OVERBERG MARKET REPORT  
Week ending 8th February 2013

INTERNATIONAL

- The US Institute for Supply Management (ISM) Purchasing Managers’ Index (PMI) measuring conditions in the services sector, decreased slightly from 55.7 in December to 55.2 in January but above the 55.0 consensus forecast and well above the key 50.0 level which demarcates expansion from contraction. Encouragingly, the employment sub-index increased sharply from 55.3 to 57.5. The manufacturing PMI meanwhile increased from 50.2 to 53.1 a 2nd successive monthly increase with all 5 of the component indices, including new orders, employment, supplier deliveries and inventories, above 50 in January. The forward-looking new orders sub-index increased from 49.7 to 53.3 and the employment index from 51.9 to 54.0 adding to the improvement in economic outlook.

- The US Labour Department reported non-farm payrolls increased in January by 157,000 in line with consensus forecast and gains over the previous 2 months were revised upwards by 127,000. However, the increase was not sufficient to accommodate new arrivals in the labour force causing the unemployment rate to rise over the month from 7.8% to 7.9%. The data reduces the likelihood of the Fed allowing its quantitative easing programme, which it has pledged to maintain until unemployment reduces to 6.5%, to expire early.

- US net household wealth increased in 2012 by $4.8 trillion, helped by a further increase in real incomes and continued deleveraging. The bulk of the increase however is attributed to rising equity markets which added $3.6 trillion and a recovery in home prices which added $1 trillion. Having fallen sharply in the 2008/09 recession net household wealth has recovered steadily from a low of around $50 trillion to $65.1 trillion, close to its 2007 high. Rising household wealth has multiplier effect on GDP growth, with each dollar increase in equity related wealth creating an estimated 2 cents in additional household expenditure, and equivalent increase in housing wealth boosting household consumption by an estimated 10 cents. With household consumption contributing around 75-80% of US GDP, a continuation of the recent trend of rising equity and housing markets should provide a solid tailwind to GDP growth prospects.

- Recovery in overseas demand combined with continued depreciation in the yen is boosting Japan’s economic outlook. Japan’s coincident composite index measuring current business conditions increased in January for the 1st time in 9 months, indicating the economy is moving out of its brief recession in 2012. The rebound is attributed to increases in industrial output, shipment volumes, and deliveries of durable goods. Core private sector machinery orders, traditionally a reliable lead indicator for investment spending, unexpectedly increased in December by 2.8% month-on-month, well ahead of the -0.6% consensus forecast decline. Meanwhile, Japan’s outstanding bank loans increased in January by 1.6% year-on-year, up from 1.4% in December and marking the 16th successive increase. Growth in bank loans is likely to accelerate as the Bank of Japan (BOJ) launches its open-ended new lending facility aimed at incentivizing banks to increase loans.

- As expected the ECB left its benchmark interest rate unchanged at 0.75% and resisted any initiation of quantitative easing, in spite of the euro appreciating in the past month to a 14-month high of $/€ 1.37 against the US dollar. ECB President Mario Draghi said...
the decision had been "unanimous". The ECB has not yet resorted to quantitative easing (QE): Its asset repurchases have so far been "sterilized", with funds equivalent to those that it injects into the financial system being simultaneously drained elsewhere with no net increase in money supply. However, QE remains on the agenda: Mario Draghi acknowledged that a stronger euro might lower the inflation outlook, suggesting this might enable more policy support. The ECB currently forecasts consumer price inflation (CPI) will decrease from 2.2% in 2012 to 1.6% in 2013 and 1.4% in 2014, well below the 2% target. France’s government is adding political pressure on the ECB to slow the euro’s appreciation, which is affecting the Eurozone’s competitiveness, especially in the region’s periphery.

- The euro retreated this week from a 14-month high versus the US dollar attributed to allegations of corruption against Spain’s Prime Minister Mariano Rajoy. The yield on Spain’s 10-year sovereign bond increased in response to the scandal from lows of 4.9% in mid-January to 5.5% earlier this week. Meanwhile Italy’s former Italian Prime Minister Silvio Berlusconi is gaining ground with his populist rhetoric ahead of the country’s general election next month. Increased support for his centre-right coalition could make it harder for Italy’s centre-left to form a stable parliamentary majority and lead continued efforts at restoring the economy’s competitiveness.

