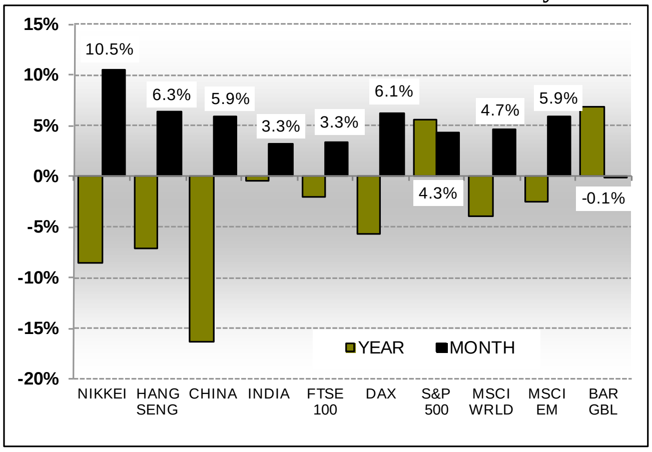
MAESTRO INTERMEZZO
Investment Letter | 12th Edition | March 2012

February in perspective – global markets

The “feel good” factor continues to influence global equity markets heavily as the monthly and year-to-date returns show. Despite spluttering progress being made in the European crisis – few believe the latest €130bn Greek bailout is anything but a “Band-Aid” solution – and no progress on the US debt crisis, investment markets continue to recover from their extremely pessimistic September 2011 levels. By way of example amongst developed markets Japan rose 10.5% in February, buoyed by a weak (-5.8%) yen, Hong Kong rose 6.3%, Germany 6.2%, the US 4.3% and the MSCI World index 4.7%. Developed markets gained even more; the MSCI Emerging market index rose 5.9%, led by Russia up 10.5%, South African 6.5% in dollar terms, China 5.9%, Brazil 4.3% and India 3.3%. Bond markets took a breather; the Barcap Global Aggregated bond index declined 0.1% and cash returns remain zero.

Chart 1: Global market returns to 29 February 2012



At the risk of repeating myself, it is worth highlighting just how fast markets have been out of the 2012 starting block. Table 1 lists the returns for selected markets since end-September 2011, the lowest monthly close for most markets, using local indices (denominated in local currencies of course), year-to-date returns, the returns for the December 2011 quarter and finally the annual returns for the calendar year of 2011. Note that only the 2011 returns are annualized i.e. the other returns are simply the percentage changes over the respective periods and are therefore un-annualized. Concentrate in particular on the second column i.e. the year-to-date (2-month) returns and to see how robust equity markets have been so far this year. Experience surely warns us that this rate of improvement is unsustainable although one could argue that the “relief rally” – in the absence of another unforeseen crisis – may have some way to go. A couple of interesting points emerge:

- In most cases the markets which declined most in 2011 have risen the most in 2012 so far; look for example at Hong Kong, Germany, Brazil and Russia.
- In local terms, at 7.5% the SA equity market is lagging other emerging markets, but in dollar terms its 25.8% return since September is one of the best. Similarly the rand’s 8.4% gain against the dollar so far this year has propelled it to one of the better performing emerging markets so far this year. And we can see from the sector breakdown that, for a change, the engine behind these gains was the financial index, up 10.4% so far this year, while the basic material sector has lagged, with a gain of only 6.7%.
- Despite the gold price strength over the past few months the JSE gold index has hardly covered itself with glory, having *declined* 2.4% and 3.2% respectively in the past 5 and 2 months. This lends credibility to our view that gold shares are unattractive – we have not invested in them for years and this view is now helping our relative returns in no small way.
- It is also interesting to note that investors are not differentiating between company sizes so far this year; the SA large, mid and small cap indices have all returned about 7.5% so far this year.
- Remember you can see a summary of the MSCI returns in our usual Table 3 at the end of this edition.

