overberg
asset management

LOCAL PERFORMANCE FACTSHEET

OAM Local Income Portfolios

ZAR Rand

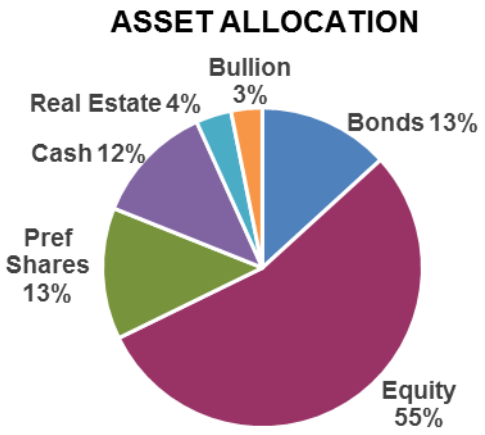
MAR 2016

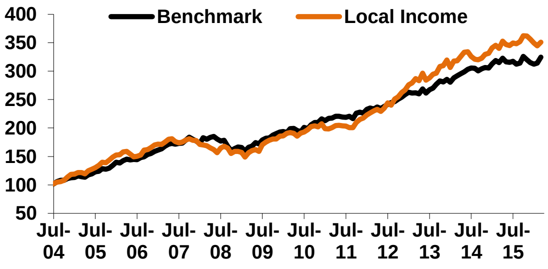
Technical Details

- **FSB** approved
- Base currency: **South African Rands**
- Minimum investment: **R750,000**
- Benchmark: **JSE AllShare (30%) and ALBI 1-3 yr Return Bond Index (70%)**
- Asset Allocation: **Flexible mix of equities, bonds and cash**

Investment Objectives:

- conservative growth
- consistent annual returns
- low volatility





(As calculated by Overberg 31 Mar 2016)

	Income %	Benchmark %
Annualised Total Return	11.28	10.54
2004 (July – December)	18.33	14.20
2005	25.71	23.16
2006	14.50	21.94
2007	4.40	12.27
2008	-10.60	-9.99
2009	16.80	18.00
2010	11.73	11.90
2011	4.79	4.78
2012	22.86	14.38
2013	19.66	10.43
2014	3.67	6.98
2015	7.64	3.09
2016 YTD	-1.55	2.98

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

Growth 2016	Growth %	Benchmark %
January	-1.96	-0.82
February	-1.40	0.47
March	1.84	3.35
April		
May		
June		
July		
August		
September		
October		
November		
December		

	%
Annualised Income Yield	5.21

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Disclosure: There is a risk associated with investing in our financial products. The value of the investments and income may rise as well as fall, and there is a risk that the client may suffer financial losses. Returns are dependent on the performance of underlying assets and other variable market factors. Past performances are not necessarily indicative of future performances.

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.

Quarterly Commentary 31 March 2016

The All Share index suffered one of its worst ever starts to the year falling -10% in the first fortnight due mainly to the continued slump in the resource sector. However, by mid-February the equity market started recovering in response to positive global developments. The Federal Reserve (Fed) adopted a more "dovish" tone and scaled back expectations for interest rate hikes. Stability also returned to the oil market after Russia, Saudi Arabia and other OPEC producers agreed to freeze oil output at current levels. The likelihood that the oil market will find a new equilibrium before year-end reduces the probability of a high profile credit default among oil players or one of their creditors. Lastly Zhou Xiaochuan the Governor of the Peoples' Bank of China (PBOC) alleviated concerns over yuan devaluation reiterating the government's pledge to not engage in competitive devaluation.

The positive global developments were especially beneficial for commodity prices which led the Resources 10 index to a +12.67% gain over the first quarter (Q1) outperforming the Financial index with a return of +4.14%. The Industrial 25 index, after outperforming in 2015 was the laggard losing -1.30% as the stronger rand held back the large multinational rand hedge stocks, in turn providing a tailwind for the All Share index which only increased +3.07% in Q1. After losing -33.86% versus the dollar in 2015 the rand strengthened in Q1 by +6.50% from R/$15.85 to R/$14.82 in spite of the evolving political crisis surrounding Zuma. The threat of a looming credit rating downgrade to "junk" status did not deter foreign investors from purchasing a net +R17.2 billion worth of SA government bonds in Q1. The All Bond index (1- 3 year) increased from 374.95 to 385.78 returning +2.89% over the quarter. The dollar gold price performed well in response to negative interest rates in the Eurozone and Japan and the likelihood of continued negative real interest rates in the US. The gold price increased from $1060 to $1231 in Q1.

Economic data remained generally disappointing during the quarter with both mining and manufacturing production falling sharply in January with month-on-month declines of -4.9% and -1.8% respectively. Consumer spending also faltered as households became more cautious in response to a weak labour market, rising inflation and higher debt service costs. Domestic vehicle sales fell sharply in March by -14.1% year-on-year accelerating from the -8.1% decline in February. According to the SA Reserve Bank Quarterly Bulletin domestic expenditure recovered from annualized growth of 1.4% in Q3 last year to 4.3% in Q4 but it is unlikely that the improvement will be sustainable. Households stepped up spending of durable goods but only to stay ahead of price increases induced by the weaker rand. Private sector fixed capital formation picked-up but driven almost exclusively by the rollout of the third phase of renewable energy projects under the "Renewable Energy Independent Power Producer Procurement Programme".

