overberg
asset management

Local Defensive Portfolio

Q1 2023

Investment Objective

The OAM Local Defensive Portfolio aims to achieve stable capital growth with favourable income returns over the medium to long-term, while maintaining a relatively low level of risk. Investments are extensively researched to assess their intrinsic value over the longer-term.

Risk Rating

1	2	3	4	5	6	7
Low risk						High risk

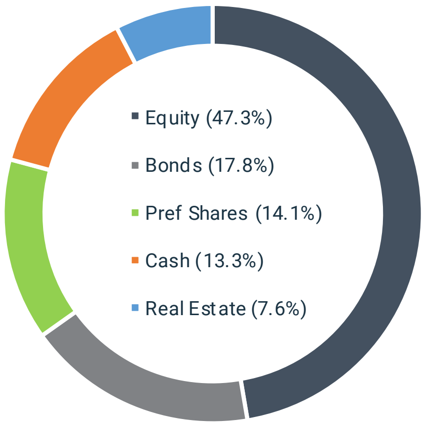
Technical Details

- Base currency: South African Rands
- Benchmark: Prime Interest Rate (2009 – 2018); 25% JSE Capped All Share, 25% ALBI (1-3y 2019-Sept'20), 15% SAPY, 35% JSET (2019-)
- Asset Allocation: Flexible mix of equities, real estate holdings, preference loan stock and cash.
- Individual portfolio representing Local Real Return investment style.
- All performance figures include income and are net of all fees and expenses (including asset management and financial advisor fees)

Investor Criteria

- Seek income and steady capital growth.
- Have a moderately conservative risk profile.
- Typically aim to invest for a period of 4 years or longer.

Asset Allocation (see through basis)

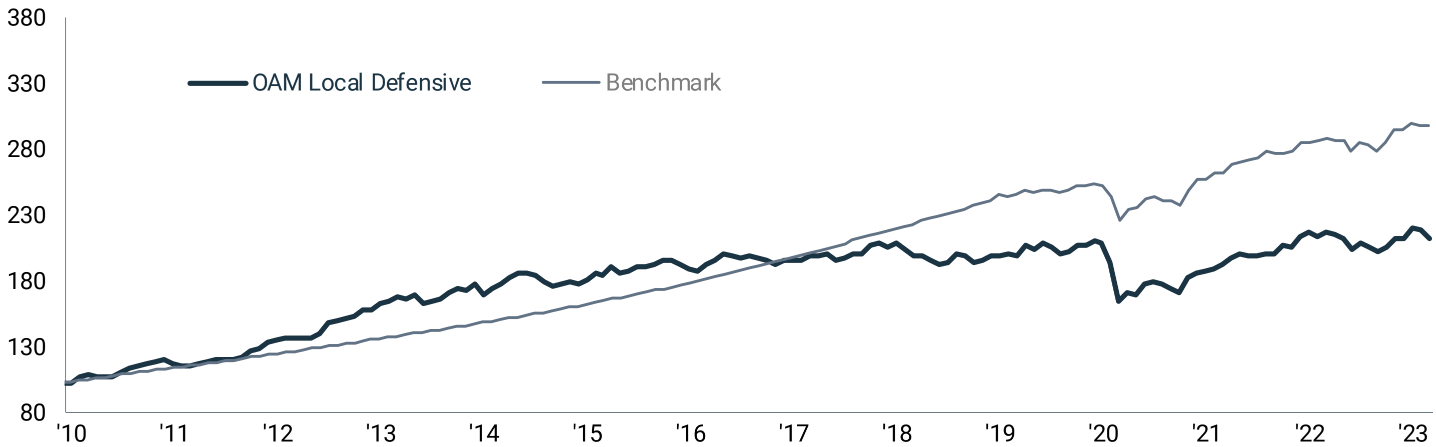


Performance

Growth	OAM*	Benchmark
Annualised (%)	ZAR	ZAR
Inception 2005	5.81	8.41
7 years	1.47	7.31
5 years	1.45	5.91
3 years	8.89	9.71
YTD	0.19	0.91
Yield**	5.21	

* Performance figures are based on a typical portfolio.
**Income yield since inception

Top 5 Holdings



Local Market Review and Strategy Outlook for the quarter ended March 2023

The JSE All Share index reached an all-time high in January, with a solid 8.9% gain over the month as bullish sentiment from the end of last year spilt over into 2023. The rally faded due to worsening load shedding, South Africa's grey listing, persistent inflation and further interest rate hikes. Despite the litany of disappointments, the JSE All Share index still posted a 4.1% gain over the first quarter (Q1), helped by China's reopening and the sharp rebound in Naspers and Prosus. As a result, the Industrial 25 index was the best performer with a 13.3% return over the quarter. The Financial 15 index only increased 0.7% with earlier gains evaporating after banking turmoil in the US and Europe affected sentiment in the sector. The Resources 20 index lost 6.1% as base metals prices retreated and production volumes failed to meet expectations. The 10-year South African government bond yield fell slightly over the quarter from 10.18% to 9.83% in line with a stabilisation in global sovereign bond yields but the rand was one of the worst performing emerging market currencies, losing 4.4% against the dollar from R/$17.02 to 17.77.

