

OAM Local Income Portfolios

ZAR Rand

NOV 2011

Introduction

Overberg Asset Management specializes in the management of individual portfolios, tailored to the investment objectives of each client. As an independent company, Overberg can set objective standards in its selection of investments. Your portfolio will be in the safe custody of Investec stockbrokers, and managed from here. We produce customised statements and investment reports to specific requirements. Constant availability and a quick and flexible response are fundamental to our client relationships.

Technical Details

- FSB approved
- Base currency: South African Rands
- Minimum investment: R500,000
- Benchmark: **JSE AllShare (40%) and ALBI 1-3 yr Return Bond Index (60%)**
- Asset Allocation: **flexible mix of equities, bonds and cash**

Investment Objectives:

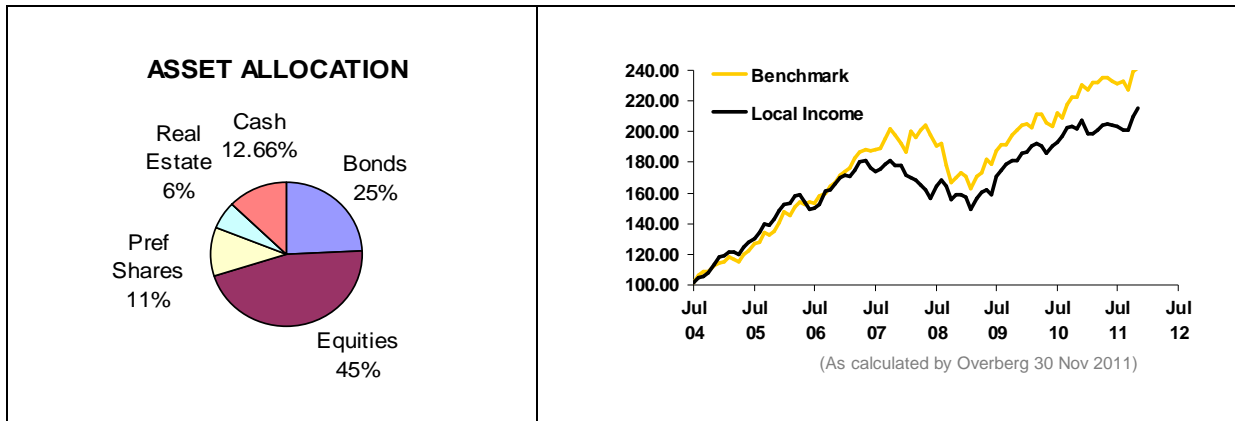
- conservative growth with income
- consistent annual returns
- low volatility

	Local %	Benchmark %
Annualised Total Return	10.89	12.63
2004 (July – December)	18.33	14.20
2005	25.71	23.16
2006	14.50	21.94
2007	4.40	12.27
2008	-10.60	-9.99
2009	16.80	18.00
2010	11.73	12.70
YTD	3.74	4.86

*Since July 2004: All performance figures include income and are net of fees and expenses

Growth 2011	Local %	Benchmark %
January	-4.09	-1.53
February	-0.31	2.14
March	1.25	0.13
April	1.66	1.51
May	0.35	-0.16
June	-0.45	-0.93
July	-0.31	-0.63
August	-1.31	0.69
September	0.03	-2.39
October	4.58	5.28
November	2.51	0.87

	%
Annualised Income Yield	6.70



Commentary

The economy expanded 1.3% quarter on quarter annualized in the 3rd quarter, down from 1.4% in the 2nd quarter and well below the 1.8% consensus forecast. Mining production shrank 17.4% in the quarter capping a 3rd successive quarter of contraction. Manufacturing output shrank 1.9%, although an improvement from the 8.8% decline in the 2nd quarter, and agricultural production fell 4.3%. The bright spots in the economy were the financial services sector with growth accelerating from 2.7% to 4.5%, and retail and wholesale sales accelerating from 5.2% to 6.1%.

