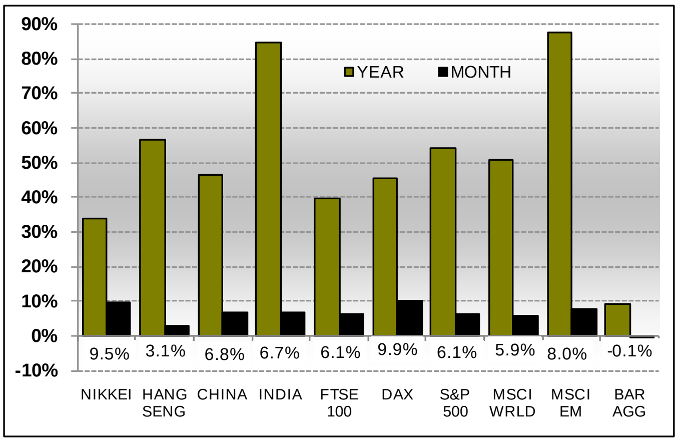
MAESTRO
INTERMEZZO
Investment Letter | 10th Edition | April 2010

March in perspective – global markets

Global equity markets continued to plod higher in what developed into a typical pattern as the month progressed: despite any poor economic news, markets inevitably closed higher, small step by small step, but when all was said and done they had posted a strong month by any standard. The German equity market ended up 10.0%, Japan 9.5%, London 6.1% and the US 6.1%. The US market posted its best March quarter since 1998. The MSCI World index ended March 5.9% higher. Table 3 contains the MSCI emerging market returns for the month, which contributed to the MSCI Emerging market's 8.0% return. Russia gained 12.7%, helped by the 8.4% rise in the oil price. China rose 6.8% and India 6.7%. The JSE All share index rose 12.6% in dollar terms, assisted in part by the 4.4% rise in the rand despite a firm dollar. Gold rose only 0.7% but other commodity prices rose much more; platinum and palladium ended up 7.3% and 11.4% respectively. We note that the sugar price, which surged throughout last year, is down about 41% from its peak, following a more favourable outlook for the Indian season.

Chart 1: Global market returns to 31 March 2010



What's on our radar screen?

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

- *The SA economy*: March was an active month on the SA calendar. The Reserve Bank (SARB) cut interest rates by 0.5% to 6.5%. Although we are of the view that we are *close to* the bottom of this interest rate cycle, we were not entirely surprised by the rate cut. In fact we would go so far as to suggest that we may see another rate cut before this rate cycle turns. The Monetary Policy Committee (MPC) itself cited further strengthening of the rand, certainty about Eskom's tariff increases (25% for each of the next three years), continued favourable food price developments and a subdued recovery in domestic demand caused by a high level of consumer indebtedness as reasons to cut rates further without endangering their inflation target of between 3% - 6% per annum. So although the odds at present are weighted against it, we wouldn't fully discount another rate cut in due course. Irrespective of whether it materialises or not, we think it will be at least another year before rates begin to rise. This is clearly a very equity market friendly environment. The SA annual inflation rate for February came in at 5.7%; service inflation remained flat at 6.8% while food inflation declined from 2.4% in January to only 1.8% in February (I can already hear the housewives disagreeing). January retail sales declined 1.7% year-on-year (up 4.6% month-on-month)

