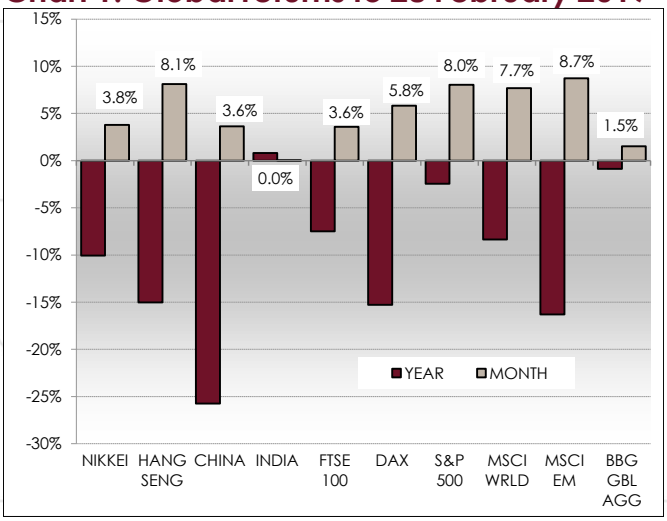
February in perspective – global markets

After the strong equity market returns last month, we were hoping that January's momentum would carry through to February and March. We thought that would underwrite, at least to some extent, the sustainability of the January bounce. Well, February is behind us and I am happy to report that global markets maintained the positive momentum with which they began the year. Corporate earnings were largely as expected – most of the companies in which our clients are invested offshore posted great results – and we were able to put another month of positive returns behind us.

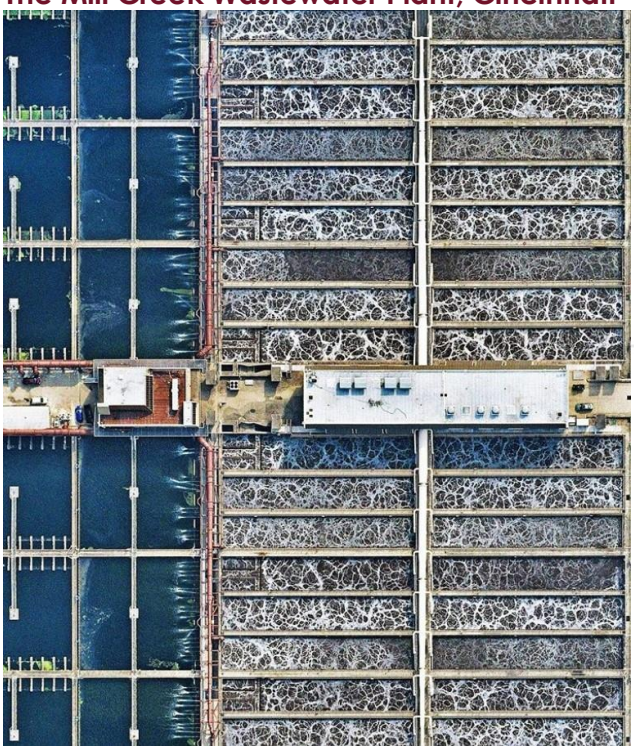
Chart 1: Global returns to 28 February 2019



The MSCI World index, a proxy from global equity markets in developed economies, rose 2.8% while the MSCI Emerging index, a proxy for emerging markets, rose only 0.1%. China continued the heady pace of gains, rising 13.8% in February, bringing its year-to-date gains to 17.9%. The Indian equity market declined 1.1%, the Brazilian equity market lost 1.9%, Russia 2.2% and South Africa 2.4% in dollar terms. Amongst developed markets, the Hong Kong equity market rose 2.5%, Japan 2.9%, Germany and the US 3.1% each, and Switzerland 4.7%. The S&P Mid and Small cap indices rose 4.1% and 4.2% respectively, while the tech-heavy NASDAQ index rose 3.4%, proof that February was characterized by investors' increase in risk appetite.

The global bond market lost ground, with the Bloomberg Global Aggregate Bond index falling 0.6%. The dollar rose marginally against most other currencies, with the trade-weighted dollar (DXY) index ending the month up 0.6%. As noted previously, the rand lost 5.6% against the dollar. Despite the firmer greenback, commodity prices were slightly firmer on the month, with the exception of some strong specific gains: the oil price rose 7.4%, the platinum and palladium prices rose 6.9% and 15.9% respectively, and the copper price rose 4.9%.

The Mill Creek Wastewater Plant, Cincinnati



Instagram handle: @dailyoverview

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

SS Maheno Wreck, Fraser Island, Queensland

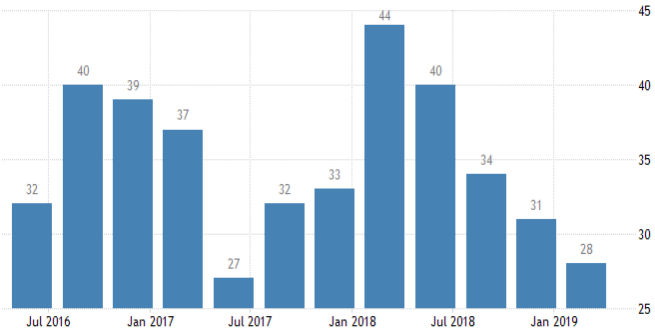
Instagram handle: @dailyoverview

What's on our radar screen?

