overberg
asset management

LOCAL PERFORMANCE FACTSHEET

# OAM Local Growth Portfolio

## Technical Details

**2020 Q2**

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

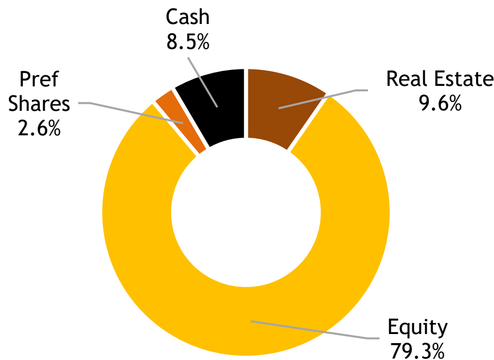
## Investment Objective

- Conservative growth
- Consistent annual returns
- Low volatility

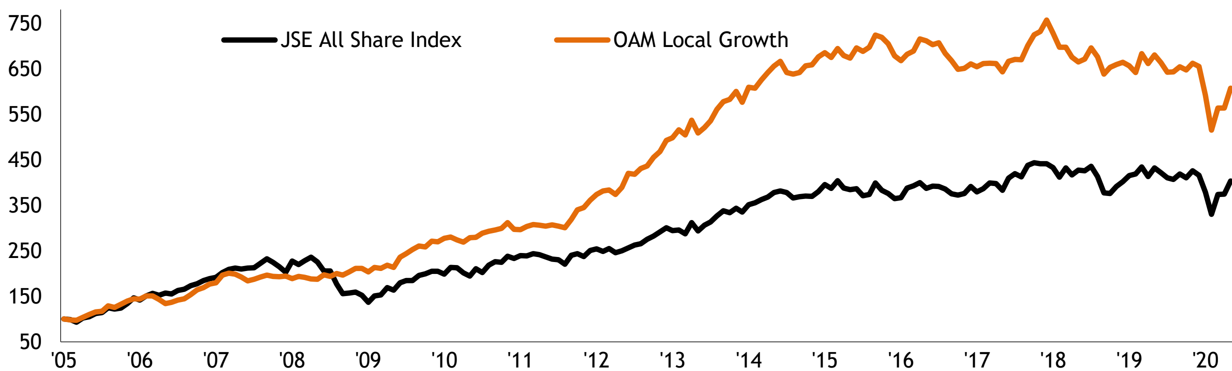
| Annualised Growth (%) | OAM | JSE ALSI |
|---|---|---|
| **Inception March 2005** | **12.48** | **8.91** |
| **10 years** | 8.08 | 7.55 |
| **7 years** | 2.54 | 4.64 |
| **5 years** | -2.06 | 0.97 |
| **3 years** | -1.91 | 1.75 |
| **2020 YTD not annualised** | -8.32 | -5.34 |

| **Annualised Income Yield** | 1.84% |
|---|---|

### ASSET ALLOCATION




| Top 5 Holdings | |
|---|---|
| NASPERS LTD | |
| ANGLOGOLD ASHANTI LTD | |
| TRANSACTION CAPITAL LTD | |
| ANGLO AMERICAN PLAT LTD | |
| FIRSTRAND LTD | |
| **Total number of holdings** | 21 |





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## Local Market Review and Strategy Outlook for the quarter ended June 2020

The JSE All Share Index enjoyed a powerful rally in the second quarter (Q2), enforcing the lesson that investment is a long-term process not to be interrupted by panic selling. The JSE found the slipstream of global markets which came roaring back amid colossal central bank stimulus and government fiscal spending. The global market rally was especially beneficial to the dual listed stocks, in particular Naspers and Prosus, which enjoyed strong earnings growth despite the lockdown. Hence, the Industrial 25 Index gained a solid 16.70% in Q2 and 8.91% for the year to date (YTD). By contrast, the Financial 15 Index, biased towards domestically focused bank stocks, only gained 6.97% over the quarter and still nursing a YTD loss of 36.0%. The Resources 20 Index surged by 40.58% in the quarter, led higher by platinum and gold shares, posting a positive YTD return of 4.13%. The heavy weighting of resource shares, and Naspers and Prosus in the All Share Index led it higher by 22.19% over the quarter, trimming its YTD loss to 4.77%. As risk appetite returned to global financial markets, the rand recouped some of its losses versus the dollar, gaining by 3.23% over the quarter to R/$17.36 although still losing 23.47% YTD. The South African Reserve Bank (SARB), after cutting the repo rate twice in Q1, followed in Q2 with two further interest rate cuts, reducing the repo rate by an aggregate 275 basis points YTD from 6.50% to 3.75%. The reduction in interest rates powered strong gains in short-dated bonds. The All-Bond 1-3 year Total Return Index gained 6.74% in Q2 and by 7.58% YTD. The gold price continued to power ahead as global investors searched for alternative safe haven investments in a zero-interest rate world. The gold price ended the period at $1780 with quarterly and YTD percentage gains of 9.88% and 21.50%.

