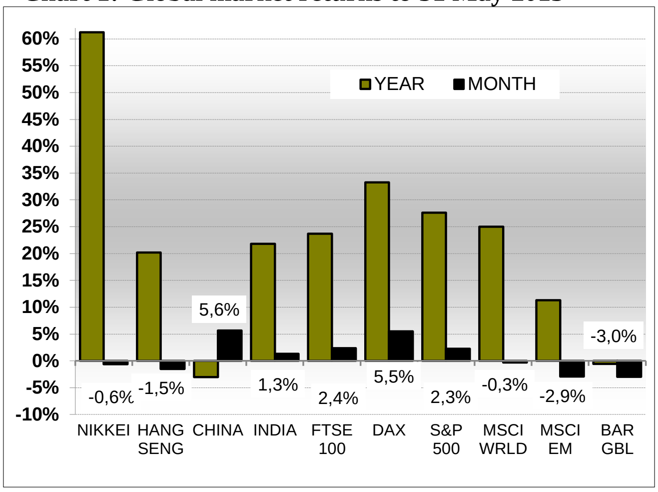
MAESTRO
INTERMEZZO
Investment Letter | 13th Edition | June 2013

May in perspective – global markets

Global investment markets' behaviour during the past month was particularly interesting. A wave of volatility swept through the markets in the last week of the month, rendering them virtually unrecognizable from the middle of the month. The major features included high drama in Japan, a sell-off in bonds across the world and the collapse in the rand which brought dramatic movements on the SA equity market. The over-riding feature and cause of the current volatility on global markets remains the Quantitative Easing (QE) of the major central banks. In Japan the Bank of Japan (BoJ) is trying to double the supply of money in a short space of time in order to create inflation and stimulate economic growth. This is a high-risk experiment in economic and social engineering, the outcome of which is far from certain. Investors agree: the Japanese equity market has risen 80.4% since its low point in November 2012. Since the beginning of the year to the end of May, it has risen 32.5% but was particularly volatile during the month, declining 15.1% off its intra-month peak. The cause of much of this volatility is the value of the yen in dollar terms; the BoJ is explicitly trying to weaken the yen in order to stimulate their export sector, which constitutes a major part of their economy. The yen volatility and uncertainty is creating huge volatility in the Japanese bond market, which declined sharply during the month. In the US, investors are increasingly speculating when the Fed will begin to scale back its QE program. This led to the dollar increasing in value against most currencies and led to a sharp decline in bonds prices and an increase in their yields. Thus, the dollar rose 1.7% against the euro and 2.7% against sterling. The Barcap Global Bond Aggregate index declined 3.0% during the month although many specific regional bonds performed much worse. Emerging markets were particularly hard hit by these events.

Chart 1: Global market returns to 31 May 2013



The large swing by global investors away from emerging markets and into developed markets is well entrenched. Outflows from emerging bond and equity markets gathered momentum and was one of the factors behind the very weak emerging currencies in May. Commodity exporters such as South Africa and Australia were particularly hard hit. We are familiar with the 10.7% collapse in the rand during May, but the Aussie dollar lost 7.6% against the dollar and the Brazilian real lost 6.2%. The rand's abysmal performance during May was thus not isolated to SA events; it was part of a broader move out of emerging markets and commodity exporters. Surprisingly, not all commodity prices were weak. Gold lost 5.1%, platinum 3.2% and oil 1.9% but palladium rose 6.4% and copper 2.3%. Iron ore lost around 15% though and the widely-followed commodity indices lost between 1.2% and 2.0%. Despite all the volatility, most global equity markets continued their steady rise to new peaks. The US market rose 2.3%, Germany's market rose 5.5% and London 2.4%. Ironically, the Chinese market rose 5.6% but that must be seen in the context of its weakness so far this year. For all its extraordinary volatility, the Japanese market ended up only 0.6% on the month. Emerging markets were not that lucky. The SA equity market lost 3.1% in dollar terms. Brazil lost 4.3% and Russia 5.0% (the Russian market follows the fortunes of the oil price closely). US mid and small caps rose 2.1% and 4.2% respectively, bringing their year-to-date gains to 16.1% and 18.1% respectively, which are quite extraordinary by any standards.

What's on our radar screen?

