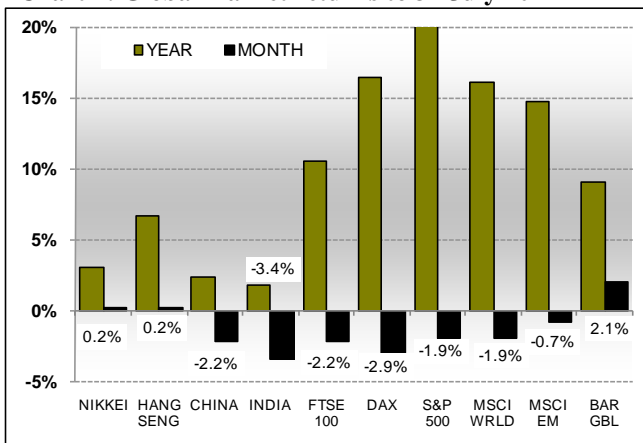




July in perspective – global markets

For the third consecutive month returns on global markets belie the nervousness and volatility experienced during the month. By way of example, the US equity market traded in a range of 4.7% during the month and the German equity market a 5.1% range. These ranges might not seem large but the intra-day ranges were worse (refer to examples below). We have covered some of the reasons for the prevailing nervousness in previous editions of *Intermezzo* so will not repeat them here. First the Greek crisis and then the more influential US debt crisis dominated market movements throughout the month. Politicians' seeming inability to understand the prevailing economic crises in their respective regions, let alone grasp the gravity of the situation, undermined their credibility to the extent that market participants now regard them more as a liability than anything else. This became patently clear in the first week of August, where the extent of economic slowdown in the US in particular, but also in certain European countries (Spain and Italy come to mind) showed just how stupid their bickering and politicking was in the face of real hardship being experienced in the lives of most citizens. The fact that many US politicians openly question if there is even a crisis is simply astonishing. Concern about the US and European governments' ability to honour their debts and manage their affairs properly, as well as the state of the global economy, which is slowing rapidly in developed economies in particular, weighed heavily on investors' minds.

Chart 1: Global market returns to 31 July 2011



Yet for all the prevailing risk, the level of returns is not that bad. Many indices – at least until the end of July - were still showing positive gains for the year-to-date. One of the reasons for this anomaly is the fact that the private (corporate) sector is actually in very *good* shape but the public (government) sector is in very *poor* shape. The former is ordinarily supportive of equity markets but the latter is undermining investor confidence and creating enormous uncertainty. Developed equity markets were

weaker than emerging ones; the MSCI World index declined 1.9% in July while the Emerging market index fell 0.7%. Japan and Hong Kong posted slight gains (remember Hong Kong fell 5.4% in June) but the German (-3.0%), UK (-2.2%) and US (-1.9%) markets declined. Brazil fell 5.7% and is now down 15.1% so far this year; India declined 3.4% and is down 11.3% so far this year. China fell 2.2% but Russia rose 3.1% and Indonesia 6.2% (that market is up 11.5% so far this year). Global bond markets fared better as investors priced in lower growth, desperately sought additional yield (income) and bought bonds as a means of protecting their assets (“safe haven” buying). The Barcap global bond index rose 2.1% and is up 6.5% so far this year. The dollar was marginally firmer in July but commodity prices were surprisingly strong, with copper rising 4.6%, nickel 5.9% and iron ore 7.3%. The price of oil rose 3.8% and amongst precious metals, gold, platinum, palladium and silver rose 8.2%, 3.3%, 8.3% and 13.2% respectively – rather hefty rises given the firm dollar and the prevailing uncertainty about the global economy.



Of course, events during the first week of August have eclipsed what happened during July. We will report in full next month on all the events but to illustrate the intraday volatility we spoke of earlier, consider the following. During the first five days of August trading in the US equity market, the respective ranges in which the S&P500 traded i.e. the difference between the low and high points reached by the index on the day, expressed as a percentage of the low point, were 3.1%, 2.6%, 2.3%, 5.7% and 4.8%. *The US equity market closed down 7.2% on the week.* The German equity market was even more volatile: on the first five trading days of August, the Dax index traded in a range of 6.4%, 3.8%, 3.7%, 7.9% (!) and 5.3% respectively; *it closed down 12.9% on the week.* These are remarkable daily ranges – and terribly weak returns - which we have not seen since the turmoil during the dark days of the 2007/8 financial crisis.



