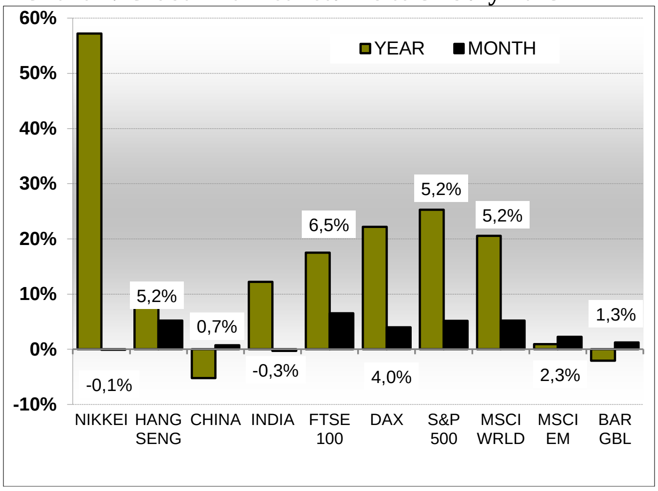
MAESTRO
INTERMEZZO
Investment Letter | 13th Edition | August 2013

July in perspective – global markets

Bearing in mind that equity markets experienced a sharp drop in mid-June following the US Federal Reserve (the Fed's) announcement about the possible tapering of quantitative easing (QE), developed equity markets had already built up a head of steam as they recovered into late-June. That momentum continued into July, resulting in meaningful gains in developed equity markets during the month despite the heady gains in the first six months of the year. The UK and US equity markets rose 6.5% and 5.2% respectively, while Hong Kong and Germany rose 5.2% and 4.0% respectively. Japanese, UK, US and German equity markets have risen 31.5%, 19.9% and 12.3% and 8.7% respectively so far this year and the MSCI World index 12.7%. The latter index rose 5.2% in July while the MSCI Emerging Market rose only 2.3%. The latter index has *declined* 8.9% so far this year – bringing to 21.6% the differential between developed and emerging equity market returns; a remarkable divergence, highlighting the dramatic reversal of fortune emerging markets have undergone over the period.

Chart 1: Global market returns to 31 July 2013



Global bond markets were less fortunate, as one would expect when the clear outcome of a decline in loose monetary policy on the part of the Fed implies higher interest rates. Remember that in the world of bonds, interest rates and prices are inversely related; thus when interest rates rise, as they have done for some time now, bond prices decline. The Barcap global aggregate bond index rose 1.3% in July, but that followed torrid returns in May and June; for the seven months of this year so far the index has declined 3.6%. The positive returns in July owed much to the fact that the economic news out of the US was disappointing, leading investors to believe that it will be some time yet before the Fed starts scaling back its extraordinary monetary support.

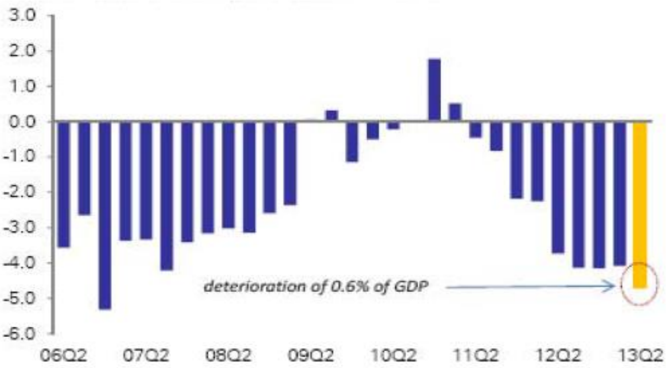
July also saw a partial recovery in commodity prices, which had experienced severe headwinds during the past two months. Why, even the gold price recovered somewhat! It rose 10.3% in July, although that was less than what it lost in June. Silver and platinum rose 5.7% and 8.8% respectively while small returns were registered by base metals like copper (0.5%), aluminium (0.1%) and iron ore (7.5%).

What's on our radar screen?

