MAESTRO
Equity Fund

PRESCIENT
MANAGEMENT COMPANY

INVESTMENT OBJECTIVE
The Fund's objective is to produce above average long-term returns by investing in the South African equity market. It will simultaneously aim to assume less risk than the risk inherent in the market itself. The Fund adopts a conservative investment philosophy.

FUND BENCHMARK (BMK)
The Fund will measure itself against the FTSE-JSE All Share Index. It will also use an internal benchmark, the Maestro Equity Benchmark, which consists of an equal weighting of the FTSE-JSE Top40 and Findi30 indices which effectively yields an index that is roughly equally weighted between the resource, financial and industrial sectors.

LEGAL STRUCTURE
The Fund is a scheme in the nature of a trust known as a collective investment scheme. The portfolio manager is Maestro Investment Management, an approved Financial Services Provider in terms of the Financial Services and Intermediary Act, operating under licence number 739, and the Financial Institutions (Protection of Fund) Act. This Fund operates as a white label fund under the Prescient Unit Trust Scheme, which is governed by the Collective Investment Schemes Control Act.

FEE STRUCTURE
The maximum initial fee is 2.0% and the annual investment management fee is 1.75%. The *annual* total expense ratio (TER) for the past year in respect of class A was 2.06%.

Income Distribution (annually)
29.02 cents per unit
31 March 2012

FUND SIZE: R 77 709 593

MANAGEMENT COMPANY
Prescient Management Company Ltd
Box 31142, Tokai, 7945

TRUSTEE AND AUDITOR
Trustee: Nedbank Limited
Auditor: KPMG Inc.

PORTFOLIO MANAGER
Maestro Investment Management (Pty) Ltd

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Maestro Investment Management
Box 1289
CAPE TOWN
8000Fax:
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The Maestro Equity Fund

Quarterly report for the period ended

31 March 2012

1. Introduction

This Report focuses on the investment activities of the Maestro Equity Fund during the past quarter although it should be read in conjunction with previous editions of *Intermezzo*, wherein we documented some of the salient events in recent months. Appendix A contains a summary of the market activity during the March quarter.

2. The investment position of the Fund

The Fund's sector allocation is shown in Chart 1. Exposure to the resource sector totalled 27.1% of the Fund, up from 25.0% in December. Financial exposure decreased 1.1% to 15.7% and industrial exposure increased 2.1% to 50.4%. Cash represented 6.8% of the Fund, down from the 12.1% at the end of December.

Chart 1: Asset allocation at 31 March 2012

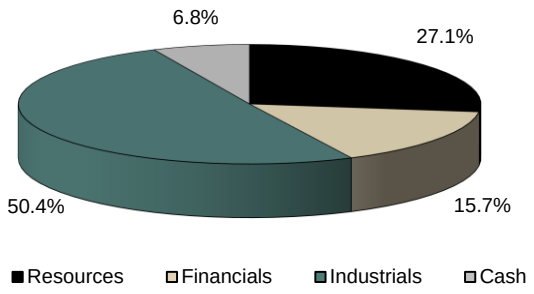
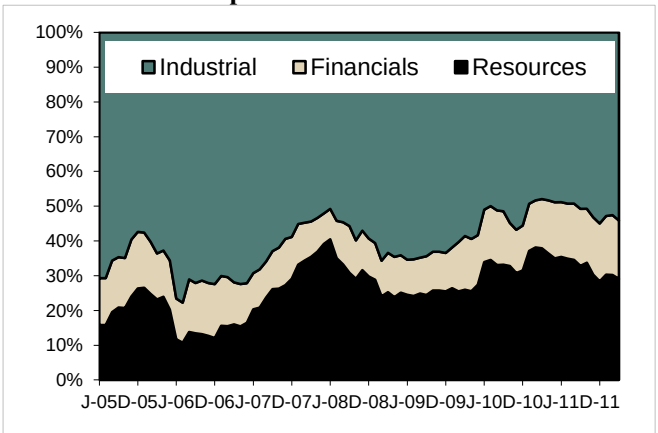


Chart 2 depicts the historical allocation to the three major sectors of the equity market, expressed as a percentage of the equity portion of the Fund.

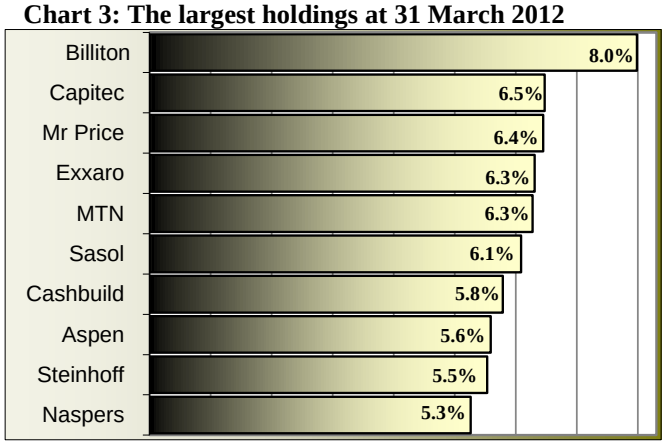
Chart 2: Sector exposure at 31 March 2012



3. The largest equity holdings

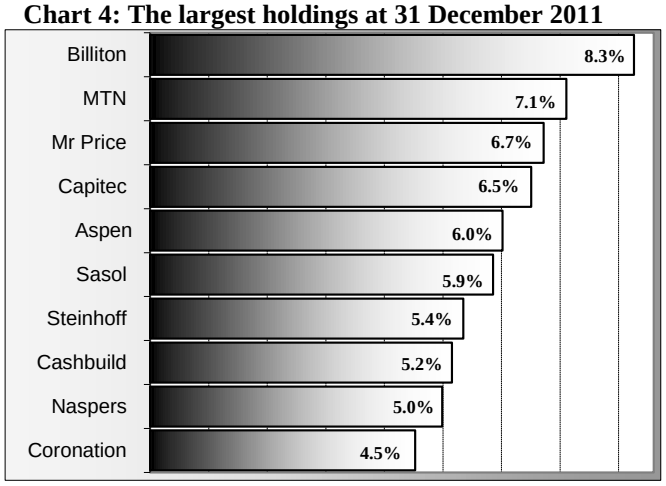
The largest holdings at 31 March are listed in Chart 3, expressed as a percentage of the equity portfolio.

Chart 3: The largest holdings at 31 March 2012



The largest holdings at the end of December are listed in Chart 4. During the quarter Exxaro replaced Coronation Fund Managers in the largest holdings. At the end of March there were 25 counters in the Fund, unchanged from December. The ten largest holdings constituted 61.7% of the Fund up from 60.5% in December.

Chart 4: The largest holdings at 31 December 2011



4. Recent activity on the Fund

The investment objective on this Fund is to *achieve long-term growth through the assumption of moderate risk.* We would emphasise the "long-term" aspect of this objective; we are confident that the companies in which the Fund is invested will deliver long-term capital growth together with a steady increase in dividends over time.

