LOCAL PERFORMANCE FACTSHEET

OAM Local Balanced Portfolio

Technical Details

2020 Q1

- 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

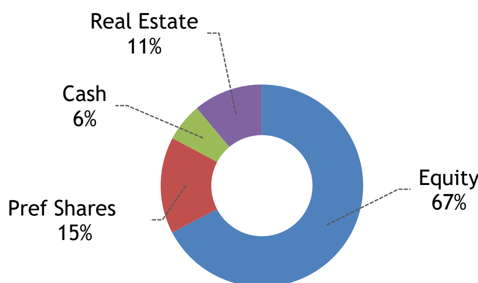
Investment Objective

- Conservative growth
- Consistent annual returns
- Low volatility

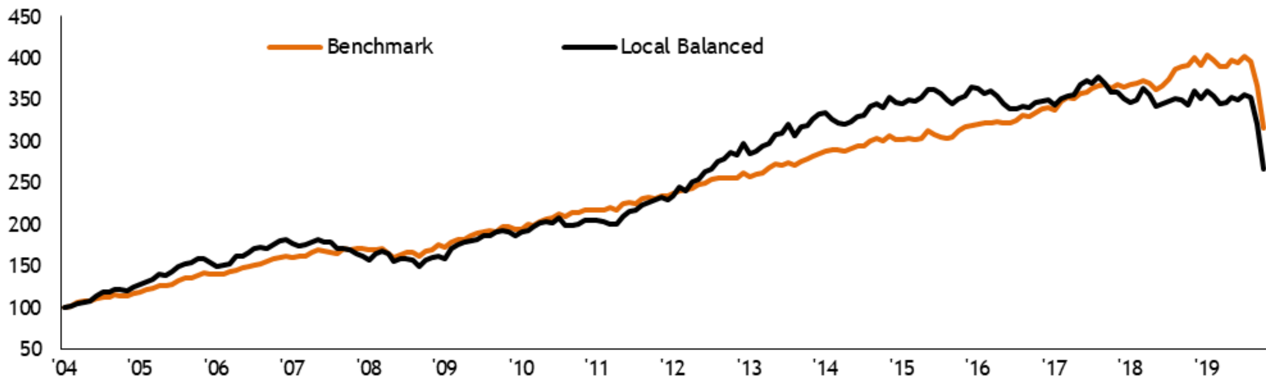
Annualised Growth (%)	OAM	Benchmark
Inception 2004	**6.43**	**7.56**
10 years	3.35	4.84
7 years	-1.02	3.00
5 years	-4.73	0.92
3 years	-8.28	-1.88
2020 YTD not annualised	-25.06	-21.48

Annualised Income Yield	2.84%

ASSET ALLOCATION
(see through basis)



Top 5 Holdings	
ANGLOGOLD ASHANTI LTD	
STOR-AGE PROP REIT LTD	
RMB HOLDINGS LTD	
NASPERS LTD	
REINET INVESTMENTS	
Total number of holdings	25



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Local Market Review and Strategy Outlook for the quarter ended March 2020

South African equity markets suffered their worst first quarter since 1998. The global spread of the coronavirus pandemic combined with the second economic recession in two years led to a sharp retreat on the JSE. The JSE All Share Index fell 22.53% in the first quarter (Q1). Among the main market indices, the Financial 15 Index, with the greatest sensitivity to the domestic economy, suffered worst with a decline of 40.16%. By contrast, the industrial 25 Index only lost 6.68%, with the dual-listed multinational components helped by a steep depreciation in the rand. The Resources 20 Index fell 25.93%. The rand, like other emerging market currencies hit by a surge in demand for dollars and other safe-haven currencies, depreciated over the quarter by 21.57% versus the US dollar, to R/$17.85. There was little refuge for investors. Even the All-Bond 1-3 Year Total Return Index gained by only a marginal 0.78% over the quarter. The dollar gold price increased by 6.47% to $1615 but the Brent Crude oil price, affected by an unprecedented demand shock and Saudi Arabia's decision to flood the market, plummeted by 65.59% to $22.76 per barrel.

