MAESTRO
Growth Fund

PRESCIENT
LIFE LIMITED

**INVESTMENT OBJECTIVE**
The Fund's objective is to produce above-average long-term returns whilst simultaneously assuming less risk than that 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. A conservative investment philosophy is adopted although 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 (STEFI) 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.

**FEE 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 34 727 235

**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)

**ENQUIRIES**
David Pfaff

Maestro Investment Management
Box 1289
CAPE TOWN
8000
Tel: 021 674 9220
Fax: 021 674 3209
Email: david@maestroinvestment.co.za

# The Maestro Growth Fund

Quarterly report for the period ended

30 September 2011

## 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 June quarter.

## 2. The investment position of the Fund

The Fund's asset allocation is shown in Chart 1. Exposure to the equity market totalled 69.1% of the Fund, down from 70.7% in June. Bond exposure decreased 0.9% to 9.9% while offshore exposure increased from 17.4% to 21.0%. Cash represented 0.0% of the Fund, slightly less than in June (1.0%).

**Chart 1: Asset allocation at 30 September 2011**

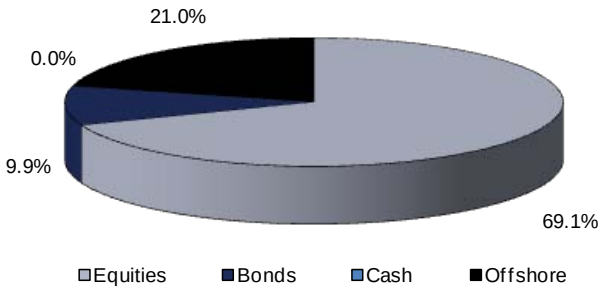
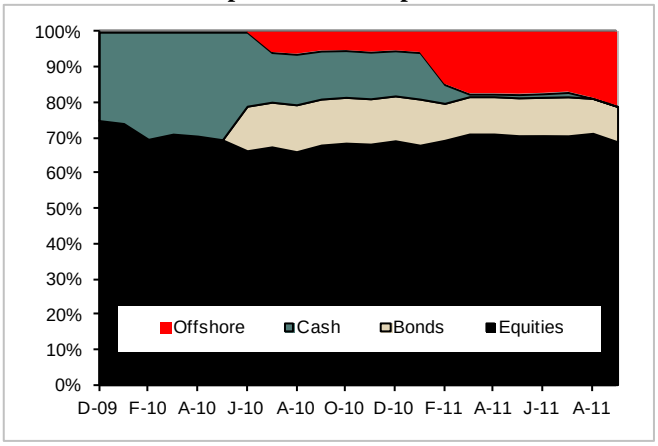



Chart 2 depicts the historical allocation to the major asset classes, expressed as a percentage of the total Fund.

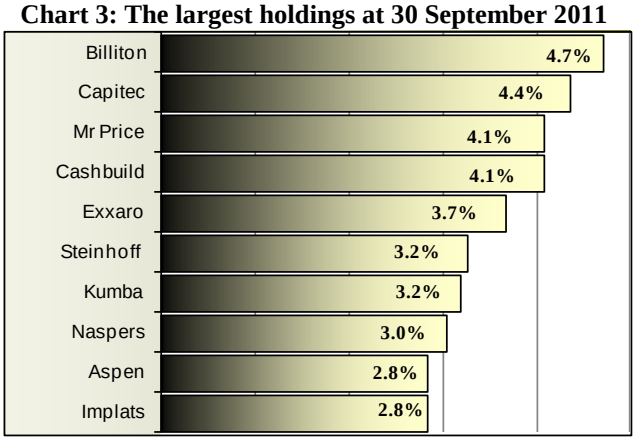
**Chart 2: Sector exposure at 30 September 2011**



## 3. The largest equity holdings

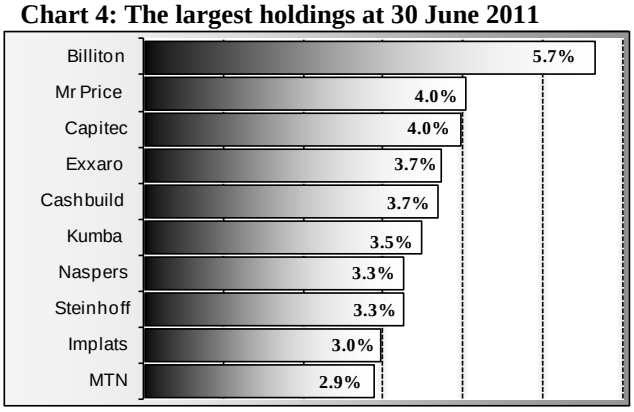
The largest holdings at 30 September are listed in Chart 3 expressed as a percentage of the Fund's equity portfolio.

**Chart 3: The largest holdings at 30 September 2011**




The largest holdings at the end of June are listed in Chart 4. Aspen displaced MTN in the top ten largest holdings during the quarter. The largest ten holdings constituted 36.0% of the Fund, down from 36.9% in June.

**Chart 4: The largest holdings at 30 June 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.

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.

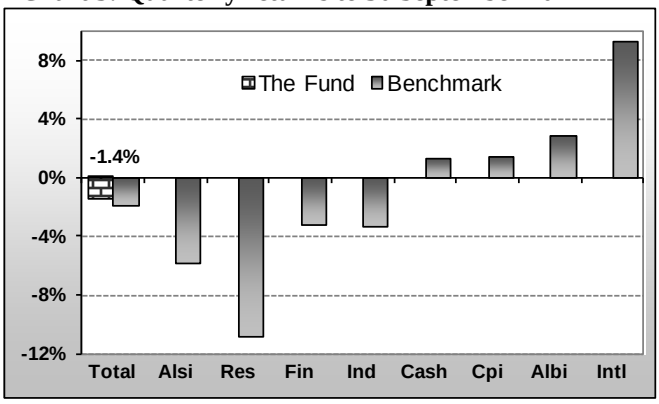
The salient features of the third quarter are discussed thought the document. A primary driver of the increased exposure to offshore markets was the devaluation of the rand during the month of September.

