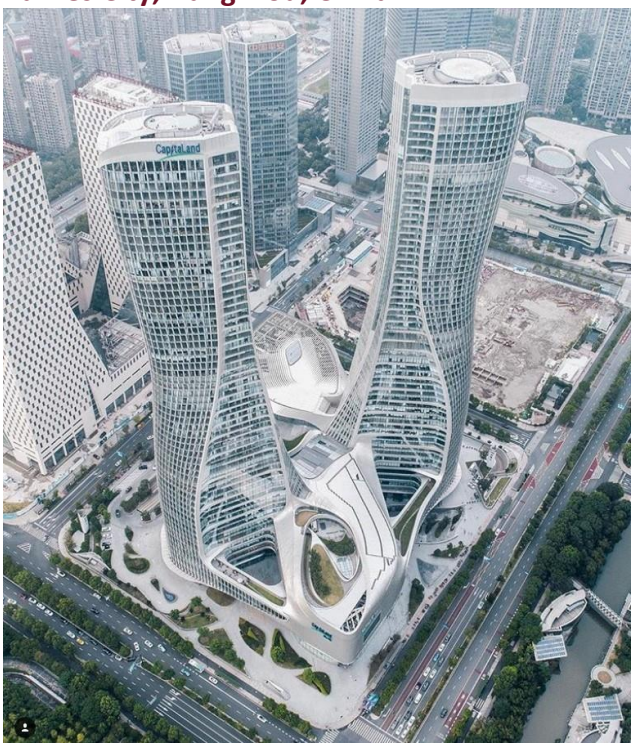
Chart 5: Assets with negative local returns



Source: Deutsche Bank

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

Raffles City, Hangzhou, China



Instagram handle: @seven7panda

The Trade War – who is going to win it?

The trade war, initiated by the US but primarily between the US and China, has been a dominant feature in and determinant of equity markets this year. We have referred to it in correspondence with clients on numerous occasions during the year. However, it has developed to such an extent that it now dominates investment markets' direction and outlook, and it has been around long enough to start assessing its effects.

Of course, what it is, who started it, why it even exists in the first place are but some of the questions, the answers to which are determined by who you ask. Seeing that the West typically dominates media channels, it is the West in general and the US's narrative in particular that is heard. One seldom hears the Chinese perspective and it is for this reason we think it is time to spend some time on this important matter.

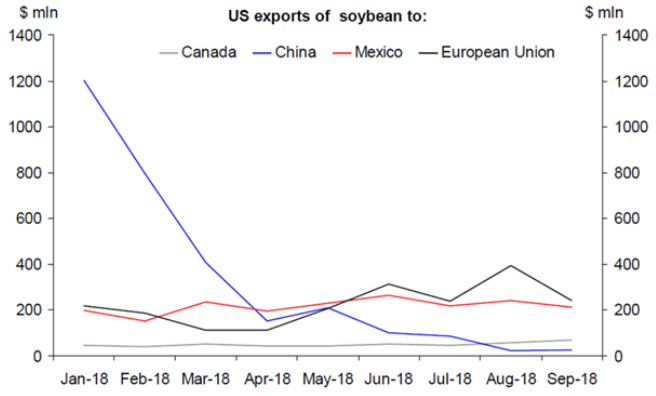
Long-time readers of *Intermezzo* and our clients will know that, if anything, we have a bias in favour of China, as we believe that the country still holds some of the greatest investment opportunities on this planet. So we are mindful of the effects a trade war could have on China, but are also conscious of just how wrong the Western narrative of China often is. The purposes of this section is thus to try and place the facts on the table and give you sufficient information to decide for yourself how this important factor will influence global investment markets.

By way of example, if one only reads US President Trump's tweets, or listens to his spokespeople, one can be forgiven for believing that China is on its knees already and suffering greatly as a result of the tariffs that Trump has already imposed. Of course, nothing could be further from the truth.

The facts are that history shows tariffs to be economically destructive for all participants – there are no winners in this war. Harm is suffered on both sides and the consequences of the war often emerge in places one would least expect – such is the complexity of the world in which we live, in global trade and global supply chain terms.

Chart 6 depicts the export of US soybeans. China was by far the largest importer of soybeans from the US, as recently as the beginning of this year. But since Trump imposed tariffs against China, surprize! Soybean exports to China have declined by 98%. Hands up, those who have ever read a Trump tweet advising the world of this fact.

Chart 6: US exports of soyabeans

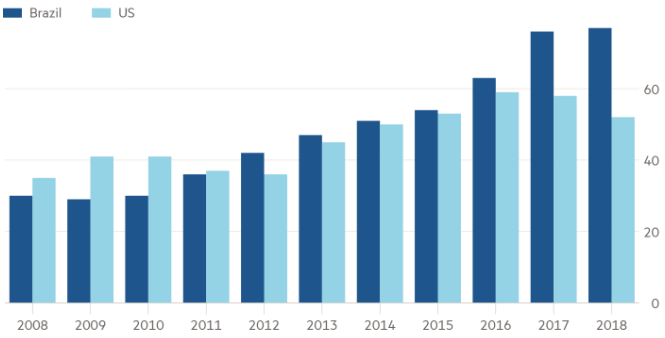


Source: Deutsche Bank

Given the nature of global trade, it is reasonable to expect there to be winners for every loser. As it happens, the US's loss has by and large been Brazil's gain – refer to Chart 7 in this regard – and as China has substituted soybeans for the likes of rapeseed, peas and sunflower seeds, the likes of Ukraine and Canada have also benefitted.

Chart 7: Brazil and US soyabean exports

Exports (millions of tonnes)



Source: Deutsche Bank

With markets being the rapidly adaptable beasts that they are, prices adjust quickly, as can be seen from Chart 8. Ironically, with the prospect of another significant El Niño on the way, early planting and a possible record Brazilian crop have benefitted Chinese soyabean importers. The trade war and early harvest have had a dramatic impact on the soyabean price (Chart 8), which has benefitted Chinese buyers even further. The point to note here is that issues surrounding global trade and supply chains are rarely simple. Change to one variable almost inevitably has unintended consequences on other variables; the outcome is never simple or as expected.

Chart 8: Trade wars dent soyabean prices

CBOT soyabean futures (dollars per bushel)

Source: FT.com

Before taking a look from another person's perspective at this topic, let me say here simply that Maestro's view on the trade war is that firstly, it is economically destructive and inflationary in the long-term. Secondly, it is our view that the primary long-term "beneficiary", or put another way, the country that will suffer the least, is China, and not the US. That is not the commonly held view it would seem and if consequent equity market movements are anything to go by. But it is still early on in the trade war and the last word has definitely not been heard on this subject.

