MAESTRO
INTERMEZZO
Investment Letter | 13th Edition | December 2013

Source: www.belgraviagallery.com

Nelson Rolihlahla Mandela

Father of the Nation

18 July 1918 - 5 December 2013

MAESTRO
INTERMEZZO
Investment Letter | 13th Edition | December 2013

Madiba – Father of the Nation

It falls on me as the scribe of *Intermezzo* to pay tribute to one of the greatest men that ever lived in our generation and surely for many generations to come. I have, for the past few years, dreaded this moment, knowing in recent months that it was moving closer and closer and aware of how utterly inadequate I am for the task. How does one pay tribute to Nelson Mandela and do him and the legacy he leaves behind justice? What can I say about him that hasn't been said and felt already? Probably nothing; he touched all of our lives in one way or another. I can scan the books on my shelf of him and of his sayings, or trawl through the thousands of online tributes that keep pouring in, but nothing will fill the void deep within us that we surely all feel; nothing will adequately match his global stature, as we slowly come to appreciate fully just how he influenced the world at large. From the thousands of English Premier League soccer fans who stood in silence and then applauded before each game this past weekend, to the cricketers and fans watching the Ashes in Australia, to the local fans and sportsmen and women at each and every sports activity, be it international cricket or rugby, or just simply a local match; from the tributes that have poured in from every global business and political leader, one is soon struck by the reality that the world has indeed just lost its greatest contemporary citizen. This giant of a man has left a legacy beyond all measure and yet did so with the humility, gentleness and lack of revenge and bitterness that simply defies understanding.

Within our daily investment activities – and you would have sensed it in all our writings and publications over the years – there was a sense that we as a country are indeed blessed by the miracle that occurred between 1990 when the ANC was unbanned (I can remember to this day exactly where I was at that moment) and the 1994 first democratic election, with its scenes of long queues that defied predictions of bloodshed and hatred. These remarkable times and indeed all the years since then, were underwritten by the tone of reconciliation and huge moral stature laid by Nelson Mandela. The SA economy, although it has stumbled in recent years, has thrived as a result of the groundwork laid in the early years of the 1990s; to this day investors are deeply indebted to the legacy of Nelson Mandela. While an economic perspective on Madiba's passing is hardly the best way to approach it, I have seen little acknowledgement of this component and benefit of Madiba's life and legacy. It is this humble thought that I would remind you of: thanks to the "miracle of SA" in the early nineties, SA investors have enjoyed unprecedented returns despite all the calamities the world has thrown in our direction. Just think where the rand would be today if it wasn't for Madiba in those early years? Just think of the disaster and bloodshed that would have ensued if it wasn't for the peace and reconciliation that Madiba preached – against all reason and odds. Investors have a great deal to thank Madiba for, apart from everything else about him!

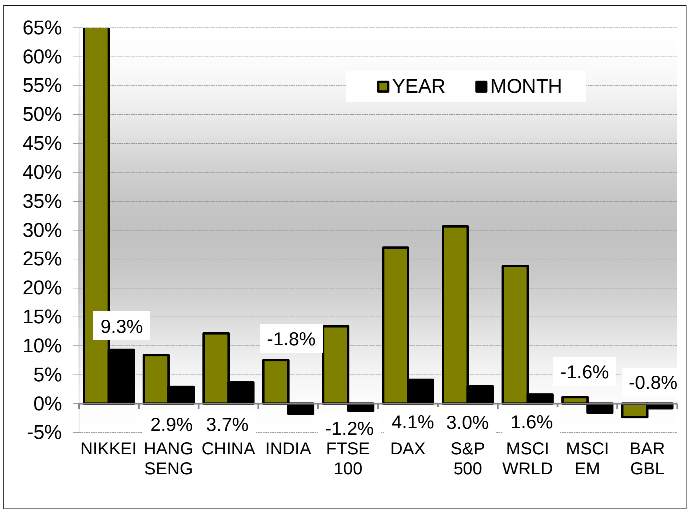
On behalf of the Maestro team, may I extend our condolences to his immediate and extended family, and to all South Africans, on the passing of its greatest leader, father and son? The world has lost one of its only true leaders of moral stature and basic humanity, and we are all the worse off for it. However, let us strive to honour his example and legacy, and use this time to commit ourselves once again, or perhaps for the first time, to our fellowman and woman, to give generously as he did so often, and to go out of our way to bless others as he did so regularly.

