MAESTRO
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Investment Letter | 7th Edition | September 2007

August in perspective – global markets

If you had fallen into a coma on 1 August and woken on 31 August, you could be forgiven for thinking that very little had happened during August on global investment markets. Equity markets produced mixed returns: a bit lower in Japan, a bit higher in Hong Kong; a bit lower in London, a bit higher in Germany; US markets all a bit higher. But of course, nothing could be further from the truth! What an incredible, and let's face it, scary month August proved to be. Central banks pumped over $500bn into the global monetary system to stem the systemic risk that is now prevalent in all major global geographic regions; the Federal Reserve lowered their discount rate following an emergency meeting during the month and most major equity markets had declined about 10% during the month before staging a remarkable recovery. A number of hedge funds active in the credit market sustained *material* losses and a number of banks in different regions across the world disclosed substantial losses related to sub-prime exposure.

August turned out to be a remarkable month; we are likely to still see a number of casualties within the financial community relating to losses sustained during the extra-ordinary volatility experienced during August. The Vix index scaled a four and a half-year high (refer to Chart 2). A number of records were set by markets for not only the largest daily declines for some time but also for the largest gains; some of these records were even set on consecutive days! The epitome of the volatility was the movement of the 1-month US Treasury Bill (TB), often regarded as a safe investment due to its short duration (age to maturity). On 20 August it declined 160 basis points (1.6%) to 1.3%, its largest daily movement since the stock market crash of October 1987. The yield on the 3-month TB declined 105 basis points to 2.7% the same day. Such was the volatility in the money market, despite it being a so-called safe investment. Concerns about the proper functioning of this market have continued into September, forcing central bankers to step in to ensure liquidity in this market.

Chart 1: Global market returns to 31 August 2007

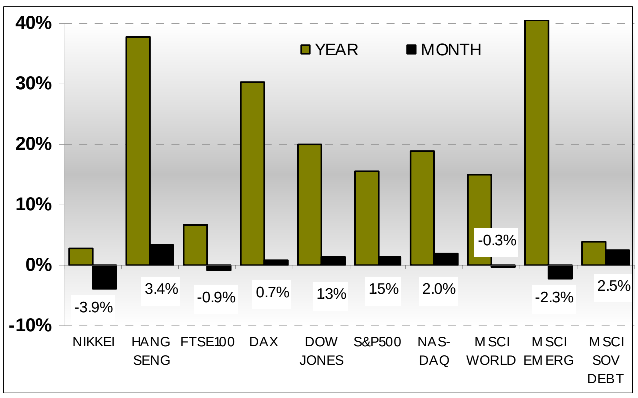
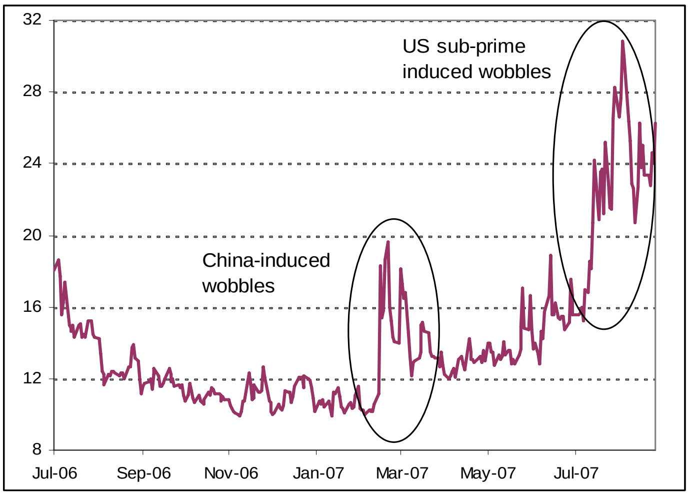


Chart 2: CBOE Volatility (VIX) index



A quick check of the facts

Some important data was released during the month that is worth bringing to your attention:

- *Second quarter US economic growth* came in at 4.0%, from 0.2% in the first quarter. There is widespread speculation that the Federal Reserve will reduce interest rates at its September 18 meeting. Data released in recent weeks has been mixed and I was sceptical that the Fed would be pressurized into a rate cute, despite the turmoil in credit and equity markets. However, the very poor employment data released in early September will surely provide sufficient reason to ease rates. If the Fed doesn't cut rates, we are likely to see a *severe* setback on global equity markets.
- *Second quarter SA economic growth* came in at 4.5%, from 4.7% in the first quarter. The primary sector (agriculture) rose 10.5%. The mining sector declined 0.1% but had been expected to decline more. Manufacturing growth slowed to 0.5% and construction spending slowed to a still impressive 14.4% but down from 21.3% in the first quarter. The service sector grew at 5.5%, driven by the financial sector, up 7.6%. Unfortunately, rising inflation and ongoing supply side constraints will more than likely result in the SA Reserve Bank increasing rates yet again next month.
- Elsewhere European economic growth continues although the European Central Bank decided to delay their rate hike in the light of the current extremely turbulent and fragile money market conditions.
- China again raised the level of reserves that banks are required to hold against their assets, in an effort to curb the accelerating growth rate in that economy. Reserve levels have been raised seven times and interest rates have been increased four times so far this year.