Here are a couple of items we are keeping a close eye on:

- *The SA economy:* SA retail sales rose 2.8% in the year to March, lower than the 3.9% annual increase for February and lower than expected. Inflation rose 0.4% on the month and 5.9% in the year to April, which was the same rate as the month before. That must have been one of the considerations for the SA Reserve Bank, who left interest rates unchanged at their monetary policy committee (MPC) meeting. One of the most disappointing pieces of data to emerge during the month was the SA first quarter (Q1) economic growth rate, which managed an increase of only 0.9%, down from 2.1% during Q4 of 2012. Mining rose the most, up 14.6% but that was off a very low (strike-induced) base. Manufacturing was the most moribund of all sectors, declining by a whopping 7.9%. If one excludes the effect of the increase in mining activity, the SA economy grew only 0.2% in Q2, woefully below expectations and certainly not sufficient to improve the lives of ordinary South Africans. Table 1 sheds more light on the respective contributions from the sectors that constitute the economy:

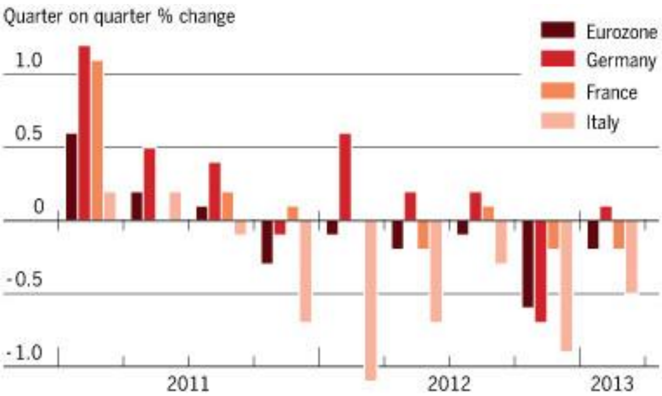
Table 1: SA GDP growth breakdown (%)
Quarter-on-quarter seasonally adjusted annualised rate

	2011	2012	2012		2013
	ann. ave	ann. ave	Q3	Q4	Q1
Agriculture	-0.1	2.3	7.4	10.0	-4.9
Mining	0.3	-4.0	-12.7	-9.3	14.6
Manufacturing	3.6	2.4	1.2	5.0	-7.9
Electricity	1.1	-1.2	1.6	-2.2	-3.0
Construction	0.5	2.5	3.3	0.2	0.9
Trade	4.5	3.6	1.7	1.5	1.9
Transport & comms	3.1	2.3	1.1	1.9	2.2
Finance & business	4.0	3.3	1.8	2.9	3.3
Government	3.9	3.1	2.7	2.6	1.9
Personal services	2.5	2.1	2.1	2.5	1.4
GDP at basic prices	*3.3*	*2.4*	*1.1*	*2.2*	*0.8*
Taxes less subsidies	4.9	3.8	2.5	1.9	1.5
Total GDP	3.5	2.5	1.2	2.1	0.9

Source: Deutsche Bank

- *The US economy:* The first estimate of Q1 US GDP growth was revised down from 2.5% to 2.4% although the underlying quality of the growth improved; personal consumption was revised from 3.2% to 3.4%. Most economic data was in line with expectations and revealed an economy that was chugging along but seemed unable to get out of first gear.
- *Developed economies:* May saw the release of a plethora of growth rates for the first quarter of this year (Q1). **Japan's** economy grew at 0.9% quarter on quarter or 3.5% in annualised terms. The December quarter (Q4) growth rate was revised up to 0.3%. So Japan has now officially grown for two consecutive quarters. The story in Europe was entirely different though, with the **eurozone** declining at a rate of 0.2% in Q1, following its 0.6% contraction in the December quarter. The Q1 decline in growth was the sixth consecutive decline in the 17-member eurozone - the longest recession since the single currency was created - highlighting just how entrenched the recession is. The individual countries' growth rates made for awful reading. **Germany** was the only economy to register positive growth, and then only at 0.1% in Q1 (it grew 0.7% in Q4). **France** contracted 0.2%, taking it back into recession, **Italy** and **Spain** shrank 0.5%. **Portugal** shrank 0.3% and the **Netherlands** 0.1% while **Austria** registered 0.0% i.e. zero growth. Chart 2 depicts more detail.

