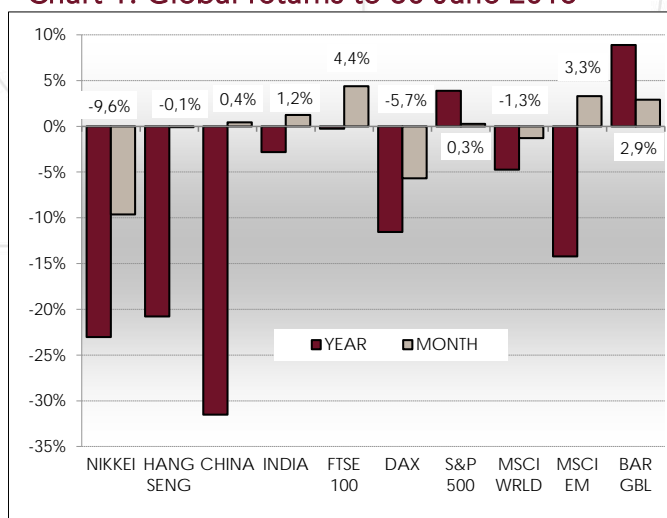


June in perspective – global markets

June 2016 will be remembered as the month in which Britain voted to end its 43-year-long membership of the European Union. Although opinion polls were close over the final few weeks leading up to the referendum, financial markets had been broadly positioned for a 'remain' vote; the assumption was that the undecided voter would vote for the status quo. That assumption proved to be incorrect, with 52% of voters wanting to leave the EU versus 48% voting to stay. Markets were caught off guard by the final outcome and moved dramatically over the subsequent days. The largest casualty was the pound, which fell 10% relative to the dollar as the referendum results were announced. Equity markets across the globe declined between 3% and 6% on the day. The subsequent resignation of David Cameron and infighting in the Labour Party compounded the uncertainty, as it became clear that neither the Remain nor the Leave camps had thought too much past the referendum.

Chart 1: Global returns to 30 June 2016



The dramatic decline in equity markets after the referendum results was followed by a strong rebound, as investors digested the news and anticipated looser monetary policies and intervention from major global central banks. As the years following the Financial Crisis in 2008/2009 have

showed us, expectations of loosening monetary policy by the major global central banks have been positive for Emerging Market equities and currencies, as well as commodity prices. It is no surprise, therefore, that the MSCI Emerging Market index, which rose 3.3% during June, outperformed the MSCI World Index, which fell 1.3%. Amongst the emerging market equity gainers were Brazil, which rose 6.3%, Indonesia 4.6%, and India 1.2%. When looking at the returns in dollar terms, however, they are even better, as these currencies all strengthened against the dollar. Amongst the developed markets, the Brexit results caused a wobble in European Banks, which declined 18.0% during the month. Peripheral European equity markets were hard hit: Greece declined 16.2%, Italy 10.0%, and Spain 9.0%. The Japanese market fell 9.6% as investor flocked to the yen, which rallied 7.5% against the dollar. The French equity market declined 6.0%, and the German market 5.7%. The UK's FTSE 100 index rose 4.4%, but this was a result of the significant non-pound earnings of many companies which make up that index. The US market rose 0.3%.

Emerging market currencies performed strongly during the month, with the rand gaining 7.1%, 7.4% and 14.5% against the euro, dollar and pound respectively. The Brazilian *real* was the standout performer, gaining 12.4% against the dollar as hopes for political changes in the country boosted the currency. Looking at the moves in developed market currencies, the movements against the reference currency of the dollar were significant. The pound and euro fell 8.2% and 0.2% respectively, while the yen rose 7.5% against the dollar. Commodity prices were led higher by precious metals prices as gold, platinum, palladium and silver rose 9.0%, 2.9%, 9.1% and 14.3% respectively. Copper rose 4.2%, nickel 11.6%, and iron ore 9.3%, while agricultural commodity prices rose as well.

"To achieve great things, two things are needed; a plan, and not quite enough time."

- Leonard Bernstein



What's on our radar screen?

