



OAM Local Defensive Portfolio

Technical Details

2019 Q1

- Base currency: South African Rands
- Benchmark: Prime Interest Rate (2009 - 2018); 25% JSE All Share, 25% ALBI 1-3y, 15% SAPY, 35% JSET (2019-)
- Asset Allocation: Flexible mix of equities, bonds and cash
- Individual portfolio representing Local Real Return investment style
- All performance figures include income and are net of fees and expenses

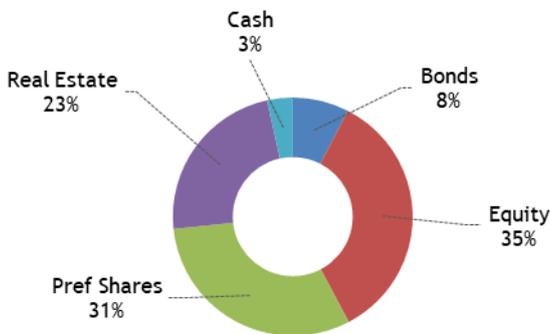
Investment Objective

- Conservative growth
- Consistent annual returns
- Low volatility

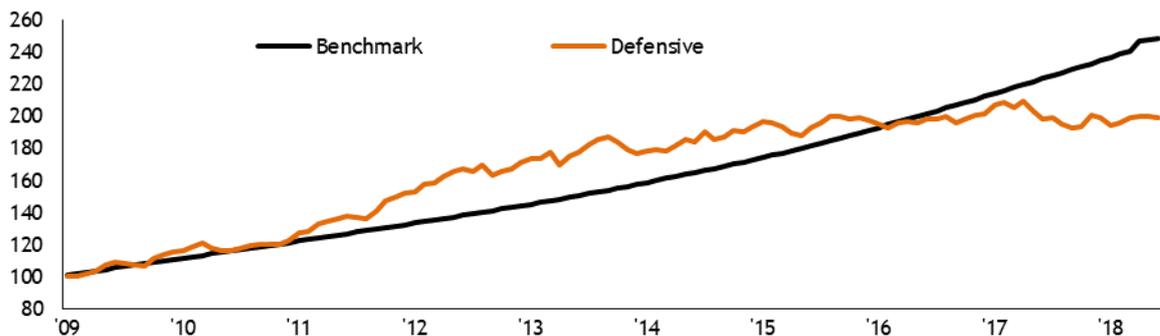
Annualised Growth (%)	OAM	Benchmark
Inception 2009	7.59	10.04
7 years	5.45	10.08
5 years	2.35	10.52
3 years	1.14	10.98
2019 YTD not annualised	0.07	3.10

Annualised Income Yield	5.54
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ASSET ALLOCATION (see through basis)



Top 5 Holdings	
ESKOM 13.5% RS 19/21N170	
NETCARE LTD PREF	
STOR-AGE PROP REIT LTD	
EQUITES PROP FUND LTD	
SASFIN HOLDINGS LTD PREF	
Total number of holdings	33





Local Market Review and Strategy Outlook

A deteriorating economic outlook did not deter the South African equity market from making significant headway in the first quarter (Q1) of the year. Encouraged by strong global equity markets, and a more constructive environment for emerging markets helped by China's economic recovery and a "dovish" Federal Reserve, the JSE started the year with solid gains despite continued political and policy uncertainty and weak domestic demand. The All Share Index gained 7.06% in Q1, led by the Resources 20 Index with a gain of 14.22%. The Financial 15 and Industrial 25 indices gained by 9.92% and 8.21%, respectively. As expected bonds fared less well, although the All-Bond 1-3 Year Total Return Index returned a stable 1.88% over the quarter. The rand weakened against the US dollar by a further 3.6% in March after losing 5.7% in February, reversing the strong gains achieved in January, due to Eskom's intense load shedding, fears that Moody's would lower its credit rating outlook and the contagion effect of the Turkish lira's sharp depreciation. The dollar gold price appreciated slightly over the quarter by 2.10%, breaking above the key \$1300 per ounce level.

