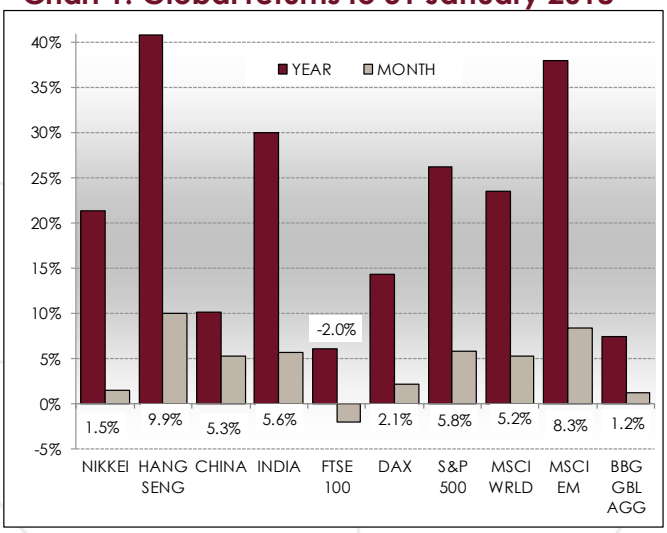
January in perspective – global markets

Hot on the heels of the remarkable year of 2017, January proved to be another unique month on global equity markets, and more profitable too. Equity markets registered their 13th uninterrupted month of positive returns, while January 2018 delivered the greatest returns of all those months. Such a long run of consecutive positive monthly returns is unprecedented historically, and bears witness to the remarkable times we are living in.

Chart 1: Global returns to 31 January 2018



A key feature and driving force of the January returns was the weak dollar. The DXY trade-weighted dollar index declined 3.2%, while the euro and pound gained 3.7% and 5.1% against the greenback, respectively. Both the Eurozone and UK economies are more resilient than expected, which supported the currency gains over and above the dollar weakness. The weak dollar had a major positive impact on emerging market currencies, and also supported emerging equity markets. Consequently, the MSCI Emerging Market index rose 8.3% in January, some way above the MSCI World index return of 5.2%, which in itself was more than respectable. Strong equity market returns were registered in Brazil, which closed 11.1% higher on the month, Russia 11.0%, Greece 9.5%, India 5.6%, and China 5.5%. Hong Kong rose an astonishing 10.0%, bringing its annual gain to 40.8%. The US equity market rose 5.8% and the tech-heavy NASDAQ 7.4%.

The global bond market produced lower returns, although still positive, other than in the US where bond yields plotted a steady path higher (and prices lower). The net result was the Bloomberg US Bond index lost 1.5% while the Bloomberg Global Aggregate Bond index rose 1.2%. The annual return on the latter is now 7.5% (the US bond market is up only 2.2%) compared to the MSCI World and Emerging Market annual returns of 23.5% and 38.0% respectively. It is clear that equity markets have been "the place to be" during the past year.

Commodity prices were generally firmer in the face of a weak dollar although the 2.4% decline in the copper price was a surprise. Oil continued to rise, adding 2.3% in January, bringing its annual gain to 21.8%.

Argentina: Buenos Aires library

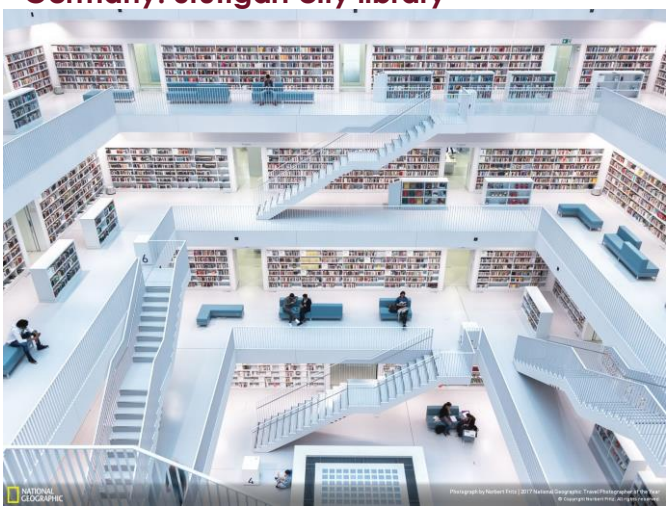
"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

What's on our radar screen?

