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 Consulting, 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 portfolio 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%. The investment management fee is 1.75% per annum.

FUND SIZE - R14 993 193

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

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

PORTFOLIO MANAGER
Capstone 96 (Pty) Ltd t/a Maestro Investment Consulting

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The Maestro Equity Fund

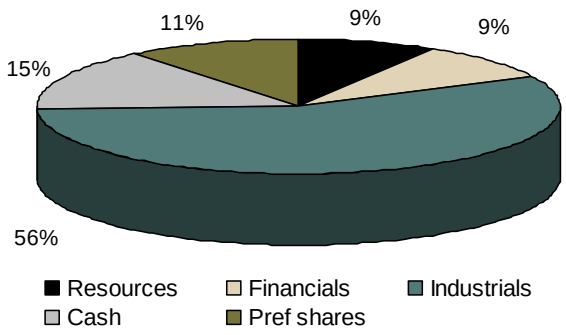
Quarterly report for the period ended

30 June 2006

1. **Introduction**
This report focuses on the investment activities of the Maestro Equity Fund during the past quarter and should be read together with *Intermezzo* and the Fund Summaries sent to all unit holders on a monthly basis.

2. **The investment position of your portfolio**
The Fund's sector allocation is shown in Chart 1. At the end of June the Fund's resource exposure amounted to 9% of the Fund, down from 21% in March. Financials represented 9% of the Fund, down from 12% in March, while industrial exposure decreased from 59% to 56% of the Fund. Cash represented 15% of the Fund, from 8% last quarter-end, while preference shares comprised the remaining 11%.

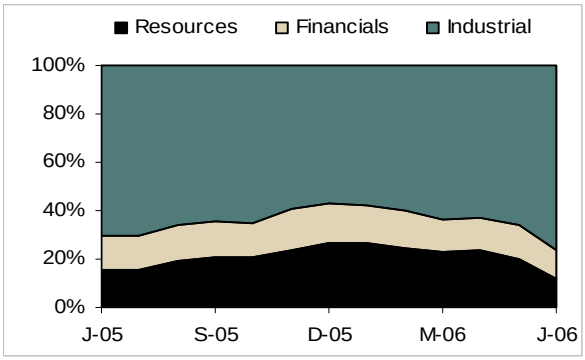
Chart 1: Asset allocation at 30 June 2006



The investment conditions that prevailed during the past quarter will be described in more detail below. Suffice is to say here that a dramatic shift on the part of global investors occurred during the quarter. The inherent risk in the market rose sharply, calling for a considerable amount of caution - at least in Maestro's opinion. The cash holding in the Fund was increased accordingly.

As will be explained later in this Report Maestro deemed it appropriate to reduce the risk profile of the Fund during the quarter. In light of the substantial gains experienced by the resource sector, particularly since the beginning of the year, and premised on its view that the rand would remain relatively firm, Maestro further reduced the Fund's exposure to resource shares during the quarter. This can be seen from Chart 2, which depicts the Fund's equity sector allocation since inception.

Chart 2: Historic equity sector allocation



3. **<u>The largest equity holdings</u>**
The Fund's largest holdings at 30 June are listed in Chart 3, expressed as a percentage of the equity portfolio excluding pref shares. Those at the end of March are listed in Chart 4 for reference purposes.

Chart 3: The largest holdings at 30 June 2006

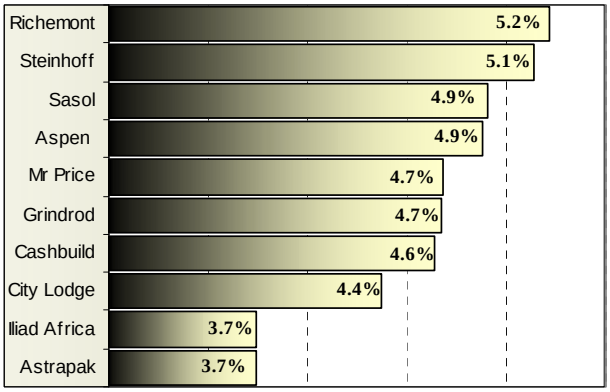
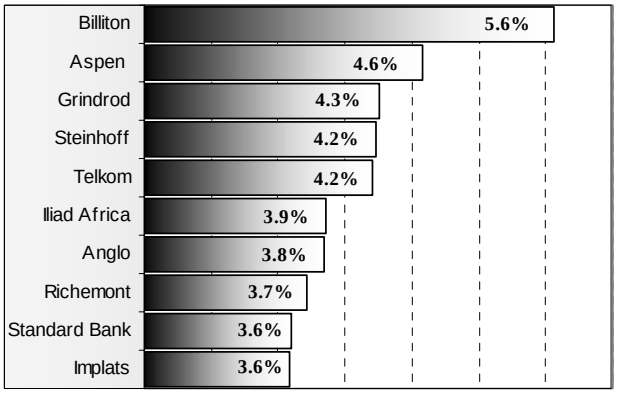


Chart 4: The largest holdings at 31 March 2006



Astrapak, Cashbuild, City Lodge, Mr Price and Sasol, displaced Anglo, Implats, Standard Bank, Steinhoff and Telkom in the largest holdings at quarter-end. There were 29 counters in the Fund at quarter-end, as opposed to 33 in March, the ten largest of which constituted 46% of the equity portfolio, up from 41% in March.

