MAESTRO Investment Consulting
INTERMEZZO
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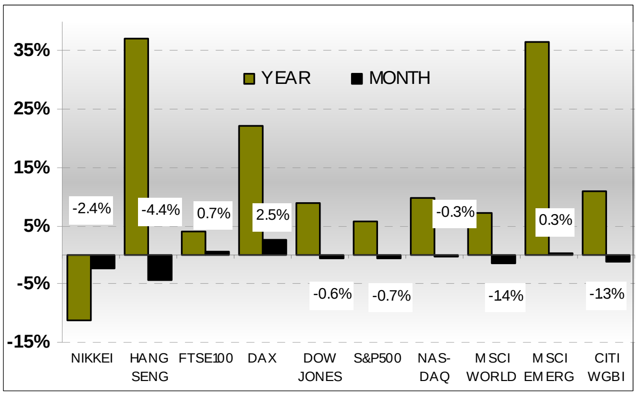
December in perspective – global markets
December provided no respite from the recent poor market conditions, with "more of the same" in just about every department. Poor economic news, particularly from the US, and ongoing global credit and liquidity problems undermined investor sentiment, relegating the traditional December rally to the same realm as Santa Claus and his long-suffering reindeer. With the exception of the German and UK markets, as well as some emerging markets returns ended in the red for the second consecutive month. The dollar came under renewed pressure, pushing commodity prices - oil and precious metals in particular - higher. The prices of gold, platinum and oil all rose more than 6%.

Chart 1: Global market returns to 31 December 2007



With 2007 behind us and many of you still on holiday, we can look back at a tumultuous year of two unequal halves. A steady and profitable first half gave way in late-July to a massive global credit and liquidity crisis, triggered by the US sub-prime housing crisis and exacerbated by excessive leverage that has developed in financial markets in recent years. The crisis, still ongoing, forced central banks to engage in unprecedented measures to overcome liquidity constraints in the banking system (on one day alone during December the ECB placed more than $500bn into the money market!) and brought about a change in the direction of interest rates in certain countries. In all, though, the year remained a profitable one for equity investors, as can be seen from the annual returns in Charts 1 and 2.

As is always the case, 2007 was full of opportunities to both make and lose money. I will spend more time on this in the Quarterly Reports, but you may be surprised to know that some well-known companies experienced remarkable price gains. Amazon and Apple gained 135% and 133% respectively in 2007; Google rose 50%. Energy shares were firm - the S&P500 energy sector rose 32% - not surprising when one considers the 58% rise in the oil price. Financials were not so lucky; the sector declined 21%. Emerging equity markets trounced developed ones, rising 36.5% and 7.1% respectively in 2007.

Political developments in South Africa
I don't hold myself out to be a political expert and don't believe it is the role of an investment manager to air strong political views. However, we have to formulate political views and assumptions on which to base our investment decisions, so the political landscape is as much part of the investment environment as monetary or fiscal policy is. During a recent trip abroad, one question dominated all others, a question which many local clients have also asked: what will happen to South Africa if Jacob Zuma becomes President of the country? So it is appropriate to share a few thoughts on the election of Jacob Zuma as the new President of the African National Congress (ANC) - note he has only been elected President of the ANC and not of the country (the next national election takes place in 2009, although it is a safe assumption that the ruling ANC President will become President of the country too, at that stage). The following does not constitute our entire view, but please allow me to make a couple of observations in order to stimulate further thought and perhaps bring a different perspective to the uniform one that has dominated the media of late.

Firstly we should retain perspective at this time, particularly in terms of what we read in the media. The uniform and monotonous story being delivered by the media of a "Zuma versus Mbeki battle" seems, to me at least, to be misleading and overly simplistic. Sure, they are adversaries and are engaged in a battle for popular support (that battle having been won by Zuma in emphatic style at the recent ANC conference in Polokwane), but so what? Isn't that what politics is all about? To look for spooks behind every decision by a state body seems over-done and a waste of time. I would like to believe that there is sufficient respect for and confidence in our constitution, the justice system and state bodies to let the process run its normal course. Remember, this very constitution and justice system is the outcome of a long and tortuous battle waged by the ANC over many years prior to 1994, so it is hard to see it being disregarded so early on in the party's rule. There are still too many painful memories of hurt and injustice suffered by many South Africans to allow politicians to ride roughshod over the current dispensation. This brings me to my second point.