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

- *The SA economy:* SA's June trade deficit narrowed more than expected to R7.7bn from R11.5bn in May. The trade deficit and more importantly the current account deficit remains one of its Achilles' heels and needs to be monitored closely – refer to Chart 2.

Chart 2: SA's trade balance (seasonally adjusted)
% of GDP

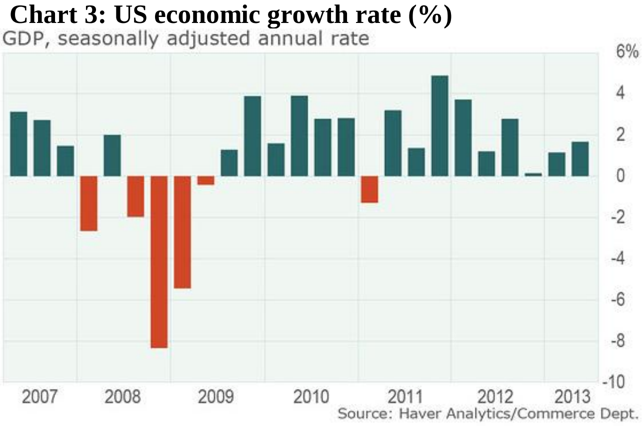


Source: Deutsche Bank

June production data in SA was, not surprisingly, rather weak: mining production is now 6.2% lower than a year ago, showing that the benefit of a weak rand has been completed missed by the mining sector. Manufacturing production is up 0.4% over the past year, which is also disappointing. However, when seasonally adjusted the numbers look a bit better and may well contribute to a relatively strong (perhaps around 3.0%) economic growth rate when the data is released later in August. Don't be fooled though; most of this is likely to be surrendered in Q3, when we are likely to see a sharp decline in the growth rate. SA will do well to grow at 2.0% in 2013 – the current threats are "to the downside" i.e. there is a greater chance of that growth rate being lower. Speaking of growth, at its recent meeting the SA Reserve Bank (SARB) revised its growth outlook for SA lower and the outlook for inflation higher. It now forecasts SA's 2013 growth rate at only 2.0%, 3.3% in 2014 and 3.6% in 2015. It sees SA's average 2013 inflation at 5.9%, 5.5% in 2014 and 5.2% in 2015.

- *The US economy:* The second estimate of US second quarter (Q2) GDP was released at the same time as the authorities released the results of a major review of the underlying methodology used to compile GDP data. The latter is not unusual and the results are normally quite interesting. The initial estimate of 0.8% for the US Q2 economic growth rate was revised up to 1.7% although the Q1 growth rate of 1.8% was revised down to 1.1%. The growth rate for 2012 as a whole was revised up from 2.2% to 2.8%. Q1 consumer spending was revised down from 2.6% to 2.3% while Q2 spending came in at 1.8%, marginally below the three-year average of 2.2%. Chart 3 depicts the US growth rate over the last few years.

Chart 3: US economic growth rate (%)



Source: www.MarketWatch.com

- *Developed economies:* Second quarter growth data was released for a number of countries, including the Eurozone region as a whole, which grew 0.3% (quarter-on-quarter, annualised) thereby breaking six consecutive quarters of negative growth. Italy "grew" at -0.2% and Spain at -0.1% respectively, while France and Germany grew faster than expected, at 0.5% and 0.7% respectively.
- *Emerging market economies:* **Chinese** June inflation rose to 2.7% from 2.1% in May, and remained unchanged in July. The June uptick was largely due to the base effect i.e. it was a function of the base off which it was measured. So, rather than provide relief for the corporate sector and investors, who are now actively looking for signs of corporates' ability to increase their purchasing power, the news was viewed as an indication of the ongoing slowdown in that economy. This was confirmed when Chinese exports declined in absolute terms; the annual change in Chinese exports to June was -3.1% from 1.0% in May. Exports to the US declined 5.4% in June, exports to the eurozone declined 8.3% and those to Japan 5.1%. Exports to most emerging markets rose though, especially those to Asia. By way of example, exports to the ASEAN region (the Association of South East Asian Nations) rose by10.2% in the year to June. Midway through July came the news that the Chinese economy grew 7.5% during the second quarter, down from 7.7% in Q1. This was better than the market had expected but the rate of growth is clearly slowing. The most noteworthy aspect of the growth rate slowdown was that the authorities seem quite happy to allow the growth rate to slow, saying that "the economy overall was stable in the first half and key indicators were within the reasonable range forecast for the year…" The authorities have been tightening up on the so-called "shadow-banking" sector, which has seen vast amounts of credit being extended outside of the formal sector. Government has tightened policy significantly to curb this activity and regain the policy initiative. While this is an admirable effort and differs notably from the "grow-at-all-costs" approach of the previous leadership it will nevertheless bring with it hardship and belt-tightening, the effects of which will be felt across the globe. Amid concern that the Australian economy was slowing, partly due to reduced demand from China for its commodities, the Reserve Bank of Australia (RBA) reduced the official interest rate by 0.25% to 2.5%.