We however still believe that equities (domestic and global) will deliver superior returns, in relation to cash and bonds, over the medium to long-term. The Fund is currently positioned to ensure that it stands the best chance to meet its target of outpacing inflation by 7% over any three year rolling period.

## 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 September quarter was -1.4%*** which can be compared to the Maestro Growth Fund benchmark of -1.9%**.** Appendix A summarizes the major developments during the quarter for your convenience.

**Chart 5: Quarterly returns to 30 September 2011**

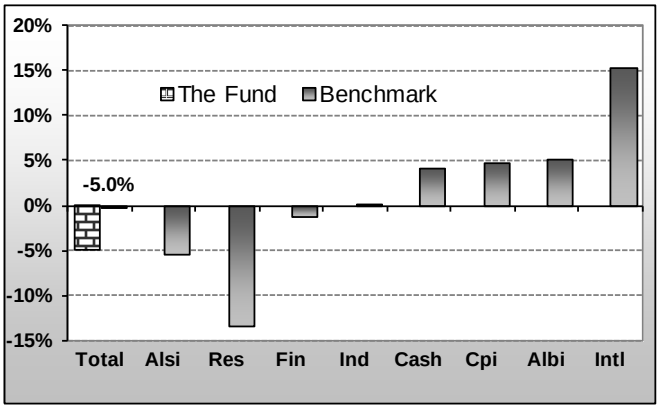



***The international component produced a rand return of 6.9%*** versus the 9.4% rise in the benchmark. The rand declined 15.7% during the quarter. ***The Fund's quarterly equity return of -4.7%*** can be compared to the Maestro equity benchmark and All share index returns of -5.1% and -5.8% respectively. We have commented extensively in recent letters and *Intermezzo* about the state of markets during the past few months and August and September in particular. You can see from the chart above that none of the major equity indices produced positive returns. In addition, despite the 15.7% decline in the rand dollar exchange rate the basic materials index led the decline, posting a 10.8% decline during the quarter. The financial and industrial indices declined 3.1% and 3.3% respectively. The weakness in the resource shares, which is very unusual given the history of their returns relative to a weak rand, shows to what extent global investors marked down basic material share prices in the light of a slowing economy and concerns about the latter's future. Globally, financials endured a tough quarter, particularly in Europe and the US; the modest decline in the local financial index should be seen in this light. The quarter was also unique in respect of the behaviour of the mid and small cap indices. In an

environment of heightened risk such as we had, one would have expected mid and small cap indices to severely underperform large caps. But this was not the case; the large cap index declined 6.6% during the quarter, due to the large weighting in resource shares, which we have already noted were sold down heavily, while the mid and small cap indices declined only 2.0% and 2.3% respectively. This vindicates Maestro's inherent favourable attitude towards mid and small caps.

The returns of the Fund's largest holdings during the quarter, excluding dividends received, were as follows: Billiton -19.2% (it declined 1.8% in the June quarter), Mr Price -1.3% (but up 11.4% in the June quarter), Cashbuild 8.6% (1.4%) and Naspers -8.1% (4.9%). In absolute terms other holdings across the equity portfolios under our management which disappointed included those in Investec, which fell 20.5% during the quarter; Anglo fell 17.9%, Digicore 15.7%, B&W 12.4% and Kumba 11.8%. Despite the weakness in equity markets - remember these returns are being measured against an All share index which declined 5.8% in rand terms and 20.6% in dollar terms during the quarter - a number of shares in the portfolio posted gains during the quarter. These included Aspen up 8.6%, Grindrod 7.6%, Capitec 6.1%, Coronation 3.6%, Blue Label 1.2% and Altech 1.1%.

**Chart 6: Year-to-date returns to 30 September 2011**

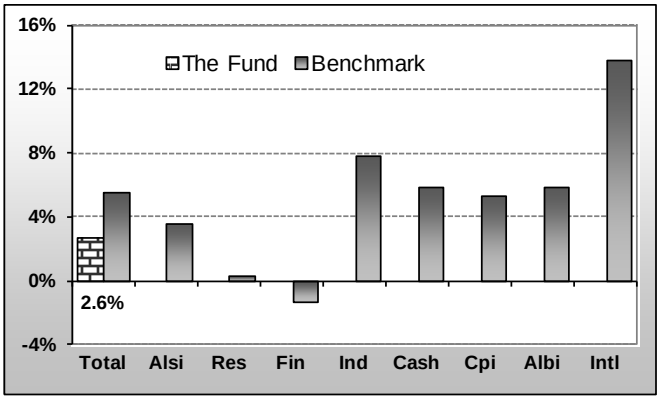



The year-to-date returns to end-September are depicted in Chart 6. It is clear that the year has not been very profitable so far. Global investment markets, with the exception of bond markets, have struggled to make progress in the face of increasing economic and policy uncertainty. At the time of writing no material progress has been made on these two fronts which make us believe that we are unlikely to experience a similar rally to the very large one experienced in the December quarter last year.

Before turning to the year-to-date returns, let me remind you that both the year-to-date and annual returns to end-September include the poor returns the Fund experienced in the first quarter of 2010. The reasons for the poor first quarter have been reported previously, but to recap, some large index constituents, such as Anglos, Amplats, Kumba, Richemont and SAB Miller, rose very strongly but were not held in the Fund's equity portfolio. The Fund thus underperformed the major indices in the first quarter; please bear this in mind when reviewing the returns for the year-to-date and the year to September.