We will miss Madiba in our daily lives. We will miss his silent but huge influence and presence in the markets on a day to day basis. We honour and salute him for all that he endowed us with and the manner in which he did it. Hamba Kahle Tata Madiba, may you rest in eternal peace.

November in perspective – global markets

Developed equity markets continued to rise in November although more sedately than during the two previous months. Emerging markets endured another rough month as investors continued to seek out "safety" and avoid countries whose critical economic characteristics such as current account (deficits) and inflation were not what they should be. The MSCI World index rose 1.6%; it is worth highlighting that this index is not only up 21.7% so far this year but it has also only experienced four negative months so far this year. Compare that to the year-to-date *decline* of the MSCI Emerging market index of 3.5% - it declined 1.6% in November - and the six negative months so far this year. Within the developed market space, Japan and Germany led the list of gainers with increases of 9.3% and 4.1% respectively. Japan's gain, on the back of a weaker yen, brought its year-to-date return to 50.7%, making it the best performing developed market index. The US and Hong Kong enjoyed robust returns of 3.0% and 2.9% respectively. There were pockets of weakness among developed market equities; the UK and France fell 1.2% and 0.1% respectively. Emerging market weakness was led by Indonesia and Russia, which fell 5.6% and 5.2% respectively, the Russian decline coming despite a 1.9% increase in the oil price. With the exception of the Chinese market, which rose 3.7% on the reforms emanating from the country's Third Plenum, other emerging markets were weak. Brazil declined 3.3%, India 1.8% and South Africa 1.1%.

Chart 1: Global market returns to 30 November 2013



Global bonds were out of favour during the month. The Emerging Market All Bond Index fell 2.6%, faring worse than the Barcap Global Aggregate index's decline of 0.8% and the Barcap US Aggregate's decline of 0.4%. Apart from the iron ore price, which rose 3.4%, commodity prices underperformed once again. Precious metals were particularly weak, with silver, platinum and gold falling 11.0%, 6.4% and 5.9%, respectively. The CRB Commodity Index, a proxy for global commodities, fell 1.0% during the month and has declined 6.8% during the year.

What's on our radar screen?

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

- *The SA economy:* inflation in the year to October declined to 5.5% from 6.0% the month before. Core inflation i.e. excluding the cost of food and energy, remained flat at 5.3%. Third quarter (Q3) economic growth was only 0.7% from a revised second quarter (Q2) rate of 3.2%. The annual rate of growth to end-September was 1.8% from June's 2.3%. The manufacturing sector declined 6.6%, having been affected by the automotive strikes during the quarter. Mining rose 11.4% but this was off a strike-affected second quarter base. Table 1 provides a useful analysis of the Q3 activity.
- *The US economy*: most of the data emanating from the US economy was better than expected. The second reading on Q3 economic growth was 3.6%, up from an initial reading of 2.8% while the unemployment rate declined from 7.3% to 7.0% amidst an increase in the number of jobs created. Inflation continues to be conspicuous by its absence.

Table 1: SA GDP growth by industry in 2013

Quarter-on-quarter (q-o-q), seasonally adjusted annual rate (saar)

	Weight	Q1(previous)	Q1 (revised)	Q2 (previous)	Q2 (revised)	Q3
Agriculture	2.2	-4.9	-4.4	-3.7	-3.0	3.6
Mining	4.8	14.6	13.4	-5.6	-5.4	11.4
Manufacturing	15.2	-7.9	-7.9	11.5	11.7	-6.6
Electricity	1.7	-3.0	-2.8	5.3	5.1	3.8
Construction	3.0	0.9	2.5	1.2	2.3	2.1
Trade	12.5	1.9	2.1	3.2	3.1	1.3
Transport & comms	9.0	2.2	2.1	1.6	1.5	2.6
Finance & business	21.7	3.3	3.3	3.5	3.5	1.3
Government	13.7	1.9	0.1	0.3	0.2	0.4
Personal services	5.4	1.4	1.2	1.9	1.6	1.6
GDP at basic prices	**89.2**	**0.8**	**0.6**	**3.2**	**3.3**	**0.6**
Taxes less subsidies	10.8	1.5	2.3	1.3	3.1	2.1
Total GDP	100.0	0.9	0.8	3.0	3.2	0.7