Gillian Tett, the US managing editor of the Financial Times, recently wrote an article entitled *America is winning the trade war with China – for now*. I thought it illustrated the point we are making here very well. So here is an edited version of her article:

Sometimes statistics don't behave as predicted. Take the thorny issue of US-China trade and Donald Trump. Earlier this year, the US president expressed fury about the size of America's bilateral trade deficit with China and imposed escalating tariffs on $250bn worth of Chinese imports. The assumption inside the White House was that this would cause the deficit to shrink, since American companies would produce more goods at home and/or find ways to avoid costlier imports.

But that theory has not played out – or not yet. Far from it. Last week the US government released data showing that America's deficit in traded goods with China jumped 4.3% in September to a seasonally adjusted level of $37.4bn, a record high. This was due to a thumping 8.0% rise in American imports from China. Exports, however, remained broadly flat.

While monthly data are notoriously unreliable, the trend is clear: in the third quarter as a whole, America's deficit with China reached $106bn, up from $92.9bn in the same period last year, also due to a startling rise in imports. For the year to September, the tally was $305.4bn, compared with $276.6bn last year.

Now, from a macroeconomic perspective, this should not matter. After all, an obsession with bilateral trade deficits is ridiculous in a multilateral trading world, where trade in services matters as much, if not more, than in goods. The White House would do better to focus on areas where the US has legitimate grievances with China, such as intellectual property abuse, not shipments of steel. But this economic logic is unlikely to sway Mr Trump right now, least of all when the White House is preparing for a meeting with Chinese president Xi Jinping.

So it is worth asking why the bilateral statistics are moving the wrong way. Part of the explanation is – ironically – the US's current economic strength: fast growth usually sucks in more imports. As some of Mr Trump's own advisers used to half-jokingly tell him, the easiest way to solve a trade deficit is to create a recession.

A second contributing factor might be a time lag issue: American companies have scrambled to stockpile imports to protect themselves from the trade disruptions. A breakdown of the data suggests, for example, that the sectors which are already subject to tariffs, such as steel, experienced a notable spike in imports earlier this year, which is now subsiding.

But there is another possible explanation that is being quietly mooted by groups who follow the intricacies of global trade: China might actually be winning the optics, if not substance, of the early round of the trade fight. "The expansion of the US trade deficit with China . . . is a sign the trade war went against America", Panjiva, a trade data aggregation service observed last week. Or as Soren Skou, the chief executive of AP Moller-Maersk, the shipping company, noted during an earnings call on Tuesday: "It is an ironic development, but after Trump turned up the volume, the US has only increased their imports from China even more", even as American exports in sectors such as soybeans collapsed. Mr Skou partly blames this on stockpiling. But, strikingly, he suggests that the position of Chinese companies in the supply chain means that they find it easier to source substitutes for American products than the US does in replacing Chinese imports.

Hohenzollern Castle, Baden-Württemberg, Germany

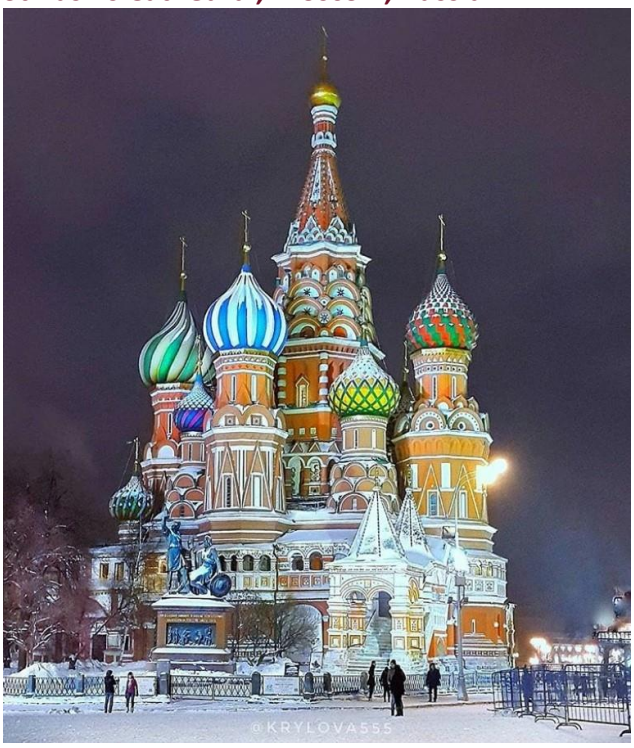
Source: Tigglefix.com

A third crucial issue, Mr Skou says, is that Mr Trump "can't tell Nike, Walmart and The Home Depot that they can't import from China". So he predicts that American companies "will continue to import from China and will work on solutions", just swallowing the hit to margins which, of course, are being partly offset anyway by the weakness in the renminbi.

Beijing, by contrast, can simply order its state-controlled companies to switch their trading patterns – and is probably doing so, given that the Chinese government, unlike the chaotic White House, has a centrally coordinated negotiating position and agenda. So does this mean that Beijing will fail to make concessions in negotiations? Not necessarily. After all, China's economy is probably more vulnerable to a trade war than America's, and the picture could change if or when stockpiling ends.

If nothing else, the ironic twist in those pesky statistics shows how hard it is to predict the precise consequences of a trade war. And perhaps the folly of underestimating China as an adversary, particularly if it stays disciplined, determined and untroubled by democracy.

St Basil's Cathedral, Moscow, Russia



Instagram handle: @shot_europe

Quotes to chew on

Getting the Big Picture right

One of the key tenets of Maestro's investment philosophy is to "get the Big Picture right", which simply means we seek to correctly identify the secular trends that bring about significant change in a particular sector, economy, or society, thereby creating long-term investment opportunities that last longer than the prevailing business cycle. Of course, that works both ways – you need to know which sectors to be in, and which ones to avoid.

I was reminded of this watching the (mis)fortunes of the one-time market darling, General Electric, during the past month. It has undergone a high-profile, spectacular fall from grace, almost of Steinhoff proportions, as investors worry about its ability to service its $115bn of debt. Rating agencies have already cut its debt by two notches this year. The following words from *Deutsche Bank's Jim Reid* captured the companies fall from grace very succinctly. They were written on 13 November.

"… General Electric (GE) lost just over $5bn yesterday but it was arguably the bigger headline grabber. Indeed the shares slumped 6.9% (-10.0% at the lows) after the company's CEO … failed to reassure market fears about a weakening financial position. The CEO suggested that the company will now urgently sell assets to address leverage. Shares hit levels first seen in 1995 yesterday and have only been lower since, very briefly, during the financial crisis.

Chart 9: General Electric price history ($)

Source: FT.com

"For a bit of perspective, the market cap of GE now is $69.5bn and it's the 80th largest company in the S&P500 (*Ed:* $63bn at the time of writing). Go back to August 2003 and it was the largest company in the index (and regularly in the world, between 1993 and 2005) at a market cap of $296bn, with $12bn of daylight to Microsoft in second

place. The tech giant has since grown to be an $826bn company, well over 10 times the size. GE's market cap actually peaked in August 2000 at $594bn before tumbling first in the tech crash and then the Great Financial Crisis."