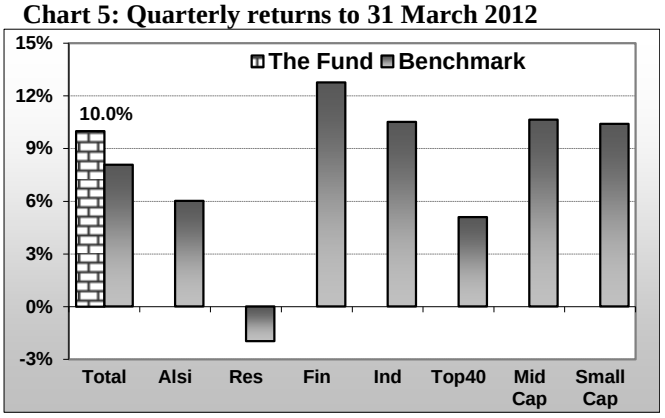
During the quarter a holding in Tiger Brands was introduced into the Fund. The defensive nature of the company (Tiger Brands is fast moving consumer goods company) and its African growth prospects are the primary reasons for the addition of the share to the Fund. Another new addition to the Fund during the quarter was Hudaco which specialises in importing and distributing high quality industrial products (power tools and other engineering and consumer related industrial products). Although the company's fortunes are governed to a large extent by the mining industry, it is an exceptionally well-managed company with good growth prospect over the short to medium term. Other activity on the Fund during the quarter includes additions to current holdings in Anglos, Billiton, Cashbuild, Exxaro, Richemont, MTN and Sasol. Holdings in Aspen, Protech, Grindrod and Mr Price were slightly reduced.

The entire holding in Impala Platinum was sold out during the quarter. The reasons for the sale include the muted earnings growth outlook for the company, labour issues (strikes) and problems with their Zimbabwe subsidiary Zimplats relating to the indigenisation issues with the Zimbabwean government, all of which are likely to provide strong headwinds in the next 12 months. After a strong recent performance in City Lodge and a muted earnings growth outlook the entire holding in the company was also sold out of the Fund early in the quarter.

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 10.0%***.

Chart 5: Quarterly returns to 31 March 2012



The Fund's return can be compared to the Maestro equity benchmark and All share index returns of 8.1% and 6.0% respectively. We commented extensively in recent fund summaries 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 the *Maestro Equity Fund* summaries by clicking here and *Intermezzo* by clicking here. I also refer you to Appendix A, which details the nature of the market movements during the quarter. Like so many other periods in the market during the past years the March quarter was unique and provided investors with much to

cheer about, so do pay close attention to what happened during each month of the quarter.

You will see from Appendix A that one of the over-riding characteristic of the past quarter was *broad gains across most risk assets.* Emerging market equities were major beneficiaries to this trend, with the local All Share Index (Alsi) gaining an impressive 5.7% in January alone. You may recall that for the whole of 2011 the Alsi rose only 2.6% and so the strong January was a welcome relief. Unfortunately, this was to be the best monthly return for the broad market as investors were more selective during the rest of the quarter regarding where to place their funds.

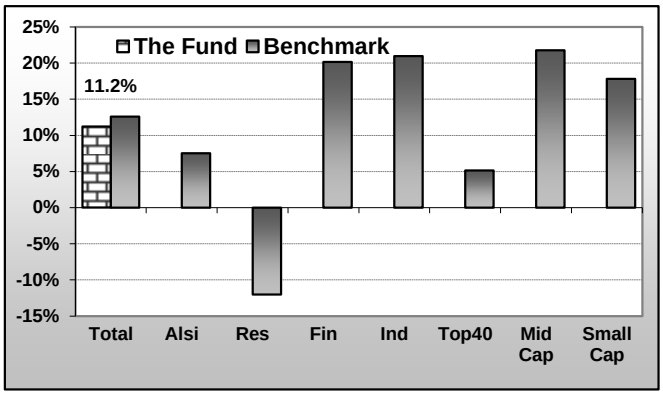
As the quarter progressed, industrial and financial shares continued to charge ahead while basic material counters faced numerous headwinds. The strong rand as well as concerns about China's economy, the largest consumer of resources, dampened investors' appetite for basic material shares. The strong performance by financials came as a surprise to most, as they have lagged other indices for a while now. Good earnings from the major banks were one of the main drivers for the financials outperformance during the quarter. Other financial heavy weights such as Sanlam and Old Mutual also played their part, gaining 15.0% and 14.1%, respectively.

The Fund's strong outperformance was partly driven by the asset allocation call (within sector allocation added to gains as well), overweight industrials and underweight resources. It is quite remarkable to see the divergence in the various indices' returns over a short period of time, such as a quarter. As you will see later in the report, this trend of industrials outperforming resources has been going on for a long time and the gap between their long-term returns is nothing short of remarkable. Chart 5 summarizes the net result for the quarter: financials led the indices gaining 12.8% during the quarter, industrials 10.5% and resources -2.0%. Across the size spectrum, large caps returned 5.1% for the quarter, lagging the mid (10.6%) and small cap (10.4%) indices.

The returns excluding dividends of the five largest holdings in the Fund during the quarter were as follows: Billiton declined 0.3% (it rose 9.4% in the December quarter), Capitec rose 15.2% (-7.3%), Mr Price 18.2% (18.6%), Exxaro 17.9% (-1.5%) and MTN -6.1% (8.5%). Other holdings in the Fund which posted positive quarterly returns included those in B&W, which rose 45.0% during the quarter, Hudaco 25.8%, Coronation 25.6%, Wilson Bayly 23.6%, Aspen 22.7%, Metmar 22.6% and Steinhoff 19.7%. On a negative note, the laggards in the Fund were Sasol which declined 3.9%, Anglo 3.7% and Digicore 1.3%.

The annual returns to end-March are shown in Chart 6. ***The annual return of the total Fund for the year to March was 11.2%***. Inflation rose 6.0% over the year and the All bond index rose 13.2%.

Chart 6: Annual returns to 31 March 2012



The Fund's annual return can be compared to the Maestro equity benchmark and All share index returns of 12.6% and 7.5% respectively. The large difference between the benchmark and the All share index performance provides some insight into the market features during the past year, as does the respective sector returns. Despite the weak (-11.9%) rand, the basic material sector declined 12.0% as concerns about the slowing global economy weighed on the prospects for mining companies. Gold shares were of particular interest as they tumbled 10.9%, despite the 15.5% rise in the gold price. The weak showing by large resources dragged the Alsi down during the past year. You will recall that the Maestro Equity benchmark allots a larger weighting to industrials at the expense of resource shares and this explains much of its outperformance relative to the Alsi. Our long-held preference for industrials over resources has once again been vindicated in the previous year. To put the industrial sector's outperformance into perspective; over the past year industrials are up 21.0% versus resources' decline of 12.0%, a variance of 33.0%! Financials too have had a profitable year, returning 20.2%, slightly below the industrials. Not shown in the chart above are the annual returns of large, mid and small cap index, which rose 5.1%, 21.2% and 17.8%. Undoubtedly, the "sweet spot" to invest over the past year has been the industrial mid cap universe, an area we have traditionally preferred to mine for investment opportunities.

