LOCAL PERFORMANCE FACTSHEET

OAM Local Real Return Portfolios
ZAR Rand

NOV 2014

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:

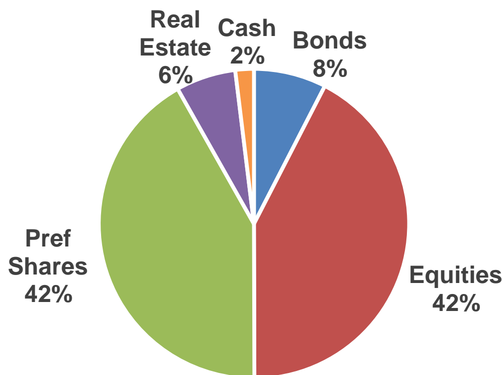
- conservative growth with income
- consistent annual real returns
- low volatility

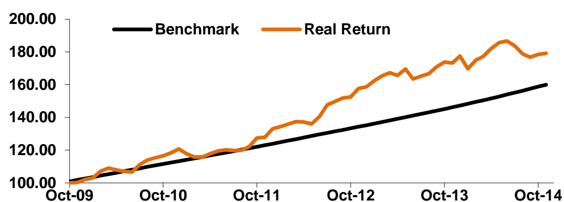
	Real Return %	Benchmark %
Annualised Total Return	12.15	9.68
2010	17.58	11.42
2011	10.14	9.38
2012	19.21	9.11
2013	11.86	8.84
2014 YTD	0.95	8.68

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

Growth 2014	Real Return %	Benchmark %
January	-4.35	0.75
February	3.10	0.75
March	1.37	0.75
April	2.71	0.75
May	1.93	0.75
June	0.54	0.75
July	-1.63	0.77
August	-2.67	0.77
September	-1.09	0.77
October	0.95	0.77
November	0.36	0.77
December		

	%
Annualised Income Yield	8.32





(As calculated by Overberg 30 Nov 2014)

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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 30 November 2014

After rallying in the first half of the year SA's equity markets succumbed to profit taking during the third quarter (Q3) with the local market unnerved by global jitters and the pending normalisation of US monetary policy. The All Share Index fell -3.16% in Q3 although maintained a gain for the year of 6.66%. The biggest culprit was the Resources 10 index which fell over the quarter by -7.74% reducing its gain for the year to 3.04%. The Financial 15 index outperformed with a modest decline of -1.63% and a gain of 11.63% for the year, followed by the Industrial 15 index with a Q3 loss of -2.08% and year-to-date gain of 7.14%. After a steady performance over the first two quarters the rand declined against the dollar by -6.44% in Q3. Surprisingly bonds continued to fare well in spite of currency weakness with the All Bond Total Return index gaining 1.16% over the quarter with a year-to-date gain of 3.69%. The gold price fell in reaction to the surge in the US dollar pushing the dollar gold price down by -8.33% although for the year gold maintained a slight gain of 0.41%.

The economy narrowly averted a technical recession after SA's GDP grew in Q2 by 0.6% quarter-on-quarter annualised an improvement on the -0.6% contraction in Q1 but below the 0.9% consensus forecast. The small improvement in quarterly growth is attributed to a pick-up in agricultural output and improved activity in the transport sector. While the platinum strike was resolved in June this was too late to avoid further contraction in the mining sector with mining production declining in Q2 by almost -10% on the quarter. Manufacturing output also declined in Q2 by -2.1%.

On the expenditure side, household consumption (HCE) growth continued to struggle, slowing from 1.8% in Q1 to 1.5% in Q2. Growth in household disposable income decelerated from 1.7% to 1.3% its slowest growth since the second quarter of 2009, hurt by higher inflation and labour strikes. The FNB/ BER consumer confidence index fell from +4 during Q2 to -1 in Q3 well below the 20-year average of +5. The decline is attributed to a deterioration in consumers' outlook for the economy and for household finances.

Investment spending also weakened. Gross fixed capital formation slowed from 2.6% in Q1 to 0.5% in Q2 its slowest growth since 2009, reflecting a contraction in investment outlays by both the private sector and public corporations. Capital expenditure by private business declined by -1.1% in Q2 compared with a 1.0% increase in Q1. Capital expenditure by the private sector will probably remain muted in the third quarter. The RMB/BER business confidence index is viewed as a proxy for capital expenditure by the private sector and while the

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index increased by five points in Q3, it is still only at 46 below the key 50 level which demarcates expansion from contraction.

