overberg asset management

LOCAL PERFORMANCE FACTSHEET

OAM Local Real Return Portfolio

Technical Details

March 2018

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

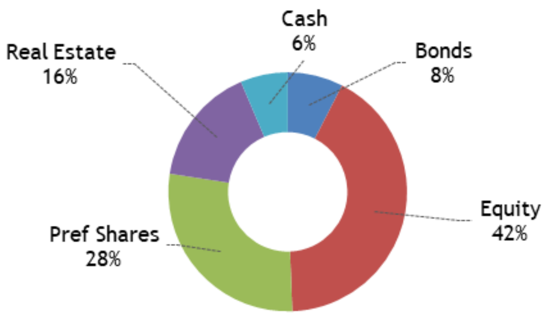
Investment Objective

- Conservative growth
- Consistent annual returns
- Low volatility

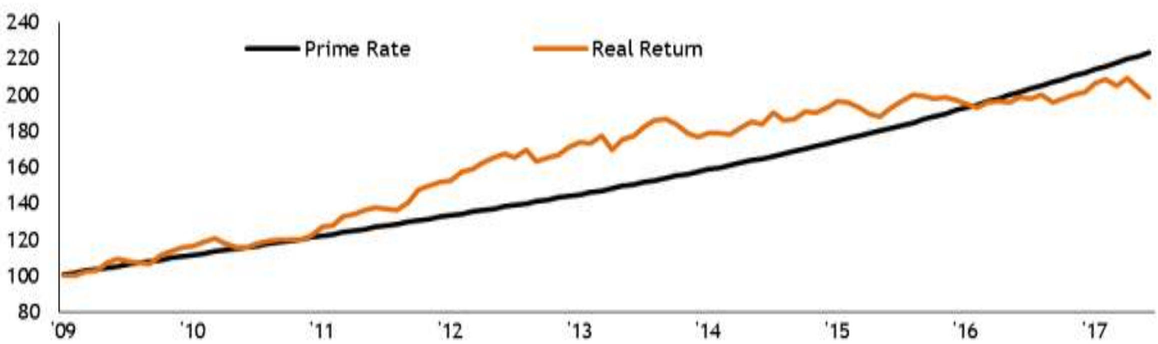
Annualised Growth (%)	OAM	Prime Rate
Inception 2009	8.84	10.02
7 years	8.00	9.83
5 years	3.47	10.09
3 years	2.55	10.63
2018 YTD not annualised	-3.19	2.56

Annualised Income Yield	5.87

ASSET ALLOCATION
(see through basis)



Top 5 Holdings	
ESKOM 13.5% RS 19/21N170	
DISCOVERY LTD	
Cash	
NASPERS LTD	
RMB HOLDINGS LTD	
Total number of holdings	34



Market Review

South African equities gave up some of the stellar returns gained in the fourth quarter (Q4) 2017. Domestic equity markets were dragged lower by global issues, namely anxiety over rising inflation and interest rates emanating from the US and by fears that US trade protectionism could develop into a global trade war. Despite improving domestic economic fundamentals the All Share, Resources 10, Industrial 25 and Financial 15 indices lost -6.77%, -4.37%, -9.24% and -1.79%, respectively. The Financial 15 index outperformed, helped by a sharply stronger rand and falling interest rates. The stronger rand had a less beneficial effect on the rand hedge industrial stocks causing the Industrial 25 index to be the worst performing index over the quarter. The rand/dollar rate improved from R/$12.35 at the end of December to R/$11.78 at the end of March, representing a +4.61% gain in Q1. The All-Bond 1-3 year Total Return Index rose +2.62% over the quarter. The gold price also provided a refuge against financial market volatility, rising over Q1 from $1302 to $1325 a gain of 1.73%.

The 14th February marked a historic end of an era for South Africa. President Zuma resigned and on the next day President Ramaphosa was officially sworn-in. Ramaphosa gave a statesmanlike speech in his State of the Nation Address (SONA) earning a standing ovation even from opposition parties. The whole first hour of President Ramaphosa's SONA was dedicated to the economy. The emphasis bodes well. Strong economic growth is needed to bring down unemployment, eradicate poverty, reduce the budget deficit and fund social upliftment. The speed with which Ramaphosa has implemented change is cause for celebration. He appointed close allies and respected leaders to the three key departments. The departments of Finance, Public Enterprises and Mineral Resources have been placed under the capable leadership of Nhlanhla Nene, Pravin Gordhan and Gwede Mantashe. The government also appointed a new board at Eskom aimed at strengthening corporate governance and ensuring financial stability. The appointment of a new board for Eskom indicates an abrupt change in government policy direction and an urgency in addressing the financial health of State-Owned Enterprises (SOEs).