Here are a few items we are keeping a close eye on:

- *The South African economy:* SA consumer confidence slumped to 7-year low in during May, echoing our concern about rapidly slowing SA economic activity. At its recent Monetary Policy Committee meeting, the SA Reserve Bank reduced its forecast for the 2016 growth rate from 0.6% to 0.0%. The International Monetary Fund reduced its 2016 forecast to 0.1%.

A man feeding swans in the snow in Tokyo



- *The US economy:* Data emanating out of the US provided a picture of an economy ticking along at a slightly faster rate than what was thought a few months ago. Job creation suffered a setback in early-June with fewer jobs (only 38 000) created than expected. However, job creation recovered in July by a greater extent predicted (287 000 jobs were created), although the unemployment rose 0.2% to 4.9%. There will obviously be a number of setbacks in the labour market recovery, but one needs to remember that the recovery has been going on for a number of years and is not going to last forever. For that reason it is only reasonable to expect the rate of recovery to slow, as the market reaches saturation and the scope for improvement recedes. Refer to [last month's Intermezzo](#) for a chart on this topic.

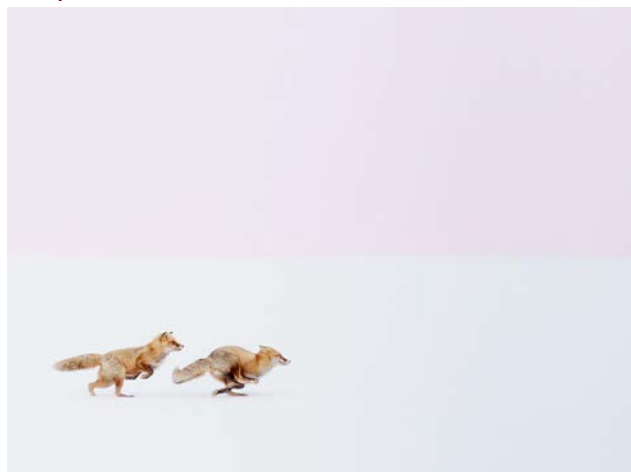
- *Emerging economies:* The Chinese economy grew at an annual rate of 6.7% during the second quarter (Q2), retail sales rose 10.6%, and industrial production 6.2%. Fixed asset investment rose 9.0%, but that represented a decline from May's 9.6%. In Malaysia the central bank (BNM) cut its overnight policy rate by 0.25% to 3.0%; the rate has remained stable since 2009. It also lowered its 2016 inflation estimate from 2.5% - 3.5% to 2.0% - 3.0%. The Malaysian government has an economic growth rate target of 4.0% - 4.5%. The major news emanating out of India was the announcement by the Governor of the Reserve Bank of India, Raghuram Rajan, that he was to step down in September. Rajan stepped into the post at a difficult time in September 2013 and earned widespread respect and credibility, particularly for the manner in which he stabilized the currency. Investors will be watching closely as to who his successor will be. In Mexico, interest rates were increased by 0.5% to 4.25% in an effort to stem the abnormal volatility that has bedevilled the peso in recent months. The Mexican economy remains relatively strong: it grew at an annual rate of 2.6% during Q1, with inflation running at 2.6% and unemployment at 4.0%.
- *Brexit:* this item was on our agenda for some time and you can now see why. I am happy to say that, by and large, our local and global portfolios didn't suffer any material adverse consequences from the Brexit fallout, although we regard market movements to date as initial only. The true consequences of the UK leaving the EU will surely only be manifest in the fullness of time. We are now going to replace our focus on Brexit with focus on the US election, although we will obviously still be monitoring the Brexit-related consequences on the UK, European and global economies very closely.

"To achieve great things, two things are needed; a plan, and not quite enough time."