*Upward revisions *Downward revisions

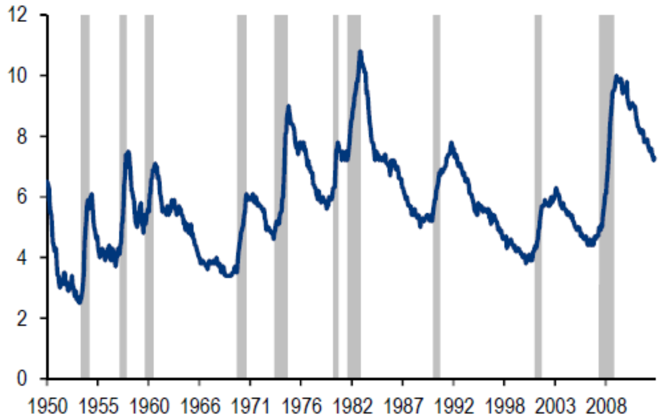
Source: Deutsche Bank

- *Developed economies:* there was more disappointment on the economics front for the European region. Economic growth in the **eurozone** during Q3 was only 0.1%, down from Q2's 0.3%. Although **the UK** economy grew 0.8%, **Germany** slipped from growth of 0.7% in Q2 to only 0.3% in Q3 while **France** slipped from growth of 0.5% in Q2 into negative growth i.e. the **French** economy shrank in Q3, by 0.1%. The European Central Bank (ECB's) latest projections for eurozone growth are for 1.1% in 2014 and 1.5% in 2015 – hardly exciting stuff! **Japan's** economic growth slowed to 1.9% in Q3 from Q2's 3.8% while the annual rate of inflation rose from 0.7% to 0.9% in October.
- *Emerging market economies:* The **Chinese** economy grew 7.8% in Q3, higher than Q2's 7.5%. Retail sales rose at an annual rate of 13.3% in October and industrial production rose at an annual rate of 10.3%. The **Hong Kong** economy grew at a rate of 2.9% in Q3, down from 3.3% in Q2. The October annual inflation rate declined to 4.3% from 4.6% in September while retail sales rose 5.1% in the year to September. **Indian** Q3 economic (GDP) growth rose to 4.8% from 4.4% in Q2. But inflation rose from 9.8% in September to 10.1% in October. **Indonesia** grew at 5.6% in Q3, down from Q2's 5.8%. **Malaysia** grew at 5.0% in Q3, **Singapore** at 5.8% and the **Philippines** at 7.0%. The **Russian** economy grew at only 1.2% in Q3, the same rate as during Q2.

Global charts of the month

With the Fed having singled out the US unemployment rate as one of the key considerations in its decision when to taper or reduce its current loose monetary policy (the so-called Quantitative Easing or QE) there is understandable focus on the unemployment rate. We have spent a lot of time on in it past editions of *Intermezzo*, highlighting how misleading it is, in that it does not capture the real picture. It does not take account of people falling out of the labour pool i.e. those who actually give up looking for a job. We have highlighted the low and declining labour force participation rate (LFPR) which shows the declining proportion of those capable of working but who are no longer actually looking for jobs. Whatever one's view of this economic indicator, the official rate is now only 7%; the manner in which the official rate has declined is shown in Chart 2.

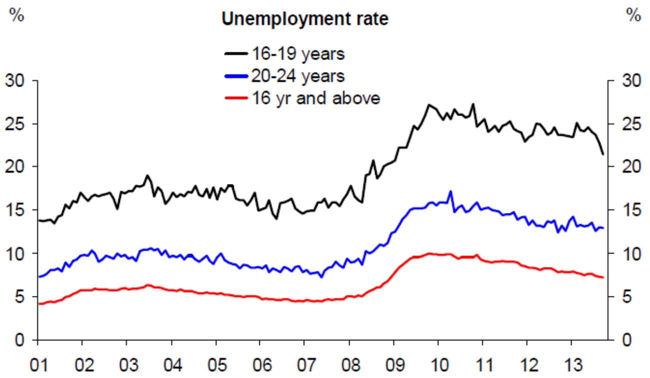
Chart 2: US headline unemployment rate (%)



Source: Deutsche Bank Research

Chart 3 tells another story though, showing the US unemployment rate across different age groups. Note just what a problem youth unemployment is i.e. younger people are simply no longer able to find employment easily, which poses a huge problem for most developed countries, given that most of their social security programs are predicated on the younger portion of the working population funding the older portion of the population. Note too from the chart that unemployment amongst the older population is by definition a lot lower i.e. firms are retaining their older, more experienced staff in preference to employing new and younger people.

