MAESTRO
Cautious Fund

PRESCIENT
LIFE LIMITED

INVESTMENT OBJECTIVE
The Fund is balanced across multiple asset classes, subject to the restrictions imposed by Regulation 28 of the Pensions Funds Act. It aims to minimise the probability of short-term (i.e. less than one year) capital loss. A conservative investment philosophy is adopted.

FUND BENCHMARK (BMK)
The Fund will measure itself against a benchmark consisting of 30% All share Index, 30% All bond Index (ALBI) and 40% Short term fixed income (STEFI) index.

LEGAL STRUCTURE
The Fund is a pooled portfolio on the Prescient Life Limited balance sheet. The appointed portfolio manager of the Fund is Maestro Investment Management (Pty) Limited, an approved Financial Services Provider in terms of the Financial Advisory and Intermediary Services Act, operating under licence number 739. Prescient Life Limited is a linked insurer governed by the Long Term Insurance Act. Prescient Life Limited issues investment linked policies. This Fund operates as a white label under the Prescient Life Licence.

FEE STRUCTURE
The annual investment management fee is 1.0%. The fee is inclusive of all underlying managers' fees, platform and administrative fees. In the case where the Fund is accessed and used as a Preservation Fund or Retirement Annuity an additional fee of 0.2% per annum is charged by Prescient.

FUND SIZE: R1 228 208

LONG TERM INSURER
Prescient Life Limited
(Reg no: 2004/014436/06)

AUDITOR
KPMG Inc.

PORTFOLIO MANAGER
Maestro Investment Management (Pty) Ltd
(Reg no: 2000/028796/07)

ENQUIRIES
David Pfaff
Maestro Investment Management
Box 1289
CAPE TOWN
8000
Tel: 021 674 9220
Fax: 021 674 3209
Email: david@maestroinvestment.co.za

The Maestro Cautious Fund

Quarterly report for the period ended

31 March 2014

1. Introduction

This Report focuses on the investment activities of the Maestro Cautious Fund during the recent past although it should be read in conjunction with previous editions of *Intermezzo*, wherein we documented some of the salient events in recent months. I also refer you to the *Market commentary – March 2014* report wherein we discuss in detail the market activity during the quarter.

2. The investment position of the Fund

The Fund's asset allocation is shown in Chart 1. Exposure to the equity market totalled 36.3% of the Fund, down from 38.5% in December. Bond exposure increased from 14.0% to 16.3% while cash represented 43.5% of the Fund slightly up from 43.0% in December quarter. Property exposure decreased slightly to 3.9% during the quarter.

Chart 1: Asset allocation at 31 March 2014

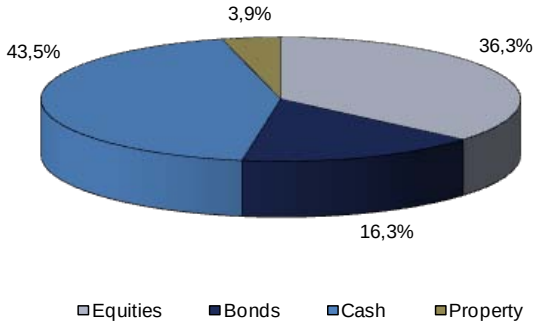
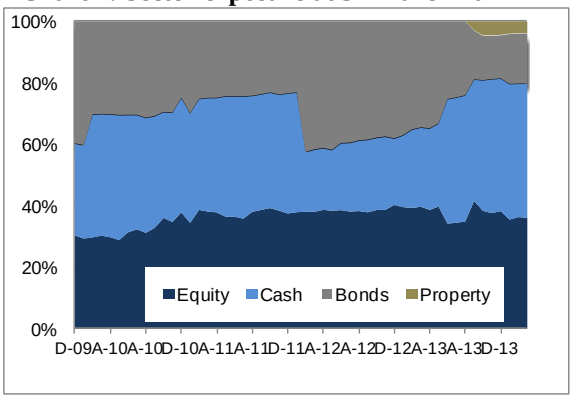


