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: R22 605 135

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

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

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

ENQUIRIES
Maestro Investment Consulting
Box 1289
CAPE TOWN
8000
Fax: 021 674 3209
Email: equityfund@maestroinvestment.co.za

The Maestro Equity Fund

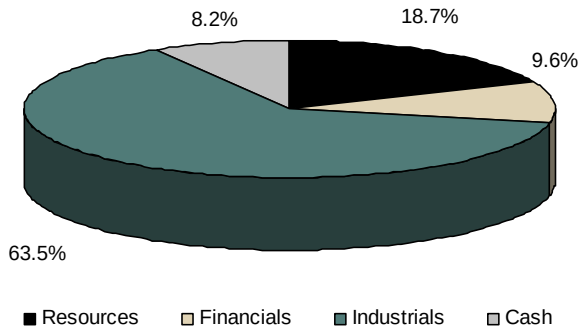
Quarterly report for the period ended

30 June 2007

1. Introduction

This report focuses on the investment activities of the Maestro Equity Fund during the past quarter. It should be read in conjunction with Maestro's monthly investment letter, *Intermezzo* and the monthly Fund Summaries which are sent to all investors.

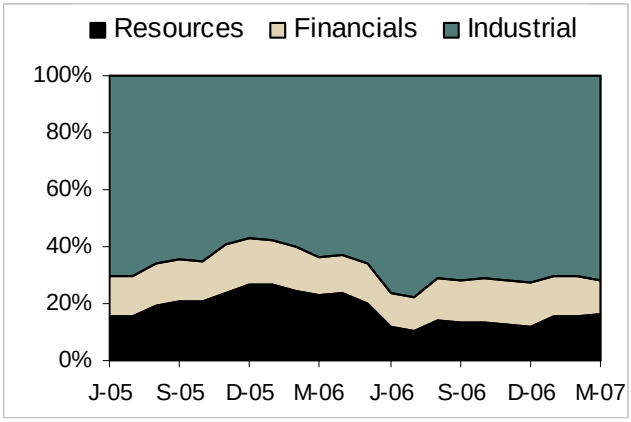
Chart 1: Asset allocation at 30 June 2007



2. The investment position of your portfolio

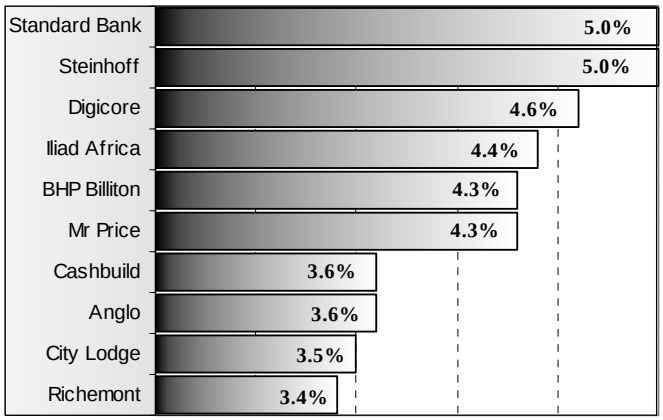
Chart 1 depicts the Fund's sector allocation at the end of June. Exposure to the resource sector totalled 18.7% of the Fund, from 14.5% in March. Financial exposure declined from 11.0% to 9.6% and industrial exposure from 65.3% to 63.5% of the Fund. Cash represented 8.2%, down from 9.2% at the end of March. 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: Historic equity sector allocation



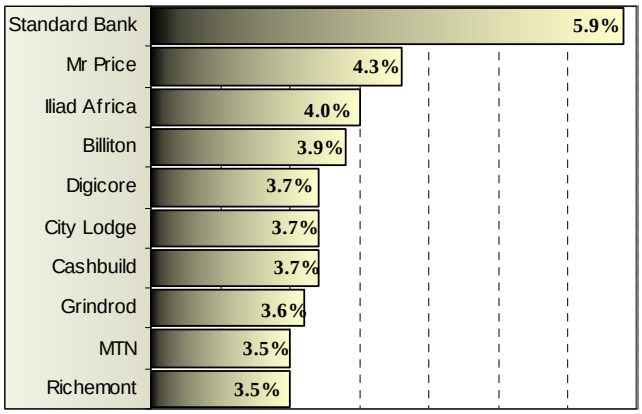
3. **The largest equity holdings**
The Fund's largest holdings at 30 June are listed in Chart 3, expressed as a percentage of the total Fund.

