INTERMEZZO

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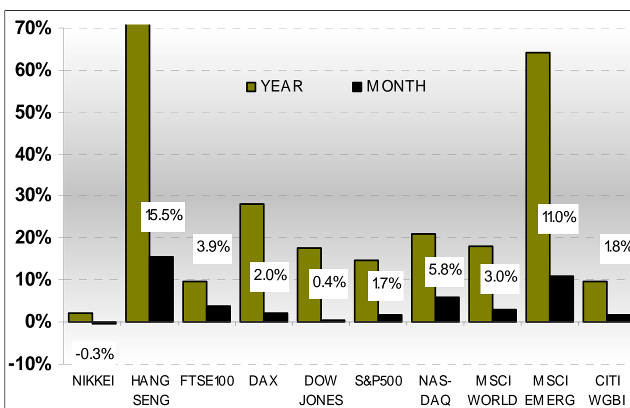
October in perspective – global markets

Following the dramatic events of August and the surge in equity markets after the Fed cut its rates on 18 September it was always going to be interesting to see what global markets would deliver in October. Well, the momentum in markets continued in most regions, as is evident from Chart 1. To a large extent we saw “more of the same” – firm developed markets, *very* strong emerging markets and a weak dollar that led to strength in commodity and energy prices. Oil hit an all-time record while the dollar dropped to an all-time low against the euro and was weak against virtually all other currencies – particularly against emerging market currencies. I draw your attention to the 14.7% rise in the Indian equity market (it rose 12.9% in September) and the 15.5% rise in Hong Kong (13.2%) both of which helped the MSCI Emerging Market index gain 11.0%, hard on the heels of its 10.9% September rise. The MSCI World index gained 3.0%, which is impressive when you consider it rose 4.6% in September. The oil price rose 13.4% and gold and platinum 6.6% and 4.6% respectively. It is impossible to capture here all that is happening in global markets right now – but there is plenty happening on a daily basis. Many of the developments are new or unusual, such as the global credit crunch, but all are inter-related and have culminated in an intense and dramatic environment. It is ironic – I appreciate not everyone has had this experience – that most equity investors have been able to navigate through the turmoil in a profitable fashion.

Chart 1: Global market returns to 31 October 2007



At the risk of alienating our offshore readers, but penned modestly with tongue in cheek, if there was any doubt we are living the decade of emerging markets, I would humbly point out that India won the inaugural Twenty 20 cricket World Cup and South Africa won the rugby World Cup, having beaten Argentina in the semi-final. If you need any more convincing, note that both these teams beat developed market teams (England and France) in their last games.

For the record

Table 1 lists the latest returns of the mutual funds under Maestro’s care. You can find more detail, including the latest Maestro Equity Fund Summary, by visiting our website at www.maestroinvestment.co.za. Returns include income and are presented after fees have been charged.

Table 1: Returns of funds under Maestro’s care

	Period ended	Month	Year to date	Year
Maestro Equity Fund	Oct	**7.0%**	**30.6%**	**41.3%**
Maestro equity benchmark **		6.5%	23.8%	34.8%
JSE All Share Index		4.8%	28.7%	37.7%
Maestro Long Short Equity Fund	Sept	**3.3%**	1.1%*	N/A
JSE All Share Index		5.0%	6.6%*	N/A
Central Park Global Balanced Fund ($)	Sept	**4.0%**	**10.5%**	**17.5%**
Benchmark***		3.0%	8.2%	13.6%

* Since 1 July 2007
** 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index
*** 40% MSCI World Index, and 20% each in MSCI Sovereign Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills

Table 2 lists the compound annual returns for the periods to 30 September 2007 on the equity portfolios in our care. The numbers speak for themselves but the *size* of returns over all the periods bear testimony to what a rewarding period this has been in SA’s equity market. Who would ever imagined, when markets were severely depressed in September 2002, that Maestro clients were about to embark on a journey that would deliver 38.3% *per annum* over the ensuing five years, and even greater returns over the shorter periods!

