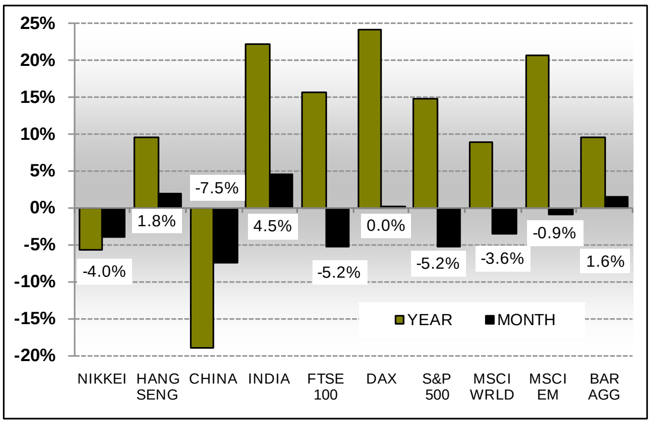
MAESTRO
INTERMEZZO
Investment Letter | 10th Edition | July 2010

Viva South Africa, viva!
I must apologize to non-South African readers for not having a suitable English translation for the word "viva". For now, let's just describe it as a loose exclamation of joy, encouragement and celebration. And that is what can be said a million times over for the manner in which our country has hosted the 2010 FIFA World Cup Soccer final.

Millions of ordinary people contributed to these games: from the construction workers who toiled under time pressure to the engineers who designed and nurtured their projects; to the policemen who showed up in force and the volunteers who assisted at every game; to the organising committee and the local soccer officialdom; to the taxpayers without whom much would not have been possible; to the drivers on SA's road who patiently sat through hours of traffic jams in the past three or four years of disruptions as the roads were widened, re-routed, fixed or rebuilt; to the citizens in the smallest of towns who flew their flags with pride irrespective of whether anyone would notice; to the Father of the Nation, Nelson "Madiba" Mandela, who sowed the seeds of reconciliation for the miracle that allowed South Africa to be considered in the first place – in one way or another the country has stood together and hosted the world in one of the most successful and spectacular fashions ever in the history of the Soccer Final (I will leave all the records set in 2010 Final for another *Intermezzo* edition). The pictures included in this edition of *Intermezzo* are a tribute to the men, women and children of South Africa who have made it all possible and who have joined in the celebration in the stadiums, the Fan parks, the Fan walks and in the furthest corners of this beautiful country. Well done South Africa – you did yourself proud!

June in perspective – global markets
The first few days of trading in June started on a positive note but as soon as the jobs data came out of the US the market was shocked back into reality. The data were far worse than expected and set the tone for what where to be many disappointing US data releases. No matter how fast emerging economies grow the importance of the US consumer as a key driver of the global economy is such that we continue to monitor his financial well-being closely. It holds the key to the immediate direction of the markets and is also a key component in the concoction that constitutes "global investor sentiment". Whether it be the extent of US home or retail sales, or the lack of adequate job creation, June provided sufficient evidence for the "bears" to gain ascendance and drive prices lower. The UK equity market was pulled lower by the collapsing BP share price and sharp losses on mining shares, as growth rates for the global economy were scaled back; it ended 5.2% lower. Speaking of miners, commodity prices fell sharply, although soft (food) commodity prices remained firm. The gold price rose 3.0%, oil remained unchanged but base metal prices declined between 6% and 10%. Back on the equity markets the German market held up very well, rising 0.02%, but the Japanese and US markets fell 4.0% and 5.2% respectively. The MSCI world index fell 3.6% while the MSCI Emerging market index fell only 0.9%; it was supported by India's 4.5% rise but pulled lower by China's 7.5% decline.

Chart 1: Global market returns to 30 June 2010



Although the euro closed off its lows, its recovery never amount to much and it ended 0.2% lower against the greenback. The pound took comfort from the emergency austerity budget tabled by the new coalition government and rose 3.0% against the dollar. The rand remained firm, despite the increase in nervousness that prevailed in the market, ending up 0.3% against the dollar. The bond market was the main beneficiary of the "flight to safety", rising 1.6% in June.