4. **<u>Recent activity on the portfolio</u>**
The investment objective on the Fund is to *achieve long-term growth through the assumption of moderate risk.* It is against this objective that the Fund's activities and performance should be assessed.

The Fund's equity exposure was reduced during the quarter in order to reduce the risk profile and simultaneously to increase the cash holding. The holdings in Anglo, Investec, Kumba, Mittal and SABMiller were consequently sold, and those in Billiton, Digicore, Hiveld, Implats, Standard Bank and Telkom reduced. During the quarter the holdings in Altech, Astrapak, Aveng, Cashbuild, City Lodge, Mr Price and Wilson-Bayly were increased and holdings in Amalgamated Appliances and Ellerine Holdings introduced into the Fund.

5. **<u>A review of the recent investment environment</u>**
Maestro has communicated a lot about the market's behaviour in recent months. In this regard I refer you to my letters of 17 May and 12 June, as well as the June and July editions of *Intermezzo*, which can be accessed by clicking here. If for whatever reason you have not received these documents, please let me know so that I arrange for you to receive them in future.

In summary, the quarter developed as follows: it started off well, but on May 10 the US Federal Reserve raised interest rates as expected but also gave a clear, and very *unexpected* signal that they would continue raising rates in order to combat rising inflation. That led to a sharp and dramatic sell-off in global equity markets, and emerging markets in particular (hence also the SA market). A retraction of risk on the part of global investors took place across the world at lightning speed, leaving many markets with substantial declines in a matter of days. The latter then recovered some of their losses going into the end of May, but declined sharply again in early June before reaching a trough around June 14. By that stage some emerging markets had seen declines similar to those experienced in the 1987 crash - in the order of 30%, some even more, as can be seen from Table 1. As if to make matters worse markets then staged a remarkable recovery in the second half of June, to finish the month with marginal declines, leaving casual observers wondering what all the fuss was about.

Not only were the losses during the quarter severe, they were also characterised by three significant phenomena: *firstly* the losses were accompanied by extraordinary **volatility**, which saw a number of daily movements in excess of 2% and 5% - up and down - on developed and emerging markets respectively. *Secondly*, the losses were **focussed on certain sectors**, while others displayed uncanny strength despite the adverse environment.

Financials in general and banks in particular, as well as mid and small cap shares were indiscriminately and severely punished. This alone is indicative of a retraction of risk, as was the extent of the emerging market losses. *Thirdly*, emerging market currencies in general, and those with current account deficits in particular, such as South Africa, Poland, Hungary and New Zealand were also severely punished. Not surprisingly, the rand lost 13.6% of its value relative to the dollar during the June quarter (it lost 20% in six weeks at one stage) and 18.2% relative to the euro.

Table 1: Stealth mini-crash: now you see it, now you don't
Selected returns in local currencies (MSCI returns in $) (%)

Country	Index	June	May peak to June trough	June trough to end-June	2006 year-to-date
	MSCI World index	**-0.2**			**4.9**
UK	FTSE 100	1.9	-10.2*	5.9	3.8
Germany	DAX	-0.2	-13.8	7.4	5.1
US	S&P 500	0.2	-7.7	4.0	1.8
Japan	Nikkei 225	0.2	-19.0	9.1	-3.8
Australia	S&P/ASX 200	0.3	-9.8	4.9	6.5
	MSCI Emerging Market index	**-0.5**			**5.8**
SA	JSE All share	3.4	-17.6	13.4	5.8
India	BSE Sensitive	2.0	-29.2	20.2	12.9
Russia	RTS	2.3	-32.0**	25.6	32.8
Brazil	Bovespa	0.5	-21.8	11.7	9.5
Turkey	IMKB National 100	-7.7	-33.1***	11.0	-11.9

* April peak
** January trough
*** February peak

More can be written about the unique events in the June quarter, but I would rather spend time on the *outlook* for markets later in this Report. Chart 5 lists the respective global market returns for the quarter and year to June. Note just how negative the past quarter was across developed markets. Markets that performed the best in the past year experienced the greatest quarterly losses.