With the above as background, it should not surprise you that within the Fund, resource counters dominated the worst performers and industrials the best performers. Onto specifics, the main detractors in the Fund over the past year were Metmar, which declined 32.5% (despite the 22.6% gain during the March quarter), Implats 22.8%, Anglo 19.0%, Billiton 13.5%, Investec 10.7% and Sasol 5.4%. On a more positive note Coronation rose

60.1%, Mr Price 54.0%, Aspen 50.0%, Cashbuild 34.8% and Capitec 22.0%. These returns exclude dividends i.e. the changes reflect only the share price movements.

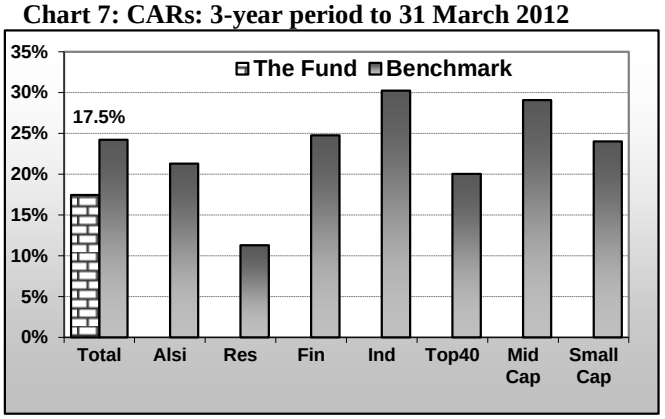
If we look at the returns for a longer period, the past two years, it is remarkable to see some of the returns that enduring equity investors have been rewarded with. The list of the top performers for shares within the Fund is led by Mr Price, which has returned an amazing 137.0% over the past two years. Capitec has gained 116.8% over the same period, Cashbuild 69.2%, Exxaro 57.4%, Kumba 49.1%, Aspen 49.0% and Blue Label Telecoms 43.1%. The largest detractors over the past two years are more-or-less the same shares that detracted from the Fund's annual returns. They are led by Metmar which has lost 36.6% over the past two years, B&W 34.6%, Implats 29.4% and Investec 24.5%.

The impressive return by Mr Price is typical of most South African (SA) retailers that have continued to confound critics for a number of years. While they have been trading at lofty valuations, they continue to chug along and outperform the market. Among other reasons, local retailers have clearly benefitted from short-term interest rates in SA remaining at record lows for a long time which has helped to increase household disposable incomes and stimulate spending. The benefit of low interest rates would also have provided tailwinds to micro lenders like Abil and Capitec who in turn have grown their lending books actively and boosted sales. It may be worth mentioning that the phenomenon of lower interest rates for longer is not unique to SA, with developed market central banks also vowing to keep interest rates at record lows for longer as well. It will be interesting to see how this concoction of low global interest rates and excess liquidity affects asset prices in the medium to long-term.

The compound annual return (CAR) of the Fund over the three-year period to March 2012, shown in Chart 7, ***was 17.5%*** and can be compared to the returns over the same period of the Maestro equity benchmark of 24.2% and the All Share Index's 21.3%. While the just-ended quarter has provided great returns to add to the three-year gains, it is worth noting that much of the spectacular three-year returns result from the base from which returns are being measured. You may recall that during the financial crises, markets troughed in March 2009 and so three-year compound annual returns measure equity gains from just about the lowest point of the crises.

Be that as it may, it is fascinating to see how markets have fared since the nadir of the crisis. The Alsi has returned an average 21.2% per annum over the last three years. Again, this charge has been led by industrials and financials which have returned 30.2% and 24.7% per annum, respectively. Resources have earned 11.3%, despite the rand's 7.4% gain against the dollar. The strengthening rand proved to be too strong a headwind for the international component of the portfolio which declined 1.3% against the benchmark return of 3.1%. Across the market cap spectrum, it will come as no surprise that the large cap index lagged the mid and small cap indices with returns of 20.0%, 28.9% and 24.0% respectively.

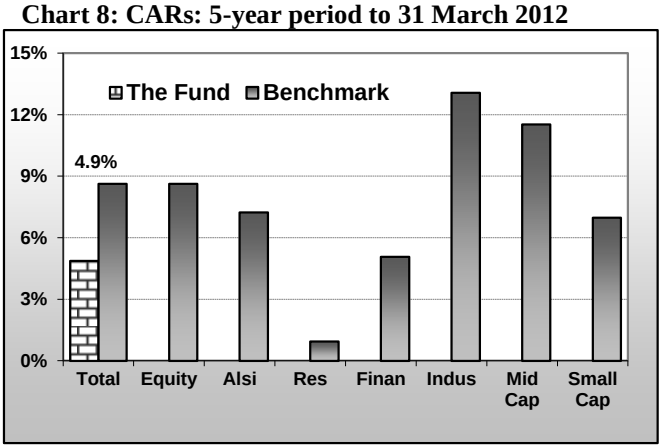
Chart 7: CARs: 3-year period to 31 March 2012



It is worth remembering that these notable returns have been earned with increased risk implicit in the markets during the period. It is fair to say that equity investors who "hung in there" through the crises and recovery have been rewarded with good returns to date. You may be interested to know that in nominal terms, the Alsi reached new all-time highs in the March quarter, though it has subsequently retreated from those levels. The respective CARs for the All Bond index and cash over this period were 10.2% and 7.0%.

Chart 8 depicts the Fund's CARs for the five-year period to 31 March 2012. ***The compound annual return*** (CAR) ***of the Fund over the five-year period to March was 4.9% per annum*** compared to the Maestro equity benchmark and All share index returns of 8.6% and 7.2% respectively. At the risk of sounding like a "broken record", we will point out again that the industrial index has been consistent throughout this period as the least volatile and most profitable area of the market in which to invest. Its compound annual return over the five-year period was 13.1% - just look at the chart to see how material its outperformance of the other major indices has been. The basic materials and financial indices produced respective returns of 0.9% and 5.1% per annum over the same period. The 5-year CARs for the large, mid and small cap indices are 6.6%, 11.5% and 7.0% respectively. The respective CARs for the All Bond index and cash were 8.8% and 8.6% over this period.

Chart 8: CARs: 5-year period to 31 March 2012



Another trend that we should bring to attention is the outperformance of the SA equity market relative to developed market returns. Whereas the All share index rose 7.2% *per annum* over the past five years, the MSCI World index *declined* 2.8% per annum while the MSCI Emerging Market index rose only 2.0% per annum. When you consider how low the global returns are, you realise that the SA equity market has been a very profitable investment destination relative to the rest of the world and long may it continue.

