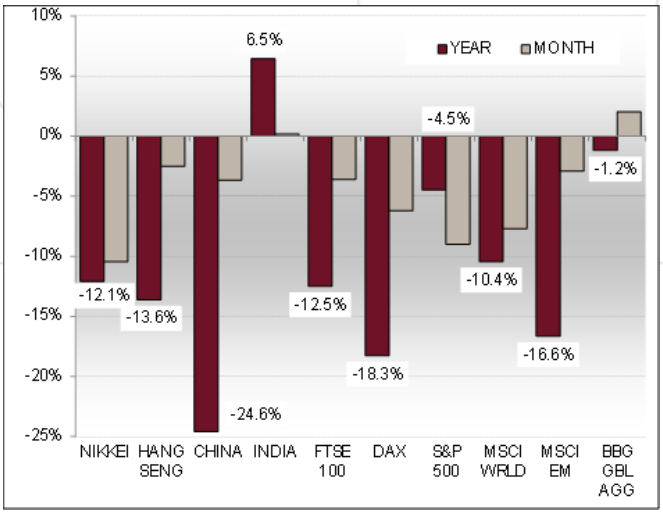
December in perspective – global markets

The misery of 2018 seemed to increase as the year progressed, culminating in a vortex of declines during December. It proved to be one of the worst Decembers ever in US market history, leaving many investors scratching their heads wondering if they had "missed something". The full and exact reasons for the sharp decline in global equity markets will be analyzed for some time to come, but reasons included the ongoing uncertainty caused by the US - China trade war, computer-driven algorithmic trading, the effects of unprecedented passive investment (index-linked) requirements, concern about a slowdown in the global economy during 2019, and concern about a slowdown in corporate earnings from 2018's record levels. Whatever the reasons, the declines were unprecedented, sharp, and relentless. Were it not for a late month rally, they would have been a lot worse.

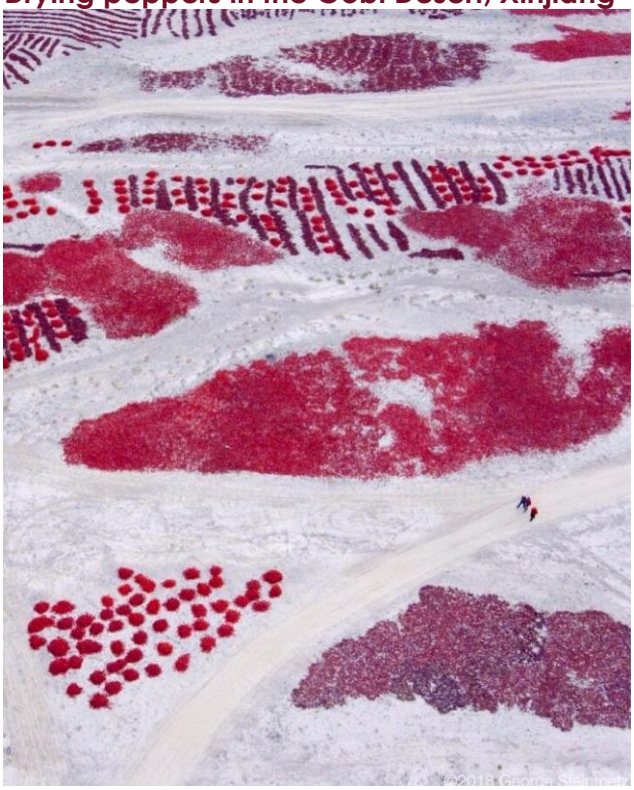
Chart 1: Global returns to 31 Dec 2018



The MSCI World index fell 7.7%, bringing its 2018 decline to 10.4%. The MSCI Emerging Market index fell "only" 2.9%, bringing its annual return to -16.6%. The Japanese equity market fell 10.5%, the US market 9.0%, Germany 6.2%, and Switzerland 6.7%. The tech-heavy NASDAQ index fell 9.5%, while the S&P Mid and Small cap indices fell 11.5% and 12.3% - note that these are all monthly returns. The annual returns of the major indices are shown in Chart 1, from which it can be seen that 2018 was not a profitable year in any market. *In fact, it was one of the worst years since 1900; 90% of major asset classes registered declines in dollar terms during 2018.*

Turning to emerging markets, the weak dollar – it declined 2.3% in December – helped emerging market returns in general, although they were still rather bad. The Chinese equity market declined 2.3%, although the Indian equity market rose 0.2%. The South African equity market rose 0.6% in dollar terms but declined 21.2% in dollar terms during 2018. The Brazilian market declined 1.8%, and the Russian market fell 5.3%, having been dragged lower by the collapse in the oil price.

