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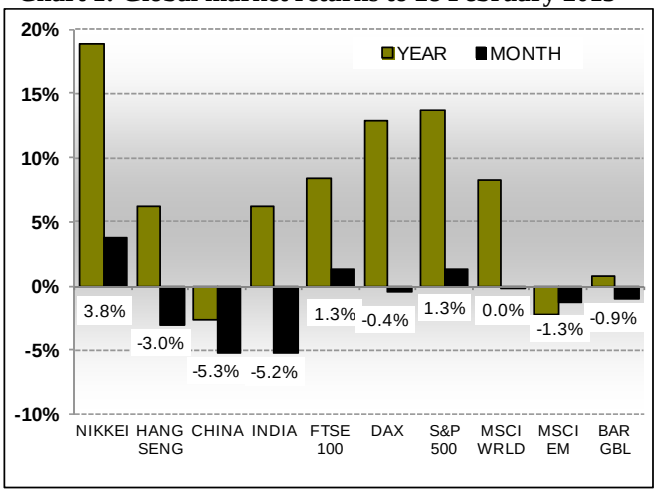
Investment Letter | 13th Edition | March 2013

February in perspective – global markets

After the strong start to the year – the current rally began in mid-November - it was inevitable that markets would pause for a breather. Apart from the effects of recent austerity measures beginning to manifest themselves, two other sources of risk resurfaced and led to instability in global markets; firstly the developments in Italy – the election in February resulted in another lame-duck parliament - and secondly the ongoing Tom-foolery in the US around ways to rein in spending, curb a rising entitlement mentality and increase revenue. Only three developed equity markets rose during February, each for different reasons – refer to Chart 1. *Japan* rose 3.8%, boosted yet again by the weak yen, bringing to 11.2% its rise so far this year. The yen has declined 15.7% against the dollar since September. The *UK market* rose 1.3% on the back of the decline in sterling. Given the strong proportion of non-UK companies in the index and the fact that many constituent companies are major exporters, the index stands to benefit from the 6.6% decline in sterling against the greenback so far this year. The third developed market to rise was *the US*, presumably as a result of renewed investor flows into that market.

Chart 1: Global market returns to 28 February 2013



Despite these gains the MSCI World index declined 0.02%, which was better than the 1.3% decline in the MSCI Emerging market index. Emerging markets fared much worse in February as investors reduced their exposure to "risk assets". Emerging currencies and equity markets were weaker; China and India declined 5.3% and 5.2% respectively, Russia fell 5.4% and Brazil 3.9%. The SA market, although weak, held up relatively well under the circumstances; it declined 2.3% in dollar terms. The global bond market was more volatile than normal and eventually ended the month down 1.0%. The SA bond market rise of 0.7% in rand terms should thus be seen as a relatively good performance. On the currency front, the dollar was particularly firm throughout the month, returning to the well-established trend of rising when there is a perceived increase in risk in global investment markets. The rand declined 0.4% against the dollar, bringing its annual decline to 17.0%, although it rose 4.0% against sterling, showing just how weak sterling was. Commodity prices declined too, as did precious metal prices; gold ended the month 4.6% lower. Silver declined 9.6%, nickel 9.5% and copper 4.4%, while the major commodity indices declined close to 4.0%.

What's on our radar screen?

Here are a couple of items we are keeping a close eye on:

- *The SA economy:* SA economic growth in the fourth quarter of 2012 (Q4 12) turned out to be stronger than expected. The SA economy grew 2.1% quarter-on-quarter, an improvement on the 1.2% experienced in the third quarter (Q3). On an annual basis the growth rose from 2.3% in Q3 to 2.5% in Q4 12. The mining sector declined less than expected – it still fell 9.3% - but the agriculture and manufacturing sectors turned in a robust performance. Further notice of the country's Achilles' heel was served when the trade deficit for January came in at R24.5bn from R2.7bn in December. The release of this data caused a sharp and immediate decline in the rand, although one should bear in mind there was a lot of "noise" in the number. The three-month average deficit is "only" R11.7bn, which compares more favourably to October R15.7bn.

