

OAM Local Real Return Portfolios ZAR Rand

FEB 2014

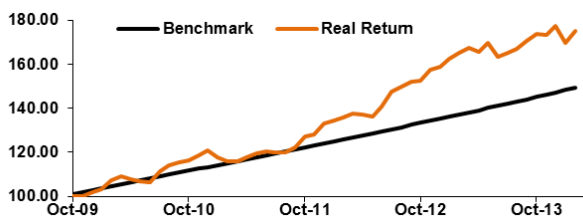
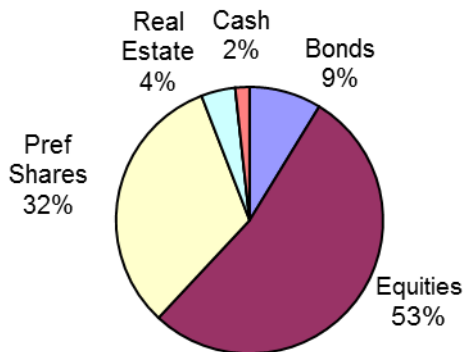
Technical Details

- 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



(As calculated by Overberg 28 Feb 2014)

| | Real Return % | Benchmark % |
|--------------------------------|---------------|-------------|
| Annualised Total Return | 13.78 | 9.71 |
| 2010 | 17.58 | 11.42 |
| 2011 | 10.14 | 9.38 |
| 2012 | 19.21 | 9.11 |
| 2013 | 11.86 | 8.84 |
| 2014 YTD | -1.38 | 1.51 |

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

| | Real Return % | Benchmark % |
|--------------------|---------------|-------------|
| Growth 2014 | | |
| January | -4.35 | 0.75 |
| February | 3.10 | 0.75 |
| March | | |
| April | | |
| May | | |
| June | | |
| July | | |
| August | | |
| September | | |
| October | | |
| November | | |
| December | | |

| | |
|--------------------------------|------|
| | % |
| Annualised Income Yield | 9.24 |

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 Nedbank Private Wealth, 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.

Quarterly Commentary 31 December 2013

SA followed global equity markets higher at the close of the year with the Resources 10, Financial 15, Industrial 25 and All Share indices recording respective gains over the 4th quarter (Q4) of 2.04%, 6.57%, 6.81% and 5.05%. Over 2013 as a whole the indices showed greater disparity of performance with respective gains of -0.43%, 15.27%, 34.85% and 17.85%. Although impressive in rand terms the returns were largely negative when translated into US dollars with the rand depreciating against the dollar by -23.79% over the year. Stemming largely from the rand's performance bonds fared poorly with the All Bond Total Return index (1-3 year) gaining just 4.35% over the year. The rand was not the only casualty during 2013. The dollar gold price also fell heavily by -28.45% from \$1680 to \$1202.

In spite of the rand's sharp depreciation inflation remained well anchored. As expected consumer price inflation (CPI) fell back within the SA Reserve Bank's 3-6% target range, moderating further from 5.5% in October to 5.3% in November. Although CPI has likely bottomed-out over the short-term it is unlikely to exceed the 6% target in spite of recent currency weakness and the threat of imported inflationary pressure. Producer price inflation (PPI) shows there is little need for concern, also declining from 6.7% in September to 6.3% in October. It is notable that PPI for many imported items is not being reflected in CPI data suggesting manufacturers and retailers are probably absorbing the cost increases. In the context of sub-par economic growth the SARB is therefore likely to keep its benchmark interest rate (repo rate) unchanged at 5.0% until at least the 2nd half of 2014.

SA's GDP growth slowed dramatically in Q3 to 0.7% quarter-on-quarter annualised from 3.2% in Q2 and well below the 1.3% consensus forecast. This marks the weakest growth in 4 years, caused mainly by the -6.6% fall in manufacturing output owing to industrial action in the automotive sector. Other sectors also suffered a notable slowdown including finance and real estate, wholesale, retail and accommodation, and electricity and gas sectors. Bright spots

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Directors: Nick Downing, Brett Birkenstock, Gielie Fourie.

included the mining sector which rebounded from its -5.4% Q2 contraction with growth of 11.4%. Agriculture also rebounded after 2 consecutive quarters of contraction with growth of 3.6%. GDP is expected to have accelerated in Q4 as manufacturing activity normalizes although not enough to boost full year figures. For 2013 GDP is unlikely to exceed 2%, placing pressure on the SA Reserve Bank (SARB) to maintain its accommodative monetary policy.