- Germany, the Eurozone’s largest economy, reported industrial production increased in December by 0.3% month-on-month, beating the 0.1% consensus forecast and ending 3 straight months of declines. The increase occurred in spite of a -8.9% month-on-month decline in construction spending, a notoriously volatile reading which is likely to reverse in coming months and add to the improved outlook. Encouragingly the forward-looking factory orders index increased 0.8% on the month, with demand from the Eurozone increasing sharply by 7.0%. The data follows stronger than expected improvements in business and investor sentiment in January and a decrease in the unemployment rate to 6.8%, matching a 2-decade low. In its statement the Economy Ministry wrote that “the recovery in factory orders and the clear improvement in important confidence indicators in recent months suggest the weak phase is coming to an end.”

- Ireland’s October 2020 sovereign bond yield fell below 4.0% the lowest equivalent yield since early 2007, in celebration of a long-awaited deal with the ECB. The deal eases the interest repayment on bailout funding, expected to reduce Ireland’s borrowing requirement by €20 billion over the next 10 years and reduce the budget deficit by €1 billion a year from 2014 onwards. Moreover the deal should help end Ireland’s reliance on additional EU-IMF loans by the end of this year.

- As expected the Bank of England (BOE) kept its benchmark interest rate and securities repurchase programme unchanged. However, Mark Carney, the current Governor of the Bank of Canada who will be taking over as BOE Governor in July, told the Treasury Select Committee hearing in his 1st public appearance in the UK that there will "unquestionably" still be room for "considerable monetary stimulus." He said the BOE should consider a more "flexible" consumer price inflation (CPI) target, allowing CPI to stay above the 2% target for as long as 3 years as opposed to the current time limit of 2 years. He is widely expected to introduce a dual mandate including GDP growth and inflation, as opposed to just inflation which has been the case for the past 20 years. The BOE will probably increase its quantitative easing programme when Mark Carney begins his tenure in July, adding to the likelihood of a sharp depreciation in sterling.

- The UK Purchasing Managers’ Index measuring conditions in the services sector rebounded from 48.9 in December to 51.5 in January, returning above the key 50 level which indicates expansion. The employment sub-index increased to its highest in
6 months and the business confidence sub-index reached its highest level since May 2012. The pick-up occurred in spite of snowy weather during the month. With the service sector comprising around 75-80% of UK GDP, the data suggests a rebound in economic growth in the 1st quarter 2013 following the -0.3% contraction in the 4th quarter 2012.

- Indonesia’s GDP grew in the 4th quarter 2012 by 6.11% year-on-year, slowing slightly from 6.17% in the 3rd quarter. Although impressive this marks the slowest growth in 2 years, due to weakening export markets and slowing government infrastructure spending. However, domestic demand remains strong, helped by rising disposable income and increasing household purchasing power. Growth should quicken this year in response to domestic demand and gradual recovery in the global economy, with the Ministry for the Economy forecasting GDP growth of 6.8% in 2013 and 7.0% in 2014.

SA ECONOMY

- Growth in manufacturing production slowed from 3.7% year-on-year in December to 2.0% in January, below the 2.9% consensus forecast. The best performing sector was “petroleum, chemical products, rubber and plastic products” which increased 5.2% on the year and contributed 1.3 percentage points of the aggregate manufacturing increase. On a month-on-month basis manufacturing production fell 2.2% in December reversing most of the 2.6% increase in November. Public sector infrastructure spending is likely to provide the most support for manufactured products in the context of weak demand from external markets and moderate domestic consumer demand. This trend should favour industries producing capital goods and other inputs for local infrastructure projects.
- In the 4th quarter 2012 a total of 68,000 jobs were lost and 257,000 more people were unemployed compared with the same year-ago period. The reduction in the unemployment rate over the quarter from 25.5% to 24.9% is explained by the high number of discouraged job seekers which increased over the quarter by 87,000. Most jobs in the quarter were lost in the “private households” category totaling 48,000, followed by 41,000 lost in the trade sector and 18,000 in the transport sector. The agricultural sector added 24,000 jobs in spite of farm-related labour unrest. Over 2012 as a whole the public sector was the strongest employer adding 126,000 jobs, followed by the financial services sector which added 65,000 jobs. Despite labour unrest the mining sector added 30,000 jobs over the year but the manufacturing sector lost 59,000 over the same period.
- Growth in total vehicle sales recovered strongly from 1.8% year-on-year in December to 14.1% in January. Passenger vehicle sales increased 12.2% and sales of light commercial vehicles increased 20.0%. While the cycle of passenger vehicle replacement is close to saturation the potential remains for increasing demand for commercial vehicles. Meanwhile, vehicle exports are gaining momentum, increasing in January by an impressive 49.9% on the year.