Table 1: SA economic growth – table of contributions

	2011	2012	2012 qoq % saar		
	ann. ave	ann. ave	Q2	Q3	Q4
Agriculture	-0.1	2.3	9.3	7.4	10.0
Mining	0.3	-4.0	30.9	-12.7	-9.3
Manufacturing	3.6	2.4	-0.8	1.2	5.0
Electricity	1.1	-1.2	-4.3	1.6	-2.2
Construction	0.5	2.5	3.4	3.3	0.2
Trade	4.5	3.6	2.7	1.7	1.5
Transport & comms	3.1	2.3	2.2	1.1	1.9
Finance & business	4.0	3.3	2.1	1.8	2.9
Government	3.9	3.1	2.5	2.7	2.6
Personal services	2.5	2.1	1.9	2.1	2.5
GDP at basic prices	*3.3*	*2.4*	*3.2*	*1.1*	*2.2*
Taxes less subsidies	4.9	3.8	5.2	2.5	1.9
Total GDP	**3.5**	**2.5**	**3.4**	**1.2**	**2.1**

Source: Deutsche Bank

- *The US economy*: The initial reading of US Q4 growth was revised up from -0.1% to 0.1% although this still represents a steep decline from Q3's 3.1%. There were also signs of the recent improvement in the labour market continuing although one has to acknowledge

there is still a long way to go. The unemployment rate declined from 7.9% to 7.7% although this had more to do with the withdrawal of people from the labour force than more jobs being created. To be fair, a number of jobs were created in the construction industry, pointing to the revival in the US housing market.

- *Other developed economies*: The Japanese economy "grew" at a rate of -0.1% in Q4 2012, a slight improvement from Q3's -0.9%. Inflation decreased 0.6% in January, similar to the prior month.
- *Emerging economies*: **Chinese** inflation rose to 2.0% in January, down from December's 2.5%. **Indian** inflation rose to 10.8% from January's 10.6%. **Indonesian** annual inflation in January was 1.0%, up from 0.5% in December - compare that to the current economic growth rate of 6.1%. The **Malaysian** economy grew 6.4% in Q4, up from Q3's 5.2%, while January's annual inflation rate was 1.3% from 1.2% in December. The **Russian** economy grew 2.9% in Q4 12, the same rate as in Q3. Inflation rose to 7.1% in January from 6.6% in December. **Turkish** inflation rose to 7.3% in January, from 6.1% in December. The unemployment rate there is currently 9.4%.

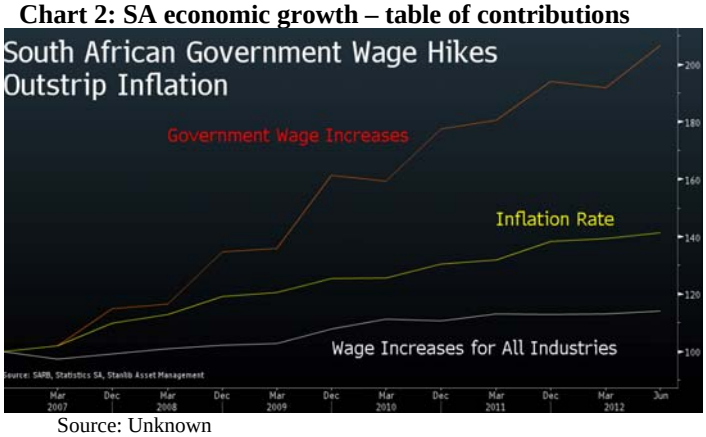
Madiba-pic 1: More to follow...

Local chart of the month

Over the last few years the spectacular rise in local retail shares has caught a number of seasoned investors off guard. They have felt that the boom in unsecured lending is directly responsible for the retail sector's stellar performance. We, too, believe that this has contributed to the rise in share prices, but are of the view that the unprecedented rise in civil servants' salaries is another significant factor. It is common knowledge that government employees make up a significant portion of the overall labour force; this is clear from the budget tabled each year. Chart 2 highlights civil servants' wage inflation over the last five years; this period coincides with the greatest financial crisis since the Great Depression.

Since 2007 salaries of government employees have risen on average by about 14.0% per year, which can be compared to the rise in general prices (inflation) of 6.3% annually. Recent events at Eskom are a good example of the type of civil servant increases we have experienced: the number of Eskom employees increased by 23% to just over 40 000 in 2012 and the average total cost per employee, increased 60% to around R500 000 per year! This kind of increase in remuneration within the public sector adds fuel to our domestic inflation problem and is simply unsustainable over the longer term. A ballooning public sector is not the way to create a sustainable middle class in South Africa. As a developing nation we should be focusing on ways to utilize our capital more efficiently. Our focus needs to be on the creation and development of small businesses and not simply "job creation" at any cost.