A Black Swan event is defined as an improbable and unforeseen event. Covid-19 was a Black Swan event, nobody saw it coming. Global financial markets went into freefall as investors panicked over the likely consequences of a global coronavirus pandemic, suffering their worst daily declines since 1987. The central scenario that the coronavirus would be a China-only incident with temporary supply-chain disruptions followed by a stimulus led "V"-shaped recovery gave way to fears of a more protracted global downturn. A downturn exacerbated by a collapse in consumer spending, the mainstay of economic growth in developed economies. The economic impact of the coronavirus turned rapidly from a localised supply-shock event into a global demand-led phenomenon, leading to global recession.

President Ramaphosa announced a 21-day nationwide lockdown of the country, implemented from Thursday 27th of March and subsequently extended by a further two weeks until 30th April. Various measures were also announced to combat the economic fallout of the coronavirus outbreak and planned lockdown. These include a crowdfunded relief fund, business funding via the IDC, Department of Tourism and Department of Small Business Development to assist businesses in financial distress, and tax and regulatory payment relief to assist workers and preserve the cash-flow and long-term sustainability of businesses. Although the quantum of fiscal relief is more modest, as a percentage of GDP, the containment and financial relief measures followed similar shutdown and relief packages implemented by other governments in Europe, UK, US and Australia.

South Africa's economy was weakening even before the coronavirus struck. The last time South Africa posted four straight quarters of growth was in 2013. The economy slumped into its second recession since 2018, as power cuts weighed on output with unprecedented level-6 load shedding implemented in December. Gross Domestic Product (GDP) declined by 1.4% in Q4 2019, following a decline of 0.8% in Q3. The load shedding brought industries to a halt, disrupted supply chains and transportation systems, leaving employees stuck in traffic or at home. Two consecutive quarters of GDP decline means that the economy fell into recession over the second half of last year, having only recently exited recession in the second quarter of 2018. This marks South Africa's third recession since 1994. For the full year, economic growth in 2019 was just 0.2%, the lowest since the 2008/09 Global Financial Crisis, and half of what the Reserve Bank estimated in January. The continued lack of growth will weigh on the government's revenue collection and efforts to tame debt and narrow the budget deficit. It will also make it even more difficult to lower an unemployment rate which is close to 30%.

Unemployment remained unchanged in Q4 2019 at 29.1%, despite the traditional boost to jobs growth over the festive season. This is the first time since 2008 that the unemployment rate has not decreased in the fourth quarter. Using the expanded definition of unemployment, which includes discouraged work seekers, the unemployment rate rose to 38.7% up from 35.5%. Youth unemployment, which includes individuals aged between 15 and 24 has reached a

critically high level of 58%. At these levels, South-Africa's unemployment is deemed unsustainably high and sharply out of kilter with efforts by president Ramaphosa to boost jobs growth and reduce poverty and inequality.

Unlike the jobs market, the current account benefitted from the country's recessionary conditions. The current account deficit narrowed to a nine-year low in Q4. The current account is a measure of South Africa's trade in goods and services with the rest of the world, and if it is in deficit it needs to be funded by foreign capital inflows. The current account deficit narrowed sharply to 1.3% of GDP in Q4 2019, from 3.7% in Q3 largely due to lower imports during the quarter, underscoring the weakness in the economy. On an annual basis, the deficit narrowed from 3.5% in 2018 to 3% in 2019. The narrowing of the deficit is helpful at this stage as it suggests the country is less vulnerable to changes in foreign investor sentiment. South Africa's current account deficit has been a key factor in the Reserve Bank remaining cautious about cutting interest rates, despite the benign inflation rate. The improvement in the current account deficit may ease some of the pressure on the rand, which has weakened against the dollar this year amid risks associated with the spread of the coronavirus and a deterioration in South Africa's public finances.

Emboldened by substantial monetary easing across developed as well as emerging economies and a relatively stable rand at the start of the year before the outbreak of the virus, the South African Reserve Bank cut interest rates by 25 basis points in January, reducing the benchmark repo rate from 6.50% to 6.25%. This was followed by an unusually large 100 basis-point cut at the scheduled policy meeting in March in line with monetary policy actions around the world in response to the negative economic and social impact of the coronavirus. Subsequent to quarter-end, the Reserve Bank implemented a further 100 basis-point rate cut on 14th April at an unscheduled emergency meeting, reducing the repo and prime rates even further to 4.25% and 7.75%, respectively. At this point, the Reserve Bank also dramatically lowered its growth and inflation forecasts. It now expects the economy to contract by 6.1% in 2020 and for consumer price inflation to average 3.6% over the year. Although the Covid-19 pandemic is the main culprit, electricity supply constraints and policy uncertainty were also cited. If the spread of the coronavirus continues and the economic impact becomes worse than currently projected, further monetary easing may be on the cards.