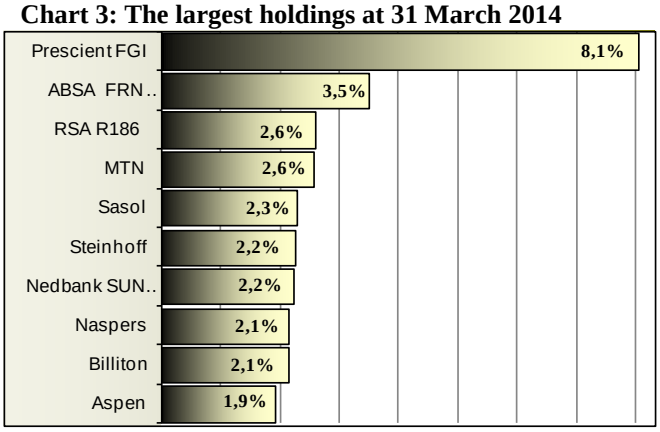
Chart 2 depicts the historical allocation to the major asset classes, expressed as a percentage of the total Fund.

Chart 2: Sector exposure at 31 March 2014



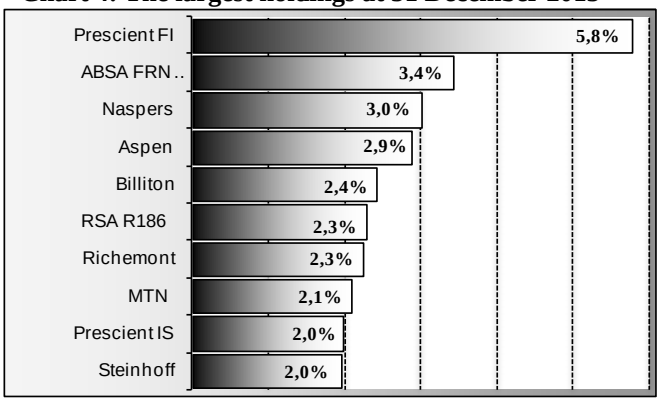
3. **The largest equity holdings**
The largest holdings at 31 March 2014 are listed in Chart 3 expressed as a percentage of the Fund's equity portfolio.

Chart 3: The largest holdings at 31 March 2014



The largest holdings at the end of December are listed in Chart 4. The relative rankings changed somewhat during this second quarter and will become evident once you have had a chance to view chart 3 and 4. The largest ten holdings constituted 29.7% of the Fund, marginally up from 28.4% in December.

Chart 4: The largest holdings at 31 December 2013



4. **Recent activity on the Fund**
The investment objective on this Fund is to *achieve short-term stability and moderate capital growth through the assumption of lower levels of risk.* We would emphasise the "short-term" aspect of this objective; as it is used as a Fund that facilitates members to preserve capital either prior to retirement (1 to 3 years) or post their working life.

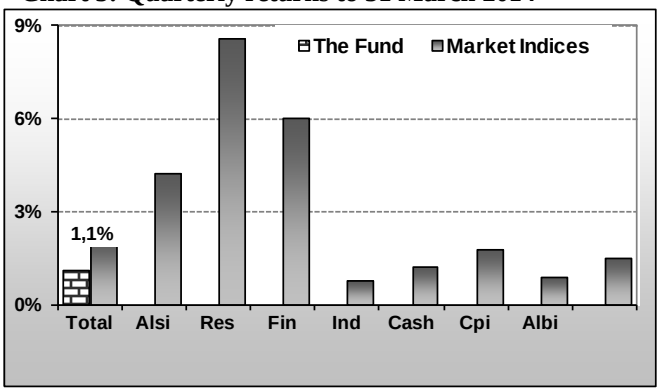
The Fund has been designed in accordance with the rules and regulations that govern Regulation 28 of the Pensions Fund Act. It is not open to the retail public and can only be accessed through a company's Provident/Pension Fund or by individuals who have preservation money or wish to either transfer or purchase a Retirement Annuity (RA). These RA's can then be converted into living annuities when the time arises.

