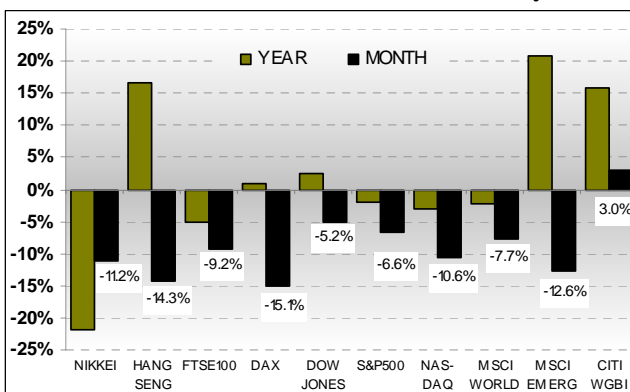




## January in perspective – global markets

If we thought November and December were volatile and unprofitable months on global equity markets, they were nothing compared to the drama of January. Markets across the world were on the back foot from day one, buffeted by concern about a slowing economy and the possible collapse of the so-called “monoliners”, the companies that guarantee the bonds of sub-par borrowers of the basis of their own investment-grade ratings. As if that wasn’t enough, there was the scandal of the Societe Generale (a large French bank) trader who lost a staggering \$7.2bn; the market mayhem on Monday 21 January as his trades were unwound (all \$70bn dollars of them!), which was compounded by the fact that US markets were closed; the emergency 0.75% cut in US rates by the Fed before trade resumed on Tuesday, only nine days prior to their usual meeting – there are few words to describe such market conditions. Mixed US economic data, the European Central Bank repeating its aversion to cut interest rates, another 0.5% cut in rates by the Fed – bringing the January rate of easing in US rates to the fastest in more than 27 years – and then a rumoured package by US banks to “save” the monoliners despite the banks themselves declaring further massive losses arising from the credit and sub-prime crunch; these are but some of the factors that led to January being the worst monthly start to the year in history, or at least for decades in some cases.

Chart 1: Global market returns to 31 January 2008



Although Chart 1 shows the resultant damage, it doesn’t tell the full story. Unprecedented volatility and massive swings characterized one of the most unsettled and remarkable months ever experienced in market history. If that sounds overly dramatic, consider that the S&P500, from peak (October 2007 for most markets) to trough (January 2008) is down 18.6%, the Russell 2000 (a US small cap index) has declined 24.1%, the German market 21.7% Hong Kong 32.1% Japan 31.3%. And talking of declines, the SA equity market is down 21.8%. In most investors’ understanding these declines constitute more than a “simple correction”.

Allow me to illustrate the daily volatility that characterised this month’s activity: on 23 January, the day after the Fed cut rates by 0.75% unexpectedly, the S&P500 declined 4.6% in the space of about two hours, then rose 3.8% and declined 3.4% again in the next two hours, only to surge 5.3% in the final hours to end the day in positive territory. To put that in perspective, Europe and Asian markets had declined in excess of 5% the previous day, and had started the day more than 2% lower – that’s what I call volatile!

During January the dollar dropped to a new low against the euro during the month, the gold price hit an all-time high (it rose 10.4% on the month), as did platinum (up 13.2%), but the oil price eased 2.4%. Other monthly returns that may interest you include the MSCI world index which *declined* 7.7%, the MSCI Emerging market index -12.6%, India -12.7%, Russia -16.7% and China also -16.7%. Table 3, at the end of the edition, lists the (dollar) returns of the respective MSCI emerging market indices.

## Economic updates – keeping track of world growth

During the month the following data was released:

- Fourth quarter **US economic growth** came in at 0.6% from 4.9% in the third quarter. Housing output dropped 23.9%. The US economy grew at 2.2% for all of 2007 compared to 2.9% in 2006.
- The **Indian economy** grew 9.6% during 2007, the highest rate in 18 years. The Finance Minister estimates 2008 economic growth at 9.0%
- The **Chinese economy** grew at 11.2% during the fourth quarter bringing growth for 2007 to 11.4%, the fastest rate in 14 years. Chinese analysts are forecasting 2008 growth at 9.5%. December’s inflation rate was 6.5%, down from 6.9% but still uncomfortably high.