***The un-annualised year-to-date return on the total Fund was -5.0% and*** can be compared to the benchmark which declined 0.27%. ***The international component produced a rand return of 10.7%*** although this is to a large extent a reflection of the rand's 17.7% decline against the dollar so far this year. ***The Fund's equity year-to-date return of -10.4%*** can be compared to the Maestro equity benchmark and All share index returns of -2.7% and -5.3% respectively. The strong negative effect of the basic material (resource) index is very evident from the chart; the basic materials index year-to-date return is -13.4% while the respective returns for the financial and industrial indices are -1.3% and 0.02%.

**Chart 7: Annual returns to 30 September 2011**




The annual returns to end-September are shown in Chart 7. The only difference between this chart and the previous one is that the very robust returns of the 2010 December quarter have been added; the All share index rose 9.5% during the December 2010 quarter. ***The annual return of the total Fund for the year to September was 2.6%*** which can be compared to the benchmark return of 5.5%. Inflation rose 5.3% during the year and the All bond index rose 5.9%. ***The Fund's international component produced a rand return of 19.9%*** versus the benchmark increase of 13.8%. In dollar terms the Fund *rose* 4.0% versus the 2.8% *decline* in the dollar benchmark. You can see from these returns that Central Park Global Balanced Fund has enjoyed a relatively good year in absolute and relative terms. The rand declined 13.3% against the dollar during the year.

***The Fund's equity annual return to end-September was -0.7%*** versus the Maestro equity benchmark and All share index returns of 4.4% and 3.6% respectively. The basic materials index rose 0.4% during the year to September and the industrial index rose 7.8%. The financial index declined 1.3%. Not shown in the chart are the respective annual returns of the large, mid and small cap indices of 3.6%, 3.2% and 5.4% respectively. The main detractors from the portfolios under Maestro's management during the year to September were B&W, which declined 40.2%, Metmar 24.3%, Investec 22.9%, City Lodge 20.7%, Blue Label 19.2%, Wilson Bayly 16.8% and Grindrod 10.7%. On a more positive note Kumba rose 17.6%, Mr Price 22.4%, Capitec 28.9%, Cashbuild 32.0%, Coronation 35.2% and Exxaro 41.6%. These returns exclude dividends i.e. the changes reflect only the share price movements.

## 6. Closing remarks

We ended the March Quarterly Report with the following comments:

> "Make no mistake; there is still a lot of risk around. To be honest we think *there are more risks around currently than there were at the beginning of the year* but nothing on the immediate horizon, at least in our opinion, detracts from our view that equity markets and the SA equity market in particular, should remain the asset class of choice and the vehicle for long-term capital growth. But as we said … *the ride will be bumpy* and there is little room for relaxation or complacency."

We are but two months away from 2012, so you can decide for yourself whether those comments were prescient or not. Sadly, for all the running we have been doing on the proverbial treadmill, not only have markets made little progress, but there is no greater clarity on the future. Indeed, we think there is less clarity now than at any time this year and so we must again warn you that *the ride will continue to be bumpy*.

We debate the outlook for the markets on a daily basis within our office. While our discussions will never influence market behaviour, through the process we learn more about the characteristics of the prevailing markets and some of the possibilities that might arise. One thing is certain and on this the whole Maestro team agrees: if – and it is a very big IF – policymakers can find a lasting solution to the current economic problems of over-indebtedness on the part of certain governments, and lay to rest investor fears and those of the public at large that policymakers actually grasp the gravity of the current problems and have the means to solve it, then the markets are quite capable of rising very sharply in a very short space of time. We call it the "elastic principle" which simply says that the more you pull on one side of an elastic whilst anchoring the other side, the greater the bounce-back when you let one end go. Rather simple, but you get the picture, I'm sure.

What lends credence to the possibility of a sharp "bounce" in markets is the fact that, by and large, the private corporate sector, but not necessarily the consumer sector, is in very good health. Cash balances at corporates around the world are at record levels and most quality companies are reporting reasonable results. So one half of the economic pie is tasty, but the other half isn't. And the pie is now only as good as its most inedible part. That's why supposedly "small" problems like the Greek debt crisis (after all Greece is hardly a leading industrialized nation) can poison the rest of the global economy. Only when policymakers realize that a coordinated policy response is required, will markets stop being so nervous. Only then will corporates begin to deploy their considerable cash resources. Sadly, the only evidence we see right now is that policymakers are getting more nationalistic and myopic than ever i.e. they are moving in the opposite direction, away from a sustainable solution.

So the global economy will continue to bump along at a slow pace and markets will continue to be nervous and volatile as we all wait – increasingly impatiently – either for policymakers to get their act together or for the "invisible hand of the economy" to work its magic. We accept that the latter option is more painful and a lot slower – right now we also think this scenario is the most likely one to develop.

But it is not all doom and gloom. Life goes on; we all go out and buy the proverbial margarine; we still drive around and buy goods and spend our money – all just at a slower rate. Consequently, there are still companies which are delivering good results and there are many opportunities in the markets at prevailing prices, which represent – at least in our opinion – good value. We continue to believe that during times like these investors should be looking for long-term *entry* points into equity markets, rather than *exit* points. The caveat emptor is that extreme caution needs to be exercised when managing assets in an environment such as the prevailing one, and in this regard we humbly submit we are ideally placed. It also calls for an approach which utilizes all the options available to us as investment managers, such as diversification, which we continue to recommend where we can.

We will consequently continue to manage your money with extreme caution and if we err, it will be on the side of caution. That does mean, however, that if someone "let go of the elastic" then we may lag the market returns for a short while. But that often proves to be a small price to pay for being cautious and trying to preserve capital as best we can.

Thank you so much for your ongoing support. These are tough times and we as a team are going through much the same as you – remember that much of our own money is invested alongside yours. Despite the volatility and short-term pain (it could have been, and could still get, much worse), our belief in the long-term benefits of investment as a means of wealth generation remains undimmed, particularly when using equity (shares) as the primary means of investment for this purpose.