With regards to the asset allocation, Equities and Property declined 2.2% and 0.6% respectively. While bonds and cash rose by 2.3% and 0.5% over the period.

A disproportionate amount of commentary is given on how the equity component of the Cautious Fund has performed. The reason for this is because this sector of the Fund is largely responsible for future growth that the Fund will record and therefore more emphasis is placed on this asset class.

5. **The performance of the Fund**
Turning to the performance of the Fund, Chart 5 depicts the returns for the quarter against the major indices. ***The un-annualised return on the Fund during the March quarter was 1.1%*** which can be compared to the Maestro Cautious Fund benchmark of 2.1%**.** I encourage you to read the commentary on the market movements during the quarter in the document entitled *Market commentary – March 2014.*

Chart 5: Quarterly returns to 31 March 2014



The Fund's quarterly equity return of 0.2% can be compared to the All share index returns of 4.3%. We commented extensively in recent letters and *Intermezzo* about the state of the markets during the past few months and refer you to those publications to refresh your memory about the salient features of this period; you can find back copies of *Intermezzo* by clicking here.

After stuttering at the start of the year, the local market picked up momentum towards the later part of the March quarter. Concerns on the effects of the US Federal Reserve's (Fed) tapering (reduction in asset purchases) clouded the outlook for emerging markets for the better part of the quarter. As the quarter progressed, investors began to focus more on the prospects of a faster growing US economy, which caused some of the taper concerns to abate. The 4.3% gain in the aggregate local index conceals the volatility investors had to contend with during the first quarter. Concerns about a slowing

Chinese economy, overvalued technology shares and an escalating crisis in Ukraine, all contributed to the share price swings during the quarter.

During the quarter, we witnessed somewhat of a switch in investors' sector preference relative to 2013. Whereas industrials were the best performing sector throughout 2013, basic materials had an impressive showing in the March quarter, as they rose 8.6%. Financials were a close second with gains of 6.1%, and industrials rose a pedestrian 0.8%. The strength in resources was led by gold miners, which returned a staggering 42.6%, although they declined 54.6% in 2013. We have often commented on our aversion to investing in gold shares and we believe that despite the strong quarterly return, the past 5 quarters provide ample evidence to support our view. Over the past 5 quarters, the gold index's returns read as follows: 42.6%, -16.6%, -0.4%, -33.5% and -17.9%. No matter which way one looks at it, those quarterly returns are the quintessential definition of volatile (read: risky). As if that volatility was not bad enough, over that 5 quarter period, an investor into the gold index would have lost 35.3% of their capital; not only has one endured high risk by investing in gold stocks, but they have also suffered lower returns.

Let us look at the March quarterly returns of some of the Fund's investments. The quarterly returns, excluding dividends, of the equity holdings in the Fund during the quarter were as follows: Naspers rose 6.0% (it rose 18.0% in the December quarter), Aspen 4.7% (2.3%), Richemont 3.4% (3.6%), Billiton 0.4% (8.9%), MTN -0.7% (10.7%) and Steinhoff 3.1% (26.2%).

As material as some of the share moves above are, we tend not to read too much into the short-term returns of the Fund's portfolio. We tend to focus more on the longer term returns and I would encourage you to do the same as you draw conclusions on the Fund's performance.

The annual returns to March are shown in Chart 6. ***The annual return of the total Fund for the 12 months to March was 12.9*** Inflation rose 6.0% over the year and the All bond index rose a meagre 0.6%. ***The annual return on its equity component was 23.6%*** which is in line with the All share index return of 23.6%. Inflation rose 6.0% over the past year and the All bond index rose a meagre 0.6%.