Chart 9: CAR: 7-year period to 31 March 2012

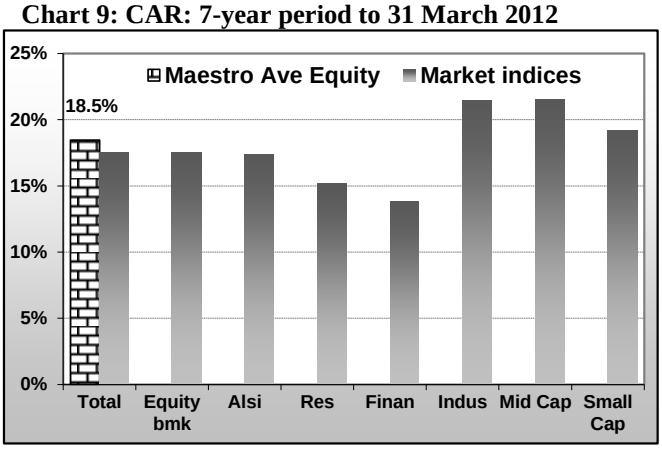


Chart 9 lists the compound annual returns (CARs) over a seven-year period. Due to the Fund not having a full seven-year history I list the **average equity return per annum for Maestro's clients over the last seven years which was 18.5%.** The CAR of the Maestro Equity benchmark over the seven-year period to March 2012 was 17.5%, which can be compared to the return over the same period of the All Share Index of 17.3%.

In order to place these long-term returns in perspective, as well as those of the SA equity market, consider the CARs of other markets over the past seven years to March: the MSCI World index, which incorporates developed equity markets, rose only 1.9% *per annum* although the MSCI Emerging market index rose 9.6% per annum. For the record, the rand declined 3.0% per annum over the past seven years.

6. Closing remarks

Having drawn the curtain on what has truly been a remarkable, and enjoyable, quarter, it is worth reflecting on where to from here on out. If you cast your mind back to where we were at the beginning of this year, it appears that market participants have taken the view that the world is not going implode, at least not yet, and things were not as bad as initially feared. We welcomed that change in sentiment and certainly enjoyed the returns that came with it. However, whichever way you look at it, equity markets "ran very hard" during the first quarter on the back of another profitable quarter, December 2011. It would be careless of us to not urge caution as we proceed into the second quarter of 2012.

In our view, there are several "hurdles" that markets will have to navigate from this point onwards that some market bulls seem to have forgotten. Apart from the Euro crises, which has already returned to the forefront of investors' minds a few weeks after the close of the quarter, there is the recession in the Euro area, slowing growth in China, the political deadlock in the US and the ever-present tensions in the Middle East that all pose a constant threat to the nascent economic recovery.

Given the above, in our humble opinion, it is highly unlikely we will see similar broad headline gains in almost every index as seen in the just ended quarter. Nonetheless, as has been the case for the past number of years, that does not mean there will be no opportunities. Many good companies will continue to deliver good earnings despite the risks prevailing in the market. It remains to us to continue to search and invest in those companies and by doing so successfully navigate the rest of the year.

Luke Sparks
On behalf of the Maestro team
25 April 2012

Appendix A

A summary of market behaviour – March 2012

We comment extensively on market movements from month to month in *Intermezzo*. We therefore provide only a summary here of the salient features of market behaviour during the March quarter. The returns of selected equity, bond, commodity and currency markets are shown in Tables 1 and 2.

Table 1: Selected returns – equity markets

	Mar quarter (%)	Dec quarter (%)	Previous 12 months (%)	2011 (%)
Japan	19.3	-2.8	3.7	-17.3
Hong Kong	11.5	4.8	-12.6	-20.0
Germany	17.8	7.2	-1.3	-14.7
UK	3.5	8.7	-2.4	-5.6
US (S&P500) and large cap	12.7	11.9	8.9	2.5
S&P Mid cap	13.1	12.5	0.5	-3.1
S&P Small cap	*11.7*	*16.8*	*3.8*	-0.2
MSCI World index	***10.9***	***7.11***	***-1.7***	***-7.6***
Brazil	13.9	8.5	-5.8	-18.1
Russia	18.8	3.0	-19.7	-21.9
India	12.6	-6.1	-10.5	-24.6
China	2.9	-6.8	-22.7	-21.7
MSCI Emerging market index	***13.7***	***4.1***	***-11.1***	***-20.4***
JSE All share	***6.0***	***8.4***	***7.5***	***2.6***
JSE All share ($)	***11.5***	***7.9***	***-5.3***	***-16.0***
Basic materials	-2.0	5.8	-12.0	-8.3
Financial	12.8	8.7	20.2	7.4
Industrial	10.5	9.1	21.0	9.2
Gold mining	-14.9	0.7	-10.9	6.9
Large cap (Top40)	5.1	8.5	5.1	2.2
Mid cap index	10.6	8.2	21.1	4.7
Small cap index	10.4	6.8	17.8	1.1

Global equity investors enjoyed a remarkable first quarter with a number of indices recording their best starts to a year in recent history. With the benefit of hindsight, it seems investors and analysts had mistakenly priced in an imminent Eurozone apocalypse and a severe slowdown in the US economy which resulted in some markets being oversold in 2011. This year began with a correction of that trend where the worst performing indices in 2011 were among the best performing in the March quarter. Table 1 above highlights this development clearly. Take for instance the BRIC equity indices, they averaged losses of over 20.0% for the 2011 calendar year but have rebounded this year to post double digit returns for the March quarter, with the exception of China.

The Chinese market was certainly a surprising performer over the past quarter. Despite being the fastest growing major economy, its stock market significantly underperformed, returning 2.9% for the quarter, less than the 7.2% earned by the Greek stock market. This striking anomaly reaffirms the principle that markets are moved by "unknowns" rather than what is "known", in other words, relative changes in market expectations are more important than the absolute view that investors hold on any investment. Despite the poor showing by the Chinese market, it did not deter the MSCI Emerging Market index from registering an impressive 13.7% return for the quarter, ahead of the 10.9% of the MSCI World Index, a proxy for developed markets.

On the whole, developed markets also had a very profitable quarter, specifically the Japanese, Hong Kong and German markets. You may recall, and it is evident from Table 1 that these markets had a very disappointing 2011 so the strong March quarter provided an air of respectability to the annual (12 month) returns, many of which are still negative. The surprise return within the developed markets was the UK's FTSE 100 index which gained "only" 3.5%. Again, this should be seen in the context of the 2011 return of -5.6%, which was "not too bad" relative to other developed market returns.

