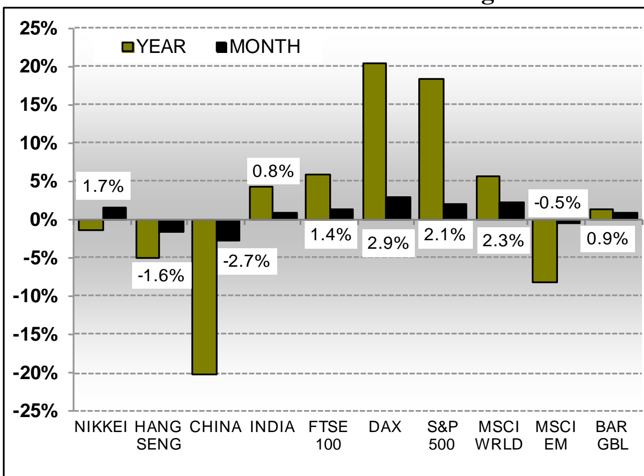
MAESTRO INTERMEZZO

Investment Letter | 12th Edition | September 2012

August in perspective – global markets

For a change, market behaviour during August seemed relatively normal. Although a lot happened by way of news and developments within the ongoing global economic crisis, the markets took it all in their stride, to the extent that they became positively becalmed towards the end of the month. Of course, there were some areas of the market that did not perform well. There were others that performed above expectations and there will always be those investments which outperform others. On the global front equities rose 2.3%, outperforming bonds, which gained 0.9%. Developed equity markets rose 2.3%, outperforming emerging markets, which ended 0.5% lower. German and US equity markets rose 2.9% and 2.1% respectively, while China declined 2.7%, bringing its annual return to -20.3%. India rose 0.8% and Brazil 2.0%. In the US large caps (the S&P500 rose 2.1%) underperformed mid (3.3%) and small (3.7%) caps, which tells you something about investor appetite towards risk. Technology shares continue to do well; the Nasdaq rose 4.2% on the month, thanks in part to Apple and Google's 8.9% and 8.2% monthly returns; both shares are amongst Central Park Global Balanced Fund's largest holdings.

Chart 1: Global market returns to 31 August 2012



We were surprised at the disparate returns within the commodity space; the oil price rose 7.4% - its second consecutive monthly gain in excess of 7.0% and hardly what the world needs now - while precious metals saw gold, silver and platinum rise 1.6%, 8.2%, and 5.4% respectively. Base metals were mixed but marginally firmer while the real loser was iron ore, which posted a monthly decline of 24.7%; it is now down 38.8% from its March levels and remains under pressure. On the currency front, the rand was the biggest disappointment, declining 2.5% in August despite a weak dollar. The greenback declined 2.3% and 1.4% against the euro and sterling respectively, although the Aussie dollar was also weak, ending 1.8% down against the dollar. Given that Europe and the UK are in all likelihood already in recession, that there is a good chance, at least in our view, the US will flirt with a recession next year, and that the Eurozone crisis is still in full swing with no sign of any substantial solution, is it not remarkable that the respective *annual* returns to end-August of the German and US equity markets are 20.5% and 18.3%? Or that the South African industrial and financial indices have risen 32.6% and 32.3% over the same period? It is no wonder we refer to the art of investing as "the gift that keeps on giving".

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 during the second quarter rose to 3.2% from 2.7% in the first quarter. On the annual basis i.e. Q2 2012 versus Q2 2011, the growth rate increased from 2.1% to 3.0%. Table 1 reflects the relative contributors and detractors. July delivered a positive surprise on the inflation front; a monthly increase in prices of 0.3% ensured that the annual rate of inflation declined to 4.9% from 5.5% the month before. Electricity and water price hikes pushed prices higher but the decline in the fuel price pulled them lower. Within the inflation basket, consumer goods inflation declined to 4.2% from 5.2% in June while services inflation declined from 5.9% to 5.8%. This data provided insight into the Reserve Bank's recent interest rate cut and demonstrated that the prospect of a further decline in due course is not entirely unrealistic. This, despite the fact that retail sales rose 8.3% year-on-year in July, up from 6.4% in June. SA's gross foreign exchange reserves stood at $49.4bn.