## All that glitters is not gold

Those who know me well will be aware that I am not keen on investing in gold; neither in direct gold holdings nor in the mines themselves. This view has saved Maestro’s clients a lot of volatility, and probably a lot of money, too. Since Maestro’s inception in January 2000 the JSE All gold index has risen 18.3 % per annum while the Maestro equity benchmark has risen by 18.9%. The range of *annual* returns on the gold index was -37.5% to 210.8% (on the back of a collapsing rand) while the Maestro equity benchmark range was a more sobering -30.0% to 65.2%. Ironically, despite the gold price hitting an all-time high late in 2007 the gold index *declined* 20.6% last year; its annual return to end-January 2008 is -8.9%, despite the gold price hitting a new record. While on the topic of the record gold price, Chart 2 (top left) illustrates the 1980 inflation-adjusted equivalent gold price. For gold to hit an all-time peak today, after adjusting for US inflation since its previous peak the price would have to rise above \$2 200.



# INTERMEZZO

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Investment Letter | 8th Edition | February 2008

But the reason I raise the topic of gold is to highlight some data that is particularly interesting. There are two gold-related topics worthy of mention. *Firstly*, many of you are probably sick of me beating the China drum, but I draw to your attention the fact that, this month, *China surpassed South Africa as the world's largest gold producer*. SA has held this position for more than a century; how ironic that it lost it at the same time that the gold price hit an all-time record. SA's gold output has declined to levels last seen in 1931 – and that was before Eskom switched off the power!

## Chart 2: Gold revisited – not quite what it used to be



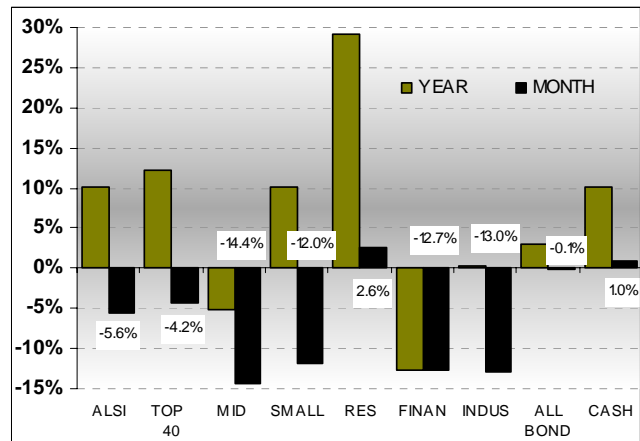
Source: FT.com

*Secondly*, did you know that the seventh largest holder of physical gold is exchange traded funds? In 2004 they collectively held 50 tonnes of gold, but this has risen sharply to an astonishing 865 tonnes – see Chart 2 (bottom right). Some people hold the view that this is a good thing, that these investors are “sticky investors” who will not easily liquidate their holdings. I beg to differ; if anything these holders are more fickle than central banks and may cause the most damage to the gold price in future if they decide to liquidate their holdings aggressively. This risk was highlighted when, in the penultimate week of January, 22.7 tonnes of gold – the equivalent of one month's gold production in China – were sold on the market by exchange traded funds.

## January in perspective – local markets

Given the traumatic conditions that prevailed on global markets one can understand why the SA equity market declined so sharply through the first two thirds of January. However, the 5.6% decline in the All Share index belies the depth of trauma experienced by the SA market in general. This mirage was caused by two factors; *firstly* the rand weakened sharply during the month, despite the weak dollar. It declined 8.9%, 8.7% and 10.0% against the dollar, euro and sterling respectively. That assisted the resource sector no end. The latter actually *rose* 2.6% on the month – refer to Chart 3. In contrast the financial and industrial indices *declined* 12.7% and 13.0% respectively. *Secondly*, to compound the effect of the weak rand, corporate action amongst the world's largest mining houses propelled their prices higher at the end of the month. Anglo and Billiton, the two largest index weightings in the All share index, rose 7.4% and 11.3% respectively on the first day of February, taking the all share index up another 5% - its second daily gain in excess of 5% in six trading days. The shares had been firm for a couple days leading up to month-end. Aside from the action in the mining sector, there was little to report other than the proverbial “blood on the streets”. The mid cap index declined 14.4% and the small cap index 12.0%.

