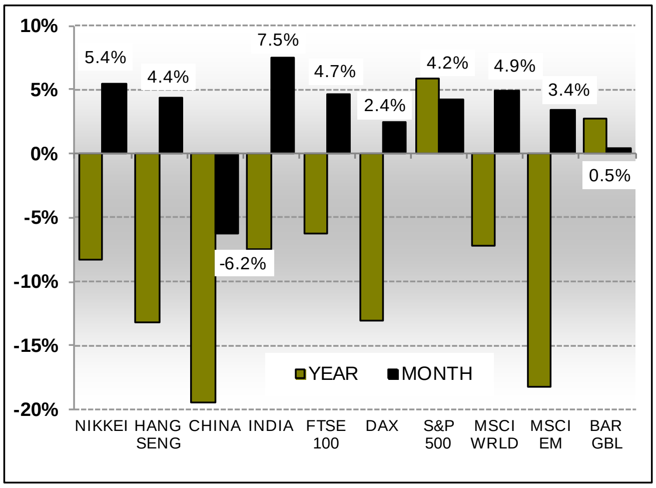
MAESTRO
INTERMEZZO
Investment Letter | 12th Edition | July 2012

June in perspective – global markets

June will go down as one of the more remarkable months on global markets in recent times. The month had just about everything: Spain on the brink a few times during the month before eventually securing a €100bn bailout despite initial denials about requiring it, bond yields surging (prices plummeting) as investors began fearing the worst for Spain and Italy; German and US bond yields at record lows (prices at record highs), record fines for the banking industry following the fixing of Libor, the global reference interest rate for trillions of dollars, a loss at US bank JP Morgan that began at $2bn but is now rumoured to be closer to $9bn – as they say in the classics ... "you can't make this stuff up!" And that is only a fraction of what happened during June.

When all is said and done though, global investment markets registered respectable returns for June – how on earth is that possible? Well, with only two days to go to month-end and ahead of yet *another* EU "emergency summit", news came to hand that Germany had softened its iron will to some extent and agreed to certain funds being made available to directly support ailing European (read Spanish) banks. That news became known half an hour before trade closed in the US, and on the final day in Asian and European markets a huge surge took place which lifted virtually all indices into positive territory, in many cases not only for the month but also for the year-to-date.

Chart 1: Global market returns to 30 June 2012



By way of example, Chart 2 shows the German equity market (the Dax 30 index) priced at hourly intervals. I have drawn vertical lines marking the beginning and end of June, and a horizontal black line at the level at which the index began June. You can see that early in the month the market was already well down on its opening month level – after three days it was already down 4.7% and below the 6 000 mark. It then moved erratically upwards until the 21st before declining sharply to levels that once again were lower than the opening level for June. On the penultimate day of the month it's return for June was -1.8%, but thanks to the huge rally on the last day of the month (remember Chart 2 is an "hourly" chart and not a "daily" one), it ended June up 2.4%; not a massive return but certainly in no way representative of all the volatility and downward pressure it had experienced throughout the entire month. Although the chart represents the German market, the trend was similar on most other developed markets. So don't be fooled by the positive monthly returns in June – they conceal a "multitude of sins".

Chart 2: The German Dax index based on hourly prices

Source: Saxo Bank

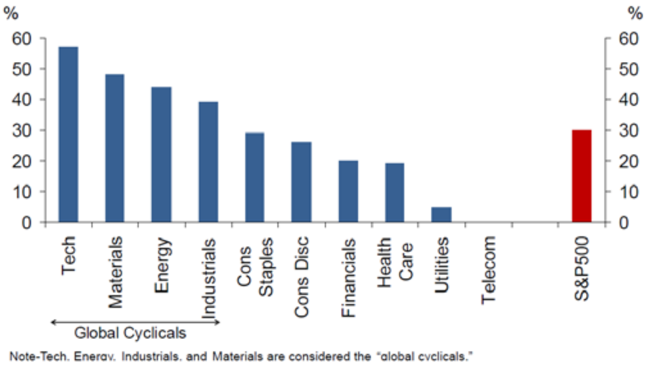
But while the returns might be misleading, they remain there for the record, so let's examine them briefly – refer also to Chart 1 and Table 2 at the end of this edition. Developed **equity markets** generated returns in excess of emerging markets for the fourth consecutive month. The MSCI World index rose 4.9% while the Emerging market index rose 3.4%. Notable rises included the equity market in Japan, up 5.4%, the UK 4.7% and the US 4.2%, while amongst emerging markets Russia rose 8.7%, India 7.5%, South Africa 6.6% in dollar terms and Hong Kong 4.4%. Brazil declined 0.3% and China declined sharply, ending down 6.2%. The dollar was relatively firm throughout the month, but the last day's dramatic events turned that upside down, resulting in it declining against most **currencies**; particularly sharp gains against the dollar were posted by emerging currencies. For example, sterling rose 1.9% against the dollar and the euro 2.6% despite all the drama in the Eurozone. But the Australian dollar rose 5.7% against the dollar and the rand 4.7%, 3.0% of which occurred on the last day of the month. The dramatic change on the final day effectively led to a huge increase in the appetite for risk, which in turn had the effect of increasing the prices of more risky assets such as commodities. While the gold price posted yet another dismal performance as a "safe haven" – it only rose 2.6% - the strong final day rally was insufficient to pull most commodity prices into positive territory for the month. The result was that most commodities posted declines on the month, the most significant one being a 4.0% decline in the oil price, following its 14.7% collapse in May.