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

- *The US economy*: The US economy grew at an annualised rate of 2.6% during the fourth quarter of 2017 (Q4). Despite strength in consumer spending (personal consumption rose 3.8%), growth during the quarter was impacted by a large increase in imports and less inventory accumulation than expected. Estimates for Q1 2018 are for the US economy to grow around 3.0%.
- *Developed economies*: **The UK economy** grew at a quarterly rate of 0.4%, bringing its annual 2017 growth rate to 1.4%. Economic activity in **the Eurozone** increased by 0.6% on a quarterly basis, bringing its 2017 growth rate to 2.7%. France grew at a quarterly rate of 0.6% and Spain 0.7%. The International Monetary Fund (IMF) upgraded its forecasts for world economic growth from 3.7% to 3.9% for this year and next, the fastest pace in seven years. About half of the upgrades were due to the US tax cuts, with US 2018 growth rate lifted to 2.7% this year. The Eurozone is projected to grow 2.2%, China 6.6% and the UK at 1.5%. The IMF cautioned that loose financial conditions, rich asset valuations and low bond yields raise the possibility of a market correction and that "a possible trigger is faster than expected increase in advanced economy's core inflation and interest rates as demand accelerates". Hence, "policy makers should take steps to raise potential growth and increase resilience to shocks, such as reforms to lift productivity and proactive financial regulations."
- *Emerging economies*: **The Chinese economy** grew at an annual rate of 6.9% during 2017, an increase from 2016's rate of 6.7% and above the official growth target rate of 6.5%. Exports proved to be the engine of growth, against the background of a robust global economy. **Indonesia** posted an annual 2017 growth rate of 5.1%, similar to 2016's rate. Investment growth was solid at an annualized rate of 7.3% during Q4, up from Q3's 7.1%, reflecting progress in the push for infrastructural investment. The government expects a pick-up in economic growth in 2018 on the back of strengthening global trade, with a forecast 2018 growth rate of 5.4%.

Germany: Stuttgart city library



Quotes to chew on

From one extreme

As you aware by now, January saw very strong equity markets, following 13 consecutive months of gains. Many commentators remarked on it in January, including the following from *Deutsche Bank's Jim Reid* (written on 22 January): "… it's worth noting that we've now passed the longest period without a 5% pull back in the S&P500 since we have daily data back to 1928. The 395 days without one pips the 394 days in the late 1990s and the 384 days back in the mid-1960s. So we're living through a uniquely strong consistent period for performance."

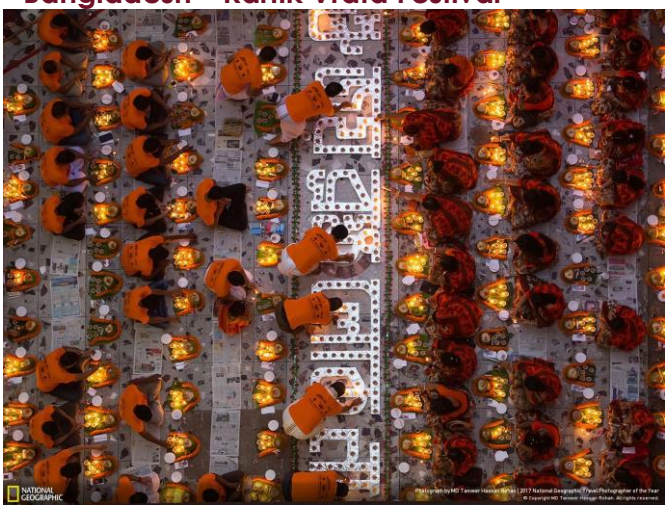
"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

To the other

Following the release of strong US wage growth on 2 February, markets were rocked out of their complacent state by a sharp fall in US equity markets, which set the scene for a week of substantial losses. Monday, 5 February in particular, saw huge volatility in the face of significant weakness. Indeed, I felt there was a "presence" in the market that we hadn't seen before, most likely the combined effect of algorithmic trading, which now forms a substantial part of daily trade, and the actions of very large passive entities, such as exchange traded funds or ETFs. Both of these forces have increased substantially in recent years. We haven't seen a market so "perfectly priced" being confronted by the forces unleashed by these two new substantial market forces.

