Volume 7, No. 12, Dec 2011

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 2011

By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

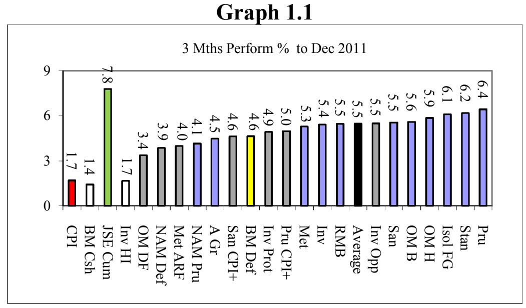
1. Review of Portfolio Performance

In **December** our **average prudential balanced portfolio** returned minus 0.13% (October 0.28%). Top performer is Sanlam (0.96%), while Stanlib (minus 1.12%) takes bottom spot.

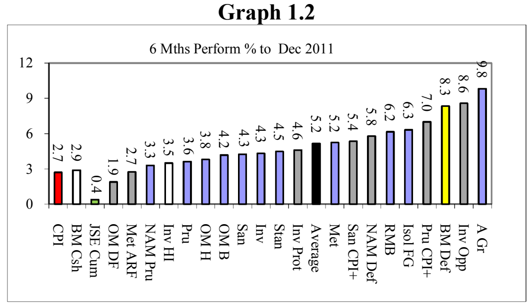
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no color bars), the average of prudential balanced portfolios (black bar), the JSE Allshare Index (green bar), and the CPI (red bar). Benchmark investors should take note of the performance of the default portfolio (yellow bar), which now represents a combination of Prudential Namibia Inflation Plus and Allan Gray. Below is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Consumer Price Index	CPI Cum (red)
JSE Allshare Index	JSE Cum (green)
Benchmark Default Portfolio	BM Def (yellow)
Average Portfolio (prudential, balanced)	Aver (black)
Special Mandate Portfolios	
Money market	BM Csh (no color)
Investec High Income (interest bearing assets)	Inv HI (no color)
Investec Protector	Inv Prot (grey)
Investec Opportunity Fund	Inv Opp (grey)
Metropolitan Absolute Return	Met ARF (grey)
Prudential Inflation Plus	Pru CPI+ (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Sanlam Inflation Plus	San CPI+ (grey)
NAM Coronation Balanced Def	NAM Def (grey)
Market related portfolios	
Allan Gray Balanced	A Gr (blue)
Investec Managed	Inv (blue)
Investment Solutions Bal Growth, (multimanager)	Isol FG (blue)
Prudential Managed	Prud (blue)
Metropolitan Managed	Met (blue)
NAM Prudential Balanced	NAM (blue)
Old Mutual Profile Balanced	OM B (blue)
Old Mutual Profile Growth	OM H (blue)
RMB Managed	RMB (blue)
Sanlam Managed	San (blue)
Stanlib Managed	Stan (blue)