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

- *The US economy*: Much of the data emanating out of the US was worse than consensus expectations, although not necessarily ours, given that we are very bearish on the US economy. Perhaps the most significant development was the cut by the Federal Reserve of its growth estimates for the economy. The Fed reduced its 2012 growth forecast range from 2.4% - 2.9% to 1.9% - 2.4%. No matter which way you look at it, that is a significant reduction. It lowered its forecast for 2013 growth from 2.7% - 3.1% to 2.2% - 2.8% and increased its forecast for 2012 – 2014 unemployment.
- *Emerging economies*: **Brazil** cut its benchmark (Selic) interest rate to 8.5%. **Australia** cut its benchmark rate by 0.25% to 3.5% for the second consecutive month, despite its economy growing by 4.3% year-on-year during the first quarter (Q1), higher than Q4's 2.3%. In **China**, consumer prices (inflation) rose 2.2% in the year to June, down from 3.0% in May NS 3.4% in April. Q1 economic growth was 8.1%, down from 9.2% in Q4. Retail sale nevertheless remained robust, rising 14.5% on an annual basis in May. The central bank, the People's Bank of China (PBoC) cut interest rates in early June and July i.e. it effectively cut its benchmark rates twice within a month. Incidentally, this brings to 35 the number of interest rate cuts by central banks in the past six months. To state the obvious, central banks are clearly concerned about slowing growth, but I would also point out that this type of action is very "equity-friendly" in the long-term. The annual inflation rate in **India** remained steady in May, at 10.4%. Not surprisingly, the Reserve Bank of India retained interest rates at their prevailing level of 8.0%. The **Indonesian** economy grew 6.3% year-on-year in Q1, down from 6.4% in Q4.Their annual inflation rate remained at 4.5% in May. The Malaysian economy grew 4.7% year-on-year in Q1, down from 5.2% in Q4 and their annual inflation rate in May was 1.7% (yes, that's one point seven percent ☺). I have gone into a bit more detail on some of these emerging markets for two reasons: firstly to show you that there are still many regions in the world that are growing at healthy rates and secondly, to serve as a reference point for the SA economy.

Chart of the month
It is useful to know what percentage of revenue of the 500 largest listed companies i.e. the S&P500 index are generated outside of the US. Chart 3 shows that for the index as a whole some 30% of revenue is generated outside of the US although when viewed in sector terms the percentage varies greatly. Not surprisingly, the sectors regarded as "global cyclicals" viz. technology, materials, energy and industrial sectors draw more revenue from outside the US than other sectors. The technology sector derives nearly 60% of its revenue from outside the US. The direction and trend of the US dollar is thus an important consideration when analysing these companies; the more revenue companies derive from outside the US the more they will suffer when the dollar strengthens, and vice versa.

