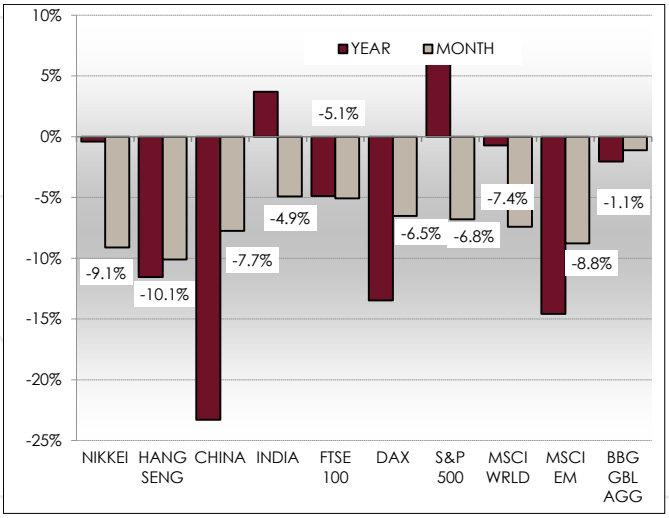
October in perspective – global markets

October was one of the worst months in terms of broad market declines, and can best be described as "brutal". There are a number of views as to what led markets lower. Concern about rising US interest rates, slowing economic growth in China, the effects of the trade war between the US and China, the sustained bull market conditions in place since 2009, and concern about slowing corporate earnings growth are all trotted out as reasons behind the market weakness. Whatever the reasons, market declines were brutal and the volatility that prevailed in most equity markets was frightening.

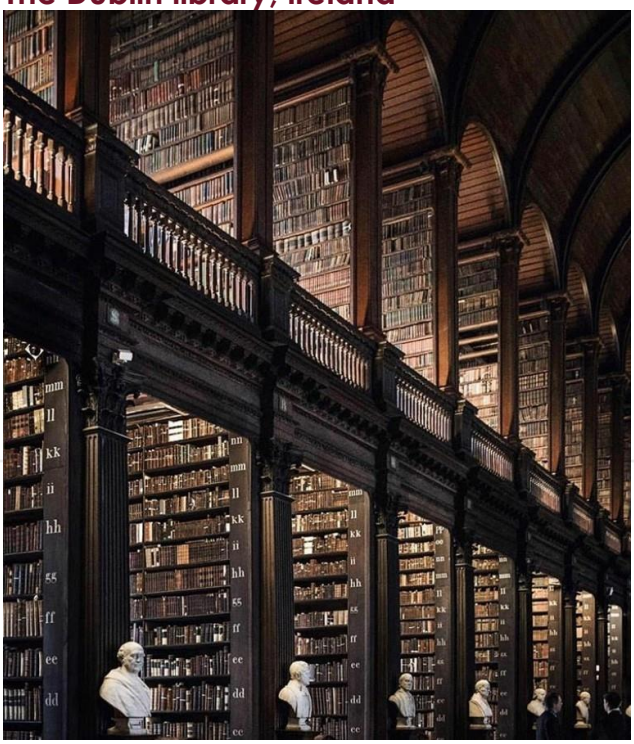
Chart 1: Global returns to 31 October 2018



The MSCI World index lost 7.4% during October, and the MSCI Emerging market index 8.8%. The year-to-date returns for these two indices are now -3.9% and -17.5% respectively. Amongst emerging markets, Turkey fell 9.8%, China 7.8% (down 21.3% so far this year), and Greece 7.5%. Amongst developed markets the Hong Kong equity market fell 10.1% (thanks in part to a 17.4% decline in tech heavyweight Tencent), Japan fell 9.1%, the US 6.8%, and the German Dax 6.5%. The tech-heavy NASDAQ index fell 9.2%, although it is still 5.8% higher than at the start of the year.

Speaking of year-to-date returns, the Hong Kong equity market has declined 16.5% so far this year, Germany 11.4%, and the US equity market 0.0%. Mid and small cap companies suffered even more pain: the S&P Mid and Small cap indices declined 9.6% and 10.5% during October, bringing their year-to-date returns to -4.0% and 1.5% respectively. Although the October equity returns are all weak and negative, the month ended with a few days of strong price gains. In reality therefore, markets were a lot lower intra-month, making the month even more brutal than it appears. Worse still, if you tried to execute any strategy during the course of the month, returns had the potential to be even worse.

The Dublin library, Ireland

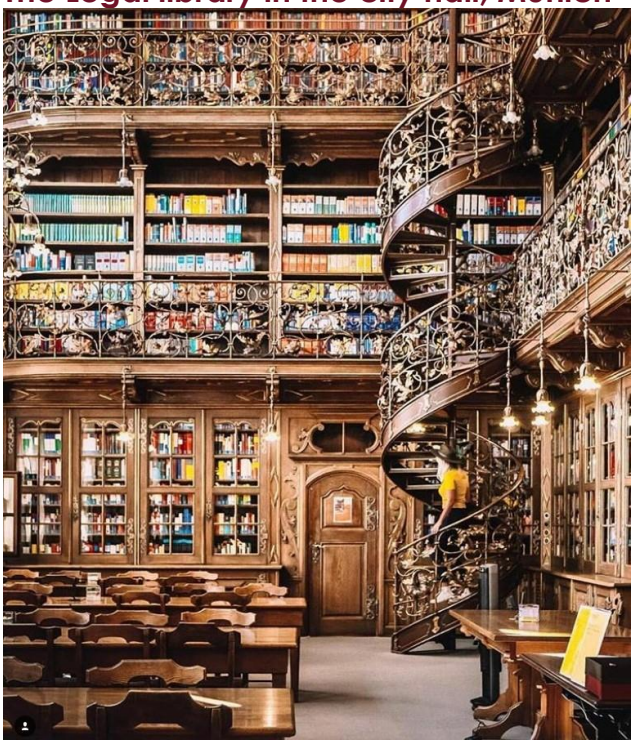


Instagram handle: @travellingthroughtheworld

Still on global markets, the Bloomberg Global Aggregate Bond index lost 1.1% in October, bringing its year-to-date return to -3.5%. Commodity prices were generally weak across the board, with the exception of iron ore and

gold. The Bloomberg Commodity index fell 2.4% during the month, reflecting the 8.5% decline in the oil price. On the currency front, the dollar (DXY) index rose 2.1%, bringing its gain for the year to 5.4%.

The Legal library in the city hall, Munich



Instagram handle: @travellingthroughtheworld

What's on our radar screen?