Julius Baer's Christian Gattiker commented on the events as follows: "The wage growth data announced the US last Friday was the straw that broke short volatility-investments' backs. On Monday, risk assets took a serious hit as some of the fancy funds shorting the stock market volatility were liquidated. As with all market-intrinsic breakdowns, there is always a lack of empirical evidence. Remember the intraday flash crash in 2010, a 1 000 index point dive or so? With all the academics trying to figure out the reason why, the causes still remained elusive in the resulting 200+ page report. This week, the narrative of volatility 'shorties' going into a death spiral, triggering an algorithmic trading reaction in stocks, is as intuitive as it is logical. I doubt we will ever learn the real reasons and causes behind this week's events. The take-away is simple: there are dynamics in financial markets (and beyond) that cannot be grasped by anyone and remain intrinsic risks… as in 1987, 1997, and 2010."

Bangladesh – Kartik Vrata Festival



More insight into the early February movements

While there were many views on the wild early-February market movements worth considering, I thought those of Guy Monson, the Chief Investment Officer of Sarasin and Partners, were prescient. They summed up yet another of the market anomalies that almost form part and parcel of the prevailing markets. He commented as follows: "The (early-February) correction was also unusual because equity leadership was largely counterintuitive. At the headline level, for example, among the most defensive major indices was actually the technology-rich NASDAQ, while among the most vulnerable was the FTSE100 (with its low valuation, high running yield and large weightings in the supposedly defensive pharmaceutical and oil sectors). For example, in 2018 to date Royal Dutch Shell (with a yield of over 6%) is still showing a decline of 7%, while Amazon (with a forward price-to-earnings multiple of 175) has gained almost 20%, even adjusting for a weaker dollar. While Brexit-related flows no doubt exaggerated UK declines, the general feeling was that classically defensive or value sectors offered little – if any – additional protection".

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

Placing the recent moves into perspective

Julius Baer's Daily Wire report on market activity – in this case it was referring to market activity of 31 January - contained the following quote, which I thought was prescient: "S&P500 declines 1% – after 112 days – bullish or bearish? The S&P500 declined by more than 1% yesterday, ending a 112- day streak without a decline of 1%. Is this the start of a correction? Probably not, as the true reason for the S&P 500 not seeing a decline of 1% was a real demand by investors, and these reasons will not go away overnight. Thus, since 1940 there have been 12 instances where the S&P500 ended a streak of more than 100 days without a 1% daily decline. Hold your breath: 6 months later the S&P 500was up by 7.2% and 12 months later by 17%. Yesterday's decline in the S&P500 is a short-term consolidation and one more trick of the bull market to force you to believe that the bull market might be over. It's not true, the US secular bull market continues to climb the wall of worry." I guess time will tell how accurate these words are.

Unpacking the Western Cape water crisis

As Cape Tonians come to grips with the overwhelming water crisis, more interesting, and in some cases shocking, facts surrounding water in general, are coming to light. We learn the following from *Eighty20's Fact of the Day*: "According to the 2016 General Household Survey released by Stats SA, of the 1.83m households living in the Western Cape, 12% do not have access to piped water in their dwelling or on their site; most of these households make use of public taps. In total, across South Africa, there are around 4.5m households or 27%, who do not have access to piped water in their dwelling or on their site."

Thailand – Monks at prayer

Those in the Cape, who have learnt to have a shower with only a few drops of water, or who are adept at running around the house with buckets of grey water, will appreciate this: according to data released by the City of Cape Town, households living in freestanding properties in the suburb of Constantia halved their water consumption between April 2017 and December 2017 from 18kl to 9kl per month. If that doesn't sound impressive, I challenge you to live off less than 50l of water per day per person.

Fix the problem instead of throwing money at it!

Hard on the heels of the Budget tabled in Parliament by Finance Minister Malusi "now-you-see-him-now-you-don't" Gigaba on 21 February, I thought the following comments from *Eighty20's Fact of the Day* were pertinent: "South Africa allocates a higher proportion of its budget toward education than the US, UK and most of Europe. Over the 2017/18 period, approximately 15% of the SA national budget was spent on basic education. However, a Global Competitiveness Report by the World Economic Forum ranked SA's primary education system as 126th in the world and higher education as 134th, out of 138 selected countries.