Chart 5: Global market returns to 30 June 2006

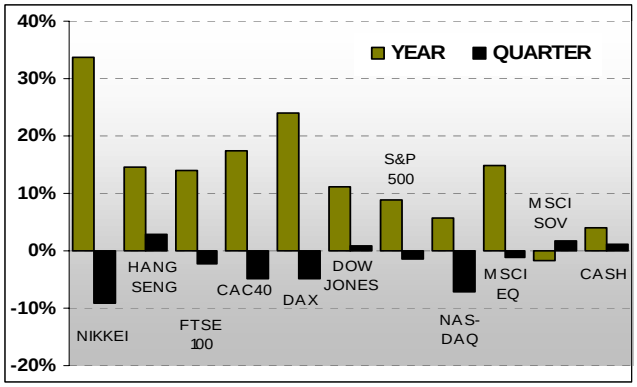


Chart 6 lists the returns to end-June of the major local indices. Here the unique nature of the SA equity market becomes apparent immediately. Although they led the losses in May, resource shares drew support from a weaker rand and recovery in commodity prices to lead the charge higher into the quarter-end, to such an extent that they registered a quarterly gain of 20.6%! In stark contrast, financial and industrial shares had a terrible quarter, participating fully in the losses but hardly recovering at all, to end the quarter 6.0% and 5.4% lower respectively. I can't recall when last markets experienced such a wide margin of disparity in a quarter – almost 26% in absolute terms – highlighting just what an extraordinary period it was. Similarly the disparities were very wide across market capitalisations: large caps (not shown on the Chart) registered a quarterly gain of 7.2% while mid and small caps declined by 9.5% and 9.0% respectively. These large disparities across both market caps and sectors had a direct bearing on the quarterly returns of the Fund, as you will see in due course. Chart 7 shows quarterly returns for selected SA indices.

Chart 6: SA market returns to 30 June 2006

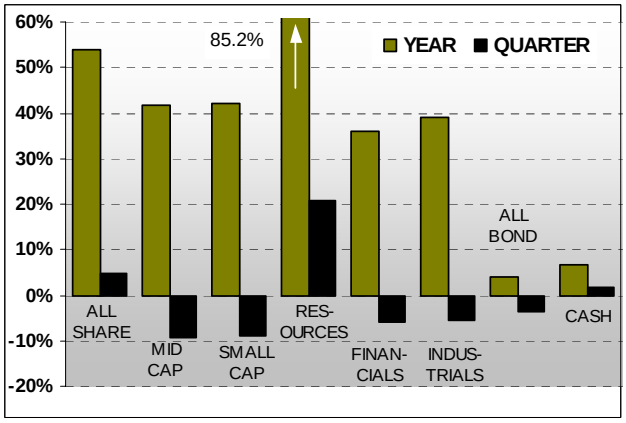
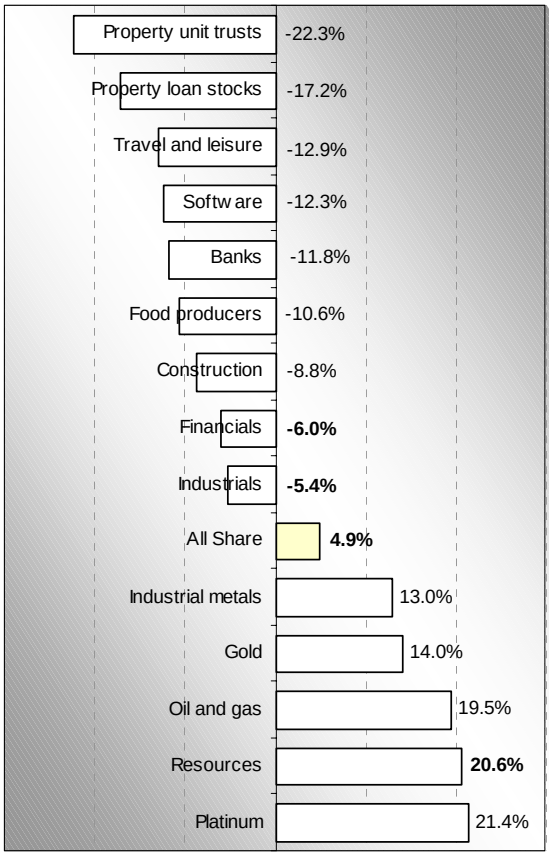