I am continually amazed at the coherence and discipline displayed by the ANC. The organisation itself is 92-years old. It has a remarkable history which the majority of its members are extremely proud of. They are unlikely to dishonour it. The ANC has given us two Nobel Peace

Laureates – Albert Luthuli and Nelson Mandela, and you can include Desmond Tutu in that tally as well, which makes three. The party has won universal acclaim around the world for its peaceful resolution of conflict situations – modern SA itself is living testimony to that. In a world characterised by intolerance, hatred and violence, that has to be worth a lot. To be frank it makes me proud to be a South African. With a history so noble – without denying the many mistakes along the way – one can understand why the charges that have been brought against Jacob Zuma are such an important issue, both for the ANC and the country. However, one has to believe that sense will prevail within the ANC and that they will find a way to manage the current crisis, with or without Zuma at the helm. There are plenty of capable leaders within their ranks who could step in as either temporary or permanent leaders. In fairness to Zuma, he needs to be given his moment in court to either be found guilty or to clear his name. The sooner that moment arrives for the country, the better. I do not for a moment under-estimate the weight of the current situation. It is grave and holds significant implications for the future of our country. We will monitor it on an ongoing basis. But we should not become obsessed with the indiscretions of one politician, albeit an important one. To do so is to grant politicians too much credit for honesty and good intentions. Corruption, dishonesty and an obsession with power are, sadly, hallmarks of politicians around the world - they are no different in South Africa.

Returning to the ANC as an organization, it strikes me as relevant that here is an organization prepared to tolerate dissent and differences of opinion within its own ranks, without falling apart or resorting to violence to achieve factions' respective aims. The greatest opposition to government is currently to be found within the ANC itself. I would suggest that that is a good thing given the dominance of the ANC on the SA political landscape at present – there is little credible and effective opposition outside the ANC. We should welcome this tolerance within the party – it makes for a welcome change from the usual African experience, where liberation movements become ossified once in power. What we saw at the Polokwane conference was in many respects evidence of the ANC's ongoing evolution from a liberation struggle to a political party and as the Financial Times suggested "a sign of (a) healthy democratic pulse in the traditionally disciplined ruling party".

Thirdly, the contrasts between Zuma and Mbeki are already apparent; I sense many are looking forward to a change. Zuma's participatory and passionate leadership style is in stark contrast to the aloof and intellectual style of Mbeki, which, although having served him well in the network of global leaders, has earned him few friends back home. One can't fault a leader that is focussed on this own country. More specifically, I noted the reconciliatory tone of Zuma's acceptance speech, which bodes well for the future tension between the two leaders (although one could argue that he was grand-standing). More noteworthy, however, was his specific mention and prioritization of the dual scourges of crime and the HIV/AIDS epidemic in the country, two aspects about which, inexplicably, Mbeki remains in abject denial. Surely *all South Africans* will welcome this change? I sense that Zuma is a keen listener and has a heart for the poor, which in a developing country like ours, is important, provided the policies employed to ameliorate poverty are not too destructive or disruptive.

So where to now? Although we are admittedly biased, Maestro's view has for many years been that *economics is more important than politics*. Without going into details there are many international precedents to support this view. So we will retain our focus on the former rather than the latter. There is no doubt that we are in for a rocky period between now and August, the date set for Zuma's trial. We will be looking for clues that hint at a change in the tone of government's policies, but I don't subscribe to the view that there will be a major deviation from the exemplary fiscal discipline that has characterised the ANC government during the past ten years. The country is enjoying an unprecedented period for growth – only a fool will go out of his way to derail something this good! The focus of government is likely to remain on fiscal *discipline* while the focus of monetary policy will, as in many other countries, remain on combating rising inflation. The global economic environment, while likely to be tougher in 2008 than last year, is supportive of the SA economy.

Finally, I offer two thoughts in closing: for those who are depressed and without hope after Zuma's election, I draw your attention to the (far too) numerous examples in other parts of the world where, *despite* ineffective, bickering politicians, the respective economies have done well and there yielded plenty of profitable investment opportunities. And on a more sombre note, if you are *still* dejected take a look at the recent events in Pakistan: military rule, bogus elections, dictator-like leaders, violence, religious intolerance and brutal assassinations. And if Pakistan seems a bit far removed, think of recent developments in Kenya. Things could be a lot worse in South Africa. We have travelled a remarkable and miraculous journey since 1992. If all we are now worried about is the effects of a Zuma presidency, we have a lot to be grateful for.

For the record
Table 1 lists the latest returns of the mutual funds under Maestro's care. You can find more detail, including the latest Maestro Equity Fund Summary, by visiting our website at www.maestroinvestment.co.za. Returns include income and are presented after fees have been charged.

