



M A E S T R O Growth Fund

INVESTMENT OBJECTIVE

The Fund's objective is to produce above-average long-term returns whilst simultaneously assuming less risk than inherent in the market itself. The Fund is balanced across multiple asset classes and is subject to the restrictions of Regulation 28 of the Pensions Funds Act. A conservative investment philosophy is adopted however this still may lead to volatility of returns in the short term (i.e. 12 to 18 months).

FUND BENCHMARK (BMK)

The Fund measures itself against a benchmark consisting of 60% All share Index, 20% All bond Index (ALBI), 10% Short term fixed income (STIFI) index and a 10% global benchmark.

LEGAL STRUCTURE

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

FEES STRUCTURE

The annual investment management fee is 1.5%. The fee is inclusive of all underlying managers' fees, platform and administrative fees. In the case where the Fund is accessed and used as a Preservation Fund or Retirement Annuity an additional fee of 0.2% per annum is charged by Prescient.

FUND SIZE: R 44 177 654

LONG TERM INSURER

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

AUDITOR
KPMG Inc.

PORTFOLIO MANAGER

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

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The Maestro Growth Fund

Quarterly report for the period ended
31 March 2012

1. Introduction

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

2. The investment position of the Fund

The Fund's asset allocation is shown in Chart 1. Exposure to the equity market totalled 63.7% of the Fund, up from 61.2% in December. Bond exposure decreased 0.2% to 10.2% while offshore exposure declined 2.2% to end the quarter at 19.4% of the Fund. Cash represented 6.8% of the Fund, down marginally from 6.9% at the end of 2011.

Chart 1: Asset allocation at 31 March 2012

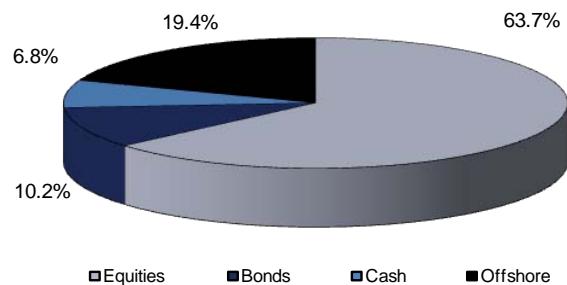
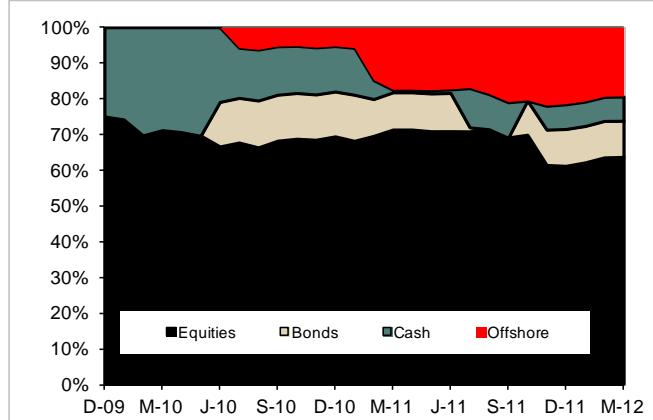


Chart 2 depicts the historical allocation to the major asset classes, expressed as a percentage of the total Fund.