Castle and church, Portovenere village, Italy

Instagram handle: @perfect_italia

More insight into November's market action

A feature of the equity market behaviour during November was how wide-spread it was. The weakness was not confined to mid and small-cap companies; many of the large caps suffered, too. Monthly declines of some of the giants, for example, include Facebook, which tumbled 13.3% from its October peak to its trough (but off 39.5% from its all-time highs reached in this year), numerous large oil giants on the back of the collapse in the oil price, and many suppliers to Apple, too, as word spread of it scaling back on orders. On the local market there were large casualties, too, with British American Tobacco falling 27.4% on the same measurement, and Intu 45.4% on the back of failed corporate activity.

The most notable casualty was also the largest of them all, namely Apple, which declined 25.7% from its intra-month peak to trough. *Jim Reid's* comment of 28 November, was very informative: "Apple continues to struggle and traded 0.2% lower yesterday as concerns continue regarding the company's demand outlook and possible tariffs on components for their goods. Notably, Microsoft overtook it to become the world's largest company by market cap again for the first time since October 2003! The last time Microsoft was larger than Apple was back in May 2010 (though at that time, Exxon Mobile was larger than either of the tech giants). Since Apple peaked in early October, it has shed around $300bn of market cap, while Microsoft has shed 'only' $60bn, or the equivalent of Pakistan's GDP to the equivalent of Panama's respectively. So in 7 weeks Apple has lost the entire annual GDP of a country with 197m people in terms of market cap."

More market trivia, but indicative of the pain

Another extract from *Jim Reid*, which is indicative of the pain felt by equity investors during November. It is hard to believe, when reading about all these negative market developments, to think that the MSCI World index actually ended the month 1.0% higher!

On 21 November, Jim wrote: "As for equities … the NASDAQ closed down 1.7% but was as much as 2.8% lower at one stage, while the S&P500 and Dow Jones closed down 1.8% and 2.2% respectively – both marginally off their lows. The NYSE FANG index also recovered to finish -1.6% from its intraday low of -4.5%, though Apple did fall another -4.8%, meaning it's now 23.7 % off the October peaks and therefore in the definition of a bear market amid concerns over demand for products. That move is also equivalent to a loss of value of $265bn, or roughly the annual GDP of Bangladesh a country with 165m people."

Obituary – Stan Lee: 1922 - 2018

Source: https://www.theguardian.com

Stan Lee, the comic book author, created a canon of superheroes beloved by millions as much for their fantastical powers as for their grounding in real-life situations and locations. Lee, who died on 12 November, helped conceive characters such as Spider-Man, The Incredible Hulk and the Fantastic Four for Marvel Comics.

They began life on the pages of comic books in the early 1960s and differed from those created by rival publisher DC Comics because they tended to be based in real cities — and often had humdrum concerns that were more relatable for readers. "It sounds like a contradiction when you're writing about characters from a fantasy angle, but I tried to make everything else as realistic as possible," Lee told the Financial Times in 2009. "There was one Spider-Man comic where he went to the dentist. Superman [a DC character] would never go to the dentist — the drill would break on his teeth. And I wanted my characters to live in real places, so they didn't live in Gotham City or Metropolis. Peter Parker [Spider-Man's alter ego] lived on the Lower East Side in Manhattan."

In recent years, Lee's characters have been the basis for a string of Hollywood blockbusters, with The Avengers series, Iron Man, Thor and others churning out billions of dollars at the box office. But their origins were on the page, brought to life by Lee as a young man eking out a living in post-war New York.

Born Stanley Martin Lieber in 1922 to Romanian Jewish immigrants, Lee was raised in the Bronx. From a young age he had ambitions to become a writer. He liked swashbuckling novels and films and dabbled with script writing after a stint in the army, where he was a signal operator during the Second World War. The urge to become a great American writer never left him, which is partly why he changed his name to the snappier Stan Lee. "I always thought that one day I would become a great novelist so I used a different name when I started writing comics," he told the Financial Times.

Lee's career in comics was almost an accident. He held a series of part-time jobs, working in a garment factory and as a delivery man for a pharmaceuticals company: he also wrote press releases for the National Tuberculosis Centre before landing a job at Timely Comics, a magazine company that was the precursor to Marvel.

His first work was published in 1941, but he strained to express himself because of the editorial restrictions that were put on his writing. "I had a publisher who was a nice enough guy but he didn't believe comics were read by anyone other than little kids or dumb adults." He wanted to quit but Joan, the Newcastle-born hat model to whom he was married for 70 years, persuaded him to give it another go. "She said: 'Before you do, why not do one story the way you want to do it?' So I did and I violated a lot of comic conventions." The characters he created and co-created with renowned comic artists such as Steve Ditko and Jack Kirby, when writing for Marvel in the 1960s, had earthy concerns. They also reflected the political and social change that swept the period. The Black Panther character, which debuted in a 1966 issue of Fantastic Four, was the first black superhero to get his own comic (the 2018 film adaptation was one of this year's biggest box office hits), while Lee's X-Men series about mutant humans with superpowers drew on themes of discrimination against minority groups.

He continued working well into his 90s but the characters he created in the 1960s were his most enduring and successful. However, Lee never owned the rights to them, which meant he missed out on the fortunes they earned from movie adaptations in later years. Developments in visual effects technology made possible the transition of superheroes from the printed page to the big screen and, with the 2009 acquisition of Marvel by Walt Disney, Lee's characters have become ever more popular at a time when rival adaptations from DC, now part of Warner Brothers, have stuttered.

Lee did not lose out completely, though. He sued Marvel in 2006, eventually agreeing an out-of-court settlement after arguing that it failed to honour a contract entitling him to a share of the film and TV profits that had been generated by his creations. Since then, relations with his former employer have been good. He has made wisecracking cameo appearances in every Marvel movie and is as indelibly linked with his creations today as in their 1960s heyday, when he would sign off every comic with his trademark farewell, "Excelsior!"

