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 2.13%.

Income Distribution (annually)
23.63 cents per unit
31 March 2011

FUND SIZE: R 68 319 319

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

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

The Maestro Equity Fund

Quarterly report for the period ended

31 December 2011

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 December quarter.

2. The investment position of the Fund

The Fund's sector allocation is shown in Chart 1. Exposure to the resource sector totalled 25.0% of the Fund, down from 29.7% in September. Financial exposure decreased 0.3% to 14.6% and industrial exposure increased 2.4% to 48.3%. Cash represented 12.1% of the Fund, up from the 7.9% at the end of September.

Chart 1: Asset allocation at 31 December 2011

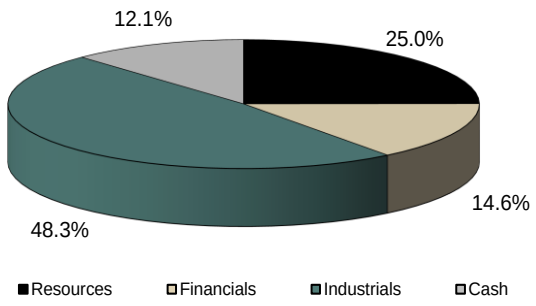
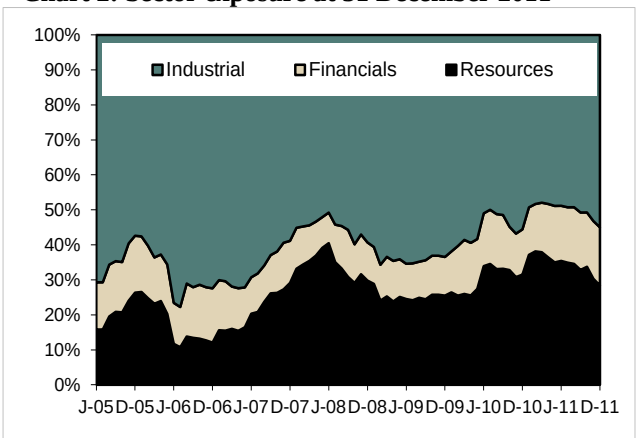


Chart 2 depicts the historical allocation to the three major sectors of the equity market, expressed as a percentage of the equity portion of the Fund.

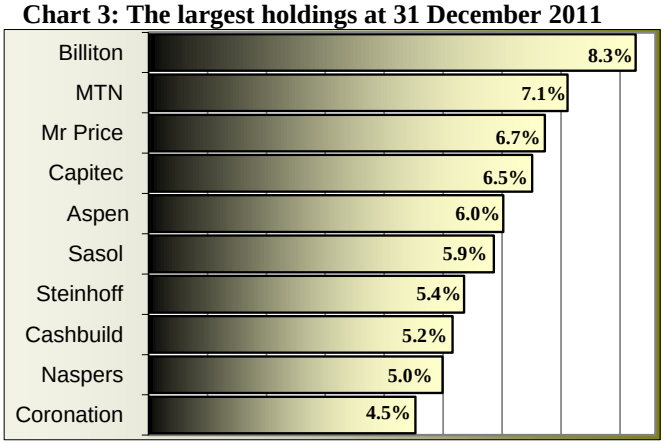
Chart 2: Sector exposure at 31 December 2011



3. The largest equity holdings

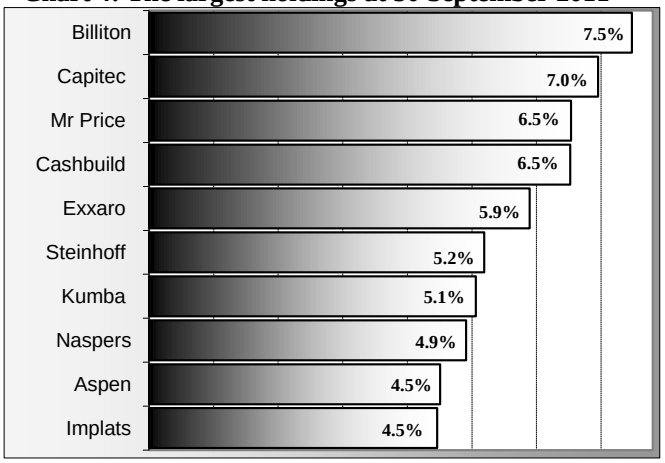
The largest holdings at 31 December are listed in Chart 3, expressed as a percentage of the equity portfolio.

Chart 3: The largest holdings at 31 December 2011



The largest holdings at the end of September are listed in Chart 4. During the quarter Sasol, Coronation Fund Managers and MTN replaced Exxaro, Kumba and Implats in the largest holdings. At the end of December there were 25 counters in the Fund, one less than in September. The ten largest holdings constituted 60.5% of the Fund up from 57.5% in September.

Chart 4: The largest holdings at 30 September 2011



4. Recent activity on the Fund

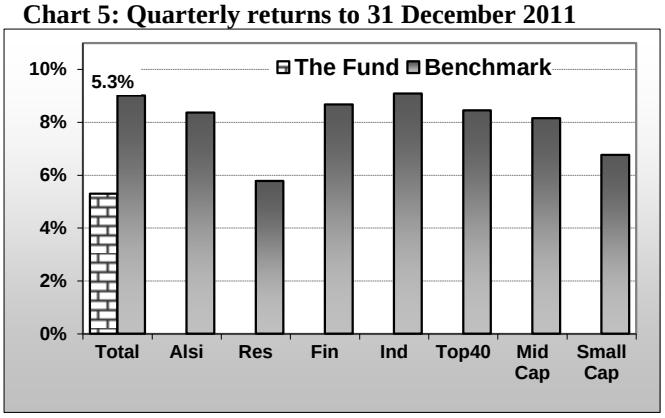
The investment objective on this Fund is to *achieve long-term growth through the assumption of moderate risk.* We would emphasise the "long-term" aspect of this objective; we are confident that the companies in which the Fund is invested will deliver long-term capital growth together with a steady increase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

During the quarter the Steinhoff and Grindrod preference share holdings along with the holdings in Altech and Merafe were sold out of the Fund. A holding in Richemont was introduced into the portfolio during the quarter and investments in Aspen, Sasol and MTN were increased. During the quarter holdings in Anglos, Cashbuild, Grindrod, Protech, Metmar, Kumba Iron Ore and Wilson Bayly were reduced to raise liquidity to meet a large redemption.

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 December quarter was 5.3%***. Appendix A summarizes the major developments during the quarter for your convenience.

Chart 5: Quarterly returns to 31 December 2011



The Fund's return can be compared to the Maestro equity benchmark and All share index returns of 9.0% and 8.4% respectively. We have commented extensively in recent fund summaries and *Intermezzo* about the state of markets during the past few months and refer you back to those publications – you can find back copies of *Intermezzo* by clicking here - to refresh your memory about the salient features of this period. I also refer you to Appendix A, which details the nature of the market movements during the quarter. Like so many other periods of the market in the past year the December quarter was unique, anything but normal, so do pay close attention to what happened each month; it has a direct bearing on the Fund's quarterly and annual returns.