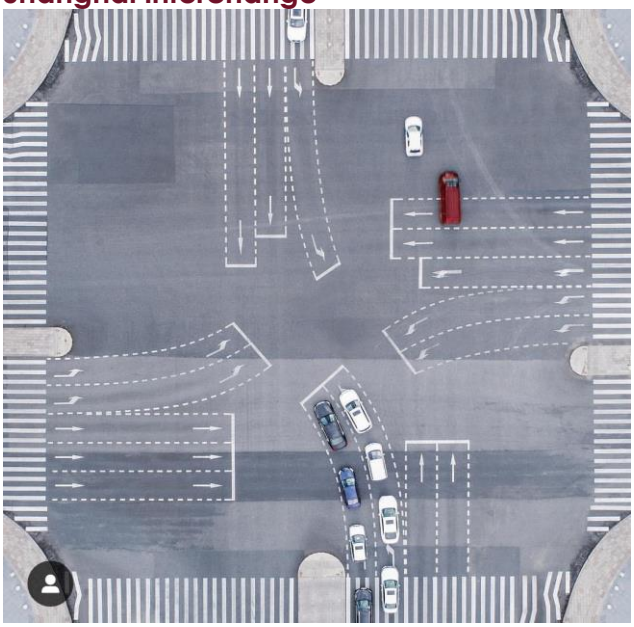
Drying peppers in the Gobi Desert, Xinjiang



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

Global and US bond markets recovered some of their composure, having been partly responsible for the onset of initial investor nervousness in October. The Barclays Aggregate Global Bond index rose 2.0% and the US Aggregate index by 1.8%, bringing their 2018 annual returns to -1.2% and 0.0% respectively.

Shanghai interchange



We have already alluded to the weaker dollar. The greenback's weakness supported the commodity price complex to some extent. It had no effect on the dramatic collapse in the oil price though, which was a feature of December's market activity. The (Brent) oil price lost 11.0% during December, following its 21.5% fall in November – the oil price has declined 41.4% since its recent peak in early October, notwithstanding OPEC's agreement to curtail production and the imposition of sanctions on Iran. The remaining commodity complex saw mixed returns in December, with palladium a feature, up 7.0% during the month and up 18.9% for the year as a whole. The iron ore price rose 11.1% albeit off a low base; it ended the year down 2.2%.

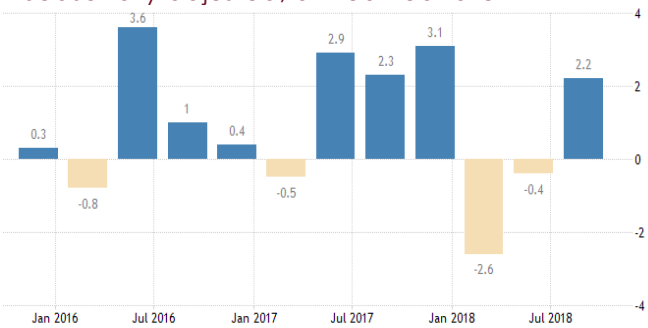
What's on our radar screen?

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

- *The SA economy:* The economy spluttered to an annualized growth rate of 2.2% during the third quarter (Q3), in so doing emerging from the recession during the first half of the year. Growth was driven by a strong performance by the manufacturing sector, the volatile agricultural sector, and the transport, storage and communication sector. The Q3 growth brought the year-on-year growth rate to 1.1%.

