overberg
asset management

LOCAL PERFORMANCE FACTSHEET

OAM Local Balanced Portfolio

Technical Details

2019 Q4

- 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, real estate holdings, preference loan stock and cash**
- Individual portfolio representing Local Growth investment style
- All performance figures include income and are net of fees and expenses

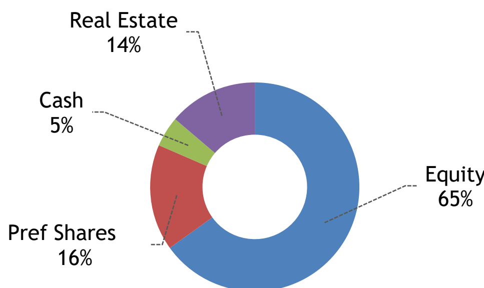
Investment Objective

- Conservative growth
- Consistent annual returns
- Low volatility

Annualised Growth (%)	OAM	Benchmark
Inception 2004	8.54	9.38
10 years	6.73	7.73
7 years	4.20	6.79
5 years	1.46	6.46
3 years	1.75	7.30
2019 YTD not annualised	2.48	7.25

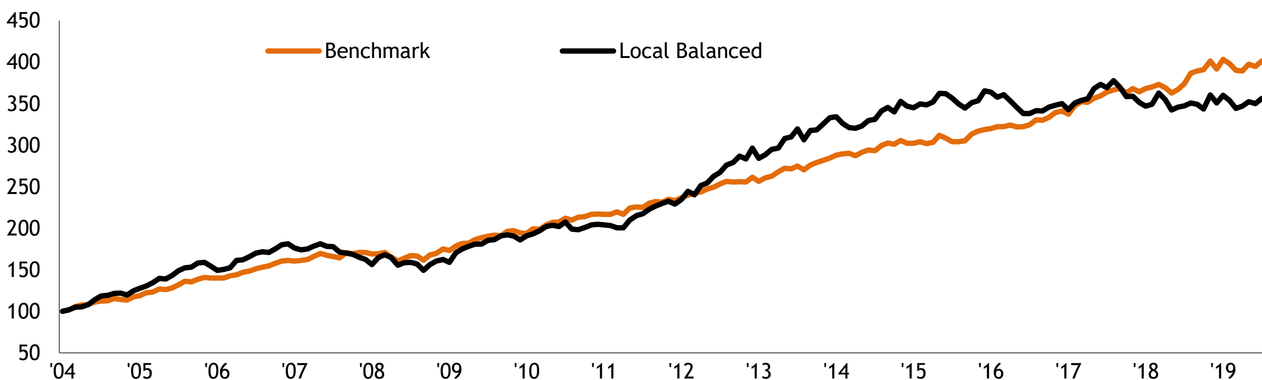
Annualised Income Yield	2.81%

ASSET ALLOCATION
(see through basis)



Top 5 Holdings
ANGLOGOLD ASHANTI LTD
RMB HOLDINGS LTD
STOR-AGE PROP REIT LTD
TRANSACTION CAPITAL LTD
PSG FINANCIAL SERV PREF

Total number of holdings	26



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Local Market Review and Strategy Outlook

Following a dismal third quarter (Q3), South African equity markets were boosted in Q4 by a resumption in global risk appetite, which despite continued delays in domestic structural reforms, pushed local markets higher over the quarter. The JSE All Share Index gained 4.12% in Q4, lifting its overall gains in 2019 to 8.24%. Helped by signs of a global economic recovery and strengthening international commodity prices, the Resources 20 Index was the outperformer over the quarter with a solid gain of 13.32% capping a winning 2019 return of 20.01%. The other sectors were less fortunate. The Financial 15 Index only gained 1.67% over the final quarter and lost 4.30% over the full year, while the Industrial 25 Index, with the assistance of large multinational dual-listed stocks, managed to post a 2019 return of 8.82% although over Q4 lost 0.49%. Emerging market currencies benefitted from the recovery in global risk appetite, which notwithstanding South Africa's deteriorating fiscal position, boosted the rand, which gained by 2.92% versus the dollar in Q4 and by a full 17.67% in 2019. The All-Bond 1-3 Year Total Return Index gained 1.56% in Q4 and 7.48% in 2019. A worldwide prevalence of negative yielding bonds and prescribed negative interest rates reduced the opportunity cost of holding gold, which supported a solid dollar gold price increase of 2.92% in Q4 and a 17.67% increase for the year.

