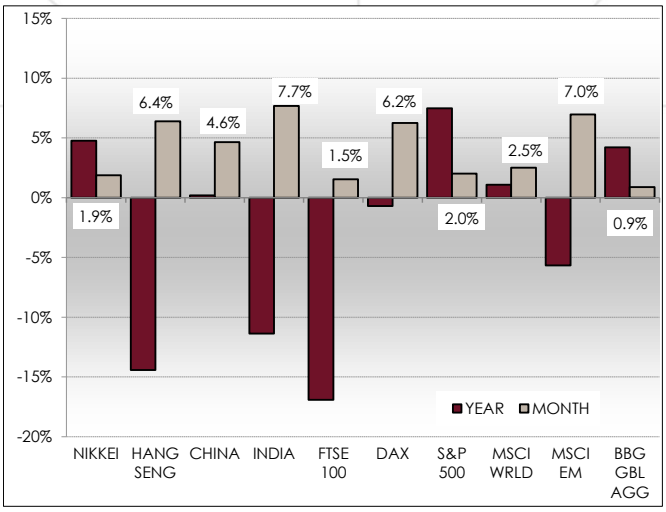
June in perspective – global markets

You don't need me to tell you we are living in truly remarkable times. Yet the challenge for me is to still make this letter interesting and find new ways to present widely-available data to you. I hope I can live up to this daunting challenge! Of course, the devil is in the detail, and space doesn't always allow me to dive into that much detail. That said, let us then consider the market behaviour during June, coming as it did after one of the most remarkable months (April) in market history ever, and May, which saw the positive momentum continue.

As the world continues to struggle with the Covid pandemic, which seems to be gaining a second wind in certain countries, the familiar US antagonism towards anything Chinese raised its ugly head again. The monthly market returns across various countries make for interesting reading, but if we take a step back and consider the annual returns to end-June, a clearer picture emerges as to where the money "was to be made".

Chart 1: Global returns to 30 June 2020



During June, most markets posted gains. The MSCI World index rose 2.5%, the US market rose 2.0%, Germany 6.3% and Hong Kong 6.4%. The Indian equity market rose 7.7% and in China 4.6%, helping the MSCI Emerging Market index gain 7.0% during June; Turkey rose 10.4% and Brazil 8.8%, which didn't do any harm. But India and Hong Kong posted weak returns in May, illustrating the point that short-term movements are often a function of low bases created in preceding periods.

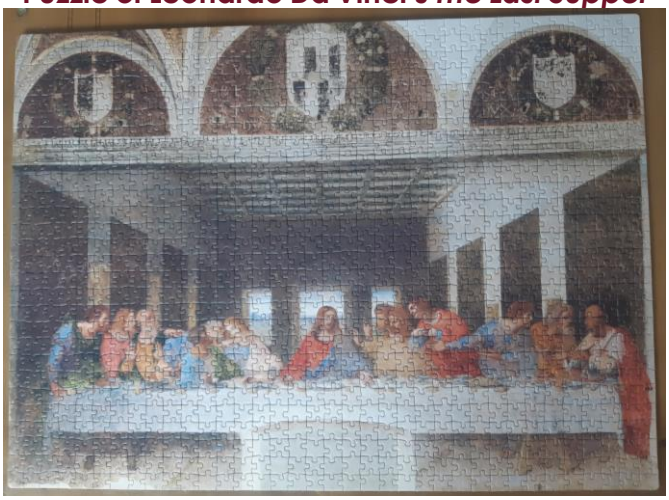
The Heidelberg region at sunset, along the N2

So let's consider the annual returns to end-June; they create a much clearer picture of the world's equity market returns. Hong Kong has had more than its fair share of trouble and bad headlines – that market declined 14.4% in the year to June. India's politicians are making heavy weather of managing the country – their market is down 11.4% in the past year. As for the UK, well, they really got the "Covid plan" horribly wrong, their "Brexit exit" isn't going too well, and their leaders don't exactly inspire much confidence – the UK is down 16.9% in the year to end-June. Germany seems to be coping relatively well on all fronts, given the global headwinds raging at present, and so is Switzerland – those two markets' annual returns to June are -0.7% and 1.5% respectively.

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

The US economy is struggling on a number of fronts, but the financial markets is not one of those fronts – the US equity market rose 7.5% in the past year. However, that return applies to big (large cap) companies only. Looking at the mid and small cap annual returns to June, of -8.3% and -12.7% respectively, tells a rather different story, doesn't it? However, the "Big Daddy" of them all, which stands out like a giant among the rest, is large US (but more accurately global) technology companies; the NASDAQ index, which is largely made up of big tech companies, has risen a remarkable 25.6% in the year to June.

Puzzle of Leonardo Da Vinci's *The Last Supper*



The point here is that if you didn't have a lot of US equity or large-cap tech exposure, your returns probably don't look that good. The annual return of developed markets (MSCI World index) was 1.1%, versus emerging markets (MSCI Emerging Market index) -5.7%, and the picture becomes clearer: to have generated any respectable return during the past year, you needed to have invested in large, US-listed tech and growth companies, and you should have avoided emerging markets.

One final point before moving on: the June quarter (Q2) will go down as one of the most rewarding quarters in history – at least on global markets. The US equity market rose 18.7% during Q2 alone, the best quarter since Q4 of 1998. Then again the first quarter (Q1) of 2020 was the worst quarter since Q4 in 2008, so the base was rather low. The engine of this growth, the NASDAQ, rose 31.0% during Q2 alone, which is remarkable when you think what a mess the global economy finds itself in, and how much uncertainty there is at present.

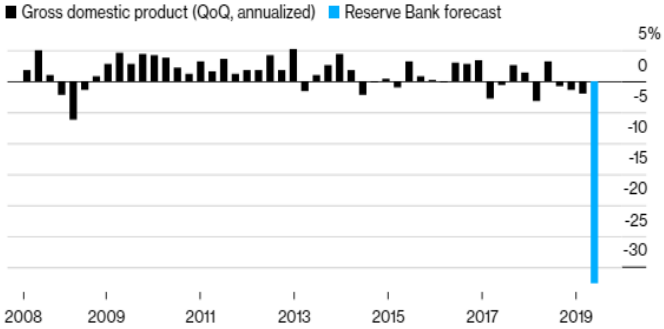
What's on our radar screen?

Here is a summary of the things we have been keeping an eye on:

- *The SA economy:* the most significant item of economic news during the past month was the supplementary budget, tabled by the Minister of Finance, Tito Mboweni. We will cover this event in more detail elsewhere in this letter, but suffice to say that the news was bad – really bad. No matter which way you look at it, the SA economy is in serious trouble. Its debt levels are out of control, there are no plans to cut expenditure meaningfully (largely because so much of it goes to pay civil servants salaries and to service debt), and its revenue is under huge pressure. Given the parlous state of the country's finances, one has to wonder how on earth the rand has held up as well as it has? Manufacturing production declined 44.3% during April as the lockdown took hold, and declined 49.4% in the year to end-April. It declined 5.5% in the year to end-March. Consumer confidence plummeted to -33 during Q2, versus -9 during Q1 and a forecast level of -15. Tellingly, the South African economy shrank by 2.0% at an annualized rate during Q1 after having shrunk by 1.4% during Q4 of 2019. So the economy was already in a

recession *before* the lockdown began. One should not be surprized then, when one considers that the SA Reserve Bank (SARB) believes Q2 "growth" will be -32.6%, as seen in Chart 2, below. Whenever you hear government forecasting an increase in the growth rate, it is worth remembering South Africa's annual growth rate has been in steady decline for the past ten years.