You are more than welcome to call on us at any stage should you wish to discuss your investments with us in more detail.

David Pfaff
*On behalf of the Maestro team*
17 October 2011

## Appendix A

### A summary of market behaviour – September 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 September quarter. The returns of selected equity, bond, commodity and currency markets are shown in Tables 1 and 2.

**Table 1: Selected returns – equity markets**

| | June quarter (%) | Sept quarter (%) | 2011 Year to date | Year to Sept (%) |
|---|---|---|---|---|
| Japan | 0.6 | -11.4 | -14.9 | -7.1 |
| Hong Kong | -4.8 | -21.5 | -23.6 | -21.3 |
| Germany | 4.8 | -25.4 | -20.4 | -11.7 |
| UK | 0.6 | -13.7 | -13.1 | -7.6 |
| US (S&P500) and large cap | 0.2 | -13.7 | -8.4 | 1.6 |
| S&P Mid cap | -1.1 | -20.2 | -13.9 | -2.6 |
| S&P small cap | *-0.4* | *-20.1* | -14.5 | -0.9 |
| ***MSCI World index*** | ***-0.3*** | ***-17.1*** | ***-13.8*** | ***-6.4*** |
| Brazil | -9.0 | -16.2 | -24.5 | -24.6 |
| Russia | -6.7 | -29.7 | -24.2 | -11.1 |
| India | -3.1 | -12.7 | -19.8 | -18.0 |
| China | -5.7 | -14.6 | -16.0 | -11.2 |
| ***MSCI Emerging market index*** | ***-2.1*** | ***-23.2*** | ***-23.5*** | ***-18.1*** |
| ***JSE All share*** | ***-0.6*** | ***-5.8*** | ***-5.4*** | ***3.6*** |
| ***JSE All share ($)*** | ***-0.9*** | ***-20.6*** | ***-22.1*** | ***-10.1*** |
| Basic materials | -4.9 | -10.8 | -13.3 | 0.4 |
| Financial | 1.2 | -3.1 | -1.2 | -1.3 |
| Industrial | 3.7 | -3.3 | 0.02 | 7.8 |
| Gold mining | -13.0 | 19.5 | 6.1 | 12.7 |
| Large cap (Top40) | -1.3 | -6.6 | -5.8 | 3.6 |
| Mid cap index | 3.3 | -2.0 | -3.3 | 3.2 |
| Small cap index | 2.3 | -2.4 | -5.3 | 5.4 |

To refresh your memories as to how the June quarter ended, recall that concerns about the Greece sovereign debt crisis had weighed heavily on investment markets, but a mad surge in prices during the last four days of the quarter, in the naïve belief that a solution was in sight, "restored the quarterly returns to a false sense of respectability" as we said in July. It must now be clear that the hopes of investors were utterly misplaced. Risk aversion returned with a vengeance in the September quarter, caused largely by the same problems, with the exception that not only was the crisis of a European nature; the US politicians weighed in with more than their share of chaos. As in the June quarter, much of the chaos was a result of *unresolved* crises rather than *new* ones, leading to an overwhelming view within the investor community and the public at large, that policymakers and politicians simply do not appreciate the gravity of the prevailing economic crisis, and are either incapable or unwilling to resolve it, or both.

What followed in terms of market action was, with the benefit of hindsight, predictable. Assets and markets seen as "more risky" were severely and indiscriminately punished, while traditional "safe haven" assets benefitted. A notable feature of the quarter was that two traditional "safe haven" assets, the Swiss franc and gold, performed very poorly, bearing testimony to how unpredictable the investment environment was and how dysfunctional markets have become; we seem to have entered a dark and unprofitable period of market history yet again. Let us explore some of the features of certain asset class behaviour during the quarter - refer to Tables 1 and 2 as we progress through the discussion; it will assist you in understanding the respective forces at work.

**Table 2: Selected returns – bonds, commodities, currencies**

| | June quarter (%) | Sept quarter (%) | 2011 Year to date | Year to Sept (%) |
|---|---|---|---|---|
| SA All Bond index | 3.8 | 2.9 | 5.1 | -2.1 |
| SA Cash | 1.4 | 1.4 | 4.3 | 5.8 |
| Barcap Global Agg. Bond index | 3.1 | 1.0 | 5.4 | 4.0 |
| Emerging market bonds | 4.0 | -1.6 | 3.2 | 1.2 |
| US 10-year bond | 3.6 | 12.1 | 15.7 | 9.3 |
| US Corporate bond | 2.3 | 2.3 | 5.6 | 4.0 |
| US High yield bond | 1.0 | -6.3 | -1.7 | 1.3 |
| Cash (US dollar) | 0.0 | 0.0 | 0.05 | 0.1 |
| DJCS Hedge index | -0.2 | -4.6 | -3.0 | 1.5 |
| Brent (Oil) | -4.2 | -8.6 | 8.5 | 24.9 |
| Gold | 4.6 | 7.6 | 14.9 | 24.0 |
| Silver | -7.5 | -13.1 | -0.6 | 38.0 |
| Platinum | -2.9 | -12.3 | -13.9 | -9.1 |
| Palladium | -0.7 | -19.3 | -23.0 | 7.2 |
| Copper | -1.0 | -23.2 | -25.9 | -11.1 |
| Nickel | -11.4 | -21.0 | -26.7 | -21.5 |
| Baltic Dry index | -7.7 | 34.4 | 7.1 | -25.9 |
| CRB Commodity index | -5.9 | -11.9 | -7.6 | 3.9 |
| S&P GS Commodity index | -5.7 | -9.5 | -2.4 | 12.5 |
| Euro dollar | 2.2 | -7.5 | 0.0 | -1.7 |
| Sterling dollar | 0.2 | -3.0 | -0.5 | -1.1 |
| Swiss franc dollar | 8.7 | -7.3 | 2.6 | 7.6 |
| Rand dollar | -0.3 | -15.7 | -17.7 | -13.3 |