What's on our radar screen?

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

- *The South African economy:* Inflation at the producer level (PPI) rose a whopping 4.4% month-on-month. The bulk of the increase emanated from the massive electricity tariffs that came into effect during the month. The electricity component (month-on-month) increased 53.4%, with further increases likely in the next month or two. Yet for all the increase in energy costs, the annual increase in PPI was “only” 7.4%. An interesting anomaly in the PPI data is that imported inflation is running at 10.4%, which is hard to understand given the 13.1% increase in the rand dollar exchange rate in the past year (and a 4.5% decline against the euro, our main trading partner). The benefit of the firm rand doesn't seem to be filtering through to importers. The annual rate of consumer inflation (CPI) during June was 5.0%, up from 4.6% in May. It is interesting to consider the *annual* rates of inflation in some of the underlying components of the inflation basket: food and non-alcoholic beverages 7.1%, alcoholic beverages and tobacco 5.7% (*Ed:* no, this is insufficient proof that it pays to drink☺), transport 5.2%, housing and utilities 6.8%, and restaurants and hotels 1.1%. KwaZulu Natal is the “cheapest” place to stay i.e. inflation in that region is the lowest, at 4.5%, followed by the Western Cape and Gauteng at 4.9%. The Eastern Cape, at 6.1%, is the most inflationary province followed by the Free State at 5.8% and Limpopo at 5.7%.
- *The Chinese economy:* the rate of inflation in China rose to 6.4% in June from 5.5% in May, prompting the authorities to increase interest rates from 6.31% to 6.56%. The one-year deposit rate rose from 3.25% to 3.50% i.e. it is still significantly negative in real terms. The Chinese economy grew at an annual rate of 9.5% during the second quarter, down from 9.7% in the first quarter. Industrial production rose 15.1% and fixed asset investment rose at 25.6%. The growth data dispelled fears that their economy was slowing too quickly in response to the policy tightening in recent months.
- *The European economy:* despite the EU debt problems the European Central Bank (ECB) nevertheless raised interest rates by 0.25% to 1.5% in response to inflation rising to 2.7%, above the ECB's official target rate of “just less than 2.0%”. The Bank of England (BoE) kept its official interest rate unchanged but Sweden raised its rate to 2.0%, its seventh increase in a year. Subsequent to month-end, the Swiss National Bank (SNB) reduced its rate to “as close to zero as possible” in an attempt to stem the dramatic rise of the franc and injected Sfr50bn liquidity into the market. Its status as a safe haven has seen the franc rise 32.8% against the

dollar, placing Swiss exporters under huge pressure and racking up a Sfr19bn loss for the SNB last year on (failed) intervention.