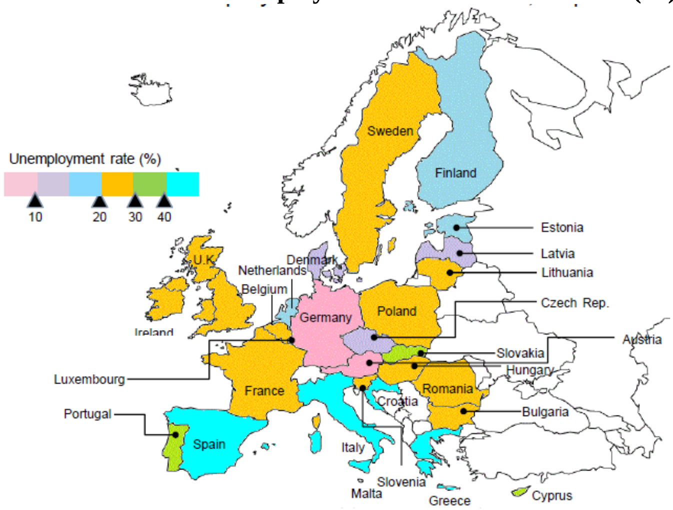
Chart 3: US Unemployment rate across certain ages (%)



Source: Deutsche Bank Research

If you think the US has a problem in this regard, the Eurozone has an even greater problem, as shown in Chart 4. Japan has a similar demographic problem in terms of aging population although its unemployment rate is not that bad. Consideration of these kinds of issues provides a glimpse into the problems that governments, societies and of course investment markets will have to deal with and come to terms with in one way or another in the coming years and decades.

Chart 4: Youth unemployment across the Euro area (%)



Source: Deutsche Bank Research

A quick review of the SARB's Quarterly Bulletin

The SA Reserve Bank (SARB) released its latest Quarterly Bulletin recently and the following represent a summary of some of the highlights.

- The third quarter (Q3) current account deficit, one of our Achilles Heels, was 6.8%, larger than the 6.0% expected.
- The trade balance i.e. the difference between imports and exports, only accounts for 46% of the current account deficit
- Net foreign portfolio investment flows for both bonds and equities was R48.8bn in Q3 - the highest inflows since Q1 2006. The relevance of these flows of "hot money" so-called because of the speed at which they can change from inflows to outflows, highlights the extent to which South Africa relies on a poor quality of capital to fund its current account deficit. It would, for example, be much better were the country to received real investment (in economics-speak "fixed direct investment" or FDI) such as investment into factories or infrastructure. So the fact that SA relies so heavily on foreign portfolio flows and not FDI should be seen as a negative and a risk to further

rand weakness, where such risk would specifically be manifest in sharp and unexpected declines in the rand versus other major global currencies.

- The annualized growth in real household disposable income slowed to 2.1% in Q3 from 2.8% in Q2
- The annualized growth in real household consumption expenditure in Q3 slowed to 2.3% from 2.8% in Q2. It is now at its lowest level since 2009

A final comment in light of the above is that under these kinds of conditions, it is hard to believe there is any upward pressure on interest rates i.e. we don't think SA interest rates are likely to rise soon.

A few quotes to chew on

How low can you go? US inflation

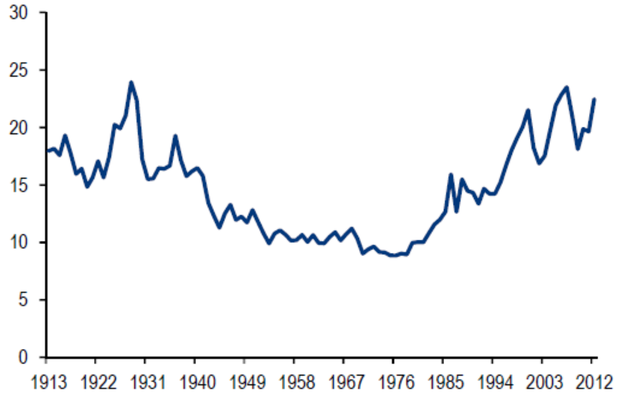
Commenting on recent US economic data in general and inflation in particular, *Merrill Lynch North American economist Ethan Harris* said the following: "Economists keep searching for special factors to explain low inflation, but there is nothing fluky here: soft commodity process and abundant spare capacity both domestically and globally are putting persistent downward pressure on inflation."

