OVERBERG MARKET REPORT

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Global Report

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The balancing act: alternative asset classes for your global portfolio

Where do you invest if you are seeking lower volatility and higher income yields than equity markets? The traditional answer is government bonds. Not any longer, at least over the medium-term. Bonds are not fulfilling their traditional role as balanced portfolio risk diversifiers. Most government bonds such as US Treasury bonds, German bunds, and UK gilts, have become too expensive. They are trading at deeply negative real yields, which is a poor starting point for investors. This means that inflation adjusted losses are guaranteed. Add this to the Fed's most aggressive rate hiking cycle in over 40 years and unprecedented quantitative tightening, and the outlook for bond investors is not pretty. There is already carnage in even the least risky bond markets. The iShares International Treasury Bond ETF has lost 16.57% year-to-date (as of 15th August). This is even worse than the 12.29% decline in the MSCI World index.

The textbook 60:40 balanced portfolio allocation to equities and bonds is being turned on its head. The chief culprit is inflation, which has upended the steady 40-year downward trajectory in bond yields. As bond yields drop, bond prices go up. Now that bond yields are rising in line with surging inflation and tightening monetary policy, bond prices are falling. This trend may persist. We advocate a paring back in balanced portfolio bond weightings. Instead, investors should look to alternative asset classes. Like bonds, these alternative asset classes tend to provide lower volatility than equities and provide higher income yields, so they are effective in mitigating risk. They have the added advantage of achieving high marks on the ESG scorecard and providing a direct hedge against rising inflation, public enemy no. 1 in today's global financial markets.

We will briefly discuss 6 alternative asset classes and the investment vehicle of choice to access these. They are all listed on the London Stock Exchange and form part of OAM's privately managed global balanced share portfolios.

RENEWABLE ENERGY: Greencoat UK Wind is the largest listed renewable energy investment company in the UK with a market capitalisation of around £2.5 billion and is a constituent of the FTSE 250 index. The company invests in land-based and offshore UK wind farms. The business model is in a sweet spot, benefitting from global decarbonisation, with rising inflation suiting the company's inflation-linked power contracts. UK electricity prices have risen sharply in line with the surge in oil, coal, and gas prices. The share price has risen 13.59% YTD, which excludes the additional 5% annual dividend yield.

INFRASTRUCTURE: The IMF and World Bank have repeatedly stated that a key driver for global GDP growth in coming years will be infrastructure spending, a theme which is likely to benefit 3i Infrastructure. Its investments, focussed on the UK and Europe, are weighted towards energy transition, utilities, transportation, and communication. The investments are intended to generate long-term yield and capital growth. Results have been impressive with a 13.1% annualised total shareholder return since the IPO in 2007. The company has a portfolio of 18 assets valued at £3.2 billion. Earnings have an explicit inflation linkage. Essential services have genuine pricing power. The share trades on a 3% dividend yield.

PRIVATE EQUITY: HG Capital is widely recognised as one of the best managed private equity investment companies listed on the London Stock Exchange. HG Capital has delivered annualised net asset value growth of 17.8% over the past decade and 15.6% over the past 20 years. There is a focus on technology and technology-enabled service businesses involved in tax and accounting, enterprise resource planning, healthcare, legal and regulatory compliance, wealth management, automation and engineering, and insurance. They are profitable businesses with high levels of recurring revenues. Exposure is across the US, Europe, and the UK. Private equity tends to be less volatile than listed equity investments. HG Capital's net asset value would be expected to fluctuate less than equity indices. The share trades at a 13.9% discount to net asset value, real value for an investment of this calibre.

MUSIC ROYALTIES: Hipgnosis Songs, listed in July 2018, has over a relatively short time acquired 146 music catalogues from songwriters and publishers, comprising over 60,000 songs. Hipgnosis provides shareholders with music royalty income via various performance platforms, including concerts, radio, streaming, movies, games, advertising, CDs, and other media. Streaming services are becoming ever popular, growing at an annualised rate of almost 30% and the share of music royalties from streaming is on the increase. The US Copyright Royalty Board has mandated an increase in the songwriter/publisher share of music royalties from US streaming from 11% to 15%. Music consumption has no correlation to business cycles, providing investors protection from economic cycles. The share trades on a 4.5% dividend yield and 23.8% discount to net asset value, offering substantial value.

SECURED LOANS: Biopharma Credit, listed in 2017, is regarded as one of the best quality sources of alternative income in the investment company universe. The company specialises in senior debt secured by approved and marketed products in the biotech sector. The biotech sector is expected to have substantial capital needs over coming years as the number of products undergoing clinical trials continues to grow. Potential upside to returns over and above regular interest payments may come from loan prepayment fees. The bulk of the debt comprises floating rate loans, which will benefit shareholders as interest rates continue to rise. The share trades on a 7.3% dividend yield.

ABSOLUTE RETURN: BH Macro is the only way for investors to access the award-winning Brevan Howard master fund, one of the world's leading global macro absolute return investment vehicles. BH Macro provides protection against market disruption, rewarding investors in the event of rising volatility in financial markets. It provides a solid counterbalance to any portfolio. The managers limit losses by buying rather than underwriting option structures, which tend to be far out of the money and therefore very cheap. BH Macro's track record is exceptional, producing an annualised net asset value return of 9.33% (GBP) since its listing in 2007. Since then, positive monthly returns have been produced in 17 of the 20 worst months for the S&P 500 index. During the Global Financial Crisis in 2008 and 2009, BH Macro returned 23.25% and 18.0%, and then 12.34% during the European sovereign debt crisis in 2011. As markets corrected in 2018 due to rising US interest rates and quantitative tightening, BH Macro gained by 12.43%, and when Covid struck in 2020, investors were rewarded with a 28.09% return. In the year to end June, BH Macro has already increased its NAV per share by 14.11%.