You will see from Appendix A that the over-riding characteristic of the past quarter was *late-month surges*, which caused havoc with any form of short-term risk management within the portfolio. After having registered a sharp (-5.8%) decline in the September quarter (-3.6% in September alone) the equity market rose dramatically in October, particularly in the last few days of the month. In the face of the sharp rally, which was led by large caps and resources shares, the Fund was unable to keep up with the surging index, given its conservative positioning and bias in favour of industrials. Consequently, the portfolio lagged the market in October and November but outperformed in December; this is hard to see if you simply look at the quarterly returns.

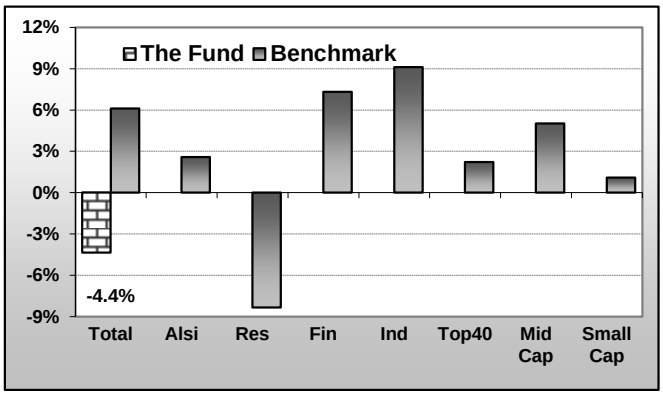
To expand further on the quarterly returns, basic materials led the charge in October, which further exacerbated the underperformance by the portfolio in that month, given that the Fund is underweight in that sector. However, during December that sector lagged the overall market badly, giving the Fund the opportunity to catch up lost ground. The Chart summarizes the net result for the quarter: the industrial index gained the most, up 9.1%, followed by financials up 8.7% (thanks to a 16.6% surge in Old Mutual late in December) and then basic materials, up 5.8%. Despite the basic material sector lagging, the large cap index actually rose the most during the quarter, up 8.5%, while the mid and small cap indices rose 8.2% and 6.8% respectively. All of the latter out-performance came in October, during the market surge, when large caps rose 10.3%, while mid and small caps rose only 4.8% and 1.9% respectively. So you can see, it was a very strange quarter by way of market activity.

One of the reasons the Fund lagged the overall market in general and the industrial sector in particular during the quarter, was not so much what the Fund held, but rather *what it did not hold*. SABMiller, Tiger Brands and British American Tobacco (BAT) are all large cap, index heavyweights. All did very well during the quarter – remember it was driven largely by the late surge in October. When that type of market behaviour occurs it is nearly always driven by large cap, index heavyweights; mid and small caps tend to lag. And that's exactly what happened in October; during the December quarter Tiger Brands rose 19.5%, BAT 12.0% and SABMiller 8.6%; the industrial and All share indices rose 9.1% and 8.4% respectively during the quarter.

The quarterly returns of the largest holdings in the Fund, excluding dividends, were as follows: Billiton rose 9.4% (it declined 19.2% in the September quarter), MTN 8.5% (-7.9%), Mr Price rose 18.6% (-1.3%), Capitec -3.3% (6.1%), Aspen 6.0% (8.6%), Sasol 15.1% (-5.9%), Cashbuild 14.6% (8.6%) and Steinhoff 2.1% (-2.1%). Other holdings across the equity portfolios under our management which disappointed included those in Metmar, which declined 25.4% during the quarter, B&W 21.1%, Grindrod 6.7% and Investec 2.5%. On a more positive note, shares which rose sharply included Coronation Fund Managers 13.5%, City Lodge 22.4% and Kumba 17.1%.

The annual returns to end-December are shown in Chart 6. ***The annual return of the total Fund for the year to December was -4.4%***. Inflation rose 6.1% during the year and the All bond index rose 8.6%. It is apparent from this chart that Maestro struggled to generate above-market returns last year. The first quarter of 2011 was the worst in terms of relative returns and I again draw your attention to the March Quarterly Report wherein we discussed the reasons for our underperformance during that quarter. The December quarter's returns are reflected above and the characteristics of this period are explained. The Fund actually outperformed the market during the June and September quarters, but the outperformance during these quarters was insufficient to make up for the poor relative returns of the first and last quarters. We regret not having delivered another year of above-average returns and are working hard to rectify our poor recent performance. Although it is unrealistic to expect above-average returns year after year, we are very conscious that Maestro now has some ground to make it and we are focusing all our efforts on ensuring that this takes place.

Chart 6: Annual returns to 31 December 2011



The Fund's annual return of -4.4% can be compared to the Maestro equity benchmark and All share index returns of 6.1% and 2.6% respectively. The difference between these two indices provides some insight into the market features during the quarter, as does the respective sector returns in the chart above. Despite the weak rand, which declined 18.1% during 2011, the basic material sector ended the year down 8.3% as concerns about the slowing global economy weighed on the prospects for mining companies. The financial and industrial indices, on the other hand, posted respectable returns under the circumstances, finishing the year 7.4% and 9.2% higher respectively. Bearing in mind that the Maestro equity benchmark specifically increases the weighting of the two latter sectors and reduces the basic material weighting, you will understand why the Maestro equity benchmark has risen so much more than the All share index. Not shown in the chart above are the annual returns of large, mid and small cap index, which rose 2.2%, 4.7% and 1.1%.

The main detractors from the Fund during 2011 were B&W, which declined 52.0%, Metmar 50.5%, Implats 28.2%, Grindrod 26.1%, Wilson Bayly 24.3%, Investec 22.5%, Blue Label 19.2%, Anglos 13.7%, Billiton 11.7% and Abil 11.5%. On a more positive note Cashbuild rose 24.2%, Exxaro 23.3%, Coronation 21.1%, Mr Price

20.0% and Kumba 17.8%. These returns exclude dividends i.e. the changes reflect only the share price movements.

You might recall that the largest detractors during 2010 included Arcelor Mittal, Altech, both of which we have sold, and Digicore, which declined 0.3% in 2011. The largest contributors in 2010 were Capitec (which rose only 3.7% in 2011), Mr Price, Blue Label (one of 2011's detractors), Exxaro and Abil (also a 2011 detractor). From this brief analysis, you can see that at least three of the investments (Capitec, Blue Label and Abil) that dragged the portfolio lower in 2011 were part of the reason it did well in 2010. This is not surprising – it is unreasonable to expect shares to continue rising significantly every year (with the exception of "stars" like Cashbuild and Mr Price); investment is a long-term activity and it should be expected that excellent companies like Capitec and Abil mark time occasionally. We hold these three companies (Capitec, Blue Label and Abil) in high regard and have no intention of selling them. We believe they will again contribute to the portfolio's performance i.e. rise at a rate greater than that of the market, in the fullness of time. But it never happened in 2011; these companies detracted from the returns last year. The same could be said for other 2011 detractors such as Billiton, Grindrod, Investec and Wilson Bayly. We would concede that we should have been more aggressive in reducing these holdings in the past year, with a view to buying them back again at lower levels. By and large, we don't really think this "more aggressive" approach will add to the Fund's long-term returns, although we have agreed amongst ourselves that we should be more pro-active in 2012.