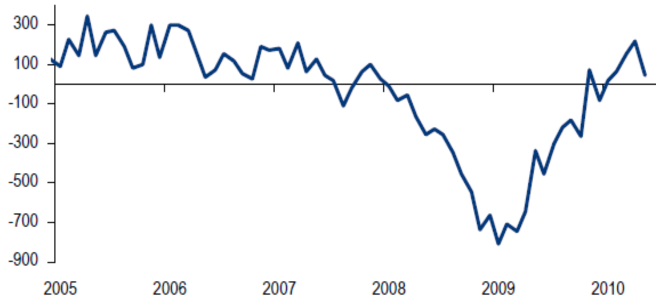
What's on our radar screen?
Here are a couple of items we are keeping a close eye on:

- *The SA economy:* inflation continues to move in the right direction, falling to 4.6% in May, its lowest rate since November 2006. Shoppers and housewives amongst our readers – yes, there are quite a few! – would be surprised to know that the annual **decline** in food and non-alcoholic beverage component was 0.8%

in May versus the decline of 0.9% in April. During May Statistics SA revised the retail sales data series - there is nothing sinister about that; it is a normal phenomenon around the world and is done to ensure that the data remains relevant. Consequently SA retail sales rose 3.7% in the year to April, up from 2.7% in March, although on a monthly basis they declined by 0.2%. We are sticking with our relatively optimistic view that there is still room for a further interest rate cut by the SA Reserve Bank (SARB) and thus wouldn't be surprised to see rates lowered by between 0.25% and 0.50% at the SARB's Monetary Policy Committee (MPC) meeting on 22 July.

- *The Indian economy*: Industrial production rose 17.6% in April from 13.9% in March. Inflation rose to 10.2% in May, prompting India's central bank to raise interest rates to 4.0% in early July. This brings to 0.75% the cumulative increase this year so far as India struggles to curtail price increases which were initially confined to food prices (following a poor monsoon season) but are now spreading through the economy. The increase in interest rates, unlikely to be the last this year, is significant as it comes just weeks after the government ended its control over the diesel price; the price subsidy was costing it vast amounts and was seen by many as excessive government interference. The move to a market-determined diesel price will add at least 1.0% to wholesale price inflation.
- *The Chinese economy*: Chinese inflation rose to 3.1% in May while retail sales rose 18.7%, marginally higher than the 18.5% in April. Industrial production rose 16.5% in May from 17.8% the previous month.
- *The US economy*: given the deluge of information emanating from the US on a regular basis it is hard to isolate the most relevant data. It is fair to say that nearly all of the data, and certainly that which reflects the state of the US consumer, was below expectations. Retail sales, excluding vehicle sales, declined 1.1% in May; new home sales were significantly less than expected (they fell to the weakest level in the 47 years the data has been compiled – refer to Chart 4) as the state-sponsored incentives fell away; existing home sales also declined; core inflation rose only 0.1% , bringing its annual increase to 0.9%, only 0.2% above the all-time low of 0.7% seen in March 1961; and the final reading of the first quarter GDP was revised down from 3.0% to 2.7%. The biggest disappointment and concern however remains the lack of private sector job creation. The US unemployment rate, currently at 9.5%, tends to vacillate as labourers move in and out of the labour pool. But you can't hide the number of jobs created. It was to be expected that there would be a recovery from the horrendous monthly loss of around 700 000 in the depths of the crisis in early 2009, but the disappointing US jobs data in recent months has brought the prospect of a jobless recovery much closer than most economists had expected. Chart 2 depicts the actual number of jobs created; it shows clearly that the number of jobs being created may well be "rolling over". The issue of job creation is also more politically sensitive than other indicators, although it is a lagging indicator. It doesn't hold much predictive power i.e. it is not a good indicator of the future direction of the US economy (other indicators are more accurate in this regard).

Chart 2: US Nonfarm payrolls ... watch closely now



Source: Merrill Lynch

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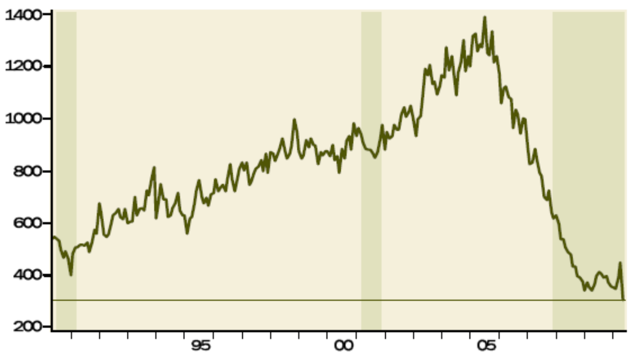
Chart 3: Lumber future prices

Source: Merrill Lynch

Charts of the month
We have already commented on the slowdown in home sales; a dead giveaway in this regard is the price of lumber futures – remember that most houses in the US are constructed of wood. Chart 3 depicts the bad news – not much demand in sight in this market, that's for sure. And Chart 4 depicts the sales of new single-family homes – whatever happened to the V-shaped recovery?