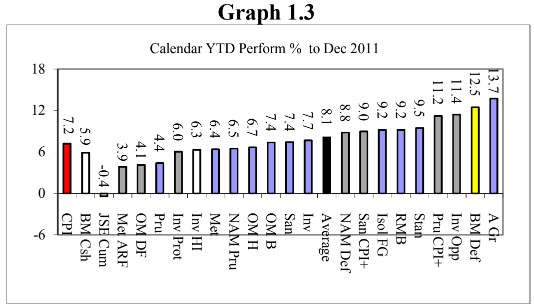
Graph 1.1



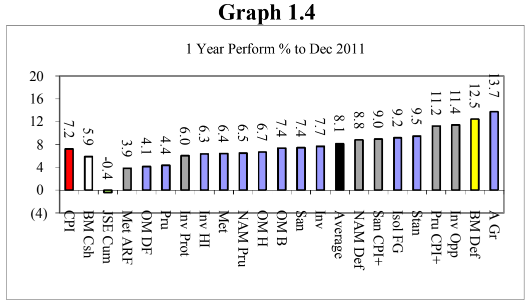
Graph 1.2



Graph 1.3



Graph 1.4



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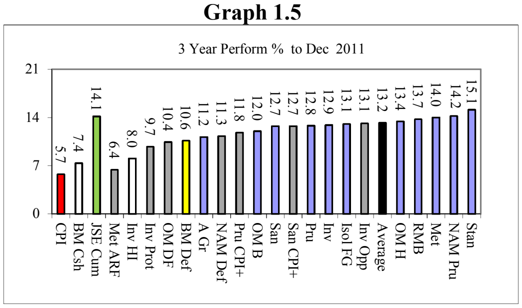
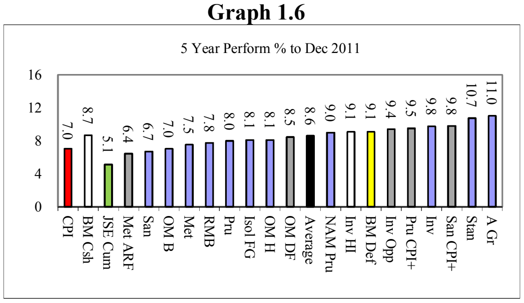
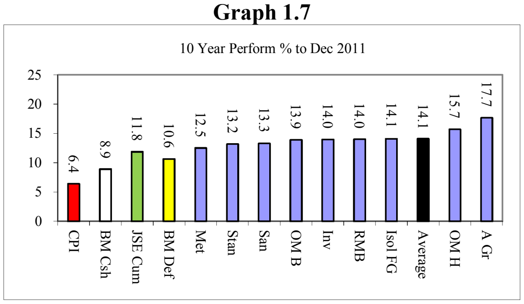
Graph 1.5