- *The Indian economy*: The Reserve Bank of India raised their interest rates unexpected by 0.25% to 5.0% in response to inflation rising to a 16-month high. For obvious reasons we share a lot about China and its "miraculous" economy, but we should perhaps spend more time examining the Indian economy, which is not too far behind China in terms of development. Let me remind you that these two countries together account for half of humanity! Towards the end of February, Pranab Mukherjee, the Indian finance minister, presented his budget. In one of the biggest understatements of the month, he was able "to say, with confidence, that (India) has weathered the crises well", referring to the 2009 economic crisis and a poor monsoon. The Indian economy grew 6.7% in its 2009 financial year and is forecast to grow 7.2% this year. Central government's fiscal deficit expanded from 2.6% in 2007/8 to 5.9% in 2009 and an estimated 6.5% this year. That sounds large, but keep in mind that India's nominal GDP grew at an average rate of 14% between 2004/5 and 2009/10. The public sector's savings rate declined from 5% of GDP in 2007/8 to 1.4% in 2008/9 but the gross savings rate (public, corporate and household savings) exceeds 30%, having peaked above 36% just prior to last year's global economic crisis.
- *The Reserve Bank of Australia* raised their rates by 0.25% to 4.5%, its fifth increase since October and indicated at the same time that there is a strong likelihood that they will be raised again this year. Australia is benefitting from its close proximity to China, and is being pulled along by the strong Asian growth particularly within the resource sector.

A few quotes to chew on

Every once in a while, the world is faced with a major economic development that is ill-understood at first and dismissed as of limited relevance, and which then catches governments, companies and households unawares. We have seen a few examples of this over the past 10 years. They include the emergence of China as a main influence on growth, prices, employment and wealth dynamics around the world. I would also include the dramatic over-extension, and subsequent spectacular collapse, of housing and shadow banks in the finance-driven economies of the US and UK. Today, we should all be paying attention to a new theme: the simultaneous and significant deterioration in the public finances of many advanced economies. At present this is being viewed primarily - and excessively - through the narrow prism of Greece. Down the road, it will be recognized for what it is: a significant regime shift in advanced economies with consequential and long-lasting effects. Mohamed El-Erian, Chief Executive of PIMCO.

The following quote was included in an article by Jing Ulrich, Managing Director and Chairman of China equities and commodities at JP Morgan, entitled *Debunking the myth of a collapse in China Markets*. In the article she defended some of the concerns surrounding the Chinese equity markets and drew attention to some less obvious risks. The following is an extract from her article: *Unlike the dramatic increase in household leverage that precipitated the US subprime crisis, Chinese household debt amounts to approximately 17% of GDP, compared with roughly 96% in the US and 62% in the Eurozone. Homebuyers are required to make minimum down payments of 30% before receiving a mortgage and at least 40% for a second home.*

By the end of this year, Organization for Economic Co-operation and Development (OECD) sovereign debt will have exploded by nearly 70% from 44% of GDP in 2006 to 71%. According to the Bank of International Settlements (BIS), it would take fiscal tightening of 8-10% of GDP in the US, UK and Japan every year for the next five years to return debt levels to where they were in 2007… Our own calculations show that the budget deficits of crisis-struck countries now equal more than 25% of global savings and 50% of savings with the OECD. And the increase is on a different scale because it affects all big economies, not just an Argentina. David Roche, President and global strategist of Independent Strategy and co-author of "Sovereign Discredit!" to be published this month.

The last time the S&P500 was rallying towards 1200 in late 2004 (it is 1193 at the time of writing) the S&P EPS was $68 versus the $57 in the fourth quarter of 2009 i.e. earnings were 20% higher. Back then we had solid and sustained employment growth, low and falling unemployment rates and high and rising capacity utilization - not to mention that credit was abundant and available to everyone at an extremely low cost. Housing and commercial real estate were rising to new heights and household balance sheets and wealth were hitting new all-time highs. Dave Rosenberg, Chief Economist and Strategist at Gluskin Sheff

The Final countdown

Last month we introduced some light relief to counter all the data and facts by including a series of pictures off Google Earth of places we comment on or follow frequently in our daily activities. This month, somewhat predictably, I want to "kick-off" a paragraph on the 2010 FIFA World Cup Final with a picture of the Johannesburg stadium, below. Don't worry though, the picture is quite old. I can assure you that the stadium is finished and ready for the Final☺.