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

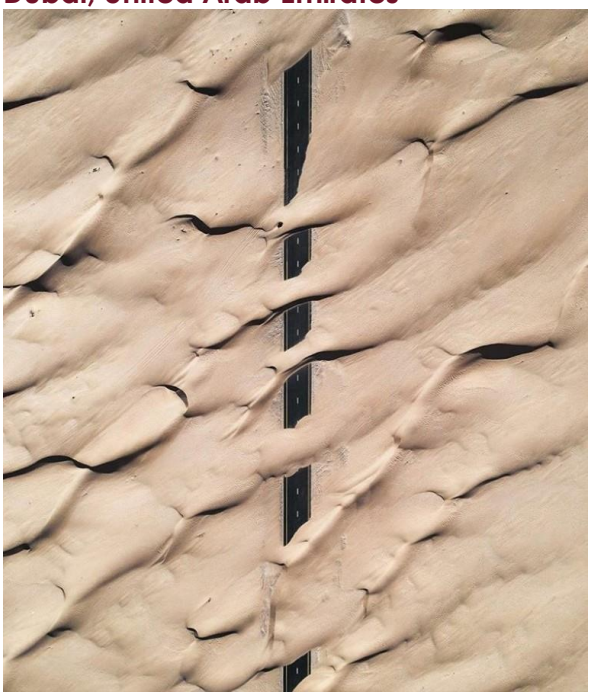
- *The SA economy:* News out of the SA economy continues to be bleak. Although the official data suggest something slightly more positive, between news emerging on a daily basis about corruption, specifically at State-owned enterprises (SoEs) – corruption of unimaginable proportions – the harsh anti-business external environment, and the looming elections on 8 May, the economy has ground to a halt. Final December quarter (Q4) economic growth revealed that SA grew by 1.4% quarter-on-quarter annualized, following the upwardly revised Q3 growth of 2.6%. On a year-on-year basis, the economy grew 1.1% during Q4, down from Q3's 1.3%. Although there was a rebound in household consumption, gross fixed capital formation declined yet again, by 2.5% quarter-on-quarter during Q4. Month-on-month retails sales all but collapsed in December, sliding 4.8%, bringing the annual decline to 1.4%, from an annual gain of 3.1% in November. Gold production slumped 31.0% month-on-month during December, while total mining production fell 1.2%. The annual decline in total mining production to December was 4.8%, from a decline of 5.6% in November. January's data was only marginally better: month-on-month gold production slid 22.5%, while the annual decline in total mining production improved from 4.8% to a decline of 3.3%. Annual manufacturing production rose only 0.3% in January. Not surprisingly Q1 business confidence declined to 28 from Q4's 31. As can be seen from Chart 2, below, business confidence has been in a steady decline; as I write this note I am literally sitting in the dark (again), thanks to Stage 4 load shedding. One can only wonder how much further business confidence will fall.

Chart 2: South African business confidence



Source: Trading economics

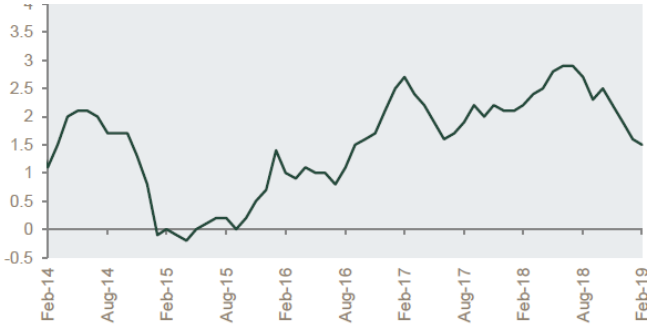
Dubai, United Arab Emirates



Instagram handle: @abstractaerialart

- *The US economy*: Retail sales rose 0.2% month-on-month in January, recovering from a downwardly-adjusted 1.6% decline in December, although the latter was affected by bad weather and the government shutdown. These two factors have given rise to a lot of distortions in the data, which is unfortunate, as we wait to see how far the US economy has actually slowed, over and above all the distortions. By way of another example, the US created only 20 000 jobs in February, but that does follow a massive upwardly-adjusted January number of 311 000. The unemployment rate fell to 3.8% and the annual increase in wages rose to 3.4%, indicative of ongoing tightness in the US labour market. Despite this tightness, core inflation rose only 0.1% month-on-month in February, lowering the annual rate to 2.1% from 2.2%. The annual rate of headline inflation in the US is now only 1.5%.