Following October's poorly received Medium-Term Budget Policy Statement (MTBPS) the 2018 State Budget returned South Africa to the path of fiscal prudence. The budget deficit is projected to decline from 4.3% of GDP in 2017/18 to 3.6% in 2018/19 and 2019/20 and to 3.5% in 2020/21 a marked improvement on the MTBPS projections. According to the Treasury, the combination of a narrower deficit, a stronger rand and lower borrowing costs will bring down the projected peak in gross government debt to 56.2% of GDP in 2021/22 far better than the projected peak of 63.3% in 2025/26 projected in the MTBPS. The country's finances have been put back onto the right path without prejudicing the country's medium-term growth potential. A Budget highlight is the planned reduction in government expenditure. At national, provincial and local government level, the government projects R85 billion in spending cuts over the next three fiscal years, more than enough to cover the increased allocations to free higher education, national health insurance, social grants, drought relief and the contingency reserve.

Moody's credit rating agency maintained South Africa's investment grade sovereign debt rating, citing a halt in the deterioration of the country's institutions, improved actual and expected economic growth, and a stabilisation in the fiscal outlook. Moody's found "a sharp recovery in business and consumer confidence, illustrated both in surveys and by other indicators such as the recent recovery in the value of the rand." By shifting its outlook from "negative" to "stable" Moody's signaled the potential for a credit rating upgrade at its next policy review in October. Moody's stated that "the successful implementation of structural reforms to raise potential growth as well as stabilise and eventually reduce the debt burden, including through reforms to the State-Owned Enterprise sector which reduce contingent liabilities, would put upward pressure on the rating."

Economic sentiment indicators signal a strong rebound in business and consumer confidence. The RMB/BER Business Confidence Index (BCI) surged by 11 points from 34 in Q4 to 45 in Q1. Although still below the key 50-level which signals contraction, the BCI has seldom risen so quickly. Sentiment improved across the BCI sub-indices with gains shown in manufacturing, retail, wholesale, new vehicle dealers and building confidence. If sustained, the Q1 BCI implies a much-improved economic growth performance in 2018. The Standard Bank Financial Conditions Index (FCI), a measure of broad financial conditions in South Africa, slipped in January to -0.21 from -0.18 in December but remains well above its levels of -0.33 for 2017 and -0.82 for 2016, indicating a pick-up in economic activity in coming months. The FCI is a barometer for economic activity over the next 6-9 months. The South African Reserve Bank composite leading business cycle indicator, a barometer for economic conditions six months ahead, increased in January to its highest level since 2012. At current levels, the leading business cycle indicator is consistent with annualised GDP growth of 3%, well above consensus forecasts.

GDP growth beat all expectations in Q4 accelerating to an impressive 3.1% quarter-on-quarter annualised, well above the 1.8% consensus forecast. Q3 growth was revised upwards from 2.0% to 2.3%. Prior quarters were also revised upwards nullifying the technical recession in Q4 2016 and Q1 2017. The biggest contributor was the agriculture, forestry and fishing sector, which grew output in Q4 by 37.5% on the quarter, contributing 0.8 percentage points to headline growth. The trade sector followed with growth of 4.8% making a 0.6 percentage point contribution. Manufacturing and finance each contributed 0.5 percentage points, with respective growth of 4.3% and 2.5% on the quarter. The mining sector shrank by 4.4% subtracting 0.3 percentage points from headline growth, while construction shrank by 1.4% subtracting 0.1 percentage points. The expenditure measure of GDP also grew 3.1% in Q4, driven by household consumption expenditure, gross fixed capital formation (GFCF) and inventory accumulation. Household consumption grew by 3.6% on the quarter contributing 2.2 percentage points to expenditure growth. GFCF increased by a robust 7.4% on the quarter, making a 1.4 percentage point contribution.