Chart 2: Sector exposure at 31 March 2012

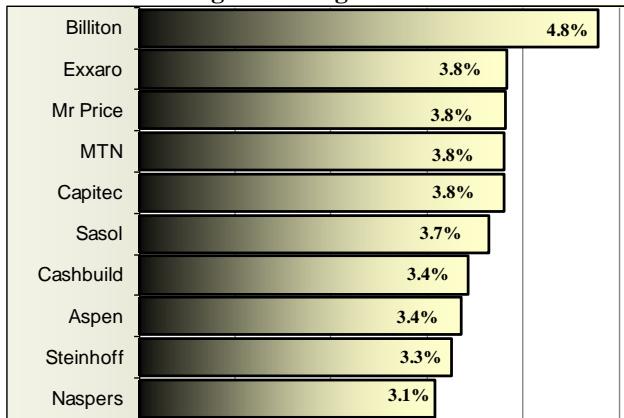




3. Largest Holdings

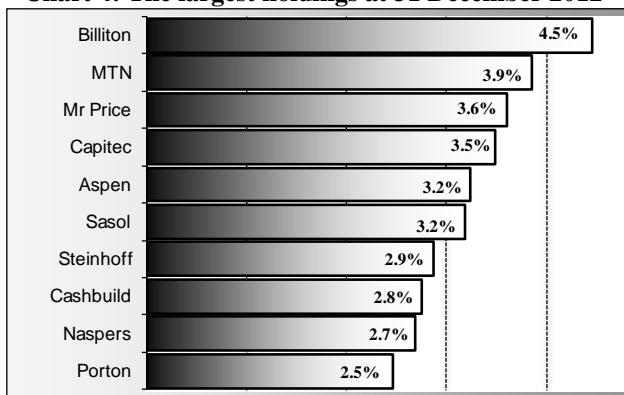
The largest holdings at 31 March are listed in Chart 3 expressed as a percentage of the Fund's equity portfolio.

Chart 3: The largest holdings at 31 March 2012



The largest holdings at the end of December are listed in Chart 4. During the quarter Exxaro displaced Porton in the largest holdings. At the end of March there were 25 counters in the equity component of the Fund, unchanged from December. The ten largest holdings constituted 36.8% of the Fund up from 32.6% in December.

Chart 4: The largest holdings at 31 December 2012



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.

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

The salient features of the first quarter are discussed throughout the document. Before we focus on the quarterly and yearly returns of the Maestro Growth Fund it is appropriate to isolate from an Asset Allocation point of view what took place.

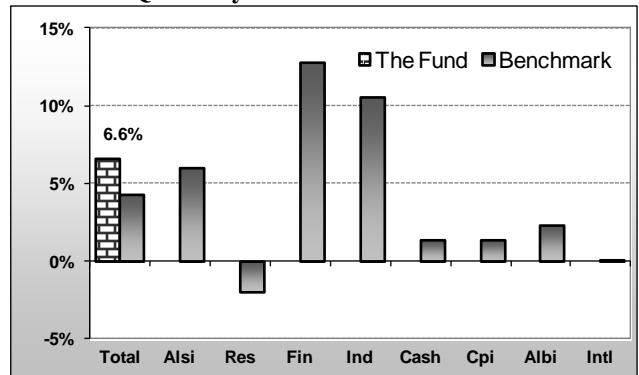
We are still of the opinion that domestic equities are the asset classes of choice over the medium to long term. The Growth Fund's exposure to equities rose 2.5% during the first quarter of 2012. This took place at the expense of the offshore allocation which reduced by a similar amount. Bonds and cash stayed relatively stable during the quarter with no major asset allocation changes taking place.

A disproportionate amount of commentary is given to how the equity and offshore components of the Fund performed. The primary reason this is the case is due to the large allocation to these sectors within the Growth Fund.

5. The performance of the Fund

Chart 5 depicts the returns for the quarter against the major indices. ***The un-annualised return on the Fund during the March quarter was 6.6%*** which can be compared to the Maestro Growth Fund benchmark of 4.3%. Appendix A summarizes the major developments during the quarter for your interest.

Chart 5: Quarterly returns to 31 March 2012



The international component produced a rand return of 1.7% versus the 0.1% rise in the benchmark; the rand rose 5.2% during the quarter. The Fund's quarterly equity return of 10.0% can be compared to the Maestro equity benchmark and All share index returns of 8.1% and 6.0% respectively. We commented extensively in recent letters and *Intermezzo* about the state of the markets during the past few months and refer you to those publications to refresh your memory about the salient features of this period; you can find back copies of *Intermezzo* by [clicking here](#). I also refer you to Appendix A, which details the nature of the market movements during the quarter. Like so many other



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periods in the market during the past years the March quarter was unique and provided investors with much to cheer, so do pay close attention to what happened during each month of the quarter.