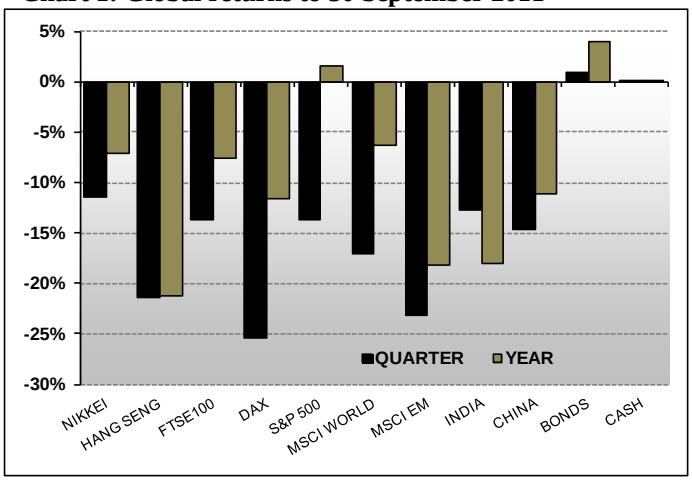
### Global investment markets

Chart 1 summarizes the quarterly and annual returns to 30 September 2011of the major equity, bonds and cash markets. While by no means comprehensive, the main features of the September quarter can be summarized as follows.

- *The downgrade of US debt by Standard and Poors (S&P) rating agency early in August*. We warned against it; many renowned analysts and economists

warned against it, rating agencies warned against it and markets, by virtue of their "internals" i.e. price action, risk measurements, volumes, etc, warned against it. Every Tom, Dick and Harry warned US politicians not to play silly games or party politics when dealing with their debt ceiling negotiations. But they did not listen; worse still, they engaged in a high risk strategy of one-upmanship, pushing investors' patience past breaking point. Their arrogance and lack of understanding of what was at stake is mind-boggling; the rest, as they say in the classics, is history.

**Chart 1: Global returns to 30 September 2011**




- *Weak equity markets*. The games played by US politicians were not the only cause of market weakness. The European debt crisis cannot be ignored. But the point is that the US folly was the final straw that broke the camel's back; it couldn't have come at a worse time. It represents a good example of how each nation is now scrambling to look after its own interests, when in reality the only solution is one of policy coordination i.e. only when global policymakers work together will they reach a meaningful solution to the current crisis. The reason I highlight the US politicians' actions is that it dashed, once and for all, any hope investors had for a resolution. Look at the charts of the equity markets and you will see that it was in early August, after the US debt ceiling deadline passed without a meaningful solution in place and S&P downgraded their debt, that the damage was done. Global equity markets were weak in July ahead of the US debt ceiling deadline, but the real damage occurred in August; Germany declined 19.2% in August alone, for example. The markets that had not suffered too much damage in August finally capitulated in September, bringing about a second wave of global equity weakness; so Germany declined another 4.9% but the MSCI World index fell 8.9% in September. An indication of how widespread the damage was is that virtually *every* major equity market declined in *every* month during the September quarter.
- *"Risk on, risk off"*. Many of you would by now be familiar with the notion of the "risk on, risk off" trade i.e. when investors turn negative ("risk off") so-called risky markets fall and those perceived to be safe, either rise or do not decline by as much. When investors believe that a solution is in sight ("risk on") more risky markets rise strongly and the safer ones lag. The September was, in its entirety, a "risk off" quarter, meaning that the perceived safe markets declined (the MSCI World index fell 17.1%) and those perceived as riskier declined *even more* (the MSCI Emerging market index fell 23.2%). I specifically say "perceived" and "so-called" because the jury is still out as to whether these movements are justified by the underlying fundamental features of the respective markets. We will only be in a position to assess the lasting outcome of this situation in the years to come.
- *The state of corporates versus sovereigns*. Another feature of the quarter was the growing disparity between the financial state of the **private** sector, which I refer to loosely as the *corporates* (the term excludes the consumer sector, which in many developed countries remains in dire straits), and the **public** sector i.e. the state of individual countries' finances. The private sector is, by and large, in very good health (cash held by US corporates, for example, is at a record level) while public sector finances, in fact we can narrow that down further to the public sector of *developed*, as opposed to *emerging* countries, is in a parlous state. It is ironic then, that equity markets, which reflect the prices of private sector corporates, took the most strain during the quarter. It is also true that investors continue to place their faith in the private sector because that is precisely where the strongest balance sheets are currently to be found.
- *No place to hide*. I have made this point earlier, but it is worth repeating that a unique feature of the quarter just passed was that, with the exception of certain bond markets and the dollar, *not one asset class or market registered a positive return*. Worse still, the quarterly declines were sufficient to push most year-to-date returns into negative territory as well. Look for example at the "September quarter" and "2011 year-to-date" columns on Tables 1 and 2, and at Chart 1, and you will see what I mean. The past quarter, and in fact the whole period since end-April, has been a case of there being "no place to hide".

You can see from the Chart 2 and the other charts depicting equity markets that the US equity market was sold down very heavily in early August. In all the charts I have used a vertical line to indicate where the quarter began. Although the markets ended the quarter on a weak note, the first week of October started on a strong note (see the bounce in the last few days on the charts).

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


Source: Saxo Bank

If you think the market action in the US was bad – refer again to Chart 2 – I humbly point out that the US equity market was one of the *better* performers during the quarter. Of the developed markets the German market (Chart 3) was one of the weakest, ending the quarter down 25.4%. Hong Kong lost 21.5% and the MSCI World index lost 17.1%.

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


Source: Saxo Bank

**Emerging markets** were also weak, with Bric markets leading the losses. Brazil closed down 16.2%, Russia 29.7%, India 12.7% and China 14.6%. The MSCI Emerging market index lost 23.2% and the JSE All share index lost 20.6% in dollar terms.