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Table 1: Returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Fund	Dec	**-2.1%**	**22.5%**	**22.5%**
Maestro equity benchmark **		-4.2%	15.1%	15.1%
JSE All Share Index		-4.4%	19.2%	19.2%
Maestro Long Short Equity Fund	Nov	**-2.2%**	**3.4%***	N/A
JSE All Share Index		-4.2%	8.3%*	N/A
Central Park Global Balanced Fund ($)	Nov	**-2.9%**	**11.1%**	**13.1%**
Benchmark***		-1.2%	9.3%	10.3%

* 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

Sovereign Wealth Funds – Part 2
I touched on the issue of Sovereign Wealth Funds (SWFs) in the November edition of *Intermezzo*, although I didn't expect to discuss aspects surrounding them so soon afterwards. However, events involving SWFs in the last two months are important and worth taking a closer look at, if only for the role they are already playing in absorbing and ameliorating some of the risk in financial markets in recent days. Comment directed at them, in particular from politicians, has been predominantly negative, emanating from protectionist tendencies on the part of their governments. But SWFs recent actions have been more saviour-like than hostile and it has been ironic – but so predictable – that the governments with the biggest mouths have been deafening in their silence as to the benefits the SWFs have brought to their beleaguered financial systems.

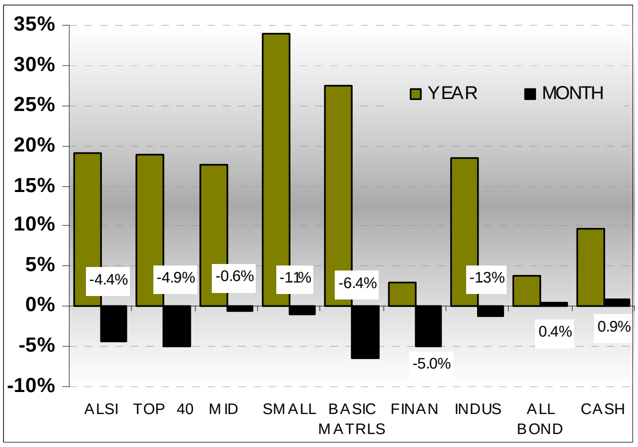
The SWF action of late that has been so fascinating is their provision of capital to ailing financial companies, who have blotted their copybooks through reckless lending or ill-advised trading bets arising out of the current credit and liquidity crisis. As banks have declared unprecedented (quarterly) losses – many in the order of $8 - $10bn, and a strong likelihood of more to come – their capital adequacy has either come under the spotlight or has fallen below the required regulatory threshold. Bear Stearns, Citigroup, UBS, Credit Agricole, Merrill Lynch, Morgan Stanley are but a few of the banks that have announced significant write downs or actual losses. Moreover, with banks now too scared to even lend to each other, central banks around the world have continued to flood global capital markets with liquidity to stave off any further collateral and systemic damage. The degree of uncertainty in general, and specifically in relation to the size and extent of as yet un-announced or unquantifiable losses has made it almost impossible for the affected banks to raise additional capital.

The capital requirements are large and the decisions surrounding such actions need to be quick and decisive. In most cases the affected banks don't want the providers of new capital to bring with them fresh demands on matters like governance, policies or management style. So on paper at least, the two needs seem almost irreconcilable.

Enter SWFs, who have in the past few weeks committed a significant amount of funds to the global financial system through the purchase of meaningful stakes in the stricken banks. Of the more recent deals that have taken place, UBS has tapped Singapore and Saudi Arabia for $11bn, Morgan Stanley called on China for $5bn and Citigroup called on Abu Dhabi for $7.5bn In addition, the provision of the capital has taken place largely without any strings attached which is exactly what the banks wanted.

SWFs are redefining many boundaries in the global investment arena and will continue to play an influential role in the coming year. Their behaviour will more than likely continue to be unpredictable. As they gain experience and learn the hard lessons that characterise any form of investment – China's SWF has already lost a third of its $3bn investment in US private equity group Blackstone and has reportedly used two thirds of its total assets of $200bn to bale out state banks – their behaviour and criteria will become increasingly sophisticated and less forgiving. Nevertheless, they have lots of money – about $3 trillion at last count and more where that came from – and there are plenty of capital-needy financial and other institutions out there, which should make for an interesting year ahead.