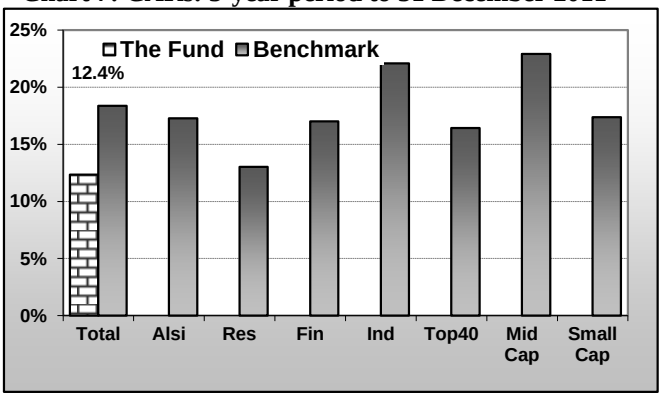
While on the topic of selling shares just because they underperform for a period, it is worth highlighting that Cashbuild and Mr Price have, during past quarters, also topped the list of detractors, but that hasn't stopped them from rising 2 965% and 1 496% (or 40.8% and 31.9% per annum) respectively, during the past ten years – and that excludes dividends. Admittedly, these are two remarkable companies, but the point remains the same; short-term, aggressive trading does not necessarily add to long-term returns.

It is appropriate to spend a few moments on B&W and Metmar, which together have taken the most away from the Fund's returns in the past year. We have remained as close as possible to B&W's management for some time now. We took a view on the company after having done the necessary homework. We felt positive about their foray into Africa, specifically on some major contracts with the large mining houses. However, after having been awarded two lucrative contracts offshore, the contracts had their initial specifications changed, which was beyond the control of B&W but which resulted in the contracts increasing dramatically in size. Together, they totally overwhelmed B&W's cash flow, which resulted in severe strain being placed on the balance sheet. The company's earnings declined substantially – the company actually moved into a loss – and the share, which does not trade too easily, consequently declined to end the year at nearly half the value at which it began 2011. We acknowledge that the company now finds itself in an awkward position: it will have to recapitalize its balance sheet eventually in order to regain its "former glory" or it will have to scale back its operations. The prospects for the company seem reasonable, but it will take time to recover fully. Seeing that the price has declined so severely, we don't believe it is worth selling the investment at these levels – unless of course the company's prospects deteriorate further. We are encouraged that management, which retain a large stake in the business (57.9% to be exact) have not reduced their holding and in fact even injected money into the company, for no consideration, at the height of their crisis. Needless to say, we will continue to monitor the company and its prospects as closely as possible.

Turning to Metmar, here is another company which is not well researched or understood by the market. It trades commodities and is prepared to take small stakes in developing mines in order to secure the offtake i.e. to sell the mine's output, on a long-term contract. Metmar should ideally be valued on its underlying assets i.e. mines in various stages of development, and the earnings they will generate in the future, and not necessarily on its current earnings, which tend to be volatile and affected by periodic "once-offs". The company has been affected by the declining value of commodity prices in the past year and by high restructuring costs, both of which have reduced their earnings. Like B&W, Metmar is tightly held and management also has a large stake (50.9%) in the business, which has stayed constant since the company listed in 2006. The tangible net asset value of the company at the latest reporting period (31 August 2011) was 231c, which is higher than the year-end closing share price of 212c. We had hoped that the overseas listing of Glencore, one of the giants in global commodity trading and a similar company in nature to Metmar, might assist the market in understanding Metmar better, but this has not happened. Metmar has been a great disappointment but we think it is worth holding the investment until its real value becomes more apparent.

The compound annual return (CAR) of the Fund over the three-year period to December 2011, shown in Chart 7, ***was 12.4%*** and can be compared to the returns over the same period of the Maestro equity benchmark of 18.4% and the All Share Index's 17.3%. Although 2011 was a poor year by way of returns in the SA equity market (but it performed better than most other global equity markets in local currency terms) remember that the base period off which this three-year return is being measured is 31 December 2008 i.e. very close to the bottom of the Great Financial Crisis; the market troughed in March 2009.

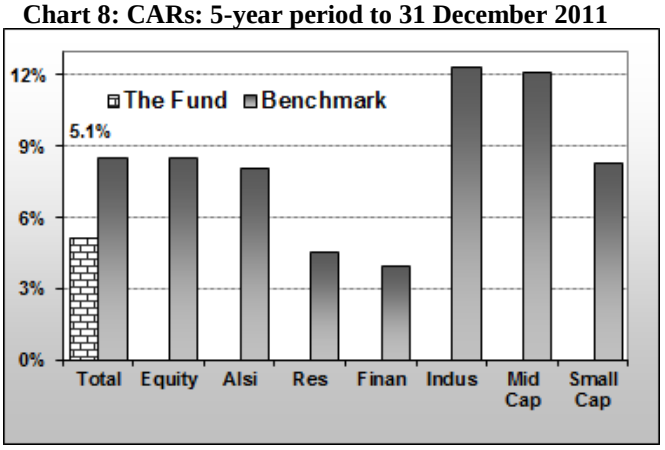
Chart 7: CARs: 3-year period to 31 December 2011



In the past I have frequently alluded to the consistently superior returns of the industrial index over the past few years. The returns of the three major sectors of the equity market are listed in the chart and it is again clear how much better the industrial sector performed over the past three years. For the record the basic materials, financial and industrial indices three-year CARs to the end of 2011 were 13.0%, 17.0% and 22.1% respectively. The returns of the large, mid and small cap index were 16.4%, 22.9% and 17.4% respectively. Notwithstanding the increased risk implicit in the markets during the past three years, industrial companies and small and mid caps have continued to deliver better returns than mining and large cap shares, which is why we continue to bias the portfolio in favour of mid caps and industrial shares in particular, together with a smattering of small caps. The respective CARs for the All Bond index and cash over this period were 7.4% and 7.2%.

Chart 8 depicts the Fund's CARs for the five-year period to 31 December 2011. The starting point (base) for the five-year period is 31 December 2006. The Great Financial Crisis began around October 2007 so the five-year returns cover ten months of rising equity markets, followed by the trauma of the Crisis, and end with a year of virtually no return (2011). One should not therefore be surprised that the five-year returns are lower in absolute terms than the three-year returns. ***The compound annual return*** (CAR) ***of the Fund over the five-year period to December was 5.1% per annum***.

Chart 8: CARs: 5-year period to 31 December 2011



The Fund's return over this period and be compared to the Maestro equity benchmark and All share index returns of 8.5% and 8.1% respectively. 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 12.4% - 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 4.6% and 4.3% per annum over the same period. The 5-year CARs for the large, mid and small cap indices are 7.5%, 12.2% and 8.3% respectively. The respective CARs for the All Bond index and cash were 8.6% and 8.8% over this period.