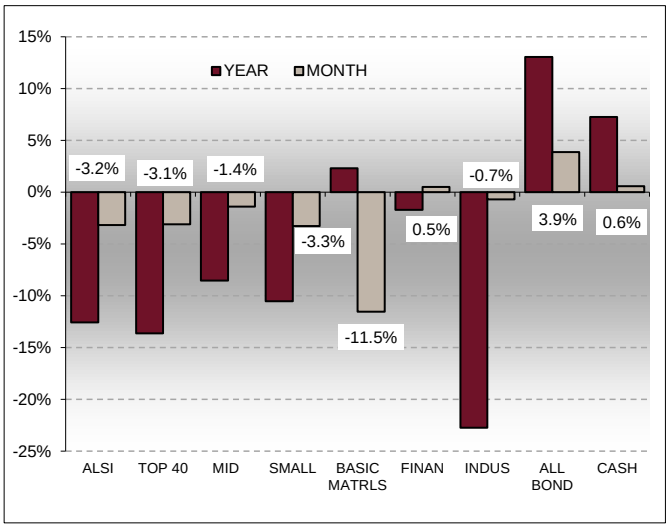
Parliamentary buildings, Budapest, Hungary

Instagram handle: @travellingthroughtheworld

November in perspective – local markets

Turning to local markets, the rand strengthened 6.4% in November, largely on the back of better global sentiment towards emerging markets. The strong move brings its year-to-date decline to "only" 10.7%. The firm rand retarded much of the local equity market strength seen elsewhere in emerging markets – the All Share index declined 3.2% as the Basic Material index's decline of 11.5% dragged it lower. The Industrial index lost 0.7% while the firm rand lifted the Financial index into positive territory, but only just: it rose 0.5%. The year-to-date returns on the Basic Material, Financial, and Industrial indices are now 2.8%, -9.3% and -19.4% respectively, while the All Share index is 12.3% lower over the same period.

Chart 10: Local returns to 30 Nov 2018



Given the rand's strength and the late-month recovery in the global bond market, the local bond market was always going to post a decent return, which it did. The All Bond index rose 3.9%, bringing its year-to-date return to 7.1%, higher even than the respective Cash return of 6.7%.

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

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	**Nov**	**-5.2%**	**-14.0%**	**-19.1%**
JSE All Share Index	*Nov*	*-3.2%*	*-12.3%*	*-12.6%*
Maestro Growth Fund	**Nov**	**-2.0%**	**-3.8%**	**-8.4%**
Fund Benchmark	*Nov*	*-1.6%*	*-4.6%*	*-4.5%*
Maestro Balanced Fund	**Nov**	**-1.6%**	**-2.2%**	**-6.1%**
Fund Benchmark	*Nov*	*-1.2%*	*-2.7%*	*-2.5%*
Maestro Cautious Fund	**Nov**	**-0.4%**	**1.5%**	**0.7%**
Fund Benchmark	*Nov*	*0.4%*	*0.9%*	*2.8%*
Central Park Global Balanced Fund ($)	**Oct**	**-8.8%**	**-11.5%**	**-8.6%**
*Benchmark**	*Oct*	*-4.9%*	*-3.6%*	*-1.2%*
*Sector average **	*Oct*	*-4.5%*	*-4.7%*	*-3.2%*
Maestro Global Balanced Fund	**Oct**	**-5.9%**	**2.7%**	**N/A**
*Benchmark**	*Oct*	*-0.8%*	*15.0%*	*3.2%*
*Sector average***	*Oct*	*-2.0%*	*12.2%*	*0.5%*

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

A few thoughts on the US bond market

Maestro has a relatively negative view towards global bond markets at present, and has held this view for a few years already. Only 1% of our global balanced fund (Central Park) is invested in US bonds. Rising interest rates are now the order of the day; the country is well into a tightening interest rate cycle as the Federal Reserve tries to normalize rates i.e. to move them higher off the artificially low levels that prevailed since the Great Financial Crisis in 2007/9.

On 8 November, *Financial Times US managing editor, Gillian Tett*, wrote an insightful piece on the US bond market, which was rather scary if any of it remotely comes to pass – hence our negative view on US and global bonds. A summary of it appears below.

International Youth Culture Centre, Nanjing, China

Instagram handle: @skyscraperengineering

"Last month, as the US midterm elections approached, Deutsche Bank analysts released a calculation that should have made American voters wince. It shows that the US government currently pays $1.43bn each day (yes, day) to service its public debt — 10 times more than any other G7 country (Italy is a distant second in this grim league). This is striking, even allowing for the size of the American economy. But what is doubly thought-provoking is that this $1bn bill has materialised when interest rates are still fairly low by historical standards.

And that invites a crucial question for the US Congress: what will happen to that debt, and servicing costs, if (or when) interest rates climb to a more normal level? Until recently, neither investors nor voters seemed to care particularly. After all, asset managers have flocked to buy US treasuries in recent years, even as America's debt pile swelled above $15trillion (tn). And those once-feared

bond vigilantes seemed all but dead last year when President Trump's government announced massive tax cuts, further increasing debt. But markets are getting more twitchy.

Consider again that daily debt servicing number. According to the Congressional Budget Office (CBO), the total annual cost of net interest payments on American debt in 2018 will be around $318bn. Right now, that sum seems manageable, relative to the overall American budget. But the CBO calculates that servicing costs will triple in size to nearly $1tn by 2028, on current policy trajectories and assuming that interest rates rise towards their long-term average of 3.7% and 2.8% for 10-year bonds and three-month bills respectively (or slightly above the current levels of 3.2% and 2.3%). If so, interest payments will soon become the third biggest item on the budget, eclipsing even military spending. However, if interest rates rise faster than the CBO expects, the picture would be worse.

For another striking feature of American debt is that its average maturity is only six years, shorter than most European countries. And during the Trump administration this maturity has - lamentably - shortened. Before the election, for example, the US Treasury quietly revealed that the deficit is poised to top $1tn for the first time in history. To plug this gap, Steven Mnuchin, the US Treasury secretary, plans to sell $83bn of bonds, which is also a record, eclipsing even the level of bond sales after the global financial crisis. Strikingly, Mr Mnuchin predicts that almost half of this tally - some $37bn - will have a maturity of just three years. This short maturity makes the debt more prone to rollover risks.

What's going on out there?

Last month we responded to some of the questions directed at us regarding recent market turmoil and weakness. Please refer back to the November edition if you missed it or want to re-read our responses – so much has happened in the investment environment since answering those questions. For your information, these were the questions we responded to last month:

- *What concerns you most about international equity markets?*
- *After the stock market rout in October, is this the end of the US equity bull market?*
- *How long will it take for the markets to recover?*
- *Should I still stay invested in such market conditions?*
- *Will US growth slow down if the US Federal Reserve (the Fed) keeps on raising interest rates? And what will be the impact on the US share market?*
- *What do you think will happen to the markets during the coming 12 months?*

This month we continue along the same vein, responding to some of the questions that were put to us in recent weeks.

Bosco Verticale, Porta Nuova, Milan, Italy

Instagram handle: @shot_europe

Should I turn my portfolio into bonds and cash and wait it out?