Chart 2: SA's deep contraction in Q2



Source: Bloomberg

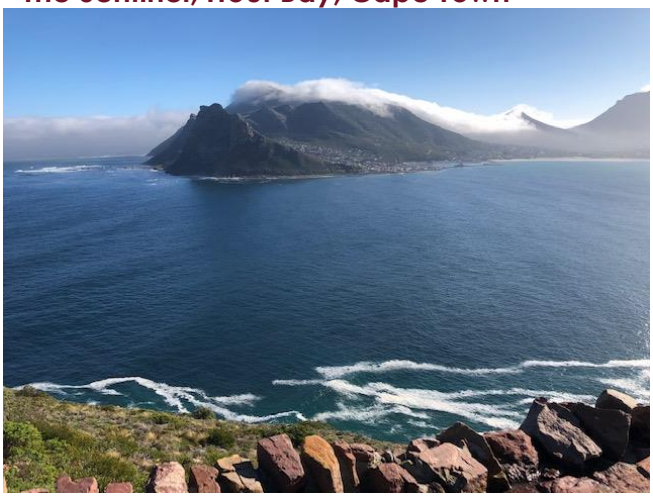
In the year to end-March, the economy declined 0.1%, a slight improvement on Q4's 1.5% decline. The SARB expects the economy to shrink 7.0% in 2020; National Treasury believes it will shrink 7.2%. We think those are too optimistic, and are expecting a decline of closer to 10.0% when all is said and done. At the peak of the Great Depression in 1931, the SA economy shrank 6.2%, which places the severity of the expected decline in 2020 into perspective. During Q1 i.e. *before* the lockdown, the unemployment rate rose to 30.1%, its highest level in the past decade, versus 29.1% in Q4 2019. The preceding record was 30.4% during Q3 in 2002, as the world went into a "September 11- induced" recession. The number of unemployed South Africans is now 7.1m; only 16.4m people are officially employed. Seven out of the ten formal sectors reduced their employment; job losses were widespread and not centred on only a few sectors. For what it's worth, Treasury projects that between 0.7m and 1.8m people will lose their jobs as a result of the pandemic. Again, we think this is woefully over-optimistic. Headline inflation for May was 2.1% - the first time in 15 years that it fell below the SARB's target range of 3% - 6%, largely due to the significant drop in the fuel price and crumbling consumer demand. The annual inflation rate to April was 3.0%. Inflation fell 0.6% month-on-month, its largest drop since November 2003. Core inflation i.e. inflation excluding food and energy prices, was 3.1%, from 3.2% in April, its lowest level in 9 years.

Long Beach, Noordhoek, Cape Town

- *The US economy*: As is our habit, we keep a close eye on Purchasing Managers Indices (PMIs) closely, as they provide a very early indication of prevailing economic activity in a particular region or country. Data reflecting quarterly or annual economic growth are important, but by the time they are released, they are typically old and of limited value. PMIs are accurate, timeous, and have a close relationship with markets,

and so are widely followed. Given that the lockdowns had such a devastating effect on economies across the world – refer to the May edition of *Intermezzo* for more detail – the PMIs are being watched closely for the much anticipated recoveries. Some evidence of this emerged last month – see the June *Intermezzo* for the detail – but PMIs are still being watched closely as the recovery in many regions is fragile, at best.

The Sentinel, Hout Bay, Cape Town



Returning to the US economy, the June Institute for Supply Management (ISM) PMI for Manufacturing reading was 52.6, which was a big improvement from May's 43.1 and 41.5 in April. Importantly, the reading is above 50, the level separating growth from contraction. The June ISM Non-manufacturing (services) PMI came in at 57.1 versus an expectation of 50.2, and the respective May and April readings of 45.4 and 41.8. The headline annual inflation rate in June was only 0.6%, while core inflation i.e. excluding food and energy prices, remained at 1.2%. June retail sales rose 7.5% month-on-month, better than the 5.0% expected. The May increase was revised up from 17.7% to 18.2%, but of course the base (April) was very low, when retail sales collapsed 14.7% from March's levels.

The US labour market continues to improve from the shocking loss of 20.8m jobs in April (and 1.4m lost in March). May saw 2.7m new jobs being created and June saw another 4.8m created. Although the June data was far better than expected, it is worth highlighting that the 7.5m jobs created during the past two months still represent just more than a third of the jobs lost in April. The unemployment rate fell from 13.3% in May to 11.1% in June, although this is not far off the record rate of 14.7% in April. The US economy is recovering slowly from the April shock. However, with so many states reneging on their initial re-openings, given the renewed surge in coronavirus infections, the outlook for the economy remains anything but clear.

One remarkable piece of data that has received surprisingly little media coverage is the US savings rate. Given the lockdowns i.e. no opportunity to go shopping, together with the government transfers to households to compensate for income losses, the savings rate soared to 32.2% in April although it declined slightly in June to 23.2%. This is extraordinary, and is nearly triple the average savings rate of around 7.7% that prevailed for most of 2019. It will be interesting to watch how US consumers behave as the economy slowly re-opens, and to also compare the US savings rate with those of other countries, especially emerging countries.

The Caledon region at sunset along the N2

- *Developed economies*: Let us start with the PMIs of developed economies. As was to be expected, the rebound in PMIs was widespread, although the devil is in the detail. The Eurozone June manufacturing PMI came in at 47.4, from May's 36.6, but it remains below 50, which shows that the economy is still contracting. Germany (45.2), Italy, Japan (40.1) Spain, Sweden, and Switzerland (41.9) are all still in contraction mode despite strong rebounds. On the non-manufacturing (services) side, a rebound was evident, too. The services sector was decimated in April and May, so the bases here are even lower than for the manufacturing sector. Yet in many countries the indices remain in contraction; the Eurozone composite index was 48.3 in June, from May's 30.5. Only France and Spain are in expansion mode. So while the PMIs offer some reason for hope, there is a lot of work to be done just to get economies back into expansion mode, let alone back to their pre-Covid levels. German unemployment jumped to 2.9m people or 3.9%, the highest rate in six-and-a-half years. Retail sales rose 13.9% in May versus the 6.5% drop in April. Eurozone retail sales rose 17.8% in May although it is still down 5.1% on an annual basis.

- *Emerging economies:* Interest rates in the emerging world continue to be reduced as governments seek to ease the pain for consumers, and stimulate demand. The Central Bank of Malaysia reduced its rate by 0.25% to 1.7%, an all-time record low. Inflation there has been negative for three months now, while the unemployment rate rose to a 30-year high of 5.0% in April. In the same month, industrial production fell 32%, and the trade balance returned to a surplus, where a 25.5% annual plunge in exports was overtaken by a 30.4% annual decline in imports. These are extraordinary movements and shows just what an effect the pandemic is having on relatively small, open economies.

  In Brazil, the central bank cut its Selic rate by 0.75% to 2.25% and left the door open for another possible cut in August. Bank Indonesia cut its rate by 0.25%, the third cut this year, to provide further support for the economy. Indonesia is blessed with benign inflation (an annual rate of 2.0%) and a limited current account deficit (1.4% of GDP), so the room to cut rates further remains large. Turning to Russia, the central bank there lowered interest rates, by 1.0% to 4.5%, following a 0.5% cut in April. The central bank expects the economy to decline by between 4% and 6% this year. The unemployment rate rose to 6.1% in May, from 4.7% in March, while industrial production declined at an annual rate of 9.6% in May, worse than April's 6.6%.

  In the Philippines, the central bank there reduced its interest rate by 0.5% to a record low level of 2.25%. It raised its 2020 inflation rate forecast from 2.2% to 2.3%, and

projected the budget deficit to widen to 8.4% of GDP this year. The central bank of Mexico cut its policy rate by 0.5% to 5.0%, the lowest level since 2016. Inflation there is around 3.3% and there are expectations that the bank could announce another rate cut in the coming weeks.