Table 2: Selected returns – bonds, commodities, currencies

	Mar Quarter (%)	Dec quarter (%)	Previous 12 months (%)	2011 (%)
SA All Bond index	2.3	3.3	13.2	8.9
SA Cash	1.4	1.4	5.7	5.7
Barcap Global Agg. Bond index	0.9	0.2	5.3	5.6
Emerging market bonds	5.1	4.8	9.1	5.8
US 10-year bond	-2.2	1.2	14.9	17.1
US Corporate bond	2.4	1.8	9.1	7.5
US High yield bond	5.2	6.2	5.6	4.4
Cash (US dollar)	0.0	0.0	0.0	0.1
DJCS Hedge index	4.0	0.7	-0.8	2.5
Brent (Oil)	14.4	4.5	4.7	13.3
Gold	5.6	-2.8	15.5	11.7
Silver	15.1	-7.5	-14.4	-8.0
Platinum	21.1	-10.4	-7.5	-22.9
Palladium	3.3	2.6	-15.0	-21.0
Copper	11.5	5.8	-10.3	-21.7
Nickel	-4.3	-0.2	-33.1	-26.8
Baltic Dry index	-46.3	-8.5	-40.0	-2.0
CRB Commodity index	1.0	2.5	-14.9	-5.4
S&P GS Commodity index	5.9	6.4	-3.9	3.9
Euro dollar	2.6	-3.2	-6.2	-3.2
Sterling dollar	-2.8	-0.2	-0.3	-0.7
Swiss franc dollar	-3.3	-2.9	-1.2	-0.3
Rand dollar	5.2	-0.4	-2.9	-18.1

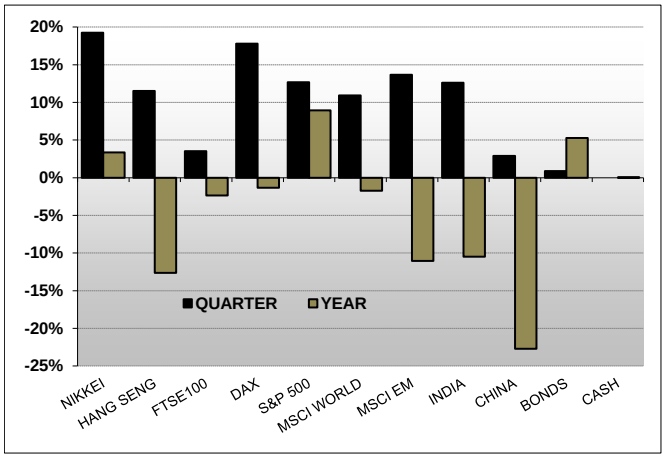
Commodities started the year on the front foot aided by the weak dollar and the increased risk appetite in the market. This strong start was somewhat mitigated towards the end of the quarter as concerns over global growth resurfaced. However, that did not prevent commodities, as represented by the S&P GS commodity index, from registering a gain of 5.9% for the quarter. This return does not begin to tell the whole story of the divergent returns among different commodities. We comment more on the varied returns across the commodity space in sections that follow.

Most currencies were stronger against the dollar during the first quarter. As you would know, the US dollar is still viewed as a safe haven currency and so in periods of increased risk appetite, one would expect a weaker dollar as investors ditch the dollar in favour of riskier currencies. The rand was a major beneficiary to this phenomenon, gaining 5.2% against the greenback, confirming its status as a proxy for increased appetite for emerging market exposure.

Global investment markets

Chart 1 summarizes the quarterly and annual returns of the major equity, bonds and cash markets. You can see clearly from this chart that the robust quarterly returns have still not managed to lift some of the annual returns into positive territory.

Chart 1: Global returns to 31 March 2012



While by no means comprehensive, the following were some of the features of the March quarter that caught our attention.

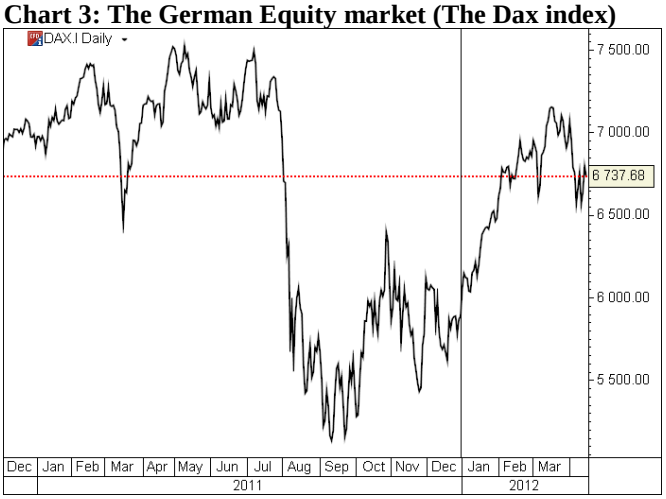
- *Strong equity markets:* Charts 2 and 3 depict the movements of the US and German equity markets over the past year. The thick vertical line in all the ensuing charts depicts the start of the March quarter as a reference point off which to measure the quarterly return. It is apparent from most of the charts just how strong global markets were during the March quarter on the back of a rather profitable December quarter – refer again to Chart 1 which shows the quarterly and annual returns. It is also clear from these charts that the strong quarter was unable to make up for lost ground in the previous year, with the exception of the US equity market, Japan and the JSE All share index.

Chart 2: The US Equity market (S&P 500 index)

Source: Saxo Bank

As has been the case throughout this economic recovery, a lot of equity gains can squarely be attributed to various actions by central banks. Investors undoubtedly view quantitative easing (QE) and its equivalents as good news for certain asset prices. The latter part of 2011 and the March quarter gave further evidence to this as the European Central Bank's (ECB) unlimited offer to provide European banks with cheap funding, a QE equivalent, for three years provided welcome tailwinds to risky assets.

Chart 3: The German Equity market (The Dax index)



Source: Saxo Bank

While the generosity extended by the ECB did not solve the underlying problems of the Eurozone, which are too much debt and very little growth, what it did was to afford politicians and policy makers much needed time to solve the problems. Interbank credit which was fast drying up across the Eurozone has now re-emerged in aggregate and investors saw this as a reason to buy into risk assets during the March quarter. As the effects of

the ECB's actions wane, one may expect investors to take some risk off the table. Perhaps we started to see the first signs of this towards the end of the quarter.

When considering the first quarter rally in equities, what is often forgotten is just how strong markets have actually been since their October lows. Table 3 below shows returns of selected indices from the previous six months in comparison to the most recent quarter, a period that covers the current bull market in equities.

Table 3: Returns: previous six months & quarterly (%)

Index	Q4 2011 & Q1 2012	Q1 2012	Index	Q4 2011 & Q1 2012	Q1 2012
S&P 500	24.6	*12.7*	Russia	22.4	*18.2*
Dax	26.3	*17.8*	South Africa	14.9	*6.0*
Nasdaq	28.3	*18.7*	Brazil	22.4	*13.9*
Nikkei	15.9	*19.3*	India	16.8	*12.6*

The above table highlights the extent to which markets have been strong over the past six months. Despite the previously mentioned reasons for this rise in markets, we caution that such gains over a short space of time are often unsustainable. When you consider that global growth is expected to be sluggish for the remainder of the year, it would be optimistic to expect the second quarter of this year to mirror the returns seen in the previous two quarters.

- *The surge in Japanese equities:* A closer look at Table 3 above and Chart 4 below, shows that the Nikkei was the standout performer in the first quarter of 2012. The Nikkei returned 19.3% in the March quarter compared to its -2.8% return in the previous quarter.