Table 1: SA GDP breakdown
Quarter-on-quarter, seasonally annualized

	Size in GDP	2012	
	Q2	Q1	Q2
Agriculture	2.1	3.4	5.8
Mining	4.8	-16.8	31.2
Manufacturing	15.3	7.7	-1.0
Electricity	1.8	-0.1	-4.2
Construction	3.1	3.8	4.3
Trade	12.5	3.0	2.8
Transport & comms	9.1	2.5	2.3
Finance & business	21.3	4.1	2.3
Government	13.7	2.3	1.9
Personal services	5.5	1.7	2.1
GDP at basic prices	*89.2*	*2.6*	*3.2*
Taxes less subsidies	10.8	4.3	3.4
Total GDP	100.0	2.7	3.2

Source: Deutsche Securities

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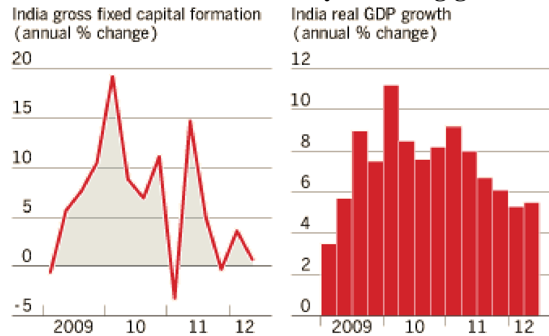
- *The European economy:* The **German** economy grew 0.3% during the second quarter while **France** remained stagnant i.e. 0.0% growth, for the third consecutive quarter. **Austria** and the **Netherlands** each grew 0.2%. **Finland** contracted 0.7%, **Italy** 0.7%, **Spain** 0.4% and **Greece** an unsurprising 6.2%. Merrill Lynch believes the Europe will shrink 0.7% during both 2012 and 2013.

Econolympics: BoE Governor King doing the "Bolt"

Source: Ingram Pinn, FT. com

- *The US economy*: data emanating from the US economy was a bit better than expected but we should not be lulled into a false sense of security. The fiscal cliff looms large and is likely to cause a slowdown in economic activity as the cliff approaches rather than only after it has passed. Although there are signs of a turnaround in the housing market – albeit very tentative – the labour market remains in the doldrums. The unemployment rate has been virtually flat for seven months in a row and wage growth is the lowest in the 47-year history of the data series.
- *Emerging economies*: The **Chinese** inflation rate declined from 2.2% to 1.8% in July. Retail sales rose 14.2%. The **Indian** economy grew at 5.5% during the second quarter, marginally better than the first quarter's 5.3% although still the lowest rate in the past three years. Consumption grew 3.9%, down from 4.9% a year ago and at the lowest rate since 2004. Gross fixed capital formation grew just 0.6%, reflecting a lack of infrastructural investment – refer to Chart 2. Indian inflation declined from 10.0% to 9.9% in July and industrial production declined 1.8% for the year to July versus the increase of 2.4% in June – more evidence that the Indian economy is slowing sharply. The Reserve Bank of India left interest rates unchanged. It highlighted inflation as a major impediment to further cuts and encouraged policy makers to reign in excessive government spending.

Chart 2: The Indian economy – stalling growth



Source: Ingram Pinn, FT. com

Still on emerging markets, **Indonesia's** second quarter growth was 6.4%, up from the first quarter's 6.3%, July inflation was 4.6% and the country's foreign exchange reserves stood at $106.6bn. **Singapore's** foreign exchange reserves are $244.1bn – not bad for one city, is it? **South Korea**'s are $314.4bn and its economy expanded at 2.4% during the second quarter. The **Russian** economy grew 4.0%, down from the first quarter's 4.9%, inflation rose from 4.3% to 5.6% in July and their unemployment rate is currently 5.4%. **Turkey's** (May) unemployment rate was 8.2% and their inflation 9.1%. Retail sales in **Brazil** rose 9.5% in June, accompanied by an inflation rate of 5.2% in July, up slightly from 4.9% in June.