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

- *The SA economy:* Retail sales in South Africa (SA) rose 2.3% in August, up from 1.4% in July. Average selling price inflation remained at 2.1% for the third consecutive month. Mining production declined 9.1% on an annual basis, faster than the 5.2% rate of decline in July, while gold production fell 15.5%. The official unemployment rate rose to 27.5% at the end of September, versus 27.2% at the end of June. One of the features during the past month was the new Financial Minister's presentation of the Medium Term Budget Policy Statement (MTBPS), wherein government's mid-term outlook and plans are tabled. The country's 2018 growth rate estimate was nearly halved, to 0.7% (that was hardly surprizing) while the economy is now forecast to grow at 1.7% in 2019 which, even if it does materialize, is woefully inadequate. SA's gross debt is now expected to stabilize at 59.6% of GDP in 2023/24, reflecting higher borrowing costs, a weaker rand, and rising interest rates. Although government revenue increased by 10.5% during the first six months of the fiscal year, revenue fell short of the budget by R24.7bn. About R20bn of the shortfall can be explained by the normalization of VAT refunds; malfeasance at the SA Revenue Service (SARS) in recent years, whereby legitimate VAT refunds were held back in order to make government revenue look better, was reversed following the removal of corrupt management at SARS. Most shocking of all, billions of additional rand was again thrown into the bottomless pit of the state-owned enterprises (SoEs), this time mainly in the direction of SA Airways. Declining GDP per capita, deteriorating fiscal dynamics, worsening debt-to-GDP, and the ongoing and increased need to support SoEs highlights the fact that a credit downgrade for the country is now firmly back on the agenda. Not surprisingly, the MTBPS was not well received by the rating agencies.
- *The US economy*: The US economy grew at an annualized rate of 3.5% during the third quarter (Q3), marginally lower than Q2's rate of 4.2% although still at a very healthy pace. Consumption growth rose from 3.8% to 4.0% while government spending growth rose from 2.5% to 3.3%.

- *Developed economies*: the annual rate of inflation in Japan in September was 1.2%, with core inflation at 1.0%. The October annual rate of Eurozone headline and core inflation was 2.2% and 1.1% respectively, from the prior month's readings of 2.1% and 0.9%. The Eurozone economy grew at a quarter-on-quarter rate of 0.2% during Q3. German retail sales rose 0.1% month-on-month in September, but posted a 2.6% decline on a year-on-year basis, due to some downward revisions and a high base. German annual inflation is now running at 2.4%, its highest level in just over a decade, while unemployment held steady at 5.1%. Quarter-on-quarter growth during Q3 in the Italian economy was exactly 0.0%.
- *Emerging economies*: In China consumer inflation rose in September from an annual rate of 2.3% to 2.5%. This was the highest reading since May 2014, although food prices rose due largely to swine flu and bad weather. Core inflation declined to a two-year low of 1.7%. Producer inflation also eased, from 4.1% to 3.6%. Broader factory gate price pressures appear to be cooling alongside weaker economic activity. The Chinese economy grew at an annual rate of 6.5% during Q3, down from 6.7% in Q2. Industrial output rose 5.8% (form 6.1% last month), retail sales 9.2% (9.0%) and fixed asset investment 5.4% (5.3%). China also announced details of a reduction in the personal income tax rate, which authorities estimate will boost the economic growth rate by 0.5% in 2019 – refer to section below which unpacks some of the detail of the Chinese tax reform plan.

The Tianjin Binhai library, China

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Chart of the month

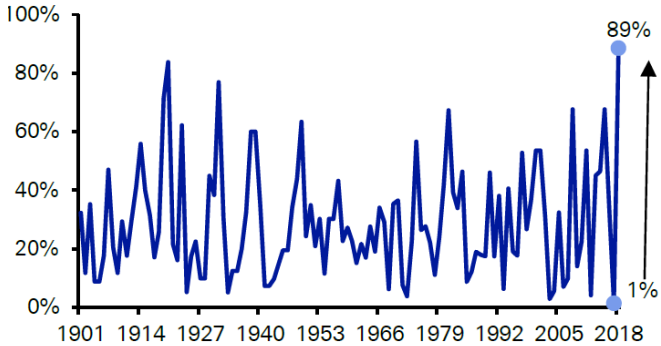
You don't need me to tell you that equity markets around the world have been weak. However, *Deutsche Bank's Chief International Economist, Torsten Slok* noted – refer to Chart 2 – that although global equity markets lost $5trn in market cap (value) during October, they have still gained about $15trn since early 2017. Slok notes that "Academic studies of the wealth effect find that households and companies don't react to short-term fluctuations in their wealth but instead react to a moving average of where their wealth levels are. The bottom line is that we need a more significant correction before it will begin to have a meaningful impact on the economic outlook".

Chart 2: Perspective on recent declines

Source: Deutsche Bank

Given the global equity market volatility during October, Chart 3 is informative. It depicts the percentage of assets that Deutsche Bank monitors whose current year-to-date total return is negative. At the end of October 2018, 89% of all the assets the bank monitors in their total return survey had declined in dollar terms so far this year. That shows how broadly based the current market weakness is – where the "market" here encompasses all types or classes of assets, not just equities. This is in stark contrast to December 2017, where only 1% of assets generated a negative total return (the only market to decline last year in dollar terms was the Philippine bond market).

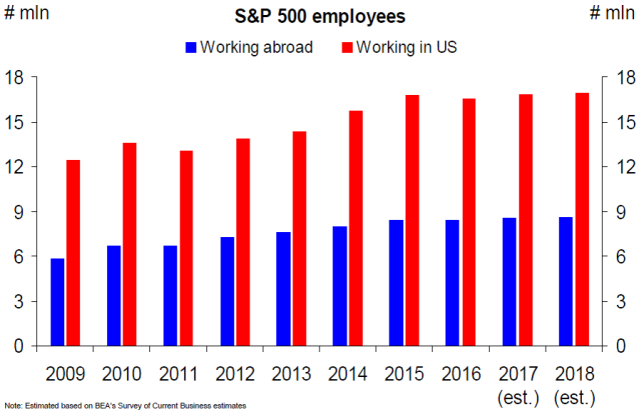
Chart 3: Assets with negative dollar returns



Source: Deutsche Bank

Note how far the chart stretches back – all the way to 1901. When one considers that 2017 was the most profitable year since 1901, using this measure, perhaps it's not surprising that this year – so far at least – is not turning out to be a particularly profitable one in any asset class. The turnaround from the best year to the worst year in just ten months is startling though. So if you are feeling a bit shell-shocked following October's brutal returns, at least you now know that you have good reason to feel that way.

Chart 4: Who really employs US workers?