## Chart 3: Local market returns to 31 January 2008



I have listed, in Chart 4, the *daily* returns of the All share index through the month. Note firstly just how volatile they were. Note, too, how large the daily fluctuations were – in a “normal” market daily returns of around 1% are regarded as large. Of the 23 trading days (including 1 February) 17 of them saw the market move (up or down) by more than 1%, 7 of them saw movements in excess of 2%, 4 days saw movements greater than 3% and we had 2 days when the market rose more than 5% in one day! And finally note the large positive movements towards the end of the month, which had the effect of boosting the All share index return, but did little for the financial and industrial shares; the large gains only occurred in the heavyweight resource sector.



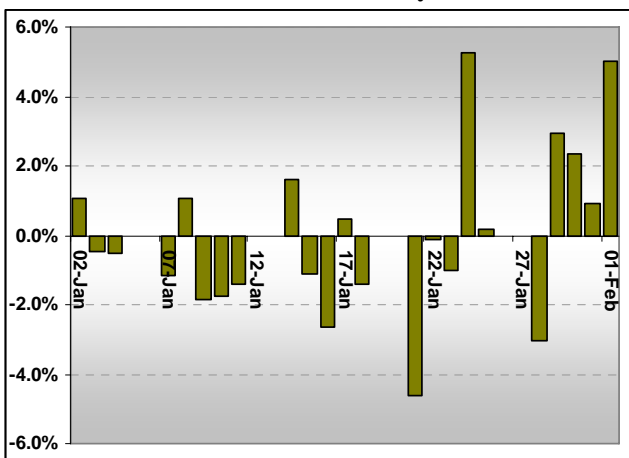
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Investment Letter | 8th Edition | February 2008

Exxaro, for example, rose 47% in the last 7 trading days of January. Consequently, it was a very difficult month in which to keep up with the All share index. Rather, most equity returns will be much worse than those of the All Share index. In this regard it is worth mentioning that the Maestro equity benchmark, which has a reduced resource weighting, declined 8.0% in January compared to the 5.6% of the All share index.

**Chart 4: The All share index – daily returns in January**



Earlier I described some of the volatility in the US equity market. Let me tell you about the SA equity market: on 22 January, the same day of the US volatility and the day the Fed cut rates for the first time, the Top40 index of the largest companies on the JSE traded in an astonishing range of 1 944 points or 8.2% from peak to trough. On one day!! And just to rub it in, the All share index declined “only” 0.1% on that particular day (the Top40 index declined 0.13%). The next day saw the Top 40 index trade in a 1 262 (4.8%) range. The All share index closed down 1.0% on the day. Is that not sufficient volatility for a month?! Apparently not – the following day (24 January) the All share index rose 5.3%! Ironically, in conditions such as these, execution risk i.e. the effect of taking *any* action on a portfolio, was one of the largest risks present. You could look like a hero one day, but look completely silly the next, but neither would be any indication of the correctness of one’s investment decision. In short, you needed to have been active in or close to the market during the past few weeks to really appreciate the effects of such volatility; you may now understand why market participants the around the world are feeling rather bewildered and bruised.

**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](http://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
<b>Maestro Equity Fund</b>				
Maestro equity benchmark **	Jan	-7.7%	-7.7%	8.0%
JSE All Share Index		-8.0%	-8.0%	3.7%
		-5.6%	-5.6%	10.1%
<b>Maestro Long Short Equity Fund</b>				
JSE All Share Index	Dec	-0.6%	2.7%*	N/A
		-4.4%	3.5%*	N/A
<b>Central Park Global Balanced Fund (\$)</b>				
Benchmark***	Dec	-1.4%	9.6%	9.6%
		-0.7%	8.6%	8.6%

\* Since 1 July 2007  
 \*\* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index  
 \*\*\* 40% MSCI World Index, 20% each in Citi World Government Bond Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills

Table 2 lists the compound annual returns for the periods to 31 December 2007 on the equity portfolios in our care. Notwithstanding the volatile and weak markets in the final quarter of last year, we continued to build Maestro’s record of outperforming the All Share index over time.

