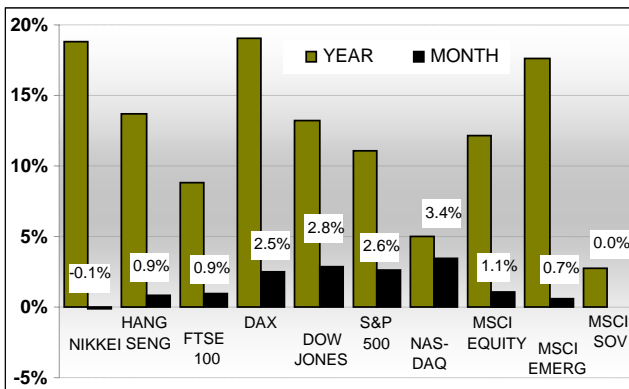




## September in perspective – global markets

September started off slowly, but when the extent of the US slowdown became apparent, thereby obviating the need for further interest rate increases by the Fed, equity and bond markets gathered momentum. A feature of the past month and a major contributor to the change in sentiment was the dramatic decline in energy prices. The price of crude oil fell 13% during September (it is 21% off its peak); other energy prices also declined sharply. Natural gas, for example, has declined 36% since the beginning of August, creating headaches for some market participants (see below). As far as the equity markets were concerned Japan struggled but the US and Germany posted strong gains, bringing their returns for the past two months to between 4% and 5%. Emerging markets were hamstrung by falling commodity prices and in some cases declining currencies. India rose 6.5%, bringing its two-month gain to 15.9%.

**Chart 1: Global market returns to 30 September 2006**



September 2005 saw global equity markets register strong gains; this number is now out of the base so the *annual* returns to September 2006 have declined, although Japan, Germany and the emerging market universe are still up more than 17% in the past year. Despite the looming global economic slowdown some equity markets are flirting with five-year highs. The Dow Jones Industrial Average for example, at 11 679, is an eighth of a polony skin away from its all-time high of 11 723, reached in January 2000. Yes, that's right; the Dow Jones has taken five and a half years to recover from the peak reached after "Y2K". The all-time high for the S&P500 was 1530, reached in August 2000; at its current level of 1335 it is 12.7% below its peak, and the Nasdaq, which ended September at 2258, is an astonishing 56% below its peak of 5133 reached in March 2000.

## Fun and games in the hedge fund world

Those of you who receive the Central Park Global Balanced Fund Mid-month Summary will recall that I hinted recently that hedge funds are not having it all their own way so far this year. Some of the most illustrious and well-known names in the industry are struggling to generate positive

returns. Still others are significantly down since the start of the year. Firms regarded as "industry benchmarks" are struggling with the volatility in some markets - energy markets being a prime example. Others are being frustrated by a lack of clear direction, as in the equity and currency markets. During September one hedge fund experienced a serious "blow-out" which will obviously not do the profession any good. Amaranth Advisors, which until mid-August had posted a 20% return for the year to date, lost no less than \$6bn in the space of two weeks, and is now down some 35%. That turnaround - 65% from peak to trough - is painful in anyone's language! It all seemed to go wrong with their positions - which must have been enormous - in the natural gas market, which declined dramatically in recent weeks. Yet another fund, Mother Rock Energy Fund, "closed down" due to "extraordinary volatility in the natural gas market. Investors in the Fund will not be receiving any of their original investment," which is a nice way of saying that investors have lost all their money.

The reason I mention this development is not to knock hedge funds or their managers. I am a firm believer in alternative funds as a separate asset class. Rather, it is *firstly* to illustrate that investment markets are proving difficult this year for all participants - refer to Table 2 in this regard. *Secondly*, even the "big names" get it badly wrong at times, despite their skill and wisdom. That should be a lesson for all of us against complacency and disrespect for the markets in which we are involved on a daily basis. For the record, the hedge funds in which Central Park Global Balanced Fund is invested have registered gains for the eight-months to August of between 3.6% and 16.5%.

## For the record

Table 1 lists the latest returns of the mutual funds under Maestro's care. You can find more detail, including the latest [Maestro Equity Fund Summary](#), by visiting our website at [www.maestroinvestment.co.za](http://www.maestroinvestment.co.za).