Source: Deutsche Bank

I found the chart 4 rather interesting, too. It shows the number of people employed by S&P500 companies i.e. those who are employed by one or more of the 500 companies included in the S&P500 index. Note that these companies constitute the largest companies in the US, effectively what we refer to in the South African context as the Top40 (large cap) index. These 500 companies employ around 25m workers, of which roughly 17m, or just more than two thirds, work in the US. The total number of non-farm jobs in the US is about 150m, which means that roughly one out of every ten workers is employed by an S&P500 company. In other words, about 90% of all employment in the US is undertaken by small and medium-sized companies. So we

should be careful when using trends in the S&P500 to predict the state of the broader US economy.

The City library, Rio de Janeiro, Brazil

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Quotes to chew on

Still on the crazy market during October

Forgive me going on and on about the crazy market conditions we experienced during October, but I thought you would appreciate *Deutsche Bank's Jim Reid's* comments in his daily EM Reid letter. These comments were written on 25 October and relate to the very weak market conditions experienced on 24 October: "Yet another chastening 24 hours for markets with many global equities closing at multi-month, year-to-date, or multi-quarter lows. The S&P 500 dropped 3.08% to its lowest level since May, and is now down 0.65% on the year. For context, it's the fourth time that the S&P500 has moved by +/-3% this year, after only four other instances in the preceding six years (2012-2017). Quite a remarkable stat. The NASDAQ fell 4.63%, for its second move +/-4% this year, after only two other instances over the preceding six years. We'll see if earnings today from Google and Amazon make much difference. The Dow Jones fell 2.41% yesterday, also undoing its gains for the year, while US banks are now down over 10% year-to-date after their 2.68% drop."

Swiss Private Bank *Julius Baër's* comment on the trading conditions on 24 October were also informative: "The fundamental reasons for the weak markets have been around for some time: Fears of 'peak profits', a 'peak economy', a Chinese growth slowdown, the geopolitical mess, woes in Italy, and the Fed's Quantitative Tightening, which is resulting in a tighter monetary environment that is bad for risk assets like stocks. But those have been flagged for some time, and earnings have beat more than missed expectations in this Q3 season so far. Wall Street has also not capitulated and made adverse changes to views. As such, we think the price action suggests programmatic selling, as up to 70%-80% of stocks traded in the US are executed by programs. The selling in the Technology sector is probably a First In-First Out (FIFO) process where the winners in the last 12-18 months are sold to preserve gains, especially for retail investors and ETF holders."

Obituary – Paul Allen: 1953 – 2018

Paul Allen, the co-founder of Microsoft, has passed away at the age of 65. The following is a precise of the Financial Times's obituary.

If history gives you only one shot at making a real difference, then Paul Allen seized his with both hands. Allen did not exhibit the charisma and drive that made Bill Gates the main force behind the software company's rise. Bowing out in 1983, before Microsoft had even announced the Windows operating system, he was not associated with the company's years of tech industry dominance. But his acute awareness of the changing technological times, along with an impatience to shape the industry he could see emerging, were key to setting today's world of ubiquitous personal computing in motion.

Source: FT.com

Allen's moment of destiny came late in 1974. An avid coder since high school, he had been tracking the steady advances in the microprocessors of the day. He was itching to put the chips to use in a new, low-cost form of computing, but was also aware that the silicon was not yet powerful enough for the job. The future finally presented itself to him that December day, on the cover of Popular Electronics magazine: a computer running on Intel's new 8080 microprocessor.

At his urging Mr Gates — two years his junior — joined him in writing the first software tools for the new machines, eventually dropping out of Harvard. Both men could see that whoever created the standard code for these new machines would have a lock on a promising market, and that software was about to become an independent business in its own right. An industry was born.

Allen was the product of a familiar type of American striving: he had a self-effacing personal style that reflected an unassuming and modest background, but was alive to the potential of a changing society and economy as the 1960s ended, and eager to ride the wave of digital technology that was about to break. His parents left Oklahoma and followed a well-trodden mid-century path west that took them to California. They eventually moved north to Seattle, where Allen's father rose to become deputy librarian at the University of Washington.

The partnership with Mr Gates was shaped while the two were still at school. They met at the computer club at Lakeside, a private school in Seattle, where Allen played older brother to the more hot-headed and precocious Mr Gates. Their relationship— both creative and adversarial — carried over into the first years of Microsoft. Mr Gates, the hard-driving pragmatist, and Allen, the more cerebral of the pair, were at first a good match. But it was a relationship that left its mark on the more sensitive Allen. He later described Microsoft's culture as "self-flagellating", a product of the intellectually aggressive and uncompromising Mr Gates.

In his later memoir, Idea Man, Allen depicted himself as the slightly unworldly visionary who was progressively sidelined in the company he helped start. He described being bullied by Mr Gates into giving up a bigger share of the company than he felt was fair. The low point came when he overheard his partner and Steve Ballmer, Microsoft's top business executive,

discussing how to reduce his influence and ownership in the company. He left soon after.
But there was little about the victim in Allen. When he quit Microsoft, he had the good sense not to sell out at the lowball price Mr Gates offered, instead betting wholeheartedly on his former partner. Mr Gates turned Microsoft into the tech industry's most feared company, making Allen rich in the process. By the time of his death, Forbes estimated his personal wealth at more than $20bn, making him the world's 21st richest person. He wasn't above flaunting it, buying a yacht that he bragged was the world's fourth longest.

Paul Allen's yacht, Octopus

Source: FT.com

Putting that fortune to use shaped the second half of Allen's life. That included buying professional sports teams — a hallmark of the American business elite. Allen described the purchase of the Portland Trail Blazers basketball team as the culmination of a personal passion. By contrast, buying the Seattle Seahawks football team was a "civic duty": rebuilding the team's stadium became the centrepiece in the redevelopment of a key part of the city.

As an investor, Allen had his share of disasters, including the $8bn he burnt in building an over-leveraged cable TV empire. Rather than fitting the popular idea of the sweeping tech visionary, he showed an eclectic interest in different fields of science, a perspicacity in the potential for breakthroughs to yield practical results, and a willingness to place large bets with his personal fortune.

One result was his backing of the private space entrepreneur Burt Rutan. With Allen's money, Mr Rutan won the Ansari X Prize for private space flight — a $10m award that became the model for many other science prizes that have followed. Earlier this decade he teamed up with Mr Rutan again for Stratolaunch, an aerial space launch vehicle that is due to have its first test flights next year.

His philanthropy and investments in the frontiers of scientific research included the creation of new research institutes to study brain science and artificial intelligence.