Table 1: Selected equity market returns to end-Feb 2012

	5 mnths (since 30 Sept 11) (%)	2 mnths (year-to-date) (%)	Dec 2011 quarter (%)	2011 (%)
Japan	11.8	15.0	-2.8	-17.3
Hong Kong	23.2	17.6	4.8	-20.0
Germany	24.6	16.2	7.2	-14.7
US (S&P500) and large cap	22.0	9.0	11.9	2.5
S&P Mid cap	25.1	11.2	12.5	-3.1
S&P Small cap	26.9	*8.7*	*16.8*	-0.2
MSCI World index	***17.6***	***9.8***	***7.11***	***-7.6***
Brazil	25.8	16.0	8.5	-18.1
Russia	29.4	25.6	3.0	-21.9
India	7.9	14.9	-6.1	-24.6
China	2.9	10.4	-6.8	-21.7
MSCI Emerging market index	***22.6***	***17.8***	***4.1***	***-20.4***
JSE All share	***16.5***	***7.5***	***8.4***	***2.6***
JSE All share ($)	***25.8***	***16.5***	***7.9***	***-16.0***
Basic materials	12.8	6.7	5.8	-8.3
Financial	20.0	10.4	8.7	7.4
Industrial	17.5	7.7	9.1	9.2
Gold mining	-2.4	-3.2	0.7	6.9
Large cap (Top40)	16.6	7.5	8.5	2.2
Mid cap index	16.3	7.5	8.2	4.7
Small cap index	14.3	7.1	6.8	1.1

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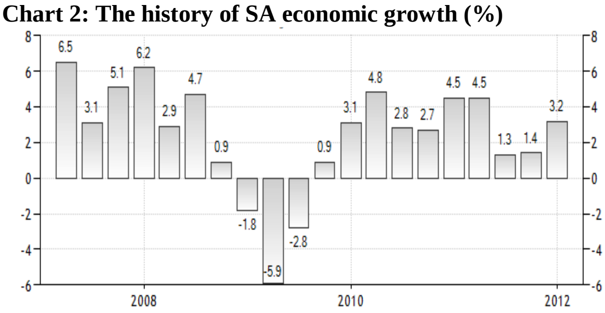
What's on our radar screen?

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

- *The SA economy:* Annual SA inflation rose from 6.1% in December to 6.3% in January. Price increases were broad-based, with the annual core rate of inflation i.e. excluding food and energy prices rising 3.9% to 4.3%. Food prices rose 1.5% on the month, bringing their annual increase to 10.7%, down from 11.6% in December. The SA economy grew at 3.2% during the fourth quarter of 2011 (Q4) when compared to the third quarter (Q3) – refer to Chart 2 below. The Q3 growth rate was revised up from 1.5% to 1.7%. Retail sales for the year to December rose 8.7%, up from November's (upwardly revised) 7.2%, their fastest growth rate since April. They rose 1.3% on the month after posting a monthly decline of 0.1% in November. Many are surprised at the resilience of the consumer but it is worth reminding ourselves that interest rates are still at a 30-year low.

Chart 2: The history of SA economic growth (%)



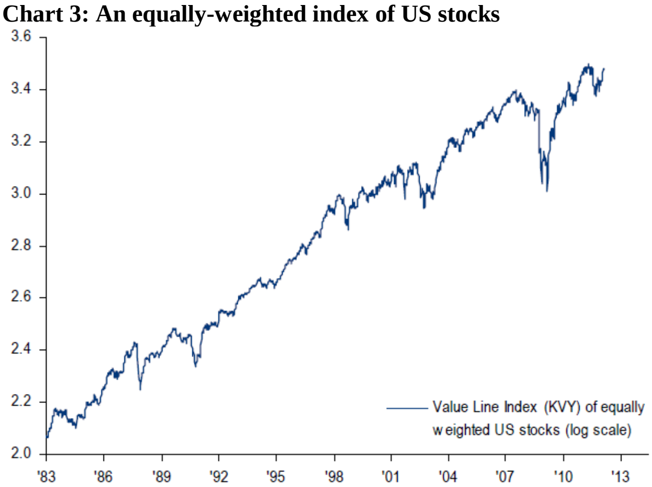
Source: [Trading economics]

