overberg
asset management

Local performance factsheet

OAM Local Income Portfolios
ZAR Rand

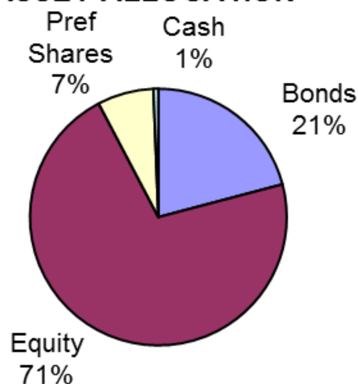
MAY 2013

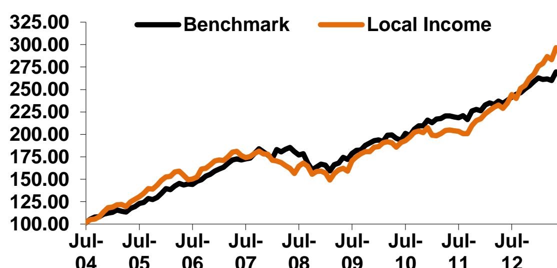
Technical Details

- **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





(As calculated by Overberg 31 May 2013)

	Income %	Benchmark %
Annualised Total Return	12.97	11.73
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
2012	22.86	14.38
2013 YTD	11.08	3.91

*Since March 2005: All performance figures include income and are net of fees and expenses

Growth 2013	Growth %	Benchmark %
January	3.37	1.60
February	1.06	-0.60
March	2.81	0.20
April	-1.27	-0.73
May	4.75	3.43
June		
July		
August		
September		
October		
November		
December		

	%
Annualised Income Yield	6.33

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Directors: Nick Downing, Brett Birkenstock, Gielie Fourie.

Introduction

Overberg Asset Management specialises 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. Privately managed portfolios provide clients with the optimal investment solution. Lower cost structures, greater maneuverability and meaningful exposure to smaller companies or tomorrow's "blue chips", all help to generate superior investment returns. Moreover, privately managed portfolios can be tailored specifically to individual requirements. At the cutting edge of investing, Overberg has a proven track record in global and domestic South African markets. Your portfolio will be in the safe custody of BOE Securities, Investec Securities or Standard Equities.

Commentary

Following the breath-taking rally in the final quarter of last year it was reasonable to expect some consolidation in the 1st quarter 2013. During the quarter the All Share index eked out only a small gain of 1.56%, with stronger performance once again provided by the Financial 15 and Industrial 25 indices with gains of 4.60% and 5.84%. By contrast the Resource 10 index lost ground by -6.77% in spite of low valuations. Global mining resources prices are declining due to uncertainty over infrastructure spending in China. Although equity returns were relatively modest they beat the traditional safe have asset classes including bonds, money markets and gold. The rand declined sharply in response to continued labour unrest and the burgeoning current account deficit, losing -8.16% against the US dollar. As a result bonds provided only modest returns with the All Bond Total Return index (1-3 year) rising just 0.91% over the quarter. The dollar gold price fell -4.83% over the quarter with gold investors deterred by the gradual stabilisation of the global economy.

The economy is going through an unfortunate bout of stagflation, suffering a combination of slowing economic growth at the same time as rising inflation. As a result there is little support that can be provided by the SA Reserve Bank (SARB) in the form of monetary stimulus. Meanwhile the government is being warned by credit rating agencies against straying from its fiscal prudence. Consumer price inflation (CPI) accelerated from 5.4% in January to 5.9% in February, well above the 5.6% consensus forecast and close to the SARB's 3-6% target ceiling. Core CPI, which excludes food and energy and tends to be less volatile, registered an even sharper acceleration from 4.7% to 5.3% suggesting inflationary pressures are becoming more broad-based. Moreover the recent sharp depreciation in the rand indicates further currency-induced inflationary pressure in coming months. CPI is likely to breach the upper end of the SA Reserve Bank's 3-6% target range in the near-term diminishing prospects for further monetary easing.

In spite of slowing economic growth Finance Minister Pravin Gordhan maintained prudent fiscal policy in the State Budget. Financial markets were encouraged by the conservative Budget even if it entails a lack of stimulus to the economy over the near-term. Gordhan pledged to slow growth in public expenditure in real terms, reducing his earlier forecast of 2.9% growth given in October's Medium Term Budget Policy Statement to 2.3%. The reduction is made possible by the successful multi-year wage agreement with civil service unions signed last year.

GDP growth recovered slightly in the 4th quarter last year but only from a low base and still remains hamstrung by weak mining and manufacturing sectors and an increasingly tired domestic consumption sector which comprises around 70% of GDP. Household disposable income is being battered by rising administered costs including municipal taxes, fuel and electricity while poor employment growth is impacting consumer confidence. For 2012 as a whole GDP grew by 2.5% the slowest pace since the 2009 recession. In spite of an expected slowdown in household consumption GDP growth is likely to improve but only slightly in 2013 to around 2.7% helped by increased

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government infrastructure spending, private sector investment spending and a moderate pick-up in exports.

The private sector seems to see little respite over the near-term explaining the decision by companies to hoard rather than invest their cash. Companies are sitting on cash balances exceeding R500 billion which suggests a lack of confidence in the economy. Undoubtedly the lack of private sector investment confidence is partly related to government policy, especially in the mining sector. The Fraser Institute global mining survey of more than 700 mining executives shows SA fell again in its ranking last year attributed to uncertainty over the direction of SA's mining policies. SA is positioned 53rd ahead of Zimbabwe and the Democratic Republic of Congo but behind Zambia, Namibia, Burkina Faso and Niger. However, there have been some positive developments. The National Energy Regulator of SA (NERSA) awarded Transnet an increase in its petroleum pipeline tariff of just 8.5%, well short of its 22.6% application. The decision will reduce the pressure on fuel prices, assisting both households and businesses. The news follows a similar decision last month when Eskom's application for a 16% electricity tariff increase was halved by NERSA to just 8%.

Although the near-term macro-economic outlook is bleak the private sector is coping admirably, managing to extract respectable earnings growth in a difficult operating environment. Corporate governance is also impressive and should provide solid reassurance to long-term investors. The World Economic Forum global competitiveness report ranks SA 1st out of more than 140 countries for its quality of auditing and reporting standards, compared with the US which ranked 37 and the UK which ranked 13. SA also ranked 1st for the efficacy of its corporate boards. The JSE meanwhile in its latest monitoring report shows that the number of companies contravening international financial reporting standards has dropped sharply, with only 3.8% of companies reviewed required to reissue statements compared with 13% in 2011.

Company earnings are steadily increasing despite the current setting of slow economic growth. Earnings growth by rand hedge companies is especially strong helped by the continuing depreciation of the currency. Equities are likely to remain the top performing asset class over the remainder of the year with valuations remaining attractive at close to their long-term average. The All Share Index is trading on an estimated 13.5X forward price to earnings multiple only slightly above the 12.8X long-term average, and on an estimated 2.0X forward price to Net Asset Value only slightly above the 1.95X average. One could argue that this slight premium over the long-term average is easily justified considering the record low returns on cash and bonds which in many cases are below equity dividend yields. This is extremely unusual and suggests there remains plenty of value left in equity markets.

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