The Stratolaunch space launch vehicle

Source: FT.com

If quitting Microsoft in 1983 felt like the inevitable end of a business relationship that had run its course, bad health also played its part. Allen was diagnosed at the time with Hodgkin's disease, reinforcing his life-changing decision. More than 25 years later, Allen discovered he had non-Hodgkin's lymphoma, a related illness. The

cancer went into remission, but he announced earlier this month that the disease had returned. Writing after the first bout of cancer Allen paid tribute to an enduring friendship with Mr Gates. His one-time partner repaid the tribute this week, declaring himself "heartbroken" and adding: "He deserved much more time, but his contributions to the world of technology and philanthropy will live on for generations to come. I will miss him tremendously."

Paul Allen with Bill Gates in 1981

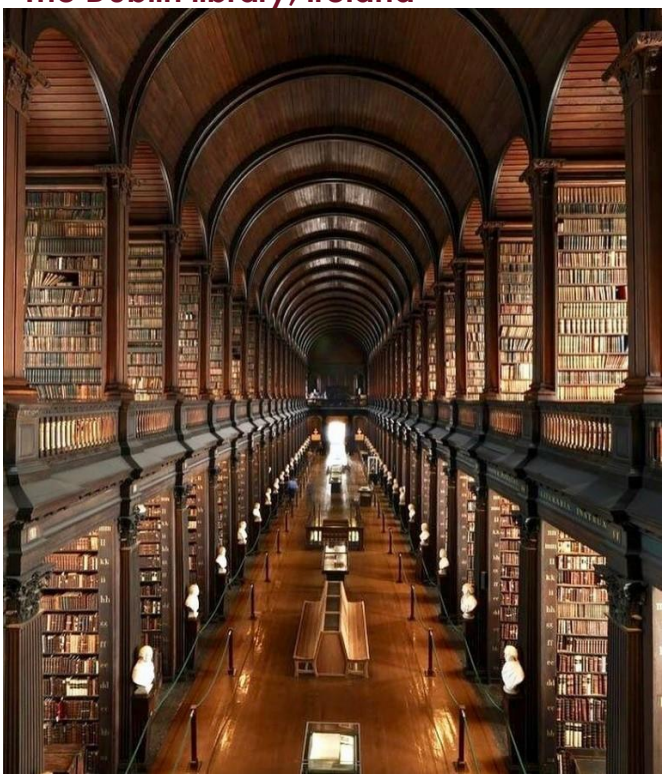
Source: FT.com

China's personal income tax revision

On 20 October, China's tax authority issued a personal income tax reform plan, which will come into effect on 1 January 2019. Although the following sections contains a lot of detail, I thought you would be interested to see it. It sheds light on how a proactive government rolls out policy in support of a slowing economy, and it highlights certain sectors likely to benefit the most from the reform plans.

The initial income standard tax deduction was raised from CNY3 500 to CNY5 000. The income tax rate remains largely unchanged, but the tax brackets for the lower tax rate was widened. As such, some taxpayers may enjoy a lower tax rate under the new tax brackets. The major surprise came from the announcement of six new tax-deductible items, which may offset taxpayers' income tax significantly (especially for the low- to middle-income level taxpayers), and include children's education, continuing education, mortgage interest for first homes, housing rent, treatment for major disease, and elderly care expense. Each deductible item is subject to a cap limit. For example, the maximum tax deductible amount for children education expense (per child) and mortgage interest are CNY1 000 per month, respectively. For major disease, the maximum deductible amount is CNY60 000 per year (on top of CNY15 000 self-paid medical expense). A rough estimation has shown that a taxpayer earning CHY10 000 per month can save tax expense of 60% or more, depending on the amount of tax deductible, under the new tax regime.

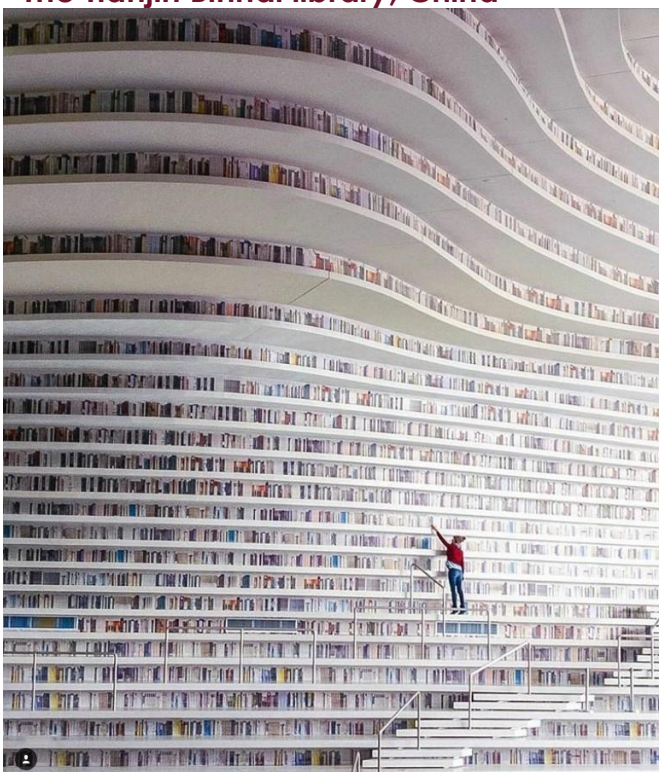
The Dublin library, Ireland



Instagram handle: @travellingthroughtheworld

The personal income tax revision can reduce taxpayers' expenses by a major amount, particularly for low- to medium-income taxpayers, because of the introduction of six new tax-deductible items. The tax reduction should be positive for domestic consumption growth, especially in the areas of discretionary, dining, entertainment, education, healthcare-related, and travel segments.