Graph 1.6

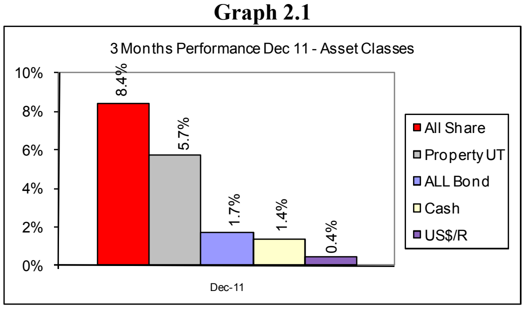


Graph 1.7

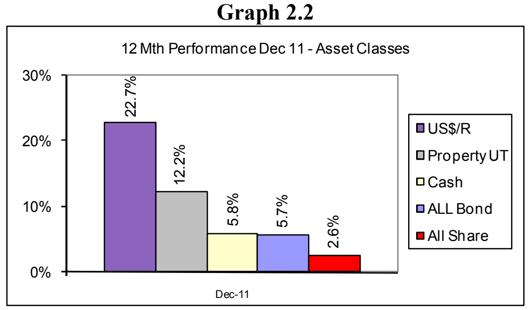


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

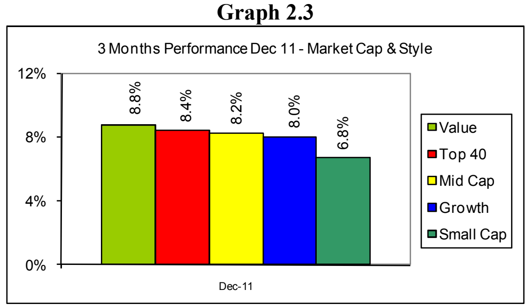
Graph 2.1



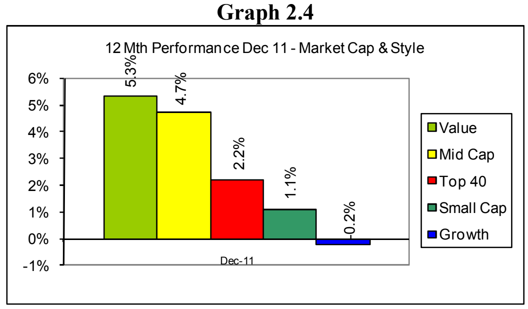
Graph 2.2



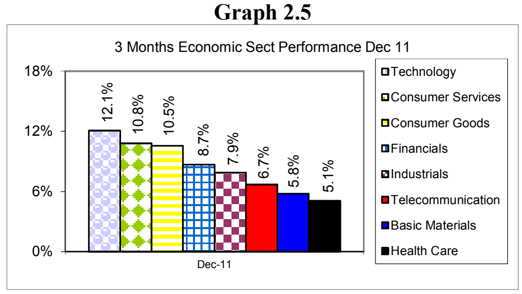
Graph 2.3



Graph 2.4



Graph 2.5



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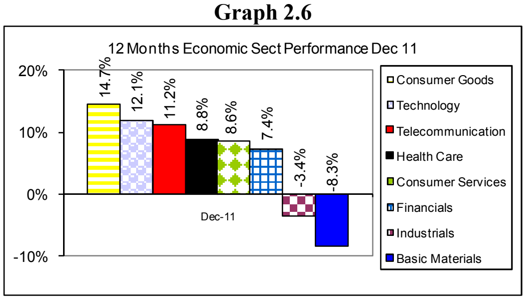
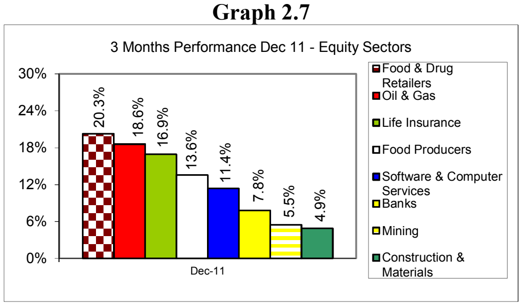
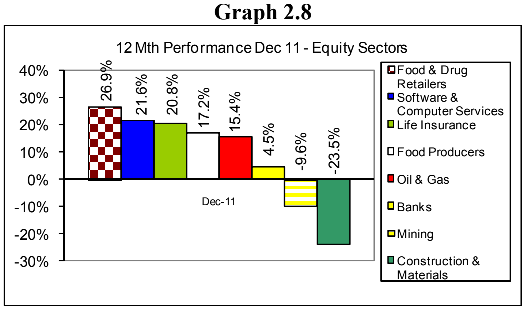
Graph 2.6



Graph 2.7



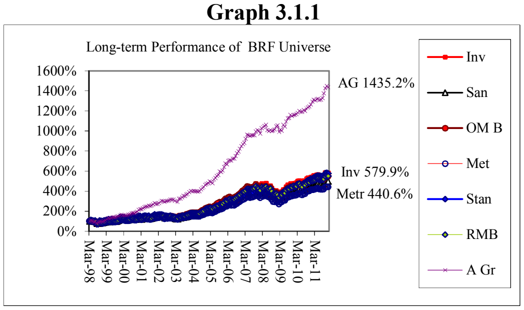
Graph 2.8



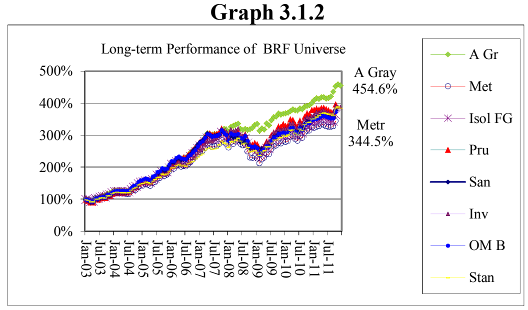
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