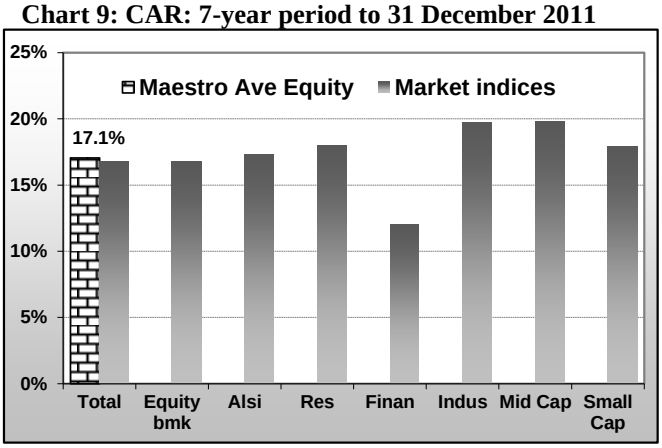
Notwithstanding the flat returns during 2011, the SA equity market remains one of the most profitable areas in which to have invested in the recent past. Whereas the All share index rose 8.1% *per annum* over the past five years, the MSCI World index *declined* 4.4% per annum over the past five years while the MSCI Emerging market index rose only 0.1% per annum. The Barcap Global Aggregate bond index rose 6.8% and cash 1.3%. When you consider how low the global returns are, you realise that the SA equity market has been a very profitable investment destination, in absolute and relative (to the rest of the world) terms.

The Maestro Equity Fund has been in existence for just less than seven years. Consequently, charts in this Report covering periods longer than seven years do not contain specific returns for the Maestro Equity Fund. However we are keen to share the market characteristics that prevailed over the longer periods so we have included the market returns in the following charts which cover these periods. For interest sake I have also included the average Maestro client's equity performance over these periods.

Chart 9 lists the compound annual returns (CARs) over a seven-year period. The CAR of the Maestro Equity

benchmark over the seven-year period to December 2011 was 16.8%, which can be compared to the return over the same period of the All Share Index of 17.3%. **The average equity return per annum for Maestro's clients over the last seven years was 17.1%.** Note once again the strong returns from the industrial index; it rose 19.7% *per annum* over the past seven years. Not shown in the chart are the respective compound annual returns for the All Bond index and cash of 9.1% and 8.6%. The returns of the large, mid and small cap indices were 16.9%, 19.8% and 17.9% respectively.

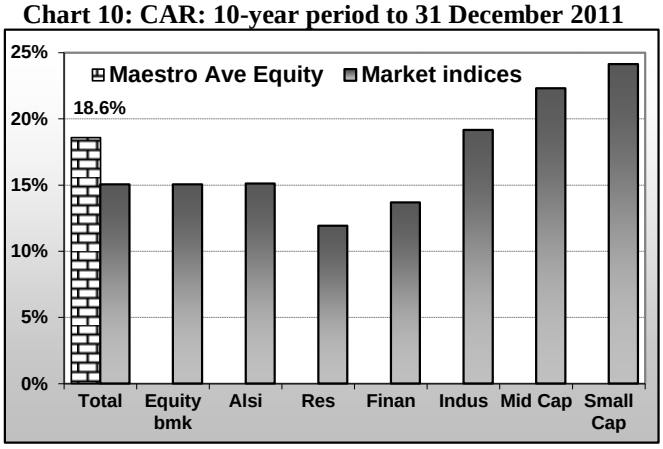
Chart 9: CAR: 7-year period to 31 December 2011



In order to place the returns of the SA equity market into perspective, consider the annual returns of other markets over the past seven years to end-September: the MSCI World index, which incorporates all global equity markets, rose only 0.7% *per annum* although the MSCI Emerging market index rose 9.6% per annum; that's a huge annual difference and underscores our inherent bias towards and fascination with emerging markets. The Barcap US aggregate bond index rose 5.9% and cash produced an annual return of 2.1%. For the record, the rand has declined 3.1% per annum over the past seven years.

We turn your attention now to the 10-year compound annual returns (CARs) to the end of December 2011. Over this period inflation in South Africa rose at 5.9% per annum while the All bond index compound annual return was 10.8%. The large, mid and small cap respective annual returns over the ten-year period were 14.0%, 22.3% and 24.1%, while the basic material, financial and industrial indices rose 11.9%, 13.7% and 19.2% respectively. Industrials remain the consistent performer while it is interesting to note that small caps generated a better annual return than mid caps over the period. The rand *appreciated* at a rate of 4.0% per annum against the dollar and 3.3% against sterling in the past decade – remember that the base for this period is December 2001 i.e. three months after the World Trade Centre terrorist attack and at a time when world markets were in a turmoil and the rand had declined dramatically, to R12.00 per dollar and R17.38 to the pound. How things have changed since then!

Chart 10: CAR: 10-year period to 31 December 2011



The compound annual returns (CARs) for the 10-year period to end December 2011 are listed in Chart 10. **The average equity return per annum for Maestro's clients over the last ten years was 18.6%.** The Maestro equity benchmark produced an annual return of 15.1% during the ten years to end-December 2011 versus the 15.1% return of the All share index.

By way of comparison and in the light of the 15.1% CAR of the All share index, the MSCI World index i.e. global equity markets, rose only 1.7% per annum over the past decade. The MSCI Emerging market index rose at 11.2% while the global bond market rose at 7.6%. The point needs to be made again just how profitable the SA equity market has been over the past decade, notwithstanding the many crises it has faced, political and economic, during this period.

On a lighter note, you may be interested to know what Maestro held in the portfolios under its management some ten year ago. In December 2001 a typical portfolio in our care had 39.7% of its assets offshore (in Investec products) 6.3% in cash and 57.5% in equities, split 31.7% in resources, 28.6% in financials and 39.6% in industrials. The share portfolios included wonderful "historic artefacts" like Energy Africa, Alexander Forbes, Liberty International, OTK Holdings, Metcash and MB Technologies, none of which remain listed. It contained jewels such as Dimension Data and Adcorp, and then also Cashbuild priced at 385c (versus its December 2011 year-end price of 11800c), Abil at 870c (3430c in December 2011), Billiton at 6150c (23430c) and Anglo at 20103c (29600c) and Sasol at 10540c (38550c). It is useful to undertake these "light-hearted" exercises, because it reaffirms the rationale behind, and reason for, investing in shares in the first place. It is clear from this exercise that the true benefits of investing are essentially long-term in nature.

6. Closing remarks

And so it is that we draw the curtain on 2011. Equity markets moved lower, risk and volatility abounded, governments toppled or went bankrupt or both, politician's ineptitude was visibly manifest, the world was shaken and affected by numerous natural disasters and Osama is dead. And when all is said and done we are not really in any better position than the one we entered 2011 in.

That said, many companies registered good earnings growth, inflation is not out of control, interest rates are still relatively low and are likely to remain that way for a long time, the lights never went out and life goes on. It is fair to say that we and many other investors around the world appreciate more fully the problems we face and what it will take to resolve them. In addition, much of the bad news is already reflected in asset prices. Remember it is not bad news that affects markets as much as surprises; it is the *unexpected* that moves markets, not the expected. And a lot of people around the world by now expect the worst.

All that remains is to thank you once more for your loyal support through what has been a tough and frustrating year for us. We value your support and don't ever take it for granted. And we look forward to continue serving you throughout what is likely to be another very eventful year.