Despite much needed assistance from the Reserve Bank, business and consumer confidence continued to plumb new lows. The closely watched Bureau for Economic Research (BER) Business Confidence Index slumped in Q1 to its lowest level since 1999, dropping from 26 points to 18. Persistent demand weakness, load shedding, bailouts of struggling state-owned enterprises (SOE's), decline in government finances and the spreading of the Covid-19 virus around the world all contributed to the slump in business confidence. More than 80% of respondents, surveyed between 12th February and 2nd March believed business conditions to be unsatisfactory. The business confidence index is not far from its record low of 12 points, reached during the 1980s at the height of political instability in South Africa. Moreover, the survey was conducted before news broke that the economy had slumped into a recession and before the full impact of the pandemic on global output and financial markets, which means business sentiment could deteriorate further. The BER Consumer Confidence index (CCI), which measures households' confidence in the economy and sentiment regarding their financial position, fell to -9 index points in Q1, well below the long-run average reading of +2 (since 1994). The sub-index measuring consumers' economic outlook for the next 12 months also deteriorated further, falling from -14 to -16. All the gains in consumer confidence sparked by Ramaphosa's election as South Africa's president have now been reversed.

The latest manufacturing survey was also bleak. The ABSA Manufacturing Purchasing Managers' Index (ABSA PMI) fell in February for a fourth straight month, dropping from 45.2 to 44.3 its lowest reading since August 2009. Four of the five index subcomponents declined, with the forward-looking new sales index taking the hardest hit. There is unlikely to be a turnaround soon, with the sub-index tracking expected business conditions in six months' time falling from 42.5 to 38.7, its lowest since February 2009 and less than half the level recorded in February 2018, at the peak of Ramaphosa's "New Dawn" euphoria. Like the BER confidence surveys, the PMI is likely to deteriorate further as the full impact of the coronavirus is measured.

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There was also some surprisingly good news during the quarter, most notably from Finance Minister Tito Mboweni. Against all expectations of yet more tax hikes and yet more state expenditure, in line with the socialist leaning budgets of the past five years, Mboweni's National Budget was business-friendly and reflationary. The budget allocated an additional R2.4 billion to the National Prosecuting Agency, Special Investigating Unit and the Hawks, facilitating the appointment of 800 investigators and 277 prosecutors, and the establishment of five additional specialised commercial crimes courts, one in each province. State capture is estimated to have cost the economy around R400 billion per annum, a similar figure to Eskom's R450 billion debt. The R2.4 billion budget allocation to fight corruption could provide one of the best available returns on investment. Rather than raise taxes the budget gave back R14 billion in tax relief by adjusting tax brackets to compensate for inflation. Budgeted expenditure over the next three years fell by R156 billion, the bulk coming from a proposed R160.2 billion worth of reductions in the public sector wage bill. Cosatu in recent months has shown a greater willingness to negotiate than is commonly perceived, provided two key demands are met. Their demands should appeal to all South Africans, namely that government holds those responsible for state capture to account and that government cuts ministerial and managerial benefits. Encouragingly, minister Mboweni also announced that he anticipates a decrease in corporate taxes in the near future to ensure corporate-SA becomes more competitive in the global economy and to encourage investment.

Cosatu contributing further to the spirit of nation building with its proposal that the Public Investment Corporation (PIC) takes on R250 billion of Eskom's debt, in what could amount to a debt-for-equity swap. Cosatu's conditions include the arrest of those implicated in Eskom state capture contracts, that Eskom generates renewable energy, the installation of pre-paid meters in all households and the payment by the National Treasury of municipal debts owing to Eskom. The most substantial Cosatu conditions are that there will be no job losses at Eskom and that Eskom will not be privatised. However, the government's stated requirement of an investment return from the proposed deal indicates the PIC's R250 billion injection would involve a debt-for-equity swap, which ironically would amount to a partial privatisation, potentially providing a positive catalyst for investor sentiment.