Chart 3: The largest holdings at 30 June 2007



Those at the end of March are listed in Chart 4 for reference purposes. Anglo and Steinhoff displaced Grindrod and MTN in the "top ten" during the quarter. The Steinhoff holding increased as a result of corporate action, whereby Steinhoff acquired Unitrans. Their new weight thus effectively incorporates the Unitrans holding. There were 32 counters in the Fund at quarter-end versus 34 in March, the ten largest of which constituted 41.7% of the equity portfolio, up from 39.8% in March.

Chart 4: The largest holdings at 31 March 2007



4. **Recent activity on the portfolio**
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.

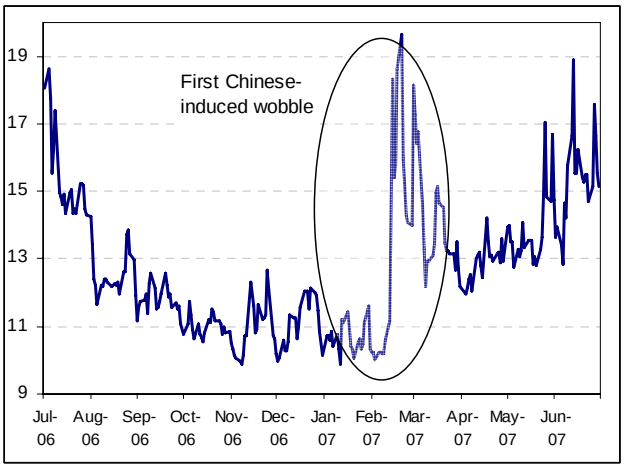
During the quarter the holdings in Anglo, Exxaro, Kumba and Implats were increased and holdings in Hiveld and Pick 'n Pay sold. The Unitrans holding was effectively swapped for more Steinhoff shares and a new holding in Jasco introduced into the Fund.

5. **A review of the recent investment environment**
The second quarter of 2007 proved to a trying one; few would have said *during* the quarter that the markets would end the quarter with such robust returns. In varying degrees, the following factors had an influence on the investment environment:

- *A rising oil price:* The price of Brent crude oil rose 4.1% during the quarter, but this belies the upward pressure on the energy price complex. Ongoing political trouble in Nigeria, refining constraints and increased global demand for oil continues to place upward pressure on energy prices. Higher oil prices placed equity markets under pressure but perversely also lifted them due to higher prices of the major oil companies, which these days constitute some of the largest in the world and hence the most heavily-weighted companies in the major indices.
- *Strong commodity prices:* Commodity prices rose throughout the quarter. Stronger than expected economic growth, largely in emerging markets, contributed to higher prices, which in turn fuelled concern about higher inflation.
- *Rising inflation expectations:* closely tied to higher oil and commodity prices, concern that inflation was due to escalate in the coming months led to periodic fears of higher interest rates and slower growth; this had a negative effect on equity markets during the quarter.
- *A Chinese equity market bubble*: the phenomenal rise in Chinese equity price has been documented in recent editions in *Intermezzo*. A couple of large (>5%) daily declines in domestic Chinese equity prices spooked global markets. However prices recovered to reach new highs on every occasion.
- *US sub-prime woes*: This, too, has been covered in *Intermezzo*. Suffice is to say that the topic will remain high on the radar screen for some time; we have certainly not heard the end of this serious threat to equity markets, and its effects have surely not been fully seen or digested.
- *A weak dollar:* closely related to the sub-prime woes, the dollar weakened consistently throughout the quarter. It ended down 1.4% against the euro, 2.2% against sterling and 4.4% against the yen. The rand gained 3% against the greenback.
- *Corporate activity:* we are currently experiencing an unprecedented rise in global corporate activity – an aspect highlighted throughout last year. At that stage it seemed inconceivable that it could increase further, but it has. In the first half of 2007 global merger and acquisition (M&A) activity rose 50% to $2.8 trillion, 44% of which took place in Europe, the Middle East and Africa. Buy-outs by private equity groups reached $569bn, 23% above the

previous record set in the second half of 2006. Private equity represented 20% of total M&A activity so far this year. Relatively low real interest rates, a favourable macro-economic environment, strong corporate cash flows and massive inflows into private equity funds have fuelled the rise in global M&A. Given that many of these issues are unlikely to dissipate soon, one can expect the high levels of M&A to continue to have a positive though unpredictable influence on global markets.

