INTERMEZZO
MAESTRO Investment Consulting
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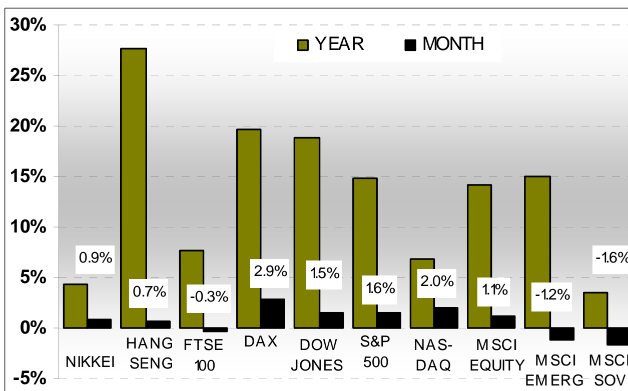
January in perspective – global markets
The positive mood that prevailed on equity markets late last year continued into January resulting in the MSCI world index rising 1.1%. The German market was particularly strong. The MSCI emerging market index declined 1.2% with good returns from Turkey and India offset by poor ones in Hungary, Russia, South Korea and Indonesia. US economic data released during January seemed to indicate that the US economic slowdown was not as severe as many believed. If correct US interest rates will decline later than investors were anticipating. The dollar drew comfort from this development and rose marginally against most currencies. The bond market, which had all but priced in the next rate cut, reacted by posting a decline on the month.

Chart 1: Global market returns to 31 January 2007

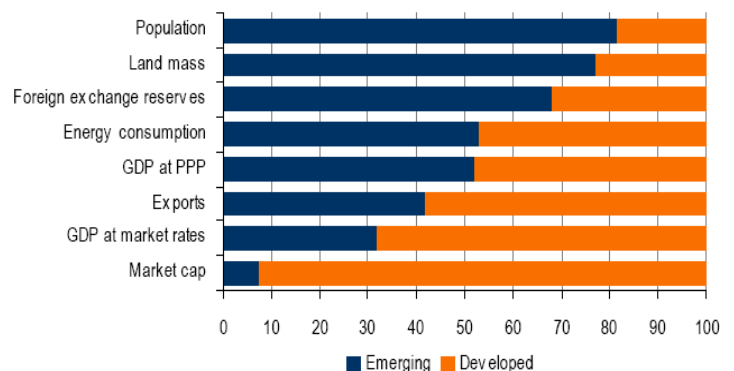


The bull in the China shop – the real McCoy
Apologies for the jarring mixed metaphor, but how else could one describe recent events on the Chinese stock exchanges? Have you noticed how strong the Hong Kong market has been of late? It rose 5.3% in December, and its annual return to January was 27.6%, down from 34.2% in December. Its market capitalization exceeded $2 000bn during the month - more than China's GDP. A factor behind the momentum in Hong Kong is the developments on the Chinese mainland, where recent market gains have been even more remarkable. The total market capitalization of China's Shanghai and Shenzhen equity markets exceeded $1 000bn during January. The Shanghai A index rose 130% in 2006, with returns of 14.2%, 27.6% and 4.0% over the past three months. This is a far cry from the same market which only eighteen months ago hit a six-year low. Investments in Chinese mutual funds now exceed $100bn, having started 2006 at $60bn. There are 56 investment houses competing in China of which 24 are Sino-foreign joint ventures that manage about 40% of all mutual fund assets. The attraction for participants lies in tapping the estimated $2 000bn lying in bank deposits. However in January the Beijing authorities put a hold on new equity mutual fund launches, signalling their concern at the recent price increases.

What is the relevance of all of this? Firstly, it is important to identify the forces behind the recent rise in the Hong Kong and Chinese markets. Secondly, it is also important not to confuse the heated equity markets with the fundamentally based, long-term "China story". Thirdly, one needs to air some concern at a market that is potentially as important as the nascent Chinese one, heading into a "bubble". The world's investment markets have enough on their plate right now (which all seems to be working rather well, thank you) than to manage the bursting of a bubble with trillions of unsophisticated dollars and investors behind it. In that respect, as much as the purists would argue their case, it is comforting to see government stepping in, as they have on previous occasions, to prevent the situation getting out of hand. Whether they will be successful remains to be seen – their track record is patchy at best. But no one can accuse them of having insufficient fire power. With the Olympic Games just one year away we can expect the authorities to manage the situation closely in order to retain the orderly façade so characteristic of China. We should also remember the sheer substance and momentum behind the changes in China, which can result in a situation more difficult to manage and control than investors are accustom to.