Table 2: The returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Fund	**Aug**	**2.5%**	**14.3%**	**17.1%**
JSE All Share Index	*Aug*	*2.7%*	*13.0%*	*18.0%*
Retirement Funds				
Maestro Growth Fund	**Aug**	**2.2%**	**11.5%**	**15.2%**
Fund Benchmark	*Aug*	*2.8%*	*12.4%*	*17.6%*
Maestro Balanced Fund	**Aug**	**2.0%**	**10.7%**	**14.1%**
Fund Benchmark	*Aug*	*1.9%*	*10.7%*	*15.5%*
Maestro Cautious Fund	**Aug**	**1.2%**	**10.1%**	**12.4%**
Fund Benchmark	*Aug*	*1.0%*	*9.0%*	*11.8%*
Central Park Global Balanced Fund ($)	**Jul**	**1.1%**	**3.5%**	**-8.8%**
*Benchmark**	*Jul*	*1.0%*	*3.7%*	*-1.2%*
*Sector average ***	*Jul*	*1.3%*	*3.3%*	*-4.8%*

* 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 ($)

For the record

Table 2 lists the latest returns of the mutual funds under Maestro's care. You can find more detail by visiting 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.

Charts of the month

At the time of writing European Central Bank (ECB) Governor Mario Draghi, or "Super Mario" as he has come to be known (Super Mario is a popular Nintendo game), has just delivered a follow-up to his comments last month that the ECB would "do whatever it takes" to support the euro. In announcing the ECB's Outright Monetary Transactions (OMT), he undertook to purchase in the open market an unlimited amount of Euro countries' short-term bonds. Markets reacted with enthusiasm, pushing the German and US equity markets up 3% and 2% respectively on the day.

So it is only appropriate that we reflect on the US equity markets at this stage, because, despite all the doom and gloom around and a nervous and uncertain future, the US equity market (S&P500) ended at its highest level since January 2008 – refer to Chart 3. The tech-heavy Nasdaq (Chart 4) ended at its highest level since December 2000 i.e. when the world was abuzz with fears of Y2K and the New Millennium was about to dawn. "Reaching new highs" has a nice ring to it, but of course it hides a multitude of sins, or perhaps more correctly in this case, pain, as Chart 4 adequately depicts.

Chart 3: US equity market (S&P500) weekly price history

Source: Saxo Bank

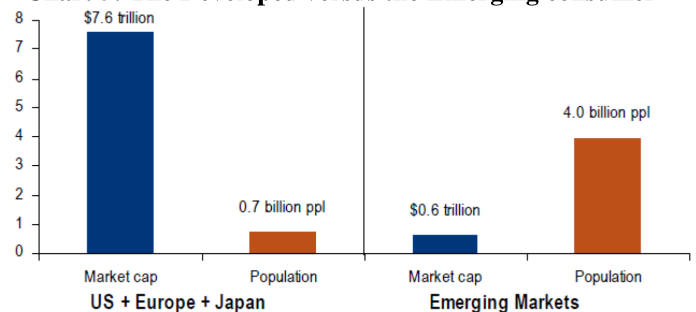
While on the topic of charts, we often refer to our **Big Picture Theme** of *The Coming of Age* which highlights the increasingly influential role played by emerging markets in general and the emerging consumer in particular. This theme places into perspective the remarkable strength in consumer-related shares on the JSE; strength which continues to baffle investors and managers alike and which has taken even us by surprise; the strength of the sector didn't surprise us but the extent of the gains did. By way of example, during the year to end-August the share price of Mr Price has risen 84.5%, Cashbuild 79.5%, Woolworths 64.6% and Foschini 42.0%. Truworths rose 22.8% and Massmart only 7.1% all of which compare with the All share index total return of 18.0% during the same period.

Chart 4: US equity market (Nasdaq) weekly price history

Source: Saxo Bank

During the past month we came across a nice chart which places the "Emerging market consumer opportunity" into perspective – refer to Chart 5. It is worth pointing out that the per capita market capitalization in developed markets is 67 times that of emerging markets. The market caps below represent the combined value of the Discretionary, Staples and Healthcare sectors.

Chart 5: The Developed versus the Emerging consumer



Source: Merrill Lynch

Some quotes to chew on

A word from the trenches

I thought the following comments by *Ton Vosloo, chairman of the Naspers Group*, made on 31 August, were pertinent: "The financial year to 31 March 2012 was another challenging, but rewarding, period for the Naspers group. Globally, the media industry is working through unprecedented change as traditional platforms mutate, new

platforms develop at lightning speed and consumers demand ever more functionality and connectedness in the language of their choice. To add to the challenge, this is all taking place in the midst of *the worst economic crisis in over seven decades"* (my italics). Hidden in the depths of his address was the following; "The impact of the new Companies Act in South Africa, as well as the guidelines in King III, remained a focus over the past year. The effect of all this bureaucracy is that 1 422 pages were distributed to our board and committees during the June board cycle. Not too environmentally friendly either!" I'm glad to see that we are not alone in thinking that much of the new regulation is "over the top" – more on this later.