The Tianjin Binhai library, China



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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	**Oct**	**-5.8%**	**-9.2%**	**-15.3%**
JSE All Share Index	*Oct*	*-5.8%*	*-9.4%*	*-8.4%*
Maestro Growth Fund	**Oct**	**-3.9%**	**-1.8%**	**-7.5%**
Fund Benchmark	*Oct*	*-3.8%*	*-3.0%*	*-2.4%*
Maestro Balanced Fund	**Oct**	**-3.4%**	**-0.6%**	**-5.6%**
Fund Benchmark	*Oct*	*-3.2%*	*-1.5%*	*-0.8%*
Maestro Cautious Fund	**Oct**	**-0.0%**	**1.9%**	**0.8%**
Fund Benchmark	*Oct*	*-2.0%*	*0.5%*	*2.7%*
Central Park Global Balanced Fund ($)	**Sept**	**-3.0%**	**-3.0%**	**3.5%**
*Benchmark**	*Sept*	*-0.1%*	*1.4%*	*4.9%*
*Sector average **	*Sept*	*-0.1%*	*-0.3%*	*2.4%*
Maestro Global Balanced Fund	**Sept**	**-7.3%**	**9.1%**	**N/A**
*Benchmark**	*Sept*	*-3.5%*	*15.9%*	*10.0%*
*Sector average***	*Sept*	*-4.0%*	*13.7%*	*8.4%*

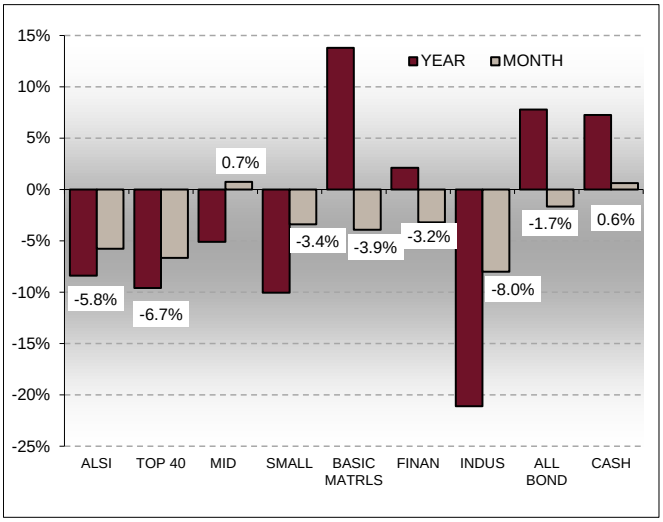
* 60% MSCI World Index and 40% Bloomberg Global Aggregate Bond Index
** Morningstar USD Moderate Allocation ($)
*** Morningstar ASISA Global Multi Asset Flexible Category

October in perspective – local markets

The All Share index fell 5.8% in October, with the large cap (Top40) index leading the declines, ending down 6.7%. The Mid cap index rose 0.7% but the Small cap index declined 3.4%. The Basic Materials sector fell 3.9% although it is still up 16.2% for the year-to-date. The Financial sector lost 3.2%, for a 9.8% year-to-date gain, while the Industrial index led local declines during October, falling 8.0%, bringing its year-to-date return to -18.9%. When one considers some of the industry heavyweight losses for the year-to-date, it is clear why the Industrial index is so much lower; heavyweight losses include Aspen, down 43.8% so far this year, Tiger Brands 42.7%, Imperial 37.9%, MTN 37.4%, Coronation 33.5%, Mediclinic 33.2%, Massmart 31.2%, and Naspers 24.9%. For what it is worth, the Gold index rose 16.8% but is still down 10.1% so far this year.

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

Chart 5: Local returns to 31 October 2018



The rand was under pressure throughout the month, even more so after the disappointing Medium Term Budget Policy Statement late in the month. It declined 4.2% against a firm dollar; it has now declined 16.2% against the dollar so far this year. The All Bond index lost 1.7%, which seemed a reasonable return given the dollar strength and bond market weakness elsewhere in global markets.

What's going on out there?

During the course of the past five to six weeks I have wanted to send clients an email regarding market conditions. Each time I started writing, market conditions changed so quickly that it rendered what I had written redundant, or new factors came into consideration. Markets either moved up or down dramatically and I thought it best to wait until they had settled down to try and make sense of it all.

While I am not entirely convinced that markets have "settled down" sufficiently to allay all our concerns, I would like to comment and share some of Maestro's views on the current turmoil in the markets. I won't spend much time on what is happening, as the details are adequately covered in this and other publications. Rather, I have taken some of the questions we received recently, which I suspect are on many minds, and answered them, in so doing hoping to share our views in the process.

The Lello bookstore, Porto, Portugal

Instagram handle: @travellingthroughtheworld

What concerns you most about international equity markets?

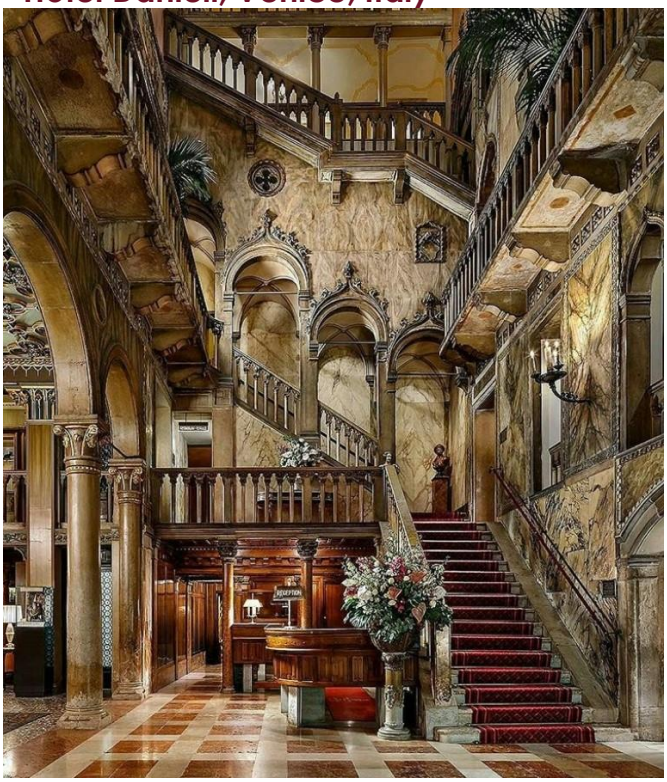
It is clear that investors around the world are rattled by a number of factors. At the outset let me remind you that markets are seldom de-stabilized by known or expected events. Rather, it is the unexpected or unknown that really send them lower. So while the following might be factors contributing to the current market nervousness, I am not of the view that in and of themselves, they are the reasons for the market weakness; these include higher and rising US

interest rates, the US-China trade war, a potential slowdown in the global economy and especially in China, the outcome of the US mid-term elections, the fact that many markets and certainly the US equity market have been in a bull market (uptrend) for many years already; and that the technology sector in particular has seen large gains in recent years. A combination of some of these factors may well be leading to the nervousness, but many of these factors have been around for a while and can hardly be described as "surprises" or "unknowns".

If I had to isolate some concerns about the future, it would be the effects of the US-China trade war and that of Donald Trump as a divisive and disruptive factor. Firstly, while the US-China trade war is now a *fait accompli,* the effects of the war are hard to quantify. In the long-term, I suspect the US will be the largest casualty – it certainly won't be China – but in the short and medium-term China will be regarded with great skepticism (this has contributed to the current weakness in Chinese markets) and the US is likely to be seen as a "safe haven". The long-term effects will be negative on all global trade and economies but it will take a long time to manifest.