Chart 2: SA economic growth – table of contributions



Source: Unknown

The South African 2012 census

It has been some time since the census was conducted and many may have forgotten about it. However, the census represents a gold mine of information for investors and can be used to identify significant trends, highlight new characteristics about different strata of the population, verify anecdotal evidence and of course be used to identify major investment opportunities within the country and amongst its people. The census tells us about ourselves, our communities, the country we live in. So we should not dismiss it as just another boring economic survey. It is a significant event and record of our people and country.

In the light of these comments, I ask you the question: how well do you know South Africa? What is the average income per person? How large is the average SA family? How many cell phones do they have, how many TVs, washing

machines, etc? The answers to these and similar questions should excite and intrigue any investor in the country.

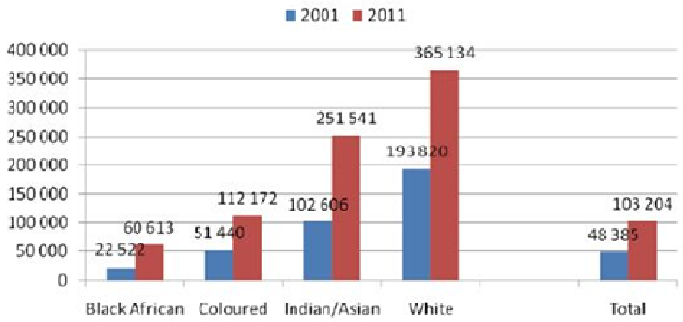
With that in mind, the following represents an edited version of the comment on the census by Investec Securities strategist Prof. Brian Kantor. It makes for fascinating reading and I am indebted to Brian for his insightful comment.

"The Census reports good real progress in household incomes and household numbers

The general impression provided by the census is that significant economic progress has been made in SA over the past 10 years. There are now 14.45m identified households, 28% more than were counted in 2001. Average household incomes of R103 204 were reported compared to R48 305 in 2001, an increase of 113% in money of the day terms. Given that inflation increased by 77% over this period, this implies a real increase of approximately 36% in average household incomes over the 10 years.

The poorest SA households are those led by black South Africans. However they did significantly better than the average SA household. Households headed by black South Africans increased their average household incomes by 169% in current prices or by nearly double, when adjusted for inflation between the censuses of 2001 and 2011. The objective of advancing the previously disadvantaged has been met about as well as the government could have realistically hoped for.

Chart 3: Average annual household income by population group of household head



Source: Investec Securities

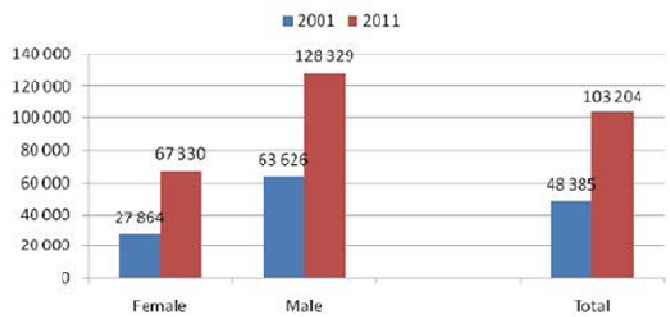
The census is consistent with National Income estimates

These increases in self assessed incomes, in response to the question asking respondents to estimate "gross monthly or annual income before deductions and including all sources of income" compare very well with the growth in per capita incomes as estimated by the National Income Accounts. Gross National Income per capita in real terms grew by 35.5% between 2001 and 2011 or at a compound average growth rate of 3.04% p.a. Such growth rates in per capita or average household incomes represent much more than the much despised trickle down. If growth is maintained at this rate over the next 10 years this would represent a doubling of average incomes in 20 years and significant economic progress indeed.

One of the benefits of higher incomes is more and smaller households

It is not surprising, given an improved standard of living, that the number of identified households has increased faster than the population itself. The population grew from 40.58m residents in 2001 to 51.77m in 2011, an increase of 14.2%, compared to the larger 28% increase in the number of households. Many more family members have had the means able to form households of their own. The average SA household therefore consists of a surprisingly few 3.58 average members in 2011 compared to a similarly few 3.62 members in 2001. Perhaps this small average household is attributable to the large number of female led households with presumably no males of working age to add to household income or numbers. Households led by women earn significantly less than the average – refer to Chart 4, below.