Photo-economix: A Macaque baby in India

More warnings about the current crisis
In a weekly note about the current economic landscape, *Merrill Lynch North American economist Ethan Harris* warns against complacency, fearing that investors are too comfortable, given the prevailing lack of "shocks". He suggests that the outlook for the global economy is worse than it looks. Commenting specifically on Europe, he writes "We believe the Eurozone crisis is far from over. At this stage the policy pattern for Europe is well established: (1) A funding problem in one of the peripheral countries arises; (2) policy makers engage in brinkmanship with the core demanding austerity and the periphery demanding bailout; (3) the markets start to melt down; (4) policy makers do just enough to satisfy the markets, but not cure the underlying problem. There is nothing merry about this go around. Over time it undercuts the foundations of the Eurozone. The economy steadily slides into recession, populist parties grow in strength and the markets become increasingly fragile. For the US and the rest of the world this means ongoing collateral damage, primarily through confidence and capital markets."

Straight talk from the manager of the largest bond fund
Many of you would have heard of *Bill Gross, the co-Chief Investment Officer of Pimco* and the manager of the world's largest bond fund - all $265bn of it! His writings are widely followed and he is appreciated for his frequent "straight talk". The following represents an excerpt from a recent piece he wrote in the Financial Times: "Psst! Investors – do you wanna know a secret? Do you wanna know what Angela Merkel, François Hollande, Christine Lagarde and Mario Draghi all share in common? They want your money! They've wanted it for years now but you are resisting by holding on to it or investing it at negative interest rates in Switzerland, Germany and a growing number of other countries considered to be European Union havens. They want you to be less frugal and more risk-seeking. They want your money as a substitute for theirs in Spain, Italy and, of course, Greece, but they don't mention that any more. The example would be too off-putting. "Investors," they plead, "show us your money!" The ultimate goal of monetary and fiscal policy in the EU is to re-engage the private sector. The EU needs the private sector as a willing (but not necessarily equal) partner in funding its economy. This often gets lost in the noisy details of all too frequent promises such as the one to defend the euro made by Mr Draghi, European Central Bank president. Investors get distracted by the hundreds of billions of euros in sovereign policy checks, promises and IOUs that make for media headlines but forget it's their trillions that are the real objective. Even Mr Hollande in left-leaning France recognises that the private sector is critical for future growth in the EU. He knows that, without its partnership, a one-sided funding via state-controlled banks and central banks will inevitably lead to high debt-to-GDP ratios, rating service downgrades and a downhill vicious cycle of recession. But private investors are balking – and for what it seems are good reasons – because policy makers' efforts have been, until now, a day late and a euro short, or more accurately, years late and a trillion euros short... The dirty little secret that sovereign debt issuing nations need to remember most of all is that credit and maturity extension is based upon trust. After all, "*credere*" is a Latin word meaning just that. After trust has been lost due to half-baked policy measures; after credit agencies belatedly have recognized embedded costs of debt that can no longer insure solvency; after marginal investors have been flushed from the system to what appear to be safer returns of principal havens; and after policy makers finally appreciate the fragility of their rigged fiscal and monetary system; after all of that – there is no coming home, there is no going back in the water. Psst investors: Stay dry my friends!"

More evidence of contradictory markets
We frequently allude to the fact that prevailing market behaviour is often contradictory and that conditions can

hardly be described as normal. We commented last month (refer to the section on *The Makings of our next Big Picture Theme* in the August edition of *Intermezzo*) about how underweight investors are in their equity exposure. In the light of these comments, we draw your attention to the following extract from a Merrill Lynch report on the in- and outflows from various asset classes and sectors. Noting the most recent weekly flows *Merrill Lynch Chief Investment Strategist Michael Hartnett* says "Today, Nasdaq closed at its highest level since December 2000 and the S&P500 closed at its highest level since January 2008. And yet weekly (investment) flows show the largest equity *outflows* in 2012. Investors have simply not been positioned for a rally. They remain more willing to take risk in fixed income, which we think is in the early stages of a bubble".

