overberg
asset management

Local Growth Portfolio

Q1 2024

Investment Objective

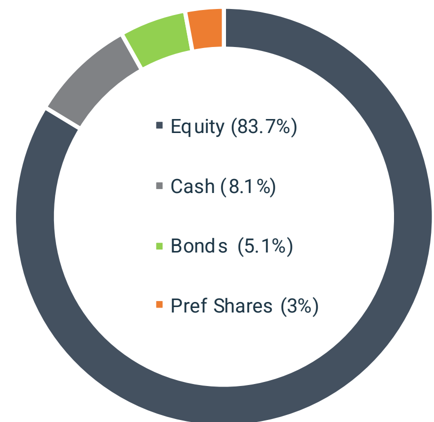
The OAM Local Growth Portfolio is designed to increase the long-term wealth of investors by primarily holding investments aimed at maximizing capital appreciation, while maintaining a moderately-high risk level. Investments are extensively researched to assess their intrinsic value over the longer-term.

Risk Rating

Technical Details

- Base currency: South African Rands
- Benchmark: JSE All Share Index (2005-2016), JSE Capped All Share Index (2017 -).
- 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 all fees and expenses (including asset management and financial advisor fees)

Asset Allocation (see through basis)



Investor Criteria

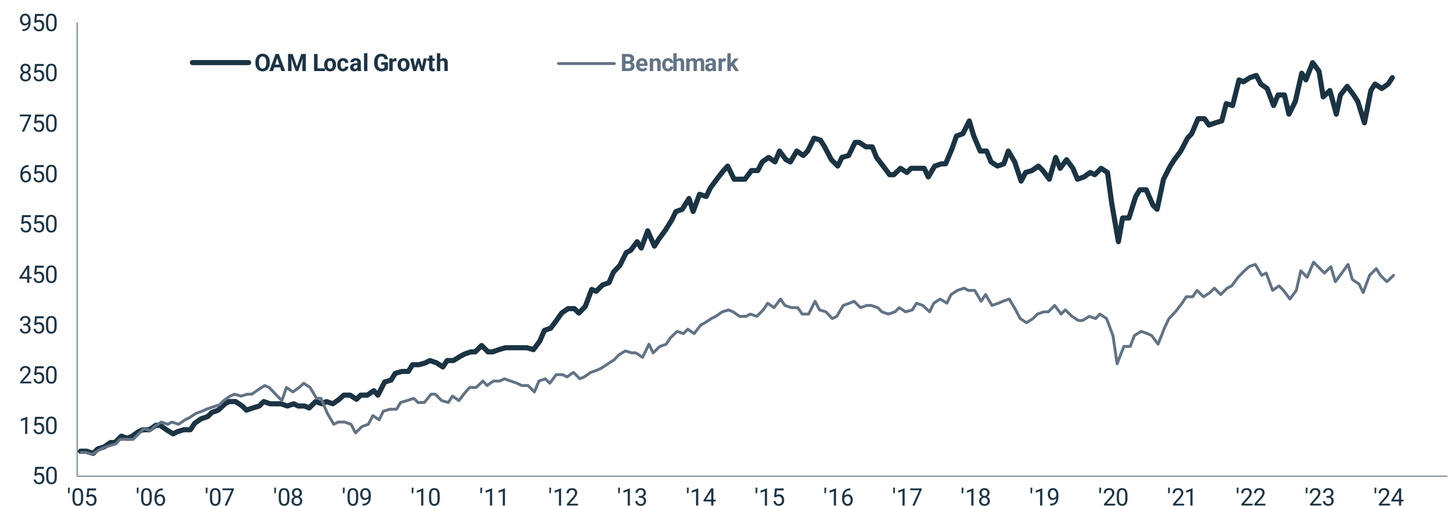
- Seek considerable long-term capital appreciation and a moderate degree of income.
- Have a moderately-high risk profile and are comfortable with short-term market fluctuations in favor of long-term gains.
- Typically aim to invest for a period of 5 years or longer.

Performance

Growth	OAM*	Benchmark
Annualised (%)	ZAR	ZAR
Inception 2005	11.82	7.76
10 years	3.33	2.39
7 years	3.53	2.38
5 years	5.61	3.65
3 years	5.24	3.32
YTD	1.61	-3.06
Yield**	2.08	

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

Top 5 Holdings



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Local Market Review and Strategy Outlook for the quarter ended March 2024

The JSE All Share index lost ground in the first quarter (Q1), decoupling from strong global equity markets over the period. After their strong year-end finish in 2023 some pullback was perhaps to be expected, given the contraction in aggregate earnings. The earnings decline is illustrated by the rise in the All-Share index price: earnings multiple between the end of December and the end of March from 10.9x to 13.2x despite the index falling in Q1 by 3.1%. Although the mining sector suffered sharp earnings declines the Resources 10 index only lost 0.5% as the profit downgrade had been largely discounted. The Financial 15 index fared worst due to weakening credit extension and concern over rising loan loss provisions. Industrials eked out a modest positive return of 0.2% helped by the dual listed rand hedge companies, which were assisted by firmer global markets. The rand also lent a hand by weakening 3.6% versus the US dollar from R/$ 18.30 to 18.95. In line with rising sovereign bond yields and the likelihood of the SA Reserve Bank (SARB) keeping its policy rate higher for longer, the 10-year RSA bond yield increased over the quarter from 9.77% to 10.88%. The dollar gold price gained by a solid 9.79% in Q1, due to strong central bank buying, providing a boost to the SARB's gold and foreign currency reserves.