A few quotes to chew on

How the mighty have fallen …

"Today (18 July) the combined market capitalization of Wells Fargo and JP Morgan ($440bn) exceeds that of every Energy and Materials company in Brazil, Russia, India and China ($420bn). Less than three years ago, those two banks were valued at less than half the market cap of the BRIC commodity sectors, indicating how quickly market leadership has rotated away from China to the US real estate story". *Michael Hartnett, Merrill Lynch Chief Investment Strategist.*

Keep a wary eye on US inflation (or the lack of it)

"The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance". *The US Federal Reserve*. This comment was included in the statement issued by the Federal Open Market Committee (FOMC) after their July meeting. Many market watchers, including ourselves, note how low US inflation is at present; it is at risk of turning into deflation i.e. where prices start declining. Such an event would cause and bring with it a lot of unwanted pressures within the US economy and, as noted by the Fed, could derail the timid recovery currently underway. Watch US inflation closely in the coming months.

MAESTRO INTERMEZZO
Investment Letter | 13th Edition | August 2013

For the record
Table 1 below lists the latest returns of the mutual and retirement funds under Maestro's care. You can find more detail on 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 Prescient Fund	**Jul**	**2.7%**	**6.4%**	**19.9%**
JSE All Share Index	*Jul*	*4.4%*	*6.8%*	*23.0%*
Retirement Funds				
Maestro Growth Fund	**Jul**	**2.1%**	**5.1%**	**15.6%**
Fund Benchmark	*Jul*	*2.9%*	*6.4%*	*17.9%*
Maestro Balanced Fund	**Jul**	**1.8%**	**4.9%**	**14.3%**
Fund Benchmark	*Jul*	*2.5%*	*6.1%*	*16.1%*
Maestro Cautious Fund	**Jul**	**1.1%**	**4.2%**	**11.1%**
Fund Benchmark	*Jul*	*1.5%*	*3.0%*	*9.6%*
Central Park Global Balanced Fund ($)	**Jun**	**-3.1%**	**-11.6%**	**-5.8%**
*Benchmark**	*Jun*	*-1.6%*	*2.6%*	*7.6%*
*Sector average ***	*Jun*	*-3.0%*	*1.3%*	*6.0%*

* 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 ($)

As regular readers will know, on a quarterly basis we publish the returns Maestro achieved on the equity portfolios in its care, which consist predominantly of tax-constrained private client portfolios. The returns, for the periods to 30 June 2013, are listed in Table 2; as is customary, the returns are listed net of fees i.e. after fees have been deducted. Chart 4 depicts the same returns but in graphic form.