Gross Domestic Product (GDP) contracted sharply in Q3. After rebounding by 3.2% quarter-on-quarter in Q2, following a 3.1% contraction in Q1, the economy contracted by 0.6%. The weakness was widespread, with six out of the ten sectors contracting. Mining production fell 6.1% in the quarter, manufacturing was down 3.9% while agriculture contracted by 3.6%. South Africa's trade, catering and accommodation sector, meanwhile, grew by 2.6%, helped by growth in wholesale trade. Output from finance, real estate and business services increased by 1.6%, while general government services increased by 2.4%. Encouragingly, gross fixed investment spending increased 4.5%, supported by imports of machinery and computer equipment. This is the first time since 2015 that the category has risen for two consecutive quarters, which suggests a growing willingness by firms to invest. While economic activity in South Africa is increasingly volatile, the trend of progressively weaker growth is clear. South Africa's economy has frequently bounced between expansion and contraction in recent years. Nevertheless, the last time South Africa posted four straight quarters of growth was in 2013. In order to achieve the expected target of 0.5% GDP growth in 2019, the economy would be required to grow by a substantial 3.2% in Q4 2019.

The latest Quarterly Labour Force Survey was equally disappointing. The official unemployment rate in Q3 increased to an 11-year high of 29.1% as construction, utilities and transport sectors shed jobs. Although employment in the agriculture and mining sectors increased by 4.5% and 9.9% quarter-on-quarter, total employment was unchanged on an annual basis, while the number of unemployed individuals and discouraged work-seekers increased by 8.4% and 2.2% year-on-year. Insufficient economic growth continues to be the biggest reason for the continued high unemployment rate. South Africa's annual economic growth rate has remained stubbornly below 2% since 2013. The lack of employment has also added to social tensions, which erodes business confidence and further dents the country's status as an investment destination.

Survey data measuring business, investment and consumer confidence, all mirror the weak economic environment. Consumer confidence, measured by the FNB/BER Consumer Confidence Index, remained unchanged in Q4 from its Q3 level of -7, its first negative reading since Q4 2017, when sentiment was affected by who would succeed Jacob Zuma as leader of the ANC. Consumer sentiment initially rocketed to a historic high of +26 at the height of "Ramaphoria" in Q1 2018. The latest data confirms the absence of consumers' willingness to spend, which combined with weak income growth, could weigh on total consumer spending. With household consumption making up about 60% of GDP,

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the decline in confidence could further weigh on economic growth. Household budgets are increasingly strained by rising unemployment, slow wage growth, high tax rates, and soaring electricity prices. Consumers are delaying high-value purchases and cutting their unessential spending to ensure basic needs and services are covered. Moreover, the Q4 survey was completed before Eskom implemented stage 6 load shedding in December, which suggests consumer confidence in Q1 2020 may fall even further into negative territory.

Business confidence, measured by the RMB/BER Business Confidence Index (BCI) was up marginally in Q4, rising by 5 points to 26 from its twenty-year low of 21 recorded in Q2. Despite the slight uptick, the improvement was marginal and not broadly-based across sectors, reflecting tough trading conditions for firms in an economy battling to grow. The reading of 26 is still well below the 50-mark separating net-negative and net-positive business confidence. The South Africa Chamber of Commerce and Industry (SACCI) Business Confidence Index, recorded a slight month-on-month increase in November, driven by higher export and import volumes. It gained from 91.7 to 92.7 but is still 3.4 points below November 2018's figure. SACCI stressed that "inevitable structural adjustments" are needed to let the economy perform better, stating that ""The effect of indecisiveness and the time lapses to taking action are going to impact critically on the economy and therefore business and investor confidence as year-end approaches."

The ABSA manufacturing purchasing managers' index (PMI), which measures the health of the manufacturing sector, dropped again in November, adding further to the evidence that the economy remained weak in Q4. The PMI dropped to 47.7 in November, from 48.1 the previous month, marking the fourth consecutive reading below the critical 50-level, which separates expansion from contraction. Despite the decline, the average level of the PMI in October and November is still slightly above the average recorded in Q3 and more positively, the PMI sub-index that tracks expected business conditions in the next six months rose for the first time in six months although still remained below 50 points. November's PMI adds to evidence that the economy remained weak in Q4. Given that economic activity contracted in Q3, anything less than a dramatic rebound in the final months of the year would lock in very poor GDP growth for 2019 as a whole.