Chart 2: SA economic growth rate (%)

Seasonally adjusted, annualized rate



Source: Trading economics

- *The US economy*: The US economy has been sending out mixed signals if the data is anything to go by, a situation that is likely to be exacerbated by the shutdown of the government over US President Donald Trump's insistence on securing funding for his infamous wall across the Mexican border. We are preparing for a slowdown during the first quarter of 2019 but expect the US economy to post a reasonable growth rate during the full year.
- *Developed economies*: The German economy grew at 1.5% during 2018, from 2.2% in 2017. Fourth quarter (Q4) growth of 0.1% was still positive, but only just. Estimates for 2019 economic growth are being scaled back to 1.0% or lower.

Despite a headwind of dramatically lower car sales (car registrations declined 8.0% during the past year), German consumption increased on the back of record-low unemployment and rising wages, making it the major driver for growth, alongside other domestic demand components. The manufacturing sector is feeling the slowdown of international trade and global growth. We note that there is plenty of evidence suggesting that the European economy as a whole is slowing quite quickly; this could be an important feature of the global economy this year, so it bears close watching.

- *Emerging economies*: Mexico's central bank increased interest rates by 0.25% to 8.25% in mid-January, the highest level since the Great Financial Crisis of 2008. The move was aimed primarily at containing inflation, which has been on a downward trend since the start of the year but still stood at a relatively high 4.7% as of November. The Chinese economy grew at an annualized rate of 6.4% during Q4, down marginally from Q3's 6.5%. The Q4 growth rate was the lowest rate since Q1 2009, and the annual 2018 growth rate of 6.6% was the lowest annual growth rate since 1991. December retail sales rose at an annual rate of 8.2% while fixed asset investment rose 5.9%. Industrial production rose 5.7%, a bit more than expected.

Chart of the month

During the course of 2018 we drew your attention to the breakdown in the relationship between the bond and equity markets. At times the short-term divergence between these two markets is understandable, but as the year progressed we grew increasingly aware of the fact that the bond and equity markets were sending out different messages about the future of the global economy in general and the US in particular. The breakdown in the relationship was particularly evident in December, which is one of the reasons for us expressing surprize at December's equity market behaviour. The latter, incidentally, has still not been fully explained – at least in our opinion.

Shanghai World Financial Centre

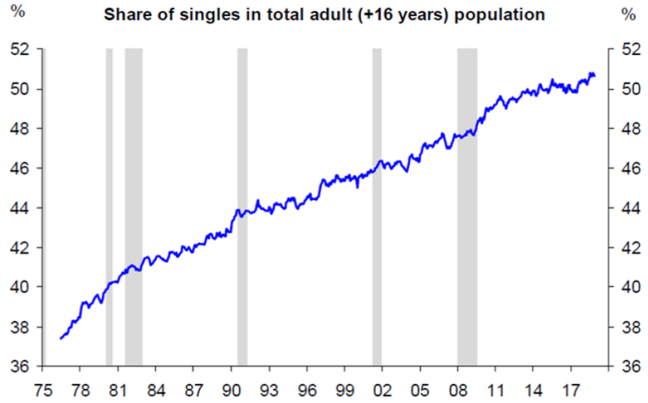
Chart 3 depicts the breakdown in the relationship very nicely. The blue line, measured on the left-hand scale, depicts the annual percentage change in the US equity market, using the S&P500 index as a proxy, while the red line, using the right-hand scale, depicts the yield (interest rate) on the US 10-year bond. The breakdown in the relation at the start of last year is obvious, with the disparity only increasing as the year progressed.

Chart 3: S&P500 change vs US 10-yr bonds

Source: Deutsche Bank

The message from the Chart is clear: either interest rates are too high, or the equity market has declined too far. This is not the appropriate medium to provide a full explanation for possible reasons for this anomaly; suffice is to say that we hope the bond and equity market will resume their traditional relationship sooner rather than later. Alternatively, we need to find and understand the reasons for the breakdown, particularly if it is going to be a permanent one, or last for some time, and build that into investors' expectations of future market returns.

