overberg asset management

LOCAL PERFORMANCE FACTSHEET

OAM Local Balanced Portfolio

Technical Details

2019 Q3

- Base currency: **South African Rands**
- Benchmark: 30% **JSE All Share, 70% ALBI 1-3yr (2004 - 2018)**
  50% JSE All Share, 20% ALBI 1-3y, 20% SAPY, 10% JSET (2019-)
- Asset Allocation: **Flexible mix of equities, bonds and cash**
- Individual portfolio representing Local Growth investment style
- All performance figures include income and are net of fees and expenses

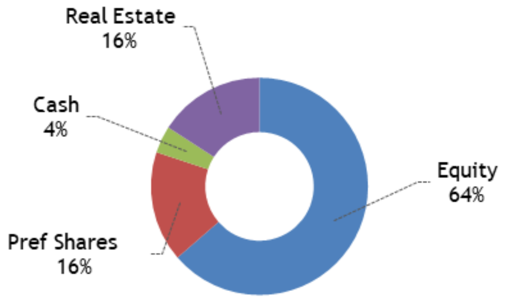
Investment Objective

- Conservative growth
- Consistent annual returns
- Low volatility

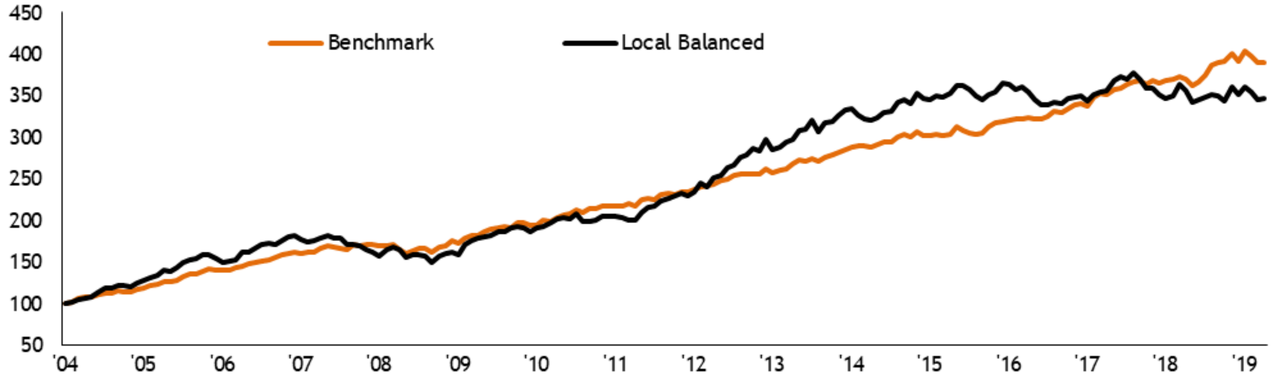
Annualised Growth (%)	OAM	Benchmark
Inception 2004	**8.50**	**9.33**
10 years	6.88	7.90
7 years	4.37	6.92
5 years	1.63	6.27
3 years	-0.60	6.33
2019 YTD not annualised	-0.11	4.12

Annualised Income Yield	2.81%

ASSET ALLOCATION
(see through basis)



Top 5 Holdings	
RMB HOLDINGS LTD	
ANGLOGOLD ASHANTI LTD	
DISCOVERY LTD	
STOR-AGE PROP REIT LTD	
TRANSACTION CAPITAL LTD	
Total number of holdings	29



Local Market Review and Strategy Outlook

The JSE, the rand and the bond market all suffered in the third quarter (Q3) under the weight of weakening global markets and a deteriorating outlook for domestic demand. The JSE All Share Index lost 5.32% in Q3 trimming its year-to-date (YTD) return to just 3.41%. The Industrial 25 and Resources 20 indices also suffered Q3 losses of 4.57% and 5.82% but held onto YTD gains of 7.77% and 6.48%, while the Financial 15 Index fared worst of all, losing 7.62% in Q3 and 6.26% YTD. While long-dated bonds weakened in line with the deteriorating finances of State-Owned Enterprises, especially Eskom, short-dated bonds provided some refuge. The All-Bond 1-3 Year Total Return Index gained 1.18% in Q3 and 5.83% YTD. The rand weakened versus the US dollar by 7.62% in Q3, resulting in a YTD depreciation of 6.26%. Gold continued to fare well, helped by the growing tide of negative global bond yields and the US/China trade war, which lifted the dollar gold price by 7.55% in Q3 and a substantial 16.85% YTD.