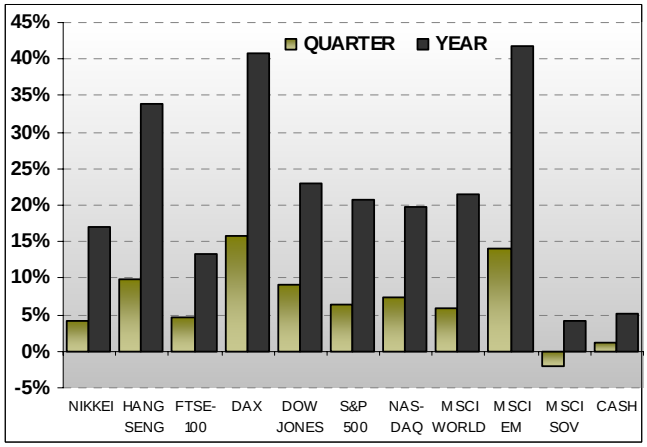
Chart 5: CBOE Volatility (VIX) index



- *Increased volatility*: Not surprisingly, given this diverse list of influences, which is by no means comprehensive, it is unsurprising that equity markets experienced a sharp increase in the levels of volatility during the quarter. Chart 5 depicts the Vix index, which you will recall tracks the implied volatilities of the S&P500 futures contracts. Note that, after the huge rise during February following the first scare from China when that equity market dropped nearly 10%, the trend has clearly turned. After declining from a level of 39.69 in September 2002, it reached an all-time low of 9.89 in January. However, after the February shock (the Vix index rose 95.9% in 11 trading days) it has risen steadily, testimony to the increased market volatility.

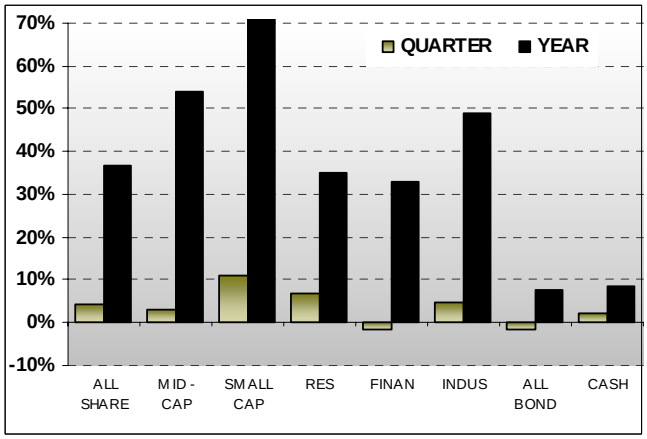
When all is said and done, global equity markets posted positive returns on the quarter, as shown in Chart 6. The German market continues to rise strongly, having gained 15.8% and 21.4% for the quarter and year-to-date respectively. Emerging markets, too, posted very strong gains, with that index rising 14.1%% during the quarter.

Chart 6: Global market returns to 30 June 2007



Turning to the SA market during the quarter, Chart 7 depicts the respective returns. As one would expect, most of the variables that affected global markets during the quarter affected local ones too, with the exception of the degree of corporate activity perhaps. The SA equity market was on the receiving end of the positive attitude towards emerging markets. Ironically though, the firm rand constrained our market returns, particularly those of the resource sector, even though it was one of the best performing sectors during the quarter. Had it not been for the strong rand SA equity market returns would have been higher. It is also strange to note that, despite the firm rand, the financial sector didn't perform well; it declined 1.7% during the quarter. This may be a reflection of the caution surrounding financial companies around the world, caused in part by the US sub-prime woes (at least from a foreign investor perspective) and in part by the caution arising from the effects of the implementation of the National Credit Act and a higher interest rate environment. In general, *quarterly* returns from the SA equity market were lower, and the *annual* returns higher than those experienced abroad.

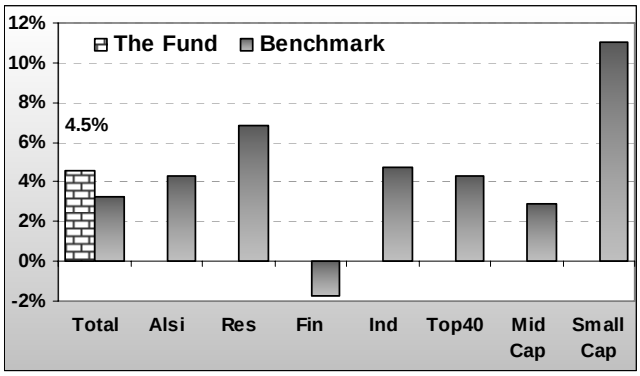
Chart 7: SA market returns to 30 June 2007