Chart 4: Share of singles in adult population



Source: Deutsche Bank

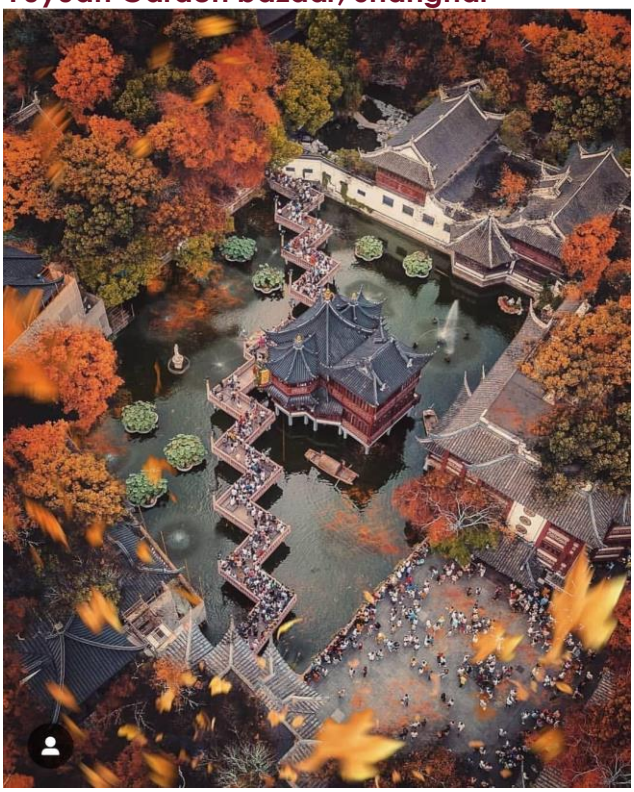
On a completely different and rather random note, I found Chart 4 very interesting. It speaks to the changing demographics of the US population, showing the percentage of adults (defined as over 16 years of age) that are single i.e. not married. It is currently around 51%, having risen consistently from 37% in the mid-70s.

Quotes to chew on

China – the Big Picture

"There are 300 million people in China's middle class. In the next 10 to 15 years, that number will double to 600 million. That number is not going to stop, trade war or no trade war. Any kind of short-term economic effects, we believe, will be cyclical." *Joe Tsai, Alibaba vice-chairman*.

Yuyuan Garden bazaar, Shanghai



More examples of this crazy market

December was a volatile and unprofitable month on equity markets. The following comments by *Deutsche Bank's Jim Reid* placed the volatility into perspective. On 20 December, he wrote: "The audience to the Federal Reserve

(the Fed) last night must have felt like screaming as the 'Powell put' became the 'Powell push'. The S&P500 closed down 1.54% and 3.03% off its intraday high. That's the sixth worst intraday drop of the year and the ninth worst since 2011. The S&P500 is now down 6.33% on the year and sits at a 15-month low. December's return now stands at -7.76% and has further extended the worst Xmas month since 1931 and the second worst on record. Given that December 1931 saw a price fall of 18.74% the record should at least hold!

On 21 December, Jim wrote "The last Early Morning Reid (Reid's daily commentary letter) of the year sees markets continuing the recurring nightmare seen of late with no circuit breaker in sight at the moment. Indeed, the S&P500 tumbled 1.58% and has dropped 5.10% this week alone and is now down 10.61% in December. The NASDAQ fell 1.63% and on a closing level has now dropped 19.73% from the intraday highs at the end of August, and therefore just shy of closing in bear market territory after trading there intra-day. The NYSE FANG index also tumbled 3.42% (down 28.03% from the year-to-date peak) while in Europe the STOXX 600 finished down 1.45% to close at a fresh two-year low. The DAX, CAC, and IBEX fell 1.44%, 1.78%, and 1.97% respectively to reach new multi-year lows as well.

"Meanwhile US High Yield (HY) credit ended another 20 basis points (bps) i.e. 0.20% wider in cash terms which means spreads are 60bps wider this week alone with one day left to play. That's within two basis points of the worst week of the last four years, which was +62bps in December 2015, which incidentally was the week before the Fed executed its first rate hike of the cycle, and also came shortly before the Fed ended up walking back its planned pace of rate hikes."