Chart 2: Eurozone Q1 economic growth



Source: FT.com

- *Emerging market economies:* **China's** inflation rate rose to 2.4% in April from 2.1% in March. In **Hong Kong** inflation rose to 4.0% and unemployment stood at 3.5%. **Indian** inflation declined to 9.4% in April from 10.4% in March. **Indonesian** inflation rose to 5.6% in April and Q1 growth was 6.0%. Its foreign exchange reserves stood at $107.3bn. **Malaysian** inflation rose from 1.6% in March to 1.7% in April, Q1 growth was 4.1% and its foreign exchange reserves totalled $140.3bn at the end of April. Although growth fell to -0.3% in **Singapore** in Q1, its reserves rose to $261.7bn – not bad for a city state, don't you agree? **Russian** inflation is 7.2% and its Q1 growth rate 1.6%.

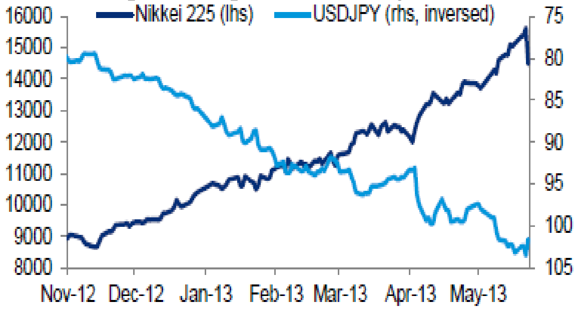
Global chart of the month

It is remarkable that more countries have not made more of a fuss of the blatant attempts by certain nations to manipulate their currencies for their own gain. The United States is an obvious example, but more recently Japan has moved into the spotlight. Japan has embarked on the largest program of quantitative easing (QE) the world has ever seen. This policy action will go down as one of the biggest gambles any Central Bank has ever taken. To put the Bank of Japan (BoJ) policy action into perspective, consider the following: the US Federal Reserve (the Fed) is making annual net purchases equivalent to 7.0% of their GDP; Japan will be purchasing close to double that, at 13.0% of GDP. In addition, The BoJ is not only buying fixed income assets like government bonds and mortgage-backed securities, but is also buying equities through exchange traded funds (ETFs) and real estate investment trusts.

This unprecedented step is an attempt to end deflation and boost domestic growth. Japan is an export driven economy. A weaker yen therefore has the effect of boosting imported inflation and stimulating growth. This is evident from chart

3 below, which depicts an almost perfect, inverse relationship between the value of the yen and the level of the Japanese equity market (the Nikkei 225 index). Over the period under review the yen has lost 25.0% of its value against the dollar while the Nikkei has climbed over 60.0%.

Chart 3: Japanese equities and the yen dollar rate



Source: Merrill Lynch

Of primary concern to us are the long-term, unintended consequences of this radical policy action. Japan's debt to GDP is well over 200% or twice the indebtedness of the United States. To make matters worse, Japan faces a population that is not only declining in size but increasing in age as well. A lot of the country's debt troubles have been masked by exceptionally low interest rates. The cynics amongst us would be inclined to think that the country could be sailing towards the perfect storm: higher interest rates, a devaluation of the currency and poor demographics. Japan is not only the third largest economy in the world, but is also the second most indebted nation in the world.

It remains a mystery to us why anyone would want to purchase a Japanese 10-year government bond that yields around 1.0%. Of greater concern is that if the Bank of Japan wants higher inflation and a weaker currency, future investors will expect to be compensated in the form of higher interest rates. When a large portion of your tax revenue is spent on servicing debt, this obligation is only going to get more onerous as interest rates rise. This gamble will unfold as the race between economic growth and repayment of debt go head to head; sadly this situation is a zero sum game.

A few quotes to chew on

Interest rates – still on the way down

On 10 May the following appeared in *Deutsche Bank's* widely followed early morning report, *The Early Morning Reid,* authored by Jim Reid. I thought the comment was pertinent, given that it is easy to think interest rate reductions are a thing of the past, given their historically low levels in absolute terms. "Speaking of rate cuts, the BoE yesterday defied joining the recent trend of surprise central bank easing seen in the past week. Our own Dr Buckley noted that the past week has seen six central banks cut policy rates: The ECB, Danmarks Nationalbank, the Reserve Bank of Australia, the Reserve Bank of India, the National Bank of Poland and, last night, the Bank of Korea which collectively represent some 23% of world GDP. The BoE's decision was not a surprise especially given the recent momentum in UK data flow."