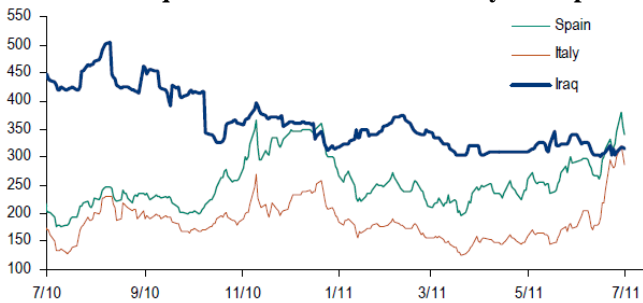


- *The US economy:* while US politicians played one-upmanship games on Capitol Hill, the US economy revealed overwhelming evidence of a dramatic slowdown. First quarter growth was revised down from 1.9% to only 0.4%. Second quarter growth came in at 1.3%, well below expectations. Earlier 2010 growth estimates were also revised lower. The housing market continues to decline and the labour market is not showing any meaningful sign of improvement. As an aside, forget about the official 9.1% unemployment rate; while the effective rate is closer to 17% the most startling piece of data as far as the labour market is concerned is that *only 58.1% of Americans of a working age have a job!* Retail sales are shrinking, which is remarkable given the consumption-driven nature of America (refer to chart 3), durable good orders are at a standstill and consumer confidence is low and declining. The latest manufacturing sector indicator, in the form of the ISM data, show a dramatic fall-off in July and many leading economists are openly questioning whether or not the US economy is already in recession. Yet policy makers continue to argue amongst themselves and collectively show little understanding of the situation let alone how to resolve it. A large group of them openly deny that there is even a problem. It is little wonder the markets are behaving as they are.
- *Emerging markets:* India raised interest rates by 0.5%, bringing its benchmark rate to 8.0%, the eleventh rate hike in 18 months, in an effort to stem rising inflation. South Korea also raised their rates by 0.25% to 3.25%, despite the fact that inflation is only 4.4%. Second quarter growth in Korea was 3.4% versus the 4.2% during the first quarter.

Charts of the month – Part 1

One of the most fascinating charts I came across this month is shown below. It depicts the cost of insuring against a debt default (5-year credit default spreads [CDS] spread, in investment jargon). The chart shows that investors now believe there is more chance of Italy and Spain defaulting on its debt than Iraq. Eina!

Chart 2: Iraq a safer investment than Italy and Spain



Source: Deutsche Bank

Maestro has long regarded the United States as the land of excess consumption. While that view has not gone down too well with everyone, it is important when assessing touchy subjects like this that we stick to the facts. So I present below a chart which shows the combined total of US government and personal consumption over the past five decades. Personal and government consumption in the US now constituted 92% of the entire US economy, and some 22% of world GDP. Is it any wonder the US is in the depths of a debt crisis? The unfortunate aspect of this state of affairs is that it affects us all; the US is still the most influential global economy, so we all need it to work. Irrespective of one's view of the US, it benefits no one to see the country slip closer towards recession and further crises.

Chart 3: US personal and government consumption

% of US GDP



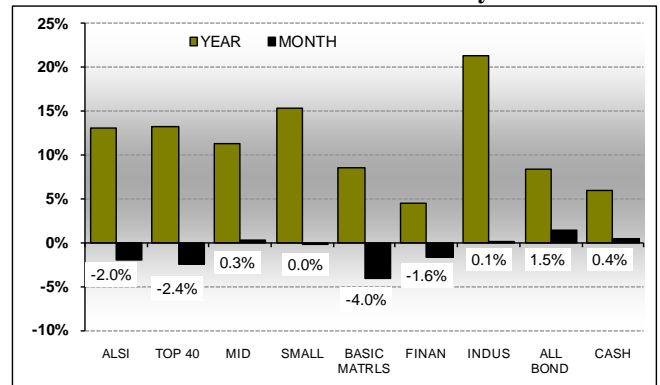
Source: Merrill Lynch

July in perspective – local markets

The SA equity market suffered from the same volatility as global equity markets while the local bond market was also a beneficiary of the nervousness during July. Concerns about the slowing global economy saw the All share index fall 2.0%, led by the basic materials sector, which declined 4.0%. Financials ended down 1.6% but industrials eked out a marginal gain of 0.1%. There is now a difference of more

than 10% in the year-to-date returns of the industrial (3.5%) and basic material sectors (-6.7%). The firm rand has had a small bit to do with that – it rose 1.0% against the dollar in July - although it is still down 1.4% for the year so far. The best performing sectors during July were automobile and parts, which rose 11.8%, software and computer services up 4.3% and food producers 3.4%. The worst performing sectors were platinum, which ended down 7.3%, media (Naspers) down 6.0% and gas and oil producers (Sasol) 5.7%.