The Modern Art Museum, Shanghai

The weakness and volatility spilled over into early January, but fortunately markets have – at least at the time of writing – recovered strongly. Jim's comments will put the volatility in early January into perspective: "Somewhat fittingly, Apple proved to be a perfect example of the feedback from China. Its shares plummeted 10.0% for the biggest drop since January 2013 and to the lowest level since April 2017. Each of Microsoft, Amazon, and Alphabet have all now overtaken Apple in the biggest company in the world table, with Apple's market cap down $75bn alone yesterday. The total market value decline since Apple's peak last October is $446bn, or the equivalent of Coca-Cola and Pfizer combined. As a result the NYSE FANG index tumbled -3.8% while there were also notable falls for other large caps like Caterpillar (-3.9%), 3M (-3.8%) and DowDupont (-3.6%)".

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

Tianmen Mountain, Zhangjiajie, China

Then just when it seemed that investors had completely capitulated, the market turned around and began what has, until now at least, been a remarkable recovery. On 7 January, Jim wrote: "If you're just getting back into the office this week then you might want to reconsider taking a few more days off as it feels like it's been a lifetime in markets so far in 2019. We saw soft China data, an unprecedented cut to revenue guidance from the previously biggest company in the world in Apple, and a big drop in the latest ISM manufacturing reading initially lead markets much lower into Thursday night. However, we then did a complete U-turn on Friday when risk assets roared back thanks to a China Reserve Ratio Requirement cut, a blockbuster US employment report which included the second biggest payrolls reading (312 000) since August 2016 and joint-second biggest average hourly earnings reading (+0.40% month-on-month) since February 2015, and comments from Fed Chair Powell which signaled a change in the policy reaction function of the Fed to being more nimble and flexible".

Telling it like it is

"It is clear but nobody wants to say the obvious: this government does not have the competence and the capacity to govern effectively." *Jonathan Jansen, educationalist and Institute of Race Relations president*.

Obituary – John Bogle: 1929 - 2019

Jack Bogle, founder of Vanguard and creator of the world's first index mutual fund, has died at the age of 89, leaving an unassailable legacy as the pioneer and leading advocate of the $10 trillion (tn) index investment universe.

Source: FT.com

Born in New Jersey to a family stricken by the Great Depression, he became one of the greatest men in the history of investing by ripping asunder the "great man" image of supreme, cerebral stock pickers who could beat the market. He launched the first-ever index fund for ordinary investors and vociferously championed the merits of cheap, passive investing for decades. Today, Vanguard is a $5tn investment behemoth, and one of the leading players in the global index investing industry.

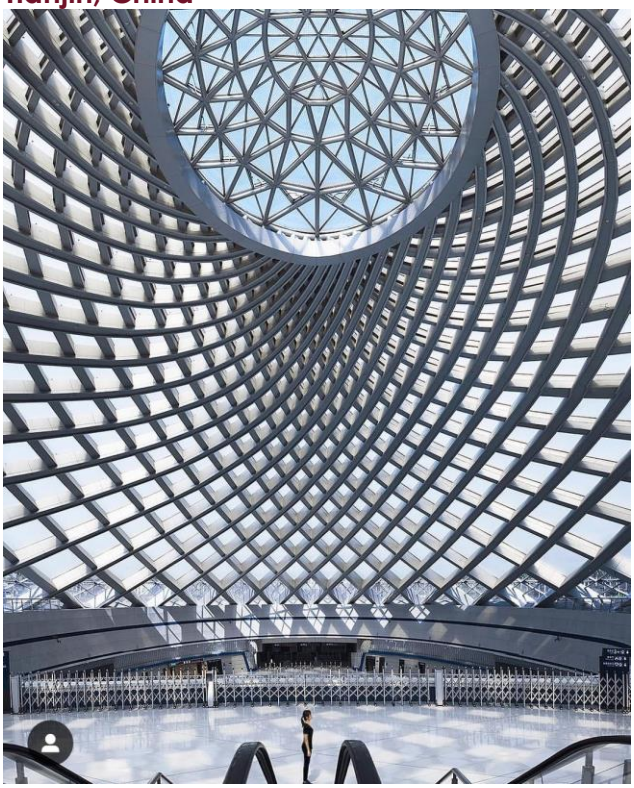
Notably, it was a success where the gains have accrued to Vanguard's customers and not its founder, as Bogle structured Vanguard to be owned by its investors. In an industry that has tended to enrich its pioneers with vast wealth, this was an unprecedented and still unrivalled move. "Jack Bogle made an impact on not only the entire investment industry, but more importantly, on the lives of countless individuals saving for their futures or their children's futures," said Vanguard's present chief executive Tim Buckley. "He was a tremendously intelligent, driven, and talented visionary whose ideas completely changed the way we invest."