- Leonard Bernstein



Japan – foxes on Hokkaido



Some quotes to chew on

A sign of the times

As we continue to draw your attention to the abnormality of the prevailing investment environment, the follow extract from *Deutsche Bank's Jim Reid* is prescient. It was written on the day that the yield (interest rate) on the German 10-year bond moved into negative territory – refer to Chart 3 below. “[Jim Reid’s daughter] Maisie is 9 months old today and has just started crawling over the last couple of days. Life just got more complicated. No longer can we just leave her in an area without defensible boundaries. I've been thinking of late as to what investments you would set up now for a young child to benefit from in years to come but also be fairly secure? Another way of looking at it is how can I get virtually guarantee to get 100 back on an investment in the middle of this century? Well one way would be to spend 231 Swiss francs today and buy a Swiss government bond that matures in 2049 (refer to Chart 4 below). You have the luxury of an annual 4% coupon to ease the pain of the ginormous capital loss but over the last couple of days, this 32.5-year bond joined the negative yield club ... You now have to pay the Swiss government for the privilege of lending to them for nearly 33 years. I wonder what the real return on that investment will be over its life time. All guesses

welcome. I don't think I'll be putting Maisie's pocket money in it.”

More evidence that the world has gone “moggy”

I am sure most of you have heard about the latest craze sweeping the world, namely “Pokémon Go” (*Ed: If you haven't, please don't ask!*) At the time of writing, Nintendo's share price has risen more than 100% from the day prior to the release of Pokémon Go in the US, New Zealand and Australia. Deutsche Bank offered the following comment, which places the share's recent performance into perspective: “Pokémon Go going viral has propelled Nintendo's share price over three-quarters higher in the last week. But how many downloads are needed to justify the \$17bn market value boost? Assume the game lasts ten years and profits fall one-tenth annually. Using a 5% cost of capital, Nintendo must generate \$3.3bn of earnings this year. That requires \$14bn of in-app revenue if Nintendo receives one-third of the revenue through its stakes in the Pokémon Company and the game's developer, Niantic, at a 70% profit margin. With Apple and Android taking their 30% cut, players must therefore spend \$21bn. If 5% of players actually pay (the same as Candy Crush) and they spend \$100 each, Nintendo's share price jump only makes sense *if the app is downloaded by every second person on planet Earth*” (my italics).

Some takeaways from Brexit

I thought the following extract from Jim Reid's EM Reid of Monday 27 June, the second working day after the Brexit vote, was relevant: “It's worth looking at the voting split in the UK's EU referendum based on polls compiled by Lord Ashcroft to get an idea of the disenfranchisement. In terms of socio-economic groups, 57% of ABs (upper/middle class – professional/managers, etc.) voted remain, 49% of C1s (lower middle class - supervisory/clerical or junior management/administrative), 36% of C2s (skilled working class) and 36% of DEs (Ds - semi and unskilled manual workers and Es - casual/lowest

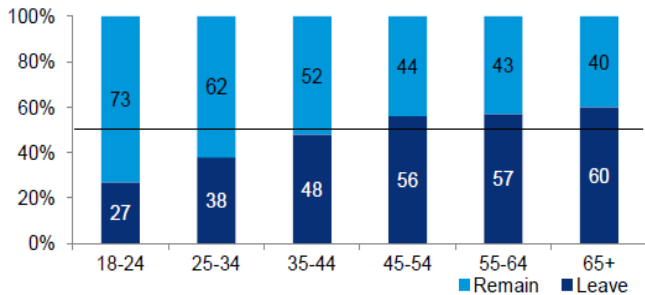
“To achieve great things, two things are needed; a plan, and not quite enough time.”

- Leonard Bernstein



grade worker or state pensioner). So there's no escaping the fact that this is a class war. Whether its globalisation, immigration, inequality, poor economic growth or a combination of all of them it's quite clear from this and other anti-establishment movements that the status quo can't last in a democracy. Eventually you'll have a reaction. This is one such major reaction and given that the UK growth rate has been ok of late, it would be strange if pressure didn't continue to build elsewhere where growth has been lower for longer."