Table 3: Global asset class flows ($m)

	Weekly flows*	wk %AUM	YTD	YTD %AUM
Equities	-10,595	-0.2%	-16,517	-0.4%
ETFs	-7,184	-0.6%	41,950	3.6%
LO	-3,411	-0.1%	-58,467	-1.7%
Bonds	3,197	0.1%	172,730	7.5%
Money-mkt	4,591	0.1%	-70,166	-2.2%
Commod	683	0.3%	7,449	3.6%

* week of 9/05/12

Source: Merrill Lynch

Some $10.6bn flowed out of equity funds in the week ended 5 September while $3.2bn flowed into bond funds; bond funds experienced inflows in 46 out of the past 48 weeks – refer to Tables 3 and 4 for a summary of investment flows so far this year.

Table 4: Net fund flows to global equities ($m)

	9/5/12	YTD
Total Equities	**-10,595**	**-16,517**
long-only funds	-3,411	-58,467
ETF's	-7,184	41,950
Total EM	**-1,783**	**16,113**
Global EM Funds	-262	24,981
Asia	-1,331	-5,551
EMEA	-128	-864
LatAm	-62	-2,453
Brazil	-25	-1,525
Russia	-51	907
India	-303	-784
China	-406	-2,191
Indonesia	-25	79
Taiwan	-365	-1,172
Total DM	**-8,812**	**-32,630**
US	-8,255	-19,156
Canada	-141	-269
Europe	-675	-24,241
Japan	-107	5,663
Pacific	-16	39
International	382	5,337

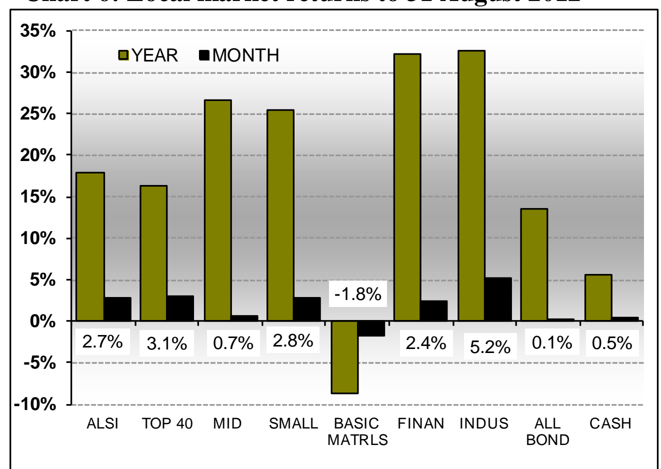
Total Equities = Total EM + Total DM

Source: Merrill Lynch

August in perspective – local investment markets

The SA bond market slipped into positive territory at the very end of the month, rising all of 0.07% on the month. As we have seen many times this year so far, industrial and financial shares posted strong gains while basic material shares (resources) posted very poor returns. The net effect was a 2.7% rise in the All share index, made up of a 1.8% *decline* in the basic material index and 2.4% and 5.2% respective gains in the financial and industrial indices. We continue to draw your attention to the difference of more than 40% (41.3% to be exact) between the annual returns to August of the basic material (-8.7%) and industrial (32.6%) sectors. This difference is nothing short of astonishing! The mid and small cap indices rose 0.7% and 2.8% respectively during the month. The best performing sectors on the JSE were the automobile and parts sector (think Metair), which rose 16.0% and personal goods (driven by Richemont) up 11.6%. Losing sectors were led by coal, down 12.0%, electronic and electronic equipment 9.3% and of course gold mining, which lost 7.9% on the month.

Chart 6: Local market returns to 31 August 2012



Growing discontent

Maestro has consistently been positive about the future of South Africa and we remain positive on its people and its short and medium-term future. However, a growing disquiet is beginning to feature in our thinking, a frustration not so much by the lack of ability to lead and govern properly – in that respect SA is no different from many (even developed) countries around the world – but in the great opportunity cost the country is beginning to bear as a result of government's failure to govern the country and serve its people properly. This is not a new frustration of ours; we have shared it in the past. We have on a couple of occasions described government as "the single largest impediment to growth in this country", a humble view we to continue to hold. I raise this issue once again here for two reasons;

firstly because it is important that in our positive view of the country you do not think we ignore the negative aspects of government and the effect of its inability to govern properly; and *secondly*, there have been a number of events in recent days which have brought this issue to the fore. There is a degree to which we all have to ignore the ineptitude and failings of government and manage our lives around it, continue to try to make a difference in the areas which touch our lives and help those around us to the extent we can. But we sense we are not alone in being increasingly annoyed at the rising cost to this wonderful country and its people, of government's failings.