John Clifton Bogle was born in Montclair, New Jersey, on May 8, 1929. His early life was shaped by the Depression. Bogle's father was a well-to-do businessman with inherited wealth that evaporated in the 1930s, leaving him broken and prone to drinking, and forcing Bogle and brothers to move in with their grandparents in rural New Jersey. However, his academic record was good enough to win a scholarship to the prestigious Blair Academy, and from there he went on to gain a degree in economics from Princeton University. Inspired by a 1949 Fortune article titled "Big Money in Boston" on the swelling mutual fund industry, he wrote a thesis on investing that caught the eye of Walter Morgan, the founder of Wellington, which managed the princely sum of $150m when Bogle joined in 1951.

By the time he was 35 he was named executive vice-president and Morgan's heir-apparent, and soon afterwards took full control. But then the asset management wonder boy made a fateful mistake. Charged by Morgan with reinvigorating Wellington's fortunes amid the ravenous appetite for racier stock market funds in the 1960s "go-go" boom, Bogle merged Wellington with Thorndike, Doran, Paine and Lewis, an aggressive mutual fund company in Boston.

When the Bull Run collapsed in 1973-74, Wellington found itself on the ropes, and the four new partners brought in in 1966 banded together and defenestrated Bogle. However, he staged an audacious countercoup, convincing the independent boards of Wellington's mutual funds to set up a new independent company that would take on the administrative tasks of running them. And thus, Vanguard was born.

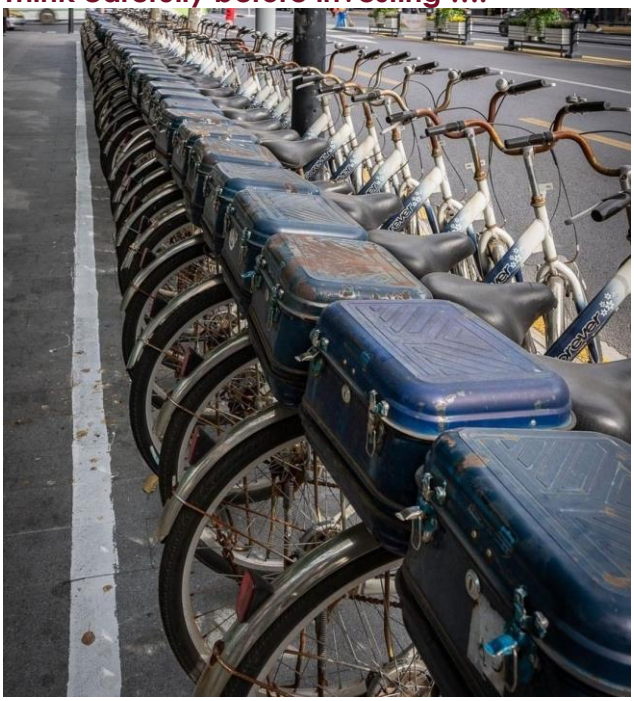
Tianjin, China



At the time, some investment groups had set up a smattering of novel, cheap funds that merely attempted to track stock market indices rather than beat them. They were only aimed at pension funds and insurers, but when Paul Samuelson, the famed economist, called for something similar for ordinary investors, Mr Bogle saw his opening. It was a product that fitted

Vanguard – which was at the time prohibited from running active, managed investment funds – and appealed to the headstrong investor, whose Princeton thesis had after all noted that "funds can make no claim to superiority over the market averages", and should be operated in the most efficient, honest, and economical way possible".

Think carefully before investing ….