Chart 2: Brexit votes by age-group



Source: Deutsche Bank

Jim Reid's analysis of the vote by virtue of income groups, or as he so succinctly puts it, by "class", is echoed across the age spectrum, as shown in Chart 2. It is clear that young people are in favour – by a large margin – of staying in the EU, while older people favour leaving. One final point to note about Brexit is that, notwithstanding the high voter turnout, effectively only 37% of eligible voters voted in favour of leaving. In many countries an absolute majority might have been set as the minimum threshold for such an important national decision. Now, the future really does hold a lot in store for the UK, in terms of the true costs and consequences of Brexit – we will be watching closely for these to emerge.

Foxes in Yellowstone National Park



China – in or out of MSCI indices?

Around mid-June, the MSCI Inc., best known for their indices used across the world, decided against the inclusion of China-A shares into the MSCI China index. Long-time readers will remember that we crossed this bridge in 2014 as well, when MSCI similarly decided to postpone the inclusion of China-A shares into their China index. This time around, MSCI ruled against an inclusion of China A-shares in the MSCI China index, pointing out that it needs more time to assess policy changes on the quota system, capital mobility, trading suspension and pre-approval restrictions on financial products. According to MSCI, it will reconsider an inclusion in its June 2017 market classification review. MSCI also left a door open for a potential off-cycle inclusion if significant positive developments occur ahead of its next annual review. The key message is that the inclusion of MSCI A-shares is not a question of if, but when. The China A-share market's combination of size and improved access makes the market hard to ignore. Julius Bär prepared a table, show below, which depicts the effects of the inclusion of China-A shares, had it happened. It is rather insightful. Even without the expected inclusion of a 5% weighting of China shares, the country still comprises more than a quarter of the MSCI Emerging market index.

"To achieve great things, two things are needed; a plan, and not quite enough time."

- Leonard Bernstein



Table 1: MSCI China – A share inclusion

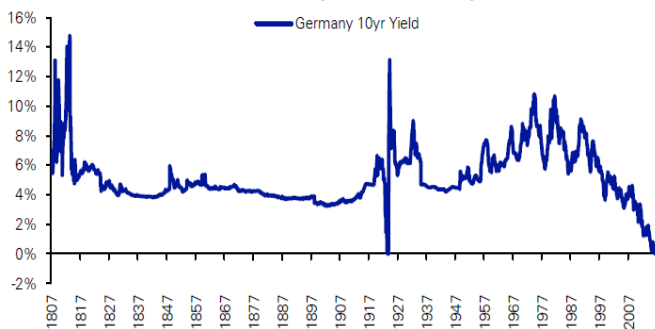
COUNTRY	WEIGHT	POTENTIAL INCLUSION (5%)	# STOCKS
CHINA	25.9%	27.3%	153
OF WHICH A-SHARES	n.a.	1.1%	
SOUTH KOREA	15.2%	14.9%	107
TAIWAN	12.0%	11.8%	88
INDIA	7.9%	7.7%	73
SOUTH AFRICA	7.1%	7.0%	53
BRAZIL	6.5%	6.4%	61
MEXICO	4.5%	4.4%	27
RUSSIAN FEDERATION	3.6%	3.6%	20
MALAYSIA	3.2%	3.2%	44
INDONESIA	2.6%	2.6%	31
THAILAND	2.3%	2.3%	32
PHILIPPINES	1.5%	1.5%	22
TURKEY	1.4%	1.4%	25
REST	6.2%	5.9%	99
TOTAL	100%	100%	835

Source: Julius Bär

Charts of the month

In what has been an ongoing feature of the markets in the years following the Great Financial Crisis in 2007/9, bond yields (interest rates) continue to decline (and prices rise accordingly). The features of the past month include the fact that the 10-year German bond moved into negative territory - refer to Chart 3, which runs from 1807. The German 30-year bond now carries an interest rate of only 0.5%.