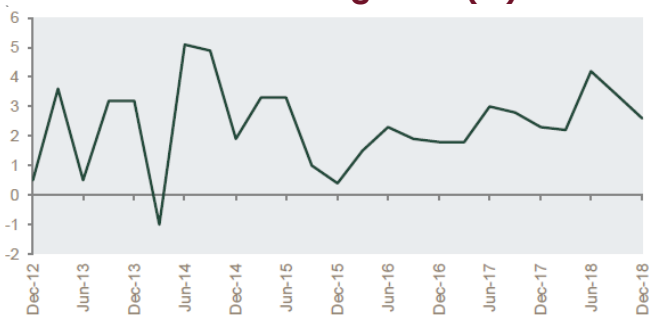
Chart 3: US annual headline inflation rate



Source: EFG

The US economy grew at an annualized rate of 2.6% during Q4, down from 3.4% in Q3 – refer to Chart 4. Private domestic demand rose 3.1%, but all eyes will be on the Q1 2019 growth, which is expected to be a lot lower.

Chart 4: US economic growth (%)



Source: EFG

Dealing a body-blow to US President Trump's protectionist agenda, the US trade deficit shot to a 12-year high of $621bn in 2018, a 12.5% increase and the largest trade gap in a decade. A 7.5% rise in imports offset a 6.3% rise in exports. The country posted an $891bn goods deficit, with China accounting for almost half that total – the deficit with China increased $43.6bn to $419.2bn, defying Trump's hopes of narrowing the gap as pledged in his presidential campaign. A final piece of economic data emerged during the month: job openings in the US rose by 102

000 to a new high of 7.6m in January, despite evidence of a slowing economy. That in turn gives rise to the remarkable position of there now being about 1m more jobs than unemployed workers. Is that not the envy of every government and country?

- *Developed economies*: Ongoing weakness in the German economy continues to be evident, with industrial orders declining 2.6% in January, the biggest decline in seven months. January industrial production fell 0.8% month-on-month. Recall from last month's *Intermezzo* just how narrowly Germany missed a recession during the last quarter of 2018. In a surprize development, the Swedish economy grew 1.2% in Q4 following a 0.2% decline in Q3. Increased public spending and a rise in exports contributed to their growth. The Swiss economy grew 0.2% during Q4, following a decline of 0.3% in Q3. Strong foreign demand led to an increase in exports of 5.6% on the back of a 1.5% increase in manufacturing. However, a large decline of 6.2% in the export of overall services is indicative of the trauma currently underway in the Swiss financial sector. Private consumption grew 0.3%. The OECD issued revised growth rates for the world, with the German economy now forecast to grow by only 0.7% in 2019, and Italy, which is already in a recession, will shrink 0.2% this year. Overall, the forecast for 2019 global economic growth was revised down from 3.5% to 3.3%.
- *Emerging economies*: Annual inflation in Indonesia declined to 2.6% in February, the lowest level since November 2009, largely on the back of declining food prices. Core inflation remained steady at 3.1%. The (central) Bank of Indonesia (BI) raised interest rates six times last year, in their attempt to stabilize their currency and to reduce the current account deficit, which rose to a 4-year high in 2018. The yield on the Indonesian 10-year bond is currently around 7.65%. Turkey entered a recession, during Q4, with their economy shrinking 2.4% during the quarter, following a 1.6% decline in Q3. The annual rate of headline inflation in China came in at 1.5%, with annual producer inflation at 0.1%. Refer to the separate section below on the fiscal stimulus being undertaken by China as it seeks to revive its slowing economy.

Arena in Arles, France

Instagram handle: @dailyoverview

A focus on Chinese economic stimulus

For some time now we have drawn attention to the slowing Chinese economy. During the course of the annual National People's Congress (NPC), a number of initiatives were announced, aimed at stimulating the economy and arresting its rate of slowdown.

The measures announced can be summarized as follows:

- The target range of economic growth was revised from 6.5% to a range of 6.0% to 6.5%. Government's goal remains to double the 2010 level of real economic output by 2020, which would require an average growth rate of 6.2% for 2019 and 2020.
- The fiscal deficit target was increased from 2.6% to 2.8%. In other words, government will tolerate a great degree of debt, brought about by their efforts to stimulate the economy. A special bond of $120bn would be raised, specifically targeting spending on infrastructure. The focus here will be on railway, road and water transportation, and information infrastructure, such as 5G and the industrial internet.
- Tax cuts totalling about $300bn, mainly for corporates, were announced. These will be brought about through, inter alia, the lowering (by 3%) of Value Added Tax (VAT).
- The target for consumer inflation was retained at 3%. With the prevailing rate around 2%, this leaves room for further interest rate reductions.
- Government plans to reduce the employer contribution rate for social security from around 20% to 16%.
- Government plans to further increase private sector support and protection, particularly with respect to market access and property rights, and open domestic markets to foreign and private investors, whilst enhancing Intellectual Property (IP) protection, improving the business environment, and accelerating mixed ownership reforms of State-owned Enterprises (SoEs). This particular aspect of the reforms looks carefully crafted to fit in with the current US China trade negotiations.
- Further cuts to medium and small banks' reserve ratio requirements (RRR) would be announced, thereby freeing up liquidity and enabling banks to increase their lending.
- The central government plans to reduce its expenditure. Targeted measures include a reduction of 5% for government general expenses, and the repatriation of excess cash held by local government.