Chart 4: The Japanese Equity market (Nikkei 225)

Source: Saxo Bank

The strong performance of the Japanese market can largely be attributed to the yen's tumble, relative to the dollar. The Nikkei index, which is dominated by large exporters, benefited from the unexpected monetary easing by the Japanese Central Bank (BoJ) during the previous quarter. The BoJ expanded its asset purchasing programme (QE) from ¥55tn to ¥65tn, a move that saw the Asian currency drop over 7.0% against the dollar. The surprise depreciation in the currency aided Japan's beleaguered exporters that are still nursing the effects of last year's natural disaster. Remember, the natural disaster occurred in March last year and so the positive (3.7%) annual return of the Nikkei should be viewed with that low base in mind. Chart 5 below shows the extent to which the yen weakened over the previous quarter.

Chart 5: The dollar yen exchange rate

Source: Saxo Bank

- *The weaker dollar, a proxy for increased risk appetite:* As we have already alluded to in this report, the dollar was highly responsive to global risk appetite, particularly against emerging market currencies. With interest rates in developed countries at historically low levels, investors' search for yield raised the appeal of currencies with attractive interest rate differentials relative to developed markets. This extension to a trend that began in the last quarter of 2011 saw "riskier" currencies enjoy a strong start to the year.

The rand, whose performance is highly correlated with emerging market equities and bonds, falls squarely into this category. Chart 6 shows how the rand has performed in the recent past and highlights the volatility borne out of changes in global risk appetite and aversion.

Chart 6: The rand dollar exchange rate

Source: Saxo Bank

While on the rand, you will recall that in previous quarterly reports we made reference to the long-term trend of the rand dollar exchange rate. I refer you to Chart 7 for a long-term rand dollar chart. It is interesting to note that for much of the last decade, apart from the spikes borne by global crises, the rand has trended marginally higher against the dollar, gaining an average 4.0% per annum. This should not come as a major surprise considering the strength in commodity prices over the last decade and the base from which we begin to measure (approximately six months post 9/11). Be that as it may, we believe that part of this long-term inclination of the rand to firm against the dollar speaks to the fundamentals of the local currency. It appears as though when investors feel that the world is not going to founder and is back to "normal", currencies such as the rand strengthen at the expense of the dollar. This is not hard to accept when you consider the wealth of challenges developed economies are facing at present, such as, the over indebtedness, lack of growth, level of real interest rates and aging populations.

Chart 7: Long-term rand relative to the US dollar

Source: Saxo Bank

And so we saw the rand benefit from this "return to normal" trend in the first quarter, as investors realised that they can afford to look at fundamentals again and direct their funds into emerging markets. It is worth mentioning that although the strength, and weakness, of the rand is largely dependent on global forces, it does help that the influence of local factors is at the very least, supportive. The previous quarter saw the South African finance minister, Pravin Gordhan, present the annual budget. Though we commented extensively on the budget in the Intermezzo publication, it is worth highlighting that the budget was well received by most stakeholders. The continued commitment by government to reduce the budget deficit is commendable and certainly does not do the rand any harm.

Another proxy for risk, the euro, strengthened 2.6% against the dollar during the March quarter. This may seem counterintuitive, considering that the ECB was effectively printing money during the quarter and lending it to banks very cheaply. In theory, this should result in diminishing purchasing power in the euro and a weaker currency. Conceivably, the strength in the euro over the past quarter should be seen from the perspective that the ECB is not the only major central bank playing this game. The Swiss National Bank and Bank of England have all been overworking their printing presses in an attempt to stimulate growth, weaken their currencies and possibly inflate their debts, though they would never admit it. The US Federal Reserve has probably done this to the greatest extent and so it is not that surprising to see the Euro "holding its own" against the greenback despite the ultra-loose monetary policy. Of course, the ever changing perceptions of the Euro zone crises will ultimately have the largest influence on its currency, but whenever that risk seems to have abated, it is always of interest to see which of the two currencies (dollar or euro) investors regard as a better investment destination.

Chart 8: The euro dollar exchange rate

Source: Saxo Bank

- *The gains across market capitalizations (caps):* As you know, we watch the respective returns across market capitalizations (market caps) or size of companies very closely because it tells us a lot about the prevailing risk appetite of investors, among other things. With risk appetite elevated during the previous quarter, you would understand our surprise that US large caps (12.7%) kept up with mid (13.1%) and small (11.7%) caps. A closer look at the outperformers in the S&P 500 easily explains this irregularity; the performance of US financial shares and Apple were the main drivers of the large caps' performance. According to Barclays Capital, Apple, the world's largest company by market cap now makes up almost 5.0% of the S&P 500 index. Apple's 48.1% rise in the March quarter added 15.0% to the S&P 500's 12.7% gain. We comment on Apple's extraordinary rise in the latest edition of Intermezzo. The second reason for the aberration in the US market cap returns is the remarkable performance by S&P 500 financials (Chart 9 below) during the quarter, albeit from a lower base. The results of the latest round of US bank stress tests carried out by the US Federal Reserve and released during the quarter were viewed positively by the market and contributed to S&P financials rising 22.0% during the quarter. These two factors were responsible for the US large caps more or less keeping up with mid and small caps.

Chart 9: The S&P Financial sector ETF (The "XLF")

Source: Saxo Bank

- *The gold and platinum differential:* It was fascinating to see the prices of gold and platinum narrow during the quarter. You may recall that the gold price has traded above the platinum price since the third quarter of last year, an occurrence that is not usual at all. The instances where the gold price has traded at a premium to platinum have been brief and rare. As you would have guessed, this is only in periods of heightened risk aversion. As risk aversion subsided during the quarter the platinum price outperformed gold, with it briefly trading above the gold price. A large part of this correction should be ascribed to platinum supply concerns in the previous quarter. The much publicised strike action at Impala Platinum, the world's second largest platinum producer, as well as concerns over the indigenisation of its Zimbabwe operations led to a 21.1% increase in the metal's price.

Chart 10: The Platinum price ($)

Source: Saxo Bank

The gold price started the quarter by consolidating last year's gains but then moved into decline as bond yields rose and increased the opportunity cost of holding the metal. The differential between the two metals (gold and platinum) will be a key indicator to investors' economic outlook going forward. Platinum's superior fundamentals i.e. its industrial use, should see it outperform gold, if and when investors begin to believe in a sustainable economic recovery and discount the possibility of further quantitative easing or its equivalents by the US Federal Reserve.

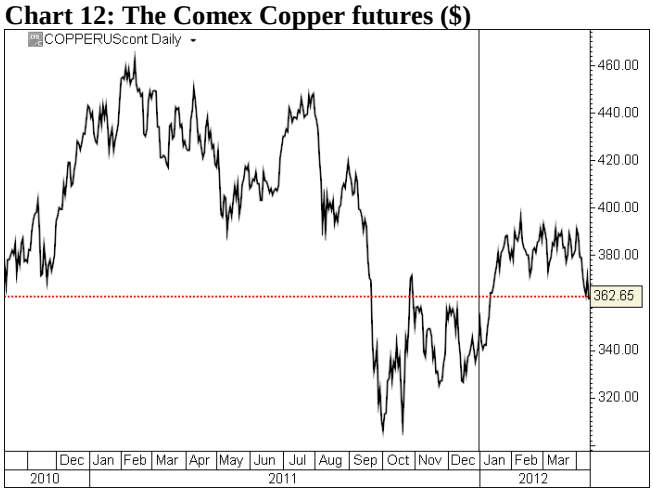
Chart 11: The Gold price ($)

Source: Saxo Bank

- *Copper and oil price:* Another interesting development in the commodity space was the surge in the copper price during the quarter. Copper is the classic cyclical

economic bellwether (its price is driven primarily by global industrial production) and it was encouraging to see the 12.3% jump in its price during January. Disturbingly, it moved sideways for the rest of the quarter as concerns about China's "hard or soft landing" returned to the fore.