Chart 4: Local market returns to 31 July 2011



As a matter of interest the SA equity market traded in a range of only 3.5% in July, less volatile than the US and European markets. As for the returns across the size of companies, large caps again had to play second fiddle to their mid cap brethren; the latter rose 0.3% while the former declined 2.4%. Small caps were flat on the month. The All bond index rose 1.5% to take its gain for the year so far to 3.7%. The rand firmed 1.0% against the dollar, once again highlighting its relative strength and attraction, which Maestro has consistently predicted despite the numerous local commentators who continue to believe the rand is on the verge of collapse.





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Table 1 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](#).

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

	Period ended	Month	Year to date	Year
Maestro Equity Fund	Jul	-0.9%	-5.5%	9.5%
<i>Maestro equity benchmark *</i>	Jul	-1.6%	0.9%	14.9%
<i>JSE All Share Index</i>	Jul	-2.0%	-1.5%	13.1%
Retirement Funds				
Maestro Growth Fund	Jul	-0.7%	-4.3%	7.2%
<i>Fund Benchmark</i>	Jul	-0.7%	0.9%	10.8%
Maestro Balanced Fund	Jul	-0.6%	-3.1%	6.6%
<i>Fund Benchmark</i>	Jul	-0.5%	1.4%	10.1%
Maestro Cautious Fund	Jul	0.1%	0.2%	7.8%
<i>Fund Benchmark</i>	Jul	0.0%	2.0%	9.0%
Central Park Global				
Balanced Fund (\$)	Jun	-1.0%	0.6%	20.2%
<i>Benchmark**</i>	Jun	-1.0%	2.8%	14.4%
<i>Sector average ***</i>	Jun	-1.3%	2.6%	15.8%

* 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 (\$)

Central Park celebrates its 7th birthday

Some of you will already be aware that the return for June of Central Park Global Balanced Fund, our offshore unit trust, heralded the Fund's 7th anniversary. Seven years ago, in June 2004, we established the Fund as the vehicle through which to manage our clients' offshore exposure. From the outset it was established as a "Fund for all seasons" i.e. one which would be able to generate returns despite adverse economic conditions. We never for a moment expected the world to head into the greatest financial crisis in living memory only three years later. The Fund invests across global equity, bonds and cash markets, and its mandate allows it a wide range of investment opportunities. The Fund is currently invested in global equities, bonds, two hedge funds and a venture capital fund, as well as having cash deposits. All the assets are subject to movements in currencies, which we regard as another asset class and which we manage actively. At the outset we set a demanding benchmark against which to measure the Fund; it consists of a 40% equity weighting and a 20% weighting each in bonds, cash and hedge funds. Most comparable global benchmarks do not contain a hedge fund component, which renders our benchmark more demanding.

We have enjoyed managing the Fund and have learnt a great deal during the process. Apart from the highlights below, we have also made our fair share of mistakes in the Fund. We invested into a hedge fund focussed on the US credit market a month before the onset of the global credit crisis and we also learnt that if we are going to include emerging market exposure in the Fund, we have to watch and manage the emerging market currency risk very closely.

But when all is said and done, I am of the humble opinion we have served our clients well through our efforts in the Fund. Some of them might not agree, but this is largely because they look at the *rand* returns of the Fund rather than the *dollar* returns. The *rand* returns are certainly important, but Central Park is a global dollar-denominated fund which needs to be assessed in dollar terms and within a global context. We have no control over the *rand* exchange rate, although we have a view on the currency, which has generally been a positive one over the life of the Fund. One of the biggest disappointments for us is that we have not gathered more assets to manage abroad. In recent years the Fund has suffered from withdrawals which have arisen outside of our control. SA clients have repatriated offshore funds because the *rand* returns are poor relative to those of the local (SA) equity market, or they have run into (often property-related) problems locally and have required additional liquidity. Some have simply grown tired and weary of the heightened risk levels abroad. But that has not detracted from the success or merits of Central Park and its returns since inception.



But as they say in the classics, the proof is in the pudding, so let me provide a summary of some of its achievements:

- Despite all the risks prevalent in the investment environment last year, the Fund generated a return of 20.2% in the year to June, which exceeded the 16.4% of return of comparable funds around the world as well as the 14.4% return of the Fund's benchmark.