The Anniversary piece - by David Pfaff

Once a year we are given the opportunity to write a piece for *Intermezzo* on anything we like. Regular readers may recall that my last contribution ended with me awaiting the birth of our first baby and one year on I'm happy to report that she arrived safely and Susan and I are now the proudest parents of our beautiful little girl, Evangeline.

It's been a life-changing year, challenging at times, but filled with moments you wish you could freeze in your memory forever. This last year has really brought home the truth behind the saying that time and tide wait for no man. The speed at which young children develop and grow is truly one of the most remarkable things I've experienced. I have to pinch myself that Eva, as we call her, turned one year old on the 18th of last month. She has six teeth, crawls in fast forward and stands up unassisted for a full ten seconds! Her mum and I are convinced that she's 'very advanced' but apparently every parent thinks the same of their own child.

I often wish I could press the "pause" button to really enjoy all the tiny milestones and achievements, but at the same time I can't help but look ahead, way into her future, to think about ways in which we can help and support her as she grows older and goes to school and beyond.

It's these thoughts that have inspired me to write this piece, partly as an exercise for my family, but also for a number of friends of ours who have also had children recently. I'm in no position to hand out parental advice, but I am in a position to help our little family prepare for the future by making plans now for Eva's education. Any parent who has put or is planning to put a child through university will know the impact this can have.

Besides loving, teaching and supporting your child through life, providing them with the opportunity to complete a tertiary education must be one of the greatest gifts you could give them. They may or may not choose to take you up on this offer, but I'd rather prepare now in order to be able to offer the opportunity should they wish to pursue it. So, seventeen years in advance, I decided to take the plunge and look through the University of Cape Town's fees handbook.

To make the exercise a little more tailor-made for Eva, Susan and I tried to anticipate what she might want to study at University so that we could 'enrol' her on a course that was suited to her current interests.

Perhaps all babies are the same, but she's currently obsessed with all things electrical. She ignores her baby toys and instead heads directly for the telephone wire, plug socket, television aerial, remote control, heater switch and basically anything that has buttons, switches or wires. With this current fascination in mind, I paged directly to the department of engineering and selected a course on electrical engineering to use as my starting point.

My goal was to establish the current cost of a university degree in order to estimate the future costs of that same degree and identify how you can invest appropriately now, in order to cover the sizeable costs in the future.

Rather alarmingly, according to the UCT fee handbook, the current cost of a 5 year BSc Engineering degree (with honours) is R530 990. This includes academic fees, accommodation, food and ancillary expenses for the full duration of the course.

I've listed the current (2013) figures in Table 2 (alongside) and I've included the projected figures of the cost of the same course in 18 years' time.

The methodology I used to arrive at the future cost of a BSc degree is as follows: I broke the costs into the categories of academic course costs, accommodation/food and ancillary expenses. What is important to keep in mind is that “UCT inflation” was just over 9.1% last year, not the official 6.0% reported. I identified this rate by comparing the 2012 and 2013 course fees and accommodation rates, all of which are clearly laid out in the fees handbook.

I think what catches most people off guard about the price of future goods is the rate at which they increase from year to year i.e. inflation. In order to take inflation into account and estimate Eva's future fees, I escalated today’s costs by 9.1% per annum over the next 18 years. The resulting figures show that a half-million rand expense today (R530 990) is a R2.5m commitment in just under two decades.

This article is not meant to scare young parents but rather to highlight the magnitude of the current cost and to help them understand how they can get themselves into a position to be able to pay for this in two decades’ time. Ensuring you have put enough away for your children’s education can be achieved by a combination of self-discipline and the power of long-term investing or compounding interest, which is only meaningful over long periods of time. What needs to be avoided at all costs is the attitude that you will simply save more money closer to the time. You may be one of the lucky ones who are able to do this, but for most people this strategy will in all likelihood backfire badly.

