MAESTRO
INTERMEZZO
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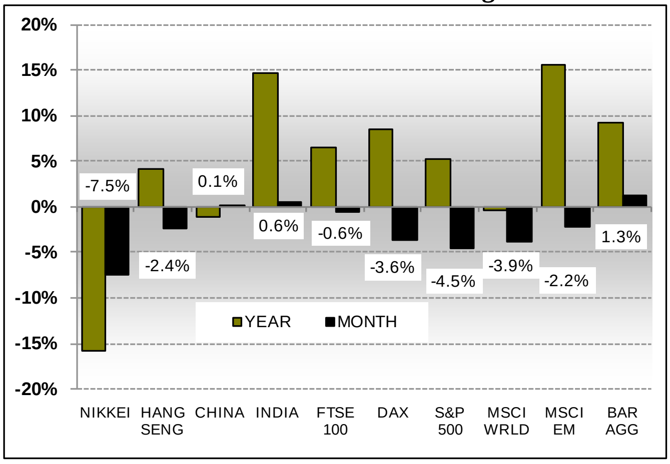
August in perspective – global markets

The realization that the fiscal stimulus-induced growth seen early in the year in most developed economies was coming to an end resulted in a decrease in risk appetite during August. Particularly weak US economic data (especially that which related to the labour and housing markets) spooked investors and sent equity markets lower. The MSCI world index fell 3.9%, led by Japan down 7.5%, US 4.5%, France 4.2% and Germany 3.6%. The MSCI emerging market index fell 2.2%. Brazil and Russia declined 3.5% and 3.8% respectively and the SA market fell 4.5% in dollar terms. China rose 0.1% and India 0.6%. The gold price rose 6.6% but other commodity prices declined, including oil which ended the month down 4.5%. Global bonds were a beneficiary of this "flight to safety" rising 1.3% and pushing yields down to record lows for the year in the process. The dollar ended the month mostly higher against other currencies; it rose 1.0% and 2.5% against the rand and euro respectively.

Chart 1: Global market returns to 31 August 2010



What's on our radar screen?

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

- *The SA economy:* the annual increase in **SA retail sales** rose from 4.5% in May to 7.4% in June and should be seen in the light of the annual retail inflation of 1.5% i.e. below the headline inflation rate of 3.7%. The monthly increase in retail sales was 1.8%; the clothing and footwear category was particularly strong rising from an annual 6.3% rate in May to 13.1% in June. The **SA economy** grew at an annualized rate of 3.2% in the second quarter (Q2) versus the 4.6% in Q1. The chief drag on growth was the mining sector, which slumped 20.8%, offsetting the 6.9% (8.4% in Q1) growth in the manufacturing sector. The wholesale and retail trade grew 5.8% from 3.3% in Q1, helped by the World Cup no doubt. Growth in the construction sector slowed, but stayed positive at 1.5% while the transport and communication sector grew at 4.5% from 2.4% in Q1. Given the (low) base effect as well as a further slowdown in the second half of the year (exacerbated by the effects of the recent strikes) SA growth for 2010 as a whole is likely to be around 3.0% (perhaps a little bit higher). The **SA inflation rate** in July was 3.7%, lower than June's 4.2%. This number includes the effects of the recent electricity increase, although next month is likely to see more pressure from this source as municipalities roll out their respective tariff hikes. Food inflation rose from an annual rate of 0.0% in June to 1.1%. It is worth noting that the categories which have the highest annual inflation rates are ones like housing and utilities, health and education, all of which are structural in nature and largely in the hands of government. This embedded structural inflation is one of the largest challenges to the SA economy, in terms of improving our global efficiency and productivity. We continue to believe, though, that there is room for a 0.5% reduction in the repo rate to 6.0% at the Reserve Bank's meeting on 9 September ... watch this space. Increasing pressure is being brought to bear on the Bank, given that, firstly, the inflation outlook is benign and secondly, continuing high rates are likely to exacerbate the rand's strength in the coming months, something which the government is increasingly worried about – for good reason.
- *The global economy*: given the time of the year, most countries released their second quarter (Q2) growth rates. Selected countries are listed in Table 1. The data speaks for itself; we have often referred to the "de-coupling debate", referring to the increasing difference between the characteristics of developed versus developing (emerging) countries. You can see just how obvious this is when you review Table 1. The growth rates are seasonally adjusted annualised rates – the jargon is "saar" if ever you come across it.

