OAM Local Growth Portfolio

Technical Details

Sep 2017

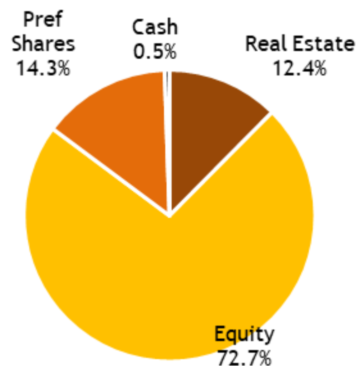
- Base currency: **South African Rands**
- Benchmark: **JSE All Share**
- Asset Allocation: **Flexible mix of equities, bonds and cash**
- Individual portfolio representing Local Growth investment style
- All performance figures include income and are net of fees and expenses

Investment Objective

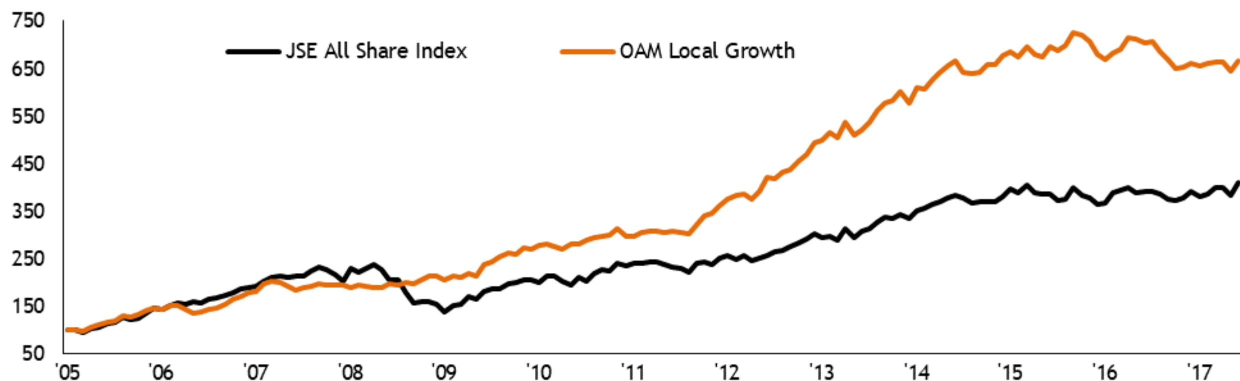
- Conservative growth
- Consistent annual returns
- Low volatility

Annualised Growth (%)	OAM	JSE ALSI
Inception March 2005	16.31	10.99
10 years	13.29	6.37
7 years	12.55	9.49
5 years	9.24	9.22
3 years	1.61	4.05
2017 YTD not annualised	2.85	9.73

Annualised Income Yield	1.78 %



Top 5 Holdings	
NASPERS LTD	
DISCOVERY LTD	
ANGLO AMERICAN PLC	
RMB HOLDINGS LTD	
SYGNIA ITRIX MSCI JAPAN	
Total number of holdings	27



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Disclosure: There is a risk associated with investing in our financial products. The value of the investments and income may rise as well as fall, and there is a risk that the client may suffer financial losses. Returns are dependent on the performance of the underlying assets and other variable market factors. Past performance is not necessarily indicative of future performance.

Market Review

Despite the economy falling into a technical recession in the first quarter (Q1) following two consecutive quarters of GDP contraction, equity markets performed well in Q3. Equity markets, which are forward-looking, appeared to be pricing-in a turning point in the economic cycle. Investor sentiment turned more positive after bell-weather resource shares resumed their dividend payments. The surprise Reserve Bank repo rate cut also boosted confidence. In line with strong global commodity prices, the Resources 10 Index gained +15.61% over Q3 and +9.05% in the year-to-date (YTD). The Industrial 25 and All Share indices gained +7.40% and +7.69% over the quarter and +17.81% and +9.73% YTD, respectively. The Financial 25 Index was a relative laggard, rising by +4.41% over the quarter and just 0.20% YTD. The rand gave up some of its earlier gains, losing -3.91% versus the US dollar in Q3 but maintained a 1.09% YTD gain ending Q3 at R/$13.55 versus R/$13.70 at the end of 2016. The All-Bond 1-3 year Total Return Index rose +7.69% over the quarter and +9.73% YTD boosted by the Reserve Bank's 25 basis point rate cut in July. The gold price continued to perform well, helped by rising political tension between the US and North Korea and expectations of a weakening dollar. The dollar gold price gained +4.33% over the quarter and +11.03% YTD.

Economic growth recovered faster than expected in Q2. After contracting by 0.7% and 0.3% in the preceding two quarters, GDP grew by 2.5% quarter-on-quarter annualised in Q2. Agricultural production rebounded by 21.2% year-on-year with good summer rains contributing to a record grain harvest. Both mining and manufacturing posted positive contributions to GDP growth in Q2. Mining output grew 2.6% quarter-on-quarter annualised and manufacturing output, following three consecutive quarters of contraction, grew by 6.1%. On the expenditure side, gross domestic expenditure grew by 1.9% year-on-year in the first half of the year, attributed mainly to a 1.1% increase in consumer spending, which rebounded strongly in Q2. Retail sales grew in Q2 by a surprisingly strong 8.9% quarter-on-quarter annualised, the strongest quarterly growth since 2011. Household disposable income was boosted by the decline in inflation, with consumers especially encouraged by the rapid fall in food prices. Household real disposable income increased in Q2 by 4.5% quarter-on-quarter more than reversing the 2.1% contraction in Q1. Debt to disposable income eased from 73% to 72.6% as households continued to improve their balance sheets. Household disposable income should gradually increase over coming quarters amid lower inflation and falling interest rates.