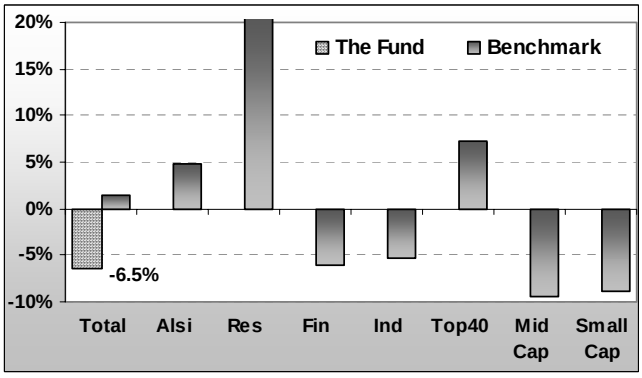
Chart 7: Selected quarterly returns to 30 June 2006



6. The performance of the Fund

Turning to the Fund's performance, Chart 8 shows the returns for the June quarter as well as those of the major JSE indices.

Chart 8: Quarterly returns to 30 June 2006

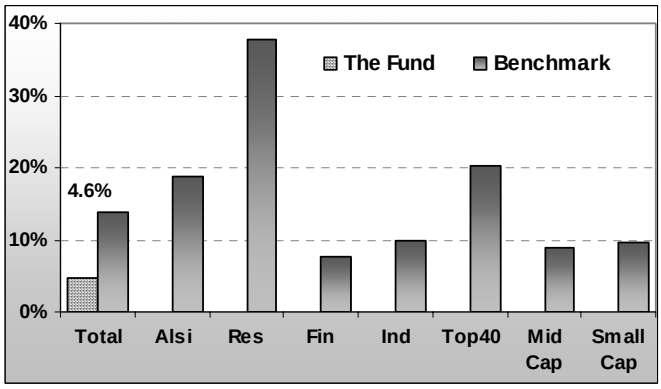


The total (un-annualised) return on the Fund during the June quarter was –6.5% compared to the quarterly return of the Maestro equity benchmark of 1.4% and All Share Index of 4.9%. This return is very disappointing and had a lot to do with the fact that the portfolio was underweight in resource shares, which registered exceptional returns (20.6%) during the quarter. It is clear from Chart 8 that you had to have had a substantial resource weighting in order to have posted a positive return during the June quarter – note the large difference between the quarterly returns of the resource index on the one hand, and those of the financial and industrial indices on the other.

Closely related to the lower resource weighting was the fact that Maestro has maintained a portfolio based on the view that the rand would remain relatively firm. Maestro has now changed that view (more on that late) but it was impossible, given the speed with which the rand declined to refocus the portfolio in such a short space of time.

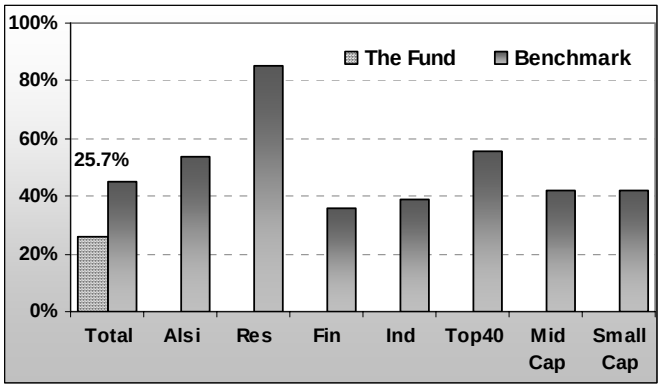
The portfolio bias in favour of mid and small cap shares also counted heavily against the Fund, given the manner in which these shares were punished during the market sell-off in May and June. The mid and small cap indices declined 9.5% and 9.0% respectively during the quarter. The severity and indiscriminate nature of the declines was astonishing and must surely be ascribed at least in some part to the presence in and hasty retreat from our market by foreign investors. The quarterly returns of the five largest holdings at quarter-end were Richemont 11.2% (up 6.5% last quarter), Steinhoff –3.8% (18.4%), Sasol –3.8% (18.4%), Aspen –15.5% (31.8%) and Mr Price –18.2% (14.4%).

Chart 9: Six month returns to 30 June 2006



The six-month (year-to-date return) is shown in Chart 9. ***The total return of the Fund for the year-to-date was 4.6%***. The return can be compared with those of the Maestro equity benchmark of 13.7% and All Share Index of 18.8%. Once again the dominance of the resource index as a source of returns during the year so far is apparent from Chart 9. The mid and small cap indices generated returns over this period of 8.9% and 9.7% respectively.

Chart 10: Annual returns to 30 June 2006



The annual returns are shown in Chart 10. ***The total return of the Fund during the year to June was 25.7%***. This return can be compared with those of the Maestro equity benchmark of 45.0% and All Share Index of 53.7%. Although the 85.2% return of the resource sector was the largest, the financial and industrial indices registered impressive gains of 36.0% and 39.0% respectively. The mid and small cap indices gained 41.9% and 42.1% respectively.