Table 1: Q2 growth rates from selected countries (%)

Developed countries		Emerging countries	
Eurozone	1.0	China	10.9
Germany	2.2	India	8.8
Japan	0.4	Indonesia	6.2
US	1.6	Malaysia	8.9
		Singapore	17.9
		South Africa	3.2
		South Korea	7.2
		Taiwan	12.5
		Thailand	9.1

Charts of the month

One of the shocks to global markets during August came in the form of weaker than expected US economic data, specifically US housing data. There is an active debate underway about the state of the US housing market; some believe it will improve in due course, while others think it is

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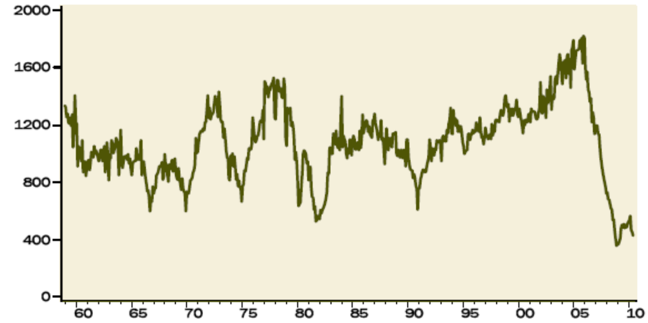
likely to get even worse. Our view is skewed in favour of the latter. One has to look behind the data to appreciate the full story, but just looking at the data itself leaves one in little doubt about the state of the US housing market. Before looking at the charts, consider the following: home prices have plummeted during the past few years, interest rates are at record lows (the benchmark 30-year mortgage rate is now 4.4%), there are a record number of homes for sale (i.e. excess supply) – refer to Chart 5 - and vast sums of money have been directed at home buyers in the form of incentives (no fewer than eight different programs have been rolled out by government to put a floor under the housing market). Surely one could not ask for a more perfect environment for the sale of houses? And we are now more than a year into the US economic recovery, right? Now take a look at the charts.

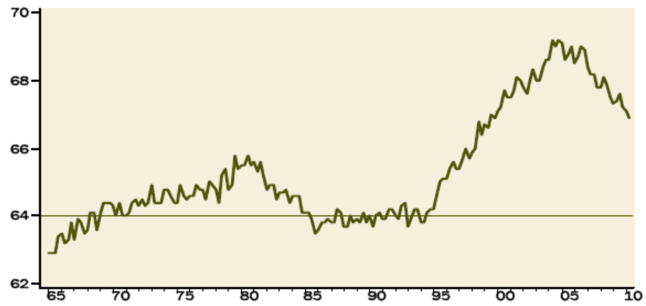
Chart 2: US single family *new* home sales (000's)
Seasonally adjusted annualised rate (000's)



Source: Gluskin Sheff

Chart 2 shows – if you look really hard – the "recovery" in new home sales. But it does look as though the downturn is about to continue. An interesting chart, below, shows that although it has reduced slightly from its record levels, the rate of home ownership in the US is still some way above the level that it was before the boom started, thanks in part to artificially low interest rates.

Chart 3: US home ownership rate (%)



Source: Gluskin Sheff

Chart 4 depicts existing (as opposed to new) home sales in the US – in August they fell 27.0% month-on-month to their lowest level since records began in 1999.

Chart 4: US total *existing* home sales
Seasonally adjusted annualised rate (000's)

Source: Gluskin Sheff

And one final thought: a full 25% of all mortgages in the US are now "upside down" i.e. the value of the mortgage (bond) exceeds the value of the house itself. In short, in our humble view there is still a lot of pain to come in the US housing market, which is very relevant because home ownership, specifically cash draw downs from mortgage bonds, was a great source of funds for the US consumer boom that fuelled the strong economic growth during the past two decades. As they say in the US, "Go figure ..."

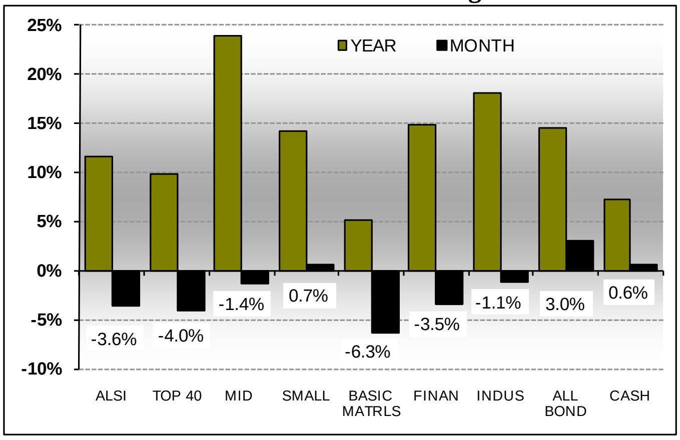
Chart 5: US single family home inventory
Number of month's supply on offer