Chart 2: Local market returns to 31 December 2007



December in perspective – local markets
The negative developments on global equity markets set the tone on local ones, which had the added burden of the uncertainty and fears surrounding the ANC conference in Polokwane to contend with. The result was not pretty; neither was it profitable. Given the large annual returns the market currently boasts there was room for some declines

without significantly tarnishing what has been another profitable year for SA equity investors. During December the rand declined 0.5% and 2.7% against the dollar and sterling respectively. As is evident from Chart 2 large caps (-4.9%) and basic material (-6.4%) shares led the way down; Note that despite a firm (+6.2%) gold price the gold index still declined 12.0% (!) bringing its *decline* for 2007 to 20.6%. Industrials shares declined “only” 1.3%. I will spend more time on the annual returns for 2007 in the Quarterly Reports (sent to clients whose assets we manage).

Inflation – the scourge of 2008?

I don’t want to be a party-pooper so early in the year but can I suggest that investors and consumers for that matter will have to contend with a phenomenon, and its consequences, which is quietly becoming a very real problem, namely *rising inflation*. It may be too early to describe it as the scourge of 2008 but there is merit in highlighting it as a major risk to markets and investors, at least for the foreseeable future.

The problem is this: although on the face of it inflation in most regions is at reasonable *absolute* levels, two common factors around the world are contributing to rising prices, neither of which seems for the moment to be controllable or about to decline. The two factors are, of course, food and energy prices. In November Eurozone inflation rose to 3.1%, its highest level in six years – food prices rose 4.3%. In the US inflation rose to 4.3% - food prices there rose 4.8%. In the UK inflation is 2.1%; food prices rose around 5.0%. We recently highlighted the rise in Chinese inflation, which is also being driven by rising food prices. The SA inflation rate is 7.9% but food prices have risen 13.4%. More specifically, meat rose 7.0% in the year to November, fruit and nuts 14.7%, grain products 18.2%, milk, cheese and eggs 20.3% and fats and oils 25.7%.

As if *historic* inflation is not a big enough problem, both factors are actually getting worse. At the time of writing, the oil price has just scaled the “magical” $100 mark. Many agricultural commodities are at record levels; soyabean prices are at a 34-year high, corn is at an 11-year high and the price of wheat is just below an all time high. The US Department of Agriculture recently forecast that global corn stocks will decline to a 33-year low of just 7.5 weeks of consumption, while wheat stocks will decline to a 47-year low of 9.3 weeks. There are a number of reasons why prices are rising so strongly: extreme weather conditions are affecting harvests, biofuel demand is creating a new source of off take and many producing countries have dramatically increased export tariffs in an effort to secure domestic supplies. Rising demand, particularly in fast growing emerging markets, and declining supply are compounding the problem.

Of course, inflation is a very powerful force on investment markets, so we need to watch these developments very closely. They could not come at a worse time, as central banks try and deal with the credit and money market crisis through lowering interest rates, but find themselves constrained by their primary mandate of maintaining price stability (inflation), which if anything calls for higher rates. Being forewarned is forearmed – keep more than a watchful eye on inflationary pressures, and food prices in particular. It may well spoil the party this year – a party whose commencement even now looks rather tepid and uncertain.

File 13: Interesting information, but worth forgetting

A quick reminder of that powerful force in the investment world, which I refer to simply as *the law of large numbers:* despite closing 365 small coal power stations, China nevertheless added 90GW of capacity to their national electricity grid in the 11 months to November last year. To put that in perspective, that is equivalent to *the entire UK electricity grid*! Now, do you think Eskom would be so kind as to build just *one* new power station south of the Limpopo River? No, I thought not, but it was worth the question.

Table 2: MSCI Emerging Market Dec returns (%)

	2007	Q4	Dec
EM countries/regions			
Peru	86.0	-5.4	-1.7
Brazil	75.3	12.7	2.7
India	71.2	23.2	7.5
Turkey	70.0	5.8	2.9
China	63.1	-3.8	-4.5
Egypt	54.8	24.0	10.1
Czech Rep	51.7	14.9	2.3
Indonesia	50.8	17.5	1.2
LatAm	**46.9**	**6.3**	**1.2**
Malaysia	41.5	11.5	6.0
Thailand	40.9	5.6	2.2
Asia	**38.3**	**0.1**	**-0.6**
Philippines	38.0	7.4	3.9
MSCI EM	**36.5**	**3.4**	**0.3**
Israel	35.8	5.2	4.1
South Korea	30.0	-4.6	-1.6
EMEA	**25.8**	**8.7**	**1.5**
Russia	22.9	17.3	4.5
Poland	22.7	1.7	-2.0
Chile	20.8	-2.0	-1.7
South Africa	14.7	0.7	-4.1
Hungary	13.4	-6.2	1.2
Mexico	9.3	-3.2	-1.1
Taiwan	5.4	-7.7	-1.3
Argentina	-5.4	-11.1	-4.9

Source: Merrill Lynch

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