Financial district, Shanghai, China

Instagram handle: @shanghaicomune

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

These represent the main features of the Chinese government's attempt to combat the slowing economy. I have gone into some detail here, to highlight the contrast between what the Chinese government are doing to stimulate economic growth, and the South African Budget, tabled during February, which contained no growth initiatives nor any changes to ameliorate the harsh business climate. It's worth highlighting that China is concerned about the fact that their economic growth rate is slowing to 6%; the SA growth rate cannot even breach 1% for a sustainable length of time, let alone the 5% to 6% called for in the National Development Plan – does anyone still remember that document? How conveniently the government has forgotten about it. It brings to mind the adage that "there are none so lost as those who don't know they are lost".

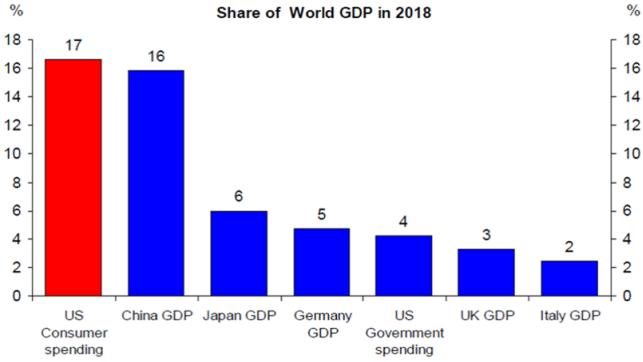
Fishing in Phu yen, Ha Noi, Vietnam

Instagram handle: @twenty4sevendrones

Chart of the month

I have a few random charts to share this month, in no particular order. Firstly, you might often wonder why we spend so much time monitoring the US and Chinese economies, and the US consumer in particular. Chart 5 provides the simple answer in graphic form: we follow them so closely because they constitute such a large portion of the global economy. It is also apparent from the chart, how important the health of the Chinese economy is in the context of the global economy.

Chart 5: The US consumer is important



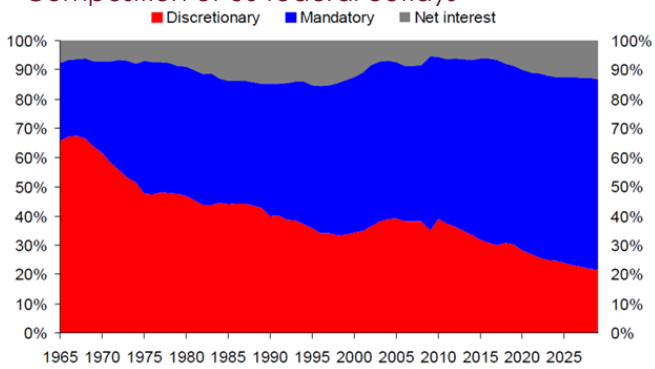
Source: Deutsche Bank

Secondly, I found the following chart interesting, if not positively scary. It depicts the composition of US federal (government) outlays, split between interest charges, mandatory and discretionary spending. It reflects much of the change in recent decades during our lifetimes, which has seen governments around the world spending a steadily increasing amount on so-called entitlement (mandatory) spending, at the expense of discretionary spending. The amount paid, though smaller, on servicing rising debt, which in the case of the US occurred during a period of steadily declining interest rates, has also risen steadily. One can only shudder to think what the equivalent South African government outlay chart looks like. The recent 2019/20 Budget tabled in Parliament in February, saw R202.2bn or

11.1% of government spending being allocated to debt servicing costs, while R278.4bn or 15.2% of government spending was allocated to (entitlement) "social development".

Chart 6: Increasing role of entitlements

Composition of US federal outlays

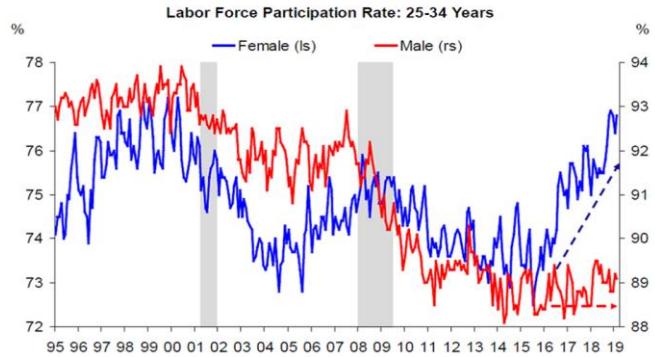


Source: Deutsche Bank

Thirdly, with all the attention on women this month, I found Chart 7 interesting. It shows that in the US, while employed males between the ages of 25 and 34 have remained a relatively constant proportion of the employable labour force in that age cohort during the past five years, the proportion of similar aged females has risen dramatically. That said, the percentage of employable men in that age group (about 89%) remains greater than woman (about 77%) – note that the scales on the two vertical axes are different.