The South African economy rebounded in Q2. Gross Domestic Product (GDP) grew by 3.1% quarter-on-quarter annualised. The biggest contributors were mining (up by 14.4%), finance, real estate and business services (4.1%), trade, catering and accommodation (3.9%) and general government services (3.4%). The positive reading means that South Africa avoided a technical recession, which is defined as two consecutive quarters of negative GDP growth. A bright spot was the 6.1% increase in gross fixed capital formation (GFCF) following 5 consecutive negative quarters. GFCF is an indication of the physical investment back into the economy. The main contributors to GFCF were an increase in machinery and equipment, transport equipment and residential buildings. Imports of machinery and equipment, mineral products and chemical products were the biggest contributors to the imports of goods and services, which increased by 18.8%. Private consumption expenditure also increased by 2.8%. Worryingly, the agriculture and construction industries declined by 4.2% and 1.6% respectively.

Despite the quarterly rebound in GDP, South Africa's unemployment jumped to an 11-year high of 29% in Q2. The last time unemployment was this high was in Q1 2008 and the only time unemployment has ever been higher was in March 2003 when it reached 29.3%. The expanded unemployment figure, taking people into account who are not economically active, increased to a bewildering 38.5%. As expected, the informal sector recording the largest employment gains, of 114 000. The agriculture sector followed with 5 000, while the formal sector and private households each suffered net job losses of 49 000.

Both the SACCI and BER Business Confidence Indices plummeted to multidecade lows in August and Q3, respectively, with executives extremely downbeat about prevailing business conditions. The SACCI Business Confidence Index fell to 89.1 points in August, from 92 points in July. The index is now at its lowest level since April 1985, when it fell to 88.1. The BER Business Confidence Index slumped to a 20-year low of 21 index points in 3Q, from 28 in 2Q, implying that eight of every ten respondents are unsatisfied with the current business environment. Of the five sectors making up the BCI, four recorded a quarter-on-quarter drop with only one recording an increase, namely the motor trade. Nevertheless, all the sectors are below the 30-point level, which reflects depressed business conditions.

The ABSA Manufacturing Purchasing Managers Index (PMI) corroborated the weak confidence survey data, falling in September from 44.7 to 41.6 its lowest in a decade and more than 10 points below its recent high of 52.1 points reached in July. Readings below the neutral 50-level indicate contraction. The Standard Bank Composite PMI, which measures economy-wide private sector business performance, recorded its fifth straight contractionary sub-50 reading in September, falling from 49.7 to 49.2.

Business confidence is usually a precursor to gross fixed capital formation growth. The fact that we are in Q3 already, with confidence levels continuing to deteriorate, tells us that investment growth will likely remain weak, or contract further in Q1 2020. This is in stark contrast to Moody's, which believes growth will likely rebound strongly, underpinning its positive credit ratings view. The credit rating agency stated that there is a low likelihood of a rating downgrade because of its stable outlook for the country, which bodes well for the rand and strengthens the case for the Reserve Bank to lower interest rates. Moody's is the only ratings agency that still has South Africa on an investment grade rating. While citing policy uncertainty, slow implementation of structural reforms and a worsening global economy, Moody's praised the restored credibility of accountable institutions, including the South African Revenue Service and National Prosecuting Authority. Moody's is confident that South Africa's institutions are still very strong, have overcome corruption, and will likely implement the various reforms that are needed to boost growth.

In July, the Reserve Bank cut the repo interest rate by 25 basis points, from 6.75% to 6.5%, the first rate cut since March 2018. The interest rate cut was motivated by slow local growth, subdued inflation, a potential slowdown in global economic growth and concerted monetary easing by the world's major central banks and across emerging market economies. Consumer price inflation edged higher in August to 4.3% year-on-year, from 4.0% in July, while core inflation gained from 4.2% to 4.3%. While inflation remains benign, it is forecast to rise marginally in 2020, due to the low base effect in the current year. For now, however, the outlook for inflation remains on track to achieve the Reserve Bank's 4.5% target this year and over the long run as well. Producer price inflation has continued to decelerate, falling in August to 4.5% on the year from 4.9% previously. This follows the global trend of falling input costs and a decline in commodity and raw material prices. Given the recent downside surprise in producer price inflation and below target consumer price inflation readings, as well as prospects for a stable rand, we believe the Reserve Bank will likely reduce the repo rate by a further 25 basis points in November.