**Currency markets,** which have become increasingly volatile in recent months, remained very volatile. The prospects for the UK economy weighed heavily on sterling (Chart 4), with the Bank of England (BoE) caught in a tussle between slowing growth and rising inflation.

**Chart 4: The sterling dollar exchange rate**


Source: Saxo Bank

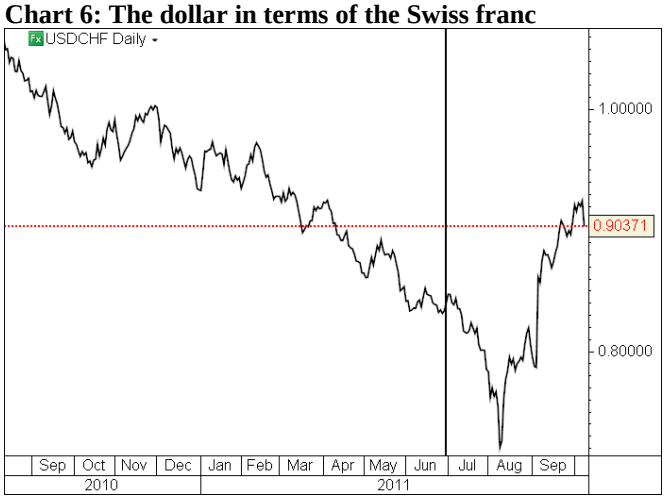
The Eurozone's problems are well known – refer to the euro dollar exchange rate in Chart 5. So it is not surprising to learn that both sterling and the euro were very weak, relative to the dollar, during the quarter. Just about all currencies were weak relative to the dollar as global investors flocked to the "default" currency in order to protect their assets from declining prices across all markets and asset classes.

**Chart 5: The euro dollar exchange rate**


Source: Saxo Bank

Last quarter we drew your attention to the rising value of the Swiss franc, noting the problems it was creating for Swiss exporters. The franc continued to rise throughout the quarter until early September when the Swiss National Bank (SNB) stepped in with huge intervention, by selling francs; refer to Chart 6. They committed the SNB to loosely preserving a rate of SFr1.20 to the euro. Pause for a moment to think what that means: a country previously fully committed to free market principles and with one of the strongest currencies in the world, consciously tying their currency to one of the weaker currencies in the world; a currency where many are questioning its very future! *That* is how dysfunctional global markets are at present.

**Chart 6: The dollar in terms of the Swiss franc**




Source: Saxo Bank

To provide insight into the consequences for investors of the SNB's move, consider the following. On 5 September our offshore mutual fund, **Central Park Global Balanced Fund**, held 7.7% of its assets in Swiss franc denominated assets. In addition we held 7.4% in euro denominated assets. However, because of the SNB actions overnight Central Park lost all of its Swiss franc exposure and now held 15.1% in euros – whether we wanted this exposure or not. This occurred because the SNB tied the value of the franc to the euro. That was the effect of the SNB's move – just think how that reverberated through global markets. In addition, Central Park lost one of its top performing safe haven assets, which had contributed substantially to the Fund's return in recent months. To describe it as annoying is an understatement.

**Chart 7: The Australian dollar versus the US dollar**


Source: Saxo Bank

Despite stronger underlying economies and higher rates of interest, which represent attractive yields for foreign investors, emerging market currencies were also sold down heavily in favour of ... you guessed it – the dollar. Chart 7 reflects the movement of the Aussie dollar against the US dollar. Other emerging currencies also found themselves up against very strong headwinds, despite the fact that little had changed in the respective underlying countries (with Russian being the exception, given the musical chairs being played by president and prime minister. But Russia is supported by the oil price, for which they should be very grateful!) The SA rand, the Brazilian real, the Indian rupee and the Russian rouble declined 15.7%, 16.2%, 8.7% and 13.4% respectively against the dollar during the quarter. While the declining rand might be rather painful, one can draw consolation from the fact that we were not alone in enduring the pain.

Moving on to **commodity markets**, it was to be expected that, in the face of a slowing global economy and a strong dollar, commodity markets would be under pressure. The returns are contained in Table 2, from which you will see that the declines were brutal, both during the quarter and now for the year-to-date. Only that perennial joker in the pack, the Baltic Dry index, which represents a miscellany of prices for shipping freight, posted an increase during the quarter. Base and industrial metals bore the brunt of the selling. What was not expected, at least not by everyone, was the correction in the gold price (Chart 8) at a time when investors expected the yellow metal to retain its value, given its popularity as a "safe haven". Given its 20% decline in a matter of days, one has to question the logic behind its safe haven status?

**Chart 8: The price of gold – scaling new heights**


Source: Saxo Bank

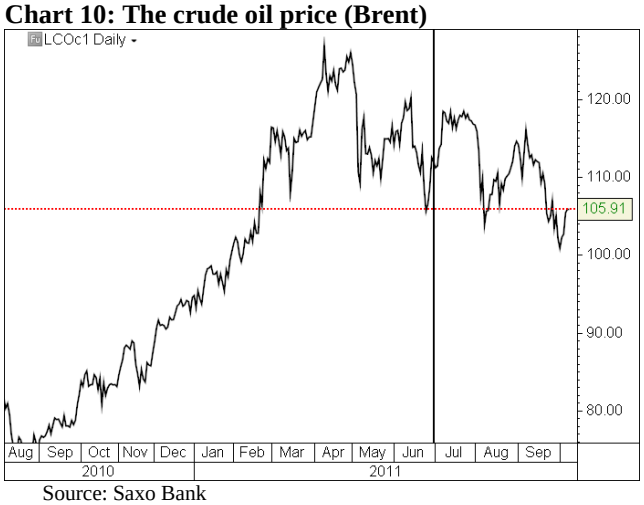
Despite its plunge in the March quarter, the silver price declined sharply yet again – refer to Chart 8. Widely known as the "poor man's gold", silver's plunges certainly made a number of investors a bit poorer during the past six months.