Weak equity market returns belie slight improvement in the macro-economic and policy outlook. The economy managed to avoid two successive quarters of contraction with GDP growing in Q4 2023 by 0.1% quarter-on-quarter and 1.2% year-on-year, up from -0.2% and -0.7%, respectively in Q3. A reduction in the severity of electricity loadshedding, port and rail delays should keep the improvement on track. The SARB estimates loadshedding will subtract 0.6% from GDP this year and 0.2% in 2025 compared with 1.5% in 2023. Research from RMB Morgan Stanley notes that the average stage of loadshedding was 1.8 for the first two months of this year versus 3.8 for the same period last year. Installed rooftop solar capacity has more than doubled over the past 12 months from 2.4GW to 5.4GW, comprising over 10% of Eskom's energy capacity. The Treasury forecasts GDP growth will nudge higher to 1.3% this year, rise to 1.6% in 2025 and 1.8% in 2026.

Finance Minister Godongwana avoided the temptation of populist spending measures in the 2024 Budget ahead of the General Election. His budget mirrored the message of fiscal prudence and utility structural reform delivered by President Ramaphosa in his State of the Nation Address. The budget deficit widened as expected to 4.9% of GDP from 3.6% last year but is projected to reduce over the next three years to 4.5%, 3.7% and 3.3%. For the first time since 2009, a primary surplus was recorded at 0.4% of GDP. The primary surplus is income minus expenditure before interest. This should allow the Treasury to start chipping away at the country's debt pile, which has risen to 70.9% of GDP and costs more than R1 billion per day to service. To ease the debt burden, the Treasury took the unusual step of tapping into the country's Gold and Foreign Exchange Contingency Reserve Account (GFECRA) to the tune of R150 billion, causing some concern that this may set a dangerous precedent and leave the currency vulnerable to future shocks. Godongwana signaled his support for structural reforms by announcing that Eskom would lose R2 billion a year in bailout funding for every year the utility delays in selling a non-core asset while Transnet's R47 billion guarantee is contingent on allowing outside parties into its railway network.

Business and consumer survey data were relatively downbeat over the quarter with both the Absa manufacturing purchasing managers' index (PMI) and the S&P Global economy-wide PMI hovering just below the neutral 50-level at 49.2 and 48.4, respectively. The FNB/BER quarterly consumer and business confidence indices declined from -17 to -16 and from 31 to 30, respectively. Private sector confidence should recover from the easing in loadshedding, but high interest rates are taking their toll compounding the effect of weak real wage growth and high unemployment. Private sector credit extension growth remained depressed at just 3.3% year-on-year indicating little appetite for credit-fueled spending or investment. The SARB has kept its benchmark repo rate at a historically high 8.25% since last May which is high compared to other emerging markets in nominal terms and especially in real terms after subtracting the inflation rate.

However, the SARB will not be hurried into cutting the repo rate. At its most recent policy meeting on 27th March the policy committee decided unanimously to keep rates on hold citing upside risk to inflation, in particular food prices and imported inflation stemming from potential rand weakness. In February headline consumer price inflation (CPI) re-accelerated from 5.3% to 5.6% year-on-year and core CPI excluding food and energy from 4.6% to 5.0%, moving away from the midpoint of SARB's 3-6% target. On a month-on-month basis CPI and core CPI gained by a substantial 1.0% and 1.2%, respectively. In his policy statement SARB Governor Lesetja Kganyago said "Given extra inflation pressure, headline now reaches the target midpoint only at the end of 2025, later than previously expected. As a result, the policy rate in our baseline forecast also starts normalizing later."

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Uncertainty ahead of the General Election on 29th May is also likely to dent domestic demand. Polls indicate the ANC's support will drop below 50%, which means it will need to find coalition partners at a national level. The newly formed MK party may force the ANC's vote closer to 40%, which could be good news for the Multi-Party Charter but also raises the risk of President Ramaphosa coming under pressure from Deputy President Paul Mashatile, which could ultimately open up the prospect of a national coalition between the ANC and EFF. Even in the more moderate scenario of a coalition between the ANC and one or more of the Multi-Party Charter parties, coalition politics are messy at the best of times, especially in South Africa where they remain untested at national level. For instance, the Constitution requires that parliament must meet to elect a new president within 14 days after the election result has been certified. Uncertainty may build even after the election has run.

South Africa's equity market valuation is depressed compared to its own long-term average and relative to other emerging markets. The disparity is explained by slower economic growth. Local growth is hamstrung by continued high borrowing rates and a lack of confidence in government policy. While an easing in loadshedding and some progress in tackling road and rail backlogs offers a glimmer of hope, far more progress is needed. Interest rates will decrease in time, which will boost confidence over the short term, but a more sustainable equity market re-rating requires a decisive shift in economic policy.

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