Before moving on to the outlook for the market for the rest of the year, allow me to comment on the Fund's recent performance. I must immediately express my disappointment that Maestro has been unable to protect the value of the Fund during the past quarter to the extent that it would have liked. With the benefit of hindsight, the Fund's resource weighting should have been greater and we should have had more rand-hedge exposure. Part of the reason for Maestro reducing the resource exposure was the fact that the Resource index has gained 135.8% during the past 18 months. Such returns are just not sustainable, particularly in an environment of decreasing risk tolerance. Maestro also underestimated both the extent and speed of the rand's decline – at one stage during the quarter the rand had declined 20% in the space of six weeks. In mitigation of our actions and as you will see from later in this Report, Maestro's view is that markets are currently in the process of a major re-adjustment, which may last a couple of months. It may well be that Maestro's actions on the Fund, specifically the manner in which it has positioned the portfolio, will bear more profitable fruit in the future. My first and primary consideration at all times in managing the Fund is to keep the risk profile of the portfolio relatively low i.e. we do not believe in taking extra or unnecessary risk in order to be "heroes". Sadly, it was this conservatism that cost the portfolio some return in the past quarter; it was this aspect that disappointed and frustrated us the most.

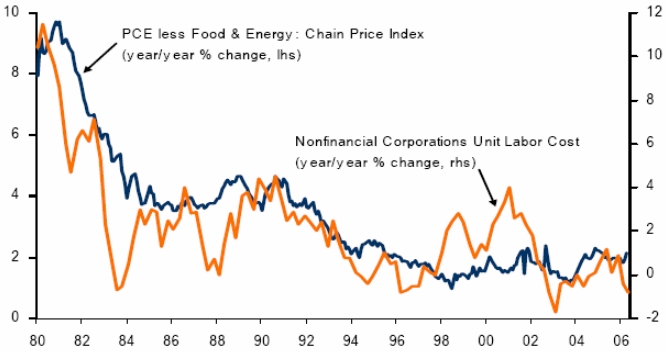
It is also worth noting that the Fund's largest investor is an offshore resident. In the midst of the turmoil in May and June there was a possibility of the investor redeeming some of the investment – "reducing emerging market exposure". In anticipation, Maestro raised the Fund's cash holdings in order to prevent it from having to raise cash in a rapidly falling market, which would not have been in the remaining investors' interests. As it turned out, the offshore investor did not redeem any funds, for which we are grateful. It did, however, leave the Fund with a large cash holding just as the market recovered in the final weeks of the quarter - the All Share Index gained 13.4% in the second half of June.

With regard to the Fund's annual performance, one should be careful in comparing the returns to both the market and other competitors. The Fund was launched at the beginning of June 2005; at that stage the All Share Index had risen 43.8% in the preceding year. It then went on to gain another 29.4% and 46.6% in the following six and nine-month period respectively. Such market gains are exceptional and unsustainable. Throughout this period the Fund received its current assets, with Maestro having no influence over the timing thereof. The investment of these cash flows was challenging, to say the least. It is not in Maestro's habit to "chase" share prices, particularly not at the end of a long period of exceptional gains. With the benefit of hindsight, we should have committed all the cash flows as they were received, but then again "millions" have been made, and none lost, on the "benefit of hindsight".

7. **<u>What lies in store for investors in the months ahead?</u>**
In order to answer this question it is imperative to review the *global* investment environment, starting with the outlook for the **global economy**. A large contributor to the recent turmoil on equity markets was ostensibly renewed inflationary fears and the fear of further interest rate increases and their effect on the global economy. Maestro is of the view that *inflation is not really the major problem* facing the world right now. It is rising, but it remains low relative to previous decades, especially in the early eighties – refer to the blue line in Chart 11 in this regard. Moreover, central banks have either acted in the required fashion (the US has raised rates at 17 consecutive meetings) or are maintaining "strong vigilance" (the European Central Bank's own words) or have indicated that their "zero interest rate policy" has come to an end: Japan raised rates on 14 July for the first time in six years. Nine of the G10 central banks are in the process of raising rates. The message is clear: we are in the midst of a synchronized global (interest rate) tightening cycle. In the face of this onslaught, despite higher commodity and energy prices, *the threat of inflation getting out of control seems*

remote. More importantly, central bankers have said on many occasions that the interest rate tightening has a lot to do with "rate normalization" i.e. bringing interest rates back to "normal" levels. This follows many years of very low interest rates, which in turn has led to a dramatic rise in global liquidity; the latter has been a major force behind higher equity markets and more recently record levels of private equity and corporate activity (M&A).