- *The European economy*: Q4 growth rates were released during the month and showed some of the early effects of austerity measures that have been foist on the EU economy. As a whole the EU contracted by 0.3% versus the third quarter of 2011, with Germany down 0.2% (it rose 0.6% in Q3), Spain 0.3% and Italy 0.7%. Greece contracted 7.0% in Q4, more than the 5% contraction in Q3.
- *The US economy*: the US economy grew at 3.0% in Q4 – the initial estimate was up 2.8%. We retain our view that the US economy will slow during the remainder of this year. Merrill Lynch forecast Q1 12 growth to be 1.8% and only 1.9% and 1.4% for all of 2012 and 2013 respectively.
- *Emerging economies:* **China's** central bank (PBoC) reduced the reserve ratio requirement (RRR) that banks have to hold against their loans, which is a tangible sign that monetary policy is easing in recognition of the slowing economy. This will free up about $70bn into the economy. The RRR is currently 20.5% for large banks and 18.5% for small banks. Consumer inflation in February declined to 3.2% from January's 4.5%. In addition, the official target growth rate for China was reduced to 7.5% from a long-standing target of 8.0%. The **Brazilian** economy grew at 1.3% during Q4, bringing its growth for all of 2011 to 2.7%. Although this was down from the 7.5% growth rate in 2010 it was sufficient to help *Brazil overtake the UK as the world's sixth largest economy*. The **Indonesian** economy grew 6.5% in Q4, the same rate as it did in Q3 of 2011. **South Korea** grew 3.4% in Q4 versus 3.5% in Q3. **Singapore** contracted 2.5% in Q4. The Australian economy "surprised on the downside" (I just couldn't resist the jargon) i.e. it declined more than most were expecting, by growing only 0.4% during Q4 of 2011, down from 0.8% in Q3.

Chart of the month

As you may know, many indices are weighted according to market cap i.e. larger companies have a heavier weight in the index. Most US equity indices are also weighted on a size basis. Given what has happened to financial companies in the US over the past few years (in case you need reminding, their prices have declined substantially) many indices, especially some of the larger ones such as the S&P500, have been pulled lower by the heavy weighting that financials used to enjoy. The chart below presents a different picture – it weights all US equities equally i.e. irrespective of the size of a company it is included as an equal weight in the index. For example, if the index consists of 100 companies, each is included as 1% of that index.

Chart 3: An equally-weighted index of US stocks



Source: Merrill Lynch

It is worth pointing out that this index is very close to an all-time high. The 30-year old history also puts into perspective the market crashes of 1987, 1998, 2001 and 2007. If there are still any doubters out there about the value of investing in shares over the long-term, you can safely point them to this chart. And although I don't have a similar chart for the SA equity market I'm prepared to wager a box of Smarties that the returns have been far better!

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A few quotes to chew on

Revisiting gold as an asset class

Long-time friends of the Maestro family will know that Maestro has, for a number of reasons, never been a great fan of investing in gold. This is not the appropriate place for a discussion on our view towards gold, but I thought you would be interested in reading *Warren Buffet's* view, taken from the latest Shareholder's Letter, which you can view on the Berkshire Hathaway website by clicking here. He writes as follows; "Today the world's gold stock is about 170,000 metric tons. If all of this gold were melded together, it would form a cube of about 68 feet per side. (Picture it fitting comfortably within a baseball infield.) At $1,750 per ounce - gold's price as I write this - its value would be about $9.6 trillion. Call this cube pile A. Let's now create a pile B costing an equal amount. For that, we could buy *all* U.S. cropland (400 million acres with output of about $200 billion annually), plus 16 Exxon Mobils (the world's most profitable company, one earning more than $40 billion annually). After these purchases, we would have about $1 trillion left over for walking-around money (no sense feeling strapped after this buying binge). Can you imagine an investor with $9.6 trillion selecting pile A over pile B? Beyond the staggering valuation given the existing stock of gold, current prices make today's annual production of gold command about $160 billion. Buyers - whether jewelry and industrial users, frightened individuals, or speculators - must continually absorb this additional supply to merely maintain an equilibrium at present prices.

A century from now the 400 million acres of farmland will have produced staggering amounts of corn, wheat, cotton, and other crops - and will continue to produce that valuable bounty, whatever the currency may be. Exxon Mobil will probably have delivered trillions of dollars in dividends to its owners and will also hold assets worth many more trillions (and, remember, you get *16* Exxons). The 170,000 tons of gold will be unchanged in size and still incapable of producing anything. You can fondle the cube, but it will not respond. Admittedly, when people a century from now are fearful, it's likely many will still rush to gold. I'm confident, however, that the $9.6 trillion current valuation of pile A will compound over the century at a rate far inferior to that achieved by pile B."

The market in the eyes of Aurum

We thought the following extract from Aurum's January letter to clients was rather prescient. "Markets are now in the optimism stage of a repetitive cycle of stress, pessimism, official intervention, optimism and then disappointment, which in turn leads to more stress. While that may sound somewhat cynical an important difference is that the intervention has given politicians a much longer window in which to work towards a solution. To date, this has certainly helped to avoid a pull-back within a few weeks as was seen time and time against last year. While investor confidence has substantially improved, Greece still poses the clearest imminent threat to the current optimism and managers are carefully watching to see if and how the ongoing negotiations are resolved."