Table 2: Maestro annual returns to 30 Jun 2013 (%)

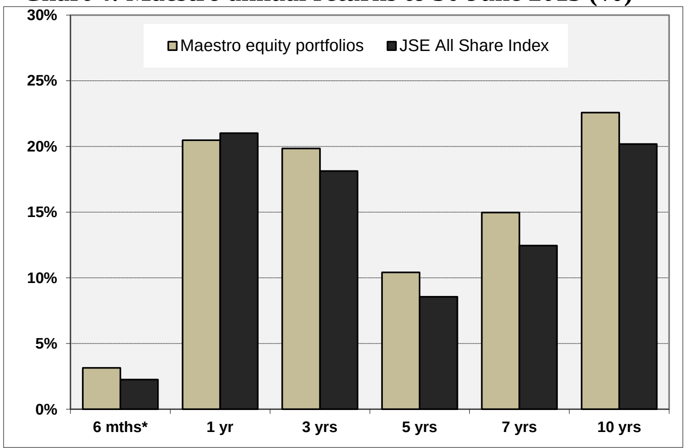
SA equity returns	6 mths*	1 yr	3 yrs	5 yrs	7 yrs	10 yrs
Maestro equity portfolios	***3.1%***	***20.5%***	***19.8%***	***10.4%***	***15.0%***	***22.6%***
JSE All Share Index	2.3%	21.0%	18.1%	8.6%	12.4%	20.2%

* 6-month returns are un-annualized

By way of reminder, Maestro's March quarter returns were slightly below market. Having achieved excellent returns in the December quarter, which were to some extent supported by the huge increases in the prices of retailers like Mr Price and Cashbuild, we underperformed in the March quarter as these shares were mercilessly sold down (although they have subsequently recovered). As is so often the case when one performs well above-average in one quarter, the subsequent quarter delivers muted returns. So, following the excellent December quarter returns, the March quarters were marginally behind the market but have been followed by another excellent quarter.

This is not the place for a detailed explanation of the factors that led to our returns – these are adequately covered in the detailed letters sent to clients every month. Let me rather comment on two relevant aspects of our returns. *Firstly*, the primary reason for our June quarter equity returns being significantly above market (the average return on a Maestro equity portfolio was 5.0% versus the All share index return of -0.2%) was the fact that we had much lower resource exposure than that of the All share index (and probably our competitors, too). We have an inherent bias in favour of industrial shares and away from resource shares, which has stood our clients in very good stead over the years and no more so than in the June quarter.

Chart 4: Maestro annual returns to 30 June 2013 (%)

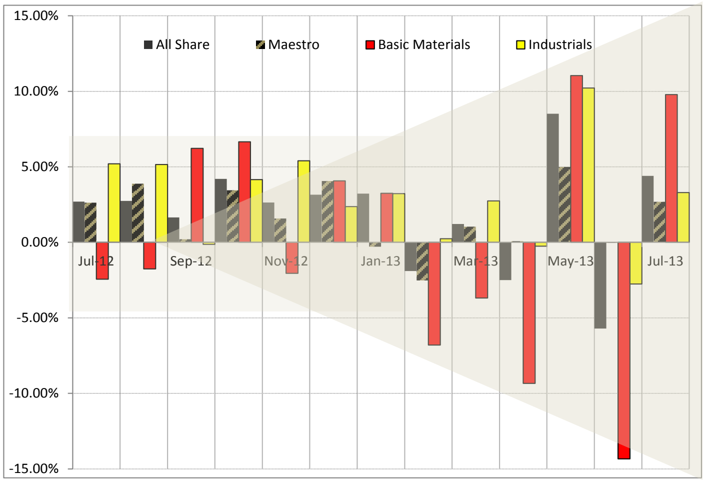


* 6-month returns are un-annualized

Secondly and very importantly, you should know by now that investment comprises two very important aspects, namely risk and return. We are all given to analysing returns but often neglect the risk component of the equation because it is more complicated and less easy to compare and understand. That said, *Maestro is on record for saying that its returns have been achieved with significantly less risk than that which is to be found in the market*. I sense though that many don't really understand what we mean by this and so it undermines one of our key abilities, namely to achieve **low risk** returns in excess of the markets. The local equity market's behaviour during the past few months provides an ideal opportunity to consider the important aspect of *risk*, as opposed to *return*.

Consider Chart 5, which depicts the monthly returns between June last year and July 2013 of the All share index in black, the basic material index in red, the industrial index in yellow and the average return of a Maestro equity portfolio next to the All share index returns in variegated green and black. Apologies that the chart is hard to read but I want to illustrate the following interesting aspects it contains.