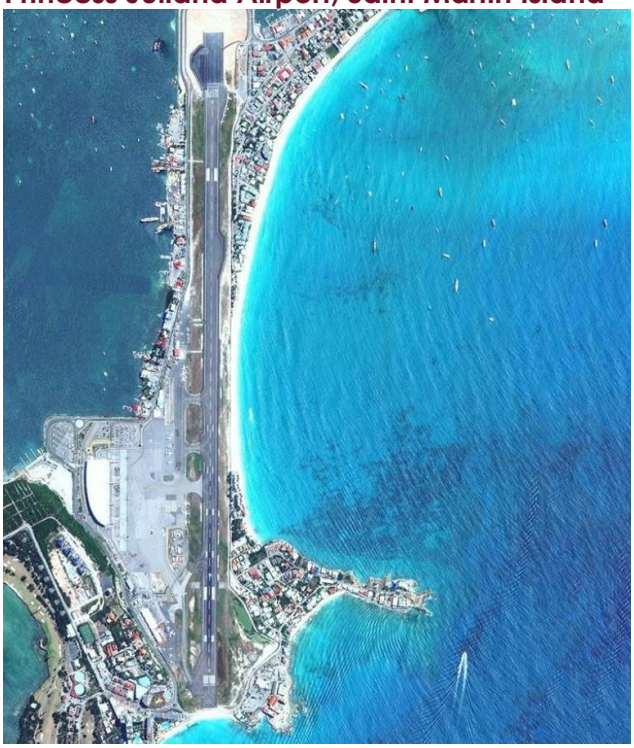
Chart 7: Millennial women power

Labour force participation rate of millennials



Source: Deutsche Bank

Princess Juliana Airport, Saint Martin Island



Instagram handle: @dailyoverview

Quotes to chew on

Reflections on a decade ago – where were you?

It is hard to believe that ten years have passed since the trough on the 2007/9 Great Financial Crisis. Can you remember where you were at that time? *Deutsche Bank's Jim Reid* provided some interesting perspective relating to that time. On 7 March he wrote "How time flies. As of 8.22pm GMT last night it was officially ten years to the minute that the S&P500 had hit its famous 2009 intraday low of 666.79. I remember being transfixed by the CNBC stream of unfolding events at home. I remember less as to whether I rung my broker and screamed "buy" at him. The fact that I'm currently worrying about carpets breaking my house renovation budget to a terminal degree suggests I didn't. Anyway, at that point it was the lowest the index had been since the mid-90s. On a closing basis the low actually came on March 9th 2009 when it hit

676.53. Since that all-time low the S&P is up 'a mere' 401% in total return terms although it doesn't lead the way with the NASDAQ up an even more impressive 557%. Compare that to Europe where the STOXX 600 is up 'just' 233%. For credit guys US HY has returned 171% while Treasuries and Bunds have returned just 27% and 40% respectively. There is one market which is negative over the last 10 years and that goes to the Greek Equity market, which is down 41%."

Telling it like it is

I came across this quote during the month, which I just have to share with you. It read, simply "People who complain about taxes can be divided into two classes: men and women". Never a truer word spoken, especially from a South African point of view. I tried to find the source of this wisdom, but it seems to be from an anonymous source.

Statue of Liberty, New York

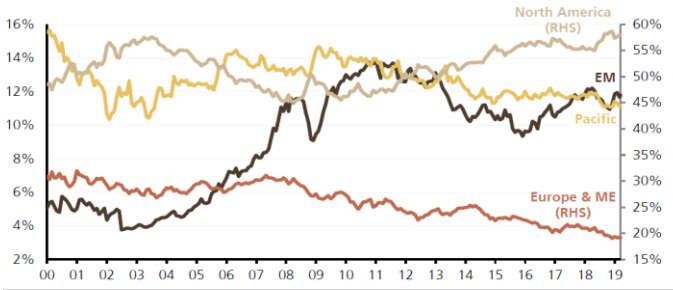
Instagram handle: @newyork_world

The changing face of EM equity markets

The MSCI ACWI index is a widely-used index which reasonably accurately depicts the world's equity markets, being those in the develop world, the emerging world and the rest (frequently referred to as frontier markets). Standard and Poor's (S&P) and Morgan Stanley Capital International (hence MSCI) are two of the world's largest and leading providers of data and compilers of indices used to track various (debt, equity) markets around the world. The MSCI All Country World Index (ACWI) provides a useful window into the size and relative importance of global equity markets. Tracking the index's changes over time provides a useful history lesson on the relative size, value and importance of countries and their respective markets over time.

It is to this topic that I now turn – the charts are self-explanatory, so I will keep my comments brief. Chart 8 depicts the changing face of the MSCI ACWI during the past 20 years. The rise of Emerging markets (EM), from around 5% in 2000, is clear, particularly in the lead up to the 2007/9 Financial Crisis, and their subsequent rise to around 14% until 2010 – a lot of this increase was due to the rise in Chinese markets – but more about that later. The North American markets have remained in a range between 45% to 55%, although their rise from about 45% in 2010 to the current 58% is significant, reflecting the strength of US equity markets over this period. Europe and the Middle East (ME) markets declined steadily over this period from about 30% to the current 20%.