Chart 4: Average annual household income by gender of household head



Source: Investec Securities

The composition of the housing stock

Of the 14.4m housing units identified by the census the great bulk are formal houses or apartments. 1.14 units are described as traditional, 1.249m as informal dwellings (stand alone shacks) with a further 713 000 shacks in back yards. The ownership structure of these housing units makes interesting reading. Nearly 6m of the units are identified as owned and fully paid off (see Table 2 below). It is these owners who surely make the most reliable and sought after recipients of unsecured loans.

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Table 2: Distribution of households by tenure and province (number)

Tenure status	WC	EC	NC	FS	KZN	NW	GP	MP	LP	SA
Rented	471 917	252 220	56 530	164 099	566 169	255 445	1 448 558	219 275	178 010	3 610 222
Owned but not yet paid off	280 413	151 106	24 657	74 346	307 917	70 143	641 384	80 983	70 537	1 701 467
Occupied rent-free	248 679	328 732	62 966	136 911	492 267	213 624	625 311	186 002	387 898	2 682 392
Owned and fully paid off	578 368	855 038	141 426	425 172	1 090 744	488 377	1 089 742	558 785	747 220	5 970 872
Other	56 623	100 289	15 825	22 786	83 333	36 426	104 026	31 483	34 436	485 208
Total	1 634 000	1 687 385	301 405	823 316	2 539 429	1 062 015	3 909 022	1 075 488	1 418 102	14 450 161

Source: Investec Securities

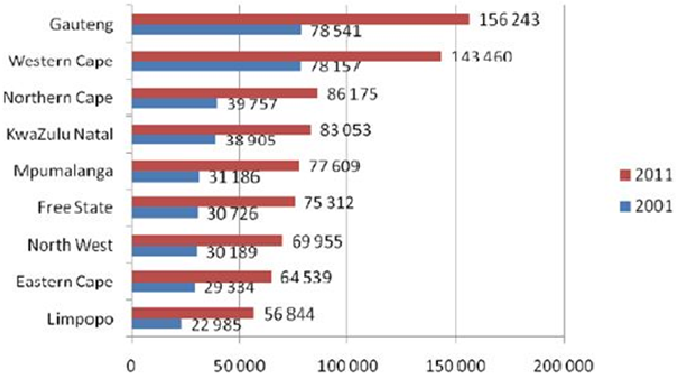
Stuff at home

These owner-rented and mortgaged homes seem very well provisioned with household appliances and consumer goods. 10m refrigerators and 11m stoves were identified, together with 4.5m washing machines and more computers (3m) than vacuum cleaners. 10.7m TV sets entertain the stay-at-homes backed up by as many as 8.5m DVD players and unsurprisingly, 13m cell phones.

Large differences in provincial income –or is it an urban / rural divide?

Much larger differences in household incomes are however recorded by the different provinces. Average household incomes are highest in Gauteng (R156 243) and the Western Cape (R143 460) - almost three times as high as average household income in the poorest provinces – refer to the Chart below. These income differences may be regarded as more of an urban-rural divide than a provincial one. The gap between household incomes in the Durban metropolitan region and that of rural KwaZulu-Natal is probably every bit as wide as it is between Gauteng and Limpopo.

Chart 5: Average annual household income province



Source: Investec Securities

Higher incomes mean greater opportunity and so migration – a force to be recognised in advance and encouraged

It is these differences in incomes and income earning opportunities that understandably have led to large numbers (presumably mostly younger men and women) migrating to Gauteng and the Western Cape. Over a million people have migrated to Gauteng over the past 10 years and over 300 000 to the Western Cape. The Eastern Cape has seen net outward migration of 278 000 persons, mostly to the Western Cape and Limpopo Provinces: a net 152 000 residents have migrated to other provinces, mostly to Gauteng. Migration plus population growth has seen the population of Gauteng increase from 9.38m in 2001 to 12. 27m in 2011, an increase of 30%. This makes Gauteng by far the most populous SA province. The population of the Western Cape has increased by 28% over the 10 years to 5.8m people, more than the population of the much poorer Eastern Cape.