Luke Sparks
On behalf of the Maestro team
23 January 2012

Appendix A

A summary of market behaviour – December 2011

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

Table 1: Selected returns – equity markets

	2010 (%)	Sept quarter (%)	Dec quarter (%)	2011 (%)
Japan	-3.0	-11.4	-2.8	-17.3
Hong Kong	0.1	-21.5	4.8	-20.0
Germany	16.1	-25.4	7.2	-14.7
UK	9.0	-13.7	8.7	-5.6
US (S&P500) and large cap	15.5	-13.7	11.9	2.5
S&P Mid cap	24.9	-20.2	12.5	-3.1
S&P Small cap	25.0	*-20.1*	*16.8*	-0.2
MSCI World index	***9.6***	***-17.1***	***7.11***	***-7.6***
Brazil	1.0	-16.2	8.5	-18.1
Russia	22.5	-29.7	3.0	-21.9
India	17.4	-12.7	-6.1	-24.6
China	-14.3	-14.6	-6.8	-21.7
MSCI Emerging market index	***16.4***	***-23.2***	***4.1***	***-20.4***
JSE All share	***19.0***	***-5.8***	***8.4***	***2.6***
JSE All share ($)	***32.4***	***-20.6***	***7.9***	***-16.0***
Basic materials	11.7	-10.8	5.8	-8.3
Financial	16.6	-3.1	8.7	7.4
Industrial	27.4	-3.3	9.1	9.2
Gold mining	12.5	19.5	0.7	6.9
Large cap (Top40)	17.2	-6.6	8.5	2.2
Mid cap index	30.3	-2.0	8.2	4.7
Small cap index	24.7	-2.4	6.8	1.1

You may recall, and it is very evident from Tables 1 and 2, that the September quarter was a very weak and unprofitable one. The good news is that, despite no real progress being made to resolve the "crisis of the moment" i.e. the Eurozone sovereign debt crisis, global markets nevertheless recovered some composure and registered strong gains during the December quarter. Although the quarterly returns on their own look good, they in no way compensated for the weak September quarter, with the result that the annual returns for 2011 in respect of equities and commodities are much worse than those for 2010 – refer again to Tables 1 and 2, which include the annual returns for both years.

It is ironic that the countries, by and large emerging ones, which are growing at faster rates than the developed markets, registered much weaker equity returns. One of the reasons for this is that investors are looking ahead and seeing that the effects of rising interest rates and policies aimed at slowing inflation and consumption in emerging markets are gaining traction, resulting in emerging market growth slowing quite sharply. The net result was a 7.6% decline in the MSCI World index during 2011 but a decline of 20.4% in the MSCI Emerging market index. There is still a perception that the US economy, currency and investment markets offer investors the best means to protect the value of their investments. The US equity market registered a gain of 2.0% - one of the few markets to post a positive return – versus the declines in the Bric equity markets of between 18.1% and 24.6%. Concerns about the slowing world economy in general and emerging markets in particular weighed heavily on commodity markets, which ended 2011 sharply lower.

Table 2: Selected returns – bonds, commodities, currencies

	2010 (%)	Sept quarter (%)	Dec quarter (%)	2011 (%)
SA All Bond index	15.0	2.9	3.3	8.9
SA Cash	6.9	1.4	1.4	5.7
Barcap Global Agg. Bond index	5.5	1.0	0.2	5.6
Emerging market bonds	12.5	-1.6	4.8	8.1
US 10-year bond	7.9	12.1	1.2	17.1
US Corporate bond	9.5	2.3	1.8	7.5
US High yield bond	15.2	-6.3	6.2	4.4
Cash (US dollar)	0.1	0.0	0.0	0.1
DJCS Hedge index	11.0	-4.6	-0.9	-2.3
Brent (Oil)	21.6	-8.6	4.5	13.3
Gold	27.7	7.6	-2.8	11.7
Silver	80.3	-13.1	-7.5	-8.0
Platinum	20.1	-12.3	-10.4	-22.9
Palladium	102.8	-19.3	2.6	-21.0
Copper	31.0	-23.2	5.8	-21.7
Nickel	34.5	-21.0	-0.2	-26.8
Baltic Dry index	-41.0	34.4	-8.5	-2.0
CRB Commodity index	13.9	-11.9	2.5	-5.4
S&P GS Commodity index	18.4	-9.5	6.4	3.9
Euro dollar	-6.5	-7.5	-3.2	-3.2
Sterling dollar	-3.1	-3.0	-0.2	-0.7
Swiss franc dollar	10.9	-7.3	-2.9	-0.3
Rand dollar	11.3	-15.7	-0.4	-18.1

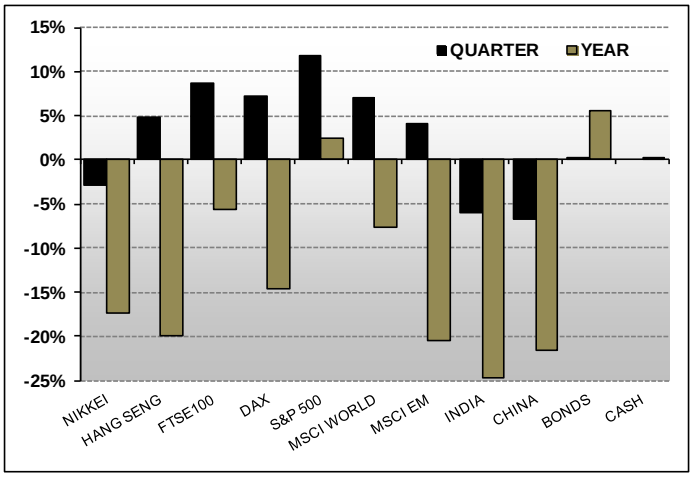
Gold proved to be a reasonable store of value, rising 11.7% for the year, despite two spine-chilling drops of about 15% in September and December. The only real safe havens during 2011 in our opinion and with the benefit of hindsight were firstly, the oil price, which gained 13.3% after a 21.6% rise in 2010 but which also never suffered any major declines during the year, and secondly, US Treasury bonds, which

although volatile, benefitted from a real "flight to safety" by investors. The 10-year US Treasury bond rose 17.1% after a 7.9% gain in 2010, while the Barclays Capital Aggregate Global bond index ended 2011 5.6% higher after a 5.5% rise in 2010. Despite all the weaknesses of the US economy and their politics, the dollar proved resilient against most other currencies.

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 positive quarterly returns were insufficient to lift annual returns into positive territory.

Chart 1: Global returns to 31 December 2011



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

- *The sharp gains at the end of each quarter:* 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 depict the start of the December quarter as a reference point off which to measure the quarterly return. It is apparent from most of the charts just how weak global markets were during the September quarter and consequently also how many of them rebounded during the December quarter – refer again to Chart 1 which depicts the quarterly returns. It is also clear from these charts that the strong quarter was unable to make for lost ground earlier in the year, with the exception of the US equity market, the oil price and bond markets. What is less clear from equity market charts are the month-end surges which we referred to in the Quarterly Report. Table 3 lists the month-end behaviour of the US, German and SA equity markets, which will give you an idea of how volatile the markets were and a sense of how difficult it was to make sense of these bursts and to manage money within such an environment.