**Table 1: Returns of funds under Maestro's care**

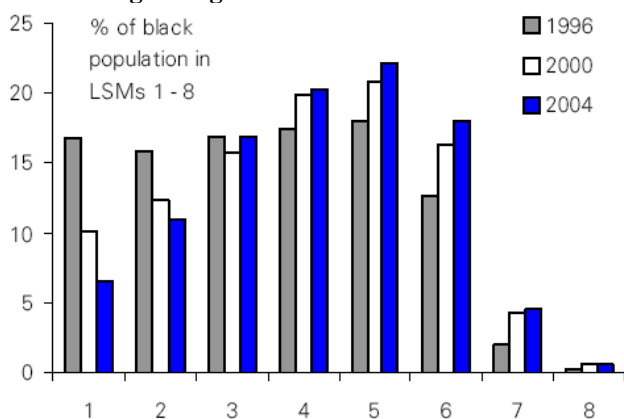
	Month	Return	Year to date
<b>Maestro Equity Fund</b>	Sept	<b>1.6%</b>	<b>11.3%</b>
Maestro equity benchmark *		3.6%	23.5%
JSE All Share Index		2.4%	26.3%
<b>Central Park Global Balanced Fund (\$)</b>	Aug	<b>1.1%</b>	<b>5.6%</b>
Benchmark**		1.4%	6.3%

\* 50% JSE Top 40 Index, 50% JSE Financial & Industrial 30 Index  
 \*\* 40% MSCI World Index, and 20% each in MSCI Sovereign Index, Credit Suisse Tremont Hedge Index and 3-month US Treasury Bills

### Chart of the month

SA companies, particularly those who focus on the retail environment, frequently refer to a “rising black middle class” when explaining the resilience in consumer demand. It seems there is a new tranche of “previously excluded” consumers entering the market resulting in a once-off rise in the level of consumption. Chart 3, contained in research by Deutsche Securities, illustrates this phenomenon well. Remember that the higher the LSM, the higher the degree of affluence. The proportion of blacks in LSM 5-8 increased to 45% in 2004 from 33% in 1996, while the proportion of black folk in LSM 1 and 2 has fallen from 32.5% to 17.5%. Black people constituted 8.2% of LSM 8 in 2004, against 2.5% in 1996. These figures do not explain the full rise in consumer spending and are not the be all and end all of understanding consumer trends, but they quantify to some extent the change that has come about in the consumer environment since the advent of the “new South Africa”.

**Chart 3: A growing black middle class**



Source: Deutsche Securities

### Equity market returns are slowing

In a presentation to one of Maestro’s retirement fund clients, I made the point that returns of global equity markets are slowing. In an attempt to illustrate the point, I compiled Table 2, which depicts historic returns of selected developed and emerging markets. Note how the quantum of returns is decreasing. In the 12-months to December 2005 and April 2006 for example, the German equity market (the DAX) registered returns of 27.1% and 43.6%. However in the year to September 2006 its annual gain was “only” 19.0% and for the year to date it has returned 11.0%. Although still a respectable return, it shows that the size of the returns is declining. The Japanese market (Nikkei 225) provides another telling example of this fact, as does the MSCI World index. **The message is clear: the investment environment is getting less rewarding, and returns are becoming scarcer.** The bottom half of the Table is even more interesting, depicting selected returns in local currencies as well as the dollar returns delivered by the respective MSCI indices. The difference between the two illustrates the extent to which the local currency has affected the returns. In respect of South Africa, in the year to December 2004 the rand was strong, boosting the dollar (MSCI) return, but in the year to September 2006 the opposite is true. The weak rand resulted in the MSCI dollar return being negative (-0.4%) despite the All Share index rising 37.0% in rand terms. The effect is even greater for the year to date as the rand weakness has accelerated in recent weeks. Two points are worth reiterating: *firstly*, recent annual returns from selected emerging markets have been spectacular and *secondly*, even these returns are decreasing

in size. **Investors take note: the “easy money” has been made and it seems the going is getting tougher.** It is time to revisit expectations of long-term equity returns, given that the global economy is slowing. Although it is still forecast to grow at a healthy rate – the IMF is projecting a global growth rate in excess of 5% - the *rate* of growth is slowing, particularly in developed markets such as the US. Given the importance of these economies, the consequences of the slowdown will ultimately impact equity returns.