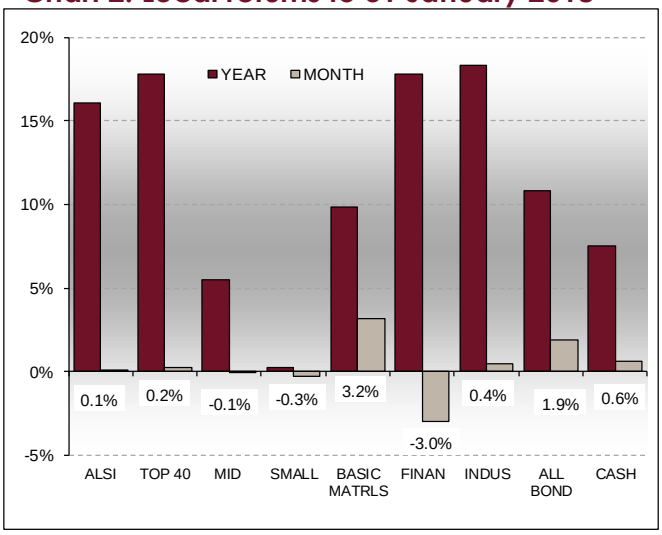
"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

India – Sadhus in Hindu temple

January in perspective – local markets

The JSE was in a less buoyant mood than global markets. The All Share index rose 0.1% although the 1.9% All Bond index return was in keeping with global bond movements. Despite the firm rand, which rose 4.3% during the month, the Financial index lost 3.0%. Similarly, despite the firm rand, the Basic Materials index rose 3.2%. The Industrial index rose only 0.4%, while the Mid and Small cap indices lost 0.1% and 0.3%, respectively.

Chart 2: Local returns to 31 January 2018



The best-performing sector during January was the Household Goods sector, which rose 47.1%. This was fully ascribable to the 47.1% gain in Steinhoff but obviously it is off a very low base. The Non-life Insurance index rose 12.1% and the Industrial Engineering index 12.9%. The worst performing sector was the Real Estate and Investment and Service sector, which declined 18.0%. The Coal Mining index lost 11.9%, and Listed Property lost 10.0%.

Charts of the month

In the light of the dramatic declines in global equity markets during early February, and the sharp increase in US bond rates over that period, the following charts provide some perspective into the extreme movements and hopefully provide some reasons why markets should stabilize in the coming weeks. Let's start by reviewing the actual US equity market action, as depicted by the S&P500 movements.

Chart 3 shows the market movement by the hour, with the horizontal line showing the time that the US labour data was released, which showed that wage growth had risen by more than expected. That is relevant, because market watchers are keeping a close eye on any evidence of rising price pressures in the US. Higher inflation is one of the bigger risks to global markets at present, and almost all investors are alert to any sign of it. US equity markets thus sold off sharply and interest rates (yields) on US bonds rose sharply (bond yields are inversely correlated to prices; thus rising bond yields implies declining bond prices). The chart also shows the subsequent movements for the month - markets have recovered a large part of their losses. However, it has been many years since we last saw the kind of volatility that characterized February's market movements.

The chart type used in Chart 3 specifically shows the ranges of each hour's trade; you can see just how volatile the markets were.

Chart 3: The week after higher US wage growth

Source: Saxo Bank

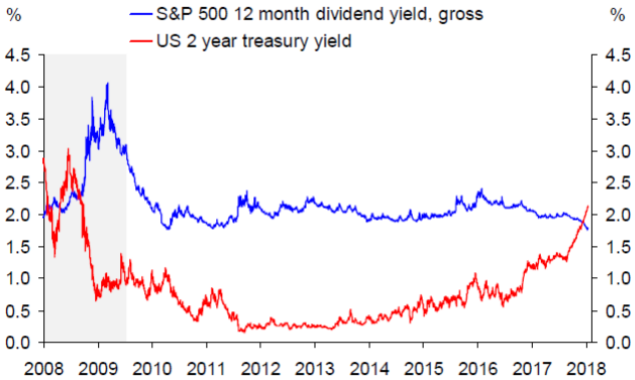
Chart 4 depicts the movement of the S&P500 in recent months, against the yield (interest rate) of the 2-year US government bond. You can see that they have moved in step with each other for some time now, until the decisive disruption caused by fears of inflation following the release of the labour data. Short-term yields spiked sharply, sending the equity markets lower and breaking the idyllic world that has existed for the last year or so.