Chart 5: Maestro returns are low risk returns



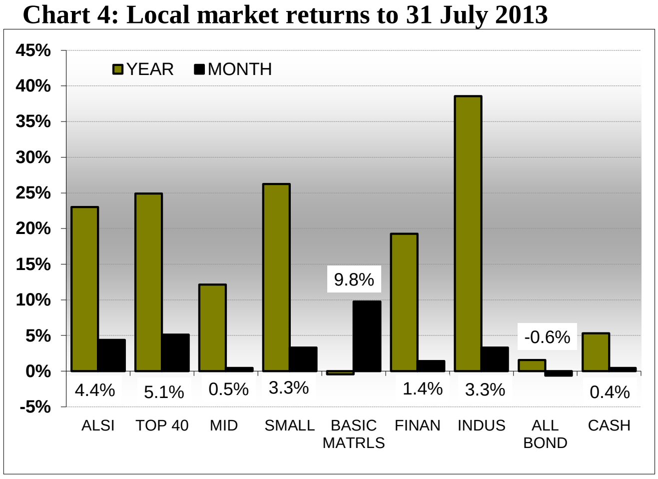
Firstly, note that between June 2012 and January this year the range of returns was relatively low; the range of the All share index returns was only 2.5% (they ranged between 1.7% and 4.2%) although the basic material index was the most volatile with a range of 9.1% (-2.4% and 6.7%). However the returns got significantly more volatile from February; in fact the volatility has increased as the year progressed. While the range of the *monthly* returns of the All share index has been 14.6% since February, which by any standard is very high, the range of the basic materials index has been an astonishing 25.4%. I don't think the average equity investor is aware just how volatile returns have been. For example, the four consecutive returns from the basic material index since April are -9.3%, 11.1%, -14.3% and 9.8%. How on earth is one to make sense of a market that moves in such extremes, remembering that this market is the one all South Africans are looking to in order to secure their retirement? Even the industrial index has displayed unusual volatility, its range since February is 13.0%. This is not a market for "sissies"!

Let us now consider Maestro's returns over this period. Between June last year and July this year the All share index posted three negative returns. The basic material index declined in seven of the thirteen months and Maestro's returns were negative in only three months, two of which were barely negative (-0.3% and -0.03%). Excluding these two marginal declines we only posted one month of declines. Throughout the period Maestro's returns were all within a tight range (refer again to the Chart) i.e. they were consistent notwithstanding the remarkable underlying volatility. June 2013 is a case in point: where the basic material and the All share indices *declined* 14.3% and 5.7% respectively Maestro's return was only -0.03%, indicative of what we mean when we talk of a low-risk return.

The accepted definition of risk is the variability (volatility) of returns. I hope by now you will agree with me that Maestro's returns have far less volatility associated with them than both the All share index and the basic material index. Note, too, the low risk nature of the returns is not achieved at the expense of performance. The cumulative Maestro returns between June last year and July this year were 23.7% versus the All share index return of 26.3% and the basic material index return of -2.9%. It was only due to July's resurgent basic material index that Maestro's returns were bettered by the All share index; Maestro's returns to June and those of the All share index were effectively the same – refer again to Table 2 and Chart 4.

In conclusion then, we remain of the humble view that the equity returns achieved on the portfolios under Maestro's management are achieved with significantly less risk than that which prevails in the market and are generally also above those of the overall market.