Photonomics 1: Soccer City near Soweto, Johannesburg

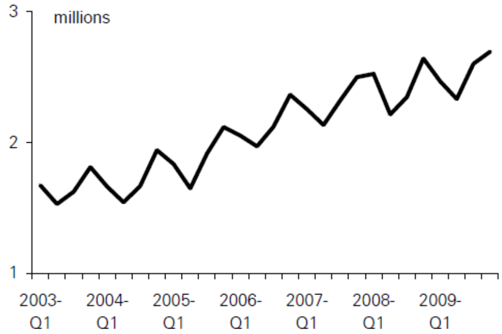
Source: Google Earth

At the time of the dispatch of this edition, there are only 58 days left to the start of the FIFA 2010 Soccer World Cup Final. For those living outside of South Africa, let me assure that the excitement is building up and we have literally entered the "final countdown" – and all that goes with it; from the doomsday prophets whose grumblings grow ever louder, to the real uncertainty of what it actually means for the country, both economically and otherwise; the practical arrangements and preparations at the stadiums, including "test-driving" the stadiums with ever-increasing crowd sizes; monitoring the ticket sale statistics; opening the final road and airport renovations and improvements - there is a lot of buzz around the Final and most South Africans, at least from what I can ascertain, are getting pretty excited. It would be fair to say that many, but certainly not all, white South Africans are skeptical about the event while most black South Africans are looking forward to the event. I guess our political baggage is hard to shake off, even after 16 years of democracy. Lest there be any doubt, the Maestro team is eagerly anticipating the event. We are all very favourably disposed to what it means for us a country. Sure, there is a degree of nervousness about some of the possibilities that could derail or upset the event, but those are largely beyond control and it would be silly to not host these events because of what "could happen".

Quantifying the economic benefits of the World Cup will always be something of a "hit and miss" process. Deutsche Securities recently published a research piece that I thought was rational and was worth sharing. The following represent some of their conclusions, remembering that they are, at best, guesstimates:

- The number of visitors to SA at the time of the event is estimated to be around 400 000. By way of comparison over 2m visitors went to the 2006 World Cup final in Germany.
- Recent reports indicate that about two thirds of the 3.8m tickets have already been sold, of which about half have been sold to foreigners.
- The direct economic impact of the foreign visitors will add about 0.6% to GDP in 2010. This is based on the assumption that each visitor will spend about $2 000 (hence a boost of about $800m or R5.8bn) which will undergo the usual multiplier effect, resulting in a total impact on aggregate demand of about R15bn to the SA economy.
- The foreign exchange inflows will probably add about $0.8bn or about 20% to the current account deficit in the second quarter. We don't think the Reserve Bank will "mop up" this extra liquidity, so it is fair to expect that the inflows will be rand supportive. Incidentally, this has been one reason, albeit a minor one, for our continued view that the rand is likely to remain strong for at least the first half of the year. Surely it is only a matter of time before the rand moves below R7.00 to the dollar?
- The inflationary impact of the World Cup will be small, given that there is a lot of spare capacity in the economy and that the restaurant and hotel component in the CPI basket is only 2.78%.
- None of the above estimates take into account the commitment already made to the Final (in his February Budget speech the Minister of Finance indicated that R33bn had already been spent on infrastructure by way of preparation for the Final) neither does it take into account any of the long-term benefits such as increased tourism, heightened awareness of SA, increased efficiency due to improved infrastructure, etc.
- Some other aspects about SA tourism in general are worth noting: some 10.1m tourists visited SA last year, of which 9.2m were holiday visits. Of the total visitors, only 2m were from outside Africa i.e. 8m were from the African continent. Latest data from the third quarter of 2009 show that foreign visitors spent on average R12 400 per visit, while African visitors spent 45% less i.e. about R6 800. And finally, as Chart 2 shows, foreign visitors to SA have been rising long before the hype surrounding the World Cup began.