Economic indicators signal that growth will remain lacklustre in Q3. The metalworkers' strike affected large parts of the manufacturing sector throughout July and while the Kagiso manufacturing purchasing managers' index (PMI) recovered the key 50 level in September some of the sub-indices were less auspicious. The employment index decreased sharply from 44.9 to 37.0 and the forward-looking new orders index fell from 53.0 to 47.4 providing a pall over the longer-term outlook. At the same time the prices index increased even further from an already elevated 77.3 to 78.6 suggesting a steady build-up of inflationary pressure. The data paints a bleak picture of slow growth combined with rising inflation.

Consumer price inflation (CPI) has exceeded the SA Reserve Bank's (SARB) 3-6% target range since March. CPI surprised on the upside in August, edging up to 6.4% from 6.3% in July due mainly to higher food prices. However, the gradual rise in core CPI, which excludes volatile food, petrol and energy costs, also continued rising to 5.8% from 5.7% in July. CPI is expected to stay above 6% for the remainder of the year and into the first half of next year.

In spite of inflationary pressure the Reserve Bank's Monetary Policy Committee left the key repo interest rate unchanged at 5.75% in September, with the Governor highlighting that the "combination of stubborn inflation and a sluggish growth outlook continues to pose a difficult dilemma for monetary policy." The Reserve Bank lowered its 2014 GDP forecast from a previous 1.7% to 1.5% and for 2015 from 2.9% to 2.8%. However, there is likely to be a further 25 basis point rate hike at the next policy meeting in November. The newly appointed SARB Governor Lesetja Kganyago has stressed in recent speeches the need to gradually tighten monetary policy to address the deteriorating inflation outlook and current account deficit. The repo rate is likely to be 6% by year-end and rise in gradual increments to 7% by the end of 2015.

SA's current account deficit deteriorated from 4.5% of GDP in Q1 to 6.2% in Q2 far worse than the 5.5% consensus forecast. South Africa's current account deficit has ballooned in recent years from just 1.5% of GDP in 2011. Capital flowing into SA had been rising over the past three years accommodating the increasing current account deficit. However, SA is especially vulnerable to a reversal of capital inflows. Foreign direct investment (FDI) into SA had been driven by the boom in commodities. Unfortunately the boom is rapidly unwinding due to slowing commodity demand from China. Meanwhile government policy uncertainty and labour unrest is providing an added headwind to FDI. As a result of expected reductions in FDI, SA will become increasingly dependent on portfolio inflows which can be more easily reversed. Moreover, most portfolio inflows in the recent past have been into SA's bond markets which are more susceptible than equity markets to changes in US interest rates. Foreigners now own 40% of SA's domestic bonds up from 20% at the start of 2011.

SA's Quarterly Employment Statistics show formal sector employment increased in Q2 by 155,000 the largest quarterly increase since the data series began in 2006. However, the bulk of the jobs were created by the public sector with an addition of 143,000. There is concern that many of the public sector jobs created may be related to the national election during Q2 and the expanded public works programme which means the jobs may be low-paid and only temporary.

Labour market rigidities remain a significant constraint on economic growth. In addition to work stoppages trade union power tends to cause wages to rise faster than productivity in turn denting company profitability and the willingness to hire labour. SA's formal sector unemployment rate of 25% is among the highest of all emerging markets. Encouragingly the government has recently broken with its long-standing traditional support of the unions. Significantly, SA's Deputy President Cyril Ramaphosa is pushing for a change in union rules which would require union members to vote in a secret ballot prior to a strike. This would reduce the likelihood of strike action. Under the current arrangement trade unions are allowed to organize a strike without consulting members. The Youth Employment Bill is also significant. In spite of union protests that it would jeopardize existing jobs the Bill was introduced earlier this year providing companies with incentives to hire

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young workers. The government's change in attitude towards the unions is encouraging. Further evidence of this trend should be closely watched as a clue to the economy's growth potential.

The appointment of Lestja Kganyago as Reserve Bank Governor came as a relief to financial markets, ensuring a continuation of prudent monetary policy. Nonetheless the policy and economic outlook remains uncertain. Investors are likely to remain wary in the build-up of Finance Minister Nene's first Medium-Term Budget Policy Statement and the anticipated sovereign debt rating updates from Moody's and Fitch rating agencies. However, equity valuations are becoming more attractive. At the end of Q2 the All Share index was trading on an estimated 18.7x forward price-to-earnings multiple. Equity market declines over the past quarter combined with earnings growth over the period have reduced the multiple to 16x which although still above the 14x long-term average is beginning to show better value. At some stage before the end of the year we envisage returning portfolios to a more fully invested position.