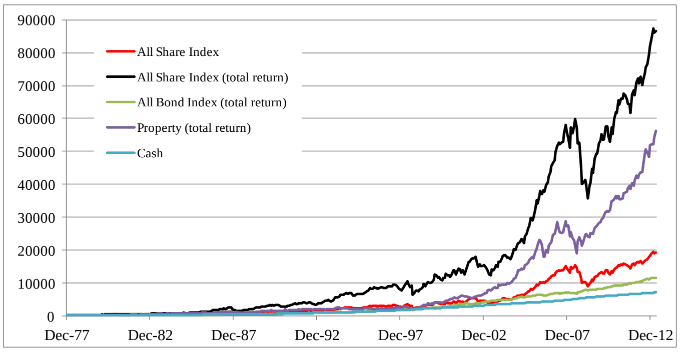
Table 2: Projecting the future cost of education

Faculty of Engineering		
Course: BSc Eng (Electrical)		
1st Year	R 44,500	
2nd Year	R 46,500	
3rd Year	R 46,000	
4th Year	R 47,500	
5th Year - BSc (Hons)	R 44,790	
Course (sub total)	**R 229,290**	
Accom. & Food		
Baxter Hall (single room)		Full catering (3 meals)
1st Year	R 36,300	R 14,300
2nd Year	R 36,300	R 14,300
Flat share (2 others)		Self catering (3 meals)
3rd Year	R 30,900	R 14,300
4th Year	R 30,900	R 14,300
5th Year	R 30,900	R 14,300
Accom. & Food (sub total)	**R 224,200**	
Ancillary expenses (p.a.)		
Books & Stationery	R 6,000	
Educational equipment	R 3,000	
Living expenses	R 6,500	
Local transport		
Sundries		
Ancillary (5 yrs) (sub total)	**R 77,500**	
Total cost (2013)	**R 530,990**	
Future estimated cost (2030)	**R 2,559,843**	

Source: UCT Fees handbook (www.uct.ac.za)

There are many tailor-made education policies that smooth-talking salesmen will try to sell you, but these products are designed to make the sellers and the institutions wealthy. The reason they're successful is due to the real need for an investment of this nature in the market place. I would argue that all you need is a good General Equity Unit Trust (or Fund). When you save money and place it into our (Maestro’s) care, as investment managers we have a few options where to invest it on your behalf. These options can be loosely defined by different asset classes, namely equities (shares), bonds, property or cash. The resultant allocation across these different asset classes will depend on the investor's objective and time horizon. If the primary goal of the investment is capital appreciation (which in our case it is), then equities are the correct (and only!) choice. In order to provide some substance to my argument I have collected three decades of data which highlight different asset class returns over this period.

Chart 4: Historical asset class indices



Source: Maestro Investment Management

You will be hard pressed to find a risk-adjusted investment that has delivered a superior return to the total return index of the Johannesburg Stock Exchange (JSE) over the past three decades. Sure, the cynic will point towards one or two single investments that would have outpaced the JSE, but what's not spoken about are the hundreds that went to zero! Remember high risk doesn't necessarily mean high return, it can also mean no return at all. By investing in a General Equity Fund, such as the [Maestro Equity Fund](), your investment is spread across approximately 25 different shares which provide great diversification and ultimately reduce the risk.

With this in mind I believe there are two approaches the average family can take in order to secure their children's education. One is the "big bang" approach, which involves investing a lump sum into a General Equity Fund right now. The approximate, current cost of a 5-year Honours degree is R500 000 which means that you need to have *about R80 000 in the market today* in order to meet the future capital requirement of R2.5m. This assumes that the General Equity Fund in which you invest will match the average compound growth rate of the All share index over the past 35 years, which, incidentally, is an astonishing 21.4%.

The second more affordable approach is by making annual contributions to the particular Fund. Although this does come with less "guarantee" of achieving the goal, given that you do not have the full contribution in the market for the entire period, it is better than having no strategy at all. The end result will no doubt be a satisfactory one and very close to what is actually required. If one chooses this method, it would be safe to assume an *annual contribution of R17 000 would be sufficient*.

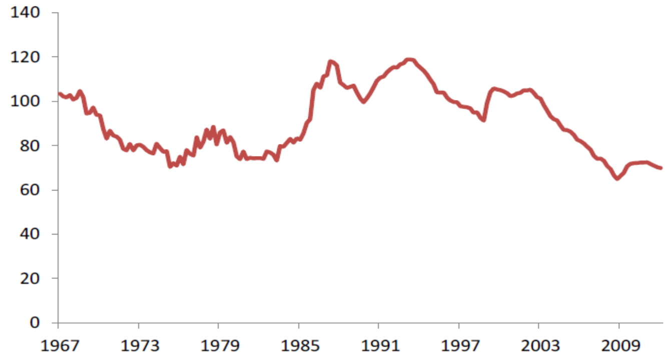
Personally I think Eva's going to be a professional tennis player and I think I'll be spending South African winters in sunny Wimbledon, watching from the side lines at Centre Court. If that's the case, our hard saved money will be spent flying across the ocean to cheer on our little girl! Either way, we realize that we need to commit now to investing in her future, no matter which direction it takes.