Chart 2: Foreign visitors to South Africa

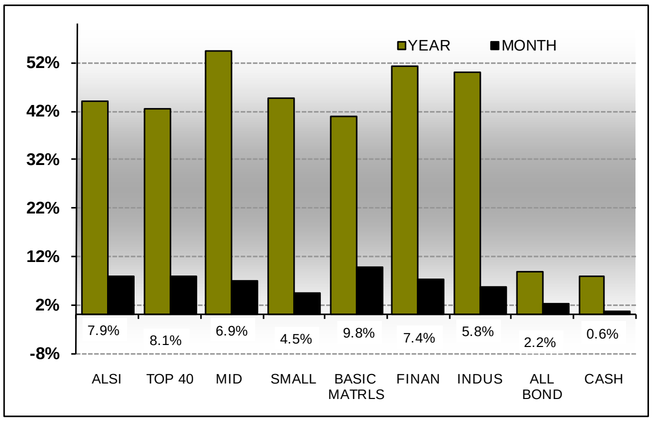


Source: Deutsche Securities

March in perspective – local markets

The positive sentiment on global equity markets spilled over to the SA markets in no uncertain terms. The basic materials sector led the charge, rising 9.8% despite the 4.4% increase in the rand dollar exchange rate. Financials rose 7.4% and industrials 5.8%. Small caps "lagged" with a return of "only" 4.5% while mid caps did a bit better, rising 6.9%. Incidentally, the US mid and small cap indices rose 7.0% and 7.7% respectively in March. The forestry and paper sector rose 14.7% and general banks 13.0% while the industrial metals sector fell 7.6%, due largely to Arcelor Mittal's 20.7% plunge.

Chart 3: Local market returns to 31 March 2010



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

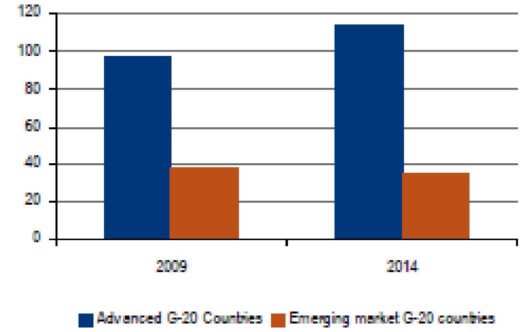
	Period ended	Month	Year to date	Year
Maestro Equity Fund	Mar	**5.3%**	**2.3%**	**33.1%**
Maestro equity benchmark *	Mar	7.2%	4.8%	46.3%
JSE All Share Index	Mar	7.9%	4.5%	44.1%
Maestro Long Short Equity Fund	Feb	**-0.5%**	**-2.4%**	**15.0%**
JSE All Share Index	Feb	0.4%	-3.2%	48.3%
JSE Financial and Indus 30 index	Feb	0.6%	-0.5%	55.2%
Central Park Global Balanced Fund ($)	Feb	**-0.1%**	**-3.5%**	**12.9%**
Benchmark**	Feb	0.7%	-0.7%	24.9%
Sector average ***	Feb	-1.1%	-3.0%	29.7%

* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index
** 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 ($)

Chart of the month

Without dwelling on any detail here, I list below Chart 4, which depicts the contrast government indebtedness between developed (in blue) and emerging G-20 economies in 2009 and what it is projected to be in 2014. Reference will be made to this chart in a later section, below.

Chart 4: Government debt as a percentage of GDP (%)
Shaded area represents forecasts



Source: Merrill Lynch

The Maestro Market Commentary

Last month we drew attention to our *Market Commentary* document, which reviewed market behaviour during the last semester and shed light on our views for the months ahead. The document has a reasonable "shelf-life" which means that it is still worth reading even a couple of months after it was written - if you wish to receive it please email me on andre@maestroinvestment.co.za and I will send you a copy. We continue to highlight here some of the themes addressed in the *Market Commentary*, as they pertain to developments within the investment environment. Last month we spoke about the "walls of cash" and the effect they would have on the global markets (look no further than the March equity market returns). As a matter of interest, we read the other day that in China, which saw credit expand by 30% last year as the economy grew 7%, household and corporate savings deposits in the banking system are now equivalent to 150% of Chinese GDP.