Chart on the month
Maestro has long beaten the drum of emerging markets as an increasingly important factor in the global economy. We have emphasized the *structural* nature of the changes many of these economies are undergoing. Of course, the cyclical nature of their economies will not disappear, but the effects and momentum of the changes will not disappear overnight. We turn again to the emerging market theme in this section in an effort to illustrate some of the potential for and components of the changes currently taking place. Chart 2 depicts emerging markets relative to the rest of the world in terms of a couple of criteria. Compare the last one, where emerging markets constitute less than 10% of the world's stock market capitalization, with other aspects such as foreign exchange reserves, population and even GDP.

Chart 2: Emerging economies as percentage of total world



Source: Merrill Lynch

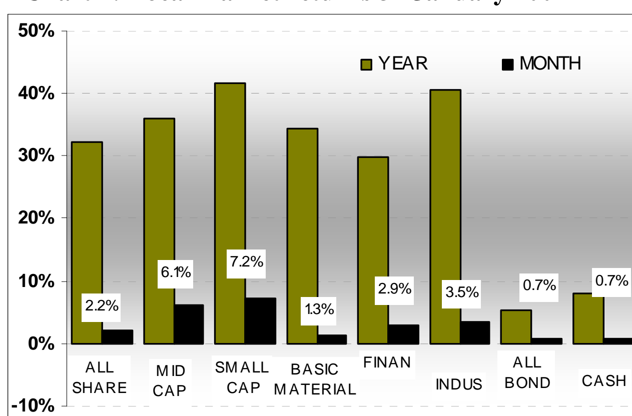
Chart 3: Basic infrastructure indicators

Region	Africa	East Asia	Eastern Europe	Latin America	MENA	South Asia
Population (mn)	674	1823	474	518	300	1378
% living on less than $1 a day	46	15	04	1	02	31
% urban population	36	43	65	77	59	28
% urban population projected by 2030	51	62	7	85	7	42
Major access indicators						
Electricity (% of population with access to network)	24	88	99	89	92	43
Water (% of population with access to improved sources)	58	78	91	89	88	84
Sanitation (% of population with access to improved sanitation)	36	49	82	74	75	35
Roads (% of rural pop. Living within 2km of an all-season road)	34	95	77	54	51	65
Teledensity (fixed line and mobile subscribers per 1,000 people)	62	357	438	416	237	61

Source: World Bank, Merrill Lynch

Within the broader theme of emerging markets, the theme of infrastructural investment is an important one, given the relevance of commodities in the SA economy. For its part the SA government has committed itself to R375bn of infrastructural investment over the next three years; this total is likely to end up being far greater – remember that private (corporate) investment is excluded from this figure. The issue of infrastructural investment in emerging markets has shifted up the priority list. It is no longer a luxury; it is now a prerequisite for further economic development. Think no further than the debilitating power outages across the country, or the traffic jams in the cities and airports, and you realise that South Africa is no different from any other growing economy. I suspect that in bigger economies such as Brazil, India and China, the needs are larger and more urgent making any further delay impossible. Chart 3 illustrates some of the challenges at hand.

Chart 4: Local market returns 31 January 2007



January in perspective – local markets

The SA equity market drew comfort and strength from the positive global investment environment, as well as a real sense of economic well-being in the country. While hard to quantify, there seems to be a growing belief that, despite some significant odds (HIV Aids and crime probably being the largest obstacles) the country *can* continue growing at 4% per annum and perhaps even faster. The fact that the plans for the FIFA 2010 Soccer World Cup are now very much part of the economic fabric is helping to lift the national "self-esteem". That other emerging markets are experiencing a similar phenomenon merely compounds its local effect. As if to bear witness to this, amongst the largest monthly returns in the SA market were those of the fixed line telecoms (+13.8%) and construction (+13.1%) sectors. With smaller companies still able to grow rapidly and make the most of the favourable circumstances, the excellent returns of the mid (+6.1%) and small cap (7.2%) indices should come as no surprise.