As would be expected, in an environment of sluggish economic growth and weak domestic demand, inflation was subdued. Year-on-year consumer price inflation (CPI) dropped to 3.7% in October, down sharply from 4.1% in September. October's reading is the lowest since February 2011 when the annual rate was also 3.7%. The average rate from January–October 2019 stands at 4.2%, well below the 4.6% recorded over the same period in 2018. The slowdown was largely driven by declines in fuel prices, which fell 4.9% on the year. On a month-on-month basis, CPI remained unchanged. The inflation rate remains at the lower end of the Reserve Bank's 3-6% target band and now comfortably below the midpoint of the range on both the headline and core CPI readings. Core inflation, which excludes food and non-alcoholic beverages, fuel and energy, remained unchanged at 4% year-on-year in October. Meanwhile, producer price inflation (PPI) slowed to 3% in October down from 4.1% in September. The October reading is the lowest for the year and marks the sixth consecutive monthly drop since April's high of 6.5%. The latest PPI figures complement the CPI slowdown and point to extremely subdued domestic demand conditions.

Despite the growing urgency to reflate the economy, a stable rand and an inflation rate which is below the mid-point of the South African Reserve Bank's target range, the decision was taken to keep the benchmark repo interest rate unchanged at 6.5%, leaving the prime rate at 10%. The Reserve Bank cited concerns over heightened global trade tensions and negative geo-political developments, which might impact the rand exchange rate. In addition, Reserve Bank Governor Lesetja Kganyago highlighted concerns over South Africa's weakening fiscal outlook, which continues to pose a risk to the rand exchange rate. Kganyago urged the government to implement bolder structural economic reforms, which he said would have far greater benefits for economic growth than cuts in the interest rate. While

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some economists have argued that a lower interest rate would provide stimulus to the struggling economy, the Reserve Bank's model predicts that a 25-basis point cut to the rate would add only 0.1 percentage points to economic growth one year after the cut. According to Reserve Bank forecasts, GDP growth for 2019 is expected at 0.5% (from 0.6%). The GDP forecasts for 2020 and 2021 were decreased to 1.4% (from 1.5%) and 1.7% (from 1.8%), respectively. Medium-term forecasts for CPI remained unchanged at 4.2% for 2019, 5.1% for 2020 and 4.7% in 2021. Although overall risks to this outlook were assessed to be balanced, it was noted that "uncertainty about inflation risks is unusually high".

The country's weakening fiscal outlook was highlighted in Finance Minister Tito Mboweni's Medium-Term Budget Policy Statement (MTBPS). Economic growth is forecast at 0.5% for 2019, down from the Treasury's February forecast of 1.5%. Future economic growth is expected to improve only modestly to 1.2% in 2020 and 1.6% in 2021, well below the 3% level needed to address unemployment. The weak economic growth will further temper much needed growth in tax revenues, which is needed to arrest the widening budget deficit. Mboweni said the debt to GDP ratio is forecast to hit 55.6% this fiscal year, rising to 71.3% in 2022/23 and 80.9% by 2027. The cost to service SA's growing sovereign debt has now reached R204bn pa. Debt servicing costs are growing at 13.7% per year, representing the fastest-growing part of the budget. There were unfortunately no specific plans to address Eskom's debt of R450bn. In fact, Eskom could potentially receive a further R230bn over the next three years. The public sector wage bill continues to increase and accounts for 46% of tax revenue. well above the global average. Mboweni plans to dramatically cut the state's wage bill and spending perks, stating that he is considering a wage freeze with the "likelihood of an adjustment downwards". He said ministers, their deputies, premiers and MECs will not be getting salary increases "for the foreseeable future." Mboweni indicated that far-reaching structural reforms are necessary, referring to the successes of countries that have implemented reforms, such as China and India. He stated that "The average person in China is seven times richer today than 25 years ago. The average person in India has become three-and-a-half times richer over the same period…. Meanwhile, the average South African is only 1.3 times better off."

Despite the bleak MTBPS, and to much relief, Moody's credit rating agency stopped short of downgrading South Africa's credit rating to junk status, deciding instead to lower its outlook from stable to negative. The change was motivated by a deterioration in the economic growth outlook and rising debt. Moody's also highlighted "the reform obstacles that the political landscape represents. The history of political infighting that has generated policy uncertainty in the past remains." Moody's change in outlook is usually the first step taken before an official downgrade. Moody's remains the only rating agency not to downgrade South Africa's credit rating to sub-investment grade. A downgrade would result in South Africa's bonds being excluded from key world bond indices potentially causing a massive bond sell-off by foreign investors, in turn taking a toll on the rand and increasing the cost of debt and vital imports such as oil. Moody's indicated that it could change the outlook back to stable if the government can rein in spending, improve tax compliance and increase economic growth but time is running out. A Moody's downgrade could come as soon as March, if the rating agency is unimpressed by the February State Budget.