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

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

The fund's outstanding performance was partly driven by the asset allocation call (within sector allocation added to gains as well), overweight industrials and underweight resources. It is quite remarkable to see the divergence in the various indices' returns over a short period of time, such as a quarter. As you will see later in the report, this trend of industrials outperforming resources has been going on for a long time and the gap between their long-term returns is nothing short of remarkable. Chart 6 summarizes the net result for the quarter: financials led the indices gaining 12.8% during the quarter, industrials 10.5% and resources -2.0%. Across the size spectrum, large caps returned 5.1% for the quarter, lagging the mid (10.6%) and small cap (10.4%) indices. The preference share component of your fund had an uncharacteristically volatile quarter, thanks largely to a surprise increase in the dividend withholding tax from the expected 10.0% to 15.0%. At some point during the quarter, the prefs were down over 5.0% but rebounded to earn a respectable 1.9% return.

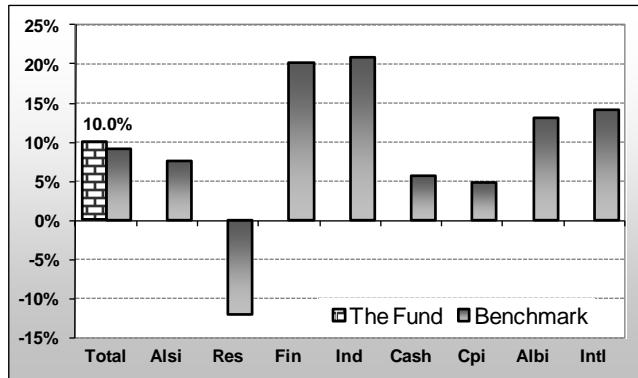
The returns excluding dividends of the five largest holdings in the Fund during the quarter were as follows: Billiton it declined -0.3% (but rose 9.4% in the December quarter), Exxaro 17.9% (-1.5%), Mr Price

18.2% (18.6%), MTN -6.1% (8.5%) and Capitec 15.2% (-7.3%).

Other holdings across the equity component of the Fund which posted positive quarterly returns included those in B&W, which rose 45.0% during the quarter, Hudaco 25.8%, Coronation 25.6%, Wilson Bayly 23.6% and Metmar 22.6%. On a negative note, the laggards in the portfolio were Sasol which declined 3.9%, Anglo 3.7%, Digicore 1.3% and Billiton 0.3%.

The annual returns to end-March are shown in Chart 6. ***The annual return of the total Fund for the year to March was 10.0%***. Inflation rose 6.0% over the year and the All bond index rose 13.2%. ***The Fund's international component produced a rand return of 7.9%*** versus the benchmark increase of 14.1%. The rand declined 11.9% against the dollar during the year.

Chart 6: Annual returns to 31 March 2012



The Fund's annual return to March on its equity component was 11.2% versus the Maestro equity benchmark and All share index returns of 12.6% and 7.5% respectively. The outperformance of the fund's equity component relative to the two indices provides some insight into the market features during the past year, as does the respective sector returns. Despite the weak (-11.9%) rand, the basic material sector declined 12.0% as concerns about the slowing global economy weighed on the prospects for mining companies. Gold shares were of particular interest as they tumbled 10.9%, despite the 15.5% rise in the gold price. The weak showing by large resources dragged the Alsi down during the past year. You will recall that the Maestro Equity benchmark allot a larger weighting to industrials at the expense of resource shares and this explains much of its outperformance relative to the Alsi. Our long-held preference for industrials over resources has once again been vindicated in the previous year. To put the industrial sector's outperformance into perspective; over the past year industrials are up 21.0% versus resources' decline of 12.0%, a variance of 33.0%! Financials too have had a profitable year, returning 20.2%, slightly



below the industrials. Not shown in the chart above are the annual returns of large, mid and small cap index, which rose 5.1%, 21.2% and 17.8%. Undoubtedly, the “sweet spot” to invest over the past year has been the industrial mid cap universe, an area we have traditionally preferred to mine for investment opportunities.

With the above as background, it should not surprise you that across all of the equity portfolios under Maestro’s care, resource counters dominated the worst performers and industrials the best performers. Onto specifics, the main detractors from the portfolios over the past year were Metmar, which declined 32.5% (despite the 22.6% gain during the March quarter), Implats 22.8%, Anglo 19.0%, Billiton 13.5%, Investec 10.7% and Sasol 5.4%. On a more positive note Coronation rose 60.1%, Mr Price 54.0%, Aspen 50.0%, Cashbuild 34.8% and Capitec 22.0%. These returns exclude dividends i.e. the changes reflect only the share price movements.