- Over the past five and seven years to June, the Fund has at least kept pace with its benchmark and has delivered returns in excess of the average sector fund.
- The Fund’s core equity portfolio, which totalled \$6m at the end of June, has done particularly well. It has consistently produced returns in excess of global equity markets, measured by the MSCI World index. The core equity portfolio grew by 3.0% and 7.8% per annum over the five and seven-year period to 30 June 2011, versus the 0.2% and 3.8% returns of the global equity market over the comparable periods.
- The Fund is managed conservatively, and is less volatile than most of the underlying markets. So it is fair to say the above-average returns have been achieved through the assumption of less risk than that inherent in the underlying markets, which was one of the key objectives when we set up the Fund seven years ago.



Maestro is very global in its investment approach, probably more so than most South African investment managers, so we are very comfortable managing assets offshore. Central Park Global Balanced Fund is unique, at least in our view, in that it is managed by a local investment manager who can also manage clients’ local assets, thereby managing and reporting on the total portfolio as one entity, which in our view is the only way to manage investments. It helps us manage the client’s risk much better and affords us a lot more flexibility. Central Park allows us to access investments which are not available locally, such as exposure to other emerging markets, or to the automobile market which is thriving at present, despite global economic woes, thanks to rising demand for cars in China and India. These are but some of the opportunities that Central Park affords our clients, not to mention our ability to remit funds offshore on their behalf without utilizing their offshore allowances. We don’t charge clients for this unique opportunity – most institutions charge between 1% and 2% to take assets offshore using their “asset swap” capacity –

and we continue to believe that the annual investment fee is extremely competitive. Where else could you obtain offshore exposure for only 1.5% per annum, and no upfront charges? This is cheaper than most local unit trusts!

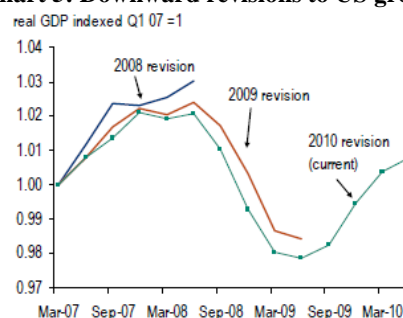
But please take note: Central Park is not approved by the Financial Services Board (FSB) for sale to the retail public. For reasons best known to the SA regulators, the FSB doesn’t approve of hedge funds within a fund such as Central Park (although there are plenty of such situations in comparable funds run by life companies). Neither does it hold the British Virgin Islands (BVI), where the Fund is domiciled, in high regard, despite the best efforts of an effective regulator there in the form of the [BVI Financial Services Commission](#). As a result we cannot market this fund as widely as we would like, but that takes nothing away from the integrity of its structure or its ability to deliver above-average returns for investors in a very cost-effective manner.

You can read more about [Central Park on our website](#), where you will find the latest [Fund Summary](#) and [Quarterly Report](#). Incidentally all the pictures in this edition of *Intermezzo* depict “The Gates” project of renowned artists Christo and Jeanne-Claude who, in February 2005, erected 7503 gates throughout Central Park. You can read about the project and view more pictures on their website [by clicking here](#).

Charts of the month – Part 2

As you are aware we are fond of charts; after all, a picture paints a thousand words, doesn’t it? With so much focus on the US economy at present we thought it worthwhile shedding more light on, arguably, the US economy’s three largest problems at present, namely growth (or the lack of it), and the labour and housing markets. Firstly then, US growth: we alluded earlier to the downward revisions in US economic growth. They are too small to be ignored: growth in 2008, 2009 and 2010 was revised down by 0.3%, 0.5% and 0.4% respectively. Chart 5 depicts the revisions undertaken each year – the disturbing thing is that the lines get lower and lower with each revision.