Secondly, Trump has proved to be a very divisive figure on the world's stage. He has lent an air of acceptance and "credibility" to opinions and attitudes that many decent people would regard as abhorrent. His presidency so far has encouraged certain anti-globalization and anti-establishment elements around the world. While Trump cannot be held responsible for this wave of global sentiment, I do fear it will gain further momentum and traction, and ultimately have the effect of undoing many of the benefits of globalization we now take for granted, and will slow the rate of growth in the global economy. This cannot be good for any investment markets; it will prove to be inflationary (bad for bond markets) and will impede economic growth and corporate earnings (which is bad for equity markets).

Hotel Danieli, Venice, Italy

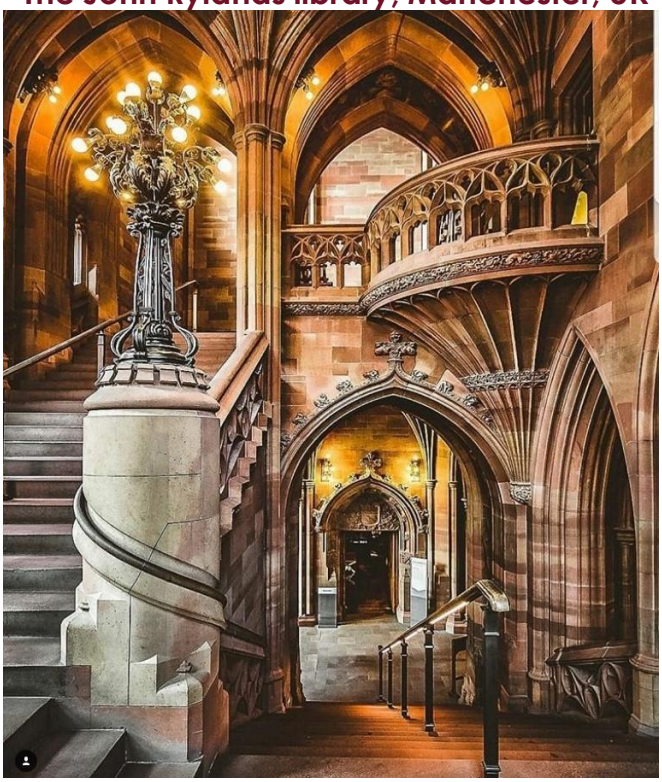


Instagram handle: @best_hotelsandresorts

A third consideration that I think bodes ill for markets is the fact that so many governments are bankrupt, or if nothing else, are grossly over-indebted. This situation cannot go unchecked. However, voters continue to vote in political parties that make promises of "a better life" without any hope of being able to deliver on those promises, which then leads to more poor governance and fiscal policies – eventually something has to give. However, this, too, is a long "cycle" and we are unlikely to have to deal with its effects for some time to come.

Finally, while these are but some of the things that concern me about markets, I could at any stage provide a list of concerns. Bull markets do indeed climb walls of worry, and it makes no sense to only consider the negative aspects of the external environment. There are still many positive aspects about the future, and which lead me to retain a positive view towards global markets, notwithstanding my expectation that they are likely to remain volatile and uncertain for some time to come.

The John Rylands library, Manchester, UK



Instagram handle: @kings_luxury

After the stock market rout in October, is this the end of the US equity bull market?

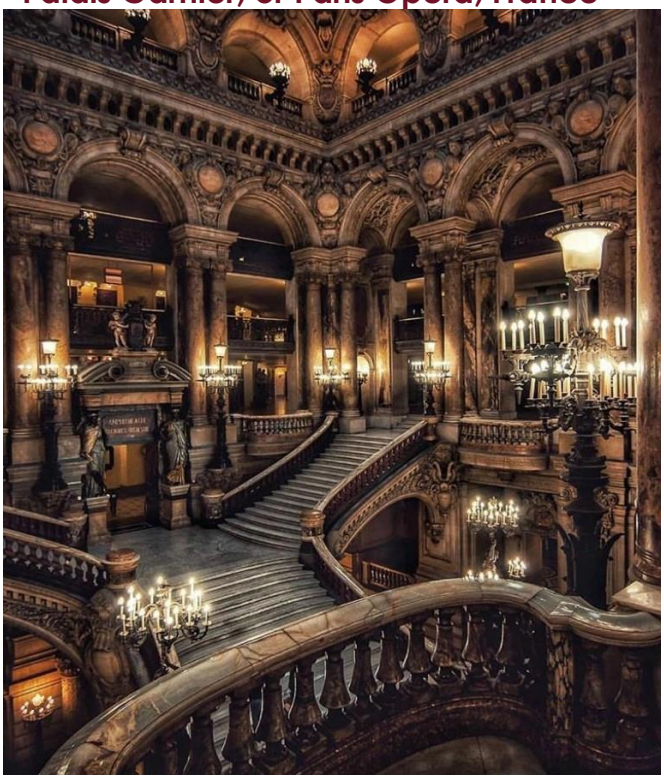
Predicting equity markets is always hard to do, so much so that we regard it as a futile exercise. This view might shock you, and prompt the question why we even invest in equity markets; is it not too risky? The simple answer is that history shows us, as does our personal experience stretching back over 30 years, that equity markets move higher over time. They are characterized by periods of decline, but inevitably corporate earnings and dividends, the two most important determinants of share prices in the long-term, recover and drive share prices higher.

Any seasoned investor will know, often through costly personal experience (what we in the profession call "school fees"), that trying to "time the market" i.e. trying when to enter or exit the market based on prevailing sentiment and expectations, is a futile exercise. As they say in the classics, "it's time in the market, not timing the market that counts!" The underlying premise is that investing is a long-term activity i.e. investors increase the value of their capital over time. To try and "be clever" and get in and out of markets based on short-term movements is, in our (and most investment professionals') view a very risky exercise. Although there is no hard and fast rule, we suggest that if you require your capital within 18 to 24 months' time, you really should not be investing in the equity market.

