overberg asset management

Local performance factsheet

OAM Local Income Portfolios

ZAR Rand

JUL 2012

Introduction

Overberg Asset Management specializes in the management of individual portfolios, tailored to the investment objectives of each client. As an independent company, Overberg can set objective standards in its selection of investments. Your portfolio will be in the safe custody of Investec stockbrokers, and managed from here. We produce customised statements and investment reports to specific requirements. Constant availability and a quick and flexible response are fundamental to our client relationships.

Technical Details

- **FSB** approved
- Base currency: **South African Rands**
- Minimum investment: **R500,000**
- Benchmark: **JSE AllShare (30%) and ALBI 1-3 yr Return Bond Index (70%)**
- Asset Allocation: **flexible mix of equities, bonds and cash**

Investment Objectives:

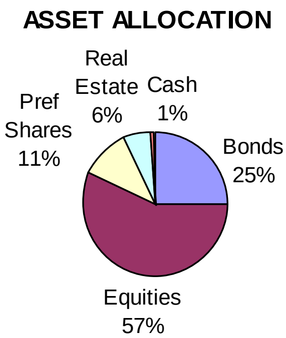
- conservative growth with income
- consistent annual returns
- low volatility

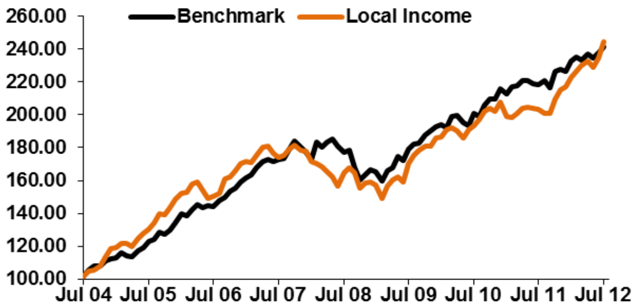
	Local %	Benchmark %
Annualised Total Return	11.69	11.52
2004 (July – December)	18.33	14.20
2005	25.71	23.16
2006	14.50	21.94
2007	4.40	12.27
2008	-10.60	-9.99
2009	16.80	18.00
2010	11.73	11.90
2011	4.79	4.78
YTD	12.44	6.75

*Since July 2004: All performance figures include income and are net of fees and expenses

Growth 2012	Local %	Benchmark %
January	2.54	2.91
February	1.66	0.95
March	1.50	-0.66
April	1.17	1.59
May	-1.55	-1.18
June	2.47	1.49
July	4.12	1.52

	%
Annualised Income Yield	6.43





(As calculated by Overberg 31 Jul 2012)

Commentary

SA economic momentum has slowed as a result of weakening external demand and due to uncertainty caused by the Eurozone crisis. Growth in gross domestic production (GDP) slowed in the 1st quarter to 2.7% quarter-on-quarter annualized, down from 3.2% the previous quarter although ahead of the 2.3% consensus forecast. An especially weak mining sector contracted a further 16%, due mainly to the prolonged strike at Impala Platinum. Gross domestic expenditure (GDE) also slowed in the 1st quarter to an annualized rate of 4.3% from 5.1% the previous quarter. Household expenditure slowed from 4.6% to 3.1% while government spending slowed from 7.3% to 2.2%. A lack of confidence by companies to invest caused private sector fixed capital formation to fall sharply from 6.2% to 1.8%. Meanwhile the trade deficit widened to R42.1 billion from R17.1 billion the previous quarter, as exports fell 2.4% over the quarter and imports increased 0.3%, contributing to a widening in the current account deficit to 4.9% of GDP its widest since the 1st quarter 2009.

The trade deficit is expected to widen further in 2012 due to weakening global demand and reduced export volumes, at the same time as growing imports due to reasonably strong consumer spending and demand for capital goods. Although by no means critical the current account deficit is forecast to deteriorate further from the 4.9% of GDP registered in the 1st quarter, itself up from 3.6% in the final quarter 2011. The cumulative deficit for the year to end May measured R45.8 billion, significantly above the equivalent year ago deficit of R7.5 billion. Unfortunately domestic supply disruptions in the mining sector are likely to exacerbate the deficit in coming months.