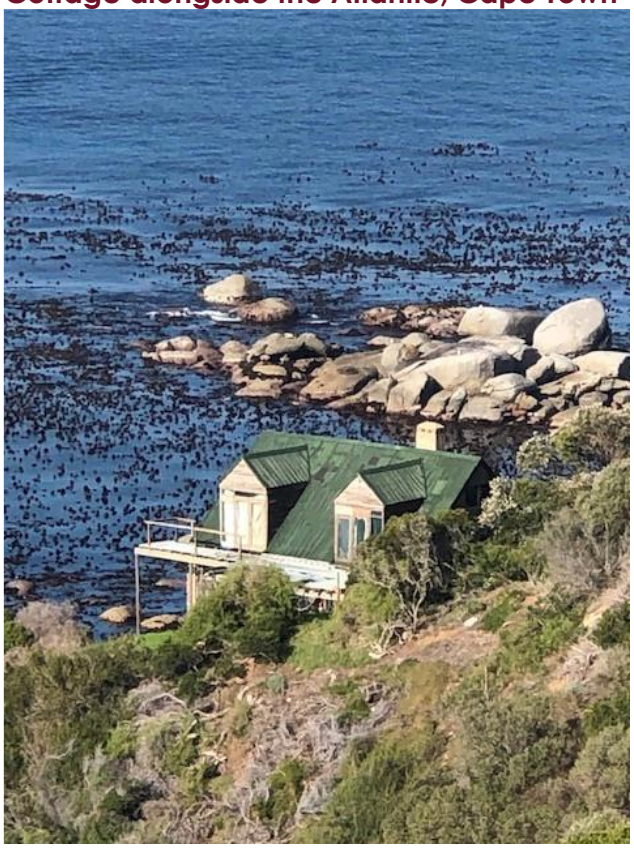
Saving the biggest and most important for last, China announced that its economy grew at a rate of 3.2% year-on-year during the second quarter (Q2). That was better than expected and means that their economy has now "grown" at -1.6% during the first half of 2020. Retail sales declined at an annual rate of 1.8% in June, an improvement from the 2.8% decline in June, and significantly better than the 20.5% declines in January and February when the lockdown took full effect. The unemployment rate declined to 5.7% in June from 5.9% in May. The June services Caixin PMI rose from 55.0 in May to 58.4. The June manufacturing PMI came in at 50.9, from 50.6 last month.

Quotes to chew on

How would you define success?

If I told you that a company listed in June 2000 i.e. 20 years ago, at $3.00, and its price was now $457.27 (that's a rise of 15 133% over 20 years, or a 28.6% compound *annual* growth rate), having risen 83.1% during the past year alone, would you regard that as being successful? I would. Apparently the founder, William Ding, doesn't yet regard that as success. The company in question is NetEase, which with a market cap (size) of $62.6bn is hardly a small cap any more. In a letter to shareholders recently, he noted "To date, we have yet to achieve success and are still growing". Oh well, okay. If he says so!

Cottage alongside the Atlantic, Cape Town



How do you feel about the lockdown?

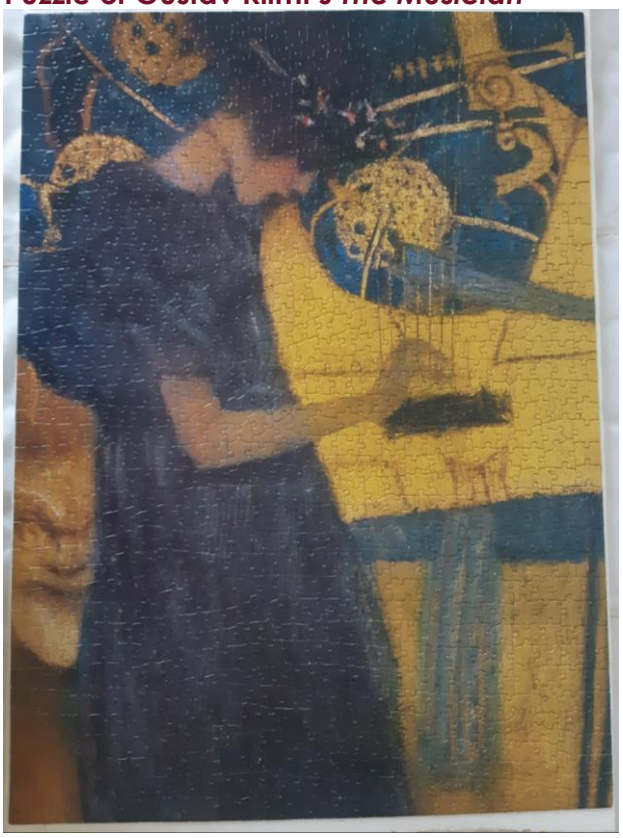
Maestro documented its view on the lockdown some time ago. Although our letter is a bit dated now, it has proved to be prescient, at least with regard to the terminal path the SA economy now finds itself on. You are welcome to ask for it by clicking here. I shared it with a friend and retired businessman. I thought his comments were apt, and echoed our views on how silent and compliant the SA business community has been in the face of the economic catastrophe, mass loss of jobs and dignity, and the pending poverty that awaits the vast majority of South Africans, not to talk of a debt-ridden, corrupt and incompetent government. He responded as follows: "What an excellent letter you shared with me – thank you! I agree 100% with everything in it, and am equally perplexed, frustrated, and

angry by the private sector's passiveness and acquiescence – particularly major corporates and top listed companies. They too will need to look in the mirror in the months and years to come and live with themselves. Abraham Heschel: 'The opposite of good is not evil, the opposite of good is indifference'. I'm sure none of our private sector leaders will accept an epithet of indifference, but in the absence of standing up to be counted – as you have – that is what their contribution amounts to".

A refreshing take on the prospects for inflation

I thought the following extract from an editorial by the *Julius Bär Chief Investment Officer, Christian Gattiker*, were noteworthy. They are self-explanatory: "The worries in the short term are clear and well expressed. A second wave of infections and an earnings season that sees corporate profits implode keep investors awake at night. Beyond that, we get more and more questions about long-term inflation effects due to the extreme monetary and fiscal money-printing lately. To be blunt: to worry about inflation during a deflationary breakdown is like worrying about obesity during times of famine. Anything like a more normal inflation rate would be a blessing now, since inflation rates in modern societies are mostly about wage increases. Of course, when using the 'i' word, everybody has the 1970s in mind or, even worse, the early 1920s, when some monetary bases completely imploded. However, those inflation experiences had completely different backgrounds (a supply-side shock hitting rigid labour markets in the 1970s, a very unfavourable post-war deal for the losers of World War I in the 1920s). Today, the concern is about steering against the spectre that has been going around in Japan for almost 30 years: structural deflation in conjunction with low growth. So yes, we can imagine that there will be overstimulation at some stage and yes, gold may spike further as the topic is the flavour of the month. But the real issue of inflation rising structurally is hardly foreseeable any time soon. So far, we have had three decades of the opposite".

Puzzle of Gustav Klimt's *The Musician*



Is government really so incompetent?

Maestro has gone on record numerous times citing government as "incompetent". That is a damning allegation, but we are fully open to being held to account for such a bold statement. Sadly, we have a very long, and still growing, list of evidence to support our view. Here is just another once such reason.

Cooperative Governance and Traditional Affairs Minister Nkosazana Dlamini-Zuma has declared that she relied on "scientific rationale" when deciding to ban the sale of tobacco products, as

well as the sale of alcohol during Level 3 lockdown. The Opposition Democratic Alliance (DA) Member of Parliament (MP) Gizella Opperman asked the Minister what the reasons were that informed the decision to declare Covid-19 a national disaster instead of a provincial or local disaster, and what data was used to classify the disaster in terms of the Disaster Management Act, Act 57 of 2002.

Similarly, DA MP Zakhele Mbhele asked: "With reference to her assertion that the sale and use of tobacco products is associated with increased risk of the spread of SARS-CoV-2, which she used to justify the prohibition of tobacco product sales, what is the scientific rationale and empirical basis for the prohibition; whether she and/or her department assessed the countervailing hypothesis that nicotine actually minimises the risk of SARS-CoV-2 infection, as suggested by data showing a disproportionate under-representation of habitual smokers in infection cases; if not, why not; if so, what conclusions have been drawn in this regard?"

