

OAM Local Real Return Portfolios ZAR Rand

DEC 2012

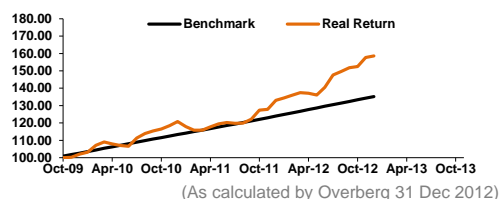
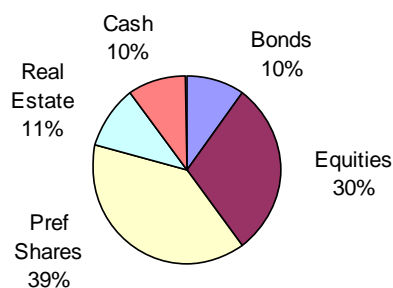
Technical Details

- FSB approved
- Base currency: **South African Rands**
- Minimum investment: **R500 000**
- Benchmark: **Prime Interest Rate**
- Asset Allocation: **flexible mix of bonds, listed commercial properties, pref shares and ordinary shares.**

Investment Objectives:

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

ASSET ALLOCATION



	Real Return %	Benchmark %
Annualised Total Return	15.68	10.00
2010	17.58	11.42
2011	10.14	9.38
YTD	19.21	9.11

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

	Real Return %	Benchmark %
Growth 2012		
January	0.98	0.75
February	1.17	0.75
March	1.10	0.75
April	-0.22	0.75
May	-0.76	0.75
June	3.29	0.75
July	5.00	0.71
August	1.43	0.71
September	1.43	0.71
October	0.41	0.71
November	3.41	0.71
December	0.61	0.71

	%
Annualised Income Yield	10.37

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.

Overberg's Real Return Portfolio is an enhanced alternative to either money market funds or bank deposits, offering the prospect of better after tax returns by generating a sizeable portion of income from dividends. Yield is increased by active management across SA government and parastatal bonds, pref shares and growth assets including listed commercial property and high yielding ordinary shares. Valuation volatility is kept at a minimal level with temporary valuation declines not expected to exceed 5% of the value of the portfolio at any point in time. This is achieved through disciplined asset allocation ranges, and diversification across asset classes and individual holdings. A small, actively managed exposure to growth assets will enhance after tax yields with a minimal increase in risk.

Commentary

Fitch rating agency downgraded SA's sovereign credit rating by one notch in January this year, citing deterioration in economic growth prospects, a decline in competitiveness and rising corruption. SA is now only 2 notches above non-investment grade according to Moody's and only 1 notch above according to S&P and Fitch. A relegation to non-investment grade would result in exclusion from the Citigroup World Government Bond Index (CWGBI) into which SA has only recently been included. A swift reversal of bond inflows would follow.

The ANC elective conference in December at Mangaung fortunately helped to shore up investor confidence, by dismissing any further party discussion of nationalization and by appointing business-friendly Cyril Ramaphosa as Deputy President. However, the rand remains vulnerable due to continued industrial unrest and credit rating downgrades. The economy is also becoming increasingly unbalanced with spending continuing to outpace production, causing an unsustainably high current account deficit measuring 6.4% of GDP in the 3rd quarter. A further deterioration in perceptions could precipitate a sharp sell-off in the rand.

As expected SA's GDP growth rate fell sharply from 3.4% quarter-on-quarter annualized in the 2nd quarter to 1.2% in the 3rd quarter, below the 1.5% consensus forecast. Output in the primary sector contracted - 7.1%, led by a -12.7% decline in mining production following strike activity in platinum and gold mines. Output in the secondary sector increased 1.5% helped by 3.3% growth in construction and 1.6% growth in utilities output. The tertiary sector remained the main engine of growth, increasing output by 1.9%, albeit a marked slowdown from the sector's 4.5% growth in the same quarter a year ago. Within the tertiary sector general government services led the way with growth of 2.7% followed by the business, finance and real estate category with growth of 1.8%.

A moderate improvement in GDP growth is expected in the 4th quarter, with continued weakness in the mining sector likely to be counter-balanced by further strength among wholesalers, retailers and other service providers as households take advantage of lower interest rates and readily available credit. Overall GDP growth of 2.5% is expected in 2012, recovering slightly to 2.7% in 2013 depending on stabilisation in external demand. Unfortunately the engines of economic growth remain narrow and increasingly unsustainable with household spending unlikely to remain buoyant indefinitely in the absence of accompanying investment spending.