The SA Reserve Bank (SARB) Q3 Quarterly Bulletin showed gross domestic expenditure (GDE) growth slowed to 1.9% quarter-on-quarter annualised as a result of slowing government and household spending. Government expenditure growth slowed from 1.7% to 1.5% while household spending slowed from 2.8% to 2.3%. Household spending, for several quarters the bulwark of SA GDP growth, is showing signs of strain. The FNB/ BER consumer confidence index fell sharply from +1 in the 2nd quarter to -8 in the 3rd quarter, the lowest level in 10 years, attributed to ongoing labour unrest, the decline in formal sector employment, slowing credit extension and rising administered costs such as municipal rates, e-tolls and electricity tariffs. A bright spot is fixed investment growth which accelerated slightly from 2.1% to 3.1%. Less encouraging however, is the sharp deterioration in the current account deficit from 5.9% of GDP in Q2 to 6.8% in Q3 the worst in 4 years, exacerbated by the impact of automotive strikes on vehicle exports. While the strikes have since been resolved the deficit is likely to remain elevated for the foreseeable future and its funding will remain a concern in 2014.

The RMB/ BER business confidence index fell by 6 points from 48 in the 2nd quarter to 42 in the 3rd quarter, which suggests that almost 60% of respondents rated current business conditions as unsatisfactory. Although there are pockets of improvement the data shows SA economic conditions remain challenging. According to the Quarterly Employment Survey SA's total non-agricultural employment increased during Q3 by +16,000, which although an improvement on the -28,000 contraction in Q2 is nonetheless underwhelming. The public sector was the main generator of new jobs with employment in the community, social and personal services sector increasing by +15,000. By contrast employment in the private sector increased by only +1,000.

In a detailed review of SA, Goldman Sachs acknowledged key advances since 1994: a tripling of GDP from \$136 billion to \$385 billion, reduction in consumer price inflation from an average 14% in the 14 years prior to 1994 to an average of 6% in the years that followed, and a rise in gold and foreign exchange reserves from \$4 billion to \$50 billion. In addition, beneficiaries of social grants have increased from 2.4 million people to 16.1 million, and black ownership of the JSE has increased from 5% to 21%. However, the report warned that it was vital for the government to make a "much more determined and coherent" effort to improve the investment climate entailing "a better balanced and friendly regulatory, productivity and labour picture." This would be essential to staving off the "twin" budget and current account deficits, unemployment and inequality. GDP growth would need to be raised from the last 20-year's average of 3.3% to 5% in order to reduce the unemployment rate and debt to GDP ratio by half, while doubling the GDP per capita.

Unfortunately, the Promotion and Protection of Investment Bill (PPIB) proposed by the government does little to improve the investment climate. The PPIB diminishes the rights contained in previous bilateral treaties SA had with various countries. The new bill does not offer the same protection, removing the obligation to international arbitration. With no mention of "fair and equitable" treatment of investors the PPIB increases the leeway for expropriation and allows the government to provide compensation at less than market value if certain conditions apply. If legislated, the bill is likely to make SA less attractive as a destination for foreign direct investment.

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With increasing regulatory uncertainty there is added pressure on Finance Minister Pravin Gordhan to shore-up confidence. Fortunately he presented an encouraging Medium-Term Budget Policy Statement (MTBPS). The budget deficit forecast for the 2013/14 fiscal year was revised lower from 4.6% of GDP to 4.2%. For 2014/15 and 2015/16 the deficits were forecast at 4.1% and 3.8%, comparing favourably with a previous forecasts of 4.6% and 3.9%. The deficits show surprising fiscal prudence given the deteriorating economic growth outlook. The credit ratings agencies are likely to view the MTBPS in a positive light, reducing the risk of a rating downgrade in the near-term.

The economy remains fragile. Consumers are financially more vulnerable and generally wary of spending. Meanwhile, an unfavourable economic, labour and policy environment continues to undermine business confidence, constraining investment and limiting employment. Financing the current account and budget deficits are likely to become harder and more expensive, adding further pressure on the rand. Notwithstanding the particular attraction of rand hedge stocks, and the pricing-in of growth potential from the African continent, we feel that SA equities are becoming expensive with the All Share index trading on an estimated 16.9x forward price-to-earnings multiple. As a result of high valuations and the difficult economic environment we will look for opportunities to make the portfolios more defensive over the coming quarter.

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