Another scene of the Overberg, from the N2

In response to both requests, the Minister replied: "The reasons that informed the decision to declare Covid-19 a national disaster will be submitted to the honourable member as soon as the detailed information is available. Thank you." In other words, they are not available i.e. "they don't exist and we are still busy making them up". That is but one example of why we regard government and most Ministers as grossly incompetent, not to talk of how illogical and economically suicidal the current lockdown is.

Another scene of the Overberg, from the N2

An ominous "sign of the times"

We know that the Chinese equity market has been on a very strong uptrend during the past few weeks, underpinned by positive statements from government on the markets, which tend to be regarded by investors as a sign to go piling into the markets. Did you know that the average holding period for shares by Chinese investors is only 7 days?! Moving on ..., I was rather concerned when I read the following, contained in a Financial Times article on the recent Chinese equity market rally. It struck me as a rather ominous "sign of the times". Commenting on the "sense of euphoria that had descended on the market", reflecting a widely held belief that rising prices were sanctioned by the State, it quoted a 29-year old investment professional from Shenzhen who had, according to the man, made a return of more than 40% on the "hundreds of thousands" of renminbi he had invested since February. He planned to buy more, the article reported, on the basis that "the

attitude of the government implies it expects a *lasting bull market*" (my italics). A what? Since when was there such a thing as a "lasting bull market" – have I missed something? We should all be concerned.

Obituary: Ennio Morricone (1928 – 2020)

The Oscar-winning Italian composer, who wrote over 400 film scores and around 100 concert works, has died in Rome aged 91.

Morricone was born in Rome in 1928, and received his first music-lessons from his father Mario, a professional trumpet-player; as an undergraduate at the Accademia Nazionale di Santa Cecilia, the trumpet was initially Ennio's first study, but following postgraduate work with Goffredo Petrassi, to whom he would later dedicate his Concerto for Orchestra, his focus shifted to composition and arrangement.

Throughout the 1950s, Morricone worked as a jazz musician and an arranger for Italian radio and television, as well as ghost-writing for cinema. His first big-screen success in his own right came in 1961, when he composed the score for Lucian Salce's *Il federale*; Morricone and Salce went on to work together on films including *Crazy Desire* (1962), *El Greco* (1963), and *How I Learned to Love Women* (1966) as well as on several projects for the theatre.

It was in 1964 that Morricone embarked upon the project which would eventually make him a household name, the 'Spaghetti Western' *A Fistful of Dollars*, directed by his former schoolmate Sergio Leone and starring Clint Eastwood as 'The Man With No Name'; the film, which was released in Italy in 1964 and in the United States three years later (along with the other two films in the 'Dollars Trilogy', *For a Few Dollars More* and *The Good, the Bad and the Ugly*), became one of the most influential in twentieth-century cinema, its impact aided in no small part by Morricone's atmospheric and supremely memorable score.

Following the success of the 'Dollars' films, Morricone and Leone made several further films together, including *Once Upon a Time in the West* (1968), and *Once Upon a Time in America* (1984). Morricone, who sustained an astonishingly prolific and varied career for the next five decades, also collaborated with directors including Sergio Sollima, Bernardo Bertolucci, Franco Zeffirelli, Roman Polanski, and perhaps most notably Quentin Tarantino, for whom he scored *The Hateful Eight* (2015). The film won the 87-year-old Morricone his first Oscar for Best Original Film Score; he had previously been given an Honorary Academy Award in 2007, the only other composer to receive this honour being Alex North in 1986. Other awards and honours included a Grammy for *The Untouchables* in 1987, BAFTAs for *The Untouchables*, *Cinema Paradiso*, *The Mission*, *Days of Heaven*, *Once Upon a Time in America* and *The Hateful Eight*, the Golden Lion for Lifetime Achievement in 1995, and the New York Film Critics Circle Special Award in 2015.

Social distancing in Bootleggers coffee shop

Alongside his film career, Morricone also composed music for television mini-series and high-profile advertising campaigns for brands including Dolce & Gabbana, Nissan, Lancia and Sky Cinema, as well as continuing to write for the concert hall. From the mid-60s until 1980, he was a key figure in the Italian avant-garde collective *Gruppo di Improvvazione di Nuovo Consonanza* (colloquially known as 'Il Gruppo' or G.I.N.C.), and his compositions included the Primo Levi setting *If This Be A Man* for soprano and small ensemble, numerous piano concertos, the opera *Partenope*, and a Mass for Pope Francis, composed in 2015. Themes from several of his film scores also took on a life of their own in concert, most famously 'Gabriel's Oboe' from the 1986 film *The Mission*.

Morricone died in hospital on 6 July after sustaining injuries in a fall at his home several days earlier. He is survived by his wife Maria Travia, whom he married in 1956 and who supplied lyrics for several of his compositions, and their four children Marco, Alexandra, Giovanni and Andrea, who had worked with him on the score for *Cinema Paradiso*.

Quo Vadis, South Africa?

Maestro has gone on record numerous times regarding our concern are about the future of this country, from an economic and social point of view. There are times, to be honest, when we feel rather lonely in this regard. Sure, there is a lot of media comment and criticism regarding government's poor governance and lack of policy implementation, but we seldom see many, let alone business or an institution, calling a spade a spade and stating simply, like we have, that the country has headed into an irreversible, downward spiral, the end of which is largely reflected in the current state of Zimbabwe. It will take many years for this to occur, but thanks to the pandemic we have been thrust ten or more years further down this road. The end destination, or as we call it "Destination Zimbabwe", is now a lot closer than it was at the beginning of the year.

We hold economist and Ninety One Head of SA Investments, Nazmeera Moola, in high regard. She writes pragmatically and honestly, without beating about the bush. Not surprisingly, we were encouraged by her candour in an article she recently wrote in the Daily Maverick, entitled *Why quantitative easing isn't appropriate for South Africa*, which you can find by clicking here.

I encourage you to read the article yourself, but for convenience sake and to emphasise our shared areas of concern, I highlight a few extracts from her 13 July article:

- Public sector employees comprise 2.5% of the SA population. Let me reiterate: In the current year 60% of tax collections will pay the salaries of 2.5% of the population. Is this fair? It is certainly not sustainable.
- Aside from cost cutting, South Africa needs to reconsider the composition of its spending. For example, if we decide to pay

a R350 per month Basic Income Grant to unemployed people aged between 19 and 59, we would need to raise roughly R42bn per annum. This equates to a 7% cut in the public sector wage bill. Therefore, we would be cutting the wages of 2.5% of the population by 7% to pay a Basic Income Grant to 16% of the population.

- Without real progress on reforms and a lower public sector wage bill, there is no way to engineer a path to fiscal sustainability in South Africa.
- After all, if South Africa is not prepared to make the reforms needed after a decade of 1% average growth and a public sector wage bill that eclipses all other spending, why should anyone believe that the country will not seek to print money to finance the budget deficit indefinitely?
- As soon as the conclusion is reached that any deficit financing is not temporary, foreigners will look to sell bonds, forcing the Reserve Bank to buy even more bonds, and the rand will depreciate. Argentina, Venezuela and Zimbabwe have provided the template of what happens next.