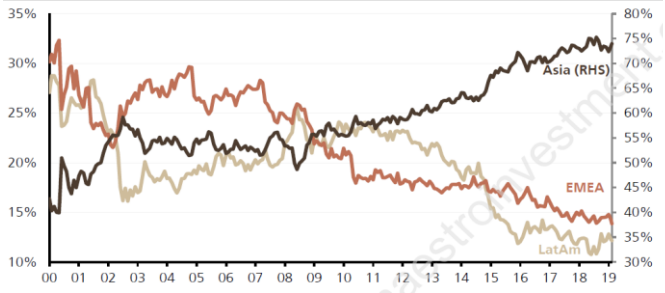
Chart 8: The changing face of MSCI ACWI



Source: UBS

Isolating the Emerging Market (EM) component of the MSCI ACWI for a moment, it is informative to see how the contribution of the underlying regions has changed over time – refer to Chart 9. Not surprisingly, Asia dominates the MSCI EM index, marking up nearly 75% of the index, having risen from around 40% in 2000. This increase has been at the expense of both Emerging Europe, Middle East and Africa (EMEA), and Latin America (Latam), which now constitute 12% and 13% respectively. The trends over the past two decades are obvious.

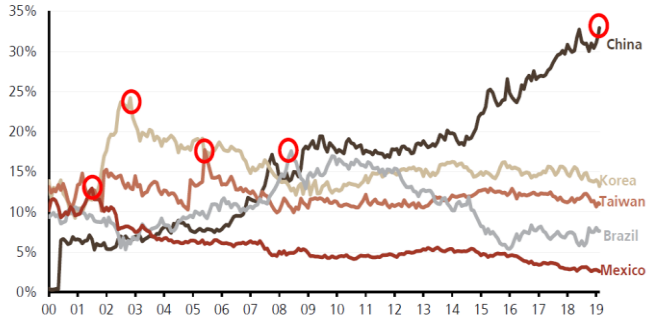
Chart 9: The changing face of MSCI EM



Source: UBS

At various times since 2000, five different markets have had the status of the biggest country within the MSCI EM benchmark. India overtook Taiwan's weight on 21 February 2000 to become the largest EM for just a single day. China has been in the lead since late-2008 and currently accounts for one third of the benchmark. The increased weighting recently announced by MSCI (refer to the section below) will increase this even further.

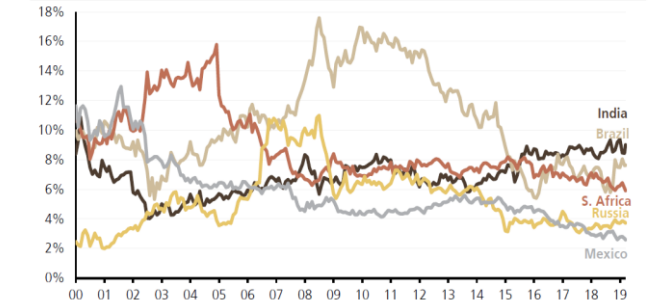
Chart 10: The biggest country within EM



Source: UBS

Chart 11 shows the weights of the five largest countries in MSCI EM after China, South Korea and Taiwan. The significance of the four big non-Asian EMs in this group has been fading since the GFC. The weights of Brazil, Mexico and Russia have roughly halved (note Brazil's spectacular decline from 18% in 2008 to 6% in 2016), while a smaller decline for South Africa has been almost entirely a function of Naspers's strength driven by Tencent. India, along with China, has been driving up the MSCI EM concentration in Asia.

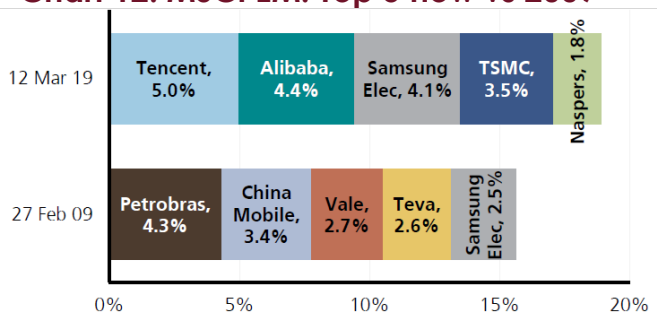
Chart 11: MSCI EM – the "next five"



Source: UBS

There is far more to share with regard to the changes that have occurred within the make-up of the various indices that are followed by trillions of dollars of assets, but space precludes a more comprehensive analysis. To end, I list a five largest components of the MSCI EM index, as they were in February 2009 and now in March 2019, ten years later.