Macro-economic data started off the year on a negative footing, with private sector credit extension, vehicle sales, retail sales, business and consumer confidence surveys and purchasing managers' surveys, as well as the SA Reserve Bank's leading economic indicator, all edging lower during Q1. Business conditions in South Africa's private sector, as measured by the Standard Bank Purchasing Managers' Index (PMI), continued to deteriorate in March. The seasonally adjusted Standard Bank PMI fell to 47 points in March down from 49.1 in February, unable to breach the expansionary 50-level. The average reading over Q1 was the worst since the survey began in 2011. Among the PMI sub-indices, the forward-looking new orders index fell sharply in March signaling weak activity in the months ahead. Ramaphoria continued to fade as it became apparent that the road to economic recovery will take longer than expected. Policy uncertainty, especially surrounding land reform, weighed on business and investor confidence.

GDP growth eased to 1.4% quarter-on-quarter in Q4 of 2018 from 2.6% the prior quarter. In 2018 growth slowed to just 0.8% down from 1.4% in 2017. The economy continues to be driven by consumption and not by investment. Gross fixed capital formation (GFCF) decreased by 2.5%, its fourth consecutive decline, while final household consumption expenditure expanded by 2%. The main contributors to the decline in GFCF were machinery and other equipment, residential buildings and construction works. The current account deficit figure provided some consolation, reducing to 2.2% of GDP in Q4 from 3.5% in Q3, helped by higher exports and lower imports during the quarter. The unemployment rate decreased by 0.4%, from 27.5% in Q3 to 27.1% in Q4. The number of employed persons increased by 149 000 to 16.5 million and the number of unemployed persons decreased by 70 000 to 6.1 million in Q4. However, the increase is probably unsustainable explained by temporary jobs over the festive season, with unemployment likely to have resumed its inexorable rise in Q1.

In the nation's Budget Speech, Finance Minister Tito Mboweni had the unenviable task of reporting on the damage done to the economy by Eskom. He allocated an additional R69 billion to Eskom to be spread over three years, marking the biggest "bailout" for a State-Owned Entity (SOE) ever. However, the finance minister denied that government was taking on Eskom's debt, saying that "Eskom took on debt. It must ultimately repay it". Other SOE's will also be assisted, but Treasury is adamant that any support will be financed through the sale of assets and will not impact the budget balance. The consolidated budget deficit increased to 4.2% of GDP in 2018/19 up from October's Medium-Term Budget Policy Statement forecast of 4.0% and significantly higher than the originally budgeted 3.6%. Gross public debt is budgeted to rise to 58.9% of GDP in 2021/22 from the current 55.6%.

Fortunately, the economic news was not all bad. The State of the Nation Address (SONA) delivered by President Ramaphosa signaled the likelihood of more meaningful stage-two structural reforms post the National Election on the 8th May. Most of the SONA speech focused on economic growth, job creation and various ways of stimulating the



South African economy. Various initiatives were highlighted by President Ramaphosa to improve the ease of doing business, attract investment and make South Africa more investable. He announced that Eskom will be split into three parts, which will improve management efficiency, the ability to manage expenses and enhance the potential to obtain financing. The government will support the company financially but not in a way that will burden the fiscus.

The South African Reserve Bank (SARB) kept its benchmark repo interest rate unchanged at 6.75%. However, it shifted its outlook for inflation risks from “tilted to the upside” to “balanced”. This change followed five consecutive meetings highlighting upside inflationary risks. Notably, the last two occasions that the SARB assessed risks to the inflation outlook as balanced, it cut interest rates by 25 basis points each time. Consumer price inflation rose to 4.1% year-on-year in February from 4% in January while core inflation remained unchanged at 4.4%. However, inflation is likely to remain contained within the SARB’s 4-6% target for the foreseeable future. The SARB’s softening attitude towards monetary tightening can also be attributed to a “dovish” shift from the world’s major central banks, especially the US Federal Reserve which is now guiding for a pause in its rate hiking cycle. The SARB’s significantly “dovish” bias suggests interest rates have peaked with the next change likely to be a rate cut.