Chart 11: US inflation – rising but under control

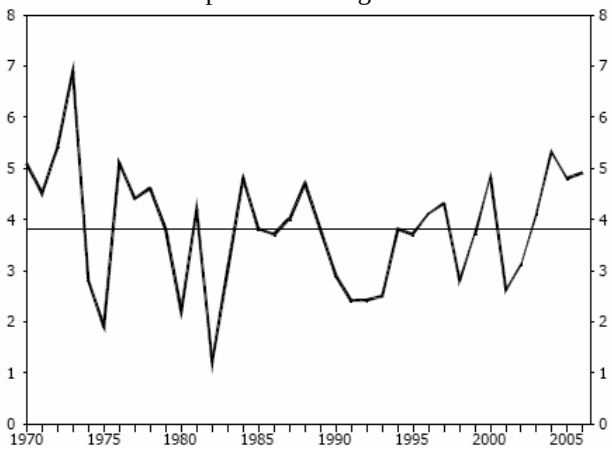


Source: Merrill Lynch

What must be clear from central bank action though, is that *the rate of global economic activity is under threat*. The world has been growing at an unprecedented rate for quite some time now, as shown in Chart 12. It really doesn't get any better than this!

Chart 12: Global economic growth (annual % Ch)

Horizontal line represents average from 1970 to 2005



Source: Merrill Lynch. IMF

Consequently, the *global economy looks set to slow down*. I believe it is this, rather than the fear of higher inflation, that is behind the recent sell-off in equity markets. Closely associated with the latter is the fear that central banks, in particular the US Fed, will go into "over-kill" mode. With Fed Governor Bernanke out to prove his credentials and credibility, the prospect of this happening is large. Already the US housing market, which has provided a substantial base for US economic activity in recent years, has slowed dramatically – refer to Chart 13 in this regard.

Chart 13: US total and pending home sales – off the boil

Source: Merrill Lynch

Maestro's assumption then, is that the US economy is going to slow (at this stage I don't think a recession is likely) from the heady pace of 5.6% in the first quarter – possibly even to as low at 2.0%. Although US growth will slow, as will the growth in other major developing economies, there will still be plenty of economic impetus from the likes of China, India and other emerging markets. Admittedly, their growth rates will be affected; fact that their growth could slow will probably come as a shock to the markets. However the underlying nature of growth in the emerging markets seems to me to be more *structural* in nature than *cyclical*, as in the case of developed countries. The global bottleneck in the supply of commodities provides another pillar of support for emerging markets, particularly commodity producing ones – see Chart 14.

Chart 14: Tied at the hip – but how much higher? MSCI

Emerging Markets index ($) (lhs) dark blue line
CRB Commodity index (rhs) turquoise line

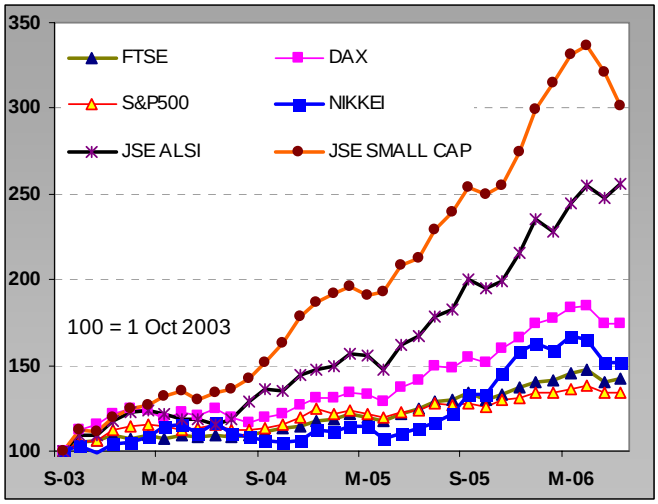
Source: Merrill Lynch

With this economic background in mind, where will that leave **global equity markets**? Given Maestro's view that the global economy is set to slow – and these are long cycles; we are not talking about a "one-quarter wonder" – one has to ask whether the equity bull market is coming to an end. Maestro thinks this may well be the case. Refer to Chart 15, which shows how profitable equity markets have been since October 2003. Corporates remain in good shape, as do consumers, although in many developed countries their finances are "extended" to say the least. But prices and hence market direction are made at the margin i.e. markets are driven by the *rate of change* and not the change itself. So although the global economy will continue to grow, its *rate of growth* will slow, leading to a slowdown in the *rate of corporate earnings*, which in turn will drive share prices lower.