Chart 4: Local market returns to 31 July 2013

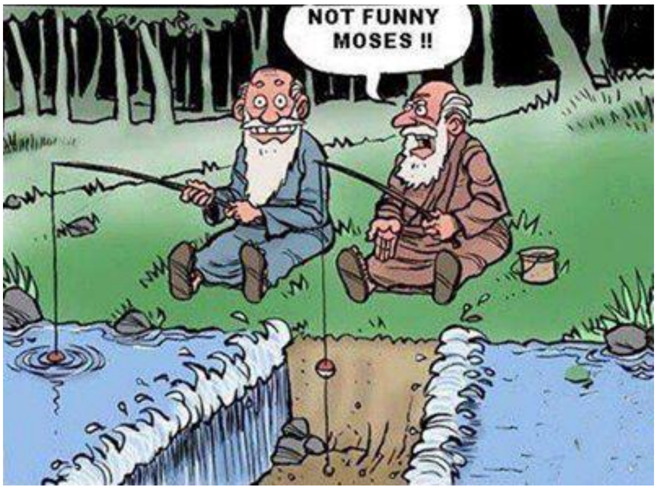


July in perspective – local investment markets

Local equity markets posted decent returns; not out of line with developed markets but they do follow the very weak month of June, particularly from the basic material sector. When all was said and done, the All share index rose 4.4%, following its 5.7% decline in June. Gains were led by the basic material sector, which rose 9.8% after a 14.3% decline in June. The industrial and financial indices rose 3.3% and 1.4% respectively. Given that the mining shares led the charge during July, it is not surprising to see the large cap index, which rose 5.1%, lead the mid (0.5%) and small (3.3%) cap index gains. The gold index could only muster a gain of 1.6% after its 19.7% collapse in June, leaving it down 44.5% on the year so far and down 47.2% during the past year. The best-performing sectors were fixed line telecom (Telkom), which rose 16.8%, forestry and paper 15.9% and media 13.0%. The worst were food and drug retailers, which declined 7.2%, real estate investment and services 3.4% and non-life insurance 3.2%.

The All bond index declined 0.6%, bringing the year-to-date return to -2.0%. The All bond index return in the year to July is now only 1.6%, a far cry from the annual return to April of 16.9%, showing you just how dramatically the fortunes of the local bond market have turned in recent months.

File 13: Information that is almost worth remembering
In the interests of getting this edition of *Intermezzo* to you I will dispense with the usual File 13 contents, but leave you with input of a lighter nature. I hope you enjoy them.



Source unknown

A teacher at an international school poses a question to the class; "In your own opinion, what is your view on food scarcity in other countries?" The African student responds "what's food?" while the European student replies "what's scarcity?" The American student asks "there are other countries?" while the Chinese student asks "what's my own opinion?"

Table of returns
As regular readers will be aware, we used to list the respective returns of MSCI indices in the final table of Intermezzo, particularly those of global emerging markets. Merrill Lynch has discontinued the report from which we obtained the table so we will in future include a table that depicts returns across a wider spectrum of markets. Sadly it excludes many of the returns of emerging markets but it includes more details of fixed income, foreign exchange, commodity and alternative markets. The table is detailed so we have listed in overleaf on a full page to facilitate its legibility.

MAESTRO
INTERMEZZO
Investment Letter | 13th Edition | August 2013

Table 3: Returns to 31 July 2013(%)