Local chart of the month

In the last two editions of *Intermezzo* the domestic chart of the month" has focused on South African labour issues. We are deeply concerned not only about labour, but government's inability to address particular issues prevalent in this sector. This month we focus on labour productivity, or the lack thereof. Despite having one of the highest unemployment rates in the world, our country remains hostage to ridged labour laws and powerful trade unions. The paid-up membership of the trade unions pales in comparison to the number of unemployed, yet the unions continue to wield a significant amount of power. The answer obviously lies in the inextricable link between government and these unions. The recent rivalry between unions has resulted in a number of wildcat strikes at different mines across the country. This not only exacerbates the problem of productivity, but ultimately results in a loss of focus by the unions as they shift from serving their members to serving themselves.

Chart 5: SA labour productivity (1967 – 2012)

Marginal productivity of labour (1960s = 100)



Source: Statistics SA, Adcorp

On one hand unions argue for a weaker rand and on the other hand government tries to defend the recent collapse of our currency. If one were looking from the outside in, it seems as though, despite well documented plans on how to develop our nation, our leaders cannot agree on how to do it. To be frank, they seem confused.

MAESTRO INTERMEZZO

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South Africa's labour productivity recently fell to a 46-year low. Most of the decline in labour productivity has occurred since 1995. It is no coincidence that the most radical change in labour laws occurred in that year in the form of the Labour Relations Act (1995). From an employer's perspective, two provisions of the Act are problematic; *dismissal protection* and *wage escalations.* In a world characterized by globalization and mobility of capital, it would be naïve to believe that further regulation of labour in favour of trade unions could be anything but detrimental to the well-being of this country. Decisive decisions about our country's future need to be made; the problem as we have suggested before, is our leader's ability to lead.

For the record

Table 4 below lists the latest returns of the mutual and retirement funds under Maestro's care. You can find more detail on 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 4: The returns of funds under Maestro's care

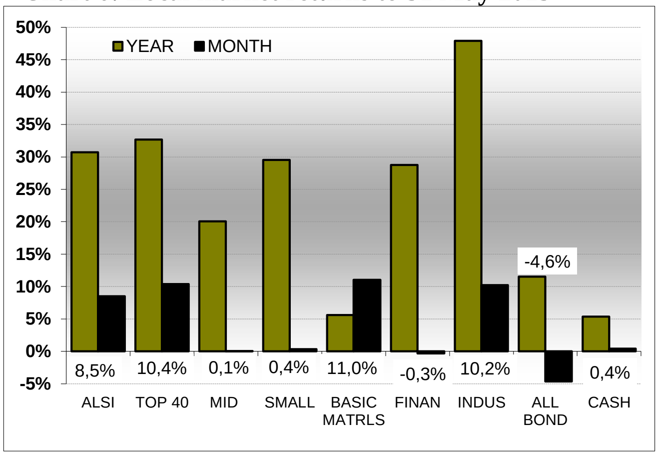
	Period ended	Month	Year to date	Year
Maestro Equity Prescient Fund	**May**	**4.8%**	**4.3%**	**20.4%**
JSE All Share Index	*May*	*8.5%*	*8.4%*	*30.7%*
Retirement Funds				
Maestro Growth Fund	**May**	**3.9%**	**4.8%**	**17.3%**
Fund Benchmark	*May*	*5.3%*	*7.7%*	*24.3%*
Maestro Balanced Fund	**May**	**3.4%**	**4.7%**	**16.2%**
Fund Benchmark	*May*	*4.5%*	*7.1%*	*21.7%*
Maestro Cautious Fund	**May**	**1.1%**	**3.6%**	**14.2%**
Fund Benchmark	*May*	*1.3%*	*3.6%*	*14.6%*
Central Park Global Balanced Fund ($)	**Apr**	**-5.7%**	**-7.6%**	**-6.7%**
*Benchmark**	*Apr*	*1.7%*	*4.9%*	*7.7%*
*Sector average ***	*Apr*	*1.7%*	*4.6%*	*5.8%*

* 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 ($)