Chart 4: New single-family home sales in the US



Source: Gluskin Sheff

A few quotes to chew on
Banks must thank the lord that they deal in ones and zeros zooming down wires unseen by the public eye. Equally fortunate, Detroit went bust because it was complacent, not because its cars blew up spraying oil over cute little animals. How else could one explain why Uncle Sam was more than happy to bail out Wall Street and America's carmakers, yet promises not to spend a cent of taxpayers' money cleaning up another national disaster in the Gulf of Mexico. Lex in the Financial Times.

… And both the United States and Europe are well on their way to toward Japan-style deflationary traps. Paul Krugman, Professor of Economics at Princeton University and the London School of Economics, New York Times columnist and 2008 Nobel Laureate for Economics.

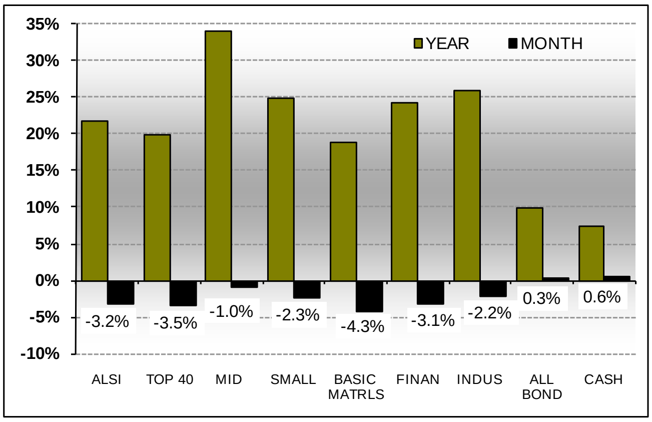
The world is not in recession, countries are … but certain of the countries we operate in, Poland, Brazil, Russia, India, China (are) actually looking quite good. We've just been accidently lucky in that the markets we're in now seem to be more healthy but it's not due to management planning, it's simply bloody luck. Koos Bekker, CEO of Naspers when asked what lay behind the company's recent success.

The IMF-led package enables Greece to be able to borrow at non-market rates for roughly 3 years, a window during which it will have to restore the primary balance to surplus. But, the bigger issue of Greek solvency is left to be dealt with at a later date: quite how Greece will manage to service a debt to GDP level of 150% in 2013 remains unanswered. Even at an interest rate of 5%, Greece will need to spend 7.5% of its GDP on debt servicing every year; to bring the debt load to a more sustainable level a budget surplus of 10% of GDP would be needed! Clearly, massive liquidity injections today do not alter the fundamental risk of sovereign insolvency. And this is what markets are unhappy with; liquidity today by no means ensures solvency tomorrow. Guy Monson and Subitha Subramaniam, CIO and Chief Economist respectively of Sarasin and Partners.

June in perspective – local markets
The general weakness in global equity markets set the trend for the local one too, which declined in similar fashion. It was encouraging to see the rand hold up as well as it did in

the face of another wave of risk aversion; it firmed 0.3% against the dollar and confirms the long-held Maestro view that the rand is likely to remain firm relative to most other currencies, at least for the time being. The basic materials, financial and industrial indices declined 4.3%, 3.1% and 2.2% respectively, *while for the third consecutive month the mid and small cap indices performed better than the large cap index*; in June the former declined 1.0% and 2.3% respectively, while the large cap index fell 3.5%. The best performing sectors were personal goods (5.9%) and food and drug retailers (5.6%) while the worst performing sector was media (-13.1%. Naspers declined 13.7%). The bond market rose 0.3% and the gold index rose 0.1% on the back of the 3.0% rise in the dollar gold price.

Chart 5: Local market returns to 30 June 2010



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.

Table 1: Returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Fund	Jun	**-2.3%**	**-3.5%**	**12.7%**
Maestro equity benchmark *	Jun	-3.3%	-3.8%	21.5%
JSE All Share Index	Jun	-3.2%	-4.1%	21.8%
Maestro Long Short Equity Fund	May	**-3.6%**	**-1.8%**	**10.2%**
JSE All Share Index	May	-5.1%	-0.9%	21.9%
JSE Financial and Indus 30 index	May	-5.0%	-1.3%	29.3%
Central Park Global Balanced Fund ($)	May	**-5.9%**	**-8.1%**	**-1.2%**
Benchmark**	May	-4.4%	-2.0%	9.0%
Sector average ***	May	-6.7%	-5.6%	7.4%

* 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 ($)

File 13: Information almost worth remembering
The following letter appeared in the Financial Times on June14. I found it so amusing that I just have to share it with you. I'm sure that many market participants as well as long-suffering parents will identify with it. It was written by TC Smith, CEO of Tullet Prebon and Deputy Chair of Collins Stewart and was entitled "The best advice for someone smelly".