To sum up, Maestro believes that we have probably seen the best of the equity market bull run. *Prices in general are likely to head lower in the coming months*, accompanied by increased levels of volatility that so often characterise inflexion points in markets following long periods of rising (or declining) trends. With specific reference to commodity prices there is real concern about the future supply of basic commodities, particularly base metals and to a lesser extent energy-related commodities. Without going into the reasons for this situation here, suffice is to table Maestro's view that *commodity prices will continue to remain "elevated"* for much longer, albeit not at their current record levels. Simply put, there are insufficient commodities to go around, and there is no realistic prospect of the required supply coming to market from new sources in the next few years. The unprecedented level of acquisitive activity in the sector supports this fact. It is a lot easier to "buy" supply than to build or mine it, hence the race to buy up existing suppliers (miners) before anyone else does.

Against a background of slowing economic activity and declining equity prices, every facet of the investment environment will be affected. Without going into detail, for time's sake, let me list a couple more tenets of Maestro's current view for the record: we continue to believe that *the dollar will remain inherently weak*, with the euro being the likely beneficiary, and to a lesser extent the yen. We don't foresee a collapse in the dollar, rather an orderly but gradual decline. *Bond yields are likely to decline* (bond prices will increase) as evidence of the economic slowdown becomes more pervasive.

Chart 15: Into the twilight zone … the end, or a pause?
Selected indices based to October 2003



When all is said and done, if Maestro's view is broadly correct then **investors need to adopt a more cautious stance i.e. reduce the risk profile of their investment portfolio, for the balance of the year.** It was primarily this belief that prompted Maestro to adopt more caution in its portfolios during the June quarter.

Where does that leave South Africa and its equity market? Please view the following comments in the light of the global economic landscape described above. Ironically, **the SA economy** *remains in good shape*. The basis for this fact is the excellent fiscal management that has characterised government in the past decade. It is true that there is more work to be done in some areas, but by and large the country's finances are in excellent shape. There is every reason to believe that the quality of management of the SA economy will continue for the foreseeable future. In this regard, I have reservations about a sustainable higher growth rate, as espoused by the Accelerated and Shared Growth Initiative for SA (ASGISA), due largely to the country's structural bottlenecks. Government's commitment to spend R372bn in the next few years on upgrading infrastructure is a good start and is indicative of the fact that they, too, are aware of the bottlenecks. Incidentally, the economic behaviour of SA regarding accelerated infrastructural investment is not dissimilar to many other emerging markets right now.

So much for the fiscus; I am less confident about the management of SA *monetary* policy. Maestro is of the humble opinion that *the recent interest rate hike by the SA Reserve Bank (SARB) was unnecessary and inappropriate.* The hike came as a shock to the markets, and called into question the *process* of setting monetary

policy that had been well established – and well received I might add – until now. One cannot but get the feeling that the Monetary Policy Committee panicked when the rand collapsed 20% in the space of 6 weeks, forcing them to raise rates for the wrong reason.

One of my biggest concerns about the rate increase is that the SARB is failing to take into consideration the structural changes in the SA economy, particularly within the consumer environment. From virtually every corner of this environment, especially the listed retailers, we hear of the creation in the past few years of a whole new tranche of consumers. As South Africans we understand where they come from and how the nature of the economy is changing; we see it all around us, in the shopping malls, in the traffic jams, the new cars. If it is so obvious to us, why can't the SARB see it?

Another concern of mine is a seeming failure on their part to understand SA's place in the pecking order of global capital. One of the positive forces driving investment into the country, both in financial (investment on the JSE) and fixed assets (investment in factories, etc) has been the presence of foreign investors. It has supported the rand significantly and has created a lot of economic momentum in the country. If the SARB is going to continue raising rates, this economic momentum will slow. SA's economic growth rate will slow, which will in turn lead to foreign disinvestment and consequently a weaker rand, which is exactly the opposite of what the SARB would like to see happen. A lower rand will place upward pressure on inflation, which will exacerbate the cycle of further interest rate increases. One only hopes that the SARB will see the error of their recent ways, and will take their foot off the interest rate pedal.

Where does that leave **the rand**? Subject to a relatively stable environment i.e. one without extraneous shocks, which admittedly in this environment is a tenuous assumption at best, Maestro's view is that *the rand will remain relatively stable*, although the "best is definitely behind us". We foresee a gradual depreciation against major currencies, driven largely by the retraction of risk by foreign investors on the one hand, but supported by the good economic prospects and the nature of underlying SA economic fabric, namely a bias in favour of commodities, on the other. The extent of the current account deficit - which represents a major structural weakness for SA - will remain the rand's Achilles heel and will be closely watched by foreign investors. SA cannot raise its sustainable economic growth rate without importing more capital goods. This in turn will increase the deficit - hence the structural weakness it represents.