Chart 4: The discount driven by inflation fears

Source: Deutsche Bank

Chart 5 depicts the same interest rate (yield) on US 2-year government bonds but this time against the S&P500 dividend yield, during the past decade. Having been suppressed for so long during the Quantitative Easing (QE) era, yields rose noticeably during 2017 but have really taken off in 2018 so far, shaking equity markets, particularly in early February. Importantly, the 2-year US bond yield has now surpassed the dividend yield on the S&P500. While there is no particularly significance to this development, it is noteworthy for not having occurred for the past decade and the rate at which the two yields have converged during the past two years. Ironically, the movements in yield are also symptomatic of bond and equity markets having become more expensive during this time.

Chart 5: US dividend and bond yields



Source: Deutsche Bank

If equity markets are getting more expensive, what is the outlook for equities? Of course this question begs a comprehensive response, for which we do not have time or space. But let me share four charts with you in support of our view that equities remain our asset class of choice.

We begin by reviewing the relationship between global equity markets and the manufacturing ISM index, which you recall is an indication of growth in the manufacturing sector. Any index

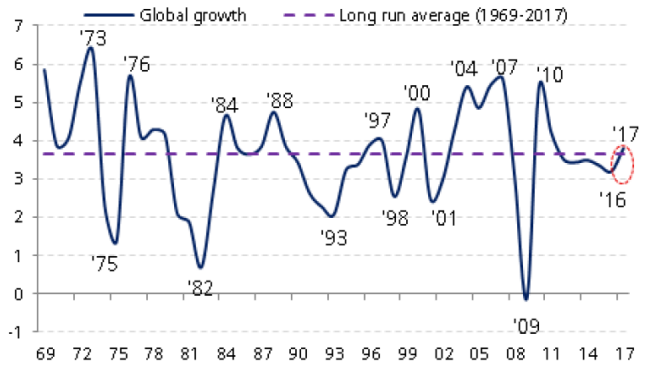
level above 50 denotes growth, and below 50 indicates declining economic activity. Not surprisingly, the ISM index has a strong and well-established relationship with the directional movement in global equity markets. Notwithstanding strong gains in equity markets in recent years, the ISM index remains very supportive of further gains in global equities.

Chart 6: The growth story remains in tact

Source: Deutsche Bank

Speaking of economic activity, the recent increase in global activity, which has been amplified by the increase in forecasts for growth in 2018, has pulled the global economic growth back to its 50-year average. Although this might sound surprising, Chart 7 shows the history of global economic growth. Of course this, too, is supportive of ongoing strength in equity markets.

Chart 7: Global growth back to 50-year ave

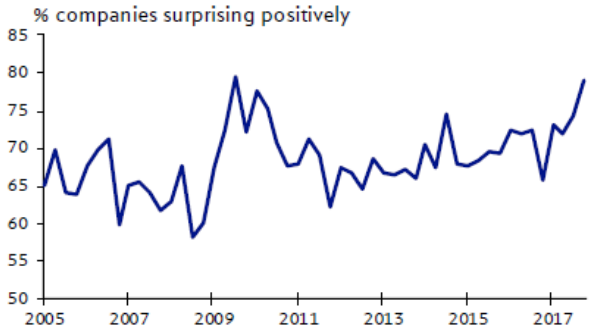


Source: UBS

Japan – Macaque baboons taking the plunge

One of the reasons behind the strength of global equity markets in recent years has been the strong corporate earnings growth. In this regard, it seems that there are more good earnings on the way, which makes sense if one accepts the strong and supportive economic backdrop. Chart 8 shows the percentage of companies that are producing positive earnings surprises. Not only is this index in positive territory (around 80% of companies have surprised positively when reporting their earnings) but the index is gaining momentum. This provides yet another reason to expect equity markets to continue firming.

