overberg asset management

Local performance factsheet

OAM Local Real Return Portfolios

ZAR Rand

APR 2014

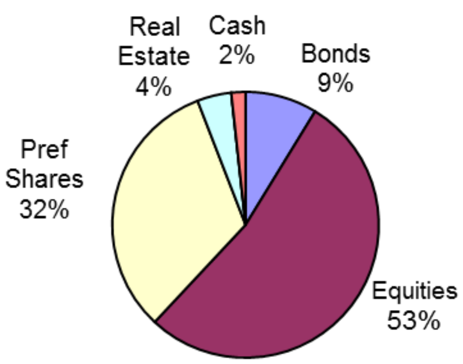
Technical Details

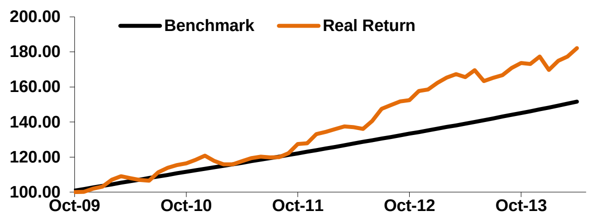
- **FSB** approved
- Base currency: **South African Rands**
- Minimum investment: **R500 000**
- Benchmark: **Prime Interest Rate**
- Asset Allocation: **flexible mix of bonds, listed commercial properties, pref shares and ordinary shares.**

Investment Objectives:

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

ASSET ALLOCATION





(As calculated by Overberg 30 Apr 2014)

	Real Return %	Benchmark %
Annualised Total Return	14.26	9.69
2010	17.58	11.42
2011	10.14	9.38
2012	19.21	9.11
2013	11.86	8.84
2014 YTD	2.68	3.03

*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		
June		
July		
August		
September		
October		
November		
December		

	%
Annualised Income Yield	8.98

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 maneuverability 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 31 March 2014

It is not surprising that SA equity markets paused for breath during the first quarter (Q1) following the robust gains in the final quarter of last year. However, the All Share index eked out a gain in Q1 of 3.27%, attributed mainly to strong gains in mining stocks with the Resources 10 index rising 8.94%. The Industrial 25 index by contrast only gained 0.16% although the Financial 15 index increased by a more impressive 6.14%. The rand stabilized during the quarter after suffering a sharp decline during February and ended the quarter with a loss against the dollar of just -0.77% to R/$ 10.57. Along with the rand the bond market also rallied off its lows with the All Bond Total Return index (1-3 year) managing a small gain of 0.72%. The dollar gold price rebounded off its lows at the end of last year, increasing over the quarter from $1202 to $1287 a healthy 7.07% increase.

Jobs growth provided a bright spot in an otherwise lackluster economy. The official quarterly employment report shows 141,000 jobs were created in the 4th quarter (Q4) last year, albeit the informal sector accounted for the bulk with 123,000. In 2013 the economy created 653,000 additional jobs marking the fastest annual jobs growth since the 2009 recession and the 5th straight quarter of accelerating employment gains.

Finance Minister Pravin Gordhan delivered a fiscally prudent 2014 Budget with the outlook generally improved compared with the Medium-Term Budget Policy Statement (MTBPS). The Budget outlines falling real expenditure growth and a narrowing fiscal budget, which should go a long way towards pacifying the concerns of the credit rating agencies. Over the medium-term (by financial year 2016/17) real growth in expenditure is projected to decline from 2.2% year-on-year to 1.6%, encouragingly with capital spending becoming the fastest growing item in the Budget, taking over from debt-servicing costs. Over the medium-term the fiscal deficit is projected to fall from 4.0% of GDP to 2.8%. The government's borrowing requirement for FY 2014/15 was revised lower from the MTBPS figure of R183.9 billion to R179.8 billion and expected to decline further to R151 billion by FY 2016/17.