You will gather from the comments on bond markets earlier in this letter that we are not in favour of investment into global bond markets. With regard to the local bond market, that market is not typically an investment destination for retail investors. The latter can access the bond market through unit trusts, but we would rather direct individual investors into cash funds, or so-called high income funds, which invest in both the cash and bond market. Back to the question: the essence of which is whether to remain in the equity markets or disinvest from them and "park" one's capital in cash until the prospects for equity markets look better.

To state the obvious, one would have been better off in cash had one adopted this strategy at the beginning of 2018, but of course that is with the benefit of hindsight, which is worth nothing when having to take an investment decision in the present. All professionals and academic literature will testify that trying to "time (entry into and out of) the market" is a fool's game, which is neither a profitable nor sustainable one in the long-run. That is our experience too; we caution clients against adopting that strategy. Any success achieved through trying to "time the market" has more to do with luck than skill – hence the view that it is an unsustainable strategy. Another conclusion based on our experience is that once this question is asked, it is typically far too late to exit the equity market.

I would say two things in this regard: if you are really worried about the volatility of and prospects for the equity market and are wondering if you should have any equity exposure at all, then perhaps you should revisit your appetite for risk. If it is causing you to have sleepless nights, then perhaps you have too much equity market exposure and you should reduce it and re-allocate some of your risk by increasing your cash holdings. Be aware though, that over time (which is a better term for the "long-run") your returns are likely to lag those of the equity market and may not even keep up with inflation i.e. the purchasing power of your money will decline steadily. Mr Market never rings any bells or sends a memo telling you it's time to get back into the equity market. On most occasions, such entry or exit points are only apparent after the event – and often a long time after the event. One therefore risks getting the timing of your exit from the market wrong, as well as getting your re-entry into the market incorrect. Those two risk events alone can prove exceptionally costly – again, we have seen this many times in our own experience of clients' decisions.

I should also just add here that moving in and out of the market is not very tax-efficient. Given the high levels of capital gains tax in South Africa, the tax consequences of timing the market often more than negate the success of your actions. Clients frequently forget just how penal the tax consequences of some investment decisions are.

Las Lajas Sanctuary, Ipiales, Colombia

Instagram handle: @travellingthroughtheworld

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

The second comment I would make is that if you are asking yourself whether you should exit the equity market with a view to re-entering it at some stage in the future, I would suggest you need to consider your time horizon. While no one enjoys losing money, if you have a long time horizon – and let's call that five or more years – then you shouldn't really be worrying about the current equity market weakness, as there is a lot of time to recover from the downturn. However, if you have a relatively short time horizon, then you should revert back to the first suggestion, namely that you reconsider your appetite for risk. Investment into equity markets carries risk to your capital and is a long-term activity. That is one of the first and most important "rules of the game", so always remember that. If you know you will need your capital in a relatively short period, then don't expose it to equity market risk, but rather invest it in something safe i.e. less risky, like cash.

One instance we see relatively frequently bears additional comment: where investors don't trust the rand to hold its value in real terms – which dictates that they invest offshore – but they are dependent on their capital to provide income in their retirement. Given that for more than a decade now interest rates offshore have been non-existent for all intents and purposes, this places this category of investor in a real dilemma. Our solution has most often been to use a combination of both local and global markets to meet their investment needs, but it is not always possible, especially where there is insufficient capital to generate income locally. These cases need to be monitored carefully and on an individual basis in order to achieve the most appropriate results for the client.

Is SA any worse off than global markets?

This kind of question is easily answered by looking at the facts. We are all easily distracted by the political component of this question, but facts i.e. hard data, are more robust and instrumental in proving an answer.

Before considering the facts though, let me re-iterate Maestro's long held view that all investors, including South African ones, should have as their long-term investment objective *the protection of the value of their investment in hard currency terms*. Given our belief that the rand will remain a weak currency, and given its dramatic decline in value over the past three decades, it doesn't take a rocket scientist to realize that the South African investment destination is not very attractive and that all long-term investments should be directed into global markets (and hence be hard currency-denominated) rather than local ones. We have consistently held this view for a period of at least five years. With that as background, Let us consider the facts, which are shown in graphic form below.

Madonna Della Corona Sanctuary, Verona, Italy

Instagram handle: @discover_europe_

The following three charts depict the same four indices: the All Share index (ALSI) in rand terms as an indication of what a South African (SA) investor would have received had he or she invested in the SA share market; the ALSI in dollar terms to indicate the dollar return that global investors would have received had they invested into the SA equity market; the S&P500, which is used as a proxy for US equity markets; and the MSCI World index as a proxy

for developed equity markets returns. The only difference between the following three charts is the period over which the returns are measured.

Chart 11 tracks the four respective indices since the start of 2000. Remember this was near the end of a massive increase in prices (not shown) in the lead-up to the turn of the Millennium, and the surge in the prices of technology-related shares. The market peaked in March 2000. It is clear that the ALSI generated the greatest return, but of course in hard currency this is a mirage, as the rand was losing value against hard currencies throughout this period. It is interesting to note how the red line, which depicts the ALSI in dollar terms moves sideways between about 2010 and 2015, which simply means the rand was losing value as fast as the ALSI was rising in rand terms.

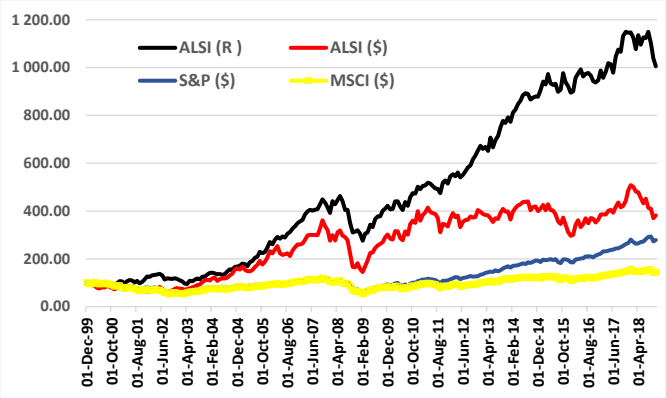
The US equity markets, shown as the S&P500 index in the blue line, only really "came into its own" from about 2009, which was of course the market trough (March 2009 to be exact) following the Great Financial (subprime) Crisis.

Porto Flavia, Italy

Instagram handle: @ig_italia

To make it more meaningful, assume you invested R1 000 at the beginning of 2000. In November 2018 i.e. the end of last month that investment would be worth R10 054 had you invested in the ALSI. Had you measured those returns in dollar terms, your R1 000 would be worth only R3 816, showing just how much the rand has declined in value against a hard currency such as the dollar. Your $1 000 would be worth $2 785 had you invested in the US equity markets and $1 437 had you invested in across developed markets (the MSCI World index). So clearly even in dollar terms the SA equity market has been a profitable place to be, had you been an investor in it since 2000.