**Table 2: Returns of selected equity markets**

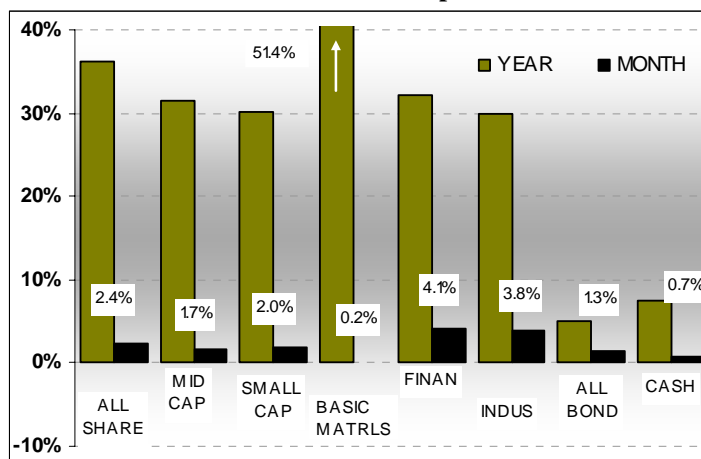
	Annual returns to				
	Dec 04	Dec 05	Apr 06	Sept 06	Yr to date
FTSE100	7.5%	16.7%	25.4%	8.8%	6.1%
DAX	7.3%	27.1%	43.6%	19.0%	11.0%
S&P500	10.9%	4.9%	15.7%	11.1%	7.0%
NIKKEI 225	7.6%	40.2%	53.6%	18.8%	0.1%
<b>MSCI World</b>	<b>12.8%</b>	<b>7.6%</b>	<b>22.2%</b>	<b>12.2%</b>	<b>9.2%</b>
<b>MSCI EM</b>	<b>22.4%</b>	<b>30.3%</b>	<b>58.2%</b>	<b>17.7%</b>	<b>10.2%</b>
Russia	1.8%	88.1%	147.2%	53.8%	37.7%
MSCI Russia (\$)	4.1%	68.9%	129.2%	37.0%	31.2%
India	16.1%	43.1%	92.6%	44.2%	32.5%
MSCI India (\$)	16.5%	33.9%	83.7%	38.6%	28.3%
MSCI Brazil (\$)	30.5%	46.7%	98.5%	14.8%	14.1%
MSCI SA (\$)	40.7%	21.3%	67.1%	-0.4%	-8.2%
JSE All Share	25.4%	46.6%	73.1%	36.3%	26.3%

Source: MSCI, Financial Times

### September in perspective – local markets

The rand once again provided the fireworks for investors during September, losing 7.2% against the dollar. A couple of factors weighed on the currency, including the extent of the trade deficit (at 6.1% of GDP it remains close to a 24-year record), renewed nervousness in emerging markets caused by a decline in commodity prices and the coup in Thailand, and of course the ongoing circus featuring Jacob Zuma as the main act. The gold price declined 3.9%, which led to the All Gold index losing 3.8% despite the weak rand. Platinum shares declined only 2.2% despite 8.4% and 7.6% declines in the platinum and palladium respectively. It was the turn of industrial (up 3.8%) and financial shares (4.1%) to lead the market higher, while the Basic Materials index (0.2%) took a back seat. The latter posted modest gains despite the weak rand, showing the extent of commodity price declines and the high base on which these shares now find themselves. Billiton, a large component of the SA market felt the added draught from the 13.0% decline in the oil price – oil comprises about 30% of Billiton’s total sales.

**Chart 2: Local market returns 30 September 2006**



### **File 13: The law of large numbers – Part 2**

Last month I tried to convey a sense of the size of a market such as India, and the effects of the sheer weight of large numbers in such an environment. This month I would like to give another example, to assist South African readers in particular in placing into perspective the size of India, or China for that matter. To illustrate this point, SA sold about 565 000 cars last year – an all-time record. Total vehicle sales in the eight months to August this year are around 427 000, and indications are that total sales for all of 2006 will again be a record. India produced nearly 10m vehicles last year, including 1.3m passenger vehicles, accounting for 7% of total global automobile production. Despite the large number of vehicles sold passenger car penetration is still low at only six cars per 1 000 people. The Indian motor industry is aiming to quadruple total sales from \$145bn in 2005 or 5% of GDP to \$145bn or 10% of GDP by 2016. The Society of Indian Automobile Manufacturers estimates that average car sales could rise at least 10% per annum until the end of this decade. It estimates that during the next ten years investment of \$35-\$40bn will be required to meet this demand, four times the total investment during the last 16 years. These estimates, and the “Big Picture” that stems from them, will help you understand some of the forces behind the rise of sleeping giants like India and China (where the numbers are significantly larger).

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