Unfortunately, fixed capital formation contracted in the first half of the year by 1.1% on the year. The continued slump in fixed investment is concerning as it not only impacts today's growth and employment but will limit the upside in the years to come. Private firms remained reluctant to invest due to heightened political and policy uncertainty. Capital expenditure by public corporations declined for the fourth consecutive quarter, reflecting the impact of strained finances, weak management and suspected widespread corruption.

The FNB/BER Civil Confidence Index, which indicates the percentage of civil engineering contractors that are satisfied with prevailing business conditions, fell sharply from 28 in Q2 to 15 in Q3, the lowest level since Q3 2000. The index reading indicates that 85% of all respondents are dissatisfied with prevailing business conditions. Respondents cited insufficient demand, stemming from depressed domestic demand and policy uncertainty.

South Africa fell sharply in the World Economic Forum's Global Competitiveness report from its position of 47 last year to 61 this year, out of 138 countries. The ranking for the quality of auditing and reporting standards fell from 1 to 30. The ranking of the country's institutional environment fell from 40 to 76 while rankings for South Africa's financial markets and goods market efficiency also fell sharply to 44 and 54. The most problematic factors for doing business in the country were cited as corruption, government instability, crime and theft, and high tax rates. Health and primary education scored an abysmal 121 out of 138 countries.

The latest Quarterly Employment Survey was worse than expected reporting a 35,000 loss in formal non-agricultural sector employment in Q2 following a loss of 41,000 in Q1. By sector the biggest losers were manufacturing, construction, transport, and community services, with losses of 13,000, 11,000, 5,000 and 10,000, respectively. More encouragingly, the public sector made progress in reducing its headcount, helping to stem the burgeoning wage bill.

Job losses at national department and provincial department level were 6,000 and 18,000. In another bright spot, growth in average gross earnings per worker slowed from 6.6% year-on-year in Q1 to 5.9% in Q2, contributing to a decline in inflationary expectations. In real terms, growth in average gross earnings gained from 0.3% to 0.6% helped by the decline in the actual inflation rate.

Despite weak economic conditions there were some positive developments. Although the trade surplus narrowed from R9.3 billion in July to R5.9 billion in August this was the highest surplus for August since the data series began in 2011. Seasonally, August tends to be a poor month for exports. Exports grew by 15% on the year boosted by resurgent demand in key export markets. The YTD trade surplus grew to R43.5 billion compared to a deficit of -R13.7 billion in the same period last year, boding well for South Africa's balance of payments and the rand.

In a surprise move, the Reserve Bank initiated its long-awaited interest rate cutting cycle on 20th July with a 25 basis-point reduction in the repo rate from 7.0% to 6.75%. The Reserve Bank's policy initiative paves the way for further rate cuts in recognition of a positive global economic backdrop, a stable rand and tame inflation. With consumer price inflation well established below the upper limit of the Reserve Bank's 3-6% target range there is a high probability of the repo rate being cut further by an aggregate 50 basis points over the next nine months. The Reserve Bank notes a moderation in average salaries and wages, which are expected to remain below 6% over the 2017-2019 forecast period. The global environment supports further rate cuts. Synchronised global economic growth is driving strong investor demand for emerging market assets. The favourable global outlook should fuel continued appreciation in emerging market currencies, facilitating further monetary policy easing in these economies.

The South African Reserve Bank's composite leading business cycle indicator unexpectedly jumped from 95.8 in June to 97.3 in July. The leading business cycle indicator, which tends to be a reliable barometer of economic activity 6 to 9 months ahead, is back at levels last reached in February when it hit 98.4 prior to the ill-fated cabinet reshuffle. February marked the highest level since November 2014, also at 98.4. The leading cycle indicator confirms that the recession is well behind us, signalling better times ahead, pointing to a steady recovery in economy activity. The economic recession in Q4 last year and Q1 this year had been predicted by the leading cycle indicator. Around 6-9 months prior to the recession, it had collapsed to 92.2 in January 2016 plumbing a low of just 91.4 in April 2016, not recovering the 93.0 level until September 2016. It is greatly recovered from these levels, rising by a solid 5.6% year-on-year in July.

The positive economic momentum being predicted is expected to draw further strength from the Reserve Bank's monetary policy easing cycle initiated in July. Moreover, with only 10 weeks to go before the ANC elective conference from the 16th to 20th December, the current cloud of political and government policy uncertainty will soon lift. The Zuma camp is losing ground to either a Cyril Ramaphosa leadership or to the compromise candidate Zweli Mkhize. Either would bring about a marked improvement on the status quo.

The prospect of lower interest rates is driving equity markets higher. Lower interest rates are unequivocally good news for the All Share Index. Lower interest rates will lead to higher intrinsic equity valuations, to capital transfers from money markets into equities, and will boost economic growth prospects and company earnings. Furthermore, a secular recovery is not out of the question in the likely event that the "technocratic constitutionalist" arm of the ANC manages to beat Zuma's patronage-based faction in December's elective conference.

Our clients' equity portfolios are positioned to exploit the expected upturn in equity markets. While a meaningful rand hedge weighting remains in portfolios to mitigate the risk of the unexpected there has been a shift towards a more domestic bias. Moreover, there has been a gradual accumulation of small- and mid-cap shares, which although more volatile over the short-term will strongly outperform the broader market over the longer-term.