Particular aspects we would highlight as examples of politicians' failure to fulfil their responsibilities properly include:

- The increasing profligacy of government that is emerging as time goes by. There are too many examples of this, but more recent ones that caught our eye include the request from Zulu King Goodwill Zwelithini for an addition R18m to build himself another (R12m) house as well as a R6m house for his 6th wife. That is over and above the R58m the royal household already receives from the provincial government, which will rise to R62.5m next year. Add to that the R50m spent in the 2010 fiscal year on helicopter flights ferrying VIPs around - a cost of R85 000 per VIP flight. And the R210m spent on flying our President and Deputy President around in their respective aircraft in the same fiscal year. Even more shocking is the fact that the ex-Minister of Defence Lindiwe Sisulu herself spent R40.6m on 286 flights, which translates into a staggering cost in excess of R151 000 *per flight*! And if you think that is bad, President Zuma's average flight cost over R491 313! Such excesses in the face of the growing poverty in our country are nothing short of immoral.
- The shocking degree of ineptitude and the extent to which politicians are simply "out of touch" with reality. Nothing has brought this into clearer focus than the tragic events at Lonmin's Marikana platinum mine. A proper discussion of this event will take all day, but virtually every aspect of this terrible event in the history of our country can be traced back to the failings of government in one way or another. Whether it be from the ludicrous wage demands of workers, the even more ludicrous role of the rabbit, the antics of hooligans like Julius Malema, the bizarre murder charges, subsequently withdrawn, against 270 miners, the denial by Trade and Industry Minister Rob Davies that the event will have no impact on foreign investors' view towards South Africa, the total lack of leadership on the part of President Zuma, his cabinet and government – all of these aspects in one way or another highlight the failure of government policies and leadership and only serve to exacerbate a very fragile situation, which could easily blow up and out of control, to the greater detriment of everyone in this country.
- The increasing ability of government, at all three levels, to carry out simple day to day responsibilities. The failure of listed construction company Sanyati due to government not paying outstanding bills is only one example of many that we could highlight in this regard. And then we have not even begun to describe the failure to deliver basic services. It is no wonder so many communities, particularly the poor ones who are least equipped to deal with the consequences, are so up in arms? Who can blame them for taking to the streets?

You will not hear much negativity from the Maestro team. Our positive attitude towards South Africa, in the face of much scepticism, even from our own clients, has secured wonderful returns for them over the twelve years since Maestro's inception. However, we feel strongly enough about this matter to raise it here and are keen to show that we are not unaware of the negative aspects of this country. That should in no way be construed to be a dramatic shift in our attitude towards investment in South Africa. On the contrary, we continue to regard the country as a unique investment destination; one whose attractions are placed into perspective by the failings of so many other countries in the world today, both in economic terms and in terms of their political leadership, or rather the lack of leadership, and management of the most pressing issues at hand.

Photo-economix: Baby monkey in Indonesia

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State of the Nation: the search for a willing PA
Many of you are aware of the following development within Maestro so forgive the repetition. For those who don't we are keen to bring to your attention the fact that Maestro is looking to employ a Personal Assistant to its Managing Director. If you know of anyone who might be suitable for the position, please drop Sue an email and she will send you the Job Description or can contact the person directly. We are keen to finalize the appointment as soon as possible.

Photo-economix: Macaque mother and baby in Thailand

Rogue regulation
Another one of Maestro's **Big Picture Themes** is that of *Strangulation by Regulation*, which refers to the increasing regulatory burden being placed on all of us in one form or another, which is slowly driving up costs and reducing efficiency. This is no more evident than in the financial industry at present although it is by no means the only area subject to wave after wave of regulation, much of it illogical, unenforceable, disproportionate and ultimately ineffective. Were we to be pushed for a date on which the regulatory culture changed and began to take hold, it would be 11 September 2001, "9/11", when the Western world lost its "innocence" and trust and naivety flew out the window. Fast forward to today, the Great Financial Crisis that began in October 2007 exacerbated and accelerated that culture, to the extent that regulators and authorities now hold the upper hand and heaven help anyone who remotely tries to "go against the flow".