May in perspective – local investment markets

May was a remarkable month by almost any measures; it held more than sufficient reasons to register substantial underperformance - if you never held large cap, offshore based industrials you simply never produced a decent return in May – but was also a month in which equity investors were again rewarded for the risk taken with their capital. The general trend throughout the month in SA equity markets was up. Industrial companies, particularly those whose primary listing is offshore, led the gains, although resource companies, which have lagged very badly so far this year, participated in the gains. Financials lagged throughout the month. However, in the last week of the month the rand took a major leg down and foreign selling became very aggressive and influential. When all was said and done the All share index ended up 8.5% on the month although you must recognize that a lot of that was driven by the weak rand pushing up the value of the likes of Anglo, BAT, Billiton, Richemont, SABMiller and the like. The industrial index, whose value is driven to a large extent by the latter companies, ended up 10.2%, bringing its annual gains to end-May to an astonishing 47.9%. Financial shares totally missed out on the party; they declined 0.3% on the month having been spooked by poor trading statements from some life assurers and more importantly from the extreme reaction to Abil's results which seemed to indicate that a crisis was developing in the unsecured lending market.

Chart 6: Local market returns to 31 May 2013



Despite all the action there are still some glaring anomalies in the SA equity market. Consider for example, that despite the basic materials index's 11.1% rise in May, it is still down 6.7% for the year-to-date; that the gold index rose 2.8% but is still down 31.9% for the year-to-date; that the industrial index is now up 16.9% for the year-to-date, notwithstanding its 40.8% rise in 2012. These are indications of just how unusual the equity market activity has been so far this year. Earlier I referred to the manner in which large, offshore-listed companies, which nevertheless form part of the SA indices, were the primary drivers of the gains during May? This is very evident when one considers that the large cap (Top40 index) index rose 10.4% in May, while the mid and small cap indices managed gains of only 0.1% and 0.4% respectively. Yet there is a large disparity between their respective year-to-date returns: the large cap index is up 9.5% thanks to their surge in May, the mid cap index is up only 2.4% thanks to the drag created by a severe down rating of retail stocks and more recently the unsecured lenders (like Abil) and finally the small cap index is up 9.8% for the year-to-date despite not really going anywhere in May. There were also pockets of real weakness in the SA equity market in May despite the gains. The property sector was very weak, for example, with the real estate investment and services index declining 9.0%. Redefine, Growthpoint, and Hyprop for example lost 8.9%, 13.9% and 14.0% during the month. And in the midst of it all, the All bond index, under pressure from foreign selling on the back of both a sell-off in bonds globally and the collapsing rand, lost 4.6% in May, reducing its year-to-date return to only 0.2%.

Freak markets – chapter 2

During the past year or so we have often alluded to the prevailing market conditions as unusual or abnormal. Some of you might wonder why, so we started this short section to explain why we view the current market conditions as anything but normal.

Chief amongst these distortionary factors at present is the powerful force of quantitative easing (QE) whereby central banks are buying up their own government debt, and other forms of debt, in order to boost the money supply, keep interest rates artificially low and boost economic growth. Chart 7 depicts in a synoptic manner how, since 1998, the yield on US bonds (5-year US bonds in this case) and the US equity markets have moved in tandem. However, since the market trough in 2009 the two have moved in different directions – the equity market has recovered while bond market yields have moved even lower. Admittedly it is rather simplistic to assume that these two indicators will always move similarly, but we thought the chart displayed the prevailing freak market conditions rather nicely. If and when US yields start rising – they are already beginning to do so in recent days – one wonders what will happen to the US equity market. That, I'm afraid, is a long discussion which we will leave for another day.

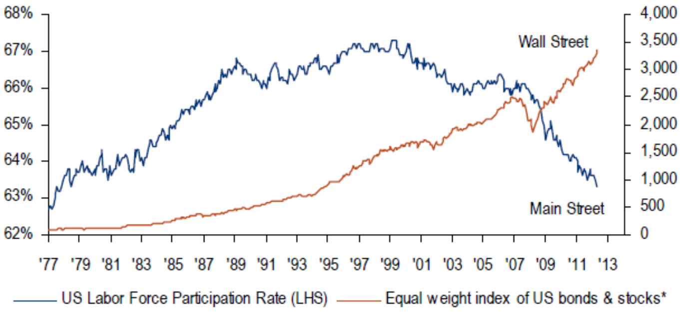
Chart 7: Record low bond yields and high equities