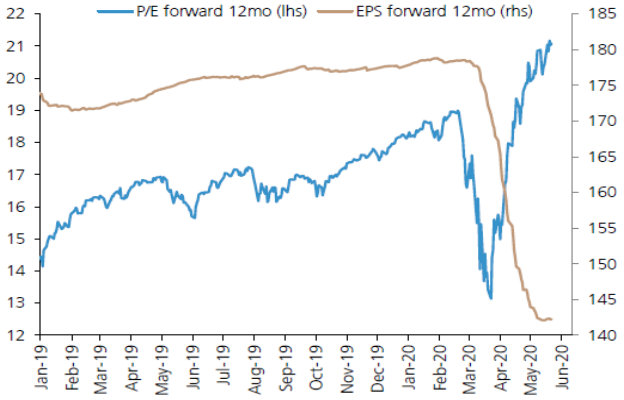
Charts of the month

Earnings visibility

For reasons that must be obvious to everyone, corporate earnings around the world have all but collapsed. Well, that is not entirely true, for many companies have benefitted substantially from the global pandemic. However, most companies have seen their earnings decimated by the lockdowns around the world, experienced primarily in the form of the disappearance of final i.e. consumer demand. It stand to reason then, that the current (Q2) earnings decline is largely a once-off event – at least we hope it is once-off! The focus must then turn to how earnings will recover for the remainder of this year and into the next one. Of course, this will differ for each company, but it would not make sense to value any company on the basis of what it earned during these bizarre times in which we find ourselves.

Chart 3 illustrates this very well, showing how the aggregate expected S&P500 earnings for the next twelve months have all but collapsed – to be more accurate, they are expected to decline around 20%. Of course, that means that the "expensiveness" or valuation of the market, shown by the prospective (next twelve months) price earnings (PE) ratio, has risen commensurately. So on the basis of the current earnings, global equity markets are exceptionally expensive. But these are exceptional times, and hopefully as and when corporate earnings recover, the level of expensiveness of the markets will decline.

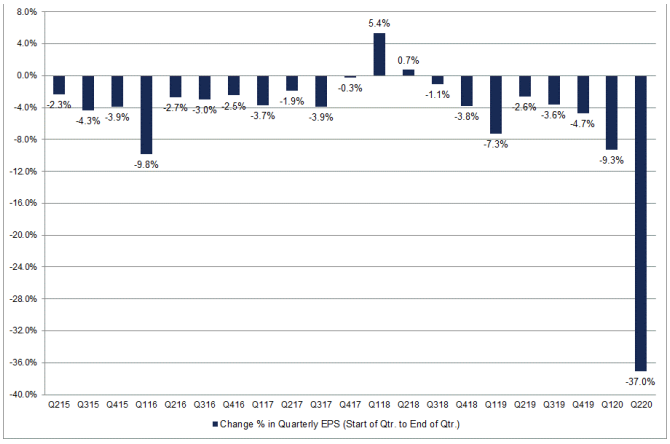
Chart 3: US equity market valuation



Source: UBS

To place the Q2 earnings collapse into perspective, Chart 4 shows the average revisions that analysts have brought about to their quarterly earnings per share (EPS) forecasts since Q2 of 2015. It is clear why we use adjectives like "unprecedented", and "historic". No investor or market participant has ever really seen anything quite like this.

Chart 4: Analysts' historic EPS revisions



Source: Factset

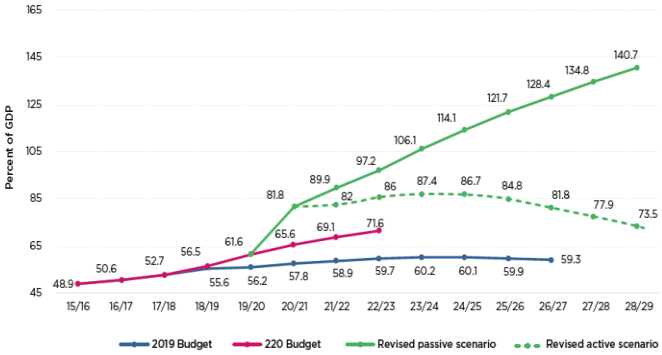
A few charts on South Africa

Since our last edition of *Intermezzo*, we have had a Supplementary Budget tabled in parliament to support and contextualize government's efforts with regard to the Covid-19 pandemic. The Budget itself didn't contain anything new and merely told us what we knew already: government revenues are under massive pressure, and it is ratcheting up its spending with money it doesn't have.

Consequently, it must now be clear to all that the country is spiralling headlong into a debt trap, from which it will not emerge. As usual, the Minister, like all government leaders, was full of talk but short of substance, and more importantly, we think government action will fall far short of its "talk" and plans. We often wonder what it will take for people to eventually not believe what government and politicians say, but rather believe what they do. Actions speak louder than words, and governments around the world, and particularly in this country, are full of talk and very short of actions. Consequently, it is that mind-set that we bring to our analysis; we are sceptics first and second, when it comes to believing what governments say.

Look at Chart 5. It shows government's projections of its debt profile, expressed as a percentage of GDP (the value of SA's economic output). The 2019 Budget last year project what is displayed by the blue line. At the time, we expressed doubt that they would achieve it, and true to form, they revised it up – displayed by the purple line - in the formal Budget, tabled in February this year. Then the virus arrived, and we now have projections shown by the green solid and dotted lines.

Chart 5: Government debt to GDP projections



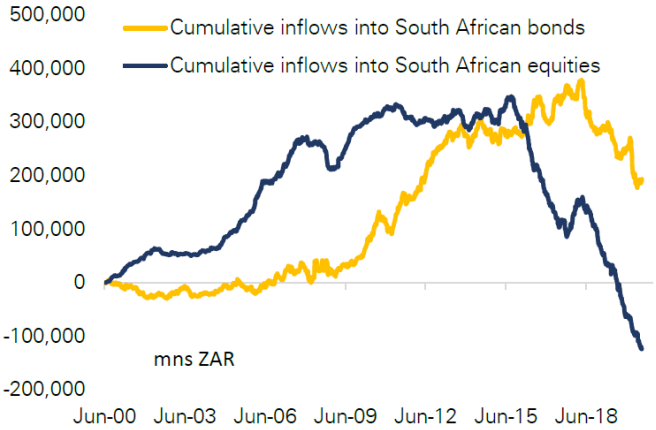
Source: Prescient Investment Management

We ignore and reject the green dotted line; we just don't believe government is capable of implementing the necessary reforms. It also lacks the political will to bring about any serious change that will positively affect the future, and finances, of this country. So we are left with the solid green line, which shows a catastrophic increase in government debt, from a position where government is already spending 21c in every rand on servicing the interest on the existing debt i.e. where the solid green line starts. Do you appreciate now why we hold the view that government is already well on the way into a debt trap from which there will be no return? Perhaps the most frightening aspect of this debate is that one gets the impression that no-one in government, other than, perhaps, the Minister of Finance Tito Mboweni, even has the

foggiest notion of where that road will lead us, or that we are even *on* that road, let alone well some way down it already. There are none so lost as those who don't know they are lost. Chart 5 represents a sad and terrifying future of misery and poverty. We should fear for the future of our children in this country should those projections prove to be correct, which, we would hasten to add, we believe they will.

One could argue that the "clever money" has already seen the future, and are voting with their feet. Chart 6 depicts foreign investor selling of South African bonds and equities. The chart speaks for itself. Foreigners' holdings of SA bonds have declined sharply during the past two years, while their holdings of SA equities is now lower than it was 20 years ago.

Chart 6: Foreign cumulative flows into SA markets

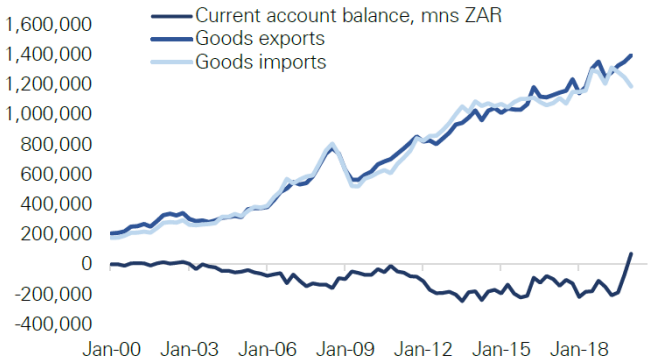


Source: Deutsche Bank

There was one bit of good news on the SA economy during the month. However, if one scratches beneath the surface you soon realize the news was less good than it seemed. South Africa posted its first current account surplus i.e. the difference between exports and imports, in 20 years. On the face of it, that appears to be good news, but as Chart 7 shows, the surplus occurred for all the wrong reasons i.e. imports declined dramatically, due, at least in our opinion, to weak internal demand. And here's the scary news – the surplus occurred <u>before</u> the pandemic hit i.e. imports collapsed before the pandemic and lockdown even occurred. We will admit it was good to see a surplus, but it occurred for the wrong reason, and merely highlighted crumbling domestic demand. As the 2% decline in the SA economy during Q1 showed us, the SA economy was already on its knees before the pandemic even began.