Chart 8: S&P500 earnings surprise index



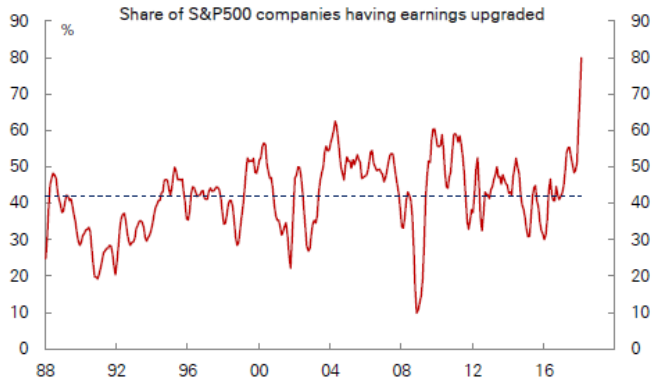
Source: Julius Baer

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

India – Varanasi, Uttar Pradesh

Chart 8 shows the historical earnings situation, but what about future earnings? In this regard, there is good news: chart 9 shows the percentage of S&P500 companies whose earnings are being upgraded. Not only have the number of corporate earnings upgrades surged in recent months, but the number is now at a record i.e. companies' earnings are being upgraded at the fastest rate on record.

Chart 9: S&P500 earnings still being upgraded



Source: Deutsche Bank

While space has precluded me from sharing a comprehensive view of why we believe equity markets will remain profitable this year, I hope these charts will help you understand why we hold this view. Of course, equity markets are not cheap. Returns in recent years have been very profitable, so we should not expect another bumper year like we had in 2013 or 2017, when the S&P500 index rose 32.8% and 21.7% respectively. However, with bond yields likely to head higher still (and thus prices head lower) we continue to believe that global equity markets will remain the most profitable avenue for investors this year.

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	**Jan**	**-0.6%**	**-0.6%**	**-0.6%**
JSE All Share Index	*Jan*	*0.1%*	*0.1%*	*16.1%*
Maestro Growth Fund	**Jan**	**0.5%**	**0.5%**	**6.1%**
Fund Benchmark	*Jan*	*0.4%*	*0.4%*	*13.0%*
Maestro Balanced Fund	**Jan**	**0.6%**	**0.6%**	**6.6%**
Fund Benchmark	*Jan*	*0.5%*	*0.5%*	*12.2%*
Maestro Cautious Fund	**Jan**	**0.3%**	**0.3%**	**5.5%**
Fund Benchmark	*Jan*	*0.9%*	*0.9%*	*11.2%*
Central Park Global Balanced Fund ($)	**Dec**	**1.7%**	**34.2%**	**34.2%**
*Benchmark**	*Dec*	*0.9%*	*14.9%*	*14.9%*
*Sector average **	*Dec*	*0.9%*	*11.3%*	*11.3%*

* 60% MSCI World Index and 40% Bloomberg Global Aggregate Bond Index

**** Morningstar USD Moderate Allocation ($)**

File 13. Things almost worth remembering

How big can the Chinese travel market get?

For the record, our offshore fund, Central Park Global Balanced Fund, initiated a new holding in CTrip.com International a few months ago. We have long fancied the Chinese online travel industry, and believe that it represents an

immense opportunity in the years ahead. The CTrip.com CEO, Jane Sun, was interviewed at Davos recently, and provided useful information on the industry. She predicted that the number of Chinese citizens holding passports will double from the present 120m to 240m by 2020, a trend that could fuel an explosion of mainland tourists exploring the world. Rising affluence is also likely to drive growth in Chinese travel. By 2020, CTrip's long-stated goal is to have as much as 1.4trn yuan ($221 billion) worth of annual gross merchandise volume, which refers to the total value of products sold on its platform. Sun has previously pledged to increase this to 2trn yuan by 2021. "The old Chinese teaching is it's better to travel 10 000 miles than to read 10 000 books," she said. "So they're going to travel all around the world."