Chart 6: Annual returns to 31 March 2014

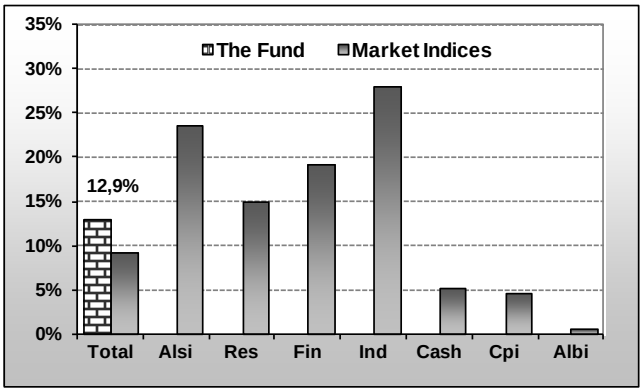
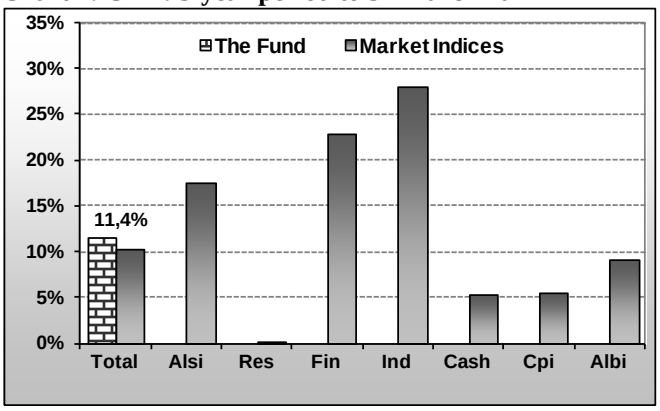


Chart 6 clearly shows the strong outperformance of the industrials index during the past year, despite underperforming in the March quarter. It is probably worth highlighting that despite our preference for industrials and financials over resources, and the fact that they have outperformed over the long-term, that is not to say there won't be periods when resources are strong, which will likely lead to us underperforming. We remain comfortable with our overweight industrial position for now. During the past year, the shares that drove the Fund's returns include Coronation, which rose 106.3%, Steinhoff 103.9%, Naspers 102.7%, EOH 66.1%, Aspen 47.3%, Sasol 44.7% and Richemont 39.3%.

The compound annual return (CAR) of the Fund, shown in Chart 7, ***over the three-year period to March 2014 was 11.4%*** while the equity component returned 16.3% which can be compared to the All Share Index return over the same period of 17.6%.

Again, it is clear from Chart 7 which sectors drove the market higher over the past three years, and it is quite remarkable that the resource sector rose a menial 0.3% *per annum* over this period. Across the market cap spectrum, the large-cap index managed to maintain pace with the mid and small-cap indices, largely thanks to the industrial shares. The three-year compound annual returns of the large, mid and small-cap indices are 17.5%, 17.8% and 22.3% respectively. The respective compound annual returns for the All Bond index and cash over this period were 9.2% and 5.5% respectively.

Chart 7: CAR: 3-year period to 31 March 2014



6. Closing remarks

Although the Fund earned a positive return for the March quarter, you will have seen that we lagged the market. While we are obviously not happy with this, we realise why this has happened and continuously work to see if any remedial action is required. Apart from that, you are probably aware that there are times when shares, and indeed portfolios, pause for a breather, which is all part and parcel of equity investing.

Our outlook for 2014 remains the same as it was at the beginning of the year; we expect a continued improvement of the global economy, which should remain supportive of equity markets and negative for bonds and cash. Having said that, company and market valuations are not cheap and earnings growth is essential for investors to enjoy another year of good returns.

There remain several risks to our view, namely, the continued slowing down of the Fed's monetary easing policy and its effects on emerging markets. Geopolitical risks also remain a key concern, with the developments in Russia and Ukraine threatening to escalate, and a slowing Chinese economy that is dampening commodity demand. Although these all represent meaningful risks, it is worth highlighting again that it is all part and parcel of investing. Rather than spending an inordinate amount of time worrying about the risks that exist in the market, we spend more time looking for companies that we believe are better able to navigate the challenges that invariably occur in all economies. This strategy has worked well for us and we believe that over time, it will continue to generate higher risk adjusted returns for our clients.

As usual, we are here to be of assistance to you, so please, do not hesitate to call on me if ever you wish to discuss anything about your portfolio in further detail.

David Pfaff
On behalf of the Maestro team
15 May 2014