6. **<u>The performance of the Fund</u>**

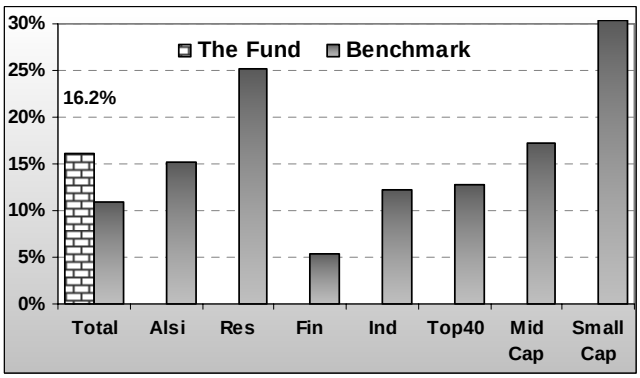
The Fund's un-annualised return during the quarter was 4.5%, which can be measured against the return of the Maestro equity benchmark of 3.2%, shown alongside the Fund's return in the "Total" column in Chart 8, and All share index of 4.3%. Despite the firm rand the resource index delivered an outstanding quarterly return, rising 6.9%. This might not seem high, but it is in stark contrast to the 1.7% *decline* in the financial index. With the benefit of hindsight the Fund would have done better if it had had greater exposure to resource shares. However strong returns from some of the larger holdings provided the impetus for the outperformance by the Fund of the All share index and the Maestro equity benchmark. The returns of the largest holdings during the quarter were Standard Bank -8.0% (up 13.0% last quarter), Steinhoff 3.7% (-6.0%), Digicore 30.3% (34.2%), Iliad 17.0% (28.9%) and Billiton 20.0 % (26.0%).

Chart 8: Quarterly returns to 30 June 2007



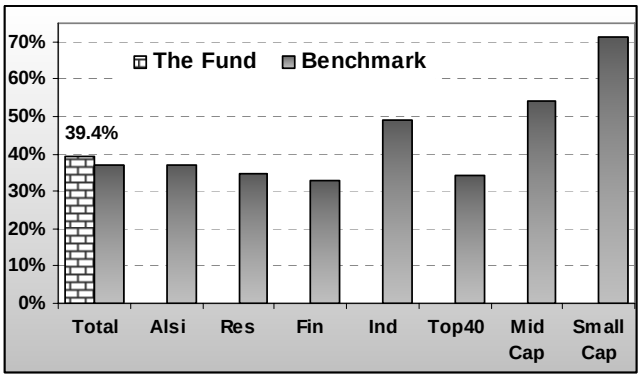
The *un-annualised* returns for the six months to 30 June are shown in Chart 9. ***During this period the Fund rose 16.2%,*** again above the major indices other than the resource index. The dominance of this resource index as a source of returns during the year so far is apparent from the Chart - it rose 25.2%. The financial and industrial indices gained 5.4% and 12.2% respectively, while the respective mid and small cap returns over this period were 17.2% and 30.3%.

Chart 9 Six-month returns to 30 June 2007



The annual returns are shown in Chart 10. ***The return of the Fund for the year to 30 June was 39.4%,*** way above the inflation rate over this period of 7.0%. This return can be compared with those of the Maestro equity benchmark of 37.1% and All Share Index of 36.9%. The resource, financial and industrial sectors produced annual returns of 34.9%, 33.1% and 49.0% while the large, mid and small cap indices gained 34.1%, 54.0% and an astonishing 71.3% respectively.

Chart 10: Annual returns to 30 June 2007



Last quarter we alluded to the improving *relative* performance of the Fund - relative to other similar unit trusts, that is. I am pleased to report that this improvement has continued; the Fund ended the quarter with above-average returns amongst all the general equity unit trusts. It is frequently the case that young funds struggle against more established ones in their early life. This was indeed the case of the Maestro Equity Fund, when lumpy inflows and a rampant market restrained the returns during the first two quarters of its existence. We also experience a very poor second quarter of 2006. However, the Fund has "settled down", its portfolio is now well-established and we are looking forward to ongoing good relative performance from the Fund, in line with the returns from other established equity portfolios in Maestro's care.

7. **<u>What lies in store for investors in the months ahead?</u>**

Without repeating what we wrote in the March Quarterly Report, much of what we expected came into being or is still influencing the global environment the way we expected it to. Admittedly, there were times during the June quarter that we had to "hold our breath", and had visions of the "world as we know it" turning out rather differently to what we had expected. In fact there were probably too many times for our comfort that we experienced these concerns, but then again is that not what one would expect after so many years of strong returns, both globally and abroad? At the time of writing, equity markets around the world are registering all-time highs, despite rising interest rates, renewed concern about inflation and higher commodity prices.