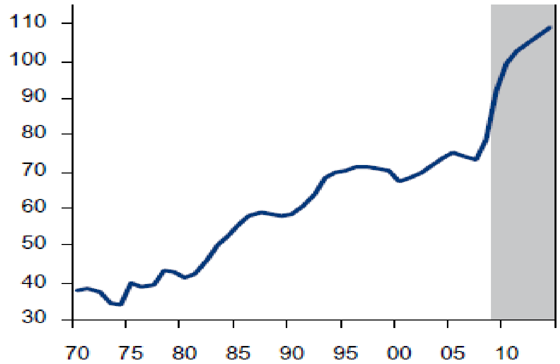
We also raised the theme of "Sovereign Risk". Greece continues to dominate the headlines, but we cautioned it would be naïve to believe it was the only or even largest "risk to the system." We continue to draw your attention to other countries where the levels of national debt and the state of finances in general continue to undermine the extent to which these countries can honour existing debt fund roll-overs of existing debt. By way of example, consider some of the developments within certain US states, which show just a few examples of how bad finances are in the US among some states:

- New Jersey has proclaimed a state of "fiscal emergency" and is taking draconian budget cuts to close a current fiscal-year deficit of $2.2bn and $11bn of debt in 2011.
- Oregon has approved a two-year $733m increase in income and business taxes.
- Arizona has increased sales taxes by 1%, which will drain about $1bn from consumer spending over the next three years.
- Colorado reversed several tax exemptions that will raise $140m annually, and
- Virginia passed an "Amazon Bill" that will raise $17m by requiring that online retailers collect state sales taxes.

Chart 4 provides one of the many reasons why we continue to regard emerging markets more highly than developed ones. The level of government debt in developed countries is forecast to rise from an already high base in 2009 while sovereign debt as a percentage of GDP in emerging markets is likely to decline between 2009 and 2014. Is it no wonder, then, that the yield (interest rate) on Greece's 10-year bond, at 7.38% is trading much higher than the equivalent bond in Brazil (4.88%) and many other emerging economies? Only last month you may recall that South Africa raised a 10-year bond (which was heavily over-subscribed) at 5.5%.

Chart 5, below, also shows the extent to which sovereign debt has risen, which poses an increasing risk to "the system" i.e. it is a systemic risk about which we are growing increasingly concerned. Without wanting to be too dramatic, many informed market watchers see it as the "next bubble". Of course this idea is brushed aside by politicians in the countries' concerned, just as bankers and politicians brushed aside the warnings about the looming sub-prime crisis. In addition, if you combine the piles of cash sitting in the corporate sector, it is not difficult to see why investors are opting to invest in corporate bonds and are eschewing government (sovereign) bonds.

Chart 5: Total public debt in advanced economies as % of GDP



Source: Merrill Lynch

File 13: Information almost worth remembering

The past month saw the anniversary of the market trough in the midst of the worst global economic crisis in our lifetime. On 9 March most equity market registered their lowest points of the crisis, although some Asian emerging markets (China for example) hit their trough in November 2008. Table 2 shows the returns, from 9 March 2009 to 9 March 2010, for selected asset classes. Merrill Lynch produced a report on the anniversary date, showing that the average return of the S&P500 in the year following the anniversary of the trough since 1926 was 9%. The returns ranged between -4% (in 1929/32) to 21% (in 1973/4), with the lowest return of -4% also being the only negative return of the ten occasions following a multi-year low.