Chart 3: German 10-year Bund yield (%)



Source: Deutsche Bank

In addition Swiss sovereign bonds, across all durations, now yield negative rates i.e. you have to pay the Swiss government to hold their debit – refer to Chart 4 for a historical perspective of the

downtrend. We draw attention to this development for a number of reasons: firstly, global bond markets have been stronger i.e. prices have firmed way beyond our expectations (although we still struggle to understand why investors would buy an asset which is assured of a negative return, assuming they hold it to maturity). Secondly, the rise in bond prices (decline in yields) has resulted in capital being reallocated into equity markets, which we think are now quite distorted i.e. higher than they would otherwise be, were it not for the unique bond market developments, which in turn are partly a function of the distortionary forces arising from central banks' quantitative easing (QE) activities. Thirdly, the bond market developments, specifically the negative rates, will cause massive problems for pensioners into the future, as investment managers struggle to find assets which will provide a steady stream of income to cover the pension funds' liabilities (to pensioners in the form of paying pensions and any annual increases therein). We are already starting to see some of the effects of this latter point, although this issue hasn't really seen sufficient coverage and we haven't started to see the consequent effects on society as a result.

Chart 4: Swiss 33-year bond yield (%)



Source: Deutsche Bank

This issue of increasing pension fund deficits is a complex and very technical one, so I won't overload you with details. However, it is one which is growing increasingly relevant in our aging society, compounded by the fact that the majority of

"To achieve great things, two things are needed; a plan, and not quite enough time."

- Leonard Bernstein



pensioners are growing poorer over time. It has a direct impact on listed companies, who are obliged to report on their pension deficits. A recent Deutsche Bank article focussed on the increasing risk to market valuations caused by rising pension fund deficits of listed US companies. I will end this section with an extract from their report: "S&P pension funding likely took a big hit given the drop in long-term yields. Companies don't report funding until year-end, which will be based on year-end interest rates and assets. The ~130bp drop in Baa corporate yields (year-to-date) likely added roughly \$250bn to the present value of liabilities. Return on assets, which includes bonds, likely kept pace with the unwinding liability discount rate. Thus, we estimate liabilities to be \$2.3trn and assets \$1.7trn right now, for a record deficit of ~\$600bn, up from the \$300-400bn range of recent years. This deficit is 3% of S&P market cap, but more significant at many Industrials, Materials, Airlines, Auto, Utilities. Year-end funding status affects 2017 S&P EPS. If near this level, it will be a ~\$1 drag to 2017 S&P EPS growth. Fair value pension charges hit 4Q 16 earnings."

Ermine in the early spring

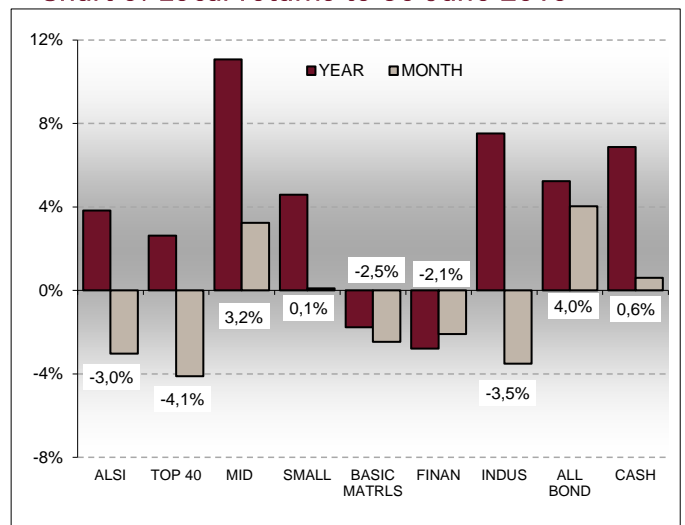


June in perspective – local markets

Most of the major indices declined during June, apart from the Gold index, which rose 23.7%. The Industrial and Basic Materials indices were inhibited by a

stronger rand, and declined 3.5% and 2.5%, respectively. The Financial index lost 2.1% despite the rand. All of this respective activity led to the All Share index declining 3.0%. The Top40 (Large cap) index fell 4.1%, but the Mid cap index (supported by the gold and platinum miners) rose 3.2%. The Small cap index rose 0.1%. Foreign investors searching for yield poured into the local bond market, which powered the All Bond index 4.0% higher.