**Chart 9: The price of silver – making gold look boring**


Source: Saxo Bank

One of the intriguing movements during the quarter was that of oil (Chart 10). One would expect that the slowing global economy and strong dollar would have pulled the oil price lower. It did to some extent, but it is still up 8.5% on a year-to-date basis and has risen 24.9% over the past year. Within the Maestro office we regard this oil as the commodity "with a PhD in Global Economics" - a term we heard once and immediately appreciated its significance. What is significant about the oil price's movements is that it acts as a direct tax on consumer spending. Any movement has a direct and almost immediate effect on the consumer. So while the latter was granted some relief during the past quarter, the oil price remains quite a constraint on consumer spending – at least relative to this time last year. South Africa, in particular, is now very sensitive to a higher oil price, given how much the rand has weakened in recent months.

**Chart 10: The crude oil price (Brent)**




Source: Saxo Bank

Apart from the dollar, which was one of the few profitable "assets" during the September quarter, the bond market, more specifically the US bond market, was the only other major asset class to post positive returns during the quarter. From Table 2 you will see that the quarterly return of the 10-year US government bond was 12.1%, bringing its year-to-date return to 15.7%. Chart 11 shows the ETF that tracks long-term bonds (20+ years); see how sharply it increased as investor fears rose through the quarter. The returns are shown in price terms and not yield (interest rate) terms.

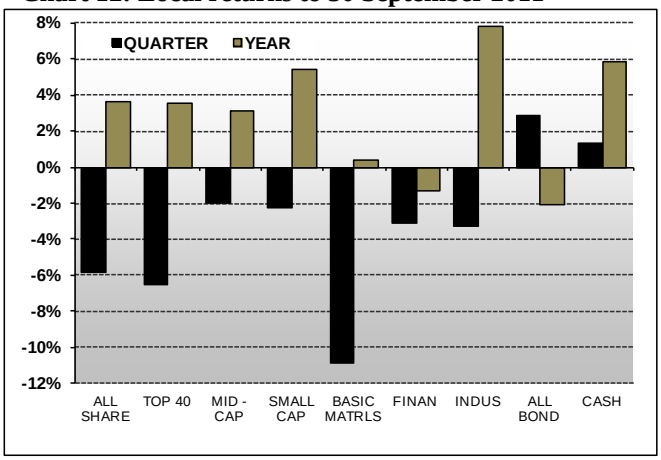
**Chart 11: iShares Barclays 20+ year Treasury Bond Fund**


Source: Saxo Bank

## Local investment markets

Turning to the South African investment markets, Chart 12 depicts the quarterly and annual gains in the major indices for period ended 30 September 2011.

**Chart 12: Local returns to 30 September 2011**




The same features that prevailed on global markets prevailed on local ones. However, because South Africa is regarded as an emerging market and a particularly liquid one at that – meaning that foreign investors can enter and exit it without too many constraints – global investors were quick to use it as a "risk off" candidate. Thus, as aversion towards risk grew during the quarter foreign investors began to exit our market, selling equities and bonds and reducing their exposure to South Africa, which they regard as a "higher risk". While this attitude is not too evident in the declines of the indices, if one converts the movements into dollar terms the carnage

becomes apparent. The All share index declined 5.8% in rand terms during the quarter, but by 20.6% in dollar terms. The other influential factor in the performance of the SA equity market was the fact that basic material shares declined sharply throughout the quarter, despite the rand's weakness, and around the world on the back of concerns that a slowing global economy would depress commodity prices and hence commodity companies' earnings. The basic materials index declined 10.8% in rand terms but a whopping 24.8% in dollar terms. That is a painful haircut in anyone's language! The quarterly mid and small cap *rand* returns were -2.0% and -2.4% respectively, and -17.3% and -17.6% in *dollar* terms. That can be compared to the respective US (S&P) mid and small cap returns of -20.2% and -20.1%.

**Chart 13: The JP Morgan emerging market bond ETF**


Source: Saxo Bank

The All bond index rose 2.9% in rand terms but declined 13.3% in dollar terms during the quarter. Compare that to the 1.0% global bond (Barcap Aggregate bond index) quarterly return and the -2.0% return of emerging market bonds (JP Morgan EMBI Global Core index). Chart 13 depicts the price of the JP Morgan emerging market bond (EMB) ETF, which tracks the JP Morgan EMBI Global Core index.

Perhaps the nastiest shock for our team during the quarter was the rapid decline in the rand dollar exchange rate – refer to Chart 14. You will be aware that it is Maestro's view that the rand will remain firm relative to the dollar. This view is predicated largely on the inherent problems in the US and developed economies, which is likely to keep interest rates there very low, and the fact that the SA economy and rand are to a large extent a function of emerging market growth and the commodity cycle; we have a positive long-term view of both of these. The relatively high rates (yields) offered in SA are likely to remain very attractive to foreign investors. The lesson we need to be reminded about, time and time again, is that during times of crisis, such as we experienced during the September quarter, all fundamentals get thrown out the window. Irrational behaviour simply takes over. Although it may sound silly, we are still of the humble view that if and when a sense of normality returns to the global investment environment, the rand will resume its firm trend. But for now let us record the 15.7% decline in the rand in dollar terms, bringing its annual return to -17.7%. You can see from Chart 14 that just about all of the weakness in the past year occurred during the September quarter.

**Chart 14: The rand dollar exchange rate**


Source: Saxo Bank

We continue to believe that the only appropriate way to arrive at a coherent view on the future of the rand is to look at the currency *in global terms*. Despite its warts South Africa can still hold its head high in terms of the issues currently troubling global investors, such as sovereign debt levels, political stability, inflationary expectations and the level of real interest rates. In the longer term it remains to be seen if this will hold true, but markets are incredibly myopic at present and are not focussing on anything long-term.