The French oil company, Total, made a significant oil and gas discovery in the Outeniqua basin off the coast of Mossel Bay with reserves of one billion barrels of gas condensate. The discovery has the potential of adding R1 trillion to the economy over the next 20 years. According to Niall Kramer, CEO of the SA Oil and Gas Alliance, there has never been a find of this scale in South Africa and if the government plays its cards right the find could reduce the budget deficit by 30%. This could be a potential game changer given that South Africa has always been a net importer of oil and gas products.

Shortly after Ramaphosa’s inauguration in March 2018, he announced the Youth Employment Service (YES) programme aimed at giving young black professionals one year’s work experience in the private sector across various industries. The YES programme is ambitious aiming to provide 1 million work experiences in the youth bracket between the ages of 18 and 35 over the next five years. According to the YES website, results have been impressive. There are already 221 companies that are registered, and more than 15 000 work experiences have been created.

Following the successful inaugural investment conference in October 2018, a total of R300 billion has already been pledged by major companies out of a target of R1.5 trillion. These funds are likely to flow into South Africa after the election. Add to this the fact that South African companies have around R1 trillion sitting idly on their balance sheets waiting to be invested once confidence improves. Ramaphosa is committed to turning South Africa’s economy around. There are many positives that he can rely on. We have an excellent financial system. The JSE is one of the best stock exchanges in the world. South African shares are the cheapest on record against emerging market peers. Ramaphosa has put measures in place to “get our house in order”. Our cabinet looks better, he has appointed key commissions of inquiry and replaced several bad apples, for instance Shaun Abrahams with adv. Shamila Batohi. He has brought back the Scorpions.

Expropriation of property without compensation (EWC), if implemented constructively in line with the successful Peruvian model, would turn tenants into landowners and consumers into producers. There are an estimated 22 million landless black people living on tribal land. Giving them ownership would be a gamechanger. If they can get ownership of the portion of the land they live on, and cultivate it to produce food, consumers will become producers. If applied correctly, EWC has the potential to be a strong economic driver. Ramaphosa is often criticised that he did nothing to stop Zuma’s senseless destruction of our economy. Maybe he heeded the advice of that master strategist, Napoleon: “Never interrupt your enemy when he is making a mistake”. It brought him the presidency. Should he win the 8th May 2019 elections by a safe margin, we are optimistic that the New Dawn will rise on South Africa.



Despite the uptick in the JSE since the start of the year, local equity markets continue to offer considerable value with the All Share Index price-earnings multiple currently at 16.7x compared with 21.0x this time last year. Excluding Naspers, the PE multiple falls to 13.8x well below the long-term average of 14.7x. The JSE's sizeable valuation discount suggests the equity market is extrapolating current economic weakness far into the future. Is this fair? Recent government initiatives under Ramaphosa and prospects of greater structural economic reforms post the election indicate that the extrapolation of past trends, which are a lagged effect from the end of the Zuma era, is unreasonable.

Blame for the worldwide underperformance in emerging market equities is largely attributed to the strengthening dollar and unpredictable US trade policy. Encouragingly, these key global market forces are close to a crucial inflection point. An inflection point in the appreciation of the US dollar and the deterioration in US trade relations at the same time as an acceleration in China's fiscal and monetary stimulus should pave the way for a re-rating in emerging market equities. What is good for emerging markets, as an asset class, is also good for the rand and South African equities. Domestically focused South African equities probably offer the greatest value and the potential for the strongest re-rating. The key catalysts will likely be global forces comprising a weakening US dollar and a reflation of China's economy, which both bode well for emerging markets generally.

South Africa's general election should also provide a positive catalyst. Markets may suffer some volatility in the lead-up to the election, although a clear mandate for Ramaphosa should usher-in bolder stage-2 reforms from May onwards, providing a solid boost to consumer and investor confidence, household expenditure and investment spending. The surprise decision by Moody's credit rating agency to keep South Africa's long-term credit rating on investment grade with a "stable" outlook strongly suggests that it has inside knowledge of plans for post-election structural reforms. Our clients' portfolios remain weighted towards domestically focused "SA-Inc" sectors and shares, comprising banks, financials, retail, building and construction shares, which will strongly outperform once, as we expect, business and consumer confidence pick-up from their current depressed levels. Domestically focused small-cap shares, which have a significant weighting in our clients' portfolios, will show the strongest gains of all.