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

Source: Saxo Bank

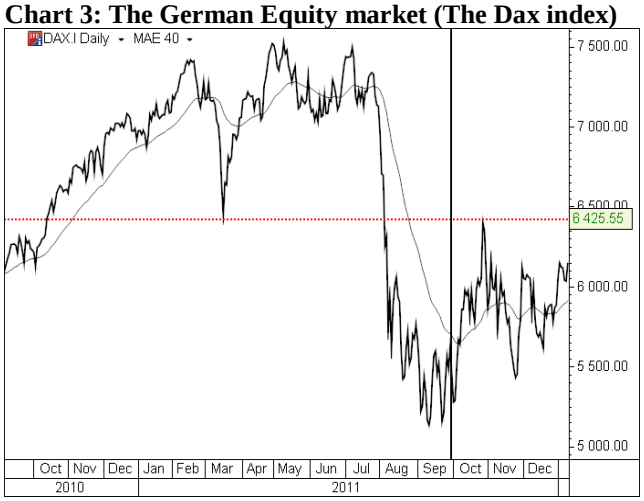
Take a closer look at Table 3. It depicts the US, German and SA equity markets, showing both the month-end surges and the eventual monthly returns. Thus, between 22 and 31 August the US equity market (S&P500) rose 8.5% but it still ended down 5.5% in August. The German market (Dax) surged 5.7% between 22 and 31 August but that did not prevent it from declining 19.2% for August as a whole. In October, between the 1st and the 28th it surged 21.7% but still ended the month "only" 11.6% higher. In some months, the surges bore no resemblance to the eventual direction of the market. In November for example, the US and German markets surged 7.6% and 12.2% during the last four trading days (the 25th to the 30th) yet despite these enormous gains the markets still ended *down* 0.3% and 0.9% respectively! If you look closely at Charts 2 and 3 you will see how volatile and traumatic a month November was.

Table 3: The Wild West: month-end surges and actual monthly returns (%)

	22-31 Aug	*Aug*	1-28 Oct	*Oct*	25-30 Nov	*Nov*	19-30 Dec	*Dec*
S&P500	8.5	*-5.5*	16.9	*11.0*	7.6	*-0.3*	4.3	*1.1*
Dax	5.7	*-19.2*	21.7	*11.6*	12.2	*-0.9*	4.0	*-3.1*
JSE Alsi	5.9	*-0.3*	10.9	*9.3*	5.4	*1.6*	0.8	*-2.5*

At the risk of stating the obvious, the US and German markets would be regarded by many as "stable, highly efficient markets. Table 3 "busts" that myth beyond belief, highlighting how unstable and uncertain equity markets were for just about all of 2011. Ironically, the respective ranges of the surges for the SA equity market were, in every instance, lower in magnitude despite the volatile rand which added yet another element to the turbulent cocktail.

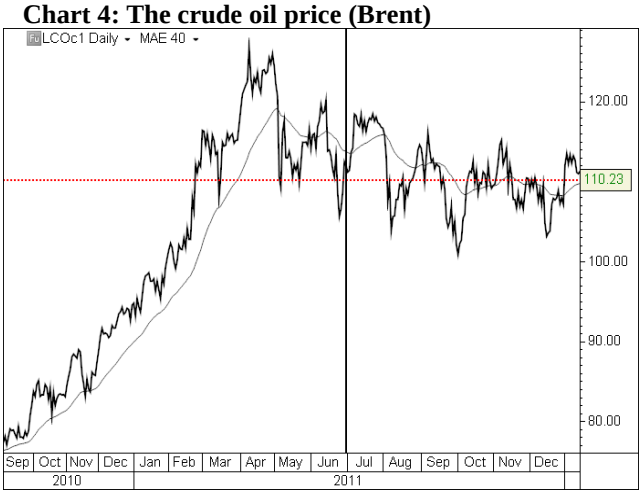
Chart 3: The German Equity market (The Dax index)



Source: Saxo Bank

- *The gains across market capitalizations (caps):* You will be aware that we watch the respective returns across market capitalizations (market caps) or size of companies very closely because firstly it tells us a lot about the prevailing risk appetite of investors and secondly because history shows us that large cap shares, which dominate most major global indices, perform worse and are more volatile than mid and small caps. Although this is hard to believe and there are still many who would dispute this statement, the facts are there as a matter of record. During times of uncertainty, volatility and economic weakness investments in smaller companies are, generally speaking, less profitable but they tend to more than catch up when the environment improves. As a consequence, you would understand our surprise that mid and small cap companies did not performed worse during the past year. It is true that this was the case in the US in 2011 (US large caps rose 2.5% but mid and caps fell 3.1% and 0.2% respectively) but the situation in South Africa was different (SA large caps rose 2.2%, mid caps 4.7% and small caps 1.1%). During the September quarter when sentiment was very negative US mid and small caps performed poorly but in SA large caps performed the worst due to concerns that a slowing global economy would affect large companies like Anglo and Billiton more than most. As sentiment improved through the December quarter the usual pattern of returns across market caps resumed i.e. mid and small caps outperformed larger ones. The point of this analysis is that last year taught us an important lesson in the prevailing climate*: concerns about a slowing global economy are more powerful than concerns about market capitalizations*, in addition to which *a weak rand is no guarantee that basic material companies*, which are mostly large caps, *will outperform small ones*. As the global economy begins to slow in 2012 we would do well to heed this important lesson about the behaviour of large, resource-orientated companies, specifically those listed on the SA equity market.
- *The oil price:* although no one has commented on it in too much detail we think one of the "best kept secret" safe havens, at least so far this decade, is turning out to be the oil price. Despite the prospect of a slowing global economy the oil price showed no real signs of declining – refer to Chart 4. The Arab spring or Iran crisis may have supported the oil price, but there always seems to be a reason for the price remaining elevated. We expect oil to remain firm during 2012.

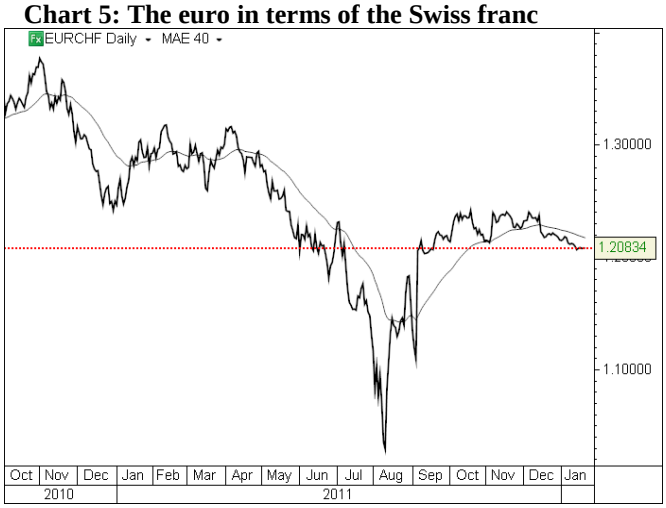
Chart 4: The crude oil price (Brent)



Source: Saxo Bank

- *The behaviour of the Swiss franc:* another intriguing aspect of the quarter, at least for us, was the fact that investors have not yet plucked up enough courage to take on the Swiss National Bank (SNB) and test their self-imposed "peg" to the euro at around the 1.20 level – see Chart 5. You will recall that, following the dramatic strength in the Swiss franc against virtually all currencies, the SNB intervened heavily and declared their intention to peg the franc to 1.20 euros and defend that level. Although we wish no harm on any currency or country, it is surely only a matter of time before speculators take on the franc and test the SNB's resolve. We know from history – the battle over sterling which led to it being summarily ejected from the then-prevailing European Monetary System comes to mind – that no central bank is bigger or has deeper pockets than the market. We miss the safety that the franc offered investors and we think it is only a matter of time before the SNB's peg is tested in an effort to reclaim the Swiss franc as a safe haven. Safe havens are currently in very short supply.