> Sir, the recent letter from French president Nicolas Sarkozy and German chancellor Angela Merkel to the president of the European Commission on the subject of regulating short selling and the use of credit default swaps reminds me of an incident involving my father-in-law.
>
> When he was a headmaster he was approached by the parents of a boy who asked him to stop other children taunting their son by calling him "Smelly". He said that he could perhaps make an announcement in assembly asking them to desist, but he also suggested a more radical solution which would address the cause rather than the symptoms – namely getting the boy to bath.
>
> Perhaps if Europe's political elite stopped trying to get markets to fund their grandiose designs and social engineering projects they would not need yet more regulation to control markets. In fact, financial markets are reacting exactly as they should do in the face of this profligacy and attempt to bribe the electorate with borrowed money.
>
> Of course, sadly in the current age my father-in-law would be reported for politically incorrect treatment of a child who was soap-phobic.

In the past, particularly at the time of the collapse in markets in 2007 and 2008, we referred on numerous occasions to the implosion of Iceland. We continue to follow developments there, particularly from a sociological point of view. As tragic as it is, one does not get the opportunity every day, or year, for that matter, to see a country implode completely. What happens to the economy? What about the people (all 320 000 of them in Iceland), what happens to their social structures, etc.

Well, the past month has answered at least some of our questions and it paints a rather sad picture. Jon Gnarr, a 43-year old stand-up comedian and self-styled anti-politician was sworn in as the mayor of Reykjavik, Iceland's capital and home to 60% of the country's population. Gnarr admitted to never having taken an interest in politics before 2008. His party, the Best party, promised to hand out free towels in public swimming pools and to bring Disneyland to the capital. "Our whole campaign was based on a lot of nonsense. Our slogans, such as 'All kinds of everything', were nonsense" he said. In his view the financial collapse had changed Icelanders' mentality. "What's been escalating in recent times is anger, fear, insecurity and paranoia. Before, people were much more peaceful and tolerant."

And from ridiculous to the even more ridiculous, here's a juicy story that offers proof that "sex" is not always enjoyable. One of the (apparently) most sought after domain names in the world, www.sex.com, is back on the market. Escom LLC, the Los Angeles-based company that bought the domain in 2006 for $14m, is facing bankruptcy after being unable to service the loan it incurred in the process. (*Ed*: never before has the difference between a "c" and a "k" meant that much to South Africans!) Perhaps the moral of the story is that, no matter how grand one's plans, it helps to have an adequate financial and business plan to support them!

Table 2: MSCI returns to 30 June 2010 (%)

	Jun'10	YTD	Q2'10
Indonesia	5.5	13.6	3.3
Pakistan	4.5	-1.1	-7.9
Colombia	4.5	13.3	2.9
India	3.9	1.8	-2.9
Thailand	3.7	8.9	-3.3
Singapore	3.6	-2.8	-1.4
Argentina	3.6	-3.8	-8.7
Malaysia	3.0	7.9	-0.3
Hong Kong	2.9	-5.2	-7.2
Philippines	2.5	5.7	2.1
EM Asia	**1.1**	**-4.9**	**-5.9**
Chile	1.0	1.5	1.5
Korea	0.9	-5.1	-7.6
China	0.9	-7.7	-6.2
Turkey	0.7	-2.6	-6.1
AP ex Japan	**0.5**	**-8.3**	**-9.7**
Peru	0.1	2.9	2.8
MSCI EM	**-0.9**	**-7.2**	**-9.1**
Morocco	-2.0	-1.3	-7.5
Taiwan	-2.0	-12.9	-9.4
Japan	-2.0	-3.6	-10.1
Australia	-2.5	-17.2	-19.6
Mexico	-3.0	-2.5	-9.5
LatAm	**-3.4**	**-11.6**	**-12.7**
MSCI DM	**-3.6**	**-10.9**	**-13.3**
South Africa	-3.6	-6.5	-10.2
EMEA	**-4.2**	**-9.2**	**-14.4**
Russia	-4.2	-11.0	-16.7
Brazil	-4.5	-16.5	-16.0
Czech	-5.4	-16.8	-16.7
Poland	-8.6	-19.5	-22.8
Egypt	-8.9	-5.1	-14.2
Hungary	-10.6	-22.4	-31.1

Source Merrill Lynch