Chart 11: Comparative index returns – since January 2000

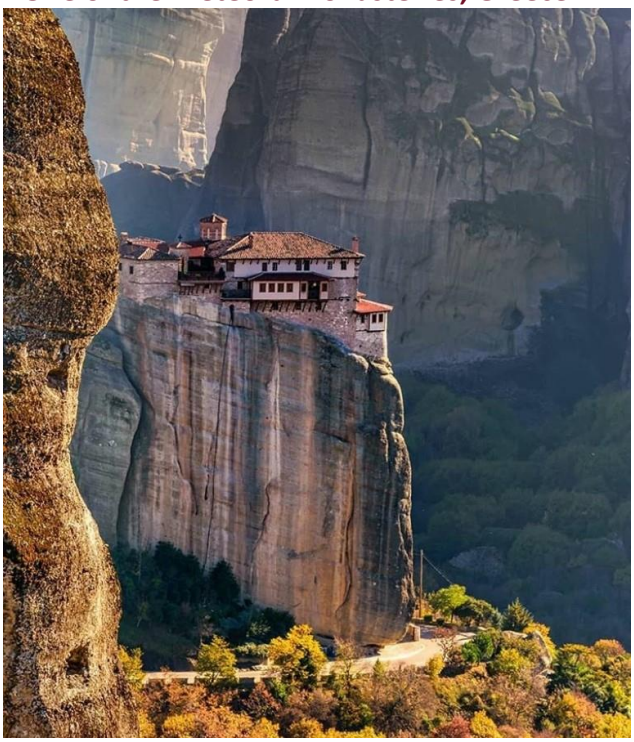


But what about more recent years? Well, Chart 12 depicts the movement of the same indices, but since April 2009, which just happens to coincide with the arrival into the President's office of one Jacob Zuma. Not surprisingly, the picture changes dramatically for all SA investors who retained the investments in rand terms.

The US equity market returns exceed all others, with the ALSI dollar return (the red line) proving to be the least profitable, which is simply a reflection of how much value the rand lost against the dollar. In other words, if you had as your investment objective the protection of your investments in hard currency terms, and you invested in the SA equity market, *you would have failed dismally*. Had you invested offshore into the US equity market (the blue

line) you would have succeeded spectacularly – in dollar and rand terms, but more about that later.

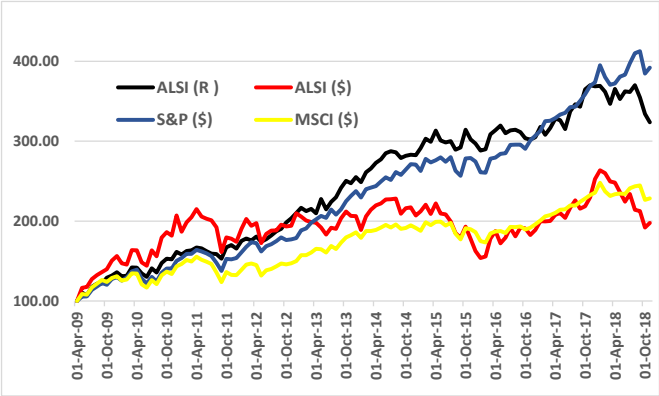
One of the Meteora Monasteries, Greece



Instagram handle: @best_earthscapes

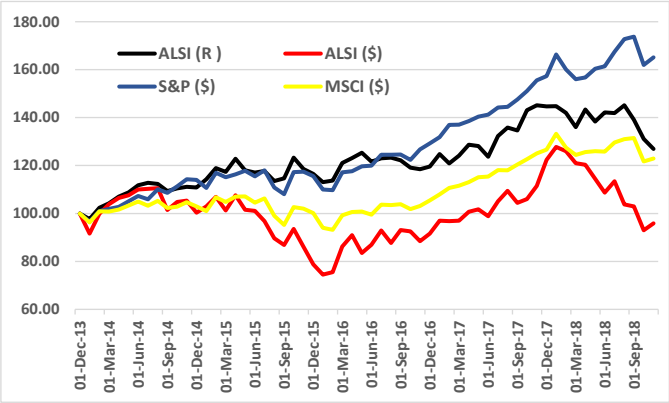
Note how you can track the movement of the rand by following the red line. The red line declines sharply around the end of 2016, which of course coincided with "Nenegate", when Zuma fired then Finance Minister Nene and we went through three Ministers within a matter of days. The rand recovered slowly in the subsequent two years – see how the red line rises – firming (rising) sharply into December 2017 with the election of President Ramaphosa. Since then the rand and the dollar return of the SA equity market have been in sharp decline ever since, which underlines just how important it is to protect the value of your investments in hard currency terms.

Chart 12: Comparative index returns – The Zuma years



Finally, let's measure the behaviour of the same indices but during the last five years, starting at the beginning of January 2014. It was during this period that Maestro started advising its clients to seek protection against the declining rand by investing offshore. We have always advocated an offshore component to portfolios, but during this period we lost complete confidence in Government's ability to manage the economy and its components, and began regarding the SA investment markets are markets to avoid. The behaviour of various markets is depicted in Chart 13 and shows that the US equity market has been the best performing market by far over this period. The worst place to have been is in the SA equity market as a dollar investor – no wonder international investors avoid the SA equity market like the plague. The value of these investors' capital is still not above its starting point – note the red line is still below the 100 level, whereas US investors are now well above 160, despite the recent market sell-off.

Chart 13: Comparative index returns – the past 5 years



At the risk of over-complicating this analysis, note that I am not showing what a rand investment would be worth in dollar terms had you invested in global markets. I have wanted to keep this analysis simple, but for those who are interested consider the following, and here I list the returns over a five-year period only i.e. the period covered by Chart 13.

- Had you invested R1 000 in the SA equity market over this period, it would now be worth R1 269.
- Had you invested R1 000 into the US equity markets at the start of 2014, your investment would now be worth R2 289 (this is not shown on any of the three charts). You would thus have doubled your money and significantly out-performed the SA equity market in rand terms.
- Dollar investors who invested $1 000 into the SA equity market over the period, would now value their capital at $959 i.e. they have lost money over the past five years.
- Dollar investors who invested $1 000 into the US equity market, have seen the value of their investment increase over the five-year period to $1 651.

Let me now return to the original question that gave rise to this comment: is SA any worse off than global markets? I think you will agree from our analysis above that the SA markets have been a terrible place to invest if you wanted to protect the value of your investments in hard currency terms. There are other, much more profitable markets to invest it, and the US equity market has been one of the most profitable to invest in in recent years.

Palais Scheherazade and Spa, Fez, Morocco

Instagram handle: @best_hotelsandresorts

Is the SA market being punished for bad national governance and high levels of corruption?