Vanguard's first fund was initially a miserable failure. The First Index Investment Trust went live with a measly $11m in August 1976, and was quickly dubbed "Bogle's Folly". Today, the renamed Vanguard 500 is a $400bn giant, and Vanguard is the second biggest investment company in the world.

Bogle's famous determination was the driving force behind its growth until he retired as senior chairman in 1999, and he remained a vociferous champion of index funds until he passed away. In a series of interviews with the FT last autumn Bogle said: "It was a crusade. If you really believe in something, you have to become a preacher," he says. "I believed the numbers would ultimately tell. The superiority of the index is guaranteed. The math will never let you down."

Bogle was not shy about the achievements of Vanguard, even if it didn't bring him many financial rewards. "What do I need a private jet for? I need my wife to drive me around. It doesn't do my psyche any good to know that I have more than someone else," he told the FT in November. "I'm very comfortable with what I've done for the world." In his last book, published in 2018, he contemplated his looming 90th birthday, longstanding health issues and mortality, and cited a poem by Sir Harry Lauder, Keep Right on to the End of the Road, as his leitmotif for life:

Every road through life is a long, long road,
Filled with joys and sorrows too,
As you journey on how your heart will yearn
For things most dear to you.
With wealth and love 'tis so,
But onward we must go.
With a big stout heart to a long steep hill,
We may get there with a smile,
With a good kind thought and an end in view,
We may cut short many a mile.
So let courage every day
Be your guiding star always.
Keep right on to the end of the road,
Keep right on to the end,
Though the way be long, let your heart be strong,
Though you're tired and weary still journey on,
Till you come to your happy abode,
Where all the love you've been dreaming of
Will be there at the end of the road.

"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

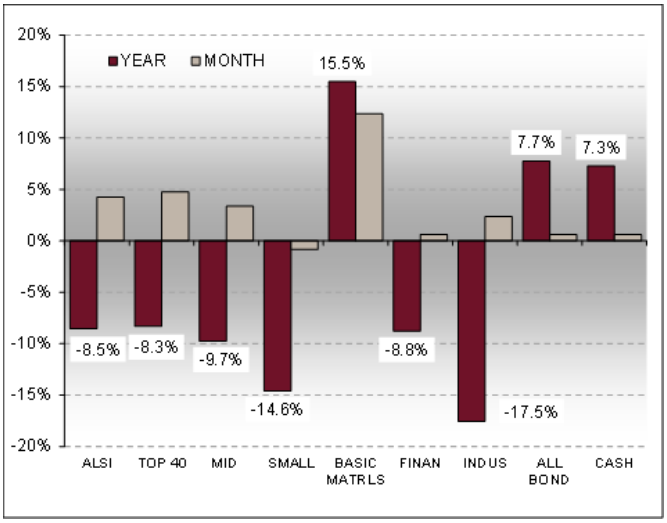
	Period ended	Month	Year to date	Year
Maestro Equity Prescient Fund	**Dec**	**0.6%**	**-13.4%**	**-13.4%**
JSE All Share Index	*Dec*	*4.3%*	*-8.5%*	*-8.5%*
Maestro Growth Fund	**Dec**	**-1.5%**	**-5.2%**	**-5.2%**
Fund Benchmark	*Dec*	*2.7%*	*-2.0%*	*-2.0%*
Maestro Balanced Fund	**Dec**	**-2.9%**	**-5.0%**	**-5.0%**
Fund Benchmark	*Dec*	*2.3%*	*-0.4%*	*-0.4%*
Maestro Cautious Fund	**Dec**	**0.3%**	**1.8%**	**1.8%**
Fund Benchmark	*Dec*	*1.7%*	*2.7%*	*2.7%*
Central Park Global Balanced Fund ($)	**Nov**	**3.0%**	**-8.9%**	**-7.4%**
*Benchmark**	*Nov*	*0.7%*	*-3.0%*	*-2.1%*
*Sector average **	*Nov*	*0.6%*	*-4.2%*	*-3.3%*
Maestro Global Balanced Fund	**Nov**	**-3.2%**	**-0.6%**	**-8.2%**
*Benchmark**	*Nov*	*-5.4%*	*8.7%*	*-0.4%*
*Sector average***	*Nov*	*-1.6%*	*-5.0%*	*-6.7%*