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Table 1: Returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Fund	Aug	**0.1%**	**18.2%**	**35.5%**
Maestro equity benchmark *		1.4%	14.1%	34.4%
JSE All Share Index		0.7%	17.0%	33.9%
Maestro Long Short Equity Fund	July	**-0.1%**	The Fund only began in July 2007	
JSE All Share Index		1.0%	16.2%	40.2%
Central Park Global Balanced Fund ($)	Jul	**0.8%**	**8.2%**	**17.4%**
Benchmark**		-0.7%	4.5%	11.8%

* 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

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. Returns include income and are presented after fees have been charged.

Chart of the month
In the midst of all the market turbulence, have you stopped to consider the parallels between 1998 and 2007? In some respects it epitomizes the changes that have occurred in the global economy over the last decade. In contrast to 1998 the US now has credit problems, not emerging markets. This time global economic growth is accelerating, not slowing. It is also true though that there is probably less transparency and more leverage this time than last time.

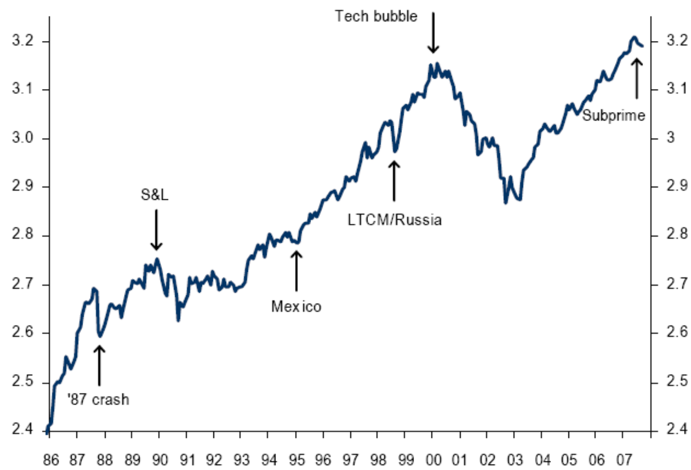
In 1998 emerging markets were seen as more risky, interest rates had been low for too long and currencies were overvalued. The developed world and the US in particular, reigned supreme. Today, in some quarters at least, developed markets are seen as more risky than emerging ones. It is their rates that have been low for too long and arguably it is the dollar that is over-valued. They sit with large trade and budget deficits; the surplus savings of the world are to be found in emerging economies. The unintended consequences of lower rates in the 1980s and 1990s were the Japanese and US equity market bubbles respectively. In contrast, the easy monetary policy that has prevailed since 2001 fuelled the US housing boom, which has popped in spectacular fashion in the form of the current sub-prime crisis – refer to Chart 3. The last decade was about the US and the developed world, this one is about China and the emerging world.

Chart 3: Too much of a good thing, is not a good thing
The NASDAQ, US housing and Chinese equities

Source: Merrill Lynch

Merrill Lynch makes a very interesting point that financial crises that are followed by recessions have lead to bear markets. However, financial crises that are *not* followed by recessions have resulted in great buying opportunities, such as the 1987 crash, the 1995 Mexican crash (the Tequila effect, remember), the 1998 Russian. LTCM crisis) – refer to Chart 4 in this regard. An accurate reading of the future from this point forward could thus prove to be particularly profitable.

Chart 4: Developed equity markets and financial shocks
The MSCI World index, log scale

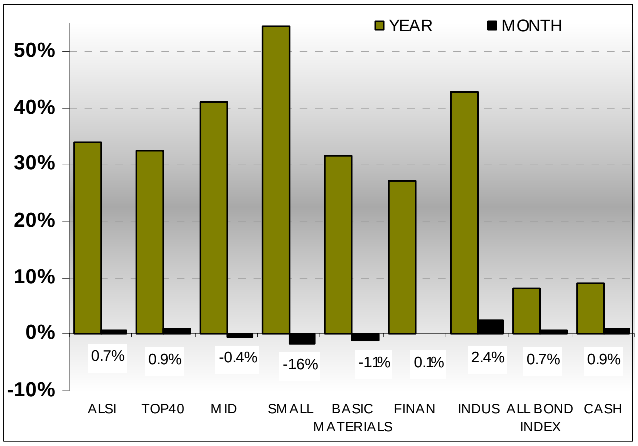


Source: Merrill Lynch

August in perspective – local markets
The SA equity market could not escape the turbulence that characterised global markets. The JSE fell more than 9% before more than recovering its losses to post a small gain (+0.7%) on the month. Financials were weak but industrials posted reasonable gains (+2.4%). The gold index lost 12.6% (it rose 6.6% in July) despite the weaker rand while the electronic and equipment sector lost 8.9%. The beverage