Since transfers from the central government to the provinces are based on the size of their populations, these developments have significant budgetary implications. The argument that the governments of the Western Cape and Gauteng will make is that with migration of this order of magnitude, 10 years is too long to wait to adjust budgets in recognition of population growth and the additional demands growth in population makes on provincial budgets.

However the logic behind the allocation of funds to the provinces based on existing populations, rather than their economic potential, should be questioned. If economic and employment growth were the objective of economic policy then it would surely be better to back the winning provinces – those that offer significant employment and income opportunity – rather than redistribute taxpayers' contributions to those provinces where economic prospects and achievement are so lacking. The economic potential of SA, as everywhere in the world, lies in the urban not the rural areas."

Madiba-pic 2: More to follow...

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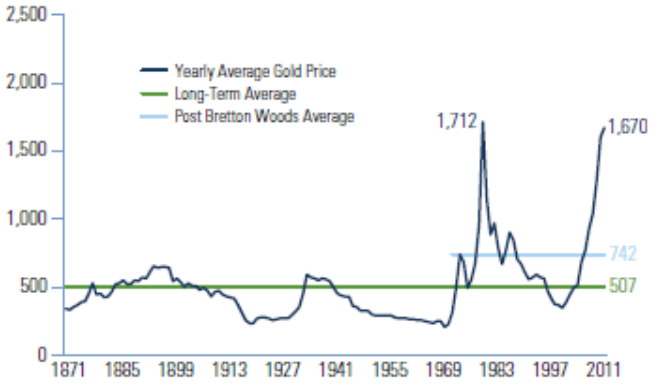
Global chart of the month

In times of uncertainty we are often faced with questions about the prospect for gold. The precious metal's rise of 5.7% last year was the smallest since 2001 and was significantly lower than the S&P 500's total return of 16.3%. Last year also marked the first time in the last decade that the physical investment demand for gold actually declined in the decade-long commodity super cycle. Since the Bretton Woods agreement was abandoned in the early 70's the long-term average for gold price has been $742 per ounce – refer to Chart 6. The prevailing gold price is 56.0% higher than its long-term average. This premium is not supported by the average cost of production, which is around $750 per ounce. The average cost seems to be supported by the fact that 80% of gold production costs less than $1 000 per ounce to mine. What is also troubling is that the average annual real gold price is a mere 2.4% lower than its historical peak during the 1980's, leaving little room for further gains (unless we experience a dramatic crisis such as a G7 default or the breakup of the Eurozone).

Chart 6: The real average annual gold price
In 2012 US dollars



Source: Merrill Lynch

The difference between the current gold price and the production cost represents the premium investors are willing to pay for its ability to hedge against inflation and the debasement of the US dollar. However, questions have recently been asked of the metal's status as a safe haven; the gold price actually declined during the worst of Great Financial Crisis, while the dollar rallied during the same period. Even outside of the crisis, gold experienced a larger peak-to-tough decline than equities over any three-year period since 1969 (-64.5% for gold versus -56.8% for equities).

Low real interest rates have supported gold prices by reducing the opportunity cost of holding it. However the opposite will be true in a rising interest rate environment. Although we believe US interest rates will be lower for longer, in our opinion they have bottomed and will eventually trend higher. The gradual improvement in growth and risk sentiment in the US economy, moderate inflation and slowly rising real rates makes the gold price even more vulnerable and increases the opportunity cost of holding the metal.

Madiba-pic 3: More to follow...

For the record

Table 3 below lists the latest returns of the mutual and retirement funds under Maestro's care. You can find more detail on our website at www.maestroinvestment.co.za. Returns include income and are presented *after* fees have been charged. Fund Summaries for each respective fund listed in the table are available on our website.

Table 3: The returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity				
Prescient Fund	**Feb**	**-1.8%**	**-0.7%**	**15.5%**
JSE All Share Index	*Feb*	*-1.9%*	*1.3%*	*19.3%*
Retirement Funds				
Maestro Growth Fund	**Feb**	**-1.3%**	**0.4%**	**16.3%**
Fund Benchmark	*Feb*	*-0.9%*	*1.8%*	*17.7%*
Maestro Balanced Fund	**Feb**	**-1.1%**	**0.7%**	**15.1%**
Fund Benchmark	*Feb*	*-0.7%*	*1.8%*	*16.3%*
Maestro Cautious Fund	**Feb**	**-0.3%**	**0.3%**	**13.3%**
Fund Benchmark	*Feb*	*-0.2%*	*1.0%*	*12.2%*
Central Park Global				
Balanced Fund ($)	**Jan**	**1.1%**	**1.1%**	**4.4%**
*Benchmark**	*Jan*	*2.2%*	*2.2%*	*7.2%*
*Sector average **	*Jan*	*2.5%*	*1.5%*	*5.7%*