The outlook for GDP growth is brightening. Inflation and interest rates are on a downward trajectory providing added relief for consumers and businesses. Political uncertainty has lifted. President Ramaphosa has moved fast to address the country's most pressing problems, tackling corruption, restoring good governance in the public sector and fiscal restraint at a national level. The world is into its second year of synchronised global growth, a rare phenomenon which due to added durability and momentum normally lasts 3-4 years. Healthy global growth combined with low worldwide inflation and interest rates is a winning backdrop for emerging markets like South Africa with its dependence on trade and commodity exports. While the world's major central banks will end their emergency quantitative easing programmes, interest rates are likely to adjust upwards gradually. The sub-Saharan economy, South Africa's largest trading partner, is expected to rebound from an estimated growth rate of 2.7% in 2017 to 4.0% in 2018 amid rising commodity prices, better rainfall, falling inflation and declining interest rates. Sub-Saharan economic growth should receive a boost from the establishment of the African Continental Free Trade Area (AfCFTA), which the African Union (AU) hopes will happen before the end of the year.

Consumer price inflation (CPI) fell more than expected in February to 4.0% year-on-year from 4.4% in January, well below the 4.2% consensus forecast and closer to the lower end of the Reserve Bank's 3-6% target range. The decline is attributed to lower fuel and food prices and the base effect of high year-ago comparative data. Core CPI, excluding food and energy prices, remained unchanged at 4.1%. While the current 4% CPI reading is expected to mark the low point in the inflation cycle due to the inflationary impact in coming months of the VAT increase from 14% to 15%, the positive reading and recent rand strength emboldened the Reserve Bank. As expected the Reserve Bank cut the benchmark repo interest rate by 25 basis-points to 6.5%, the first rate cut since July 2017. The Reserve Bank indicated a moderation in inflation risks and raised its outlook for growth due to improved business and consumer confidence as well as better fixed investment.

Despite increased global risk aversion amid rising US trade protectionism and domestic uncertainty over land expropriation without compensation, foreign investors have remained strong net buyers of South African securities since the start of the year. Net foreign investor inflows into South Africa's equity and bond markets in Q1 were R28.82 billion and R23.60 billion, a total of R52.43 billion. The net equity inflow marks a substantial turnaround from the total net equity outflows of R43.1 billion in 2017, R124.8 billion in 2016 and R1.9 billion in 2015. The year-to-date equity inflow is almost level with the R36 billion inflow recorded in the whole of 2010, the year South Africa hosted the FIFA World Cup.

The issue of land expropriation without compensation has damaged business and consumer confidence over the short-term. However, the parliamentary committee tasked with making recommendations will very likely allay concerns. The ANC will not want to deviate from its core policy of promoting economic growth, which it recognises is dependent on business and consumer confidence. Land expropriation is likely to be centred on tribal land, home to an estimated 17 million people. Tribal land is seldom developed and remains unproductive as those living on the land do not have title and therefore do not qualify for bank loans. The distribution of tribal land would help meet the objectives of land expropriation, namely to redress inequality and increase agricultural productivity, in a manner that does not "undermine future investment in the economy."

Financial market optimism has surged over the past three months in positive response to Ramaphosa's ascendency. Despite the strong outperformance by the rand and South African gilts versus other emerging markets, they remain cheap on a relative basis. The R186 bond yield is still around 400 basis points above inflation, a much higher real yield than most emerging markets. There is considerable scope for further tightening in yield spreads versus other emerging market bonds and for further strengthening in the rand. The country risk premium, measured as the yield difference between the US and South African 10-year Treasury bonds has narrowed from a peak last December of 708 basis points to the current level of 530 basis points well below the pre-Nenegate level of 636 basis points. As encouraging as this may be the spread versus the US 10-year Treasury bond went as low as 233 basis points in 2006, well below today's 530 basis points, indicating the potential for further substantial declines over coming months.

The speed with which Ramaphosa has implemented change is cause for celebration. Few expected him to take over as the nation's president so soon. The strength and conviction of his reforms is likely to build momentum. Like the changes that have occurred so far, the pace of improvement will take many by surprise. The positive outlook for the rand, inflation and interest rates significantly brightens the prospects for consumer and business confidence and the outlook for the JSE. Premised largely on the expectations for a strengthening rand and declining interest rates, Goldman Sachs has identified South Africa as the "big emerging market story" of 2018. Overberg Asset Management correctly reported in October and November 2017 that South Africa's GDP growth expectations for the fourth quarter and for 2017 were overly pessimistic. We were one of very few asset management companies to correctly predict GDP growth rate of 3% in Q4. GDP growth will likely continue to surprise to the upside over the course of the year offering a significant boost to domestically focused equity sectors.