The rich get richer and the poor get poorer

There has been increasing focus lately, around the world, on the widening income gap i.e. how the rich seem to be claiming an increasing proportion of available income (in a nutshell, getting richer) at the expense of those who receive little income. We understand why this is becoming an increasing area of focus, particularly on the part of governments. We think the subject will receive increasing attention in the future and eventually come to dominate many debates on economics and indeed the whole capitalist system. Not surprisingly, given that it is a very sensitive political issue in the US at present, where "Wall Street" has benefitted enormously at the expense of "Main Street", a lot of debate is taking place around the causes of the widening income gap. Equally unsurprising is that many fingers are being pointed at the Fed and their unprecedented loose monetary policy or Quantitative Easing (QE). We are sympathetic to this view and suspect there is at least a small element of truth in the argument, although it needs more and proper academic research before concrete conclusions can be made.

Be that as it may, we thought the following comment, again by Merrill Lynch's *Ethan Harris*, placed the debate into some context. He writes as follows: "it is important to recognize that the widening income gap is a multi-decade, global phenomenon. A recent OECD study found that from the mid-1980s to late-2000s, income inequality increased in 17 out of 22 countries and it narrowed in only two countries. The widening has been particularly big in the US: the share of income accruing to the top 1% of households has been rising since the 1970s and now is the highest since the 1920s – refer to Chart 5, below. Digging deeper, much of the widening occurred due to a surge in the share of capital gains and business income and a shift in the composition of government transfers in favour of middle-income benefits like Social Security and Medicare. The academic literature also points to automation and globalization as causal factors."

Chart 5: The top 1% share of total pre-tax income (%)



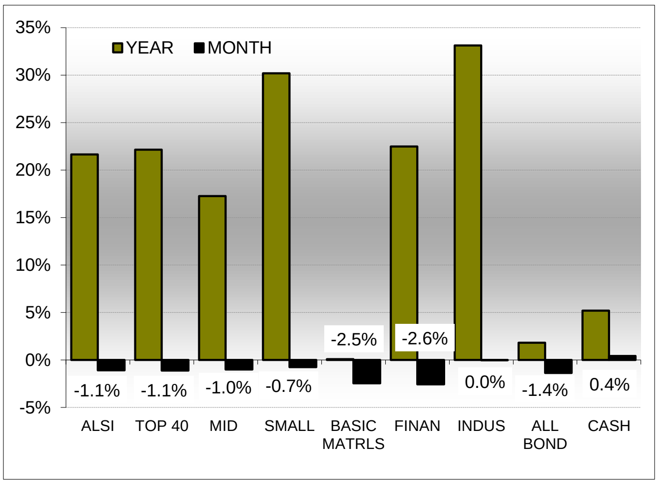
Source: Merrill Lynch

November in perspective – local investment markets

Turning to the local investment markets, the All Bond Index tracked other emerging market bonds and fell 1.4%, bringing its year-to-date return to -0.5%. The SA bond market looks set for only its second negative calendar year return in over 13 years. On the equity front the All Share Index fell 1.1%, with the "usual culprit" (i.e. the all gold index) declining a further 12.3% during the month – it has fallen 48.8% during the course of this year. Financials and basic materials also weighed heavily on the index, declining 2.6% and 2.5% respectively. Industrials fared better and returned a flat return for the month. Across the size spectrum, the large caps were the worst performers, falling 1.1%. The mid and small cap fell 1.0% and 0.8% respectively. The top performing sector during November was the household goods sector, which rose 6.2% (Steinhoff rose 4.1%), followed by industrial engineering (4.1%) and media (3.5%). The lagging sectors were general retailers, which declined 7.1% on the month, coal mining down 8.8% and the hardy annual laggard, the gold index, which lost 12.3% in November, bringing its annual decline to 51.0%.