Australia – Salmon migration, Margeret River

Obituary – Bra Hugh Masekela (1939 – 2018)

It is hard to know where to start to pay tribute to such a national and musical giant. I couldn't hope in the space of a few lines to pay due respect to a musician that was so loved and respected around the world yet who, for all the beautiful music he left us, led a sad, difficult and nomadic life. Fortunately his discography is substantial, so he leaves behind not only memories but also ample music for him to live on in our lives for many years. If you are interested, you can read comprehensive tributes to "Bra Hugh" from the Guardian by clicking here and in the Washington Post here. These sites include You Tube links to Masekela's playing.

Ramopolo Hugh Masekela was born in Witbank on 4 April 1939. The son of a health-inspector father and social-worker mother, Masekela was raised by his grandmother, who ran a shebeen. One wonders what influence that had on him; he struggled with addictions throughout his life. He acknowledged addictions to "drinkin', cokin', smokin' — you name it, all the 'kins." Drug use, he said, led him to squander $50m over the course of his career.

Masekela had shown promise on piano as a child but was entranced with the trumpet after seeing *Young Man With a Horn*, a 1950 Kirk Douglas film about a troubled jazz musician. At the time, he was attending St. Peter's, an Anglican prep school in the suburbs of Johannesburg, where his musical precociousness was matched only by his reputation for unruliness. "If I can get a trumpet," he promised his chaplain, "I won't bother anybody." His chaplain, anti-apartheid activist Trevor Huddleston, granted his wish, and soon found enough interest among other students to

start a band. Within a few years, Masekela became a founding member of the Jazz Epistles. The 1960 Sharpeville massacre squashed dreams of touring with the group. With the support of entertainers including Harry Belafonte, Masekela moved to New York, studied at the Manhattan School of Music and released his first record, *Trumpet Africaine*, in 1963. He married another South African legend, Miriam Makeba, affectionately known as "Mama Africa", in 1964 although they were divorced in 1966. The couple continued performing together until her death in 2008. Masekela's marriages to Chris Calloway and to Jabu Mbatha also ended in divorce. In 1999, he married Ghanaian-born Elinam Cofie, but that, too, ended in divorce.

Kenya – Surveying His Majesty's Kingdom

Masekela received a Grammy nomination for best world music album with his 2012 record *Jabulani* and appeared at a White House jazz gala in 2016. Masekela worked with just about all the famous jazz musicians of his time, including Miles Davis, Herb Alpert and Jimi Hendrix. He composed and arranged the music to Mbongeni Ngema's musical *Sarafina*! and was very involved in Paul Simon's controversial 1986 tour of and activity in South Africa, the output of which is contained in the record-breaking *Graceland*.

I am conscious that the readership of *Intermezzo* is probably predominantly white and Western. My experience over the past decade has made me realize that most South African whites are blissfully unaware of the unique, home grown genre of jazz music that is now known around the world as Township Jazz. This music is more widely appreciated and acknowledged abroad than at home, but there is nothing like it in the world, nor will there ever be. It encapsulates the political stories and journeys, trials and hardship of black South Africans like no other art form. Bra Hugh Masekela, together with other icons of our time, like Miriam Makeba, Abdullah Ibrahim, Jonas Gwangwa, and others, were pioneers of this remarkable and unique South African heritage.

The rise and development of this music form cost many black musicians their lives and forced others into exile, where they led tough existences yet rose above the remarkable odds against them. No musician captured this better than Bra Hugh. His story is captured in the 2004 book *Still Grazing – The Musical Journey of High Masekela* which he co-authored with D. Michael Cheers. I encourage you to pop into any CD store and buy a CD or three of Masekela's music – he recorded more than 40 albums in total - if you have never heard it before. Not only will his songs and music be missed in the future, but his presence and

persona, what he personified about the struggle of black South Africans, is unlikely to be filled in a hurry, if ever. Masekela passed away on 23 January after losing the battle against prostate cancer. South Africa has lost a true son and icon and we are the poorer for it.

Kenya – the King of the beasts

So what's with the pics?

The pictures that appear in this month's *Intermezzo* were chosen somewhat randomly. They are all candidates in various categories for National Geographic's 2017 Photo of the Day series. I hope you found them enjoyable.

Amsterdam - Rembrandt's Drapers Guild

Faroe Islands lighthouse

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