Chart 3: S&P Foreign revenue by sector



Source: Deutsche Bank

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Some quotes to chew on

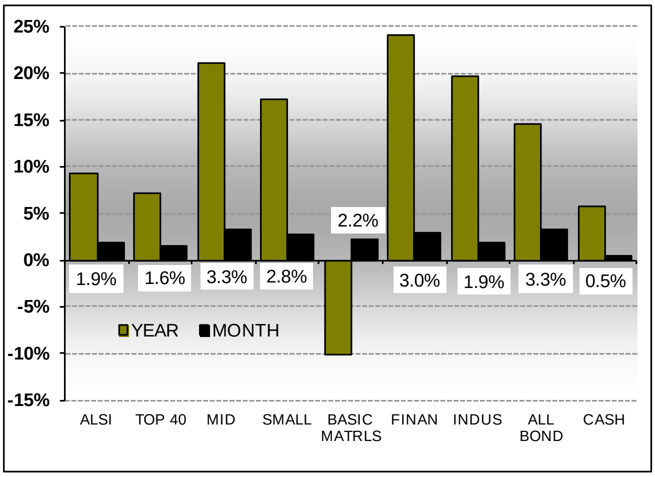
Commenting on European and US fiscal policies in the June Investment Overview, *Merrill Lynch Chief Global Equity Strategist Michael Hartnett* had the following to say. “Common sense fiscal consolidation is necessary in both the US and Europe. Business and consumers both seem to be on a buyers strike, dooming government attempts to stimulate demand through debt-financed spending (as the public saves to pay for future tax increases to pay off the debt). This impasse can only be broken by a clear framework to reduce government debt in Europe and the US. Politicians in neither region seem currently up to the task”.

UBS Chief Investment Officer Alexander Friedman stated the obvious but was bold enough to verbalise what is on many investors’ minds, when he said “This is a tricky time to be an investor”.

June in perspective – local investment markets

The bizarre monthly movements of global markets, biased by the last day of the month’s trade as they were, were mirrored in the local equity markets. However, as we have seen on previous occasions, the rand bore the brunt of the volatility, thereby shielding SA investors from much of the whirlwinds experienced on international markets. So while the All share index rose 1.9% in June, in dollar terms it rose 6.6%, thanks to the 4.7% increase in the rand against the dollar. Remember that in June the All share index declined 3.6% in rand terms but by 12.7% in dollar terms. Despite the rand’s volatility the respective year-to-date returns of the All share index are not that far apart; it is 5.7% higher in dollar terms and 7.1% in rand terms. But unlike in May when the basic materials index declined significantly more than the financial and industrial indices, in June all three indices posted reasonable gains. The basic materials index rose 2.2%, financials 3.0% and industrials 1.9%. The annual returns of these indices though, tell a very different tale: the annual return to June of the basic materials index is -10.2% while the financial index is up 24.2% and the industrial index 19.7% over the same period. Chart 4 shows just how material this difference is; financial and industrial sectors have been preferable to basic materials, despite the 17.1% decline in the rand dollar exchange rate over this period.

Chart 4: Local market returns to 30 June 2012



The gold index declined 9.2% in June, bringing its year-to-date loss to 16.8% despite its rise of 15.3% in May. The travel and leisure sector gained the most in June, up 9.6%, followed by food and drug retailers up 8.4%. On the other side of the scale, the fixed line telecoms sector (read Telkom) declined 17.1%, the gold index 9.2% and the personal goods sector (read Richemont) 8.3%. The firm rand supported the bond market – the All bond index gained 3.3% in June, bringing its annual return to 14.6% versus the All share index’s annual return of 9.3%.

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For the record

Table 1 lists the latest returns of the mutual funds under Maestro's care. You can find more detail by visiting 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 Fund	**Jun**	**0.6%**	**9.3%**	**9.7%**
JSE All Share Index	*Jun*	*1.9%*	*7.1%*	*9.3%*
Retirement Funds				
Maestro Growth Fund	**Jun**	**-0.2%**	**7.0%**	**9.5%**
Fund Benchmark	*Jun*	*1.4%*	*6.6%*	*10.9%*
Maestro Balanced Fund	**Jun**	**-0.2%**	**6.4%**	**9.2%**
Fund Benchmark	*Jun*	*1.3%*	*5.9%*	*10.5%*
Maestro Cautious Fund	**Jun**	**1.3%**	**6.6%**	**9.7%**
Fund Benchmark	*Jun*	*1.7%*	*5.6%*	*9.6%*
Central Park Global Balanced Fund ($)	**May**	**-4.5%**	**3.3%**	**-9.7%**
*Benchmark**	*May*	*-4.1%*	*0.7%*	*-5.2%*
*Sector average ***	*May*	*-5.0%*	*0.3%*	*-8.3%*

* 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 ($)

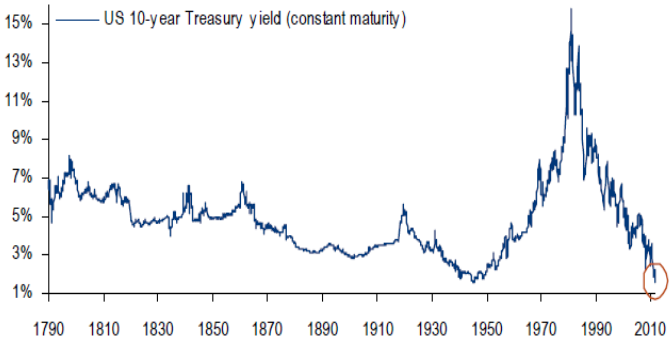
So bad is it, really?