So back to the question of whether or not the US equity bull market has come to an end following the weakness in October, my response is "No", although clearly a lot of damage has been done to sentiment and many investors are questioning the outlook for the market. To repeat, we do not know where equity markets are heading in the short-term. But using the useful attitude of working off what we do know, rather than what we don't know, we do know that the corporate sector, particularly in the US, is in very good health. Companies are likely to continue to increase their earnings and dividends in the years to come. Cash flows are and are likely to continue to be very strong. The short-term

volatility during October, and for most of this year so far, has not seriously impeded the ability of companies to increase their earnings. In addition, the US economy is in excellent condition, which provides an ideal backdrop for quality companies to continue increasing their profitability. So, based on the certainty that US companies will continue to increase their earnings and dividends for the foreseeable future, we do not believe the US bull market has ended. Will its rate of growth slow? Yes, more than likely. Will it be more volatile in the coming months than in previous years? Yes, more than likely. But is the US equity market about to begin rolling over and decline sharply and for a sustained period of time? We don't think so.

Palais Garnier, or Paris Opera, France



Instagram handle: @map_of_europe

How long will it take for the markets to recover?
You would have seen elsewhere that one of the destabilizing influences on global markets at present is the uncertainty created by the US-China war. Our view is that until greater certainty exists as to what the real outcome or effect of the global trade war will be, markets are likely to remain nervous and possibly move lower. With US interest rates likely to head higher (and bond prices consequently move lower) it is hard to see bonds as an alternative to equity as an asset class. This is likely to be supportive of equity markets, but it doesn't necessarily mean they will continue their long-term uptrend just yet.

Bear in mind, too, that notwithstanding the negative equity market returns so far this year, most global equity markets have been in an uptrend in recent years. This has resulted in them not being as "cheap" as in the past. We do see some pockets of value in the market, and we don't regard them as being excessively valued. However we would be the first to agree they are not "dirt cheap", which means they could conceivably churn at current levels. Remember though that as earnings are increasing, it won't take too long before a fair degree of value returns to equity markets. Of course, no one rings the bell when it is time to get back into the markets, but with the recent sharp declines in markets, and in particular amongst some of the Chinese shares we hold in our equity portfolios, added to their robust earnings growth, many of these companies are looking very attractive again. This provides another reason why we hold the view that now is not a great time to withdraw one's investments from global equity markets.

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

Back to the question of how long it will take for markets to recover, we don't know, but we suspect we may have seen the worst of equity market declines this year, assuming of course the US-China rhetoric regarding the trade war doesn't increase, and some reasonable solution can be found without disrupting the healthy state of the global economy. Global markets are likely to "mark time" or even churn a bit at current levels, based partly on global trade war concerns. However, as corporate earnings increase greater value is being restored to the market on an ongoing basis.

The Parliament, Budapest, Hungary

Instagram handle: @cbuiron

Should I still stay invested in such market conditions?

I hope that our response to the preceding two questions has answered this question. If you are a long-term investor we are of the view this is not the time to be exiting the market. In other words, stay invested. (Note that these comments pertain to our view of global equity markets. We remain very negative on local markets and the SA economy and its prospects). That said, be prepared for a bumpy ride i.e. markets are likely to experience increasing volatility. There is sufficient time to enter the market at attractive levels i.e. there is no rush or urgency to increase one's equity market exposure, but on the other hand, don't be caught with no equity exposure.

Will US growth slow down if the US Federal Reserve (the Fed) keeps on raising interest rates? And what will be the impact on the US share market?

The primary reason for any central bank raising interest rates is to ensure that prices (inflation) do not escalate out of control. They ensure they achieve their objective by (primarily) changing the level of interest rates, thereby indirectly affecting the underlying demand for goods and services. So it makes perfect sense that the US economy will eventually slow down as a result of rising interest rates. We think the Fed will increase interest rates by between four and five times between now and the end of next year.

That said, the US economy is in very good health right now, so its ability – at the consumer and corporate level – to weather rising interest rates is relatively good. As long as the increase in rates in orderly and well-executed and communicated to the markets and consumers, we do not expect any major disruptions to equity markets. The US economy will certainly have to slow down from its current levels, but if the slowdown is gradual and managed, the equity market should fare relatively well.

At this stage, we think the US economy will grow 3.0% in 2018, easing to about 2.5% in 2019. The global economy is forecast to grow between 3.5% and 4.0% in 2018 and 2019, indicating that even though there is likely to be a slowdown in growth into 2019, it is not forecast to be too material. Given that so many of the large US-listed companies operate as multi-national corporations, we suspect that the slowdown in the US economy will not affect the US equity market too much.

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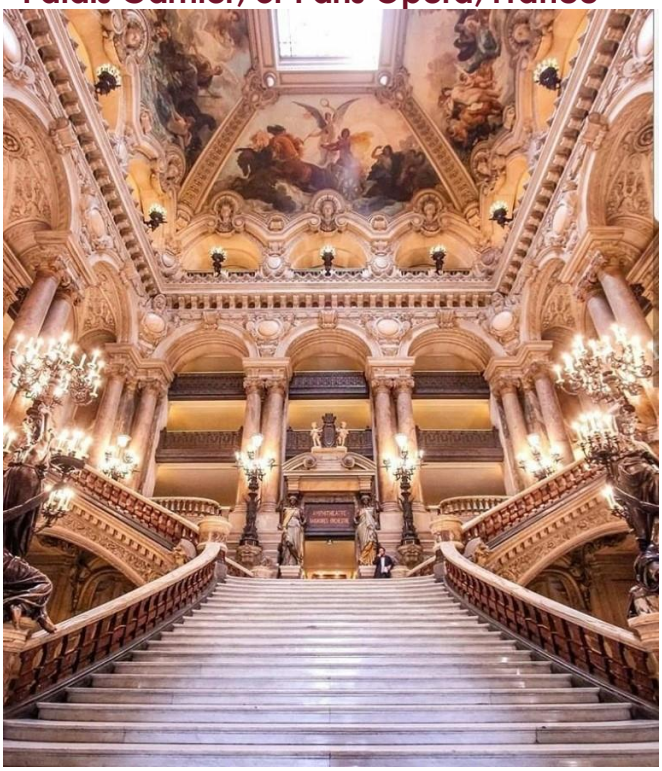


Instagram handle: @kings_luxury

What do you think will happen to the markets during the coming 12 months?

This is a particularly hard question to answer. I refer you to an earlier response wherein we noted that it is hard to predict short-term movements of global equity markets. So much can change between now and the end of 2018, and whatever happens will certainly have a bearing on the fortunes of global markets in 2019.

One way of trying to answer the question is to note that we view companies we invest in, or are likely to consider investing in, as stand-alone investment opportunities. Yes, we take market considerations and conditions into account, but our emphasis is on trying to understand the underlying companies, their dynamics, and their respective prospects for earnings and profitability, rather than trying to guess where equity markets are likely to go.