For the record

Table 1 lists the latest returns of the mutual funds under Maestro's care. You can find more detail, including the latest Maestro Equity Fund Summary, by visiting our website at www.maestroinvestment.co.za. The December Quarterly Report in respect of the Maestro Equity Fund is available, should you wish to read it. Please contact me directly on andre@maestroinvestment.co.za if you would like to receive a copy.

Table 1: Returns of funds under Maestro's care

	Month	Return	Year to date
Maestro Equity Fund	Jan	**4.7%**	**4.70%**
Maestro equity benchmark *		2.0%	2.0%
JSE All Share Index		2.2%	2.2%
Central Park Global Balanced Fund ($)	Dec	**1.8%**	**13.4%**
Benchmark**		0.9%	12.1%

* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index
** 40% MSCI World Index, and 20% each in MSCI Sovereign Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills

Whilst on the topic of returns, Table 2 lists the compound annual returns for the periods ended 31 December 2006, (the 6-month return is un-annualised) on the equity portfolios under Maestro's care. For the first time we are able to list a 5-year return. Without going into too much detail, suffice is to say that Maestro's performance during the second quarter of 2006, specifically during May and June, was below par. We reduced the risk of portfolios when emerging markets around the world got the "wobbles", which with the benefit of hindsight proved to be the perfectly *incorrect* thing to do. We dealt directly with our clients regarding this matter; hopefully they understand the reasons for us taking this action at that time. I am happy to report that the performance, in relative and absolute terms, of their assets under our management has returned to levels that meet Maestro's standards, although of course there is always room for improvement. Fortunately last year's disappointing returns did not make too much of a dent in our longer-term returns, and in this regard the returns over the three, four and five-years periods are most respectable. We touched on it last month: once again the sheer quantum of returns over the longer periods bear testimony to what a rewarding period this has been for investors in SA's equity market. I would hasten to add, particularly for the benefit of readers outside of South Africa, that the returns are even greater in dollar terms.

Table 2: Maestro annual returns to 31 Dec 2006 (%)

SA equity returns	6 months	1 year	2 years	3 years	4 years	5 years
Maestro average – ***short-term, actively traded portfolios***	***26.0***	***34.1***	***36.6***	***45.3***	***47.8***	***56.8***
Maestro average – ***long-term portfolios***	***30.8***	***43.1***	***42.2***	***42.3***	***39.6***	***38.6***
Maestro equity benchmark *	23.5	40.5	40.3	38.7	32.5	28.2
JSE All Share Index	18.9	41.2	43.9	37.5	31.8	29.0

* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index

File 13: Ringing the changes in India

For the benefit of new readers "File 13" is a section wherein interesting facts or knowledge are highlighted which, once assimilated, can be relegated to File 13 i.e. the mental dust bin. They are less relevant – at least to some readers - and are listed purely for edification and interest purposes.

In line with the theme of emerging markets this month, some of you may be aware that the race is on to buy Hutchison Whampoa's stake in Hutchison Essar, India's fourth largest mobile phone operator. The stakes are large, but the prize even larger – at least in the long-term. Telephone penetration in India was 2% in 1999. Thanks to government de-regulation in the same year, allowing competition from the private sector, today it stands at 16.6% (*Ed*: anyone from the SA government or Telkom out there?!). In November 2006, India added 6.8m subscribers, bringing the total wireless customer base to 143m. India's mobile market is now growing faster than China's. India's Department of Telecommunications has set itself the ambitious target of 500m telephone subscribers by 2010 – representing a compound annual rate of nearly 50%. As is the case in many emerging markets though, penetration levels are unevenly spread. 70% of India's 1.1bn population live in rural areas, where the telephone penetration is only 2% - 3%, compared to 50% in cities today. As an aside, in its recent trading update Vodacom estimated that the total South African SIM-card penetration stands at 80%.

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