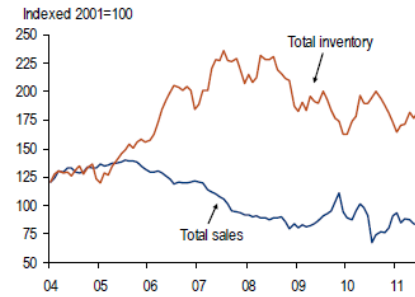
Chart 5: Downward revisions to US growth over past 3 yrs



Source: Merrill Lynch



Chart 7: The US housing market is deteriorating again



Source: Merrill Lynch

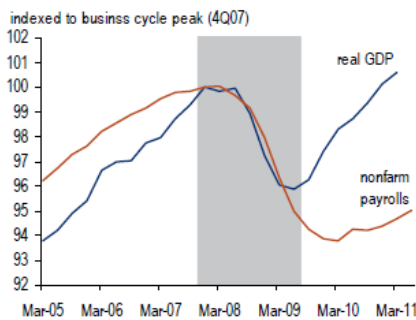
A few quotes to chew on

“Europe is slowly but surely falling into the same trap Latin American countries fell into, again and again, during the second half of the last century. The more the authorities try to avoid a currency crisis, banking failures and sovereign default, the more likely such doom becomes. One thing we have learnt from our region’s experience is that piecemeal, time-buying strategies always end up in a messier outcome – and almost always in the messiest possible one. Very much like past duets of emerging markets with international financial institutions, Greek and European authorities are stuck in an unsustainable strategy of buying time. This creates perpetual recession and increasing unrest in the heavily indebted nations, and a heavier fiscal burden and thus lesser popular support elsewhere in the European Union. It increases, not reduces, the chances of Greece ultimately both defaulting and leaving the currency union – and of further contagion throughout southern Europe. To paraphrase John Maynard Keynes, Greece’s insurmountable debt is no longer Greece’s problem. Nearly 60 per cent of its outstanding sovereign debt is owed to the European financial stability facility, the European Central Bank and non-Greek European banks – that is roughly €200bn. The guardians of European monetary union are now held hostage to Greek taxpayers... If done properly and quickly, this restructuring would save Eurozone taxpayers a lot of money; prevent banks and the ECB losing their diminishing capital; have private bondholders pay at least a share of the losses but without triggering default clauses and credit default swap claims; and give Greece a long enough grace period to have a decent shot at getting its act together... Time and a cheap currency were the pillars of Argentina’s recovery in the last decade. While the latter may not be readily available to Eurozone countries, the former can still be put to work to Europe’s benefit.” *Alfonso Prat-Guy, Argentinean central bank governor in 2002 - 2004.*

This is an excerpt from a refreshing article by the author in the Financial Times. In it he offered great wisdom, learnt through the Argentinean crisis, and offered a plan for the EU and Greece to begin solving the current crisis. If you would like to read the whole article, [please contact me.](#)

Secondly, with respect to the labour market, Chart 6 highlights the extent to which jobs seem to have disappeared permanently from the US economy. With real US economic growth (GDP) and nonfarm payrolls i.e. new jobs (outside of the agricultural sector) created, indexed to the business cycle peak in the fourth quarter of 2007, you can see from the chart that while US growth has recovered to a new peak, the absolute level of jobs created has hardly recovered and is still about 5% below its 2007 peak. And given the recent slowdown in growth and deteriorating prospects for the future, the labour market is looking more vulnerable now than ever before.

Chart 6: Downward revisions to US growth over past 3 yrs



Source: Merrill Lynch

Finally, the US housing market remains extremely weak and nowhere near the bottom. A weaker economy and labour market simply means weaker demand for housing. Yet despite this, the inventory of houses, although heading lower, still far exceeds the number of houses being sold – refer to chart 7. To make matters worse home sales are declining faster than the housing inventory, which means that house prices are likely to fall even further than initially expected and at a faster rate. No wonder we now only expect the first interest rate increase by the US Federal Reserve to be sometime in 2013.