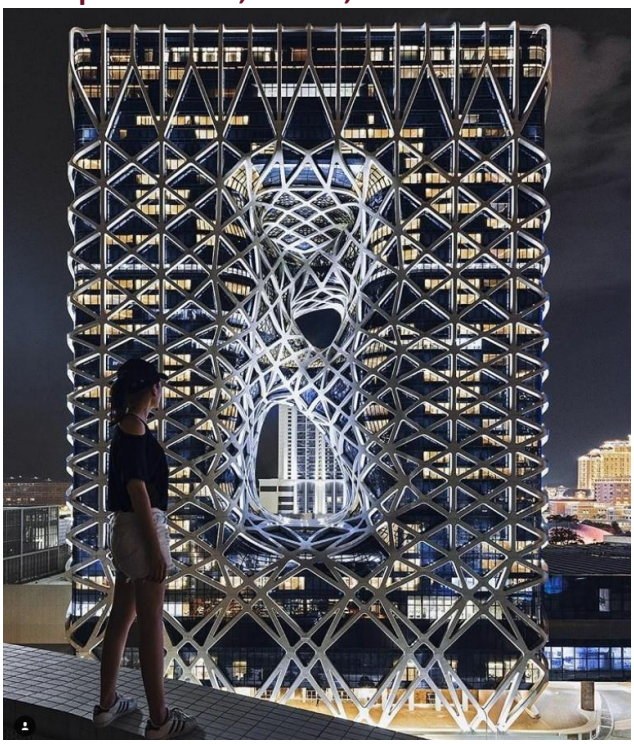
We all have our own opinions as to why our markets have and are performing so badly. Our own view is that equity markets are ultimately driven by earnings, which in turn reflect the underlying economy. Currencies are driven by the level of interest rates in that specific country and by foreign sentiment towards that country or group of counties, such as towards emerging markets as a whole in the case of the rand.

You don't need me to tell you that the SA economy is well and truly broken. It is going to take something beyond miraculous to fix it. As romantic as we would like to be about the political situation and future of this country, SA needs capital, and lots of it – way more than its own

citizens and savers can produce. We just don't see any change on the part of Government occurring that will be significant enough to attract foreign investors into this country. The risk to their capital is simply too high, and so their capital will be directed to more attractive countries and opportunities.

That leaves SA in a scary place as its infrastructure crumbles, the ability to deliver even basic goods like water and electricity declines by the day, and more and more people become unemployed and a lot poorer. So is SA being punished for bad governance and high levels of corruption? Well, bad governance, partly throughout simply incompetence and lack of education, and rampant corruption, which we don't see changing anytime soon, lead to a lack of confidence, locally and abroad, in the country and its markets. As long as that prevails, our markets are likely to struggle and the rand will continue to decline in value over time.

Morpheus Hotel, Macao, China



Instagram handle: @seven7panda

Should I still externalize my assets even though the rand has been very weak this year?

I have failed totally in my explanations above if you do not answer this question in the affirmative. Yes, if you are a long-term investor and wish to protect the value of your investments in hard currency terms, you should still be externalizing your assets over time.

How have markets (overseas and local) performed over the last 10 years – so I can see the current moves in perspective?

Ironically, this is a more difficult question to answer simply than one imagines. The answer is, of course, it depends on which currency you invest in and denominate your investments in. Ah, you say, of course it will be the rand. However, if you can – and under current exchange control regulations in SA virtually all investors now can – invest your funds offshore, why should you only think in rand terms? The whole point of Maestro's assertion to protect your investments in hard currency terms, is because you can. That being the case, why think like a rand investor? No, we should all be thinking in hard currency terms, for what point is there in thinking in rand terms when the rand is losing value consistently over time. Hence our view that all South Africans should regard themselves as global investors, and for the sake of ease and convenience, we think investors should regard themselves as dollar-denominated global investors i.e. they should measure the value of their investments, and hence also their returns, in dollar terms.

Table 2: Selected global market returns

Returns to 30 Nov 18	YTD	1 year	3 years	5 years	7 years	10 years
S&P 500	5.0%	6.2%	12.0%	11.1%	14.5%	14.5%
DAX	-12.9%	-13.6%	-0.4%	3.7%	9.2%	9.2%
FTSE 100	-9.2%	-4.7%	3.2%	1.0%	3.4%	5.0%
Hang Seng	-11.4%	-9.2%	6.4%	2.1%	5.7%	6.7%
Nikkei 225	-1.8%	-1.6%	4.2%	7.4%	14.9%	10.1%
Shanghai Composite	-21.7%	-22.0%	-9.1%	3.1%	1.5%	3.3%
MSCI World	-3.0%	-1.7%	6.4%	4.6%	8.1%	8.6%
MSCI EM	-14.1%	-11.2%	6.9%	-0.5%	1.0%	6.6%
10 Year Treasury	2.7%	2.9%	2.4%	2.3%	2.2%	2.4%
Barclays Glbl Agg Bond	-3.2%	-2.8%	2.2%	0.6%	0.8%	1.6%

I will keep a more detailed analysis of this seemingly simple distinction for next month, but for now will simply list the returns of selected global and local returns in

Tables 2 and 3 respectively. You can draw your own conclusions but it is clear that over virtually every period during the last decade, US markets have performed the best and SA markets have definitely not been the place to invest in. Within each table, the black highlight indicates the market that has performed the best, and the red block highlights the worst performing market during that period.

Table 2: Selected local market returns

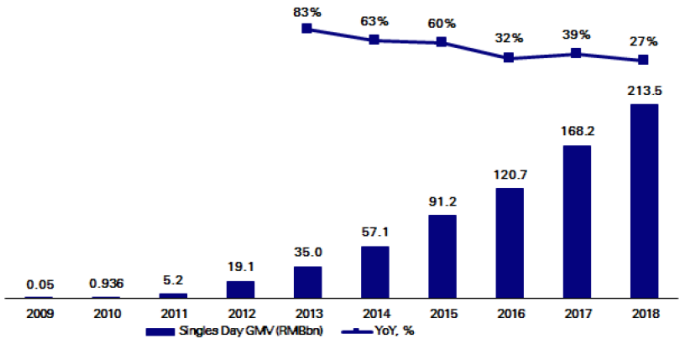
Returns to 30 Nov 18	YTD	1 year	3 years	5 years	7 years	10 years
All Share Index	-12.3%	-12.6%	2.3%	5.5%	9.6%	12.3%
SWIX All Share	-16.1%	-15.4%	N/A	N/A	N/A	N/A
All Bond Index	7.1%	13.1%	8.3%	7.8%	7.8%	8.3%
Top 40	-12.5%	-13.6%	1.6%	5.2%	9.3%	11.8%
Mid Cap	-12.7%	-8.5%	4.5%	5.9%	10.0%	14.5%
Small Cap	-15.9%	-17.0%	-1.2%	5.1%	9.1%	10.1%
Value	-13.3%	-12.0%	0.4%	-2.1%	1.9%	6.7%
Growth	-4.1%	4.0%	5.6%	10.0%	12.1%	8.6%
Cash	6.6%	7.3%	7.4%	6.8%	6.4%	6.7%
SWIX 40	-16.3%	-16.2%	-3.7%	1.2%	5.6%	N/A

File 13. Things almost worth remembering

Alibaba Singles Day

I have in past years always drawn your attention to Alibaba's Singles Day, and I do so again this year. Just to refresh your memories, Singles Day was celebrated long before Alibaba turned it into a Chinese ecommerce day of epic proportions. It is a day when Chinese people celebrated being single, and occurs on 11 November. In 2009 Alibaba initiated their "Singles Day Festival" and its dramatic rise is depicted in Chart 14. GMV depicts Gross Merchandise Value, being the value of all goods traded (bought) through the Alibaba website in the 24 hours that constitute the day of 11 November in China.