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

December in perspective – local markets

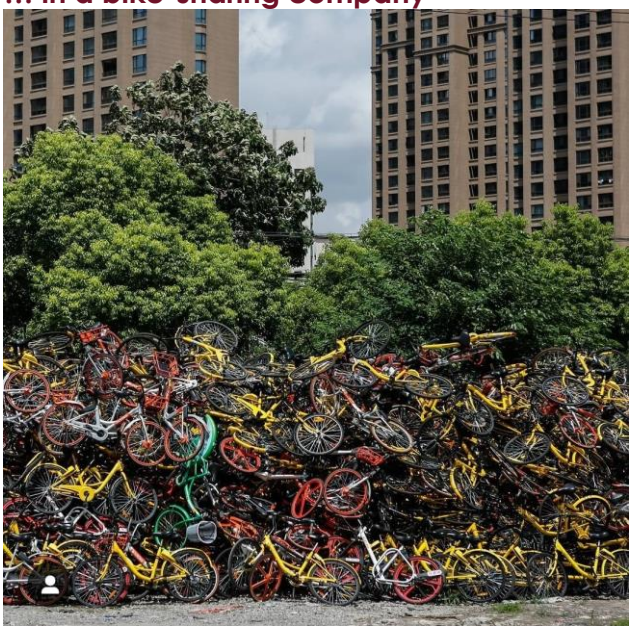
Turning to local markets, the rand declined 3.5% despite the weak dollar, bringing its 2018 decline to 13.9%. The rand weakness assisted the Basic Material and Gold sectors, which rose 12.4% and 25.2% during the month. The Financial sector rose 0.6% and the Industrial sector 2.4%. The Mid and Small cap sectors posted respective monthly returns of 3.4% and -0.9%, bringing their annual returns to -9.7% and -14.6% respectively.

Chart 5: Local returns to 31 Dec 2018



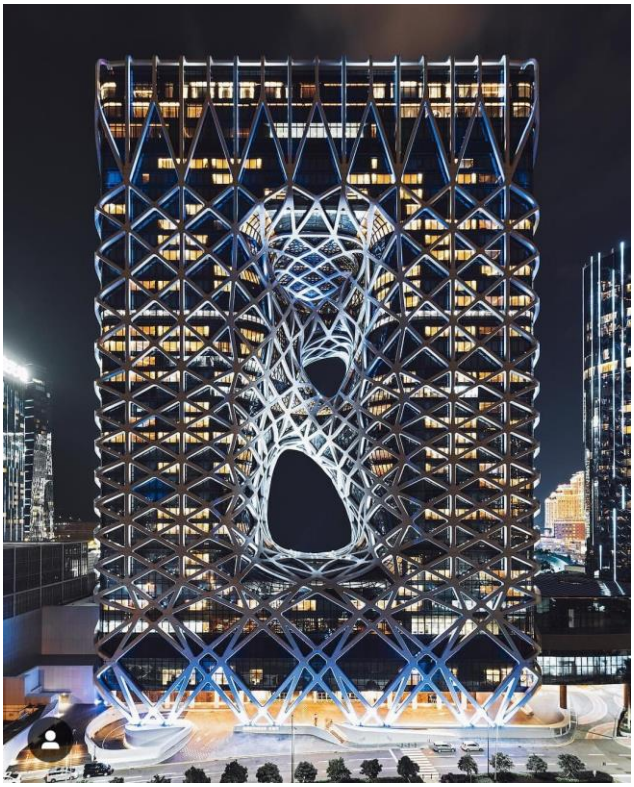
When all was said and done, the All Share index rose 4.3% during the month, bringing its annual 2018 return to -8.5%. The bond market followed the global bond market strength; the All Bond index rose 0.6%, bringing its 2018 return to 7.7%, marginally higher than the annual cash return of 7.3%. The 2018 returns of local markets are shown in Chart 5.

… in a bike-sharing company



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

Morpheus Hotel, Macao



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 China folder – have all been lifted from Instagram. 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.

Fisherman at work, Xiapu, Fujian Province