Chart 12: MSCI EM: Top 5 now vs 2009



Source: UBS

Yacht in Jersey, Channel Islands

Instagram handle: @twenty4sevendrones

The changing face of China in world markets

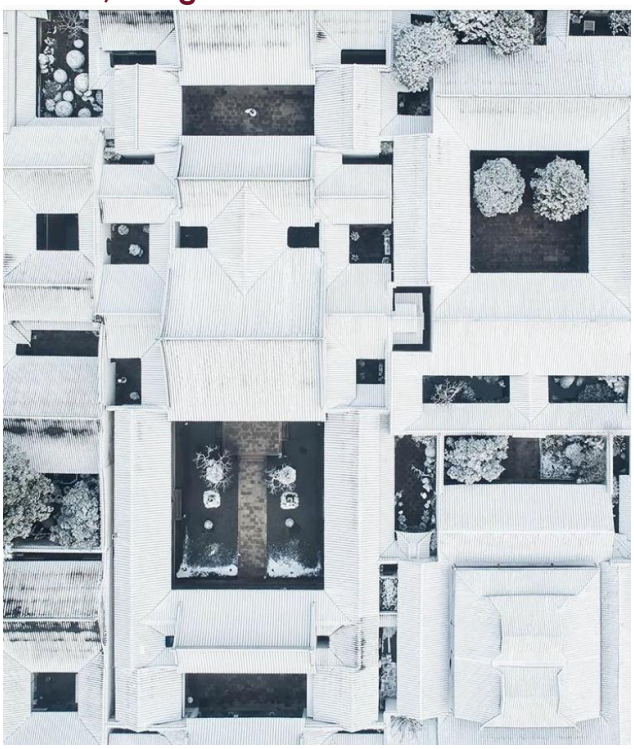
Following on from our brief review of how the MSCI indices have changed over the years, in early March MSCI announced that China's A share weighting within the MSCI EM index will quadruple from its current 0.7% to 3.3% in November 2019. The increase in weighting will be phased in in three steps to allow funds that track the indices to bring their holdings in line with the revised weights without unduly influencing market prices. China's so-called A shares are shares which trade on the China mainland stock exchanges, such as those in Shenzhen and Shanghai, but not Hong Kong. In recent years China has slowly relaxed the ability of foreigners to trade on these markets, but the reforms are still at an early stage and A shares remain by and large outside the scope of investment for foreigners. The MSCI announcements represent another significant step, albeit a small one, in the opening up of the internal Chinese equity markets to foreign investors. It is estimated that the MSCI changes will lead to a $67bn fund inflow to the A-share market this year.

MSCI have strict criteria for inclusion in their indices, and they listed as reasons for the increased weights of A shares the smooth running of Stock Connect program, which the Chinese authorities put in place to facilitate trade between the Hong Kong and internal stock exchanges, and improvements in market accessibility, such as the quadrupling of the Stock Connect daily limit and a visible reduction in trading suspensions. MSCI indicated that the weight of A shares may further increase if China continues to promote the further opening and development of the market though, for example, permitting the listing of index futures.

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.

Suzhou, Jiangsu



Instagram handle: @seven7panda

Table 1: The returns of funds in Maestro's care

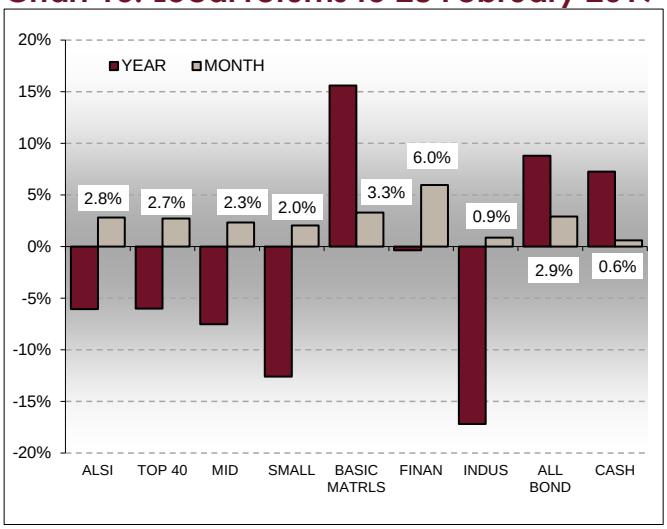
	Period ended	Month	Year to date	Year
Maestro Equity Prescient Fund	**Feb**	**2.9%**	**5.9%**	**-5.9%**
JSE All Share Index	*Feb*	*3.4%*	*6.3%*	*-0.9%*
Maestro Growth Fund	**Feb**	**4.8%**	**6.0%**	**2.0%**
Fund Benchmark	*Feb*	*2.8%*	*4.9%*	*3.0%*
Maestro Balanced Fund	**Feb**	**2.2%**	**3.3%**	**-0.7%**
Fund Benchmark	*Feb*	*2.5%*	*4.3%*	*3.9%*
Maestro Cautious Fund	**Feb**	**0.1%**	**-0.2%**	**1.8%**
Fund Benchmark	*Feb*	*1.1%*	*3.1%*	*4.1%*
Central Park Global Balanced Fund ($)	**Feb**	**4.0%**	**13.7%**	**-6.9%**
*Benchmark**	*Feb*	*1.5%*	*6.8%*	*-0.9%*
*Sector average **	*Feb*	*1.7%*	*6.5%*	*-1.7%*
Maestro Global Balanced Fund	**Feb**	**10.2%**	**14.5%**	**11.4%**
*Benchmark**	*Feb*	*7.5%*	*4.4%*	*18.1%*
*Sector average***	*Feb*	*8.0%*	*6.0%*	*15.3%*

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

February in perspective – local markets

On the local front, the new Minister of Finance tabled the Budget, which though robust and delivered under tough conditions, was underwhelming and contained no incentive for growth. The positive investor mood globally spilled over into the local market though, and the All Share index ended up 3.4%, driven by a 9.1% rise in the Basic Materials index (a combination of firm commodity prices and weak rand). The Financial index, on the other hand, suffered from the weak rand, and ended down 2.1% in February while the Industrial index rose 3.5%. The Large cap (Top40) index rose 3.6%, the Mid cap index rose 2.3% while the Small cap index lost 2.7%. The All Bond index lost 0.4% although it did rise 2.9% last month.

