overberg asset management

LOCAL PERFORMANCE FACTSHEET

OAM Local Real Return Portfolios

ZAR Rand

JUL 2015

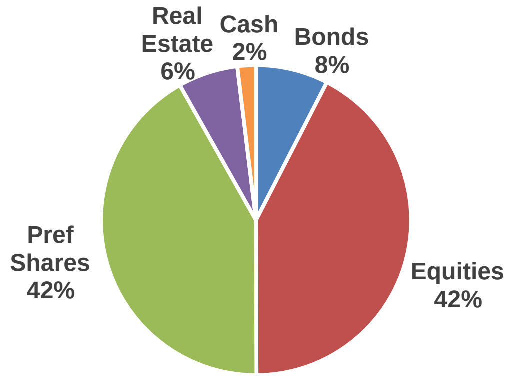
Technical Details

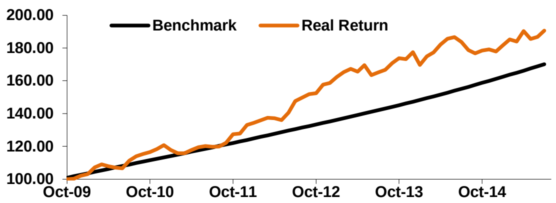
- **FSB** approved
- Base currency: **South African Rands**
- Minimum investment: **R750 000**
- Benchmark: **Prime Interest Rate**
- Asset Allocation: **flexible mix of bonds, listed commercial properties, pref shares and ordinary shares.**

Investment Objectives:

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

ASSET ALLOCATION





(As calculated by Overberg 31 Jul 2015)

	Real Return %	Benchmark %
Annualised Total Return	11.87	9.68
2010	17.58	11.42
2011	10.14	9.38
2012	19.21	9.11
2013	11.86	8.84
2014	0.26	9.52
2015 YTD	7.17	5.54

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

Growth 2015	Real Return %	Benchmark %
January	2.16	0.77
February	1.96	0.77
March	-0.68	0.77
April	3.45	0.77
May	-2.55	0.77
June	0.68	0.77
July	2.05	0.79
August		
September		
October		
November		
December		

	%
Annualised Income Yield	7.59

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 manoeuvrability 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 July 2015

The local equity market struggled to make ground in the second quarter (Q2) constrained by weak domestic economic growth and an increase in global risk aversion stemming from the Greek debt crisis and a sharp sell-off in China's equity market. Only the Industrial 25 index managed a positive +1.7% gain for the quarter lifting the year-to-date performance to +7.06%. The Financial 15 index lost -3.98% for the quarter but held onto a +5.47% gain for the year and the All Share index lost -0.72% for the quarter narrowing its year-to-date return to +4.09%. The Resources 10 index was the clear laggard with respective losses for the quarter and year-to-date of -4.59% and -6.68%. Bond market gains were modest due to the spill-over from the sharp sell-off in German government bonds and the prospect of domestic interest rate hikes. The All Bond Total Return index (1-3 year) returned just +0.92% over the quarter and +2.47% for the year. The rand lost further ground against the dollar falling -1.61% over the quarter and -5.82% since the start of the year to R/$12.28. The gold price lost -2.25% over the quarter but remained relatively stable considering the strength of the dollar with a year-to-date loss of just -0.85% to $1173 per ounce.

GDP growth slowed markedly from 4.1% quarter-on-quarter annualized in Q4 2014 to just 1.3% in Q1. The culprits were manufacturing which contracted -2.4% annualized and agriculture which shrank by a surprisingly large -16.6%. Unfortunately recent indicators suggest the SA economy fared little better in Q2 due to the disruptive effects of load shedding, low commodity prices, poor domestic demand and weak demand from external markets. Mining production fell in May by a far worse than expected -4.7% month-on-month and the -4.1% contraction in April was revised lower to -4.7%. Production of iron ore, platinum group metals, and coal each contracted by -7.0%, -8.3% and -8.8% on the month. Manufacturing production fell in May by -0.5% marking two straight months of contraction following the -2.0% reading in April.

The Reserve Bank's latest Quarterly Bulletin shows growth in household consumption expenditure increased +2.8% quarter-on-quarter in Q1 up from +1.6% the previous quarter. However, consumer confidence remained generally weak, impacted by high debt, rising inflation, and weak employment growth. Meanwhile government consumption expenditure declined -1.9% on the quarter, the first quarterly drop since 1998, brought about by civil servant resignations due to 'misinformed' fears over pension fund reforms. Growth in fixed capital formation, a key driver of the pace of economic activity and job creation in the years to come, slowed from +2.6% to a modest +1.8% on the quarter. Growth in capital outlays by the private sector, which accounts for almost 64% of total capital formation, eased from +1.7% to +1.6%. Capital expenditure by public corporations fell by -0.6% as construction of the country's new power plants was once again disrupted by strikes and technical problems.