Globally, central banks are once again injecting liquidity into the financial system, led by a surge in liquidity injections by the People's Bank of China since May and more recently a pick-up in liquidity injection by the US Federal Reserve. The European Central Bank is expected to follow suit from November onwards. Increased central bank liquidity is positive for financial markets and particularly for risk assets, such as emerging market bonds and equities. In such circumstances, emerging market currencies would be expected to outperform. As the most liquid emerging market currency, the rand is expected to benefit from the recovery in global central bank liquidity. Despite rising global trade uncertainty and the pressure of rising deficit spending on South Africa's fiscus, the rand has been relatively stable since the start of the year. Prospects for a stable rand are boosted further by the US Federal Reserve's interest rate cutting cycle, which invariably leads to a weaker US Dollar and a firming in emerging market currencies. Historically, emerging markets have outperformed their developed market peers during periods of dollar weakness. What is positive for global markets tends to be positive for the South African market. Lower global rates along with benign inflation expectations affords the Reserve Bank the opportunity to cut interest rates and give the South African economy a much-needed boost.

Alongside prospects for a stable rand and lower interest rates, Finance Minister Tito Mboweni offered renewed hope for the economy with the Treasury's Economic Plan. The Economic Plan clearly acknowledges that inflexible labour laws and regulatory red tape are handbrakes to the economy, especially for small, medium and micro-sized enterprises (SMMEs), which are the greatest source of employment growth. The Treasury understands that SMMEs should be given red carpet treatment, not red tape, "An overly onerous regulatory environment can reduce the rate of entrepreneurial activity and business ownership." Despite privatisation being anathema to many within the

ANC, the Treasury bluntly includes privatisation as a solution to Eskom's dire situation. It is understood that the private sector should play a vital economic role. Tourism and agriculture are identified as key sectors for growth due to their vast potential, low barriers to entry and the capacity for employment of unskilled labour. The report argues for the need to reform tribal land, urging for people with informal or communal land rights to be awarded title deeds. The beleaguered construction and building materials sector should take solace from the proposed push for "Deepening regional industrialisation through construction" and the need for infrastructure spending. The Treasury's Economic Plan will meet stiff resistance from the trade unions and ANC factions opposed to president Ramaphosa. Yet, every day that Ramaphosa cements his authority makes implementation of the Economic Plan less far-fetched. Despite the bleak daily headlines which appear to indicate the opposite, Ramaphosa's popularity and authority are gaining.

The South African economy appears to be lurching steadily weaker, defying the hope and optimism which accompanied Cyril Ramaphosa's election as the country's president in February 2018. Economic data, including GDP measures, business confidence, investor sentiment, bond yield spreads and equity market ratings, are all at historically low levels. GDP grew in Q2 by 1% year-on-year, which means the country narrowly escaped recession. However, in nominal terms, the year-on-year GDP growth was just 4.4%, its slowest nominal growth since the early 1960s. The lack of investor confidence is reflected in the high bond spreads between 10-year South African gilts and equivalent local currency bonds in other countries, exceeding the average developed market rate (excluding the US) and average emerging market rate by the most since 2004. The JSE All Share Index has returned just 11.18% over the past five years or 2.25% on an annualised basis. It is the first time since 1970 that the 5-year return has been exceeded by the cash deposit rate, which hovers above the Reserve Bank's repo rate, currently at 6.50%.

There were great hopes for meaningful economic structural reforms after Ramaphosa's CR17 campaign prevailed at the ANC National Elective Conference in December 2017. It is now 20 months later, with a strong boost from a resounding victory at the National Elections in May 2019, and yet there is little in the way of meaningful structural reforms. Instead, business, household and investor sentiment has been rattled by anxiety over ill-advised policy initiatives, including expropriation of land without compensation, the National Health Insurance Bill, the National Credit Amendment Act and the threat of forced prescribed asset investments. It is no wonder that confidence is at a low ebb. However, a credible catalyst will spark a considerable rebound. Confidence boosting structural economic reforms will provide the required catalyst.

The fightback against Ramaphosa's policy and structural reforms were always going to be tough. However, he is gaining ground and his recent endorsement of the Treasury's Economic Plan is extremely encouraging. It is from points of maximum pessimism and low valuations that equity markets provide the best returns. Following years of weak performance, the JSE is now trading at extremely cheap valuations, on an estimated forward price-earnings multiple of 13.5x, well below its long-term average of 15.5x and levels of above 20x as recently as two years ago. With prospects for a stable rand, falling interest rates, improvement in the state's anti-corruption and broader governance credibility, and the implementation of the Economic Plan, the JSE is likely to enjoy a long overdue rebound in the year ahead. Given the starting point of such attractive valuations, the rebound is expected to be substantial, especially among the domestically focused SA-Inc shares.