Chinese rice paddies

Source: National Geographic

Western Civilization – Decline or Fall?

As a team we enjoy reading the output of *Niall Ferguson, professor of history at Harvard* (amongst others) although he is so prolific we have trouble keeping up with his output at the best of times. We recently came across a summary of his latest book *Civilization: The West and the Rest* and immediately recognized many of the concerns and themes he raises in the book as those that concern us, too - we refer regularly to these in our client communication; we call them our **Big Picture themes**. Herewith is an extract from a summary he wrote about his new book – apologies for it being a bit long, but I'm sure you will find it fascination.

"As a freshman historian at Oxford back in 1982, I was required to read Edward Gibbon's *Decline and Fall of the Roman Empire*. Ever since that first encounter with the greatest of all historians, I have pondered the question whether or not the modern West could succumb to degenerative tendencies similar to the ones described so vividly by Gibbon. My most recent book, *Civilization: The West and the Rest* attempts an answer to that question.

The good news is that I do not believe that Western civilization is in some kind of gradual, inexorable decline. In my view, civilizations do not rise, fall, and then gently decline, as inevitably and predictably as the four seasons or the seven ages of man. History is not one smooth, parabolic curve after another. The bad news is that its shape is more like an exponentially steepening slope that quite suddenly drops off like a cliff...

...The West first surged ahead of the Rest after about 1500 thanks to a series of institutional innovations that (to entice younger readers) I call the "killer applications":

1. *Competition.* Europe was politically fragmented into multiple monarchies and republics, which were in turn internally divided into competing corporate entities, among them the ancestors of modern business corporations.
2. *The Scientific Revolution.* All the major 17th-century breakthroughs in mathematics, astronomy, physics, chemistry, and biology happened in Western Europe.
3. *The Rule of Law and Representative Government.* An optimal system of social and political order emerged in the English-speaking world, based on private-property rights and the representation of property owners in elected legislatures.
4. *Modern Medicine.* Nearly all the major 19th- and 20th-century breakthroughs in health care were made by Western Europeans and North Americans.
5. *The Consumer Society.* The Industrial Revolution took place where there was both a supply of productivity-enhancing technologies and a demand for more, better, and cheaper goods, beginning with cotton garments.
6. *The Work Ethic.* Westerners were the first people in the world to combine more extensive and intensive labour with higher savings rates, permitting sustained capital accumulation.

For hundreds of years, these killer apps were essentially monopolized by Europeans and their cousins who settled in North America and Australasia. They are the best explanation for what economic historians call "the great divergence": the astonishing gap that arose between Western standards of living and those in the rest of the world. In 1500 the average Chinese was richer than the average North American. By the late 1970s the American was more than 20 times richer than the Chinese.

Westerners not only grew richer than "Resterners." They grew taller, healthier, and longer-lived. They also grew more powerful. By the early 20th century, just a dozen Western empires—including the United States—controlled 58 percent of the world's land surface and population, and a staggering 74 percent of the global economy.

Beginning with Japan, however, one non-Western society after another has worked out that these apps can be downloaded and installed in non-Western operating systems. That explains about half the catching up that we have witnessed in our lifetimes, especially since the onset of economic reforms in China in 1978.

I am not one of those people filled with angst at the thought of a world in which the average American is no longer vastly richer than the average Chinese. I welcome the escape of hundreds of millions of Asians from poverty, not to mention the improvements we are seeing in South America and parts of Africa. But there is a second, more insidious cause of the "great reconvergence," which I do deplore—and that is the tendency of Western societies to delete their own killer apps.