President Ramaphosa received wide ranging praise for his swift, courageous and presidential management of the Covid pandemic crisis. Lockdown measures were implemented quickly, allowing the country to “flatten the curve”. In the process, Ramaphosa solidified his position within the ANC. He also announced a massive R500bn fiscal stimulus plan on the 19th April, close to 10% of GDP, in an attempt to limit the impact of the Covid-19 induced economic slowdown. The R500bn support package was well targeted, with a focus on providing bridging finance for corporates as well as increasing healthcare and poverty alleviation. R130bn of the support package was met by reallocation within the 2020/2021 budget expenditure, which means that in practical terms the additional cost to the fiscus was R370bn rather than R500bn. Specifically, the package increased existing grants and food assistance through vouchers and cash transfers. It also included a R200bn bank loan guarantee scheme underwritten by the SARB, Treasury and the commercial banks, encouraging banks to take on more risk and lend funds to assist companies with turnovers of less that R300 million. The R200bn loan guarantee scheme is financed by the major banks and will only affect government’s expenditure if the state and the SARB are called on to deliver on guarantees. In practice therefore, it appears that a far lower amount will actually be added to the budget deficit by the support measures, potentially as little as R130 billion, rather than the headline figure of R500 billion.

However, on 24th June Finance Minister Tito Mboweni delivered an emergency Budget to address the impact of the Covid pandemic on state finances, in which he painted a bleak outlook for state finances and the economy. He warned of a debt crisis if no action is taken. He warned of an imminent fiscal reckoning, where debt spirals out of control, debt service costs crowd out public spending, private investment is deterred, and South African citizens will be left poorer today with the inheritance of future generations severely eroded. According to Treasury’s forecasts, GDP is expected to contract by 7.2% in 2020, with a recovery projected to settle at 1.5% in 2022. The main budget deficit is expected to increase from 6.8% of GDP projected in February to 14.6%. Debt-to-GDP is expected to reach 81.8% by the end of 2020/2021 and rise further before stabilising at 87.4% of GDP in 2023/24. The Director-General of Finance, Dondo Mogajane confirmed that debt levels risk breaching the 100% mark in 2023/24.

GDP shrank in Q1 by 2% quarter-on-quarter annualised, marking the third quarterly decline in succession, following falls of 0.6% in Q3 2019 and 1.4% in Q4 2019. The nationwide lockdown was fully implemented at the tail end of the

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quarter on 27th March, which means the economic contraction will be far more severe in Q2. Banks, economists and government have all warned that South Africa will experience an unprecedented GDP decline in 2020 as a result of the lockdown and freezing-up of key export markets, with current projections ranging between 5% and 10%. Prospects were already bleak prior to the lockdown with the consensus forecast GDP growth rate pegged at just 1%. The unemployment rate rose to a 17-year high in Q1. The jobless rate increased over the quarter from 29.1% in Q4 2019 to 30.1%. Under the expanded definition of unemployment, which includes people who have stopped looking for work, the rate jumped from 38.7% to 39.7%. Overall, conditions in the labour market remain depressed and likely to show significant deterioration in Q2 before undergoing a mild rebound in the second half of the year.

Economic survey data weakened sharply during the quarter, as business and consumer confidence and activity levels reflected the full impact of the pandemic. The SARB's composite leading business cycle indicator dropped in April by a massive 8.7% year-on-year. The South African Chamber of Commerce and Industry (SACCI) business confidence index plummeted from 89.9 in March to 77.8 in April, its lowest since the index began in 1985, which SACCI attributed to recessionary economic conditions, the Covid-19 lockdown, an over compromised fiscal position, and the downgrading of South Africa's sovereign credit rating to junk status. The decline in business confidence to record low levels does not bode well for new investment, employment and capacity utilization. Stats SA conducted the Covid-19 Business Impact Survey, covering 2182 businesses over the period 14-30th April when the country was under Level-5 lockdown. Most worrying is the permanent damage to businesses, as 8.6% of respondents indicated they had permanently ceased trading. As the quarter wore on and lockdown restrictions were eased, conditions did improve although off an exceedingly low base. The ABSA/BER manufacturing purchasing managers' index (PMI) improved during May, as the lockdown moved from Level-5 to Level-4, easing some of the constraints on the manufacturing sector and the wider economy. Although still in sub-50 contractionary territory, the headline PMI surged higher from its all-time low of 5.1 in April to 43.2 in May. However, survey respondents noted that although able to increase production, both domestic and external demand remained slack. The economy-wide Standard Bank/IHS Markit Purchasing Managers' Index (PMI) made for less cheery reading, falling from 35.1 in April to 32.5 in May, its lowest since the data series began in July 2011. The sub-index measuring expectations for business activity in the coming year turning negative for the first time, signaling a prolonged and bumpy post-pandemic recovery. Due to widespread job losses, the increased number of distressed businesses, pressure on household disposable income and continued uncertainty surrounding the Covid-19 lockdown and future economic policy, overall business activity is unlikely to return to pre-pandemic levels before mid-2021.

