Local performance factsheet

OAM Local Real Return Portfolios

ZAR Rand

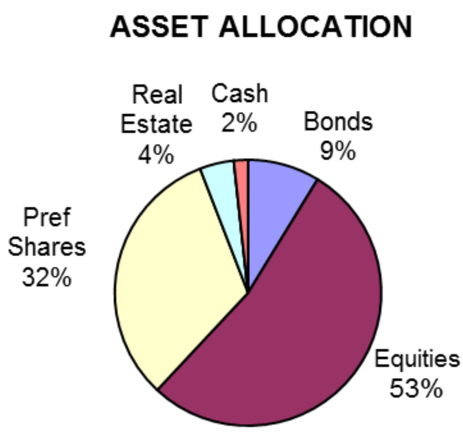
JUL 2013

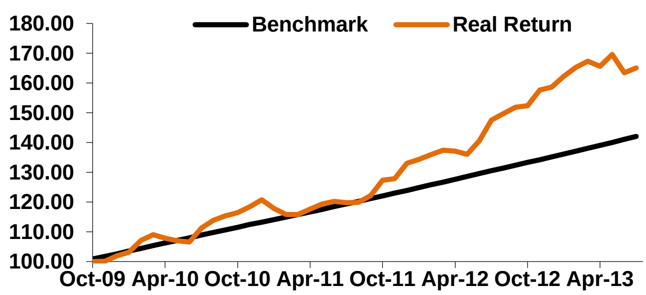
Technical Details

- **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





As calculated by Overberg 31 Jul 2013)

	Real Return %	Benchmark %
Annualised Total Return	14.31	9.82
2010	17.58	11.42
2011	10.14	9.38
2012	19.21	9.11
2013 YTD	4.12	5.06

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

Growth 2013	Real Return %	Benchmark %
January	2.34	0.71
February	1.84	0.71
March	1.21	0.71
April	-1.03	0.71
May	2.43	0.71
June	-3.64	0.71
July	1.04	0.71
August		
September		
October		
November		
December		

	%
Annualised Income Yield	9.73

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.

Commentary

SA was not immune to the wave of global anxiety which followed the Federal Reserve's quantitative easing "tapering" plans. Like other emerging economies SA suffered from capital outflows, currency depreciation and a general decline across asset prices. Commodity stocks were especially badly hit, compounded by China's slowing growth rate. The Resources 10 index fell over the 2nd quarter by -11.29%. The Financial 15 index lost a marginal -0.71% but the Industrial 25 index, laden with strongly performing rand hedge stocks, outshone the rest with a gain of 7.76%, tempering 2nd quarter losses in the All Share index to -0.71%. The rand continued to lose ground declining against the US dollar by -6.96% over the quarter. Besides rand hedge stocks there was little refuge for investors. The All Bond Total Return index (1-3 year) gained just 0.3% over the quarter. Gold, the long standing stalwart, suffered significant losses, declining -20.89% in dollar terms with rand losses even more severe.

While the poor performance of the rand and SA's financial assets is attributed largely to the Fed's actions, the domestic outlook is also to blame. GDP growth slowed in the 1st quarter (Q1) to an annualized rate of just 0.9% well below the 1.6% consensus forecast and a sharp slowdown from 2.1% in the 4th quarter last year, marking the slowest rate of growth since the 2nd quarter 2009. Continued output disruptions in the mining sector, electricity supply constraints, weak global demand and falling commodity prices are impacting negatively on supply side conditions. Meanwhile on the demand side the outlook for household expenditure, in recent years the main driver of growth, appears to have weakened with the FNB/ BER consumer confidence index declining to a 9-year low in the 1st quarter and further still in the 2nd quarter. This trend is likely to continue due to a weak jobs market, heavy debt burdens as well as rising electricity and fuel prices. Household credit is unlikely to make up the slack with growth in total loans and advances to the private sector moderating steadily from the recent peak in December.

The rand has enjoyed some respite in recent weeks but its downward slide may resume soon with SA's latest wage negotiation season set to commence in earnest. Given the slowdown in company profitability especially in the mining sector, the disparity between wage demands and what companies are willing to pay is likely to be wider than usual. The Chamber of Mines has offered a basic wage increase of 4% while the National Union of Mineworkers (NUM) has demanded a minimum pay increase of 60% for all underground mine workers while the rapidly growing Associated Mining and Construction Union (AMCU) has demanded an equivalent increase of 150%. Another outbreak of prolonged strike action and labour unrest seems inevitable especially given the increasingly combative nature of labour relations. Worryingly, the rand has broken its close long-term correlation with global risk appetite, as measured by the VIX index. The rand has been closely correlated with the VIX index over the past 10 years but in the past few months has followed an uncorrelated trajectory. The diversion has increased dramatically in the past quarter suggesting the rand's current vulnerability to domestic rather than exogenous factors.

While currency weakness tends to have less impact on overall inflation in a weak demand environment, if sustained the rand's current rate of depreciation poses a significant risk to the inflation outlook. Meanwhile, core inflation, excluding food and energy, is expected to be adversely affected over coming months by increases in a number of administered prices particularly water and municipal rates and taxes. The SA Reserve Bank (SARB) Monetary Policy Committee (MPC) is also concerned over prospects of a potential wage-price spiral. Unsurprisingly the SARB has resisted any temptation to cut its benchmark interest rate in spite of the economic slowdown. If anything the next move is now more likely to be a rate hike. Forward Rate Agreements are pricing in a 34% chance of a 50 basis point repo rate hike in 3 months-time and a 68% chance in 9 months-time.

Fortunately there are some bright spots. The latest World Economic Forum Global Competitiveness Report placed SA among the best in the world for its strength of auditing and reporting standards, efficacy of corporate boards, protection of minority shareholders' interests and the soundness of banks. Meanwhile a report by the Presidential Review Committee on State Entities was surprisingly encouraging, recommending the partial listing on the JSE of some State-Owned Enterprises (SOEs) and the outright privatization of others. In further positive news the registrar of banks Rene van Wyk reported in the bank supervision report for the year ended December 2012 that average capital adequacy of the banking system remained well above the minimum requirement of 9.5%, at 15.9%. He also described as "remarkable" SA's achievement of being 1 of only 11 countries that had complied with the new Basel 3 regulations by 1st January.

SA's quarterly labour force survey shows 44,000 jobs were added in the 1st quarter. While not enough to accommodate the growing labour force the data is nonetheless promising, showing the 1st net employment gain in the 1st quarter since the current data series began in 2008. The 1st quarter traditionally shows net job losses as temporary hiring over the December festive season is reversed.

Although the near-term outlook for the economy is concerning the private sector remains competitive and should continue to reward shareholders with high returns on equity. Equity valuations have become slightly less attractive following earnings downgrades in the resources sector with the estimated forward price to earnings multiple of the All Share index rising from 13.5 at the end of Q1 to 15.6 at the end of Q2 compared with a 12.8 long-term average. However, certain sectors are offering excellent value especially banks and financials which continue to trade at a sizeable discount to the broader market. Despite elevated valuations we also continue to favour rand hedge stocks based on the uncertain outlook for the rand and likelihood of further sharp declines in the currency.

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