overberg asset management

LOCAL PERFORMANCE FACTSHEET

OAM Local Growth Portfolio

Technical Details

2019 Q2

- Base currency: **South African Rands**
- Benchmark: **JSE All Share**
- Asset Allocation: **Flexible mix of equities, bonds and cash**
- Individual portfolio representing Local Growth investment style
- All performance figures include income and are net of fees and expenses

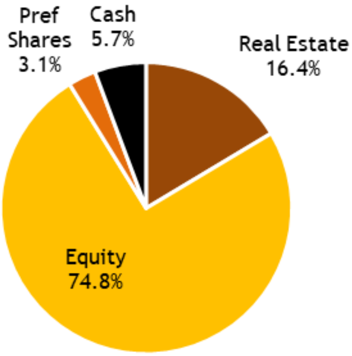
Investment Objective

- Conservative growth
- Consistent annual returns
- Low volatility

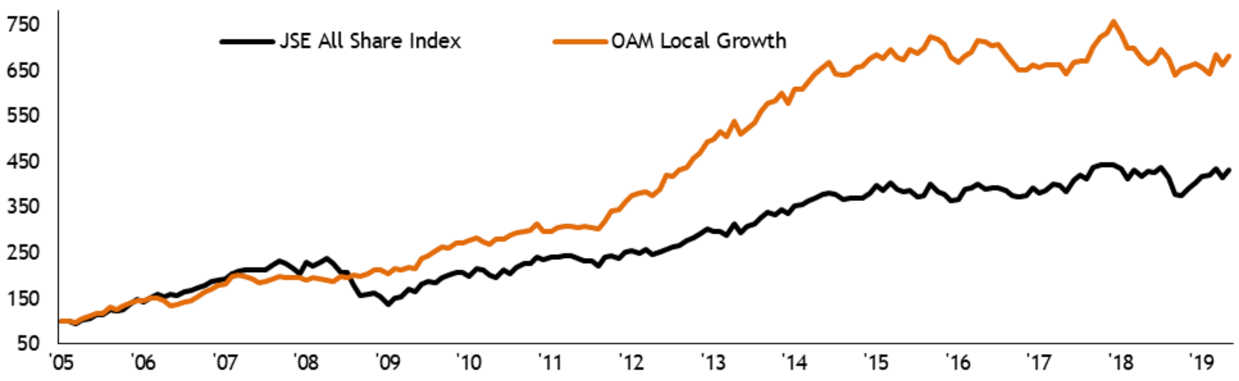
Annualised Growth (%)	OAM	JSE ALSI
Inception March 2005	**14.32**	**10.01**
10 years	12.28	10.19
7 years	8.30	8.12
5 years	0.75	2.70
3 years	-1.47	3.68
2019 YTD not annualised	3.26	10.37

Annualised Income Yield	1.67%

ASSET ALLOCATION



Top 5 Holdings	
DISCOVERY LTD	
NASPERS LTD	
RMB HOLDINGS LTD	
TRANSACTION CAPITAL LTD	
ANGLOGOLD ASHANTI LTD	
Total number of holdings	23



Local Market Review and Strategy Outlook

During the second quarter (Q2), it was revealed that South African GDP posted its biggest quarterly contraction since Q1 2019. GDP shrank by a substantial 3.2% quarter-on-quarter annualised versus growth of 1.4% in the previous quarter. Despite the almost recessionary state of the economy, the JSE continued to post solid gains in Q2, boosted by improved political and policy certainty following the May 8th National Election, and a constructive global environment for emerging market currencies and asset prices. The All Share Index added a further 3.08% in Q2 lifting its year-to-date (YTD) return to 10.37%. The Resources 20 Index was the frontrunner with a Q2 and YTD return of 2.28% and 16.83%, followed by the Industrial 25 Index with respective gains of 4.10% and 12.65%. The Financial 15 Index was the laggard due to its greater domestic focus, leading Q2 gains with 4.49% but falling short YTD with a modest return of just 3.74%. As usual, the All-Bond 1-3 Year Total Return Index continued to provide solid ballast, with modest but reliable Q2 and YTD returns of 2.66% and 4.60%. The rand lost 1.88% versus the dollar in Q2 but maintained its YTD gain of 1.22%, while the dollar gold price flourished in line with expectations of easier global monetary policy, rising from $1292 to $1408 in Q2, a 9.04% increase, burnishing a YTD gain of 9.89%.