The current account deficit unexpectedly narrowed from -5.1% of GDP in Q4 2014 to -4.8% in Q1 better than the -5.1% consensus forecast. The cumulative trade deficit for the first five months of 2015 was smaller at -R29.41 billion compared with the -R48 billion recorded over the same period last year. The outlook for the current account deficit will benefit from lower oil prices, higher vehicle exports and a normalization in platinum group metal exports. However, any improvement will likely be held back by continued electricity supply disruptions and lower commodity resource export prices.

Despite the improved current account balance SA still has the largest deficit among emerging markets making it especially dependent on portfolio capital inflows. On the last six occasions when the Fed started tightening interest rates portfolio capital inflows into emerging markets either diminished or reversed, adding to the already negative outlook for the rand. SA's vulnerability is increased by the scale of foreign ownership of its financial assets. SA's bond market has the highest level of foreign ownership out of all emerging markets with the sole exception of Indonesia. Over 40% of SA's domestic bonds are owned by foreign investors, making the rand especially prone to any change in sentiment. Surprisingly the rand has outperformed other emerging market currencies since the start of the year with the trade weighted rand index only losing -6% compared with losses of -17% and -15% for the Brazilian real and Turkish lira. The rand's relatively strong performance is remarkable considering the challenges ahead including large budget and current account deficits, uncertain policy environment, and load shedding. The rand's surprising resilience so far signals the potential for significant depreciation from current levels.

The rand's depreciation is spilling over into higher inflation. Consumer price inflation (CPI) has accelerated steadily from 4% year-on-year in March to 4.5% in April and 4.6% in May. CPI is expected to rise to around 6.6% by year-end, well above the SA Reserve Bank's (SARB) 3-6% inflation targeting range. Thereafter, inflation is expected to moderate slowly but to remain above 6% for much of 2016. SARB Governor Lesetja Kganyago has sounded increasingly "hawkish" in recent weeks citing concerns over how firmly inflation expectations are anchored at 6%. Kganyago said the SARB would have to hike rates if it believed there would be a persistent breach of the inflation target. The prospect of further rand weakness raises the likelihood that the inflation breach will be worse than the current SARB forecast. The deteriorating inflation outlook has caused the Forward Rate Agreement market to price-in 170 basis points of rate hikes over the next 21 months.

In the Institute of Management Development (IMD) annual world competitiveness ranking SA dropped from 52 last year to 53, out of 61 economies. The IMD cited SA's electricity infrastructure issues ranking the economy in last place on this category. In addition the IMD cited poor performance in terms of education and health, as well as labour regulations. The country's ranking has fallen sharply since 2012 when it was placed 37.

There have been some positive developments. Standard & Poor's and Fitch credit rating agencies left SA's sovereign risk ratings unchanged although both agencies cited concern over the country's weak economic potential, lack of appropriate economic reform, sizeable government debt and dependence on volatile portfolio flows. Encouragingly the government and public sector unions agreed to a three-year wage deal. The deal comprises a 7% wage increase in year one followed by wage increases of CPI plus 1% in years two and three. Although slightly above the SARB's 3-6% CPI target range the long-term nature of the deal should provide certainty in budget forecasting. The National Energy Regulator of SA (Nersa) also provided cause for celebration after declining the application by Eskom for a 9.58% tariff increase.

Perhaps most encouraging is the renewed decline in the oil price. After reaching a peak of close to $70 per barrel in early May the Brent crude oil price has since fallen below the key $60 level. The International Energy Agency (IEA) highlights that oil supply is growing far quicker than demand exacerbating the global oil glut which suggests the oil price will fall further over coming months. Global crude oil inventories increased in Q2 by an estimated 2.5 million barrels per day (mb/d) up from 1.8 mb/d in Q1 and more than double the 2014 average of 1.1 mb/d. Cheaper oil will be a windfall for SA which imports 100% of its oil. The benefit from lower oil prices will be felt throughout the SA economy, lowering company production and transportation costs, boosting profit margins and earnings growth. Households will also be key beneficiaries, with lower oil prices translating to cheaper petrol and higher disposable income. Lower oil prices will boost the JSE especially those sectors exposed to high transportation and logistics costs, and household discretionary spending.

While the outlook for the broader SA economy is not especially encouraging with slow growth expected over the medium-term certain sectors of the equity market offer good investment opportunities. For instance the financial sector which has little exposure to union activity or labour unrest, and will remain relatively unscathed by electricity outages. The low oil price will be of particular benefit to certain companies, involved in logistics, distribution and consumer discretionary sectors. With the rand likely to depreciate further in coming months amid a gradual improvement in the global economy rand hedge stocks should also continue to provide solid outperformance. The only exception is the mining resource sector which remains prone to global over-supply and the slowdown in China’s demand for raw materials.