KEY MARKET INDICATORS

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<th>YEAR TO DATE %</th>
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<td>JSE All Share</td>
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Overberg Asset Management (Pty) Ltd is authorised as a Category 2 financial services provider.
Directors: Nick Downing, Gielie Fourie, Brett Birkenstock.

JSE Fini 15  +2.90
JSE Indi 25  +4.49
JSE Resi 20  +4.13
R/USD       - 5.76
S&P 500     +5.83
Nikkei      +9.25
Hang Seng   +2.30
FTSE 100    +5.61
DAX         - 0.28
CAC 40      - 1.10
MSCI World  +4.74

TECHNICAL ANALYSIS

- The US dollar has dropped below the key $/€ 1.30 level versus the euro confirming the longer-term trend remains dollar weakness.
- The rand has fallen through successive support levels at R/$ 8.20 and R/$8.60 and seems set to weaken further, targeting the R/$ 9.0 level during 2013. It needs to return below the key R/$8.00 level to restore medium-term stability. Being the most liquid emerging market currency, the rand is a good barometer for global risk appetite.
- The JP Morgan global bond yield has broken up from a descending “falling wedge” pattern which often signals a trend-reversal. The likely catalyst for the trend reversal is the renewal of central bank quantitative easing (QE). The 2 previous US QE programmes both triggered a sell-off in bonds as investors switched to so-called riskier assets.
- The shorter dated R157 SA Gilt has broken lower from its medium-term trading range of between 5.25-5.75% to a new trading range of 5.00-5.55%.
- US and global equity markets have broken above key technical resistance levels in the past month suggesting further gains in the near-term.
- The Nikkei exhibits the most bullish pattern from a technical viewpoint with the recent descending “flag pattern” signaling a likely continuation of the recent upward move to a potential target of 15,000.
- The Coppock Curve is a long-term momentum indicator with an excellent track record in identifying major market bottoms. It shows that the March 2009 low was a long-term low unlikely to be broken.
- The Brent crude oil price is clinging onto the key $108 support level, preserving its long-term bull trend.
- Copper is regarded a reliable lead indicator for industrial commodity prices and barometer of global economic growth. It is struggling to remain above the key medium-term uptrend which if broken could signal a strong directional change and significant additional downside.
- The Economist’s world food index has tripled since its base in 1999-2001 and continues to threaten rising global food price inflation. However, agricultural prices have fallen steadily since mid-2012 which suggests a gradual leveling-off in the strong long-term upward trend.
- Gold needs to regain the key $1750 before scaling the next medium-term target of $2000. The risk of a dramatic sell-off is rising following 11 straight years of price gains.
The All Share index has increased to a new record high but is forming a "rising wedge", a pattern often associated with a change in trend. Financials are likely to continue outperforming Industrials which in turn are expected to outperform Resources. Small cap stocks still offer good value relative to the All Share and likely to continue their outperformance in 2013.

**BOTTOM LINE**

- Of the 300 or so constituents of the US S&P 500 index which have so far reported quarterly earnings, around 74% have beaten consensus forecasts. This is a higher proportion than any of the past 4 quarters and above the average since 1994. Since the past quarter the consensus aggregate 2013 earnings growth forecast for the index has been revised upwards from 1.7% to 4.5%. US companies are sitting on excess cash reserves estimated at around $2 trillion. These have accumulated due to a protracted negative economic outlook and more recent fiscal cliff concerns. However, the retreat of these anxieties should help unlock pent-up investment spending. An early clue is the level of expenditure on mergers and acquisitions, which picked-up strongly in the 4th quarter with about $427 billion in announced deals compared with about $272 billion in the year-ago period. Investment spending has been the missing link in the economic recovery so far and could be the potential catalyst for an upside surprise to GDP forecasts in 2013.