The contraction in GDP, although well below the consensus forecast, was somewhat expected given the weak economic data that was released prior to the GDP announcement. On a quarter-on-quarter basis seven of the ten sub-sectors contracted. The sectors that recorded the biggest contraction included agriculture (-13.2%), mining (-10.8%), manufacturing (-8.8%) and electricity (-6.9%). The only three sectors that recorded a quarter-on-quarter increase were personal services (1.2%), finance (1.1%) and government (1.2%). GDP growth will need to improve dramatically in the remaining quarters of 2019 if South Africa is to achieve the 1% GDP growth rate the South African Reserve Bank (SARB) forecasts for 2019. Fortunately, monthly data over April, May and June indicate a growth recovery albeit a modest one in Q2. Manufacturing output has rebounded, and retail sales have been stronger than expected, receiving a substantial boost over Easter. Mining output has continued to contract although at a slowing pace signaling a bottoming out and an expected recovery in the sector in the second half of the year. While domestic vehicle sales have been weak due to poor consumer demand, there is growing business demand in the truck segment, and vehicle exports have grown strongly, which together with other export data and an improvement in South Africa's terms of trade, bode well for the trade balance and the current account.

Total new vehicle sales continued to decline in June dropping by 1.6% year-on-year hamstrung by low business and consumer confidence, and growing pressure on household disposable income. However, vehicle exports were again the shining light increasing by 14.3% on the year. Vehicle exports for the year to date were 19.3% higher than the corresponding period last year. Improving new vehicle exports bode well for the country's trade balance and a narrowing of the current account deficit. The cumulative trade deficit in the five months to end May was R6.05 billion an improvement from R12.1 billion recorded for the same period in 2018. While the current account deficit, measured as a percentage of GDP, deteriorated to 2.9% in Q1 from 2.2% in Q4 of 2018, it should improve over the remainder of the year, providing support to the rand.

Sadly, the South African unemployment rate in Q1 increased to 27.6% up from 27.1% in the previous quarter. Traditionally unemployment in Q1 is expected to be higher, given the fact that school leavers enter the labour force and various temporary workers' contracts end after the festive season. However, the figures make for poor reading. Year-on-year the unemployment rate increased by 0.9%. Consumer confidence remained depressed due primarily to the weak labour market and the effect of higher personal income taxes, and sharp fuel and electricity price hikes on household disposable income. The FNB/BER Consumer Confidence Index increased slightly in Q2 to +5 index points, up from +2 in Q2 but below the +7 level recorded in Q4 of 2018 and well below the +26 level achieved just after president Ramaphosa took office in Q1 2018.

Among business confidence surveys, the ABSA Manufacturing Purchasing Managers Index (PMI) increased slightly from 45.4 in May to 46.2 in June, although still below the neutral 50-level which separates contraction from expansion. Among the PMI sub-indices, the business activity, new sales orders and inventory indices all increased on the month, although none exceeded the neutral level. The employment index average for Q2 was the lowest since 2009 which does not bode well for job creation in the strained manufacturing sector. While moving in the right direction the manufacturing PMI remains deep in contractionary territory. A greater urgency from government in implementing much needed structural reforms may be required for the PMI to revert to 50-plus expansionary territory. More encouragingly, the SARB Composite Leading Business Cycle Indicator, a key barometer of expected business conditions 6 months ahead, increased in the first four months of the year from 103.1 to 105.5, which suggests a much-needed improvement in economic conditions in Q2 and Q3 at least compared with Q1.

The SARB, as expected, kept its benchmark repo interest rate unchanged at 6.75%. However, the decision was not unanimous. Three members of the Monetary Policy Committee voted to keep rates on hold while two members voted for a cut of 25 basis-points. The improved inflation outlook for the rest of the year has set the tone for a possible interest rate cut by the SARB, made more likely by the new easing bias from the US Federal Reserve (Fed). The inflation forecast generated by the SARB's Quarterly Projection Model has improved since the previous Monetary Policy Meeting. Headline inflation is expected to average 4.5% in 2019 (down from 4.8%), increasing to 5.1% in 2020 (down from 5.3%) and moderating to 4.6% in 2021 (down from 4.7%). Headline CPI inflation is expected to peak at 5.5% in Q1 2020 and settle at 4.5% in the last two quarters of 2021.The SARB also decreased its GDP growth outlook for 2019 to 1.0% (down from 1.3% in March) while for 2020 and 2021 the forecast was kept unchanged at 1.8% and 2.0%. The downward revision of the 2019 GDP growth forecast further supports a potential interest rate cut.