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

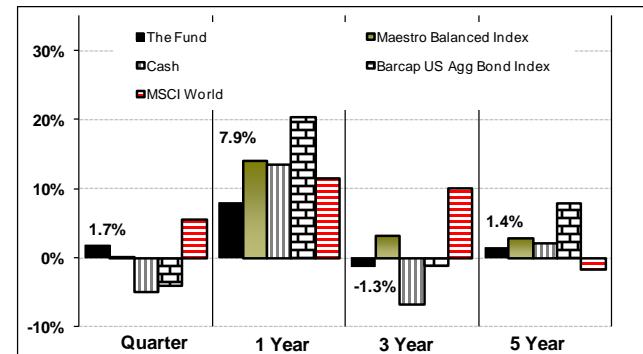
The impressive return by Mr Price is typical of most South African (SA) retailers that have continued to confound critics for a number of years. While they have been trading at lofty valuations, they continue to chug along and outperform the market. Among other reasons, local retailers have clearly benefitted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

6. International component of the Fund

The activities of [Central Park Global Balanced Fund](#) are communicated via monthly [Fund Summaries](#) as are the positioning and performance of its portfolio. I suggest you use the [Central Park Quarterly Report](#) as the primary document for the evaluation of Central Park’s return as it is unaffected by timing and currency distortions. The returns to end-March of the Fund’s international component, in rand terms, are listed in Chart 7 and the *same* returns in dollar terms are listed in Chart 8. We have mentioned a couple of times in the past but it is worth repeating here; the benchmark against which Central Park measures itself is a demanding one, as it contains a 20% weighting in a hedge fund index, which most of Central Park’s peers do not have. Although markets in general have been volatile and weak during the past decade, hedge fund indices have been less volatile and weak which has supported the benchmark returns during most periods. This is worth bearing in mind when analysing the returns shown in the charts.

The strong March quarter, during which time Central Park rose 7.0% versus the benchmark return of 5.3%, was not enough to lift the annual dollar returns which are still low in absolute terms. Over the past year, the weakening rand added some respectability to global investments which have lagged local markets for many years now, as shown previously and by the charts below.

Chart 7: Global rand returns to 31 March 2012



Appendix A summarizes the salient features of the market behaviour during the March quarter. It is best to review the offshore returns in the light of these comments. I refer you to the March Central Park Quarterly Report, which will be published in a few weeks’ time, for a detailed analysis of Central Park Global Balanced Fund’s returns.

In short, it was encouraging to see Central Park register a strong quarter at the start of the year. Many of the factors that affect Central Park’s returns and worked against us for most of last year were the very same ones that

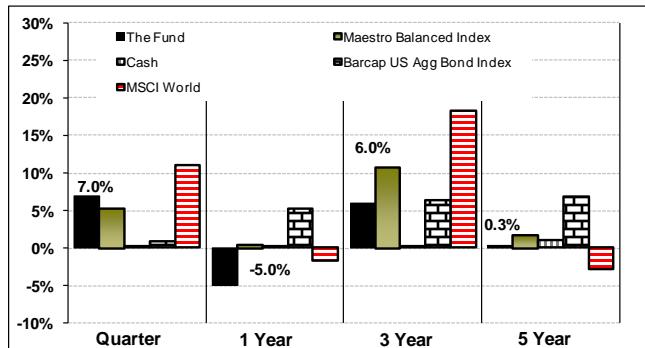


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reversed and led to the Fund's strong first quarter, namely, a relatively weak dollar, strong emerging market currencies and strong commodity prices. You will recall that for most of last year the sharp month-end rallies hurt Central Park as our conservative position caused the Fund to lag its comparative indices. This year so far has not had that kind of volatility and irrational market movements, which has allowed Central Park to benefit from the return of some "normality" to the market and positive sentiment to risk assets such as emerging market equities and currencies.

You would also be aware that though Central Park is a dollar denominated fund, at the end of the quarter only 51.7% of the Fund was invested in dollar assets, a view taken in light of our concerns regarding the long term fundamentals of the dollar. Given the above, you would understand why the fund had a strong quarter on the back of a weak dollar. Despite the strong quarter the Fund's annual returns (-5.0% in dollars) are still negative and were below the benchmark's 0.5% return. The rand's weakness aided the Fund's return to 7.9% over the year versus the benchmark's 14.1%.