Chart 13: Local returns to 28 February 2019

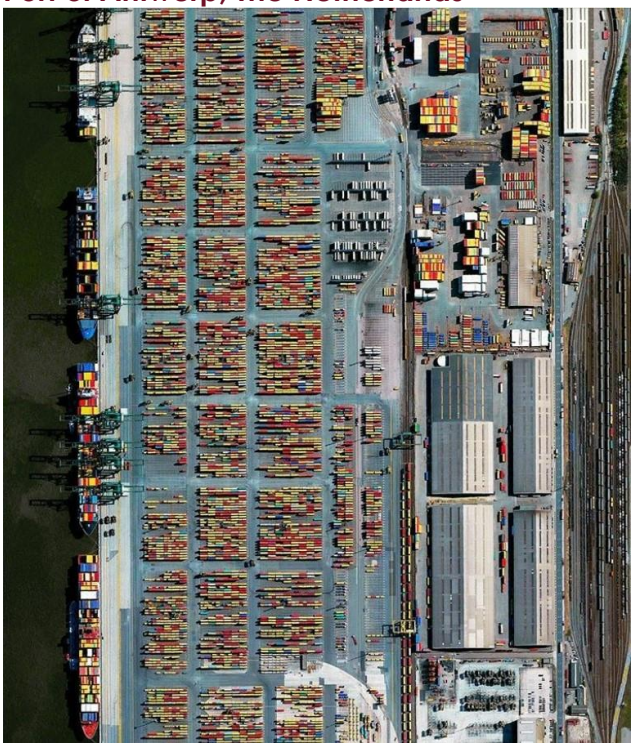


So what's with the pics?

In recent months, I have become a great fan of Instagram, which is unsurprising, 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.

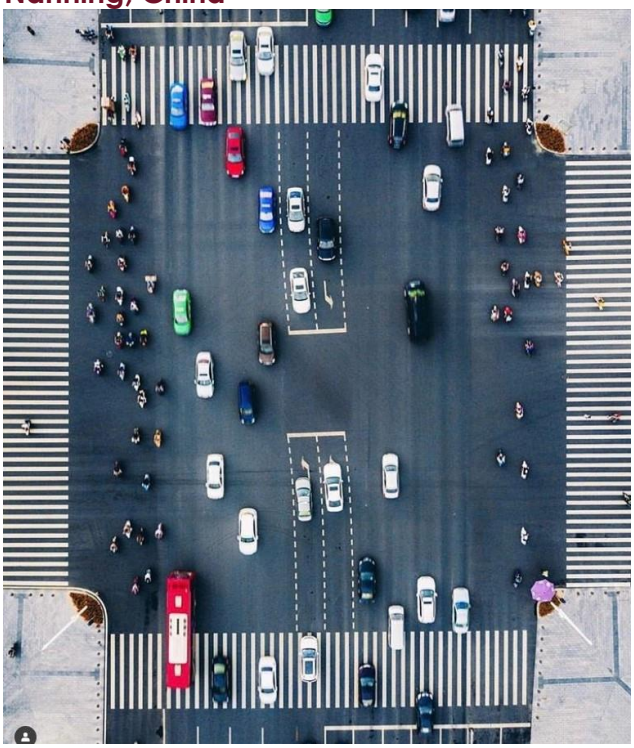
"To achieve great things, two things are needed; a plan, and not quite enough time."
- Leonard Bernstein

Port of Antwerp, The Netherlands



Instagram handle: @dailyoverview

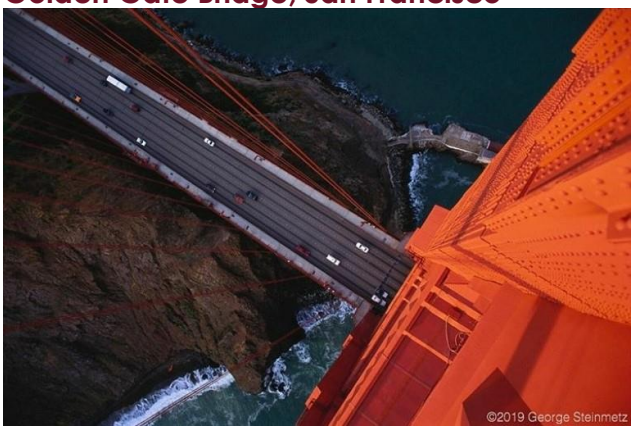
Nanning, China



Instagram handle: @drone.globe

That said, I have created folders compiled along thematic lines. The photos that appear in this edition – taken from my Aerial 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.

Golden Gate Bridge, San Francisco



Instagram handle: @geosteinmetz