If our company-specific analysis indicates the company's prospects are attractive (and that in itself is another whole discussion) and we regard the firm as offering reasonable value (another big discussion), then we are likely to invest into the share, provided it fits into our current portfolio and can be accommodated within our Big Picture Themes. The latter are themes we have identified within the external environment that are likely to shape and influence markets, economies and trends for many years to come, *irrespective of the fortunes of specific economies or markets*. So for example, the role of technology, the rise of China within the global economy, the ageing Chinese population, the Chinese education sector; these are all Big Picture Themes that provide guidance to our investment team's thinking as we seek out global investment opportunities.

As we focus our efforts at this level, although it might sound heretical, where equity markets are headed becomes an important but nevertheless secondary consideration. In responding to the question of what will happen to markets in the coming 12 months, we would typically start by

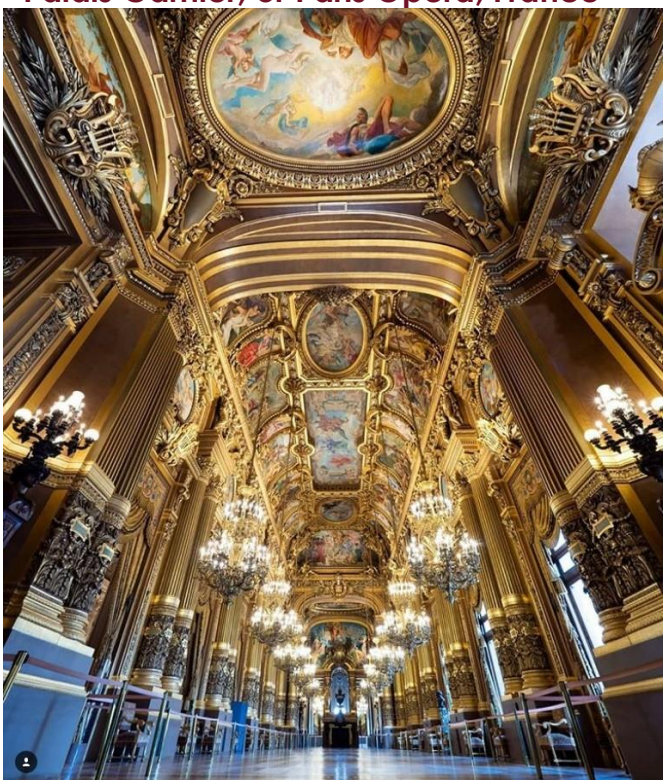
asking a number of questions. These would include, but are not limited to:

- How will the US-China (global) trade war be resolved and what will its impact be on the global economy?
- To what extent will corporate earnings be affected by rising interest rates?
- How will the slowdown in China affect the global economy?
- How will the rest of the world react to the ongoing volatility and unpredictability of the Trump administration?
- What about the European political scene: Brexit, Germany, Italy, etc.?
- When will investors decide equity markets have de-rated sufficiently? What is an appropriate rating e.g. a price earnings ratio (PE) for global markets as we head into 2019?
- What is a reasonable expectation for corporate earnings, especially for US companies that have been increasing their earnings at more than 20% for a number of years already?
- Where will the current tightening of US interest will rates end? How will the equity market react if the US 10-year bond yield reaches 4.0% (currently 3.2%) before the end of 2019?

The answers to the questions above, and others, will provide guidance as to what will happen to equity markets in the coming year. I am sure you can come up with your own answers to these, and other questions. However, for what it is worth, we are of the view that equity markets are likely to be volatile next year and may track sideways to slightly higher during the course of 2019. Of course that hides the fact that there are still a number of attractive and wonderful companies and investment opportunities out there. We will be focusing on those rather than trying to guess where markets are headed.

If that sounds flippant, let me end by saying we obviously track markets very closely – we eat, sleep and drink their every movement – but we are of the view that there are no risks, at least not from what we can see (and we obviously can't predict the unpredictable) that are so large and material that lead us to believe we are on the verge of an imminent market collapse. We expect "more of the same" – volatile markets characterized by uncertainty, a slowing global economy, crazy and unpredictable politicians, but also full of investment opportunities. And in the longer-term, markets will be much higher than they are at present – and that is the point of equity investment.

Palais Garnier, or Paris Opera, France



Instagram handle: @gogojungle

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

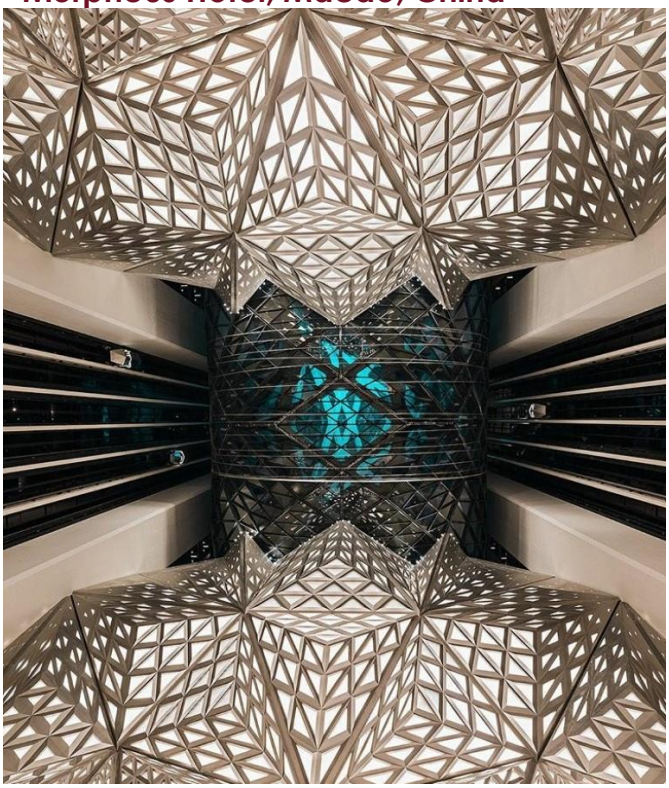
So what's with the pics?

During the past few months, I have become a great fan of Instagram. For regular readers of *Intermezzo*, that will not surprise you, given my fondness for photographs and things visual. Instagram doesn't lend itself to sharing much of the beautiful photos that appear on it from users around the globe, other than on the Instagram platform itself. That said, I have created for my own use folders compiled along thematic lines. The photos that appear in this edition – taken from my Buildings folder – have all been lifted from Instagram. In an effort to guide you to their source, and to honour the original creator of the photo, I have included the Instagram handles below each photograph. 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.

The Natural History Museum, London

Instagram handle: @citybestviews

Morpheus Hotel, Macao, China



Instagram handle: @seven7panda