Water buffalo and child - Vietnam

Source: National Geographic

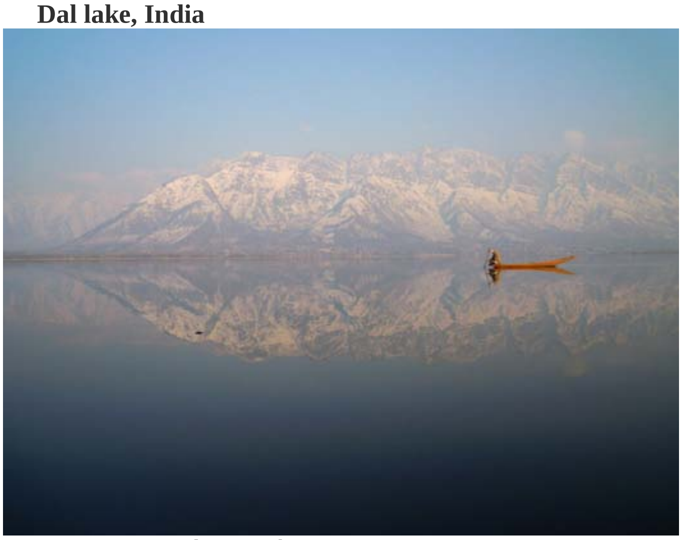
Who's got the work ethic now? The average South Korean works about 39 percent more hours per week than the average American. The school year in South Korea is 220 days long, compared with 180 days in the U.S. And you do not have to spend too long at any major U.S. university to know which students really drive themselves: the Asians and Asian-Americans. The consumer society? 26 of the 30 biggest shopping malls in the world are now in emerging markets, mostly in Asia. Modern medicine? As a share of gross domestic product, the United States spends twice what Japan spends on health care and more than three times what China spends. Yet life expectancy in the U.S. has risen from 70 to 78 in the past 50 years, compared with leaps from 68 to 83 in Japan and from 43 to 73 in China.

The rule of law? For a real eye-opener, take a look at the latest World Economic Forum (WEF) Executive Opinion Survey. On no fewer than 15 of 16 different issues relating to property rights and governance, the United States fares worse than Hong Kong. Indeed, the U.S. makes the global top 20 in only one area: investor protection. On every other count, its reputation is shockingly bad. The U.S. ranks 86th in the world for the costs imposed on business by organized crime, 50th for public trust in the ethics of politicians, 42nd for various forms of bribery, and 40th for standards of auditing and financial reporting.

What about science? U.S.-based scientists continue to walk off with plenty of Nobel Prizes each year. But Nobel winners are old men. The future belongs not to them but to today's teenagers. Here is another striking statistic. Every three years the Organization of Economic Cooperation and Development's Program for International Student Assessment tests the educational attainment of 15-year-olds around the world. The latest data on "mathematical literacy" reveal that the gap between the world leaders—the students of Shanghai and Singapore—and their American counterparts is now as big as the gap between U.S. kids and teenagers in Albania and Tunisia.

The late, lamented Steve Jobs convinced Americans that the future would be "Designed by Apple in California. Assembled in China." Yet statistics from the World Intellectual Property Organization show that already more patents originate in Japan than in the U.S., that South Korea overtook Germany to take third place in 2005, and that China has just overtaken Germany too.

Dal lake, India



Source: National Geographic

Finally, there's competition, the original killer app that sent the fragmented West down a completely different path from monolithic imperial China. The WEF has conducted a comprehensive Global Competitiveness survey every year since 1979. Since the current methodology was adopted in 2004, the United States' average competitiveness score has fallen from 5.82 to 5.43, one of the steepest declines among developed economies. China's score, meanwhile, has leapt up from 4.29 to 4.90.

Not only is the U.S. less competitive abroad. Perhaps more disturbing is the decline of meaningful competition at home, as the social mobility of the postwar era has given way to an extraordinary social polarization. You do not have to be an Occupy Wall Street activist to believe that the American super-rich elite—the 1 percent that collects 20 percent of the income—has become dangerously divorced from the rest of society, especially from the underclass at the bottom of the income distribution."