Many of our clients are expressing concern about the state of the global economy in general and equity markets in particular. This is not the appropriate place to share our view of the global economy into the next year or two, but it is a useful place to highlight to what extent certain indicators, including asset prices, have fallen or risen to, and to show exactly "how bad it is". We have long held the view that while markets recovered very quickly from the trough in March 2009, the "Great Financial Crisis" which began with the sub-prime implosion in October 2007, is still well and truly underway; we are nowhere the end of that crisis. Given the rewarding South African equity environment in recent years, though, local investors can be forgiven for being fooled into a false sense of security that "all is well". While we do not mean to scare clients or investors away –we certainly don't think there is any reason to, or benefit from, liquidating quality investments at present – it is our duty to draw your attention to "how bad it really is". Herewith, then, a few facts and charts to shed light on the prevailing investment environment.

As at the end of May:

- The US 10-year yield, at 1.55% is at its 200-year low sent in November 1945 (refer to Chart 5). Chart 6 provides the equivalent long-term chart of SA 10-year bond yields.
- The Dutch 10-year yield at 1.7% is the lowest in the past 500 years
- The German 10-year bund yield at 1.3% is the lowest in the past 200 years (barring the hyperinflation period of 1923)
- The French 10-year government bond yield at 2.4% is at a 260-year low

Chart 5: US 10-year bond yield – now at a 200-year low



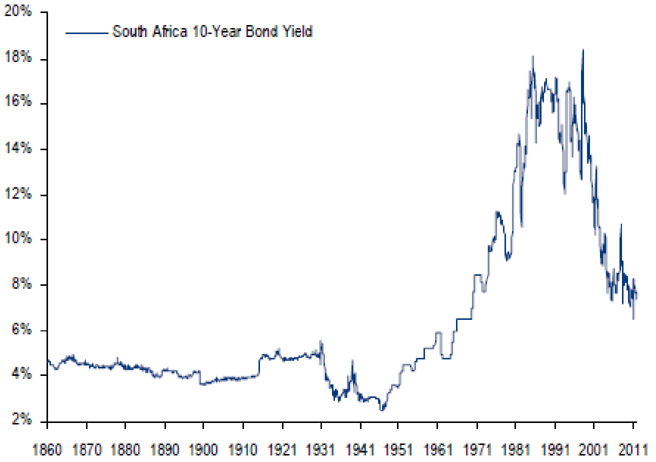
Source: Merrill Lynch

At the end of May, the following was also true:

- The market cap (size) of the entire Italian financial sector, at $47bn, was the same size as the market cap of Colgate Palmolive
- The market cap of all Eurozone financials, at $361bn, was less than that of the Canadian financial sector at $377bn
- The size of combined Spanish and Italian equity markets, at $396bn, barely exceeded that of the entire Taiwanese market ($368bn)

- The size of the total Portuguese share market ($16.4bn) was the same size as the 191st largest company on the US equity market
- The size of the total Greek share market ($5.8bn) is the same as the 400th largest company on the US equity market, roughly equivalent to the size of Tiger Brands listed on the SA equity market.