Table 2: Maestro annual returns to 30 Sept 2007 (%)

SA equity returns	6 mths*	1 yr	2 yrs	3 yrs	4 yrs	5 yrs
Maestro long-term equity portfolios	***12.5***	***48.2***	***41.5***	***46.4***	***44.9***	***38.3***
Maestro equity benchmark **	8.2	32.2	32.7	37.4	38.5	29.0
JSE All Share Index	11.3	37.4	36.9	40.2	39.1	29.7

* 6-month returns are un-annualised
** 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index

Sovereign Wealth Funds

The increase in size and influence of sovereign wealth funds (SWF) has thrust them into the spotlight recently. We first focussed on a major SWF in the August 2006 edition of *Intermezzo*, when we looked at the Norwegian Government Pension Fund, but let’s take another look at them briefly. SWF are state-backed investment funds. Their rapid increase in size - their combined assets total an estimated $2

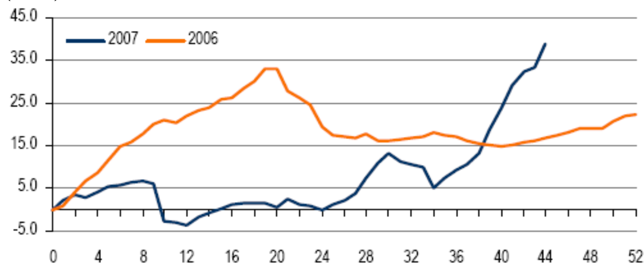
trillion - has been fuelled by four driving factors: high oil and commodity prices, growth in foreign exchange reserves, the returns they have generated and other discretionary factors such as how much the respective government wants to put in them. Of the twenty largest funds, fourteen of them have their origins in rising oil and commodity prices. The seven largest funds – the so-called “Super Seven” - have a combined asset base of $1 810bn. The funds are those of Abu Dhabi, Norway, Kuwait, China, Russia and two from Singapore. One of the latest additions to the ranks of the SWF is Libya, which recently kicked off its Fund with a $40bn injection. The issues at stake are what actions these SWF take and how aggressive will they be against an increasing backlash by US and European establishments. Just think for example what controversy would arise if the Libyan Fund took a stake in a strategic US interest, say in telecoms or the media, in energy or finance? Although they are a relatively new phenomenon, they are likely to become an increasing influence and force on the investment landscape. And at least for the time being, given the way in which commodity prices have continued to rise, as have many of the countries’ reserves, it is clear that the number and size of these funds is only going to increase. So too will their power and influence. Watch this space …

A couple of titbits

The following is relevant to our investment view:

- The Chinese economy grew by 11.5% during the third quarter. This means that during the first three quarters of 2007 it has grown in excess of 11%, the fastest growth rate since 1993 when China grew at 13.1%. Inflation eased slightly, to 6.2% from the 10½ - year peak in September of 6.5% - this topic was covered in last month’s *Intermezzo*
- The first estimate of US third quarter growth came in at 3.9% - a bit higher than most were expecting.

Chart 2: Cumulative YTD inflows into EM equity funds ($bn)

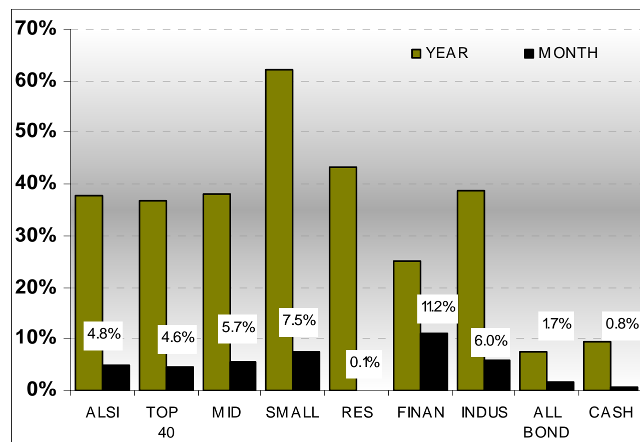


Source: Merrill Lynch

Chart of the month

We have concentrated quite a bit on emerging markets in recent Maestro communication, so it is only fitting to look at the recent inflows into long-only emerging market equity funds. Chart 2 depicts the cumulative year-to-date inflows for both 2006 and 2007 – the legend shows the weeks of the year. It is clear that inflows have accelerated sharply in recent weeks. Although these inflows are impressive, it is worth noting that record inflows have historically often been associated with sharp corrections.