The past quarter was not all negative. Euphoria erupted across South Africa after the Springboks' victory in the Rugby World Cup. This was followed by President Ramaphosa's second Investment Conference in Sandton, where he outlined the slow but steady progress being made to make South Africa a more competitive investment destination. He said government was in the process of implementing several reforms to improve the business climate and attract further job-creating investments. He made specific reference to the liberalisation of tourist and business visa systems. The business-registration process, which currently takes more than a month, is being overhauled. Ramaphosa promised to reduce the process to hours rather than the day outlined in the pilot project. Progress is being made in setting up

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an Investment Fund, which will draw on both public and private finance to ease ongoing economic and social infrastructure backlogs. Energy security is being prioritised, with investment in new generation technology and self-generation promoted by the recently approved Integrated Resource Plan. Under the leadership of newly appointed CEO Andries de Ruyter, Eskom will be split into three independent units comprising generation, distribution, and transmission. The process of releasing high-demand broadband spectrum has been initiated, seen as critical to both creating capacity for growth in the information communication and technology sector, as well as lowering the cost of communications and digital services.

Ramaphosa's Investment Conference highlighted South Africa as the ideal launch pad for businesses tapping into the broader African market, made all the more relevant by the signing this year of the African Continental Free Trade Agreement (AfCFTA). Signed by 54 out of 55 countries in Africa and commencing in July 2020, the trade agreement will cover a population which by 2040 will be bigger than China and India combined. Member countries have pledged to cut trade tariffs to zero on 90% of all goods. Currently, only 18% of African exports are traded within the continent compared with 60% in Asia. The scope for growth is huge. The UN Economic Commission for Africa forecasts a 50% increase in intra-continental commerce in four years. To facilitate increased trade, the demand for infrastructure will surge, comprising road, rail and urban development. At the African Investment Forum hosted last week in Johannesburg by the African Development Bank and Infrastructure Consortium for Africa, it was announced that infrastructure investment commitments in Africa exceeded $100 billion in 2018 for the first time, rising year-on-year by a massive 24%. This figure can only grow under the auspices of the AfCTFA.

Quick on the heels of his second Investment Conference, President Ramaphosa launched the Tshwane Automotive Special Economic Zone (SEZ), utilising 162 hectares of idle municipal land. The Ford Motor Company is the anchor investor with an investment of R3 billion, initially creating 7,000 jobs. A further nine companies have confirmed they will establish facilities by January 2021. Additional SEZs will be set up in Gauteng, in the West Rand, Ekuhuleni, Sedibeng and Johannesburg developmental corridors, luring investors with incentives, putting out the red carpet rather than red tape. SEZs have been so effective in promoting the vehicle manufacturing industry, that the government will be rolling out the SEZ model to other industries, in particular textiles, clothing and footwear, and agricultural processing, food and beverages, and logistics, rail, capital equipment and machinery.

The anti-corruption drive is gaining momentum, with decisive punitive action initiated against several high-profile suspects, including Adriano Mazzotti, Dr Iqbal Survé, Zandile Gumede and Bongani Bongo. We can expect more corrupt individuals to have their day in court after Hermione Cronje, head of the National Prosecuting Authority's Investigating Directorate, assured South Africans that we "will see the work that has gone on in the background." Meanwhile, the USA has blacklisted the three billionaire Gupta brothers, Rajesh, Atul and Ajay. South Africa has approached eight countries, the USA, Canada, China, Hong Kong, India, Switzerland, Mauritius and the UAE, to have the Guptas extradited to face prosecution for years of state capture. Ramaphosa said that "overseas criminals" will be brought to book.

There is clear evidence of dissatisfaction over the slow pace of structural reforms, reflected in depressed business and consumer confidence, and expressed by business leaders and even from within Ramaphosa's own cabinet. The media, quick to report on the negative stories, has started to ridicule Ramaphosa's "new dawn". However, one needs patience. After nine years of misrule and factions within the ANC determined to maintain the status quo, it will take time to restore investment confidence. We admit that it may take longer than originally expected for economic activity to recover, and for this reason we made slight adjustments towards the end of last year to local portfolios' domestic exposure. However, we remain confident that economic activity will gain traction from mid-2020 onwards

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and that the greatest beneficiaries will be domestically focused shares, which despite their slight reduction, still remain the bulk of our clients' local portfolios.

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