Table 2: Returns since 9 March 2009 (%)

Emerging Market Equities	93
US Small Cap Stocks	83
Global High Yield Bonds	70
Oil	69
Global Equities	68
US High Yield Bonds	65
US Large Cap Equities	63
US Inv. Grade Corporate Bonds	26
Gold	21
10-Year US Treasury Bond	-2
The US Dollar	-10

Source: Merrill Lynch

Those who work with me know that I have a simple theory I call "the law of large numbers" which says that *when the numbers are large enough, you cannot ignore their effects*. It is a primitive theory, but is hard to ignore. I recently came across another good example of it: Mr Han Jun, a rural expert at Beijing's Development Research Centre, reckons that by 2040 the number of people in China's countryside will have shrunk by 500m to 400m, which means that China's city-dwellers would rise to over 1bn, catapulting the urban population from 45% to 70%. In a recent research piece, the McKinsey Global Institute estimated that by 2025 China would have 15 super-cities each with a population of more than 25m (it already has 170 cities with a population above 1m). To put that in perspective if Han Jun's estimates are correct, over the next three decades a population the combined size of Britain, Canada, France, Germany, Italy, Poland, Spain, South Africa and South Korea will move to China's cities. That's what I call "the law of large numbers" and you can rest assured it will affect your investment returns one way or another over that period.

Here is something for all you property watchers to chew on: did you see the story about Russia's richest oligarch and the world's 40th richest man, with an estimated $9.5bn (and probably one of the world's most eligible bachelors, too)? In 2008 44-year old Mikhail Prokhorov put down a 10% deposit, a cool $53m, on one of Europe's most expensive properties, the Belle Epoque villa Léopolda on Cap Ferrat between Monaco and Nice (see accompanying pictures) which was originally built for King Leopold II of Belgium. During the global crisis, Prokhorov had second thoughts and decided to terminate the deal. Although he claimed he was eligible for the return of his deposit, the courts felt otherwise, and he landed up forfeiting it. Yes, that's right; he walked away from his R382m deposit.

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Speaking of the "rich and famous", with the World Cup so close, Cape Town has seen an increase in the number of cruise ships entering its harbour. We were recently visited by the Queen Mary 2, an impressive outfit by any standards. But while everyone was staring wide-eyed at the ship, another smaller but more impressive monster sailed quietly into the port. It was the *Rising Sun*, the $290m yacht owned by Oracle founder Larry Ellison and movie mogul David Geffen. Apparently the 6th largest yacht in the world, and made with the specific instructions that it should be longer than Microsoft's co-founder Paul Allen's $280m, 126m long yacht, *Octopus* (*Ed*: the only thing larger than the yacht has to be Ellison's ego), *Rising Sun* is 138m long and boasts 82 rooms on five stories, covering 8 000m^2. It has 3 300m^2 of desk space and the usual trappings of Jacuzzis, gym, spa, saunas, etc.

Table 3: MSCI returns to 31 March 2010 (%)

	Mar'10	QTD
Hungary	17.8	12.6
Turkey	15.9	3.8
Argentina	14.2	5.3
Thailand	14.1	12.6
Indonesia	11.9	10.0
Poland	11.0	4.2
South Africa	10.4	4.1
Mexico	10.2	7.7
Russia	10.0	6.7
EMEA	**10.0**	**6.0**
Korea	9.3	2.8
India	9.2	4.8
Malaysia	8.5	8.2
MSCI EM	**8.0**	**2.1**
Australia	7.7	2.9
Israel	7.3	9.8
AP ex Japan	**7.3**	**1.5**
Brazil	7.0	-0.5
LatAm	**6.9**	**1.3**
Taiwan	6.8	-3.8
MSCI DM	**5.9**	**2.7**
Pakistan	5.5	7.5
China	5.4	-1.6
Hong Kong	5.3	2.1
Philippines	4.4	3.5
Singapore	4.2	-1.4
Japan	4.2	7.3
Peru	3.7	0.1
Colombia	3.0	10.1
Morocco	3.0	6.7
Czech	2.4	-0.2
Egypt	1.6	10.6
Chile	-2.0	0.1

Source Merrill Lynch

Photonomics 2: Moses Mabhida stadium, Durban

Source: Google Earth