Chart 3: Local market returns to 31 October 2007



October in perspective – local markets

I referred earlier to “all that is happening” in the markets at present. We had a wonderful example of that in the SA equity market during October. The record will show that the All Share index rose 5.0% and 4.8% in September and October respectively, which looks great on paper - *and* in the pocket of course. However, a closer analysis of the underlying drivers of these returns reveals just how different the two months were. In September the resource index rose 13.4% (!) yet managed a gain of only 0.1% in October. In contrast, the financial index *declined* 2.4% in September but rose 11.2% in October. In the space of two months you had a 15.8% outperformance of the former by the latter index, then it immediately swung around and produced an 11.1% differential in the opposite direction. You need a pretty robust portfolio to keep up with this kind of sector rotation and still deliver decent returns! And to complicate matters, when theory would dictate that large caps are, for a number of good reasons, the “place to be” right now, the actual returns proved the exact opposite: the large, mid and small cap returns for October were 4.6%, 5.7% and 7.5% respectively. The top performing sectors in October were mobile telecoms up 20.9%, banks 15.8% and oil and gas (Sasol) 14.3%. The laggards included gold mining down 5.9% despite the highest gold price in 28 years, and forestry and paper (Sappi and Mondi) down 4.8%. The rand was a real feature of the month, gaining 5.5% against the dollar (after a 4.0% rise last month) and 3.0% and 2.9% against the euro and sterling respectively. Needless to say, given the strong market and rand, the *dollar* return of the All Share index came in at a cool 10.1%, after the 9.2% of September – who said this wasn’t the Promised Land?

Table 2: MSCI Emerging Market dollar returns (%)

	October	YTD
EM countries/regions		
India	17.0	62.6
China	16.6	97.6
Indonesia	16.4	49.4
Brazil	15.4	79.5
South Africa	13.6	29.4
Peru	12.7	121.7
Czech Rep	12.7	48.8
Poland	12.4	35.6
LatAm	**11.5**	**54.1**
Turkey	11.2	78.8
Asia	**11.1**	**53.6**
MSCI EM	**11.0**	**46.6**
Thailand	10.7	47.8
EMEA	**10.4**	**27.7**
Russia	10.2	15.5
Chile	10.1	35.7
Egypt	9.5	36.8
Philippines	8.4	39.3
Malaysia	7.9	37.0
South Korea	7.1	45.9
Taiwan	5.4	20.4
Israel	4.1	34.4
Argentina	3.8	10.5
Mexico	3.7	17.1
Hungary	-1.8	18.7
EM sectors		
Energy	17.5	48.2
Industrials	14.4	91.6
Telecoms	12.7	55.1
Financials	12.7	43.8
Materials	8.4	77.5
Consumer Staples	7.5	28.2
Utilities	6.6	37.4
Consumer Discretionary	5.9	24.8
IT	4.9	12.5
Health Care	0.4	22.7

Source: Merrill Lynch

File 13: Interesting information, but worth forgetting

We have been commenting on the spectacular rise in the Chinese equity market for some time, having dwelt with it in many editions so far this year. Slowly but surely, this phenomenon, which once seemed far removed from SA investors, is touching their every day lives, or at least affecting their investment portfolios.

For the record, the Shanghai A index is up 122.1% so far this year, the Shanghai B index 192.4% and the Shanghai Composite index about 106%. The effects of these gains have catapulted the values of large Chinese companies into the "big league". PetroChina's market cap, for example, is just $50bn less than Exxon Mobil, which holds the position as the world's largest company by market cap. Four of the ten largest companies in the world are now to be found in China, one of which, the Industrial and Commercial Bank of China (ICBC) took a 20% stake in Standard Bank of South Africa in October, at a total cost of $5.5bn. The ICBC IPO - at the time the world's largest - was covered in the January 2007 edition of *Intermezzo*. Although this might have come as a surprise to the lay-investor, it follows a well-trodden path into Africa that is viewed in some quarters as the "re-colonization-by-stealth" of the strategically important parts of Africa. China recently established a $5bn Fund to support development on the continent. It also entered into a $5bn loan agreement with Angola in exchange for oil and recently agreed to commit a similar amount to the construction of roads, railways and infrastructure in the Democratic Republic of Congo, in return for access to that county's vast mineral resources.

Talking of Chinese IPO's (initial placement offerings when companies list on the market for the first time), the following bears testimony to the remarkable conditions in that equity market at present. Alibaba.com is China's largest business-to-business website, and is listing on Hong Kong's market on Tuesday, 6 November. Ahead of its listing, it attracted $58bn of subscriptions for the $375m shares on offer to the retail markets, while no less than $160bn of orders were received for the $1bn on offer to institutions. When ICBC raised $16bn in Hong Kong last year, it received orders for $350bn from institutional investors and $55bn from retail investors.

And finally, herewith a beautiful picture of China – source unknown.

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