With the exception of retail sales, data continues to be lackluster. Vehicle sales lost momentum in October, with growth slowing to 18.9% on the year from 30% in September. On a monthly basis, total new vehicle sales dropped 3.7%. Private Sector Credit Extension (PSCE) slowed in September to 5.47% on the year from 6.06% in August and less than the expected 5.9%, attributed to a combination of slowing income growth, high personal indebtedness, and a slow jobs market. Mortgage advances, the biggest component of household borrowing slowed from an annual rate of 1.4% to 1.2%, the lowest since the current data series began in 2003. Corporate borrowing slowed from 7% in August to 5.8%, attributed to low levels of both business confidence and capacity utilization.

Confidence indicators signal a weakening outlook. The Bureau for Economic Research business confidence index decreased slightly from 39 in the 2nd quarter to 38 in the 3rd quarter, well below the neutral 50 level. While not necessarily signalling an imminent recession the data suggests a continuation of only modest growth. The SA Chamber of Commerce business confidence index fell from 98.4 in September to 97.5 in October, the 4th monthly drop in a row and to the lowest level since May 2010. The decline is attributed to the eurozone sovereign debt crisis and sluggish global economic growth, adding to uncertainty in SA's business environment.

Consumer price inflation (CPI) reached 6.0% in October. However, food and fuel prices were the key culprits contributing 0.3% and 0.2% to the 0.5% monthly increase. Core CPI excluding volatile food and energy components, remained unchanged at 3.8% on the year indicating there are few other inflationary pressures in the economy. The Reserve Bank (SARB) expects CPI to exceed the 6% target ceiling for longer than previously expected, from the 4th quarter of this year until the 3rd quarter of 2012 while peaking at 6.3% in the 1st quarter 2012. However, interest rates are unlikely to be increased given the weak domestic and global economic growth outlook, and the "cost-push" nature of current inflationary pressure, which is beyond the influence of monetary policy.

In fact, the Organisation for Economic Cooperation and Development (OECD) reported scope for further cuts in the repo rate if SA's economy weakened further, in spite of current inflationary pressure. The OECD points out that underlying inflation excluding more volatile food and energy prices, is "well anchored" within the target range. It also highlighted the "negative output gap" between actual and potential economic output. While acknowledging that the eurozone sovereign debt crisis poses a key risk to growth, the OECD nonetheless forecasts SA economic growth of 3.2% this year, well ahead of most economies. It forecasts 3.4% growth in 2012 accelerating to 4.7% in 2013, above the Treasury's 4.1% forecast.

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Since the start of October the rand has broken away from its normal close correlation with other emerging market currencies, weakening by more than predicted by the MSCI Emerging Market equity index. The decoupling is attributed to recent SA specific events, including the lowering by Moody's of SA's sovereign credit rating outlook and parliament's vote in favour of the State secrecy bill. While the rand's 22% decline against the US dollar since the start of the year might be expected given the increase in global risk aversion, similar declines against the Aussie dollar and Brazilian real are indicative of SA specific selling.

More encouragingly, the Medium-Term Budget Policy Statement (MTBPS) was well received by financial markets, exhibiting strong fiscal prudence. Finance Minister Pravin Gordhan plans to reduce the increase in public sector expenditure to just 2.3% per annum over the next 3 years. This is below the economic growth rate, which implies a shrinking budget deficit over the longer term. The public sector borrowing requirement (PSBR) for this year is budgeted at 8.1% of GDP, down from 9.5% in February, while the longer-term PSBR is forecast at 5% of GDP in 2014/2015 from a previous 6.3%. In further positive news, the government unveiled the National Development Plan (NDP) which differs from the New Growth Path launched last year, by emphasizing the need for more flexibility in labour laws. Notably, the NDP also stresses the need to provide clear certainty over property rights, tax treatment and mineral rights in the mining sector.