Confidence indicators also signal a loss in economic momentum. The SA Chamber of Commerce and Industry (SACCI) business confidence index fell from 94.3 in April to 92.8 in May, its lowest level since November 2002, attributed by SACCI to the “lack of alignment across economic policy positions”. The most recent low was 93.1 reached during the recession in March 2009. The report states that “tensions are developing between policy support for a growth-enhancing investment-friendly environment and the public sector” in turn hampering “private sector growth, business expansion and employment creation opportunities.” The decision by government to veto the purchase by South Korea’s KT Corporation of a strategic stake in Telkom was viewed as disappointing. The sub-index measuring manufacturing confidence fell over the quarter from 47 to 29. Retail confidence also suffered an unexpectedly sharp decline from 61 to 39 suggesting retail spending, the bulwark of recent economic output, may provide a smaller contribution to economic growth in coming months.

The Bureau for Economic Research/ Rand Merchant Bank business confidence index fell sharply from 52 in the 1st quarter to 41 in the 2nd quarter, reflecting concern over the deteriorating global economy and a lack of consensus on domestic economic policy. The decline indicates a deteriorating outlook for private sector investment and economic growth with only 4 out of 10 respondents rating current business conditions as satisfactory. More recent data corroborates the uninspiring outlook. The Kagiso Purchasing Managers’ Index (PMI) measuring conditions in the manufacturing sector fell from 53.6 in May to 48.2 in June. The index is below the key 50 level, which demarcates contraction from expansion, for the 1st time since December 2011. Among the sub-indices, the business activity index fell sharply from 56.0 to 47.0 while the new sales orders index also fell into negative territory at 46.5 and the employment index remained equally subdued at 46.8.

Overseas institutions seem to be more optimistic. The Organisation for Economic Cooperation and Development (OECD) forecasts SA's economic growth will accelerate from 3.1% last year to 3.3% in 2012, exceeding the Treasury's forecast for 2.7% growth and the 2.8% market consensus. The OECD cites a resumption of employment growth, accelerating domestic demand, productivity growth and investment, which barring any adverse shocks will contribute towards 4.2% economic growth in 2013. This is also above the consensus forecast of 3.6%. Similarly, the IMF raised its forecast for SA economic growth in 2012 to 2.7% from its previous forecast in January of 2.5% while keeping its forecast for 2013 unchanged at 3.4%. The IMF report cites abating inflationary pressure as a result of lower food prices, which in turn could facilitate additional monetary easing.

Fortunately, inflationary pressures have receded at the same time as economic momentum has slowed. Consumer price inflation (CPI) fell in June to 5.5% on the year from 5.7% in May and below the 5.6% consensus forecast, well within the Reserve Bank's 3-6% target range. CPI increased by just 0.2% on the month. Encouragingly food prices fell by 0.2% on the month, led by a 4.3% decline in fruit prices while meat prices fell by 0.5%, with the year-on-year rate of food price inflation reducing from 6.8% to 6.0%. The 55c per litre drop in the petrol price helped private transport inflation decrease from a year-on-year rate of 16.2% to 12.0%.

Private Sector Credit Extension has also eased slightly from its rapid pace set at the start of the year, reducing from year-on-year growth of 9.2% in March to 8.3% in May, which should dispel the SARB's earlier concern that it may be growing too swiftly. Other loans and advances, made up largely of rapidly expanding unsecured lending, fell a further 0.1% on the month after shrinking 2.3% in April. Overall, the credit extension figures showed a continued loss of momentum following the 1st quarter's strong growth. Taken together with easing inflationary pressure, below trend economic growth, and deteriorating export markets, the market had expected interest rates to remain at their record low level for at least the remainder of the year and possibly until the 3rd quarter 2013.

However, nobody expected the Reserve Bank, perhaps paying heed to the IMF recommendation, to cut the benchmark repo rate by a further 50 basis points to 5.0%. This represents the first rate cut since November 2010, taking the repo rate to its lowest since 1974. The rate cut is good news for the economy and financial markets. It should provide a solid boost for equities, making them even more attractively valued compared with bond yields and money market rates. In many cases dividend yields are above money market rates, with the recent rate cut making the anomaly even more pronounced. SA equities are also attractively valued on a price to earnings basis. The JSE All Share Index is trading on a 12 times price to earnings multiple, at least 15% below its long-term average. With low debt at government, company and household levels, and relatively respectable economic growth of close to 3%, local equities should continue to attract foreign investment inflows.