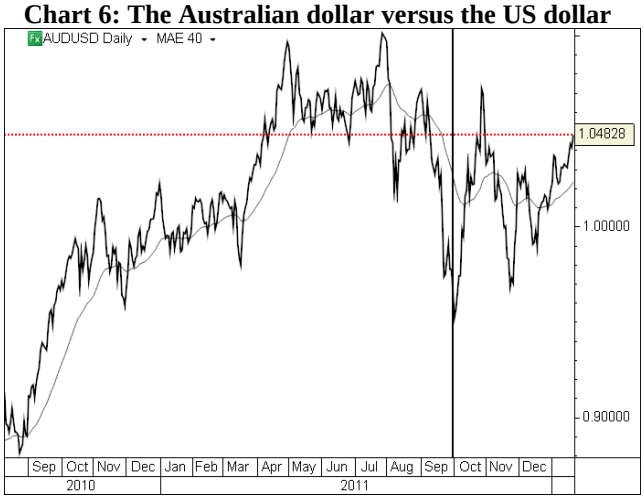
Chart 5: The euro in terms of the Swiss franc



Source: Saxo Bank

- *Stable emerging market currencies:* You will be familiar by now with the weak markets in September and their subsequent partial recovery in the December quarter. We note with interest that emerging market currencies were very quick to recover some ground lost in the September quarter. Chart 6 depicts the Australian dollar while Chart 14 depicts the rand's movements over the past year.

Chart 6: The Australian dollar versus the US dollar



Source: Saxo Bank

While the rand declined marginally (-0.4%) during the quarter it was nothing like its 15.7% collapse during the September quarter. It resilience in the December quarter should be seen in the light of the ongoing commodity price weakness; the rand is typically weak when commodity prices are weak, but this was not the case during the December quarter. Despite the fact that most emerging countries have embarked an easing phase of monetary policy i.e. interest rates seem to have peaked, emerging currencies showed noticeable strength during the December quarter. This speaks to a theme that we believe will re-emerge this year, namely a search for yield on the part of global investors. With interest rates in developed countries either non-existent or at historically low levels, investors continue to search for yield (income) where they can find it. This factor will support certain emerging countries, particularly those with budget surpluses. From the behaviour of global markets last year one thing was apparent: as soon as investors regain some form of confidence in the future, they buy emerging market currencies and equity markets. When they fret about the future, they sell them. This phenomenon is likely to continue throughout 2012, which if nothing else will prolong the volatility and uncertainty of currencies in general and emerging market currencies and the rand in particular.

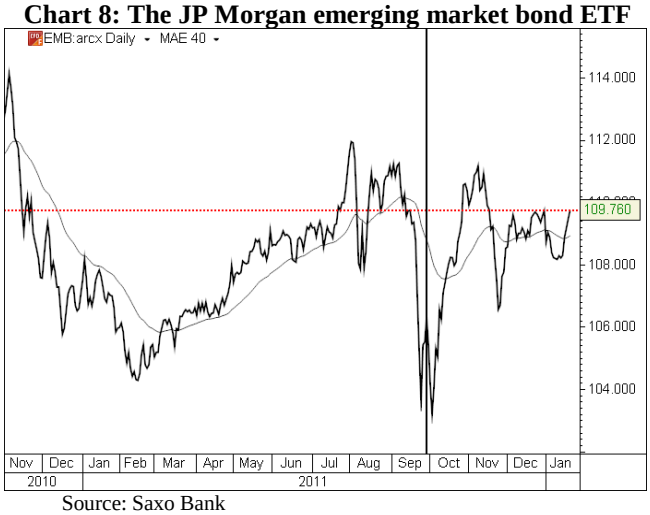
Chart 7: iShares Barclays 20+ year Treasury Bond Fund

Source: Saxo Bank

- *Strong bond markets:* we have already alluded to the strength in the bond market during 2011 – at least in US, German and corporate bonds. Chart 7 depicts the exchange traded fund (ETF) of the US long (in excess of 20-year duration) bond and Chart 8 the Emerging market bond ETF. Ironically, we doubt there is any *real* investor appetite for long-term bonds at yields (rates of interest) lower than 2.0%, the prevailing level of US and German 10-year bonds. Rather, investment into these bonds is being driven by a fear that any other investment will not retain its value over this period, or simply by a lack of alternatives. With yields at these levels, which are below the prevailing respective inflation rates, anyone investing into bonds is dooming themselves to a negative real return for the next ten years, assuming of course they hold the investment for this period. While this gives an inkling into how fearful investors are at present, one cannot ignore the strength in the bond market during 2011 and 2010. With yields so low, it is hard to see how they can go lower still. We thus find little value in bonds at prevailing levels, and would rather take the risk of some capital growth for which we will be compensated by a (dividend) yield in

some cases two or three times the prevailing yield on bonds.

Chart 8: The JP Morgan emerging market bond ETF



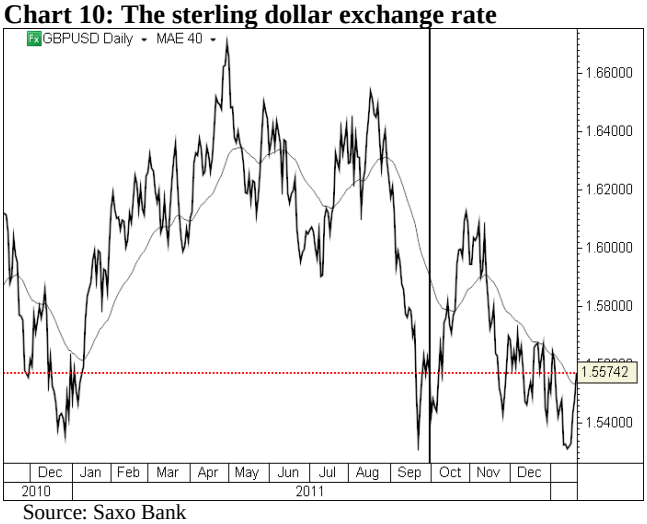
Source: Saxo Bank

- *The Eurozone crisis:* what can we say about the Eurozone crisis that has not been said already or that you don't already know?! You must be as sick and tired of it as we are, yet it is unlikely to go away and we do not foresee any material progress being made on the major issues within the next few quarters. It is likely to dominate the investment landscape for the early part of 2012, notwithstanding the robust start to 2012 made by both the euro (refer to Chart 9) and equity markets.