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One of Maestro's Big Picture themes is "*The future value of the dollar*" by which we suggest that the prevailing value of the dollar must be treated with caution, firstly because the fundamentals of the economy which it represents i.e. the US are deteriorating daily and secondly, the value would be substantially less were it not for the fact that the dollar also acts as the world's currency. We therefore found the following comments, taken from an article by *Financial Times* commentator *Henny Sender*, very interesting. "For most of the rest of the world, the unseemly squabbling over the debt ceiling merely confirmed what many have long believed: the dollar is no longer worthy of its status as the world's reserve currency. It doesn't matter whether the rating agencies ultimately downgrade the US, although some of the world's sovereign wealth funds – among others – believe they must. In the minds of many, the downgrade has already happened. The world needs another reserve currency. The problem is there is no credible alternative yet. The euro, which once could have been a contender, is also badly tarnished at the moment ... With every day it seems clearer that when China removes the restrictions on its capital account, the renminbi will be the most credible contender for reserve currency status... The disenchantment with the dollar is likely to come as a surprise only to officials in parochial America. So far, the cost of capital in the US remains low, which is perhaps more an indication of deflationary expectations and growth concerns than anything else. There is no sign of the relief rally that many anticipated. Still, the US should take advantage of this moment to allocate its capital wisely. Because the time will come when the rest of the world will have more compelling investment choices elsewhere than it does today".

"There is growing scepticism among investors about the systemic capacity of the euro area to respond to the evolving crisis." *José Manuel Barroso, European Commission president.*

"The worry for investors is that government and politicians on both sides of the Atlantic have lost credibility thanks to the debt debate in the US and inaction in Europe." *Richard Milne, Financial Times journalist.*

"No major advanced economy is doing anything to promote growth and jobs. We're in a political as much as a debt crisis." *George Magnus, senior economic advisor to UBS.*

"This feels unnervingly like the 2008 crisis." *Gillian Tett, Financial Times commentator.*

Needless to say, given how chirpy and opinionated our community of investment professionals can be, there have been reams of comment and analysis of current market and political developments. Some have been of limited value, other comment has been outstanding. We read a lot of it, as we learn a lot from it and it stimulates ideas and generates plenty of informed debate within the Maestro office. Some of the analysis has been witty too, at the same time as being prescient. Consider the following comment by *Jerome Booth, head of research at London-based Ashmore.* He writes as follows: "Europe and the US are slowly coming to terms with their debt crises through the five stages of grief outlined by the psychiatrist Elisabeth Kübler-Ross: denial, anger, bargaining, depression and acceptance. The rich countries are faced with a corpse lying on their kitchen floor – the death of the highly leveraged economy – and yet are mainly in denial. The Eurozone, for one, is covering the body with a sheet and ignoring it. Denial is palpable, but the blood is unfortunately spilling out under the sheet and starting to damage Eurozone shoe leather ... Still, while the Eurozone authorities' response to their debt problem may have been dilatory and uncoordinated, America's effort is worse. If the Eurozone is ignoring its corpse, in the US the cadaver has been placed in a chair, given a cup of coffee and is being engaged in conversation".





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File 13: Information almost worth remembering

Crazy bank stress tests

We expressed extreme cynicism when the first round of “bank stress tests” was undertaken in Europe last year. The main reason for our scepticism was that the criteria used to test the banks were devoid of reality i.e. they were insufficiently stringent or stressful. We were not alone in feeling this way. Our scepticism was vindicated when, just a few weeks after the results were announced – a few small and largely immaterial banks failed the tests – the Irish banking system collapsed, causing the government to nationalise it and European governments to hastily cobble together yet another rescue package.

Surely after an experience like that, you would think these guys would learn from their mistakes? Apparently not. July saw another round of “bank stress tests” and blow me down if the set of criteria was again hopelessly inadequate. If you think I am exaggerating, consider this: at the time that Greece was on the verge of total collapse, for the umpteenth time, owing billions to European banks, and news of the Greek crisis was on virtually every newspaper and news bulletin, you would think that one of the criteria for the stress tests would at least include some form of Greek or sovereign default? Not so; the criteria used contained no hint of any Greek problem whatsoever i.e. the very concern weighing on everyone’s minds and weighing even more heavily on European banks’ balance sheets was not even addressed. Rather, a pathetic two-pronged set of criteria was used; firstly an economic slowdown in Europe of 0.5% in 2011 and 0.2% in 2012 was assumed – hardly “stressful” in our view – and secondly various declines in commercial real estate prices were assumed. Spanish banks for example, had to assume a 15% and 30% decline in residential and commercial property prices respectively over a two-year period – this, in a country in the grip of a full-blown property crisis and flirting with default disaster. You can hopefully see why we are so annoyed at technocrats and politicians’ inability to grasp the gravity of the current