Perhaps the best news over the quarter came from the SARB, which followed its two Q1 interest rate cuts totaling 125 basis points, with two further cuts in Q2, reducing the repo interest rate from 5.25% to 4.25% on 14th April and to 3.75% on 22nd May, culminating in a massive 275 basis point rate cut since the start of the year. The bold easing in monetary conditions will provide much needed economic stimulus to the economy and financial markets. Notwithstanding the benefits of monetary stimulus, at the May policy meeting the SARB downgraded its forecast for economic contraction in 2020 from a previous 6.2% to 7%. The Governor of the SARB, Lesetja Kganyago, noted that although the lockdown will be relaxed in coming months, investments, imports and exports are expected to decline sharply for the year as a whole with job losses likely to be widespread. GDP growth is expected to pick up in 2021 and 2022 but only by 3.8% and 2.9% respectively, reflecting little confidence in the hoped for "V" shaped recovery. Due to the weak demand environment, the SARB forecasts consumer price inflation will average 3.4% in 2020 and 4.4% in 2021 and 2022, well below the midpoint of the 3-6% target range over the entire period. Benign inflation should facilitate further interest rate reductions. The SARB Quarterly projection model indicates a further two rate cuts of 25 basis points over the next two quarters, which together with reduced regulatory requirements on commercial banks should further ease financial conditions, boosting liquidity and assisting the balance sheets and cashflow of businesses and households. Mr Kganyago reiterated however, that monetary policy cannot on its own

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improve the potential growth rate of the economy or reduce fiscal risks. These should be addressed by implementing prudent macroeconomic policies and structural reforms that lower costs generally, and increase investment opportunities, potential growth and job creation.

Preoccupied by its management of the pandemic it is perhaps understandable that the government was unable to embark on structural reforms. However, a presentation by the ANC's head of economic transformation, Comrade Enoch Godongwana, dated 22nd May, titled "Economic Reconstruction" raised several red flags for domestic investors. Many had hoped that President Ramaphosa would heed Winston Churchill's advice to "never let a good crisis go to waste" and use the coronavirus crisis as an opportunity to embark on the structural reforms which the economy desperately needs. His bold leadership of the pandemic response, especially in the initial phases, ignited a brief period of "Ramaphoria", similar to the confidence he imbued after the ANC elective conference in December 2017 and after the National Election in May 2019. With each burst of Ramaphoria, there is renewed confidence from businesses, consumers and investors that the government may be finally prioritising economic growth, through structural reforms. Yet, in all 38 pages of the ANC Economic Reconstruction presentation, there is not a single mention of structural reform. Instead, the main theme of the presentation is the prospect offered by the pandemic crisis of even greater State intervention. The essence of structural reform is less rather than more state intervention. Yet the ANC Economic Reconstruction document is touting the exact opposite, despite the ruling party's appalling track record. The presentation returns to the ill-fated call for Prescribed Asset investment regulations, which would force pension fund investment into state-owned enterprises and other government sponsored projects. Although the ANC Economic Reconstruction presentation is a draft and is decisively contradicted by Finance Minister Tito Mboweni's National Treasury Economic Policy document, it nonetheless raises concerns over the long-term government policy outlook.

The lack of impetus in structural reforms is a disappointment, which contributed to our decision to further reduce portfolio exposure to domestically focused shares and to increase the weighting to the large dual listed industrial rand hedge stocks, making clients' portfolios less vulnerable to the structural impediments of the South African economy. However, there is a silver lining to the global pandemic, which should benefit the domestic stocks remaining in our clients' portfolios. With robust balance sheets, strong management and sound business models these companies are in a good position to come out of the crisis with gains in market share and increased profitability. Unprecedented monetary easing by the world's major central banks, the accompanying surge in global liquidity combined with a V-shaped recovery in China's economy provide an extremely positive backdrop for capital inflows into emerging market financial assets. The rand is expected to rally from oversold levels and inflation is expected to drop below the Reserve bank's 3-6% target range enabling further cuts to the repo interest rate. Low interest rates are a powerful tonic for credit growth, business investment spending and consumer spending, and for financial markets. The country is passing through the eye of the Covid-19 storm, but as the rate of new infections and active cases starts to decline, the economy should rebound fairly rapidly, taking it back to its pre-pandemic trend rate.

The expected economic rebound combined with a strengthening rand and declining interest rates, and positive global markets, are likely to be celebrated with further gains on the JSE over the second half of the year. Clients' portfolios, with a healthy balance of large-cap dual listed industrial and resource stocks, and blue-chip domestically focused shares, should benefit from the broad-based market upswing.

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