* 40% MSCI World Index, 20% each in Barclays US Aggregate Bond Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills
** Lipper Global Mixed Asset Balanced sector ($)

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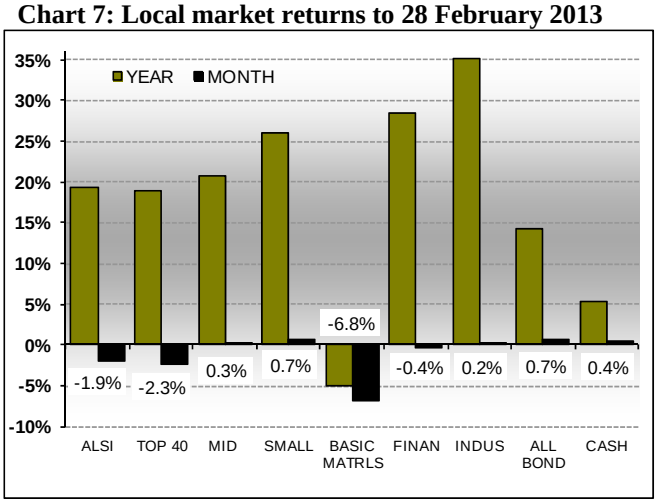
February in perspective – local investment markets

The All share index ended February down 1.9%, pulled lower by the basic materials index which declined 6.8%. The financial index fell 0.4%, but the industrial index rose 0.2%. Spare a thought for long-suffering gold bulls; that index declined 11.5% in February, bringing its decline for the past year to 29.4%. The large cap index declined by 2.4%, but the mid and small cap indices ended the month up 0.3% and 0.7% respectively. The best performing sectors were software and computer services, which rose 10.3%, general industrials 6.4% and industrial transportation 6.3%. The worst performing sectors were led by the gold mining, which declined 11.5%, platinum mining 9.4% and fixed line telecommunications 8.7%.

Chart 7: Local market returns to 28 February 2013



So what's with the pics?

You probably think I am mad putting in pictures such as the ones you have seen so far. However, there is method in my madness, for if you page down you will see another picture of the same monument, this time seen from the "right perspective". The work was created by Marco Cianfanelli and was inaugurated on 12 August 2012. It marks the exact spot in the Kwazulu-Natal Midlands where Nelson Mandela was arrested after holding a clandestine meeting with Chief Albert Luthuli. Having evaded authorities for 17 months, he was finally captured, at which point he disappeared from public view for the next 27 years. You can read more about the story by clicking here. If you would like to see more pictures, you will find them here.

Table 4: MSCI returns to 28 February 2012 (%)

	YTD	MTD
ACWI	4.3	-0.2
DM	5.0	0.0
Asia Pacific	6.7	2.3
Australia	8.9	3.2
Hong Kong	5.1	-0.7
Japan	6.4	2.6
New Zealand	8.3	-1.6
Singapore	1.4	0.0
GEM	-0.1	-1.3
EM Asia	0.8	-0.2
China	0.0	-3.9
India	-2.8	-7.4
Indonesia	12.6	10.1
Korea	0.3	4.6
Malaysia	-3.5	1.4
Philippines	17.0	8.6
Taiwan	0.6	0.4
Thailand	8.1	2.2
EMEA	-3.9	-3.5
Czech	-9.8	-4.0
Egypt	-4.7	-2.6
Hungary	4.1	-6.3
Morocco	-2.0	-3.2
Poland	-6.7	-3.7
Russia	0.3	-5.6
South Africa	-7.6	-2.0
Turkey	0.1	-1.6
LATAM	0.7	-2.9
Brazil	0.1	-2.6
Chile	6.4	-0.9
Colombia	-3.6	-5.4
Mexico	2.2	-3.2
Peru	-7.5	-6.5

Source: Merrill Lynch

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Madiba-pic 4: Cianfanelli's new Mandela monument

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