Source: Gluskin Sheff

August in perspective – local markets

Given the increase in risk aversion during the month the SA equity market was always going to end lower. As it happens the All share index closed 3.6% lower, led by the basic materials index, which tanked 6.3% despite the weaker rand. The financial index fell 3.5% and industrials eased 1.1%. In another sign of ongoing strength in mid and small cap shares, despite the "riskier" environment both sectors comprehensively outperformed large cap shares. The Top40 (large cap) index fell 4.0% but the mid cap index fell only 1.4%. The small cap index actually *rose* on the month, ending August 0.7% higher. The year-to-date returns for the SA large, mid and small cap index to end-August are -2.2%, 14.2% and 5.4% respectively. The best performing sectors in August were automobiles and parts (12.4%) and gold mining (7.3%) while the worst were platinum (-12.0%), general mining (-8.7%) and coal mining (-6.7%). The All bond index rose 3.0%, bringing its year-to-date return to 13.3%.

Chart 6: Local market returns to 31 August 2010



A few quotes to chew on

The strikes underway in SA at the moment will have a very negative effect on the SA economy, irrespective of the final outcome in terms of wage settlements. It has also generated a lot of discussion and I thought the following extracts were thought-provoking.

Over the past three years R100bn has been added to the pay packets of the million or so teachers, nurses, police, doctors, cleaners and others who work for national and provincial government departments. This year government will add at least R26bn more ... This is our tax money that's been spent. So we are entitled to ask whether we are getting value for our investment. At the moment, it is not at all clear that we are. *Peter Bruce, Business Day editor*.

... After all, the public service workers got an 11.5% increase last year ... after getting double the inflation rate, it would be amazing if the unions didn't think of government as a soft (target) because this is exactly what it has been ... However, there are other causes for the strike. The workers are incensed by the high-living antics of the elite. They have absorbed the meaning of Blade Nzimande's new Merc, Siphiwe Nyanda's five-star hotel living and the enrichment of the Zuma and Gupta families by the manipulation of mining licences ... all these things fed into the strike. The workers are fed up with President Zuma's antics, with corruption and that the government has done nothing about unemployment. *RW Johnson, political commentator*.

The public sector as an employer is weak and trade unions will persist with demands they know will be granted. The ANC is ideologically at its weakest. With some of its talented strategists sidelined by the fractious nature of the party and the Polokwane victory; it has no new idea for alliance partners who demand an equal role in policy making. In the short term, SA should brace itself for a bleak future characterised by policy volatility and governance geared to meet the interest of any strong civil society group whose favour the ANC wants to curry. *Khehla Shubane, political commentator*.

The political and economic elite must also be seen to be limiting their immediate aspirations and needs. This, of course, has not happened. Government ministers never spoke of affordability when they had to buy Mercedes Benzes and BMWs as ministerial cars. Instead they responded crassly that it is allowed by the Ministerial Handbook and that it represents their tools of trade. The list of profligate consumption can go on and include the dubious cosy relationships that have developed between the President, ministers and senior state officials on the one hand and companies and individual businessmen on the other. Is it surprising that workers and citizens believe that the political (and economic) elite are hypocritical, when they demand responsibility from workers, yet they indulge in crass consumption, often at a cost to the public purse? The public sector wage demands today, and therefore the current strike, represent a backlash against the crass consumption and consumerism of the political (and economic) elite. If we are to fix the problem, the political elite has to provide leadership by beginning to practise the frugality it demands of workers and other citizens. *Adam Habib, Deputy Vice-Chancellor: Research, Innovation and Advancement at the University of Johannesburg*.

SA politics – a closer look

In light of the recent strikes and disorder in South Africa, the following might be of interest; we were recently privy to a review of SA politics by a respectable and independent analyst. As part of the presentation the results of a November 2009 survey by Ipsos Markinor were discussed. Some of the data was rather sobering: two thirds (67%) of ANC voters do not work, 24% work full time and the remaining 9% work part time. Only 8% of ANC supporters have higher education qualifications, 23% have graduated from high school and 69% either have no education at all or never completed high school. 46% of ANC supporters earn less than R2 500pm ($343). By way of contrast, 29% of Democratic Alliance (DA) voters have high school education, 38% have graduated from high school and 32% have tertiary education. The analyst went on to list the constituencies that are left out of the equation: organized labour, local industries, white middle class, commercial farmers, independent professionals and civil society, especially religious institutions. In short those "of little voice" are the main taxpayers that finance the social welfare programs of the black poor and provide subsidies to multinational corporations to entice them into basing their operations in SA; think, for example of the (2009/12) R2.7bn subsidy to foreign car manufacturers in SA.