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The strain on household spending is already evident. Gross domestic expenditure slowed from a quarter-on-quarter annualized rate of 4.9% in the 2nd quarter to 3.0% in the 3rd quarter, the lowest since the 2nd quarter 2011. The slowdown is attributed to a slowing in household expenditure growth from 3.1% to 2.6%, the weakest since the 3rd quarter 2009. The data did however contain some bright spots: In spite of rapid growth in unsecured lending the ratio of household debt to disposable income remained unchanged at 76.0% while lower interest rates reduced the ratio of debt service cost to disposable income from 6.9% to 6.5%. Growth in gross fixed capital formation (GFCF) increased from 7.0% to 7.2%. While growth in private sector GFCF remained subdued at 2.8%, government's long-awaited infrastructure development programme is finally showing signs of activity. Capital expenditure by general government increased 23.4% attributed to new road construction and maintenance, water infrastructure and informal housing. Investment by public corporations increased 9.3% driven by ongoing projects at Eskom and Transnet.

Encouragingly, the Rand Merchant Bank (RMB)/ Bureau of Economic Research (BER) business confidence index was less affected by industrial unrest and policy uncertainty than might have been expected. Contrary to expectations for a dramatic drop the index only declined from 47 in the 3rd quarter to 46 in the 4th quarter. While the motor vehicle sector suffered a heavy decline from 79 to 54, the other 4 sectors enjoyed slight gains with the manufacturing sector increasing from 33 to 38 and building contractors from 26 to 28, albeit both well below the neutral 50 level. The wholesale and retail sectors were the outperformers, gaining from 53 to 57 and from 46 to 54. More worryingly however, manufacturers overwhelmingly anticipate declining investment spending over the next 12 months and the percentage of manufacturers rating the political climate as a business constraint increased sharply from 58% to 73%, the highest since SA's 1st democratic elections.

The Mechantec CEO Confidence Index was less flattering, dropping from 58.1 in the 3rd quarter to 52.0 in the 4th quarter the lowest since the 2nd quarter 2009 when SA was last in recession. Of the 6 sectors measured including basic materials, consumer goods, consumer services, financial, industrial, and technology, only the financial sector recorded an increase in confidence. The low confidence levels are attributed to political instability, the rising trade and current account deficits, corruption and uncertainty over government policy and the 2014 election. While weak confidence helps explain low investment and employment growth, a positive consequence is the significant increase in the cash balance of non-financial companies, estimated by the Reserve Bank at R542 billion. Current cash reserves offer the potential for a significant increase in private sector investment once confidence returns.

Employment data unfortunately remains dismal with the unemployment rate increasing from 24.9% in the 2nd quarter to 25.5% in the 3rd quarter. While 198,000 new jobs were created during the quarter there were 397,000 new entrants into the labour market. The financial services sector added 74,000 jobs during the quarter followed by manufacturing with 49,000 and transport with 43,000. Meanwhile private households shed 29,000 jobs and the mining sector shed 8000. Total employment is 13.65 million, still below peak employment of 14.03 million reached in 2008. Private employment growth is expected to be modest in coming months due to weakening external markets and declining domestic consumer spending. However, employment in the public sector may increase as government accelerates its infrastructure programme. Average wage growth meanwhile grew by 8% year-on-year or 2.9% in real terms, down sharply from 12% and 6% the previous quarter, likely to exacerbate the slowdown in domestic consumption.

In the context of a challenging economic outlook beset by rising unemployment, industrial and social unrest, policy uncertainty and deteriorating terms of trade, it is surprising the JSE All Share Index has increased to new record highs, for the first time exceeding the key 40,000 level. However, the equity gains are less surprising when identifying the outperforming sectors. A large portion of the market's strength is explained by the rally in rand hedge stocks. We feel this trend will continue and in anticipation of further rand depreciation believe the best opportunities lie in rand hedge stocks. At the same time as domestic risks are rising, conditions in developed economies are brightening. The improving outlook for developed economies and their currencies should dampen the trend of the last few years towards emerging market currencies. We plan to add further rand hedge exposure to the portfolios over coming weeks.

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