Asset class	2011	2012	1mo	3mo	12mo	YTD	3yr[2]	5yr[2]	10yr[2]
Equity Indices (%, US dollar terms)									
S&P 500	2.1	16.0	5.1	6.1	25.0	19.6	17.7	8.3	7.6
NASDAQ Comp	-0.8	17.5	6.6	9.3	25.2	20.9	18.5	10.5	-
FTSE 100	-2.7	15.2	6.5	1.4	18.1	7.2	10.7	2.5	8.0
TOPIX	-11.9	8.1	0.8	-3.5	24.9	16.5	7.8	1.2	5.7
Hang Seng	-17.3	27.7	5.2	-1.6	14.5	-1.0	4.9	2.8	-
DJ Euro Stoxx 50	-16.7	20.2	8.7	4.5	32.3	8.3	4.4	-3.6	5.8
MSCI EAFE	-11.7	17.9	5.3	-0.8	24.0	10.0	9.1	1.5	8.5
MSCI Emerging Markets	-18.2	18.6	1.1	-7.7	2.3	-8.4	1.3	0.9	13.5
Size & Style (%, US dollar terms)									
Russell 2000	-4.2	16.3	7.0	10.7	34.8	24.0	18.7	9.5	9.6
S&P 500 Citigroup Growth	4.7	14.6	5.1	5.5	20.5	17.7	18.2	9.2	7.6
S&P 500 Citigroup Value	-0.5	17.7	5.1	6.7	30.3	21.6	17.4	7.3	7.7
S&P 600 Citigroup Growth	3.6	14.6	7.3	11.6	32.3	24.2	21.3	11.2	11.3
S&P 600 Citigroup Value	-1.4	18.2	6.4	11.1	37.4	24.1	19.8	10.6	10.6
S&P 500 Sectors (%, US dollar terms)									
Consumer Discretionary	6.1	23.9	5.2	9.1	38.7	26.0	25.9	17.9	9.5
Consumer Staples	14.0	10.8	4.1	1.5	18.9	19.9	18.8	11.9	10.4
Energy	4.7	4.6	5.1	5.6	18.6	15.3	17.1	3.8	14.5
Financials	-17.1	28.8	5.4	10.0	42.4	25.9	13.7	1.0	0.1
Health Care	12.7	17.9	7.3	8.3	35.6	29.0	24.0	12.2	7.9
Industrials	-0.6	15.3	5.7	9.5	28.7	20.3	16.9	7.6	8.6
Information Technology	2.4	14.8	4.2	5.0	11.1	10.8	14.4	9.0	7.4
Materials	-9.8	15.0	5.6	3.0	18.7	8.7	12.1	2.8	8.8
Telecom Services	6.3	18.3	0.2	-5.4	5.6	10.8	18.2	10.0	9.0
Utilities	19.9	1.3	4.3	-4.3	8.0	14.6	13.7	5.0	10.9
BofA Merrill Lynch Global Research Bond Indices (%, US dollar terms)									
10-Year Treasury	17.2	4.2	-0.8	-7.0	-6.5	-5.6	4.1	5.7	5.3
2-Year Treasury	1.5	0.3	0.1	0.0	0.2	0.1	0.7	2.0	2.7
TIPS	14.1	7.3	0.6	-7.7	-6.4	-7.3	4.9	4.7	5.8
Municipals*	11.2	7.3	-1.1	-5.4	-2.5	-3.9	3.8	5.2	5.1
US Corporate Bonds	7.5	10.4	0.7	-4.3	-0.3	-2.6	5.3	7.5	5.7
US High Yield Bonds	4.4	15.6	1.9	-1.3	9.5	3.4	9.9	11.4	9.1
Emerging Market Corporate Bonds	3.8	15.8	1.1	-4.5	2.9	-3.0	6.4	7.8	7.4
Emerging Market Sovereign Bonds	5.8	17.5	1.2	-6.3	1.1	-5.4	6.6	7.4	9.1
Preferreds	4.1	13.6	-1.4	-4.9	1.2	-1.0	6.9	4.6	2.5
Foreign exchange (%, in local currencies)**									
US dollar	0.5	1.5	-1.7	1.1	5.7	5.5	1.0	0.9	-2.0
British pound	1.9	2.9	-1.2	-1.8	-5.6	-5.0	-1.2	-3.2	-1.9
Euro	-3.2	0.9	1.3	1.9	11.4	5.2	0.8	-1.9	0.7
Yen	5.9	-11.0	0.2	-0.6	-22.1	-11.8	-4.4	3.3	1.3
Commodities (%, US dollar terms)**									
CRB Index	-8.3	-3.4	3.0	-1.5	-5.2	-3.8	1.2	-7.4	3.0
Gold	10.1	7.1	7.3	-10.3	-17.9	-20.9	3.9	7.7	14.1
WTI Crude Oil	8.2	-7.1	8.8	12.4	19.3	14.4	10.0	-3.3	13.1
Brent Crude Oil	13.8	3.8	7.0	6.9	2.6	-3.1	11.2	-2.5	14.3
Alternative Investments† (%, US dollar terms)									
Hedge Fund - CS Tremont[1]	-2.5	7.7	-1.7	0.1	9.2	3.7	6.3	2.9	6.5
Hedge Fund - HFRI Fund of Funds[1]	-5.7	4.8	-1.3	0.1	7.4	3.5	3.0	-0.6	3.5

Source: Merrill Lynch