Source: Merrill Lynch

Another indicator of the unusual market conditions, and perhaps something far more serious than market "levels and yields" is the issue of society at large. At our recent Quarterly Investment Meeting we re-examined our Big Picture Themes as they were in need of being refreshed. We will share them with you at some stage but I can tell you that one of our big concerns, which we tabled as a Big Picture Theme, was what we have called the "Social crisis in the making". This refers to the rising number of unemployed and disenfranchised youth around the world, who have been the casualties of the recent financial crisis and large austerity programs implemented by governments. In addition they will be asked to bear the brunt of the burden of repaying trillions of dollars of debt that policy makers are currently heaping upon future generations with gay abandon. This is a complex subject and its implications for investment markets will require some serious and thorough debates, but as an example of what I am referring to, consider chart 8, which shows how the participation in the US labour force has declined i.e. an increasing number of employable workers are giving up looking for employment, plotted against an equal weighted index of US equities and bonds i.e. measures of wealth. Common sense dictates that these two measures cannot move in opposite directions indefinitely – yet look at the dramatic movements in recent years in these two indicators.

Chart 8: Haves versus Have-nots – the US experience

New highs on markets, multi decade lows in labour participation



Source: Merrill Lynch

And just in case you thought it was a US phenomenon, chart 9 depicts the similar trend that has developed in the eurozone. It shows an equal weighted index of German bonds and equities against youth unemployment in the 15 to 24-year old age cohort in Greece, Italy, Portugal and Spain. So not only are we experiencing freak market conditions, but the latter are also giving rise to problems which will shape the economic landscape for decades to come and the resolution of which are complex and at this stage at least, impossible to fathom.

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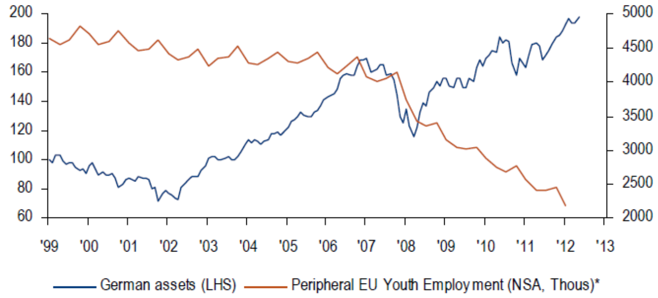
Chart 9: Haves versus Have-nots – the EU experience
New highs on markets, multi decade lows in youth unemployment



Source: Merrill Lynch

File 13: Information that is almost worth remembering
Putting QE into perspective
We have written a lot about governments' policy of quantitative easing (QE), whereby central banks are buying up their own government debt, and other forms of debt, in order to boost the money supply, keep interest rates artificially low and boost economic growth. Earlier in this edition we alluded to the fact that the US Fed was buying the equivalent of 7.0% of their entire GDP on an annual net basis while Japan was buying virtually double that, at 13% of their GDP. What is even scarier is that the Fed bought more than a third of all the debt which the US government issued during the first quarter of 2013. It makes one wonder where interest rates would be, or where the US and global growth would be, in the absence of such vast quantities of artificial stimulation by means of QE!

Table 5: MSCI returns to 31 May 2013(%)

	YTD	MTD
ACWI	**8.1**	**-0.6**
DM	**10.0**	**-0.3**
Asia Pacific	**7.8**	**-7.3**
Australia	-1.6	-12.8
Hong Kong	2.9	-2.6
Japan	13.5	-5.7
New Zealand	0.1	-12.9
Singapore	-0.4	-5.7
GEM	**-4.4**	**-2.9**
EM Asia	**-1.4**	**-1.1**
China	-4.7	-1.3
India	-2.0	-3.3
Indonesia	9.3	-5.1
Korea	-6.0	0.4
Malaysia	5.4	2.6
Philippines	16.8	-3.2
Taiwan	3.7	-0.1
Thailand	4.2	-6.9
EMEA	**-10.5**	**-4.0**
Czech	-17.4	-2.5
Egypt	-9.3	4.0
Hungary	2.6	1.1
Morocco	-6.4	-7.1
Poland	-8.3	3.1
Russia	-10.1	-4.6
South Africa	-15.2	-5.4
Turkey	4.1	-4.6
LATAM	**-7.7**	**-7.2**
Brazil	-7.8	-7.4
Chile	-7.8	-8.3
Colombia	-18.3	-7.2
Mexico	-3.0	-6.2
Peru	-22.3	-8.4

Source: Merrill Lynch