MAESTRO INTERMEZZO
Investment Letter | 13th Edition | December 2013

Chart 6: Local market returns to 30 November 2013



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

	Period ended	Month	Year to date	Year
Maestro Equity Prescient Fund	**Nov**	**-1.4%**	**19.6%**	**24.2%**
JSE All Share Index	*Nov*	*-1.1%*	*17.9%*	*21.6%*
Retirement Funds				
Maestro Growth Fund	**Nov**	**-0.7%**	**15.0%**	**17.4%**
Fund Benchmark	*Nov*	*-2.7%*	*11.9%*	*14.1%*
Maestro Balanced Fund	**Nov**	**-0.6%**	**13.5%**	**15.6%**
Fund Benchmark	*Nov*	*-2.6%*	*10.6%*	*12.5%*
Maestro Cautious Fund	**Nov**	**-0.7%**	**10.6%**	**13.0%**
Fund Benchmark	*Nov*	*-0.6%*	*7.2%*	*9.2%*
Central Park Global Balanced Fund ($)	**Oct**	**2.5%**	**-4.1%**	**-2.4%**
*Benchmark**	*Oct*	*2.1%*	*8.8%*	*10.4%*
*Sector average ***	*Oct*	*2.1%*	*7.6%*	*9.4%*

* 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 ($)

File 13. – Things almost worth remembering
The increasing influence of Chinese investment managers
Some interesting information came out of a survey released by consultant firm Towers Watson last month. We are all familiar with the world's largest investment management firms, measured by their assets under management – these include Blackrock, Pimco and Vanguard. But an interesting feature of the survey is the fact that while only nine Chinese investment managers made it into the top 500 managers in 2011, that number more than doubled in 2012, to 24. Two companies made it into the top 200: China Asset Management and Harvest Fund Management, with $50.5bn and $48.8bn assets under management respectively. China has approximately 80 different domestic fund managers, none of whom represent more than 7% market share.

Consider the following: there are approximately 45m upper middle class Chinese in the country's biggest cities. That number is forecast to grow to 225m in the next ten year. Chinese household savings are approaching $7tn (trillion) although the unit trust (mutual fund) penetration rate is just 6% - far behind the 38% penetration rate in the US and 14 in the UK.

And so the year comes to an end…
It is hard to believe that we are on the cusp of another year and one is slipping into history. The records will show 2013 as a profitable one for investors despite the numerous risks that they had to navigate. Equity investors would have enjoyed it, bond investors not; neither would gold investors or those who invested in mining shares and commodities. We will present more data and reflect in more detail on what an extraordinary year 2013 has been for investors in next month's publications.

All that remains is for me to wish all our clients and readers a very blessed Festive Season and a safe passage through into 2014. If you are travelling, please do so carefully and safely. The Maestro team is very grateful for your loyal support and the friendship, kindness and hospitality that so many of you have shown us throughout the year. Thank you very much.

We look forward to being of service to you in the coming year and hope you have a wonderful rest and holiday, if you have that opportunity. May you will find sufficient time to spend with your friends and loved ones, wherever you and they may be in the world.

Table 3: MSCI returns to 30 November 2013(%)

Region/Country	Market cap (U$m)	YTD	MTD
ACWI	**35,174,109**	**18.3**	**1.2**
DM	**31,318,029**	**21.7**	**1.6**
Asia Pacific	**4,351,758**	**15.3**	**-0.4**
Australia	1,008,594	1.6	-5.1
Hong Kong	376,789	8.0	0.9
Japan	2,753,079	24.0	1.4
New Zealand	15,365	6.7	-5.4
Singapore	197,930	-0.2	-1.6
GEM	**3,856,081**	**-3.5**	**-1.6**
EM Asia	**2,423,607**	**1.1**	**0.1**
China	777,955	4.0	4.9
India	232,562	-8.3	-3.4
Indonesia	83,927	-24.3	-12.2
Korea	622,376	4.8	1.2
Malaysia	144,742	3.0	-2.1
Philippines	35,151	2.5	-5.9
Taiwan	436,225	5.1	-1.5
Thailand	90,669	-9.9	-8.8
EMEA	**686,591**	**-7.1**	**-3.9**
Czech	9,649	-11.4	-6.2
Egypt	6,816	-2.6	-0.2
Hungary	9,744	-8.2	-6.1
Morocco	6,494	-6.4	-7.0
Poland	67,429	3.0	1.0
Russia	228,387	-4.1	-5.3
South Africa	278,757	-9.8	-4.0
Turkey	67,478	-15.3	-4.0
LatAm	**745,882**	**-13.3**	**-4.7**
Brazil	426,603	-14.5	-6.8
Chile	60,394	-21.6	-6.4
Colombia	40,390	-21.8	-9.3
Mexico	203,310	-2.6	2.2
Peru	15,185	-34.4	-9.2

Source: Merrill Lynch