Chart 6: SA 10-year bond yield

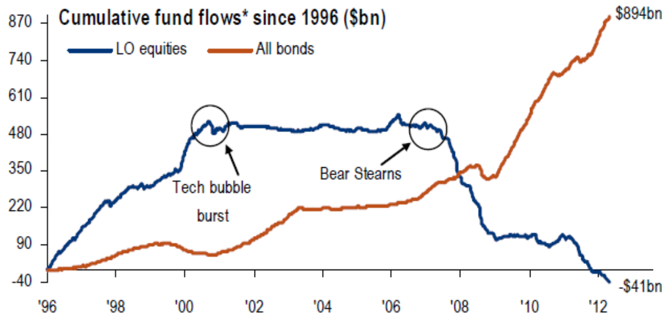


Source: Merrill Lynch

Now, before we all start slitting our wrists – for which there is no need, please believe me – let me say that within our investment process we are slowly seeing the coming together of the elements that will result in our next **Big Picture Theme**, namely *The Great Rotation*. We will share more about this theme in the coming months – it is too far away to spend too much time on it now – but by *The Great Rotation* we simply mean that over the past decade there has been a massive flow out of global equities, and US equities in particular, and an even greater inflow into bond markets, again US bonds in particular. The effects of that are clear; simply put, global equities have generated abysmal returns over that period, in contrast to bonds, which have performed very well. Now, it is a simple function of maths that you will not generate much of a return if you buy a bond on a very low yield (interest rate), such as those I have just drawn your attention to. Yet global investors continue to pour billions into global bond markets at the neglect of equity markets. Despite there being no sense or logic behind this action, we understand why it is occurring – regular readers will know how often we remind them that the prevailing global investment conditions and markets are anything but normal. However, although it is hard to believe at this point in time, and also hard to foresee the catalyst that will turn this crazy situation around soon, as sure as night follows day eventually investors will leave the bond market and begin to redeploy existing and invest new capital into equity markets i.e. there will be a "Great Rotation" from bonds into equities.

By way of illustration, Chart 7 shows that since 1996 investors have invested a cumulative total of $894bn into global bond funds while disinvesting a total of $41bn out of equities. Indeed, over the past decade alone investors have disinvested a cumulative total of $550bn out of equity funds and poured $760bn into bond funds. This type of flow is unsustainable and will change in the years to come – and that change and trend is what our Big Picture Theme of *The Great Rotation* alludes to.

Chart 7: Cumulative investment flows since 1996 ($bn)



Source: Merrill Lynch

"Stop for The One" by Melody Nowai

Incredible how time flies…It feels like yesterday since I became part of the Maestro team. Joining Maestro has been one of the best things that ever happened to me since moving to SA.

I like boasting about my colleagues so…I work with one of the most supportive and hard working teams of colleagues one could ever wish for. There is a great sense of harmony and responsibility in our team such that I believe anyone who joins will without much effort uphold the standard that has already been set in the office.

But I must confess that since being part of this team, the frequency of *tea bag top up* has increased ☺ - I'm not apologizing though - at least I brought back something little from my nearly five years stay in England! Besides, who wouldn't want to work in a company where the 'boss' makes tea for you? Incredible!

Before moving on to another topic, I must mention that one of the things that captivates my heart about Maestro is the great sense of relationship building with people who we come in touch with as a business. For example, we not only look after clients' money but have a genuine relationship with each client and often, long after they are no longer our clients, still maintain this great relationship with them. As most of you may already know, this was one of the motivating factors for Andre when he started the business –I think we're still living up to it. And now onto something close to my heart…

"Stop for The One"

Moving out of one self, time and again, out of our comfort zones to make a difference in another's life is often at times more rewarding than we can imagine. One thing that made an impression on me when I moved to SA was the enormous number of people in need and the huge disparity between the wealthy and the poor. For the record, I personally believe that at some point in life, we are each responsible for where we find ourselves. We live in a world where you do not have to try very hard to find an excuse for anything you want. Put aside all the excuses we might make, we know that somewhere in the world there's always someone who's going through a more precarious situation than we are but somehow they manage to make things work, leaving no room for some of our own excuses. That said, we can either choose to become overwhelmed by the need around us and do nothing or *"stop for the one"* and do our own little bit to change lives. In whatever sphere of life we find ourselves, we can make a difference in the life of *"The One"!* In the words of Mother Teresa *"Not all of us can do great things but we can do small things with great love." And again, "never worry about numbers. Help one person at a time and always start with the person nearest to you".*

This is the challenge I took up with a group of three friends a year ago. Whilst having dinner one night, the topic of reaching *"The One"* came up; we mostly contemplated those who are the unfortunate victims of other people's choices, like kids suffering for the 'sins' of their parents. For a moment – the conversation revolved around the need to help these ones. Instead of just talking about it and doing nothing, we resolved to take a leap into one of the townships in Cape Town and see for ourselves.

That simple trip changed my life forever – its one thing hearing the stories but it's another seeing it for yourself! The innocence and sorrow on the kids' faces was very glaring, yet one could intuitively pick up the potential in their dazzling eyes.