The fact that so many investors are expecting markets to correct severely provides some comfort that the markets will weather the storm better than most expect. In this respect, I would encourage you to read through our comments in the March Quarterly Report as far our expectations are concerned, to get a better picture of what is currently happening in the global investment environment. In a nutshell, our views can be summarised as follows:

- *The global economy* is still in good condition and is likely to register one of its strongest years ever. This, despite the slowdown in the US economy, where we expect growth to be constrained by an over-indebted consumer, many of whom are now saddled with negative "home equity" i.e. the value of their mortgage bonds exceed the market value of their homes. Strong emerging markets, buoyed by rising domestic demand, should more than compensate for slower demand from the US
- *Global inflation:* despite record commodity and oil prices we hold the humble opinion that inflation is not about to get out of hand. Central banks seem to be managing expectations well and will act quickly to stem any sharp rise in inflation – at least to the extent that they are able and where the rise in prices is not a function of supply constraints, as is the case in many instances.
- *Interest rates:* closely tied to the previous point we have seen that central banks are not scared to raise rates where necessary. We suspect that the peak in US rates may already have occurred in this cycle, but we expect rates in the EU to continue rising. South African rates could possibly also rise again, although many of the price increases are a result of supply constraints rather than excessive demand or consumption.
- *Currencies*: the dollar seems to have resumed its weakness against most other currencies – we think this is likely to continue, but in an orderly fashion. That essentially implies that the rand is likely to remain firm, which incidentally bodes well for future SA inflation. Just imagine where inflation would be at the current oil price but at a rand dollar rate of, say, R8.00?! The concern surrounding the carry trade that was so prevalent last quarter seems to have abated, but we would do well to remember how quickly markets could react if this ogre raises its head again.
- *Valuation and corporate earnings*: we continue to believe that most global equity markets are not excessively valued. That said they have risen sharply in recent years and are due for a breather. In the current environment, they will remain volatile and stand a better than even chance of moving sideways for some time to come, but we don't expect a very sharp correction any time soon.
- *Corporate activity* is likely to continue to play an influential and supportive role on global equity markets. However, we have noted the interest of politicians to focus on the favourable tax dispensation the private equity industry enjoys. It could well be that in the face of a new regulatory onslaught, private equity players temper their high profile for the time being, if only to let the dust settle. However, as long as corporate cash flows remain strong and real interest rates relatively low, corporate activity is likely to dominate the radar screen. One only need think of the commodity industry, where size of market share and scarcity of physical resources play an increasingly influential role, to understand why the current "land grab" i.e. where it is easier to buy new capacity than to create it, is likely to persist.
- *Commodity prices* will therefore, we feel, continue to be firm - even if they don't rise much in the coming months - given the strong global economy and scarce supply. Delivery bottlenecks, refining constraints, geopolitical factors – these are all realities that have become common place in the commodity space in 2007.
- *Emerging markets*: a number of the above factors conspire to support emerging markets, specifically in the areas of consumer and infrastructural spending. We talk and think so glibly of China and India, but I read a recent article that pointed out that the combined infrastructural spending programs over the next three years in Russia, the Gulf, South Africa, Turkey and Eastern Europe, at $575bn exceeded those of India and China combined (at $510bn). Such is the momentum and substance of emerging market economic activity.

Turning our attention to the **local investment environment,** our positive views remain largely unchanged from what they were at the beginning of the year - you will find them more clearly laid out in the December Quarterly Report**.** We think the SA "economic story" is a good one, structurally sound, with a shelf life longer than most people think. Developments within the SA economy at present are entirely in keeping with other emerging markets, which we will continue to monitor for any signs of a change in sentiment on the part of global investors. That said there is no room for complacency; we are mindful of the "great heights" that the market currently occupies. If there are any risks, they will in all likelihood emanate from across the waters, which is why we focus so much on the global economy and its markets. For the time being, equities will remain Maestro's asset class of choice for local portfolios.

8. Closing remarks

Last quarter we ended our Report as follows: "*The year has begun well and the Fund is off to a good start. The returns have been positive, in absolute and relative (to the benchmark and All share index) terms. However, despite our positive view, we have been around long enough to know that* ***the current rate of annual returns of between 30% and 50% is unsustainable****. Consequently we urge you to reduce any excessive expectations you may have regarding similar returns in the future…*"

It is therefore with a sense of bemusement yet gratitude that I confess to "having got it wrong". Markets *have* moved higher still, though a fair portion of the large annual returns was generated in the second half of last year. That said, our warning remains as valid as ever: the current high rate of annual returns is unsustainable, and you should lower any unrealistic expectations about future returns.

In closing, may I thank you for your ongoing support and trust in Maestro's ability to take care of your assets? We value it highly and are very grateful for it. We look forward to being of further service to you throughout the remainder of the year.

Andre Joubert
24 July 2007