Chart 7: Good news on the current account

But for the wrong reason …

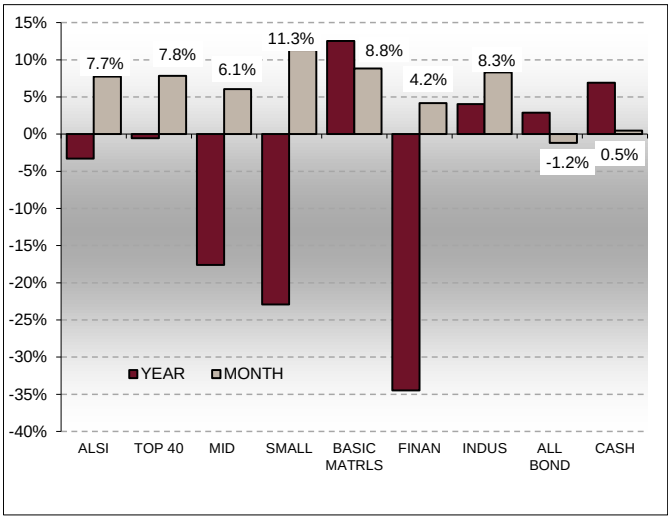


Source: Deutsche Bank

June in perspective – local markets

For a change, let's start with a review of the All Share index annual return to end-June, which at -3.3% is hardly worth getting excited about. If you invested in large (cap) companies, your annual return would have been -0.6%, but as you headed down the size scale, your returns started deteriorating rapidly: mid caps returned -17.6% in the past year and small caps -22.9%. Of course these are rand returns – if you add the 18.8% decline in the rand over the past year, you can see how easy it was to lose more than 40% of your money in dollar terms during the past year alone.

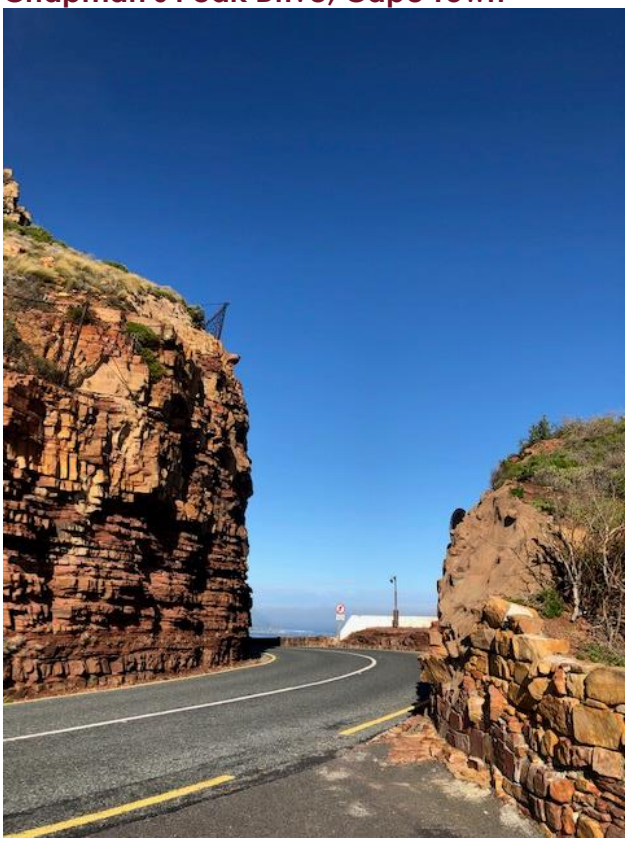
Chart 8: Local returns to 30 June 2020



At Maestro we encourage all investors to set an investment objective of "at least maintaining the value of one's investments in hard currency terms". Clearly, if you lost more than 40% of your money in one year, you are not exactly off to a great start, which simply underscores our belief that *the best returns lie outside of South Africa*. To wrap up on SA markets, the Basic Material, Financial, and Industrial indices rose 8.8%, 4.2% and 8.3% respectively during June, making it a pretty profitable month. Large, mid, and small caps rose 7.9%, 6.1% and 11.3% respectively. The All Bond index declined 1.2%; its annual return to June is only 2.9%, but that is better than the All Share index return of -3.3% over the same period.

With regards to what lies ahead in the investment world and markets, global investors are preparing themselves for the second quarter reporting season, which is likely to go down as one of the worst in history ever, as the effects of lockdowns, trade wars, and pandemics take effect – this time for the full quarter. In light thereof, it is remarkable to see how markets have recovered (from their trough on 23 March) despite the fact that the world is going into its greatest economic slowdown in living memory – by some accounts much worse than the Great Depression in the early 1930s. Complicating an analysis of future company prospects is the fact that the consensus view seems to be that the economic slowdown will be a temporary event (albeit it that the recovery will take place slowly and in an uncoordinated fashion) and more importantly that global central banks have literally pumped trillions of dollars into financial markets in an effort to boost consumer demand, ease the pain for businesses, and keep interest rates artificially low. With so much money "sloshing through the system" it is understandable that equity markets are being boosted; bond markets are also expensive but the next move for interest rates is likely to be up, and thus for prices to head lower, making them unattractive relative to equities.

Chapman's Peak Drive, Cape Town



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

Our efforts have been to concentrate our investments into areas likely to benefit from a Covid- or post-Covid world, and into companies which have strong balance sheets and are able to withstand the severe economic conditions that we believe will remain a feature of the external environment for the foreseeable future. Although our returns so far have exceeded our expectations, we would be failing in our duty to remind you that the investments markets, a bit like the rest of the world at present, are fraught with risk and characterized by uncertainty and poor visibility. We believe caution remains the watchword. We will be doing our best to continue to look after the assets which you entrusted into our safe keeping.

I would hasten to point out that, while we have always been very concerned about the future of South Africa, we think the Covid pandemic and specifically the lockdown have cast the die for the future of the country. That die leads to economic devastation, and endless hardship and poverty for millions of South Africans. Now, more than ever, we are concerned about the future of the country – the lockdown has just accelerated our country's woes and ultimate destination by ten years, yet we see no clear evidence that government are in the slight bit concerned or even have an understanding of the effect of their lockdown, or the economic devastation of our major trading partners. The consequences of years of corruption, poor governance, and incompetence will become more evident far sooner in a post lockdown world. As South Africans, we should brace ourselves for traumatic and tough years ahead. Hardship will not only characterize our economic world but will also extend into the social one; acrimony and social dissonance will become the order of the day, focused through the lens of race and inequality, and vast misunderstanding of how businesses or the economy works.