**Chart 15: The rand dollar exchange rate**

A long-term perspective – June 1994 to September 2011


Source: Saxo Bank

Last quarter we showed you some specific quarterly share price movements, both the best and the worst. Table 3 below is taken from the June Quarterly Report and can serve as a

reference for the information contained in Table 4. Note that in Table 4 the returns exclude any dividend payments and the forward PE ratios and dividend yields have been calculated at prices prevailing at the close of trade on 12 October 2011.

**Table 3: JSE winners and losers – six months to June**

| | YTD return (%) | Forward PE ratio (times) | Forward Div Yield (%) |
|---|---|---|---|
| B&W | -30.4 | 3.2 | 3.4 |
| Blue Label | -28.6 | 8.4 | 4.0 |
| Grindrod | -26.4 | 10.5 | 3.1 |
| Metmar | -25.5 | 13.2 | 3.6 |
| Implats | -21.8 | 9.2 | 4.0 |
| Wilson Bayly | -20.9 | 7.3 | 3.0 |
| City Lodge | -19.5 | 16.9 | 4.0 |
| Altech | -11.4 | 10.2 | 6.2 |
| Abil | -11.2 | 11.6 | 6.0 |
| ***All share index*** | ***0.51*** | ***10.1*** | ***3.4*** |
| Exxaro | 31.0 | 8.2 | 4.2 |
| Kumba Iron Ore | 14.0 | 9.3 | 8.3 |
| MTN | 7.1 | 13.0 | 4.7 |
| Capitec | 5.5 | 18.7 | 2.0 |
| Sasol | 2.8 | 8.7 | 3.8 |
| Mr Price | 2.6 | 14.3 | 4.3 |

The point we would highlight is that, partly as a result of the share price declines and partly due to good results from many of the companies in which you are invested, more value can now be found in the equity market. We are of the humble opinion that long-term investors should be giving serious consideration to entering the market and not leaving it. We will be the first to recognize the above-average levels of risk in the current environment, but we are also conscious that the world is not about to end, neither will the equity market collapse in a heap. In many instance the after-tax income returns on many top quality companies exceed, by some margin, the after-tax returns on cash.

**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 to our clients.

That said, it is worth repeating what we said last quarter in the conclusion to our June Report.

> "We would, however, be failing in our duty were we not to warn investors that there are indeed dark clouds on the economic horizon ... So it is appropriate to ... affirm our belief in equity investment as the primary means to achieve long-term capital growth. It is true that there are a lot of risks prevalent in the environment but it is equally true that any attempt to time the market i.e. to wait until it is 'at the bottom' before beginning to invest in it, is a fool's game and is accompanied only by luck, or in the absence of luck, very poor returns. We don't subscribe to either, so prefer to stick to the fact that investment in the equity market has, over time, protected investors against rising inflation and has generally proved to be an excellent way to generate wealth, provided a disciplined approach is adopted when investing.
>
> We see no reason why this should not continue into the future, despite the clouds on the short-term horizon".

**Table 4: JSE winners and losers – nine months to Sept**

| | June quarter return (%) | Sept quarter return (%) | Forward PE ratio (times) | Forward Div Yield (%) |
|---|---|---|---|---|
| Investec Bank | 4.7 | -20.5 | 7.4 | 5.6 |
| Billiton | -1.8 | -19.2 | 6.0 | 3.8 |
| Richemont* | 11.2 | -18.2 | 14.7 | 1.4 |
| Anglo | -4.8 | -17.9 | 7.1 | 1.9 |
| Digicore | 27.3 | -15.7 | 9.9 | 2.9 |
| B&W | 2.4 | -12.6 | 7.8 | 0.0 |
| Kumba Iron Ore | 1.3 | -11.8 | 8.2 | 8.7 |
| Metmar | -17.1 | -11.0 | 6.1 | 5.6 |
| Implats | -6.9 | -9.9 | 13.7 | 3.6 |
| Naspers | 4.9 | -8.1 | 15.6 | 1.1 |
| MTN | 5.4 | -7.9 | 12.4 | 5.3 |
| ***All share index*** | ***-0.6*** | ***-5.8*** | ***9.2*** | ***3.9*** |
| Aspen | 6.3 | 8.6 | 13.5 | 1.5 |
| Cashbuild | 1.4 | 8.6 | 10.2 | 4.5 |
| Grindrod | -5.9 | 7.6 | 11.3 | 2.9 |
| Central Park A ** | -0.2 | 6.9 | N/M | 0.0 |
| SAB Miller* | 1.0 | 6.4 | 14.6 | 3.0 |
| Capitec | 7.7 | 6.1 | 19.6 | 2.0 |
| Coronation | 8.4 | 3.6 | 12.5 | 7.2 |

* *Not part of Maestro's equity portfolio*
** *In rand terms*

Thank you, as always, for your support and continued belief in Maestro's ability to look after the assets you have entrusted to us. In times such as these, we are more grateful than ever for your support.

The Maestro Investment Team
13 October 2011

*Units in linked insurance policies should be considered as medium to long-term investments. The value of units may go up as well as down and past performance is not necessarily a guide to future performance. Unit prices are calculated on a net asset basis, which is the total value of all the assets in the portfolio including any income accruals and less any permissible deductions (Brokerage, Securities Transfer Tax, VAT, Auditor's fees, Bank Charges, Custodian fees and the annual Management fee) from the portfolio divided by the number of units in issue. Fluctuations or movements in exchange rates may cause the value of any underlying international investments to go up and down. Forward pricing is used. Maestro Investment Management (Pty) Limited and Prescient Life Limited are members of the Association for Savings and Investments of South Africa (ASISA).*