The reason we raise this issue now is that September saw the unfolding of an event we always knew was coming; it was probably not the first and it certainly won't be the last such event. It was, however, the highest profile yet of what I call *rogue regulation*. I am referring to the bizarre situation that UK bank Standard Chartered (StanChart) found itself in early in August. What made this example more notable was that StanChart had successfully avoided the fallout from the Great Financial Crisis. It emerged relatively unscathed due to its focus on Asia and the fact that investment banking doesn't constitute a large portion of its activities. Space precludes a full description of the events surrounding this event, but they illustrate how powerful regulators have become and raise the worrying aspect of accountability. Who are regulators accountable to; who keeps a check on them as they keep a check on others; what happens when they step out of line; what happens when banks transgress regulations in one country with activities that are permissible in other countries? What happens when one nation starts "picking on" another to protect their self-interest? These are some of the issues this event raised and which are likely to continue to dominate all economic entities in the years to come. In a nutshell, the following represent how matters unfolded:

- On Monday 6 August a new regulatory body in New York, called the Department of Financial Services (DFS) - led by Benjamin Lawsky (I kid you not) announced that the StanChart had "schemed with the government of Iran to process up to 60 000 secret transactions involving at least $250bn" in breach of sanctions. Lawsky described the bank as "a rogue institution, carefully planning its deception of US authorities ... using fraudulent procedures and forging business records to stage a staggering cover-up". The DFS threatened, amongst others, to withdraw StanChart's US banking licence, which would be very damaging indeed. The use of such strong and venomous language was unprecedented, to the extent that other, more senior US regulators expressed their shock at the utterances.
- StanChart immediately refuted the allegations, saying that 99.9% of the transactions complied with regulations. In addition, it said the estimated $14m of transactions that did not comply were merely the result of small clerical errors. It further claimed that the transactions in question did not breach the sanction controls of other regulators such as those in the UK and Europe and that these practices were laid down in agreements with the US authorities. It later emerged that the bank had been discussing the allegations with other US regulators for some time and had offered to pay a $5m penalty a few months earlier.
- Not surprisingly the StanChart share collapsed as much as 20% at one stage on Tuesday, 8 August, as investors struggled to establish the truth and what the possible consequences for StanChart would be.
- On Tuesday, 14 August, StanChart agreed to pay $340m to the New York state to settle the accusations, just one day before the official public inquiry into the bank's alleged activities.

By settling the allegations, StanChart avoided a bruising, high profile clash with US authorities, but will we ever know the truth behind the allegations? Is this not a case of legal extortion? We know that governments around the world are clamouring for funds – successful and profitable companies are obvious targets for unscrupulous regulators.

What makes this case so ironic is that StanChart, of all banks, and its Chief Executive Peter Sands, of all people, seem the least likely to have committed the activities as described by the DFS. Mr Sands is widely viewed as having a sharp intellect and strong grasp of the technicalities of banking. As the British banking system teetered on the brink of collapse in 2008, he helped the government structure radical bailout plans, hosting critical meetings for advisers and ministers at StanChart's City of London headquarters. Since then he has maintained close ties with regulators and the government and has regularly been tipped as a potential successor to the governor of the Bank of England. Mr Sands is also not afraid to speak out about the dangers of excessive financial regulation. In hard-hitting speeches around the world he has warned against crippling the West with "interventionist regulation and tough constraints on pay".

The event evoked a wave of comments and discussions at all levels of the financial community, examples of which follow:

- "This is not a good settlement for Standard Chartered on any measurement," says Simon Morris a financial services partner with law firm CMS Cameron McKenna. "Last week there was a flat denial of wrongdoing, so this would make $340m an immense penalty for the 0.1% of transactions that supposedly slipped through the net. This is a hefty price to pay for a continuing license to run a branch in New York."
- "It was a business decision," says Sarah Jane Hughes, a banking law and payment system expert who teaches at the University of Indiana. "If Standard Chartered is processing $190bn a day through New York, then $340m is not a particularly large sum to keep that volume in place. Even the threat of a license suspension would have caused their best and cleanest customers to be looking for a new clearing option in the US."
- Mervyn King, governor of the Bank of England, observed that while American and British regulators had co-operated on the Barclays case, in the StanChart case "one regulator, but not the others, has gone public while the investigation is still going on".
- Kishore Mahbubani, *dean of the Lee Kuan Yew School of Public Policy at the National University of Singapore, wrote* "Mr Lawsky's decision to go after Standard Chartered was flawed for three reasons. First, his decision to expose StanChart appears to have been driven by domestic political considerations, not by the merits of the case. In the strange political climate of the US, anyone who stands up to Iran is a hero. Second, Mr Lawsky's decision undermined the move to create global co-operation among financial regulators. Finance is not a domestic industry. Billions of dollars cross borders with a mouse click. The only way to regulate this industry is through global norms and processes. The third reason why Mr Lawsky's decision was flawed was that it seems it did not even occur to him to ask: would another regulatory authority someday similarly retaliate against an American bank? It is obvious why this question did not occur to him: American power appears, to him at least, to be unassailable.
- It was reported that in private US Treasury and Federal Reserve Bank officials were furious that the DFS Lawsky had "gone it alone".
- The extent of the national differences and enmity can be gauged by a reported comment from a StanChart director; "You f..king Americans. Who are you to tell us, the rest of the world, that we are not going to deal with Iranians?" That goes to the heart of at least one aspect of this debate, doesn't it? Compare that to the comments of Senator Carl Levin, Chairman of the Senate Permanent Sub-committee on Investigations, who, in praising the DFS, said "The agency showed that holding a bank accountable for past misconduct doesn't need to take years of negotiation over the size of the penalty; it simply requires a regulator with backbone to act".

Chart 7: Standard Chartered price history

Prices shown with the daily high, low and closing levels

Source: Saxo Bank

And did I mention that, only days before this “scandal” broke, Standard Chartered had published its interim results, which showed that interim pre-tax profits had risen 9% to $4bn, its tenth consecutive record of first half profits. Ironically, that result hardly seemed to matter in light of the subsequent events, which just goes to show how important the issue of regulation is in the prevailing environment. While we do our best to identify exceptional companies with above-average prospects – StanChart’s results having vindicated our actions – the issue of regulation, or rogue regulation in this case, is impossible to predict or to diversify away. For the record, Standard Chartered has long been one of our international unit trust, Central Park Global Balanced Fund’s holdings. At the end of August, it constituted 1.8% of the total Fund.

I hope this brief discussion provides some insight into our concerns about the increasing tsunami of costly regulation that we are being subject to. Although it is only going to get worse we recognize it as a feature of the prevailing times which is unlikely to reverse direction in the foreseeable future. That said its full impact on society in general, and consumers and investors in particular, remains unknown. It will continue to constitute an unmanageable risk for investors and business operators alike. The **Big Picture Theme** of *Strangulation by Regulation* will remain on our investment agenda for some time to come.

Photo-economix: Mother and baby

So what’s with the pictures?

Readers will know by now that I enjoy high quality pictures, so their inclusion in this month’s edition is no exception. The source of all the pictures is National Geographic and the theme is obviously monkeys. If you want to be specific, let’s say there is an “emerging market” theme this month, given that they all emanate from emerging markets - emerging market monkeys, so to speak ☺.

Table 5: MSCI returns to 31 August 2012 (%)

	Aug'12	2012
Czech Republic	15.1	4.0
Egypt	8.8	48.4
Turkey	4.1	35.7
Pakistan	3.9	21.7
Poland	3.7	8.9
MSCI DM	2.3	8.2
Taiwan	1.9	4.2
Hungary	1.6	11.0
India	1.0	7.9
EEMEA	0.9	7.1
Russia	0.9	2.0
Hong Kong	0.4	10.0
Malaysia	0.4	6.5
Brazil	0.2	-8.1
Thailand	-0.1	15.2
MSCI EM	**-0.5**	**3.4**
LatAm	-0.7	-1.7
Japan	-0.8	-1.2
AP ex-Japan	-0.8	6.4
Australia	-0.8	7.7
Korea	-0.9	7.2
EM Asia	-0.9	4.3
South Africa	-1.1	5.0
Singapore	-1.4	19.6
Chile	-1.4	3.6
Mexico	-2.3	12.9
Colombia	-2.6	13.9
Philippines	-2.7	23.2
China	-3.2	-0.6
Indonesia	-3.6	-3.4

Source: Merrill Lynch

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