For the record

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

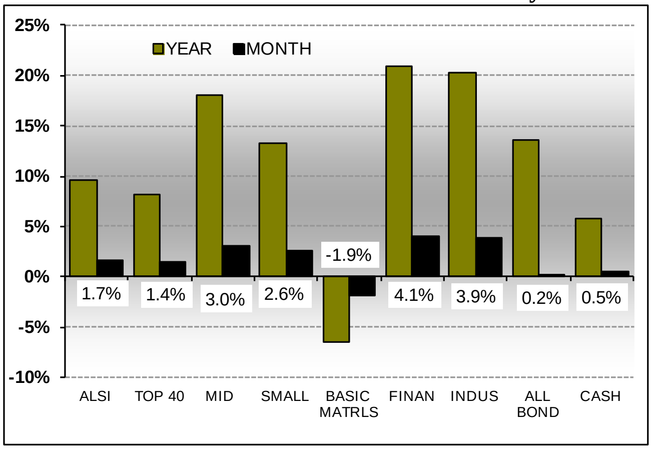
	Period ended	Month	Year to date	Year
Maestro Equity Fund	**Feb**	**2.8%**	**7.8%**	**7.9%**
*Maestro equity benchmark **	*Feb*	*2.8%*	*8.1%*	*14.4%*
JSE All Share Index	*Feb*	*1.7%*	*7.5%*	*9.6%*
Retirement Funds				
Maestro Growth Fund	**Feb**	**1.1%**	**4.4%**	**7.4%**
Fund Benchmark	*Feb*	*0.9%*	*4.7%*	*10.0%*
Maestro Balanced Fund	**Feb**	**0.9%**	**3.7%**	**7.1%**
Fund Benchmark	*Feb*	*0.7%*	*4.1%*	*9.6%*
Maestro Cautious Fund	**Feb**	**1.4%**	**3.8%**	**9.0%**
Fund Benchmark	*Feb*	*0.8%*	*3.3%*	*9.4%*
Central Park Global Balanced Fund ($)	**Jan**	**5.7%**	**5.7%**	**-4.5%**
*Benchmark***	*Jan*	*2.8%*	*2.8%*	*-0.6%*
*Sector average ****	*Jan*	*3.5%*	*3.5%*	*-3.0%*

* 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 ($)

February in perspective – local investment markets

Please refer to Table 1 for the returns of selected local indices so far this year. The SA equity market has mirrored the positive movements in global markets, led by financial companies. During the month the non-life insurance sector posted the largest gain, up 14.3%, followed by chemicals at 9.1% and forestry and paper 8.8%. The worst sector returns were posted by fixed-line telecoms (Telkom continues to self-destruct) down 12.4%, followed by the gold index's 6.6% decline. When all was said and done the All share index ended February 1.7% higher, led by financials which gained 4.1% and industrials, up 3.9%. Basic materials declined 1.9%, having run into the headwind of a firm rand – it gained 4.7% against the dollar, 3.4% against sterling and 2.4% against the euro. The mid cap sector led gains across the size spectrum, followed by small caps up 2.6%. The large financial company gains were sufficient to offset the losses of the large resources shares, resulting in the large cap (Top40) index rising 1.5%. As with overseas markets, bonds endured a very subdued month, rising only 0.2%, less than the 0.5% monthly return on cash.

Chart 4: Local market returns to 29 February 2012



File 13: Information almost worth remembering

Comparing Apples with ... economies

There has been much fanfare about the price performance of Apple, the company that has in recent years arguably done more to influence society's engagement with technology than any other company or institution. We can write all day about the company, but the point I wish to highlight here is that the company's market capitalization (cap), which is a measure of its size, exceeded $500bn during the month. In GDP (gross domestic product)-terms, that makes Apple the 20th largest economy in the world! At the time of writing Apple's price had just hit an all-time high $589.58, which values the company at $549.7bn. For the record, our offshore fund, Central Park Global Balanced Fund, currently has 2.5% of its assets invested in Apple.

Chart 5: A recent price history of Apple ($)

Source: Saxo Bank

Table 3: MSCI returns to 29 February 2011 (%)

	Feb'12	2012
Egypt	14.7	47.9
Thailand	11.9	21.1
Russia	9.6	25.8
Chile	8.9	16.8
Hong Kong	8.5	18.8
EEMEA	7.9	20.8
Taiwan	7.4	17.1
Colombia	7.4	17.4
South Africa	7.1	15.4
Turkey	7.1	27.0
China	6.5	18.0
Hungary	6.4	30.0
Czech Republic	6.4	10.7
MSCI EM	5.9	17.8
EM Asia	5.6	16.7
Brazil	5.4	21.1
LatAm	5.1	18.2
Philippines	5.0	15.9
Japan	5.0	9.7
AP ex-Japan	4.9	15.5
India	4.8	26.6
Singapore	4.7	19.8
MSCI DM	4.7	9.8
Korea	4.5	15.1
Poland	4.4	20.1
Malaysia	4.1	8.6
New Zealand	3.5	10.6
Mexico	2.9	10.5
Australia	2.0	11.0
Indonesia	-1.3	2.5

Source: BofA Merrill Lynch Global Equity Strategy, DataStream

Source: Merrill Lynch