President Ramaphosa's third State of The Nation (SONA) speech on 13th February was also encouraging although as has been the case throughout his presidency, the devil will be in the implementation. Nonetheless, the president acknowledged the major areas of concern in South Africa, including unreliable energy provision, the precarious fiscal position, and more broadly the weak economic growth environment. The president announced concrete steps to alleviate the energy constraint. These include allowing municipalities to purchase power directly from independent power producers (IPPs). Without committing to any timelines, the fifth bidding round of the IPPs will also be launched. Furthermore, the licensing waiting period for the self-generation of electricity will be shortened dramatically.

Unfortunately, the improved policy reform momentum was too little to prevent the long-awaited credit rating downgrade from Moody's. South Africa lost its last investment grade credit rating when Moody's downgraded its sovereign credit rating to Ba1. Moody's also maintained its negative outlook indicating the potential for a further downgrade. Moody's highlighted both immediate and longer-term growth risks pertaining to the impact of the coronavirus pandemic and "persisting domestic impediments". These impediments included structural economic bottlenecks which limit GDP growth potential and employment creation; social and political divisions which hamper reform progress while simultaneously generating policy uncertainty; deteriorating public finances; unfavourable debt dynamics; and the continued financial dependence of state-owned enterprises, in particular Eskom. The loss of the remaining investment-grade rating means South African government bonds will be excluded from global bond indices at the end of April, forcing asset managers to sell the bonds. However, a downgrade need not be a disaster over the short term. Bad news has already been factored in and foreign investors have already sold off big tranches of government bonds and JSE listed shares. The downgrade may also swing the pendulum of political power over to Ramaphosa, giving him a stronger mandate for structural reform. The specter of an IMF bailout is becoming less far-

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fetched and would entail a far more draconian set of reforms than contained in the National Treasury's Economic Plan.

While the pandemic could not have arrived at a worse time, afflicting an economy already reeling from a recession and the loss of its investment grade credit rating, the president could emerge from the crisis in a stronger political position. The president's proactive and bold response to the containment of the pandemic has been implemented with urgency without the usual procrastination and endless consultation with ANC political structures. His actions have been lauded, boosting his popularity and giving him greater political authority to push through structural reforms. The balance of power has clearly shifted from Luthuli House to the presidency. On 29th March, Ramaphosa called Finance Minister Tito Mboweni and told him "we now need to move more boldly on the structural reforms programme." Mboweni reported that a new unit called Vulindlela will be established within the Finance Ministry to drive the structural reform process. Always the astute politician, Ramaphosa will want to capitalize on a strengthened "social compact", which has made it easier to drive through potentially unpopular structural reforms. As the saying goes, he will not want to let a good crisis go to waste.

Assuming that as expected the coronavirus dissipates in due course, the extraordinary levels of global monetary and fiscal stimulus may well boost financial markets to higher levels than they would otherwise have been without the coronavirus. The global economy was on the path to recovery before the virus struck and is likely to resume this positive underlying trend. The prospect of even greater global monetary stimulus, comprising a correspondingly weaker US dollar, coupled with the rapid normalisation of China's economy, bodes especially well for emerging markets. Low oil prices are also beneficial, especially to oil importing countries like South Africa. Emerging markets, which have underperformed developed markets over the past three years and are now at extreme relative under-valuation, should benefit from currency strength, lower interest rates and capital inflows as the world searches for higher yields.

Share prices on the JSE were low even before the start of the bear market. Today prices are 30% lower. The average dividend yield of the JSE Top 40 Index, excluding Naspers and Prosus, is 6.84%, the earnings yield is 9.98% and the price-earnings ratio is 10.02. The market has not been so cheap in decades. It is a buyers' market. When can we expect a recovery? Typically, economists have divergent opinions. Economists, who we have learned to trust, expect it could all be over within six months. Investment bank Goldman Sachs said Ramaphosa could unleash a wave of investment in South Africa by rolling out structural reforms and that 'if there is an economy in which investors would be delighted to jump back in with both feet, more than in most other emerging markets globally, it's South Africa."

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