The US Fed has signaled that it will cut its benchmark fed funds interest rate by 25 basis-points at its upcoming policy meeting concluding on 31st July. This together with a greater easing bias from the European Central Bank, the People's Bank of China and Bank of Japan, will likely provide a significant boost for equity markets worldwide. A lower fed funds rate is especially positive for emerging markets as lower rates invariably lead to a weaker US Dollar (USD). Historically, emerging markets have outperformed their developed market peers during periods of USD weakness. What is positive for global markets tends to be positive for the South African market. The SARB is likely to embark on an interest rate cutting cycle during the rest of 2019. Lower global rates along with benign inflation expectations affords the SARB the opportunity to cut interest rates and give the South African economy a much-needed boost. Economists believe that the benchmark Repurchase (repo) interest rate will be cut by 50 basis-points during the remainder of 2019. Expected interest rate cuts, along with Ramaphosa's fiscal stimulus via infrastructure spend should pave the way for a better second half of 2019. If history is any indicator, JSE investors should start to feel optimistic. The local market has always recorded strong gains during a declining interest rate cycle.

Every National Election is important. However, some political commentators argued that the election on 8th May was the most important general election since the dawn of our democracy. There may be several reasons for this sentiment. The main reason is that, we hope, it finally brought an end to the Zuma era. The end to nine lost years, and the start of our New Dawn. Although the ANC remains divided by factional in-fighting, it secured a comfortable 57% majority, placing Ramaphosa in a stronger position to implement structural reforms. In the words of political analyst Simon Freemantle: "The ANC's majority was high enough to allow reform, but not too high to reduce the urgency for change. Not too high, not too low, but just right". Freemantle describes it as the "sweet spot", a "Goldilocks outcome". Ramaphosa's three appointments in the Economic Cluster, are viewed positively from an economic viewpoint. He ensured continuity and stability with the reappointment of Tito Mboweni as Minister of Finance, Pravin Gordhan as Minister of Public Enterprises and Ebrahim Patel, as Minister of Trade and Industry. Cosatu objected to all three appointments, but Ramaphosa did not budge.

The past ten years can be divided into five fat years (2009 – 2013) and five lean years (2014 – 2018). During the five fat years the JSE All Share index more than doubled from 21 764.90 to 46 589.70 index points - 114% in total. During the five lean years the index slowly inched ahead to 51 264.06, a feeble 10%, far less than the inflation rate for the period. The five fat years were never sustainable. As normally happens during good times, people said: "This time is different". Enter Jacob Zuma! His second term as president started May 2014. Poor policy decisions, maladministration and corruption during Zuma's second term cost the South African economy an estimated R470 billion. He was ousted after nine years in power. Ramaphosa described the Zuma years as "nine lost years". We hit the bottom with a recession in 2018. Will we ever recover? Now, once again, people say: "This time is different – we won't recover". Put in contaxt, the decade of the 1980s was far worse than it is now but the country recovered. The nation's debt levels then were so high that we were on the verge of defaulting. GDP growth fluctuated between zero and negative. To crown it, the equity market crashed in 1987. We remember those years very well. We are not near to a crash now. For the first time in ten years the market is offering compelling value.

We believe economic growth will pick up and revert to the mean, although it won't happen overnight. Ramaphosa is quietly busy with several exciting initiatives. The appointments of Shamila Batohi, Edward Kieswetter and the new Scorpions are extremely positive. So is the firing of corrupt officials like Tom Moyane, Nomgcobo Jiba and Shaun Abrahams. His YES program to address youth unemployment, is working. The Public-Private Growth Initiative (PPGI) led by Roelf Meyer is a winner. Meyer and his team meet with the cabinet on a weekly basis. Ramaphosa's investment drive has gathered momentum and is paying off. The R290bn influx in investment is expected to add R338bn to GDP over the next five years and create 165,000 jobs. Global companies like Rio Tinto, Nissan and Amazon have announced big investments in South Africa. They could have invested anywhere in the world, but they picked South Africa. The biggest project, Total's Brulpadda gas reserve development could be a game changer for the country.

The gradual but incremental shifts towards better governance and the prospect of more meaningful structural reforms, coupled with the powerful stimulus from lower interest rates both globally and locally gives us confidence that our clients' portfolios will show strong performance over the remainder of the year and into 2020. We remain steadfast in our commitment to domestically focused shares in our belief that these will fare best given the improving domestic outlook and the global backdrop of a weakening USD and strengthening emerging market currencies.