According to a 2009 study by the University of Cape Town, between 53% and 75% of the black population in SA are classified as poor. Given that blacks comprise about 80% of SA's 48m population, at least 20m blacks live in poverty. Assuming that half vote for the ANC, the dominant party is thus assured of at least 10m votes of the registered 22m voters. This simple calculation, the analyst continued, shows that the ANC will remain the dominant party because of the support it receives *from* the poor black community in return for the government's extensive welfare program *for* the poor. SA's economic policies are thus fairly predictable: the ANC needs the support of big business and multinationals and is thus compelled to pursue conservative economic policies despite its association with Cosatu (the trade union federation) and the SA Communist Party, its tripartite alliance partners. That should shed light on what can often be a confusing state of affairs for foreigners to grasp.

For the record

Table 2 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.

Table 2: Returns of funds under Maestro's care

	Period ended	Month	Year to date	Year
Maestro Equity Fund	Aug	**-3.5%**	**-1.3%**	**2.8%**
Maestro equity benchmark *	Aug	-3.1%	1.9%	12.4%
JSE All Share Index	Aug	-3.1%	-0.1%	11.6%
Maestro Long Short Equity Fund	Jul	**2.3%**	**0.6%**	**8.9%**
JSE All Share Index	Jul	8.1%	3.7%	19.4%
JSE Financial and Indus 30 index	Jul	10.3%	8.4%	22.4%
Central Park Global Balanced Fund ($)	Jul	**7.8%**	**-3.5%**	**1.0%**
Benchmark**	Jul	3.7%	0.4%	7.3%
Sector average ***	Jul	4.9%	-0.6%	6.8%

* 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 ($)

We don't normally comment on the results in the return table, but would point out two quick observations. Firstly, we communicated our poor October and November 2009 returns to clients at the time and explained the reasons for them. But these will soon fall out the base for the annual returns, highlighting the improvement in our *relative* returns; compare the *year-to-date* and *annual* Maestro Equity Fund returns to those of the All share index and the Maestro equity benchmark, for example. Secondly, note the pleasing return of Central Park in July thanks to a large (63%) increase in the Fund's private equity investment.

File 13: Information almost worth remembering

With all the negative news emanating out of the US, we have obviously been watching the data very carefully. July's home sales data was extremely poor - new home sales fell 12.4% in July from a month earlier, the slowest pace on record (records date back to 1963). We found the following information from the National Association of Home Builders (NAHB) very interesting: each new home built in the US creates, on average, the equivalent of three jobs for a year and generates about $90,000 in taxes.

Table 3: MSCI returns to 31 August 2010 (%)

	Aug'10	YTD	QTD
Colombia	8.8	39.6	23.2
Thailand	8.7	25.7	15.4
Chile	7.2	21.9	20.1
Malaysia	6.1	20.6	11.8
Philippines	4.6	13.6	7.4
Argentina	4.4	16.3	21.0
Peru	3.8	15.3	12.1
Egypt	1.6	1.6	7.1
Hong Kong	0.7	1.0	6.6
Singapore	-1.4	3.3	6.3
Turkey	-1.4	11.4	14.3
India	-1.6	0.8	-1.0
EM Asia	**-1.7**	**-1.7**	**3.3**
AP ex Japan	**-2.1**	**-3.8**	**4.9**
MSCI EM	**-2.2**	**-2.0**	**5.7**
Taiwan	-2.2	-9.0	4.5
Japan	-2.3	-2.5	1.1
LatAm	**-2.5**	**-3.6**	**9.1**
Korea	-2.7	-0.7	4.6
Indonesia	-2.7	16.4	2.4
China	-2.8	-6.3	1.5
South Africa	-3.1	1.9	9.0
EMEA	**-3.2**	**-1.0**	**9.0**
Brazil	-3.6	-8.4	9.6
Poland	-3.7	-7.4	15.0
Hungary	-3.8	-15.3	9.1
Russia	-3.9	-5.0	6.8
Australia	-3.9	-10.7	7.9
MSCI DM	**-3.9**	**-7.5**	**3.8**
Czech	-4.7	-9.9	8.3
Mexico	-5.0	-2.2	0.3
Morocco	-5.3	-1.0	0.3
Pakistan	-6.9	0.5	1.5

Source: Datastream, data as of 31 August 2010

Source Merrill Lynch