Chart 8: Global dollar returns to 31 March 2012



7. Closing remarks

Having drawn the curtain on what has truly been a remarkable, and enjoyable, quarter, it is worth reflecting on where to from here on out. If you cast your mind back to where we were at the beginning of this year, it appears that market participants have taken the view that the world is not going implode, at least not yet, and things were not as bad as initially feared. We welcomed that change in sentiment and certainly enjoyed the returns that came with it. However, whichever way you look at it, equity markets "ran very hard" during the first quarter on the back of another profitable quarter, December 2011. It would be careless of us to not urge caution as we proceed into the second quarter of 2012. In our view, there are several "hurdles" that markets will have to navigate from this point onwards that some market bulls seem to have forgotten. Apart from the Euro crises, which has already returned to the forefront of investors' minds a few weeks after the close of the

quarter, there is the recession in the Euro area, slowing growth in China, the political deadlock in the US and the ever-present tensions in the Middle East that all pose a constant threat to the nascent economic recovery.

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

David Pfaff
On behalf of the Maestro team
14 May 2012



Appendix A

A summary of market behaviour – March 2012

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 March quarter. The returns of selected equity, bond, commodity and currency markets are shown in Tables 1 and 2.

Table 1: Selected returns – equity markets

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

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

indices, they averaged losses of over 20.0% for the 2011 calendar year but have rebounded this year to post double digit returns for the March quarter, with the exception of China.

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

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

Table 2: Selected returns – bonds, commodities, currencies

	Mar Quarter	Dec quarter	Previous 12 months	2011
	(%)	(%)	(%)	(%)
SA All Bond index	2.3	3.3	13.2	8.9
SA Cash	1.4	1.4	5.7	5.7
Barcap Global Agg. Bond index	0.9	0.2	5.3	5.6
Emerging market bonds	5.1	4.8	9.1	5.8
US 10-year bond	-2.2	1.2	14.9	17.1
US Corporate bond	2.4	1.8	9.1	7.5
US High yield bond	5.2	6.2	5.6	4.4
Cash (US dollar)	0.0	0.0	0.0	0.1
DJCS Hedge	4.0	0.7	-0.8	2.5



index	14.4	4.5	4.7	13.3
Brent (Oil)	14.4	4.5	4.7	13.3
Gold	5.6	-2.8	15.5	11.7
Silver	15.1	-7.5	-14.4	-8.0
Platinum	21.1	-10.4	-7.5	-22.9
Palladium	3.3	2.6	-15.0	-21.0
Copper	11.5	5.8	-10.3	-21.7
Nickel	-4.3	-0.2	-33.1	-26.8
Baltic Dry	-46.3	-8.5	-40.0	-2.0
index				
CRB				
Commodity index	1.0	2.5	-14.9	-5.4
S&P GS Commodity index	5.9	6.4	-3.9	3.9
Euro dollar	2.6	-3.2	-6.2	-3.2
Sterling dollar	-2.8	-0.2	-0.3	-0.7
Swiss franc	-3.3	-2.9	-1.2	-0.3
dollar Rand dollar	5.2	-0.4	-2.9	-18.1

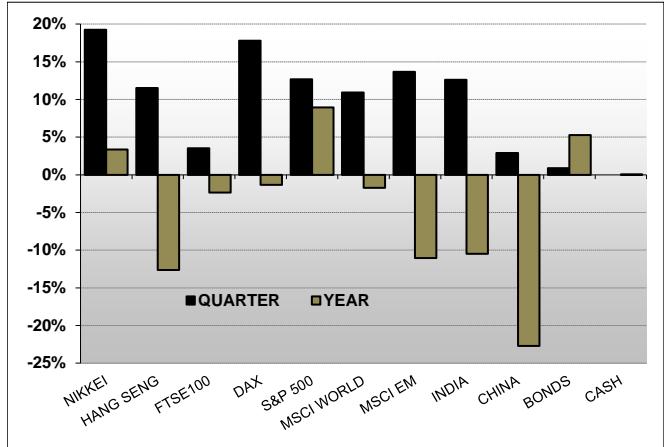
Commodities started the year on the front foot aided by the weak dollar and the increased risk appetite in the market. This strong start was somewhat mitigated towards the end of the quarter as concerns over global growth resurfaced. However, that did not prevent commodities, as represented by the S&P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

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

Global investment markets

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

Chart 1: Global returns to 31 March 2012



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

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

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



Source: Saxo Bank

As has been the case throughout this economic recovery, a lot of equity gains can squarely be attributed to various actions by central banks. Investors undoubtedly view quantitative easing (QE) and its



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equivalents as good news for certain asset prices. The latter part of 2011 and the March quarter gave further evidence to this as the European Central Bank's (ECB) unlimited offer to provide European banks with cheap funding, a QE equivalent, for three years provided welcome tailwinds to risky assets.