Chart 5: Local returns to 30 June 2016



The best-performing sectors on the SA equity market were Industrial Metals, which rose 37.1%. Gold Mining rose 23.7% and Fixed Line Telecoms rose 19.3%. The worst performers were Chemicals, down 15.4%. The Beverage sector fell 13.2% and Real Estate Investment and Services 12.9%.

For the record

Table 2 lists the latest returns of the mutual and retirement funds under Maestro's care. Returns include income and are presented *after* fees have been charged. Fund Summaries for each respective fund listed in the table, as well as all the historic returns, are available on [our website](#).

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Table 2: The returns of funds in Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Prescient				
Fund	Jun	-0.8%	-0.3%	-3.2%
<i>JSE All Share Index</i>	Jun	-3.0%	4.3%	3.8%
Maestro Growth Fund				
Fund	Jun	-3.3%	-3.0%	-2.4%
<i>Fund Benchmark</i>	Jun	-1.6%	4.9%	6.3%
Maestro Balanced Fund				
Fund	Jun	-3.1%	-2.1%	-1.0%
<i>Fund Benchmark</i>	Jun	-1.3%	4.8%	6.6%
Maestro Cautious Fund				
Fund	May	0.8%	2.1%	1.4%
<i>Fund Benchmark</i>	May	0.6%	6.2%	5.7%
Central Park Global				
Balanced Fund (\$)	May	-5.4%	-6.3%	-18.2%
<i>Benchmark*</i>	May	-0.1%	1.2%	-2.2%
<i>Sector average **</i>	May	-0.2%	0.5%	-5.7%

* 40% MSCI World Index, 20% each in Barclays Capital Global Aggregate Bond Index, Dow Jones Credit Suisse Hedge Index and 3-month US Treasury Bills

** Morningstar USD Moderate Allocation (\$)

So what's with the pics?

I thought it would be appropriate, seeing most of our readers are in the midst of winter, to use snow as a theme for this month's photographs. Unless otherwise indicated, all of the photographs were sourced from National Geographic's [Photo of the Day](#) series.

Snowy owl in Canada



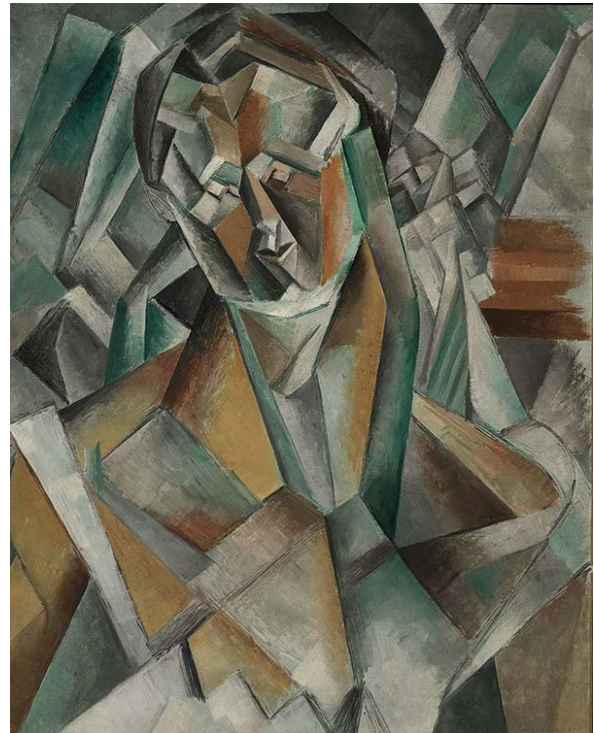
File 13: Information almost worth keeping

Picasso's Femme Assise

In [last month's Intermezzo](#) we reported on the expected sale in June of a very rare Picasso painting, *Femme Assise*. You might be interested to know that the work sold for \$63.5m.

Pablo Picasso. *Femme Assise*. 1909.

Oil on canvas, 81 x 65cm. Private Collection.



Source: www.news.artnet.com

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