Chart 14: The rise of GMV on Singles Day



Source: Deutsche Bank

Moszna Castle, Poland

Instagram handle: @awesome_phototrip

From modest beginnings in 2009, the Day has increased in size, with consumers buying 27% more goods this year than last. Some of this year's highlights included:

- Total GMV settled through AliPay, Alibaba's online payment company, was RMB213.5bn ($30.8bn), an increase of 27% compared to 2017.
- The first $1bn GMV was purchased within 1 minute and 25 seconds after midnight when the Festival opened, and the first $10bn purchased after 1 hour and 48 seconds.
- Cainiao Network, Alibaba's delivery company, processed more than 1bn delivery orders. Last year it processed 812 000.
- More than 180 000 brands participated in the Festival, with over 40% of the purchases made from international brands. In the 2017 Festival, "only" 140 000 brands participated.
- 237 brands exceeded RMB100m ($14.4m) in GMV, including leading international brands such as

Apple, Dyson, Kindle, Estée Lauder, L'Oréal, Nestlé, Gap, Nike and Adidas.

- Consumers from 230 countries and regions completed transactions
- For the first time this year, one of the companies that Alibaba has invested into, Lazada, which runs an ecommerce operation in South East Asia, participated in Singles Day, bringing the Festival to consumers in Singapore, Malaysia, Thailand, Indonesia, the Philippines, and Vietnam.
- The first packages ordered by consumers were delivered 8 minutes past midnight. Last year it took 12 minutes.

Château de Chantilly, Chantilly, France

Instagram handle: @hello_france

Christmas comes early for Coates

Have you ever heard of Denise Coates? If you live in the UK I am sure you have heard of her, but to most South Africans she is an unknown. It is likely to stay that way for those unlucky people who don't read *Intermezzo* of course.

Very large global executive packages have always been energetically debated in the Maestro office, partly I suspect out of envy but also out of disbelief when we "do the numbers" and convert the package in question into rands. It is at that point that all participants tend to go quiet and the discussion ends.

What, I hear you ask, has that got to do with Denise Coates? Quite a lot actually, because a few weeks ago she became the highest paid woman, and executive in the UK, and to be frank in the corporate world. The 51-year old co-founder and controlling shareholder of UK online gambling company Bet365 was awarded an amount of R3.62bn (£220m) early in November.

Of course many would argue that it is none of our business, and that she has worked hard enough to deserve it, etc. What makes the award controversial is the evidence that is now coming to the fore about the chronic problem of gambling addiction amongst the young people in the UK, and elsewhere I have no doubt, primarily through mobile devices and phones in particular. Late in November the UK's Gambling Commission published a report on children and gambling trends. It showed, for example, that in the UK 14% of 11 – 16-year olds had spent their own money on gambling in the past week, compared to 13% who had drunk alcohol, 4% who has smoked cigarettes, and 2% who had taken illegal drugs in the past week. Over the past year, 39% of 11 – 16-year olds had spent their own money on gambling. Smart phone gambling in the fastest growing form of gambling in the UK, where more than half of the 9m gamblers do so via mobile phone or tablet.

Where does this leave Denise Coates? Well, very well off, if nothing else. There is plenty of evidence bearing testimony to her support of the Stoke-on-Trent community, her home of origin and where she is regarded as nothing short of proof of Divine intervention. After all, one of her assets is the Stoke football club – although it is ironic that her recent award was the equivalent of twice the payroll of the total Stoke City squad.

I am sure you have your own view of outsized corporate packages – I'd love to hear them. If nothing else, now you know who Denise Coates is and are unlikely to forget that name in a hurry.

So what's with the pics?

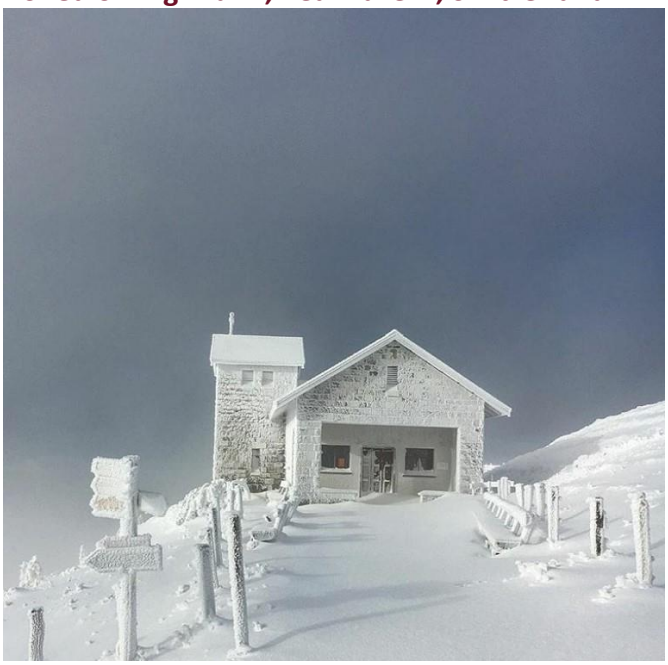
During the past few months, I have become a great fan of Instagram. For regular readers of *Intermezzo*, that will not surprise you, given my fondness for photographs and things visual. Instagram doesn't lend itself to sharing much of the beautiful photos that appear on it from users around the globe, other than on the Instagram platform itself.

That said, I have created folders compiled along thematic lines. The photos that appear in this edition – taken from my Buildings folder – have all been lifted from Instagram. In an effort to guide you to their source, and to honour the original creator of the photo, I have included the Instagram handle below each photograph. Inevitably, using this approach, some quality is lost along the way, but I hope the photographs are of sufficient quality for you to still enjoy them.

Château de Chambord, Chambord, France

Instagram handle: @hello_france

Shed on Rigi-Kulm, near Luzern, Switzerland



Instagram handle: @#mylucern