



OAM Local Real Return Portfolios
ZAR Rand

SEP 2015

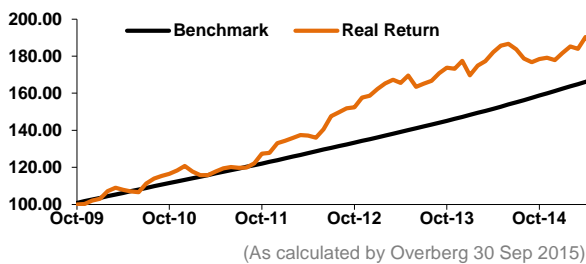
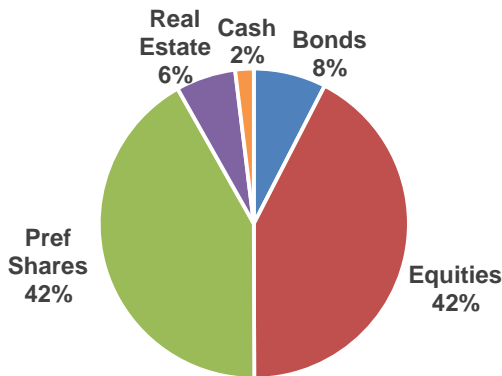
Technical Details

- FSB approved
- Base currency: **South African Rands**
- Minimum investment: **R750 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



	Real Return %	Benchmark %
Annualised Total Return	11.77	9.69
2010	17.58	11.42
2011	10.14	9.38
2012	19.21	9.11
2013	11.86	8.84
2014	0.26	9.52
2015 YTD	8.61	7.22

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

	Real Return %	Benchmark %
Growth 2015		
January	2.16	0.77
February	1.96	0.77
March	-0.68	0.77
April	3.45	0.77
May	-2.55	0.77
June	0.68	0.77
July	2.05	0.79
August	-0.15	0.79
September	1.51	0.79
October		
November		
December		

	%
Annualised Income Yield	7.53



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.

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 30 September 2015

Downward momentum in local equity markets continued into the third quarter (Q3) exacerbated by China's unprecedented yuan devaluation, slowing global demand for commodities and weakening economic growth in emerging markets. Given the sharp decline in commodity prices the Resources 10 index was the worst performer over the quarter, losing a massive -19.14% and -24.54% year-to-date. The Financial 15 and All Share indices suffered milder losses in Q3 of -3.90% and -3.32%, holding onto year-to-date gains of +1.36% and +0.64%. The Industrial 25 index outperformed with Q3 and year-to-date gains of +0.62% and +7.72%, boosted by SABMiller's takeover offer from Anheuser Busch Inbev. Rising global risk aversion affected all emerging market currencies including the rand which fell during Q3 by -14.17% versus the US dollar to R/\$14.02 a loss of -20.85% since the start of the year. However, the bond market remained relatively immune to rand depreciation with the All Bond Total Return index (1-3 year) gaining +1.77% over the quarter and +4.28% for the year. The gold price reacted badly to a resurgent dollar, losing -4.77% over the quarter and -6.53% over the year to \$1117 per ounce.

SA's GDP unexpectedly contracted in Q2 by -1.3% quarter-on-quarter annualised in stark contrast to the 1.3% expansion in Q1. The weakness was broad-based, manufacturing contracted -6.3%, mining by -6.8%, agriculture by -17.4%, and electricity and gas by -2.9%. Even the wholesale, retail, and motor trade, catering and accommodation category, contracted by -0.4%. The consumer, which for so long has been making-up for weakness on the production side of the economy, started to falter. Consumer spending growth halved from 2.4% in Q1 to 1.2% in Q2. Growth in gross fixed capital formation weakened further from 1.8% in Q1 to just 1.0%. Growth in private sector capital outlays fell dramatically from 1.6% to 0.1%. On the other hand fixed investment by general government remained buoyant rising from 5.1% to 5.3% driven by infrastructure spending in energy, water, transport and education sectors.

Unfortunately economic conditions remained unfavourable during Q3. Better output growth figures for mining and manufacturing sectors largely reflect the impact of last year's very low strike-affected base, rather than any underlying recovery in production or confidence. The SA Reserve Bank's (SARB) Quarterly Bulletin and leading indicators point to a poor economic outlook dampened by weak business and consumer confidence. The SARB's leading economic indicator (LEI) fell in July by -1.7% month-on-month while its year-on-year decline deteriorated from -2.3% in June to -3.6% in July. The LEI is at its weakest since November 2009 with eight of the 11 sectors comprising the index showing declines in July. The LEI deterioration raises the risk of a second straight quarter of negative GDP growth in the third quarter, which would meet the technical definition of a recession.