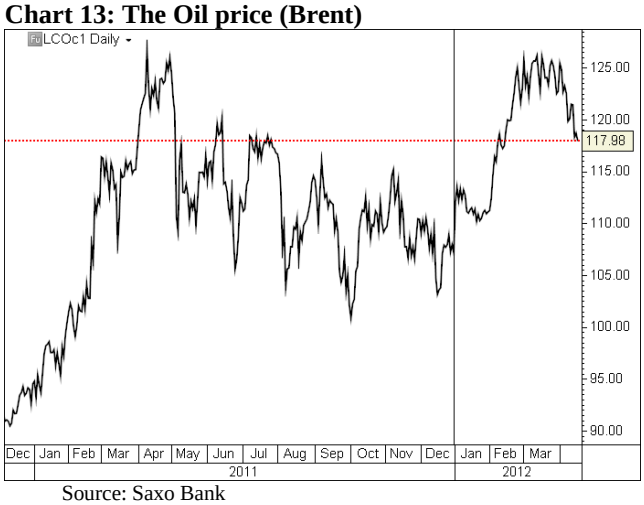
Chart 12: The Comex Copper futures ($)



Source: Saxo Bank

We have mentioned in previous quarterly reports our concern regarding the stubbornly high oil price, despite the lethargic global economy. The rally in the oil price during the quarter created worries about "demand destruction", a point where higher oil prices become a deterrent to consumer spending thereby reducing demand and further slowing economic growth. With Brent crude oil reaching multi-year highs during the quarter, our concerns are certainly valid. South African consumers have felt the full brunt of this development, with the rand not strengthening as much as the oil price's increase in the past quarter, the petrol pump price has risen significantly over the past few months to almost R12 per litre in some parts of the country.

Chart 13: The Oil price (Brent)



Source: Saxo Bank

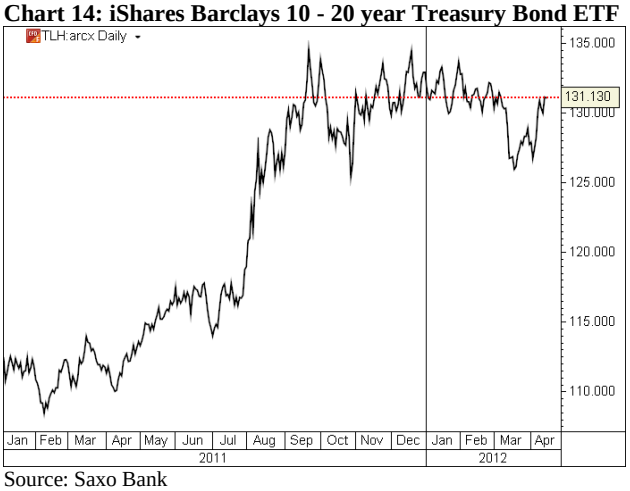
Many western politicians have been quick to attribute the strong oil price directly to the political instability in the Middle East, particularly Iran. We do not contest that fears of supply constraints have had a hand in the higher oil price. However, a closer look at the long-term gains in the oil price provides an interesting perspective. Below is a table that shows how different assets have fared over the past five years, which period covers the financial crises and recovery.

Table 4: Five-year returns for selected assets
Absolute increases to 31 March 2012

Asset	Return (%)	Asset	Return (%)
Gold	*150.6*	US Bond index	*37.4*
Silver	*142.9*	S&P 500	*-0.8*
Brent oil	*79.6*	Dax	*0.4*
Copper	*30.6*	MSCI World	*-13.4*

There are no prizes for guessing that the best performing asset class over the past five years are commodities, particularly precious metals. Gold has led the way returning 150.6% in dollars, followed closely by silver 142.9%. Though significantly below the two precious metals, Brent oil is third on the list. While precious metals have benefited from increased risk aversion buying during the last five years, the broad rise in industrial commodities can also be credited to the profligacy of the US Federal Reserve by way of unprecedented loose monetary policy. Given that this liquidity has been directed mostly to the purchasing of fixed income assets, it is of little surprise that fixed income takes up the next slot of gainers. Equities lag other asset classes in the table as they have received limited direct assistance from policy makers. Perhaps the US politicians and policy makers should consider this when they next complain about the rise in gas prices. By further loosening monetary policy they are for all intents and purpose "plugging one hole and opening another."

Chart 14: iShares Barclays 10 - 20 year Treasury Bond ETF



Source: Saxo Bank

- *"Safe" bond weakness:* On the bond front, the quarter began with safe government bonds offering low yields, as investors were willing to lock in negative real returns over extended periods rather than risk their capital. As risk aversion abated and better than expected economic data impressed, particularly in the US, we saw a selloff of safe bonds into higher risk bonds, namely emerging market and high yielding debt. US 10 year treasuries declined -2.5%, while the SA All Bond index, a proxy for emerging market debt, rose 2.3%.

Chart 15: The JP Morgan emerging market bond ETF

Source: Saxo Bank

Local investment markets

Turning to the South African investment markets, Chart 16 depicts the quarterly and annual gains in the major indices for period ended 31 March 2011.

Chart 16: Local returns to 31 March 2011

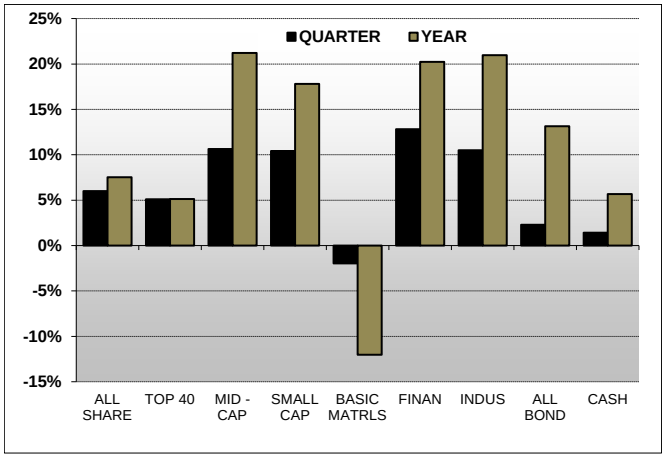


Chart 16 shows that, with the exception of the basic material sector, the first quarter proved to be a very profitable one. The extent of the gains in the March quarter was enough to lift the previously marginal annual returns into impressive gains, particularly for the industrial and financial sectors, which returned 21.0% and 20.2% respectively. It is clear from the table above that the large resource shares weighed on the All Share Index and limited the index's quarterly and annual gains to just above 5.0%. Gold miners, most of which are large cap shares, were one of the worst performing sectors declining a remarkable 14.9% during the quarter, bring its annual return to -10.9%. Of great interest to us is the outperformance of the mid (21.2%) and small caps (17.8%) compared to the large caps (5.1%) over the last year. With the amount of risk that was prevalent in the market over the previous year you may have expected large caps to have performed much better than smaller companies, which are often viewed as risker. This was not to be so, and it is worth pointing out that this occurrence is not a "once off". History shows us that during times of volatility and uncertainty large cap shares lag mid and small caps. One possible reason for this anomaly may be that, investors find it easier to "get in and out" of large cap shares and so they do this more readily than with smaller companies that are often less liquid. It will be interesting to see how this trend develops as the year progresses, considering that the mid and small cap indices have already earned double digit returns so far this year.