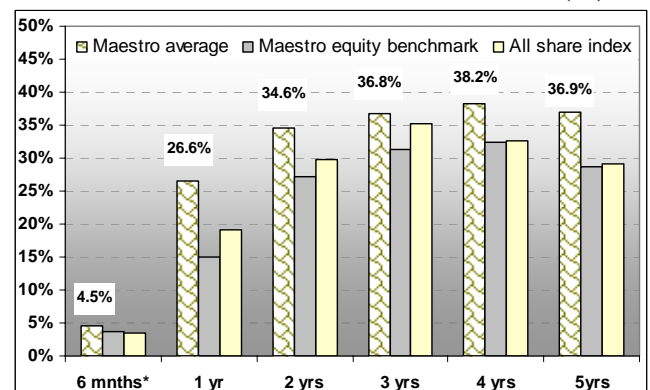
**Table 2: Maestro annual returns to 31 Dec 2007 (%)**

SA equity returns	6 mths*	1 yr	2 yrs	3 yrs	4 yrs	5 yrs
<b>Maestro long-term equity portfolios</b>						
Maestro equity benchmark **	4.5	26.6	34.6	36.8	38.2	36.9
JSE All Share Index	3.6	15.1	27.1	31.3	32.4	28.8
	3.5	19.2	29.8	35.2	32.7	29.2

\* 6-month returns are un-annualised  
 \*\* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index

The results in Table 2 are depicted graphically in Chart 5, making it a bit easier to see the consistent outperformance of the market by Maestro’s equity portfolios. The returns were also achieved with less risk than that inherent in the market itself.

**Chart 5: Maestro annual returns to 31 Dec 2007 (%)**



\* 6-month returns are un-annualised



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8th Edition

February 2008

### File 13: Items almost worth remembering

This time of the year, the most important topic occupying investment bankers' minds are ... bonuses. Given the global credit crisis and the sub-prime problems, the unprecedented write-downs by the investment banks, which are closing in on \$100bn when last I looked, and the severe harm they have caused the broader financial community through reckless and irresponsible lending and market activity, you would think that bonuses would have, at the very least, been placed on the back-burner. Not so! The five largest Wall Street investment banks, being Goldman Sachs, Merrill Lynch, Morgan Stanley, Bear Sterns and Lehman Brothers paid out a staggering \$66bn in compensation last year, which included an estimated \$44bn in bonuses. Goldman Sachs alone paid out \$20.2bn in bonuses – that's R151bn or one and a half times the size of Firstrand's total market capitalization, in one year alone!

Whilst on the topic of investment banks and large amounts of money, I'm sure you have heard the story a number of times already, but this edition of *Intermezzo* would be incomplete if we didn't list, for the record, the staggering developments at Societe Generale (SocGen) during the past month. They went something like this: Sunday 20 January, the head honchos at SocGen discover a fraud perpetrated by a junior trader, Jerome Kerviel, who managed to wrack up losses of \$2.2bn (!) without anyone knowing about them – at least that's the official "spin". The bank immediately starts unwinding the positions – which involve a cool \$70bn of market exposure (!!). But market weakness exacerbates the losses, which end up at \$7.2bn when all is said and done. The market caught wind of the losses earlier in the week but they were only officially disclosed on Friday, 25 January. Monday, 21 January saw European markets fall more than 5% - who do you think contributed to *that* decline - while the US markets were closed. Early Tuesday, 22 January, before the US markets open the Fed cuts US rates by 0.75% in an unprecedented move... was the Fed pushed? Were they duped by the ECB or the Banque de France into lowering rates to "support" the unwinding of the SocGen position? The conspiracy theory will rage for many years, but not so the careers of Jerome Kerviel and his so-called "supervisors".

Table 3: MSCI Emerging Market Jan returns (%)

	Jan-08	2007
<b>EM countries/regions</b>		
<b>MSCI EMERGING MARKETS</b>	<b>-12.6</b>	<b>36.5</b>
Morocco	13.4	44.0
Jordan	1.9	20.9
Malaysia	-1.1	41.5
Mexico	-1.3	9.3
Indonesia	-2.0	50.8
Chile	-2.0	20.8
Egypt	-2.8	54.8
Israel	-4.3	35.8
Peru	-4.5	86.0
LatAm	-6.4	46.9
Thailand	-6.7	40.9
Argentina	-7.8	-5.4
Philippines	-7.9	38.0
Brazil	-8.5	75.3
Taiwan	-10.5	5.4
Czech Rep	-10.8	51.7
Hungary	-12.2	13.4
South Africa	-13.2	14.7
EMEA	-13.6	25.8
Poland	-13.9	22.7
South Korea	-14.2	30.0
India	-14.3	71.2
Asia	-14.5	38.3
Russia	-16.1	22.9
China	-21.6	63.1
Turkey	-23.6	70.0

Source: Merrill Lynch

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