Having dropped sharply in August from 51.4 to 48.9 the Barclays manufacturing purchasing managers' index (PMI), which measures conditions at company level, increased slightly in September to 49.0. However, the PMI is still below the contractionary 50 level which is disappointing given the recent absence of load shedding, suggesting that manufacturing is being impeded by weakening demand as well as supply-side constraints. The business activity sub-index fell from 48.6 to 46.6 and the expectations index fell from 52.5 to 49.3 its lowest level since 2009. The RMB/BER business confidence index fell for a third straight quarter from 43 in Q2 to 38 in Q3 well below the 42 consensus forecast and substantially below the contractionary 50 level. Business confidence was low across all five surveyed sectors but notably weak in consumer related sectors with retail business confidence falling from 52 to 34 the weakest since 2009. In recent years consumer spending has propped-up GDP growth making the fall in retail business confidence especially concerning. After slumping in Q2 to a 14 year low of -15 the FNB/BER consumer confidence index recovered to -5 in Q3. However, the index remained firmly in negative territory indicating that consumers believe economic prospects will deteriorate further over the next year.

Weak economic activity has certain benefits, including a narrowing in the current account deficit from -4.7% of GDP in Q1 to -3.1% in Q2 well below the -5.4% average in 2014. The improvement is attributed to the trade balance which showed its first surplus since Q4 2011. Unfortunately it is unlikely the current account improvement can be maintained in the context of China's economic slowdown and further key commodity price declines. The potential for strike activity in the gold and coal sectors would also undermine trade and current account balances.

Consumer price inflation (CPI) also moderated as a result of the lackluster economic environment. CPI fell from 5.0% year-on-year in July to 4.6% in August. Core CPI which excludes volatile food and energy inflation also eased from 5.4% to 5.3% reflecting weak domestic demand. Although there is little evidence so far of inflationary pressure from the weaker rand there tends to be a substantial lag-time before higher imported costs are passed-on. A weaker rand, the base effect of low comparative data, and rising food inflation suggest CPI will rise during Q1 2016 peaking at around 6.5% before returning to the SARB's 3-6% target range in Q2. Projections however depend to a large extent on the rand exchange rate and oil prices which may alter significantly from current levels.

In spite of weaker than expected CPI the SARB hiked interest rates in July for the first time since July 2014 lifting the repo rate from 5.75% to 6.0%. SARB Governor Lesetja Kganyago cited concerns over the inflation trajectory due to the influence of higher maize prices and the impact of a weaker rand. At the following policy September meeting the SARB left the repo rate unchanged although stated that "it remains on a gradual policy normalization path" due to risks to the inflation outlook suggesting the current interest rate hiking cycle has further to go. However, the unanimous decision to keep rates on hold suggests the trajectory of rate increases may be more gradual than previously expected. The SARB lowered its forecasts for CPI for 2015 from 5.0% to 4.7% but raised its forecasts for 2016 and 2017 from 6.1% to 6.2% and from 5.7% to 5.8%. The SARB's GDP forecasts were marked significantly lower from 2.0% to 1.5% in 2015, from 2.1% to 1.6% in 2016, and from 2.6% to 2.1% in 2017, contributing to the reluctance to hike interest rates in spite of concern that CPI will breach its 3-6% target in 2016.

Moody's credit rating agency reiterated its Baa2 credit rating for SA's sovereign debt and left its outlook unchanged at "stable". Moody's expects the debt/GDP ratio to stabilize as early as this fiscal year but warned that government's efforts to make state-owned enterprises more financially self-reliant could take longer than expected. Moody's listed specific potential developments which would lead to a downgrade of the credit rating. These include a faltering in government's commitment to fiscal consolidation and debt stabilization, and further deterioration in the investment climate which would endanger external funding of the current account deficit.

Global investors tend to treat emerging markets as a collective. While domestic credit creation has been relatively modest, SA is nevertheless vulnerable to the global aversion to emerging market risk. Capital inflows are therefore likely to remain volatile. The rand remained under persistent pressure in September, depreciating over -3% on a trade-weighted basis touching record lows against most major currencies. The slide in emerging



market currencies paused after the US Fed's decision to delay its interest rate hike, but overriding global sentiment towards emerging markets as well as commodities remains negative. Longer-term depreciation remains the primary trend. As such, any pullbacks in the rand will probably be treated as buying opportunities for those looking for hard-currency exposure.

SA stocks appear stretched on a valuation basis relative to other global bourses. SA equities trade on a trailing price-earnings multiple of 19.2x which is significantly above global peers. This would be warranted if companies and the economy were exhibiting above-average growth rates but this is currently not the case. Foreign investors have been net sellers of hefty quantities of equities in the past fortnight. Foreigners' contribution to total market traded volume has also been far higher than average. The increased selling by foreigners lifts the chances of a market correction. During the past quarter we raised substantial amounts of cash in portfolios, which we envisage reinvesting at more attractive valuations once the anticipated correction occurs.