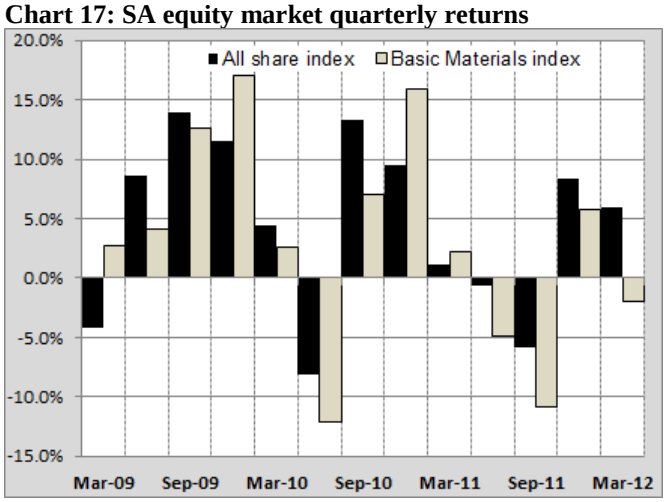
Our local bond market benefited from the stronger rand and gained 2.3% for the quarter and 13.2% for the year to March, ahead of the Barcap Global Aggregate bonds which returned 0.9% for the quarter and 5.3% for the year. The local bond market was supported by lower risk aversion as investors moved from developed market government bonds into "riskier" emerging market bonds that offer higher yields. With developed market bonds still at very low yields, it will not be surprising to see this trend continuing for the foreseeable future.

In closing

As you would know, the purpose of this document is not to pass comment on future events but rather to review the events that would have occurred in the previous quarter. Be that as it may, after the extraordinary quarter we have just had, we think it is worthwhile to spend a bit of time on our expectations of the coming quarter and the rest of the year.

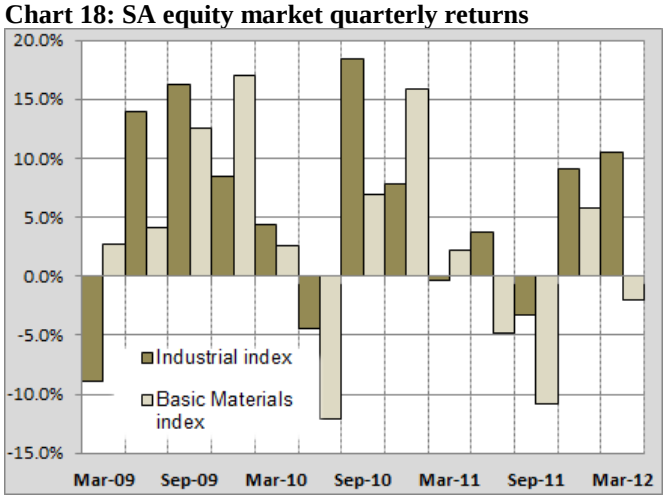
In the December quarterly report we included Chart 17 and 18, to illustrate the volatility and performance variance between the All Share index, Industrial and Basic Material indices since the March quarter of 2009. We have included the updated charts below to further illustrate the point we made last quarter that divergence between the indices and their volatility for a past number of years has been nothing short of extraordinary.

Chart 17: SA equity market quarterly returns



With that as a backdrop, it should not surprise you that we are "preaching caution" as we go into the second quarter. You will recall that for most of last year, the Eurozone crisis was at the forefront of investors' minds. The actions of Central Banks earlier mentioned in this Report eased some of those tensions earlier in the year and were aided by better than expected US economic data . With Central banks ceasing (at least for now) their unconventional monetary easing policies, investors' focus will turn solely to growth. We already began to see signs of this towards the end of the quarter with a few disappointing economic numbers leading markets lower.

Chart 18: SA equity market quarterly returns



A number of market participants, of which we are one, expect a slowdown in the US economy as the year progresses. Apart from the anticipated fiscal tightening that is expected in 2013, another reason for our sombre outlook on the US economy is the elections towards the end of the year. As history would confirm, very little progressive policies are enacted in the run up to an election. Politicians tend to be more polarised and focus more on politicking rather than taking any significant steps towards fixing problems.

The Eurozone's growth prospects are also not very encouraging. As austerity takes hold we are likely to be disappointed rather than pleasantly surprised with the economic developments emanating out of Europe.

One could argue that some of the growth prospects are "priced into the markets" already - a comment we feel is a fair one. Probably the biggest unknown, as far as growth is concerned, is China. As the world's second largest economy and largest contributor to growth, it is imperative that China's economy chugs along at or above 8.0%, a level regarded as a "soft-landing" by investors. It would have been difficult to get a clear picture of China's economy in the past quarter due to the disruption brought about by the lunar holidays. So along with other investors, we will keenly follow how the China growth story unfolds this coming quarter as it will have a direct impact not only on our basic resource shares but more importantly the broad mood of the market. One source of comfort is that, if we see material weakness in the Chinese economy, we will likely see decisive action by the country's central bank, the People's Bank of China, which would give markets cause to cheer and ease some of the fears about insufficient growth in the Chinese economy.

An additional source of comfort going into the new quarter is the continued strength in corporate profits. Since the recession, corporates have successfully trimmed a lot of the "excess fat" from their operations and are in lean condition. US corporates in particular are operating at record margins and are holding large amounts of cash on their balance sheets. This healthy state of corporates should provide equity investors with some encouragement as the year progresses. The contrast in corporate and sovereign balance sheets is best exemplified by the number of large corporations that are trading at dividend yields higher than some government bond yields and even gaining access to capital at lower yields than their respective governments. Apart from highlighting the strong balance sheets of corporates, this fact also shows the kind of opportunities that still present themselves in this market.

Looking ahead, it is highly unlikely that we will see broad gains across most asset classes in the coming quarter as we did in the March quarter. Despite our cautious outlook, it does not mean there are no opportunities in these markets. We continue to expect corporate profits to deliver earnings growth although not as broad based as seen previously. The challenge for us remains to seek out these companies for your benefit.

The Maestro Investment Team
24 April 2012

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