Eskom marked its centenary on the 1st March. It was founded in 1923. However, the occasion provided little cause for celebration, the date also marking 100 consecutive days of load shedding and 6 straight days of Stage 6 load shedding. Outgoing Eskom CEO Andre de Ruyter made explosive remarks in a television interview, in which he claimed roughly R1 billion was being lost at Eskom each month to corruption and that at least one senior cabinet member was benefitting from organised crime extortion at the utility's plants. The worsening power crisis led president Ramaphosa to declare a national state of disaster at his State of the Nation address, raising concerns that new patronage abuse would emerge. Bowing to external pressure, government rescinded the state of disaster in the first week of April.

Intensifying power shortages impacted economic activity. Mining and manufacturing output both fell, with the latest available figures showing year-on-year declines in February of 4.9% and 5.2%, respectively. The manufacturing purchasing managers' index fell steadily throughout the quarter, from 53.0 in January, to 48.8 in February and 48.1 in March, well below the critical 50-threshold that signals contraction. Business and consumer confidence slumped. The SACCI business confidence index fell from 117.3 in December to 112.9 in January. The BER business confidence index continued to drop, to 36 in Q1, marking a steady decline from 46 in Q1 2022. The BER consumer confidence index fell sharply to -23 in Q1, from -8 in Q4 compared with -13 in Q1 2022. The Reserve Bank cut its forecast for 2023 GDP growth from 0.6% to 0.3% at its January policy meeting and again at its March policy meeting from 0.3% to 0.2%, highlighting the worsening power supply crisis.

Power shortages also fuelled price increases. Headline consumer price inflation reversed its recent downtrend in February, rising from 6.9% to 7.0% year-on-year. Food price inflation hit a near 14-year high of 13.6%, pushing month-on-month CPI up by a heady 0.7%. Core CPI, which excludes food and energy prices, jumped from 4.9% to 5.2% on the year, a 6 year high, indicating that companies are passing on costs associated with electricity outages. After slowing its pace of interest rate hikes to 25 basis points at its January policy meeting, the Reserve Bank unexpectedly returned to a 50 bp rate hike in March, lifting the repo rate from 7.25% to 7.75%, marking the 9th consecutive hike and a cumulative 425 bp increase. The prime lending rate has risen over the period to 11.25% from 7.0% in September 2021. The hawkish bias suggests the Reserve Bank is more concerned with inflation than potential recession.

Although well received, the state budget did little to alleviate the cost-of-living crisis for households. Finance minister Enoch Godongwana promised restraint on the expenditure side, pledging below-inflation public sector wage increases and lower projected government spending over the next two financial years. Although restrictive, continued fiscal prudence was well received. Tax revenue collections exceeded the 2022 Budget by R93.7 billion. The corporate tax rate was reduced from 28% to 27% effective from 1st March. The National Treasury announced it would assume 60% of Eskom's debt burden amounting to R254 billion, over a 3-year period with conditions attached. Tax incentives and tax rebates were announced to support business and household investment in rooftop solar energy. These measures signal a growing willingness by government to increasing private sector involvement. In 2010, Eskom accounted for 97% of the country's electricity supply. By December last year, its contribution dropped to 85% and is set to decline further.

Q4 GDP fell by a greater than expected 1.3% quarter-on-quarter compared with an upwardly revised 1.8% expansion in Q3. The latest GDP figure is only 0.3% above the 2019 pre-pandemic level, lagging the 3.5% increase in the country's population over the same period. Over 2022 GDP grew by 2.0% compared with 4.9% in 2021. The contraction in Q4 was broad based with especially large declines in the primary sector, in agriculture and mining, which contracted by 3.3% and 3.2% q/q. The impact of power outages appeared to have spread across all sectors of the economy. Construction remained the worst affected sector, still 23.1% smaller than before the pandemic, and contracting in 2022 for the 6th consecutive year.

President Ramaphosa finally announced his long-awaited cabinet reshuffle, which lacked the streamlining that had been hoped for, and many under-performing ministers remained at their posts, including police minister Bheki Cele. However, the first-time appointment of a minister of electricity, Kgosientsho Ramakgopa may create more urgency in reforming the electricity utility. One of the debt transfer conditions imposed by the National Treasury is that Eskom's coal fired power stations must be concessioned to private sector operators. Ramaphosa pledged commitment to Eskom's unbundling in the SONA. The process will likely be accelerated by the worsening power crisis and de Ruyter's shock allegations. The National Transmission Company is less than a month away from being a legally separate company, marking the first stage of Eskom's unbundling and opening the electric power market to private sector competition. In grey-listing South Africa, the Financial Action Task Force identified 8 deficiencies, but this is down significantly from 67 previously. The EFF's planned national shutdown was a relative non-event, attracting far less support than some had feared but there are growing concerns that the party will be invited by the ANC to form a coalition government after the 2024 national elections.

With the country in darkness for several hours each day and a recession almost a certainty, the outlook for company earnings is not encouraging. It is no surprise therefore that the All Share index is trading at a 23% discount to its long-term average. Despite the JSE All Share index rising since the start of the year, its price earnings multiple has derated further since the start of the year from 12.8x to 11.21x. The economy is currently caught in a stagflation vice grip of declining growth and rising inflation, with the bulk of the blame lying squarely on load shedding. There is a glimmer of hope that Eskom's unbundling and greater private sector participation could provide a catalyst for improved sentiment. A peak in SARB interest rates would also be helpful. Fortunately, equity valuations are rock bottom, so the downside from this point is limited. The best prospective returns are usually locked-in when sentiment is at its lowest ebb.