Another scene of the Overberg, from the N2

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	**Jun**	**3.9%**	**-0.1%**	**-3.4%**
JSE All Share Index	*Jun*	*7.7%*	*-3.2%*	*-3.3%*
Morningstar sector ave	*Jun*	*5.8%*	*-7.8%*	*-7.2%*
Maestro Growth Fund	**Jun**	**2.6%**	**9.4%**	**11.0%**
Fund Benchmark	*Jun*	*4.5%*	*0.9%*	*2.2%*
Morningstar sector ave	*Jun*	*3.0%*	*-1.9%*	*0.6%*
Maestro Balanced Fund	**Jun**	**2.4%**	**8.5%**	**10.4%**
Fund Benchmark	*Jun*	*3.8%*	*1.6%*	*3.3%*
Morningstar sector ave	*Jun*	*2.2%*	*-0.6%*	*1.9%*
Maestro Cautious Fund	**Jun**	**1.1%**	**4.0%**	**6.5%**
Fund Benchmark	*Jun*	*2.2%*	*0.9%*	*3.2%*
Morningstar sector ave	*Jun*	*1.5%*	*0.4%*	*3.2%*
Maestro Global Balanced Fund	**May**	**3.6%**	**27.1%**	**34.8%**
Benchmark	*May*	*0.4%*	*21.3%*	*26.7%*
*Sector average **	*May*	*0.6%*	*14.7%*	*21.4%*

* Morningstar Global Multi Asset Flexible Category

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

Notwithstanding the returns listed above, we thought it would be appropriate to list our longer-term returns for our various investment solutions, shown in the following tables. All returns are for periods to 30 June 2020, and are taken from Morningstar's monthly unit trust survey. Returns are shown net of fees i.e. after all fees have been deducted.

Table 2: The Maestro Equity Prescient Fund

Morningstar (ASISA) South Africa Equity General- June 2020						
	3 mths	6 mths	1 year	3 years	5 years	10 years
Maestro Equity Prescient Fund	***15.7%***	***-0.2%***	***-3.5%***	***-2.8%***	***-3.0%***	***6.4%***
Maestro Equity Fund benchmark	20.4%	-0.9%	-3.0%	4.3%	3.8%	12.9%
SA Peer Group Average	19.5%	-7.8%	-7.2%	0.7%	0.7%	8.0%
Maestro position within Group	133	23	48	119	98	47
Number of participants	169	169	162	143	109	60
Quartile	4th	1st	2nd	4th	4th	4th

Table 3: The Maestro Growth Fund (Reg. 28)

Morningstar (ASISA) South Africa Multi-Asset High Equity - June 2020						
	3 mths	6 mths	1 year	3 years	5 years	10 years
Maestro Growth Fund	***10.2%***	***9.4%***	***11.0%***	***6.1%***	***3.2%***	***8.6%***
Maestro Growth Fund benchmark	17.0%	0.9%	2.2%	7.3%	6.3%	10.6%
SA Peer Group Average	13.5%	-1.9%	0.3%	3.6%	3.7%	8.6%
Maestro position within Group	169	4	8	16	81	24
Number of participants	200	197	193	168	118	50
Quartile	4th	1st	1st	1st	3rd	2nd

Table 4: The Maestro Balanced Fund (Reg. 28)

Morningstar (ASISA) South Africa Multi-Asset Medium Equity - June 2020						
	3 mths	6 mths	1 year	3 years	5 years	10 years
Maestro Balanced Fund	***9.6%***	***8.4%***	***10.4%***	***5.1%***	***3.0%***	***8.0%***
Maestro Balanced Fund benchmark	14.8%	1.6%	3.3%	7.6%	6.6%	10.1%
SA Peer Group Average	11.3%	-0.6%	1.9%	4.3%	4.1%	7.9%
Maestro position within Group	73	1	2	24	50	18
Number of participants	93	93	93	79	61	35
Quartile	4th	1st	1st	2nd	4th	3rd

Table 5: The Maestro Cautious Fund (Reg. 28)

Morningstar (ASISA) South African MA Low Equity - June 2020						
	3 mths	6 mths	1 year	3 years	5 years	10 years
Maestro Cautious Fund	***4.4%***	***4.0%***	***6.5%***	***6.1%***	***4.8%***	***8.5%***
Maestro Cautious Fund BMK	10.4%	0.9%	3.1%	7.2%	6.7%	8.6%
SA Peer Group Average	8.3%	0.4%	3.2%	5.1%	5.2%	7.8%
Maestro position within Group	145	14	21	43	67	16
Number of participants	154	154	149	132	97	47
Quartile	4th	1st	1st	2nd	3rd	2nd

Table 6: Maestro Global Balanced Fund

Morningstar (ASISA) Global MA Flexible - June 2020						
	3 mths	6 mths	1 Year	3 Years	5 Years	10 years
Maestro Global Balanced Fund	***11.6%***	***27.1%***	***34.8%***	***N/A****	***N/A****	***N/A****
Global Balanced Fund benchmark	9.4%	21.1%	26.7%	15.0%	12.2%	14.1%
SA Peer Group Average	8.5%	14.7%	21.4%	12.0%	10.0%	12.8%
Maestro position within Group	10	1	1	N/A	N/A	N/A
Number of participants	35	32	30	24	17	11
Quartile	2nd	1st	1st	N/A	N/A	N/A

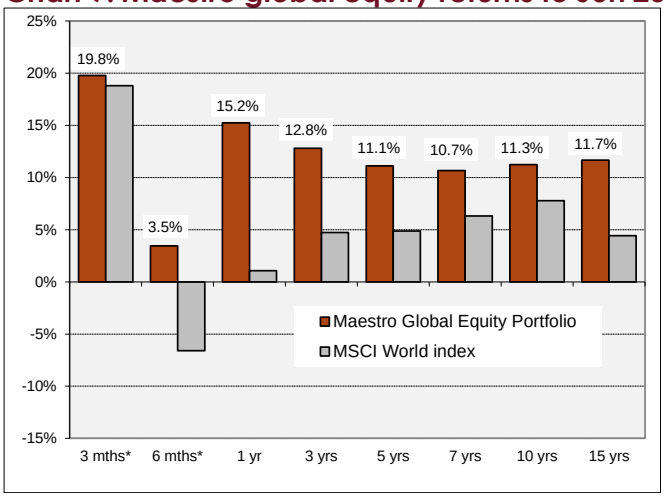
It is with some gratification that we are able to list, for the first time, a 15-year history of our offshore unit trust, Central Park Global Balanced Fund, show in Table 7, below.

Table 7: Central Park Global Balanced Fund

Morningstar USD Moderate Allocation - June 2020							
	3 mths	6 mths	1 Year	3 Years	5 Years	10 years	15 years
Central Park Global Balanced Fund	***15.9%***	***3.7%***	***11.5%***	***8.8%***	***3.6%***	***3.3%***	***4.4%***
Central Park Fund benchmark	12.5%	-2.5%	2.8%	4.7%	4.6%	6.0%	6.5%
Global Peer Group Average	11.1%	-4.2%	0.1%	2.2%	2.5%	4.7%	N/A

The Central Park returns have been driven, increasingly in recent years, by the equity portfolio within the Fund. These are shown in Chart 9, below, and which also span a period of 15 years. It is gratifying to see that we have consistently beaten global equity market returns, depicted by the MSCI World index, over every period and despite the fact that the period covers three major and unprecedented global crises, being "September '11" in 2001, the Great Financial Crisis of 2007/9, and of course the current coronavirus pandemic. These returns are show gross of fees i.e. before our investment management fees, of approximately 1.5% per annum.

Chart 9: Maestro global equity returns to Jun 20



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

File 13: Information almost worth saving

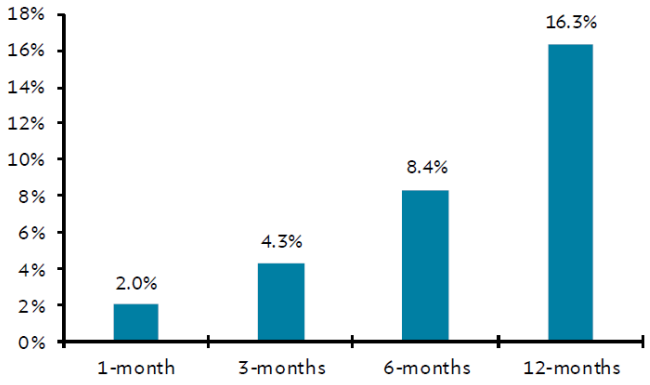
Hard to believe – but true

I am perhaps doing this contribution a disservice by placing it in "File 13". Don't be fooled – it is as important as all the other content of this letter. By way of introduction, at times one can analyze information, or market behaviour, and it just doesn't seem true; or it sounds counterintuitive, or just plain unbelievable. After nearly 35 years in the investment profession though, I have come to appreciate that at times, I just need to accept the outcome of some analysis, even it if doesn't make sense, or I can't get my head around it. And so it is with the following excerpt – it is almost as hard to believe as the excerpt that follows this one. But for now, I give credit to *Mensur Pocinci*, a *technical analyst from Julius Bär*. I quote his comments verbatim from an 8 June article.