Most private firms remained reluctant to invest due to deteriorating business confidence. After remaining unchanged in Q4 last year the Bureau for Economic Research (BER) manufacturing survey index fell from 34 in Q4 to 18 in Q1 the lowest level since Q3 2009. The survey shows that eight out of ten manufacturers are currently dissatisfied with current business conditions. The biggest constraint on companies' willingness to invest is the general political climate pushing the related index to 83 the highest on record.

The economy is in a typical “stagflation” rut marked by rising inflation, slowing economic growth and rising unemployment. The SA Reserve Bank (SARB) lowered its GDP growth forecasts for 2016 from a previous 1.9% to 1.5% while the IMF was more severe in its forecast cut from a previous 1.3% to 0.7%. Meanwhile consumer price inflation (CPI) has been surging higher from 5.2% in December to 6.2% in January and 7% in February well ahead of the SARB’s 3-6% target range. The upward pressure is largely attributed to drought-induced food price inflation which jumped from 6.9% in January to 8.6% in February but there are emerging signs of broader based pass-through inflation from the weaker rand. Despite weak economic growth the SARB hiked its benchmark repo interest rate twice in Q1 by a larger than usual 50 basis points in January and again by 25 basis points in March to 7.0% lifting the prime lending rate to 10.50%. Although SARB Governor Lesetja Kganyago indicated that the second rate hike was a difficult decision with the policy committee split down the middle he pointed out that over 87% of the CPI basket is now above 6% signaling the danger of rising inflation expectations. As a result there are likely to be two further 25 basis point rate hikes during 2016.

The weak economy made Finance Minister Pravin Gordhan’s job of preparing the State Budget more difficult than usual. Although displaying the hallmarks of fiscal prudence the credibility of the deficit and debt reduction targets was constrained by the risk that economic growth may be persistently weaker than expected and that inflation may be higher than forecast. The budget contained encouraging statements about the restructuring and down-sizing of state-owned enterprises (SOEs) but was vague on details and timelines giving the impression of being inhibited by political pressure.

While Pravin Gordhan was confident that the budget will be enough to avert a credit rating downgrade the three rating agencies responded with notable caveats. Standard & Poor’s (S&P) noted that the budget did not contain measures to promote economic growth. Moody’s cited concerns over a lack of detail on future tax increases and implementation risk. Fitch also cited concerns over implementation risk.

The growing political crisis surrounding Zuma may worsen the outlook of rating agencies contributing to a possible downgrade to “junk” status when S&P conducts its next review in June. Initially the Constitutional Court judgement against President Zuma pushed the rand stronger versus both developed and emerging market currencies with weekly gains of between 4-6% on hopes that the president would either be impeached or recalled. While there is a growing likelihood that Zuma is unlikely to last his full term in office he will probably survive past the upcoming local elections on 3rd August, which means a “lame duck” president and little new economic initiatives over coming months. However, the longer-term outlook may improve considerably, a change in political leadership would have major repercussions for both local and foreign investor confidence.

Encouragingly in his quarterly Systems Update Eskom CEO Brian Molefe reported solid progress in the last quarter 2015 with planned outages down -10% compared to the previous year, falling to 13.8% of generating capacity, the lowest since July 2014. Although the first unit of the new 1,300 megawatt Ingula power station will only be in commercial operation by March 2017 rather than 2016 Molefe indicated Eskom would be able to avoid load shedding even during the coming winter months. While analysts were quick to point out that the absence of load shedding has as much to do with slowing electricity demand due to the weak economy, and businesses and households increasingly moving off the grid, the decline in power outages will certainly contribute to improved productivity.

Rand volatility intensified in March due to wild swings in global risk aversion driven by speculation around the pace of US interest rate increases and domestic political developments. However, the trade-weighted rand index managed to end the quarter on firmer ground gaining a substantial +4.4% in March and +1.3% since the start of the year. The rand together with other emerging market currencies would gain support from more gradual than previously anticipated Fed tightening. However, the tailwind from improved commodity prices may be short-lived due to excess global capacity and continued slowdown in China, which combined with credit rating reviews in June, and local elections in August will likely reassert downward pressure on the rand.

The performance of the JSE since the start of the year has been mediocre with the only bright spot being the resources sector. However, the run in resource stocks is based on weak foundations and unlikely to last. Metals prices are rising on the hopes of added fiscal stimulus in China. However, with China's fixed asset investment now four times larger than it was in 2009 at the time of the last fiscal stimulus programme the incremental effect of any new stimulus is likely to be extremely modest by comparison. The recent sharp increase in metals prices is due largely to speculative activity. Throughout developed and emerging economies weak forward-looking indicators, such as purchasing managers' indices, testify to a distinct downward trend in manufacturing, construction and fixed investment, sectors which are vital to a prolonged increase in commodities prices.

The rally in resource stocks in spite of the earnings recession in the sector has contributed to a re-rating in the All Share index so that it currently trades on an extremely high 21x price to earnings multiple, significantly above the 13x emerging market average as well as its own 14.5x long-term historic average. On this basis SA equities appear dangerously over-priced. Foreign investors were net sellers of –R18.9 billion of SA-listed equities during the first quarter raising the probability of a steeper market correction in the coming quarter or second half of the year. A significant rand hedge weighting will protect portfolios against rand depreciation. Portfolios are also well diversified across non-equity asset classes including preference shares, real estate investment trusts and more recently gold bullion, in order to withstand any market correction. These defensive asset classes will be redeployed to equity holdings as better value opportunities arise following the expected period of consolidation.