A portfolio portioned equally between these 6 alternative asset class investments at the start of the year would have gained 2.48% (GBP) by 15th August. This excludes the 3.48% dividend yield. Moreover, at current prices the portfolio trades at a 3.56% discount to net asset value. Overberg Asset Management specialises in truly diversified individual global share portfolios and through careful asset allocation we have achieved a 20-year track record of outperforming our benchmarks, especially during market turbulence. Let us help you diversify your global portfolio the smart way.

Asset Class	Share	Price YTD	DIV YLD	NAV Premium Discount
Renewable Energy	Greencoat	13.59%	4.80%	5.10%
Infrastructure	3i Infrastructure	-3.37%	3.00%	11.10%
Private Equity	HG Capital	-6.85%	1.70%	-13.90%
Music Royalties	Hipgnosis	-7.75%	4.50%	-23.80%
Secured Loans	Biopharma	0.00%	7.30%	-7.80%
Absolute Return	BH Macro	19.29%	0.00%	13.80%
TOTAL		2.48%	3.48%	-3.56%

Currency : GBP. Date: 15 August 2022. Source: London Stock Exchange

Local Report

Gielie Fourie

Attractive South African shares

INTRODUCTION: Local shares and bonds currently offer good value. The longer dated 10-year bond yield is trading at 10.15% versus 9.71% in January 2022. The Price Earnings (PE) ratio of the JSE All Share index is 12x.This is the same level as in March 2020 when Covid started. One year later in March 2021 the PE ratio doubled to 24x. At the present PE ratio of 12x, the JSE is offering value. For both shares and bonds, the downside is limited - opportunities abound. Peter Armitage, Anchor Capital CEO, said in a recent presentation: “An investment in local shares and bonds is bound to deliver the best returns over the next 12 to 24 months. Domestic equities are expected to give a return of around 15%, and local bonds just more than 10%. Global equities will return only 10%, and government bonds 3%. Domestic shares are very, very cheap.” We look at attractive local shares.

BANKS: Last week we wrote about the benefits of exposure to banks in times of rising interest rates. The PE ratios of our biggest banks, Nedbank, Absa, Investec, Standard Bank, and First Rand (FNB) vary between 8.08x and 12.20x. Bank PE ratios are very low. Mike Hutchings of Reuters wrote: “Bank share prices are reminiscent of a ‘fire sale’ with several at low price-earnings ratios of six to seven times.” PE ratios move in tandem with share prices.

COMMODITIES: While the start of monetary policy tightening in the US and war in Ukraine spurred weakness for most risk assets, commodities benefitted. Commodity prices have soared in 2022. The S&P Goldman Sachs CI (commodity index) is up 19.87% year-to-date, boosting the JSE, strengthening the Rand and improving our trade balance. Which commodity share to buy? It is now more important than ever to distinguish between specific commodities since each has its own identifiable structural driver. Identify the driver, then invest accordingly.

Platinum group metals (PGMs) stand to be negatively impacted by the decline in sales of internal combustion vehicles as they are replaced by electric vehicles for short-distance travel and hydrogen-powered vehicles for both longer distances and heavy-duty transportation needs. Analysts recommend PGM shares as a "hold." Copper's widespread use in electric motors and electricity conduction could see demand increase over the coming years. Reducing our dependence on fossil fuels is in fact not possible without the use of copper.

Anglo American is a diversified, but not too diversified, leading global mining company that we hold. Glencore is one of the world's largest global diversified mining companies, producing more than 60 commodities. According to Glencore, capital expenditure at major miners has not reached the levels of 2013 that led up to the downward cycle in prices of 2015. It seems that capital expenditure is trending downwards, with miners prioritising returns to shareholders through dividends and share buybacks. From a supply-side view, one could certainly argue that the current commodity cycle could be longer than past cycles. Gold? When a recession is looming, it is a good time to buy gold. Gold prices tend to increase when stock markets tank. We do not hold any gold shares as we believe the best investments when recessions loom are energy stocks (like oil) and banks. This is backed by data over 95 years from research house SSRN. We hold Sasol and banks.

HELIUM: Renergen is a popular topic in investment circles. Renergen is an emerging producer of helium in Virginia in the Free State. Its natural gas contains one of the richest helium concentrations recorded globally. Renergen was on track to start production by mid-2021. However, by the end of July 2022, production had not yet started. Phase Two of the project will require around $900 billion to start production. Ivanhoe, a Canadian mining company listed on the Toronto Stock Exchange, bought a 4.35% stake in Renergen in March 2022, and had options to increase it to as much as 55%. The deal lapsed in July 2022. With the production time overrun and uncertainty with funding Renergen is too risky in our view.

OTHER SHARES: "Tech continues to have a place within a balanced portfolio. Tech spending is increasingly mission-critical for businesses to grow their earnings. We believe that it would be a mistake to avoid the sector as a whole" says James Bennett of Anchor Capital. We believe that both Naspers and Prosus will perform well. Other shares we think will outperform are construction companies, Raubex and Afrimat, and mobile phone operators MTN and Vodacom. We hold shares in Transaction Capital, operator of three businesses: SA Taxi, WeBuyCars and Transaction Capital Risk Services. In the retail space we hold Mr Price and AVI. There are more attractive shares on the JSE, like Reinet, but we do not have space to discuss them all.

BOTTOM LINE: As mentioned in the introduction, local shares are "very, very cheap." Investors will be rewarded but they must be prepared for volatility. The Russia/Ukraine war, quantitative tightening (QT), high unemployment, Eskom, and corruption can be negative for markets. There is also a general election scheduled for 2024. If you are interested in investing, please contact one of our highly qualified consultants. Remember, when you invest, you are buying a day that you do not have to work.

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