macro-economic mess and why we are so scathing about the stress tests. When asked why they had not included the possibility of a sovereign default in the criteria the European Banking Authority, who conducted the tests, said they had been precluded from doing so by the European Commission. We rest our case.

The end of an era

We read with interest that the legendary investment manager George Soros has decided to close his Quantum fund to external investors. Although I have been unable to obtain the exact returns of the Quantum Fund, which Soros started in 1973, the consensus return seems to be about 20% per annum, which if correct, is an astonishing return, possible quite unparalleled. Soros, one of the largest and most vocal philanthropists in the world, is remembered for taking on the Bank of England in 1992, betting that the UK will be forced to leave the European exchange rate mechanism, the forerunner of the euro, and devalue sterling. Soros view proved correct (a lesson yet to be learnt by central bankers, who still believe they are “bigger than the market”, yet never win) and Soros made \$1.8bn on that trade alone. The most interesting aspect surrounding the closure of his fund was the reason given for the decision – regulation. Increasingly costly and onerous regulations were cited as the reason for closing the fund. It is worth recalling that the primary reason we closed the Maestro Long Short Equity Fund at the end of last year was exactly the same – costly regulation that bore no relation to the underlying nature and characteristics of the fund. “*Strangulation by regulation*” is one of Maestro’s Big Picture themes, and Soros’s decision is just one example – we suspect there will be many more – of the extent to which regulation is having the exact opposite effect than the one given for its existence. Rather than protecting investors it is forcing many managers to question their continued participation in the industry. Costs, ultimately borne by investors, are being driven higher, the number of alternatives available to investors is being reduced and the industry is becoming less productive and more onerous for both investors and investment managers; a situation that is hardly sustainable or in investors’ best interests.





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Table 2: MSCI returns to 31 July 2011 (%)

	July'11	YTD	Q2'11
Thailand	11.6	11.9	-3.1
Peru	8.4	-22.0	-16.4
Indonesia	6.8	19.0	6.5
Philippines	6.7	4.7	2.7
Singapore	4.6	4.4	0.5
Japan	3.5	-2.5	0.1
Russia	2.0	10.2	-7.1
Hong Kong	2.0	-0.8	-2.0
Korea	1.7	9.2	0.8
EM Asia	0.3	0.7	-0.9
AP ex Japan	0.0	0.5	-1.0
Malaysia	-0.4	6.2	2.8
EMEA	-0.6	-0.1	-4.0
MSCI EM	-0.7	-1.2	-2.1
South Africa	-0.8	-6.0	-2.5
China	-0.8	-1.6	-3.6
Mexico	-1.0	-1.8	-1.3
Taiwan	-1.3	-4.5	1.0
Pakistan	-1.3	-1.5	0.4
MSCI DM	-1.9	2.0	-0.3
Israel	-2.2	-10.8	-6.1
Australia	-2.2	-0.5	-1.4
Czech	-2.3	15.3	1.4
India	-2.5	-11.4	-4.2
Colombia	-3.2	1.8	5.2
LatAm	-3.5	-6.6	-3.6
Argentina	-3.6	-15.1	0.1
Poland	-4.0	5.5	2.8
Turkey	-4.3	-15.0	-6.0
Brazil	-4.4	-7.7	-5.3
Morocco	-4.5	-4.6	-5.3
Chile	-5.4	-7.0	7.2
Egypt	-6.3	-30.8	-3.2
Hungary	-7.3	11.5	0.1

Source: Merrill Lynch



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