Chart 9: The euro dollar exchange rate

Source: Saxo Bank

Chart 10: The sterling dollar exchange rate

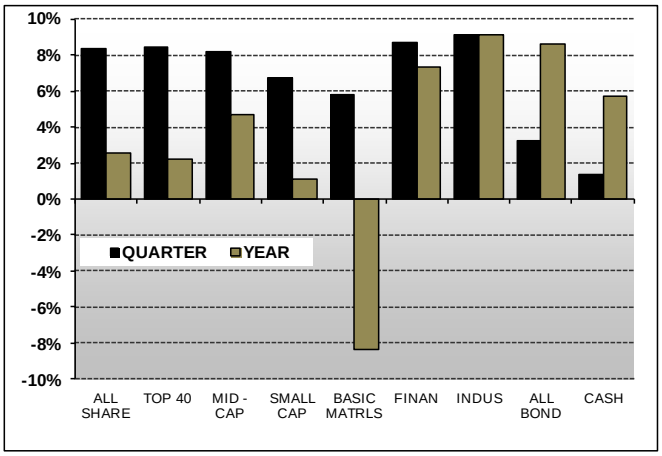


Source: Saxo Bank

Local investment markets

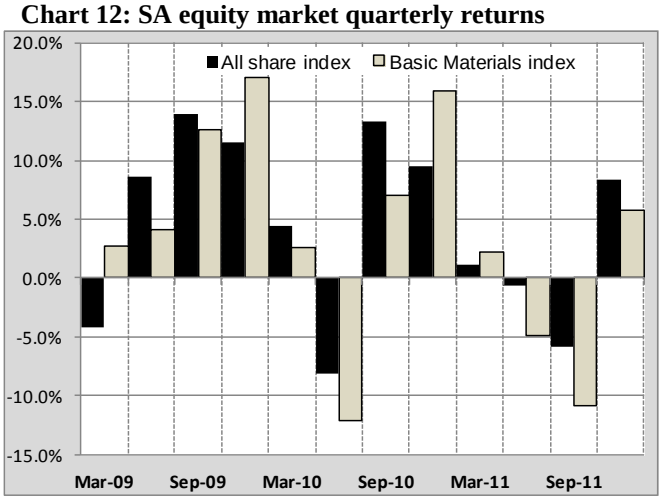
Turning to the South African investment markets, Chart 11 depicts the quarterly and annual gains in the major indices for period ended 31 December 2011.

Chart 11: Local returns to 31 December 2011



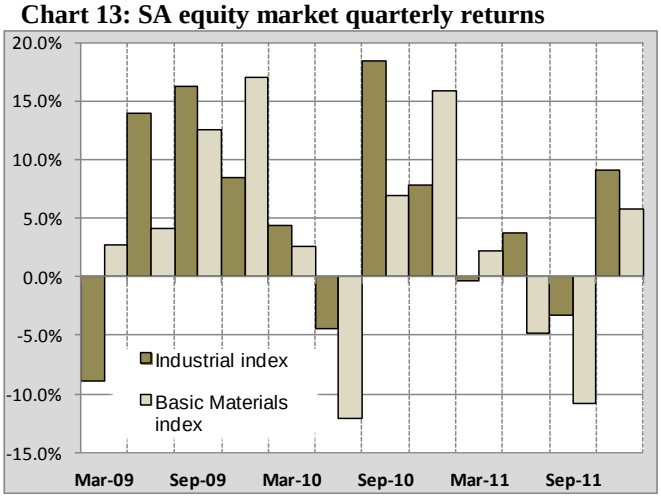
The same features that prevailed on global markets prevailed on local ones. Chart 11 shows that, with the exception of the basic material sector, 2011 proved to be a profitable year although by historic standards the absolute level of returns was quite low. The industrial and financial sectors posted reasonable returns during the quarter and year. What is not that evident from the chart is the extent of volatility that investors have endured during the past few years. Chart 12 depicts the quarterly returns of the All share and basic material (resource) indices between December 2009 and 2011. It is very clear from the chart just how volatile the market has been. After the strong gains in 2009, which represented the bounce after the 2008 meltdown, the returns have vacillated between positive and negative values with effectively only two consecutive quarters (September and December 2010) of positive returns.

Chart 12: SA equity market quarterly returns



While one would expect the basic materials index to be volatile, Chart 13 shows its returns together with those of the industrial index over the same period. Even a casual glance shows that the industrial has been anything but stable over the period. In many instances it has been even more volatile than the mining sector. It has been hard to make sense of all the volatility, particularly when the source of this volatility was outside the country (largely in Europe) and driven almost entirely by headlines, as opposed to concrete achievements. At the risk of sounding like an old man, back in the old days and before the advent of "new normal" environment, one would have expected a volatile market to rise or fall by a couple of percentage points. But note the scale of the charts – the range is from -15.0% to 20.0% which is extraordinary when you consider we are talking about quarterly returns and not annual ones. Refer again to Table 3 to get a better understanding of how abnormal the market conditions have been over the past few years.

Chart 13: SA equity market quarterly returns



In closing

It is not our habit to pass comment on our views for the future in the Quarterly Report. The purpose of the document is to serve as a record of what has transpired during the quarter. Our views will be shared in other reports sent during the normal course of reporting.

Chart 14: The rand dollar exchange rate

Source: Saxo Bank

That said it is worth ending this summary of market movements with a few comments about the future. Firstly, with regard to the global economy, we have little doubt that the rate of growth is slowing. The Eurozone is in all likelihood in a recession already and there is a fair chance their economic momentum will slow even further. The US might see reasonable growth early in 2012 but this is likely to slow towards 2013 as they become mired in electioneering and as their political machine becomes even more paralysed – it is already all but broken. This would not be that serious were it not for the fact that, firstly the US remains the global engine of growth and secondly, the US is facing enormous challenges and is facing the very real prospect of another few years of low or no growth in critical areas that affect ordinary people, such as the housing and labour markets. We continue to be very concerned about the long-term future of the US economy, although that does not mean sentiment will turn against it in the short- term. If you need a reminder about how severe the US's future is, refer back to the report by Mary Meeker, which we discussed in the December edition of *Intermezzo*, which you can access by clicking here.

Perhaps the most vital economy of all, at least in the short to medium term, is the Chinese one. Growth there, too, is likely to slow, but the important issue is, to what extent? For now we will grant the Chinese authorities the benefit of the doubt in terms of engineering a soft landing, but one should not underestimate the effects of a hard landing or the effects on markets if investor sentiment changes due to a belief that the Chinese authorities might get it wrong. So we will be watching the global economy for any signs of a larger-than-expected slowdown.

It remains true that the corporate sector is in relatively good health; the world's financial problems lie largely with governments and the public sector. But it makes little difference where the problems lie, given that we all inhabit one planet. Equities will remain cheap and volatile, and bond markets and the dollar are likely to continue strengthening as long as the degree of uncertainty about the current global crisis increases. As soon as there are any signs of tangible progress, we expect equities – and emerging markets in particular - commodities and emerging market currencies to rise sharply. If all of this sounds familiar, that is not surprising: it is exactly what we saw in 2011. We expect "more of the same", at least for the first half of the year.

Despite the uncertainty though, we think long-term investors will be rewarded for their patience. The world experienced a heightened degree of risk last year, yet many companies posted reasonable returns and continued to pay good dividends. The challenge for us is to seek out these companies for your benefit. Much of the bad news is already priced in to equity markets, which offers some hope that we will again see positive returns from equities in the coming year.

The Maestro Investment Team
25 January 2011