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



Source: Saxo Bank

While the generosity extended by the ECB did not solve the underlying problems of the Eurozone, which are too much debt and very little growth, what it did was to afford politicians and policy makers much needed time to solve the problems. Interbank credit which was fast drying up across the Eurozone has now re-emerged in aggregate and investors saw this as a reason to buy into risk assets during the March quarter. As the effects of the ECB's actions wane, one may expect investors to take some risk off the table. Perhaps we started to see the first signs of this towards the end of the quarter.

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

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

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

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

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

Chart 4: The Japanese Equity market (Nikkei 225)



Source: Saxo Bank

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



Chart 5: The dollar yen exchange rate



Source: Saxo Bank

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

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

Chart 6: The rand dollar exchange rate



Source: Saxo Bank

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

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



Source: Saxo Bank

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



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

Chart 8: The euro dollar exchange rate



Source: Saxo Bank

- *The gains across market capitalizations (caps):* As you know, we watch the respective returns across market capitalizations (market caps) or size of companies very closely because it tells us a lot about the prevailing risk appetite of investors, among other things. With risk appetite elevated during the previous quarter, you would understand our surprise that US large caps (12.7%) kept up with mid (13.1%) and small (11.7%) caps. A closer look at the outperformers in the S&P 500 easily explains this irregularity; the performance of US financial shares and Apple were the main drivers of the large caps’ performance. According to Barclays Capital, Apple, the world’s largest company by market cap now makes up almost 5.0% of the S&P 500 index. Apple’s 48.1% rise in the March quarter added 15.0% to the S&P 500’s 12.7% gain. We comment on Apple’s

extraordinary rise in the latest edition of [Intermezzo](#). The second reason for the aberration in the US market cap returns is the remarkable performance by S&P 500 financials (Chart 9 below) during the quarter, albeit from a lower base. The results of the latest round of US bank stress tests carried out by the US Federal Reserve and released during the quarter were viewed positively by the market and contributed to S&P financials rising 22.0% during the quarter. These two factors were responsible for the US large caps more or less keeping up with mid and small caps.

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



Source: Saxo Bank

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



Chart 10: The Platinum price (\$)



Source: Saxo Bank

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

Chart 11: The Gold price (\$)



Source: Saxo Bank

- *Copper and oil price:* Another interesting development in the commodity space was the surge in the copper price during the quarter. Copper is the classic cyclical economic bellwether (its price is driven primarily by global industrial production) and it was encouraging to see the 12.3% jump in its price during January. Disturbingly, it moved sideways for the rest of the

quarter as concerns about China's "hard or soft landing" returned to the fore.

Chart 12: The Comex Copper futures (\$)



Source: Saxo Bank

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

Chart 13: The Oil price (Brent)



Source: Saxo Bank

Many western politicians have been quick to attribute the strong oil price directly to the political instability in the Middle East, particularly Iran. We do not contest



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that fears of supply constraints have had a hand in the higher oil price. However, a closer look at the long-term gains in the oil price provides an interesting perspective. Below is a table that shows how different assets have fared over the past five years, which period covers the financial crises and recovery.