SA's GDP growth rate recovered from a dismal 0.7% quarter-on-quarter annualised in Q3 2013 to 3.8% in Q4 well above the 3.4% consensus forecast. The manufacturing sector grew 12.3%, adding 1.8 percentage points to the final GDP figure although largely due to the base effect following a protracted vehicle manufacturing strike during Q3. The rate of manufacturing growth is unlikely to be maintained. Mining was also strong with Q4 growth of 15.7%. However, excluding mining and manufacturing, GDP growth was only 1.6% little changed from 1.5% in Q3. For 2013 as a whole GDP grew by 1.9% down from 2.5% in 2012. Unfortunately the outlook for 2014 remains uncertain. The mining sector has suffered a poor start to the year with a protracted strike at the 3 major platinum producers already costing over R8 billion in lost revenues. The manufacturing sector has so far not capitalised on the weaker rand and January's manufacturing purchasing managers' index remained below the key 50 level which signals contraction. Meanwhile Eskom has reported it may enforce its emergency agreement requiring industrial customers to cut electricity by 10%. Electricity is expected to remain a downside risk to manufacturing and mining during 2014.

The SA Reserve Bank's (SARB) Quarterly Bulletin shows a sharp decline in domestic demand with real gross domestic expenditure (GDE) declining in Q4 by -3.6% quarter-on-quarter annualised following contraction of -0.8% in Q3. Household consumption remained lackluster with growth of 2.0% compared with 2.1% in Q3, and is likely to remain weak in coming months due to rising interest rates and higher consumer price inflation. Investment slowed with gross fixed capital investment growth declining from 7.0% in Q3 to 3.1% in Q4. Private investment was the biggest culprit slowing from 8.6% to 2.4%. Inventories suffered a sharp drop with destocking of R22.3 billion in Q4 contributing to the contraction in GDE.

As was widely anticipated, the SA Reserve Bank (SARB) kept the benchmark repo interest rate unchanged at 5.5% at its March policy meeting after hiking unexpectedly by 50 basis points in January. The decision was influenced by the rand's recent strength and limited evidence of secondary inflationary effects from the rand's earlier slide. Despite this, SARB stressed that the medium-term outlook for inflation remained 'uncomfortably close to the upper end of the target range' with the risk to the outlook still on the upside. The SARB made it clear that interest rates are in a tightening cycle. At the same time the SARB lowered its GDP growth forecast from 2.8% to 2.6% for 2014 and from 3.3% to 3.1% for 2015 with platinum industry strikes and electricity supply constraints potentially leading to further downgrades in GDP forecasts. In spite of the lackluster economy the market is now pricing in 250 basis points of rate hikes in the current cycle, with 100 basis points to take place this year.

Consumer price inflation (CPI) rose in line with market expectations in February, edging up to 5.9% year-on-year from 5.8% in January. There was still little evidence of second-round inflationary effects from the weaker rand, with core inflation excluding volatile food, petrol and energy costs holding steady at 5.3%. However, inflation is still forecast to increase further, breaching the Reserve Bank's upper 6% target in March. The SARB forecasts CPI will average 6.3% over 2014, peaking at around 6.6% in Q4 before dipping below 6% around Q2 2015. Producer price inflation (PPI) accelerated sharply from 7.0% year-on-year in January to 7.7% in February well above the 7.3% consensus forecast. On a month-on-month basis PPI increased by 1.3% underlining the fact that there is upward pricing pressure in the economy. The biggest upside risk to inflation remains rand depreciation and higher food prices. The rand remains vulnerable to adverse changes in global investor sentiment, which could be triggered by either global or domestic events.

Balance of payments trends were mixed in the first quarter: Although the trade account surprised with a surplus of R1.7 billion in February following a deficit of R17.1 billion in January, the data highlights that the weak rand has so far had little positive influence on SA's trade activity. As a result the current account deficit is likely to remain under pressure signaling further rand depreciation in coming months. Unfortunately the boost to competitiveness from a weaker currency is being undermined by other domestic challenges and infrastructure constraints. With platinum accounting for 16% of total exports, the continued strike poses significant risks to the trade balance.

Over the next few months the economy will probably continue to feel the effects of the strike in the mining industry, uncertainty ahead of the upcoming national elections, fragile household finances and general infrastructure constraints. The economy remains fragile. Financing the current account and budget deficits are likely to become harder and more expensive, adding further pressure on the rand. Notwithstanding the particular attraction of rand hedge stocks, and the pricing-in of growth potential from the African continent, we feel that SA equities are becoming expensive with the All Share index trading on an estimated 16.8x forward price-to-earnings multiple. As a result of high valuations and the difficult economic environment we will continue to make the portfolios more defensive over the coming quarter..

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