And so began our momentous journey of going to these shacks every month; reaching out to kids of the community in small ways like handing out food parcels, teaching them songs, playing games, taking them out to watch movies, getting them meet other kids, etc with the simple goal of getting them to experience what they will never be able to experience otherwise. For some of them, this has been the greatest experience ever of their lives.

Let me conclude by saying I am really excited about working with people who are equally big on giving back to the community – as you may well know we recently put together **The Maestro Charitable Trust**. We call on all of you who are passionate about touching other lives to use this platform for that purpose.

Always remember this*: "We know only too well that what we are doing is nothing more than a drop in the ocean. But if the drop were not there, the ocean would be missing something."* ***Mother Teresa***

File 13: Information almost worth remembering

Who learned you to speak English?!

With all the market stress behind and around us, let's take some time off to have a little fun. All those who do not have English as their home language will appreciate the following poem. I unfortunately don't have the poet or even its title, but it makes for a good laugh at ourselves and our crazy language. Enjoy!

We'll begin with a box, and the plural is boxes,
But the plural of ox becomes oxen, not oxes.
One fowl is a goose, but two are called geese,
Yet the plural of moose should never be meese.
You may find a lone mouse or a nest full of mice,
Yet the plural of house is houses, not hice.

If the plural of man is always called men,
Why shouldn't the plural of pan be called pen?
If I speak of my foot and show you my feet,
And I give you a boot, would a pair be called beet?
If one is a tooth and a whole set are teeth,
Why shouldn't the plural of booth be called beeth?

Then one may be that, and there would be those,
Yet hat in the plural would never be hose,
And the plural of cat is cats, not cose.
We speak of a brother and also of brethren,
But though we say mother, we never say methren.
Then the masculine pronouns are he, his and him,
But imagine the feminine: she, shis and shim!

Let's face it - English is a crazy language.
There is no egg in eggplant nor ham in hamburger;
Neither apple nor pine in pineapple.
English muffins weren't invented in England.

We take English for granted, but if we explore its paradoxes,
We find that quicksand can work slowly, boxing rings are square,
And a guinea pig is neither from Guinea nor is it a pig.
And why is it that writers write, but fingers don't fing,
Grocers don't groce and hammers don't ham?

Doesn't it seem crazy that you can make amends but not one amend?
If you have a bunch of odds and ends and get rid of all but one of them,
What do you call it?

If teachers taught, why didn't preachers praught?
If a vegetarian eats vegetables, what does a humanitarian eat?

Sometimes I think all the folks who grew up speaking English
Should be committed to an asylum for the verbally insane.
In what other language do people recite at a play and play at a recital?

We ship by truck but send cargo by ship...
We have noses that run and feet that smell.
We park in a driveway and drive in a parkway.
And how can a slim chance and a fat chance be the same,
While a wise man and a wise guy are opposites?

You have to marvel at the unique lunacy of a language
In which your house can burn up as it burns down,
In which you fill in a form by filling it out,
And in which an alarm goes off by going on.
And in closing..........

If Father is Pop, how come Mother's not Mop.???

What's with the photographs?

In last month's edition of *Intermezzo* we showed pictures of crazy kayakers tackling some of scary waterfalls, and committed ourselves to sharing more adrenalin-seeking individuals this month's edition. All the photographs are per kind favour of National Geographic although I was unable to find the respective photographers. I hope you enjoy them.

Table 2: MSCI returns to 30 June 2012 (%)

	Jun '12	2012
Turkey	17.8	25.4
Hungary	15.8	9.9
Poland	15.6	9.1
Mexico	12.8	13.2
Russia	9.2	-1.5
EEMEA	8.2	3.8
India	6.9	7.5
Australia	6.8	1.1
Singapore	6.2	12.7
Chile	5.7	5.5
Philippines	5.4	24.1
Japan	5.0	2.0
MSCI DM	**4.9**	**4.5**
South Africa	4.9	3.1
Indonesia	4.4	-5.2
Hong Kong	4.2	5.8
Czech Republic	4.0	-7.5
LatAm	3.8	-2.2
AP ex-Japan	3.5	3.6
MSCI EM	**3.4**	**2.3**
Thailand	3.2	12.5
Korea	2.9	4.4
EM Asia	1.9	3.6
Malaysia	1.0	2.9
Brazil	1.0	-9.5
China	0.5	1.4
Colombia	-0.6	14.8
Pakistan	-0.6	10.4
Taiwan	-0.6	3.6
Israel	-3.3	-7.6

Source: Merrill Lynch