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

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

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

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



Source: Saxo Bank

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

Chart 15: The JP Morgan emerging market bond ETF



Source: Saxo Bank

Local investment markets

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



Chart 16: Local returns to 31 March 2011

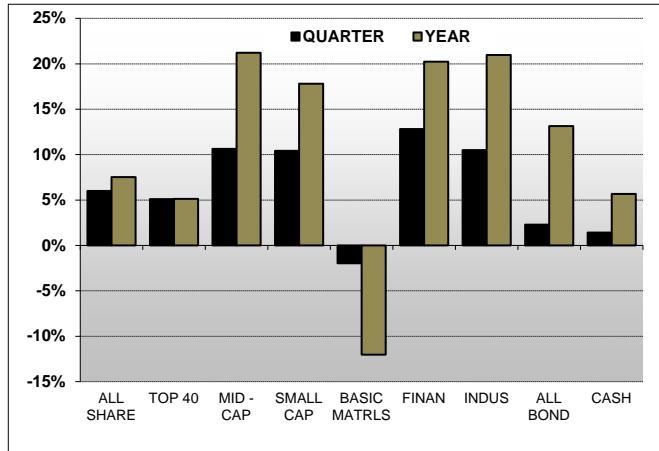


Chart 16 shows that, with the exception of the basic material sector, the first quarter proved to be a very profitable one. The extent of the gains in the March quarter was enough to lift the previously marginal annual returns into impressive gains, particularly for the industrial and financial sectors,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

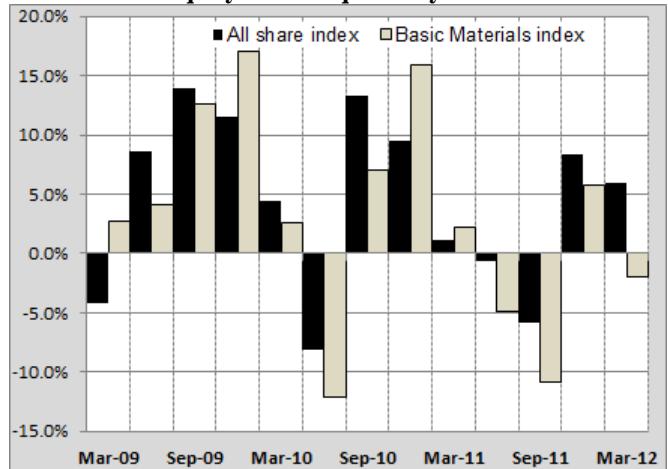
Our local bond market benefited from the stronger rand and gained 2.3% for the quarter and 13.2% for the year to March, ahead of the Barcap Global Aggregate bonds which returned 0.9% for the quarter and 5.3% for the year. The local bond market was supported by lower risk aversion as investors moved from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

In closing

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

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

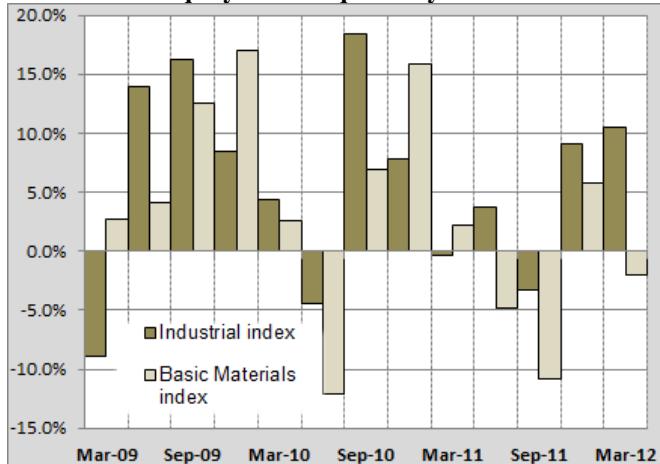
Chart 17: SA equity market quarterly returns



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



Chart 18: SA equity market quarterly returns



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

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

One could argue that some of the growth prospects are "priced into the markets" already - a comment we feel is a fair one. Probably the biggest unknown, as far as growth is concerned, is China. As the world's second largest economy and largest contributor to growth, it is imperative that China's economy chugs along at or above 8.0%, a level regarded as a "soft-landing" by investors. It would have been difficult to get a clear picture of China's economy in the past quarter due to the disruption brought about by the lunar holidays. So along with other investors, we will keenly follow how the China growth story unfolds this coming

quarter as it will have a direct impact not only on our basic resource shares but more importantly the broad mood of the market. One source of comfort is that, if we see material weakness in the Chinese economy, we will likely see decisive action by the country's central bank, the People's Bank of China, which would give markets cause to cheer and ease some of the fears about insufficient growth in the Chinese economy.

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

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

The Maestro Investment Team
14 May 2012

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