and non-life insurance sectors posted the largest gains of 8.0% and 7.9% respectively. For the second consecutive month the large cap index (+0.9%) outperformed the mid (-0.4%) and small (-1.6%) cap ones. Although August was a rather unprofitable month for most SA equity investors, one can take comfort from the fact that the JSE was one of the better performing markets during the month. The dollar returns of the MSCI SA index declined "only" 2.8%, which although not as high as China (4.3%) are also not as bad as those of Turkey (-11.5%) and Hungary (-10.0%), the other major emerging markets with large current account deficits – refer to Table 2 for the August emerging market returns.

Chart 5: Local market returns to 31 August 2007



State of the nation

It is with sadness that I have to announce that Tracy will be leaving Maestro at the end of this month. Tracy joined Maestro in August 2004 and has made a considerable contribution to the development of the company. Through her efficiency, diligence and professionalism, she has raised the standard for all of us within the firm. She will be greatly missed. I am sure those of you who had anything to do with Tracy will join me in wishing her well for the future. She has no immediate plans, but wants to "smell the roses" for a while before turning her hand to something different. Thanks Tracy, for your enthusiasm, loyalty and the wonderful way in which you served our clients during your time with us. We wish you, Shaun and your three boys the very best for the future.

I am also sad and disappointed in having to announce that Otto has decided to leave as well, to take up a position in Johannesburg in another industry. Thanks for *your* contribution Otto - we wish you the very best for your future and in all your endeavours.

At the same time I am pleased to welcome Vicki Sabor on board. Vicki will be picking up where Tracy "left off" and will join Maestro as a full-time member on 11 September. Vicky and her family returned from a 14-year stint in the US in May this year, where she spent much of her time at Merrill Lynch as a Personal Assistant. Vicki matriculated from Rhenish Girls High School in Stellenbosch and holds a number of professional US licences (investment market-related qualifications).

Despite the changes within the company and the turbulence in the markets, a quiet reflection on Maestro's progress so far reveals that we are having a good year. We have successfully launched our hedge fund, David has joined the team and is already an actively contributing member, the returns of Maestro's offshore and local unit trusts have improved and look respectable in absolute and relative terms (refer to Table 1 in this regard) and last but not least, our clients' portfolios are generating returns substantially ahead of the market for the year to date. We are grateful to all our clients for their ongoing confidence in Maestro – we are hoping that in the remainder of the year we will add even more value to their investments and continue to be of service to them.

Something a bit more positive

One of the most fascinating articles I read during August was a piece by Stephen Green, Standard Chartered Bank's Chief Economist in Shanghai, called "Get ready for the next Big China effect". Stephen Green's article in the Financial Times is worth reading in its entirety; for that reason I will not try to precise it but direct you to it on the FT.com website. If for some reason you are unable to access it please let me know and I will send it to you.

The article goes some way to explaining why, in the midst of collapsing equity and credit markets, and unprecedented turmoil in money markets, the Chinese equity market continues to scale new heights – it has risen five-fold in the past two years. Even its neighbour, the Hong Kong market, seems largely unaffected by the current turmoil – refer to Chart 6 below. I encourage you to read the article.

Chart 6: The Hang Seng index over the past year

Source: FT.com

File 13: Interesting information, but worth forgetting
Did you see that a research report released late in August estimated that the daily turnover on global currency markets now exceeds $3 trillion per day!

Table 2: Emerging market returns during August (%)

	August	YTD
EM countries/regions		
Morocco	4.5	34.1
China	4.3	38.2
Czech Rep	1.5	20.8
Israel	-1.9	19.9
South Africa	-2.8	4.9
Argentina	-3.6	-1.2
Mexico	-3.6	9.3
Asia	-3.9	21.1
MSCI EM	-4.6	16.3
EMEA	-4.9	5.0
India	-5.2	16.7
Russia	-5.6	-5.0
LatAm	-6.1	19.3
Taiwan	-6.2	4.8
South Korea	-6.3	24.3
Egypt	-6.7	10.4
Brazil	-7.4	25.0
Poland	-8.0	10.5
Indonesia	-8.5	11.4
Malaysia	-8.7	17.6
Philippines	-9.3	16.1
Thailand	-9.5	23.3
Hungary	-10.0	9.7
Turkey	-11.5	31.5
EM sectors		
Telecoms	2.0	23.5
Health Care	-2.9	16.3
Materials	-3.2	35.2
Industrials	-3.2	47.9
Consumer Staples	-3.7	8.9
Utilities	-4.5	16.9
Energy	-5.4	6.5
IT	-6.9	0.4
Financials	-6.9	13.1
Consumer Discretionary	-7.4	7.1

Source: Merrill Lynch, MSCI