Turning the attention to the prospects for the **SA equity market** it is hard to see the JSE heading dramatically higher when the rest of the world's markets are heading south. We may be great, but not *that* great! This is where the dilemma underlying the nature of the JSE becomes apparent and which caught Maestro on the wrong foot in the June quarter. On the one hand we are calling for a decline in equity prices around the world in the coming months, yet also for commodity prices to be well supported at high levels. Within such an environment the rand is likely to retain a weak bias and thereby support commodity and resource shares on the JSE, which constitute a significant portion of the market. So commodity-related share prices could move higher while the rand and global equity prices move lower. This represents a major conundrum and seems to me to be, ultimately, unsustainable. Of course that leaves resource shares rather vulnerable, because if the proverbial budgie hits the fan and the environment turns "really nasty" even commodity prices will decline sharply. It is hard to see the JSE continuing to head north when the rest of the world is heading south in a rapidly deteriorating environment. The downside risks to the SA equity market are exacerbated by the significant presence of foreign investors who wouldn't hesitate to withdraw their funds from SA if they deem it appropriate.

On a more positive note, the local equity market is not excessively valued. On the contrary, Maestro contends that existing valuations are rather attractive. Balance sheets are in good shape, cash flows are strong and earnings prospects, particularly for companies focussed on the consumer environment, remain attractive. Almost all of the companies in which the Fund is invested have excellent management teams in whom Maestro has great confidence. These companies will remain the focus of our attention. Companies whose operations are focussed on the SA economy are less likely to be affected by the deteriorating global economic environment.

With respect to resource companies you would have seen from the earlier charts in this Report that the resource sector rose 85.2% in the past year. During this time, the rand declined 6.8%. The rise in the resource sector was thus driven to a large extent by the actual and expected increase in underlying commodity prices. We know that commodity prices have risen sharply in the past year; that much is "baked into the cake" so to speak. My point here is that for JSE resource shares to rise *even further* from their already elevated levels would require either another sharp increase in commodity prices or a sharply weaker rand, or a combination of both. With respect to the former, notwithstanding the supply constraints it is hard to see commodity prices posting gains similar to those of the past year in an environment

characterised by slower economic activity. As for the rand, I do not expect it to decline *dramatically* either, leaving one to question where the impetus for further *substantial* advances in resources shares will come from. I would again point out that it was these concerns that prompted Maestro to retain an underweight resource weighting in the equity portfolios under its management during the June quarter, which in turn led to the underperformance. Similarly, it is these concerns that lead me to retain the view that *global equity markets are currently in a re-adjustment process*, as markets grapple with slower growth and lowered expectations of earnings and returns, the final outcome of which will only be clear in the future.

Consequently, it is still Maestro's considered view that the inherent risk in equity markets is currently higher than most appreciate. Chart 16 shows the well-established inverse relationship between risk (as depicted by the Vix index - the implied volatility of S&P futures) and emerging market performance relative to developed ones. When risk rises, emerging markets, of which the SA equity market forms part, underperform developed ones. The scary aspect of Chart 16 is that although risk has risen recently and emerging markets have declined, one can see that this process may well have only begun. Clearly, there is no room for complacency in the current investment environment.

Maestro's belief remains that there are greater downside risks in the resource sector, whose fortunes are dependent on ongoing rand weakness and higher commodity prices, than in the financial and industrial sectors. The Fund's equity portfolio will therefore retain a bias in favour of domestically focussed companies, whose quality and predictability of earnings is more certain. We may raise the current underweight resource exposure *slightly* if the opportunities arise, but that should be seen as a function of our very underweight position, our view that the rand is likely to depreciate *gradually* into the future, and the fact that supply constraints are likely to keep commodity prices at high levels. We will also seek alternative ways to protect portfolios from the advent of a weaker rand.

Chart 16: Risk and emerging market performance
MSCI Emerging Markets relative to MSCI World - dark blue line Equity volatility (VIX index (rhs)

Source: Merrill Lynch

8. Closing remarks

I cannot over-emphasize how disappointed I am that the Fund has underperformed in the past quarter. It is frustrating when your own conservatism "catches you out" but I remain of the opinion that it is appropriate to retain a cautious approach in the current and expected investment environment. The geopolitical environment remains fractious at best and the economic environment is, if nothing else, very uncertain.

I will therefore continue to adopt a prudent and cautious attitude towards the management of the Fund. I am very grateful for your support, particularly through the past few months, and assure you that Maestro will continue to employ its best endeavours to ensure that your trust and confidence in us is vindicated.

As always any feedback or inquiries regarding the Fund's investments are more than welcome.

Andre Joubert
20 July 2006