"Last week saw strong demand for equities, as the S&P 500 continued to advance and, importantly, did so with broad-based buying by investors. Currently, 96% of all S&P 500 stocks are in a medium-term uptrend, the highest number since 1991. It is intuitive to think that this number cannot go above 100%, and therefore that an imminent decline in equity prices is in the cards.

Chart 10: S&P500 performance

After 96% of stocks in medium-term uptrend



Source: Julius Bär

However, the opposite is true. Strong short-term demand for equities is usually a good indicator of future price movements, and, as you can see on the chart below, strong medium-term equity demand has led to above-average equity market returns. Without doing too much maths, therefore, you can see what this suggests, namely that new all-time highs for the S&P500 are in the offing. This may seem hard to believe given that the background noise is so bearish, but it should not actually come as a surprise – after all, the Nasdaq 100 is already trading at all-time highs. As the rally is broadening, the most beaten-down stocks are likely to outperform in the coming three to six months, before growth stocks resume their outperformance".

I love a good night's sleep

Here is another "hard to believe" analysis. However, given the credible source (*Julius Bär*) and their great research, I have to accept that it is correct, despite the outcome being so remarkable! Credit again to technical analyst *Mensur Pocinci;* I quote him verbatim from a short article penned on 22 June, appropriately named *Profits overnight, headache the next day*.

"Since 1993, the S&P500 has seen a negative return during the day. More than 100% of all returns have come overnight. We recommend that investors allow their capital to compound overnight and enjoy a good night's sleep.

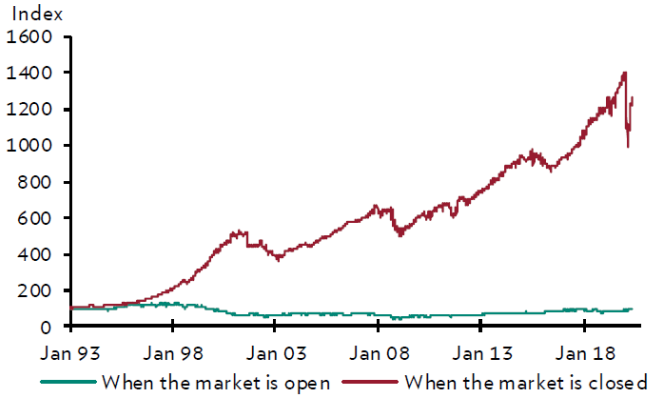
It is still fascinating to see how many ways the market knows how to distract investors from truly seeing the underlying trends and investment opportunities. Imagine if I told you the S&P500 has risen more than twelvefold since 1993, and the return during the day's price action (from the opening to the closing price) was a negative figure of 5.9%. Of course, you would not believe it, but please review the chart below.

More than ever before, it remains crucial for investors to filter out the noise and focus on the facts. This is exactly what we do in technical analysis: we ignore all the headlines, since we assume all the information is already priced in. We recommend that investors align their investment strategy with the big underlying trends and try to avoid any distractions from the market.

And yes, there are long-term trends that have continued to work … Investors should try to detox their investment process from noise and let their capital compound while enjoying a good night's sleep".

Chart 11: S&P500 overnight performance

More than 100% of all returns have come overnight



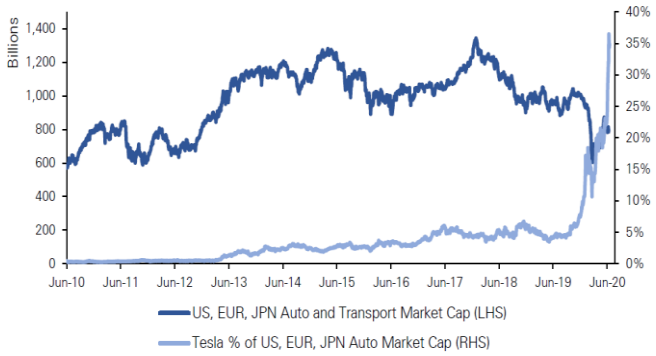
Up, up, and away …

No, I'm not talking about Elon Musk's SpaceX, but I *am* talking about his Tesla, which has over the past few weeks, months, and even years, become a landmark of economic and financial history, no matter how you look at it or what you think of the company, or the man, for that matter. Irrespective of what I write, or how fast I write it, it will be out of date by the time you read it. So let me just give you some comments and analysis from a few days ago, that remain correct and mind-boggling at the same time. I admire shareholders of Tesla – well done to them on their returns and for having sufficient courage to hang on to the share despite its gains. For the record, we don't own Tesla shares, and have never owned them in any of our funds at any time. Pity about that, but for now we will remain on the sidelines.

The following statistics are shared purely for the record and for interest sake, but they remain truly "off the charts", or perhaps that should read "off this planet". It seemed like only a few days ago that Tesla CEO Elon Musk tweeted that, in his opinion, the Tesla share price "looks too high". For the record, that was on 1 May. The previous day's closing price had been $781; it opened trading on 1 May at $755 and plunged to $693 before closing the day's trade at $701. At the time of writing this note (28 July), merely three months later, the price is now $1 513. Here are some more remarkable statistics on the share price of Tesla.

Tesla is up about 330% since 18 March, and over 760% since June 2019 when it was troubled by bankruptcy concerns. Two weeks ago it surpassed Toyota to become the world's largest automaker. As Chart 12 shows, Tesla's market cap (size) of $287bn has grown to over a third of the combined market cap of the US, EU and Japanese auto industries (excluding Tesla). Since March, Tesla has added just over 8 Ford Motor Companies, 27 Renaults, or more than the entire market cap of Toyota. In fact, Tesla is over 3 times the size of the S&P500 Automobiles and Parts sector, even though it's not a member or in the S&P500 (it would be the 15th largest S&P member were it to be included in the index). Tesla's overall share of the global autos market has grown from 0.1% in 2017 to an expected 0.8% in 2020, but remains minuscule. For context, VW is at about 14%.

Chart 12: Tesla relative to 3 big auto regions



Source: Deutsche Bank

On 1 July, Tesla's market capitalization (size) surpassed that of Toyota. Its price on that day was $1 135, versus the current price of $1 513 i.e. since surpassing Toyota is has increased in size by another third. To put that in perspective, during the first quarter of this year, Tesla produced about 103 000 vehicles, while Toyota produced 2.4m vehicles during the same period. During all of 2019, Tesla produced 367 200 cars, while Toyota produced 10.5m i.e. about 28 times more than Tesla. At the time of writing, Tesla's market cap was $273.7bn.

Chart 13: Tesla's size relative to Toyota

Source: FT.com

Finally, it is worth noting that since it was listed, Tesla's share price has appreciated at a rate of about 51% per annum, or some 6 448% in absolute terms. During that period European auto stocks have risen "only" 6% per annum. No matter what ones thinks of the company and its valuation i.e. whether or not you think it is excessively priced, those are mouth-watering returns to have missed out on!

So what's with the pics?

Last month I invited readers to send in some picture of what they had been doing during lockdown, of what had kept them sane in what remains a crazy world. So the picture, in no particular order, are from readers who went for bike rides around the Cape Peninsula, or built puzzles, or who travelled up the Garden Route. I hope you enjoy them.