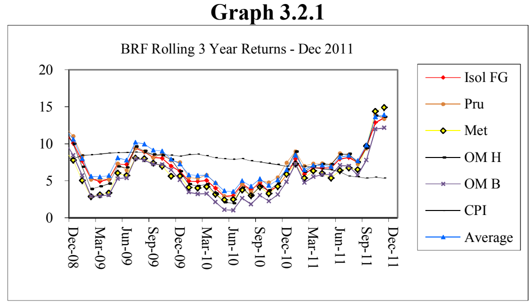


Graph 3.1.2

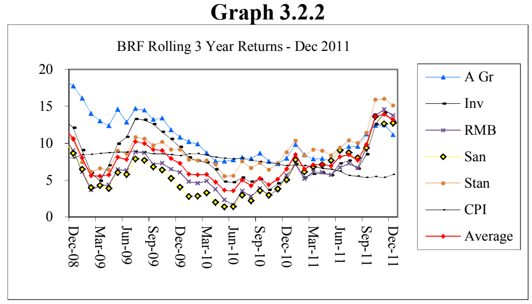


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

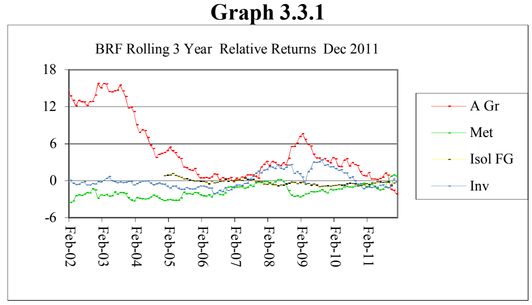


Graph 3.2.2



3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



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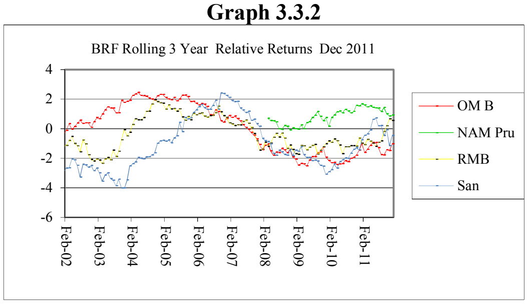
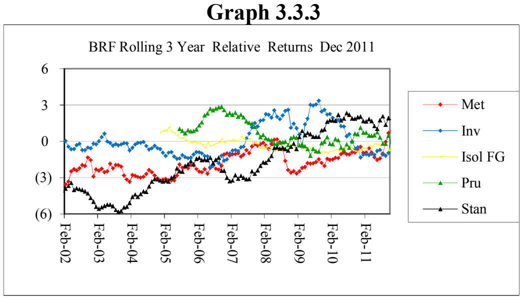
Graph 3.3.2

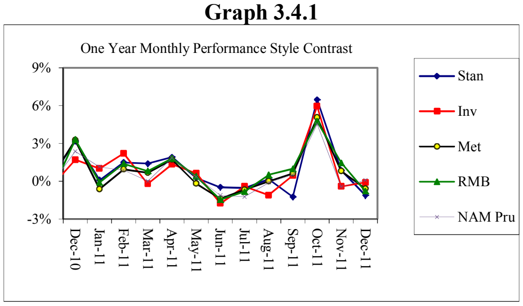


Graph 3.3.3

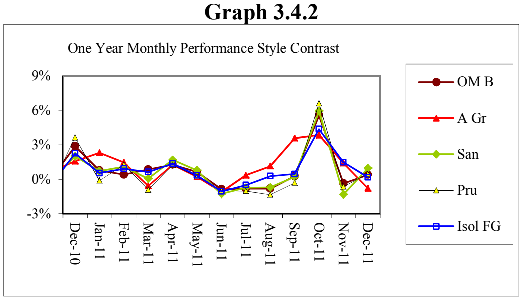


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

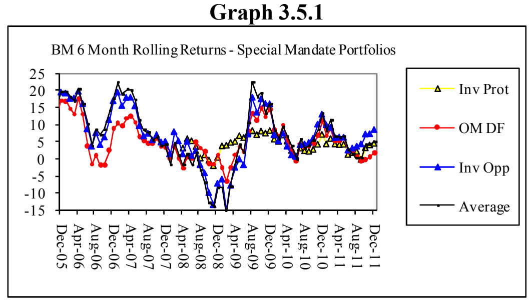


Graph 3.4.2

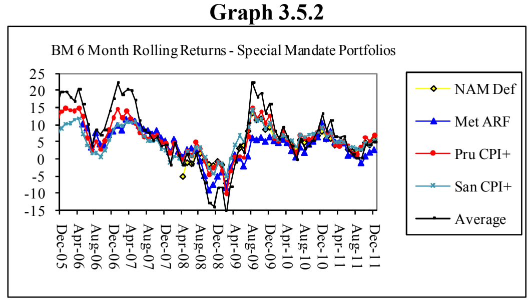


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

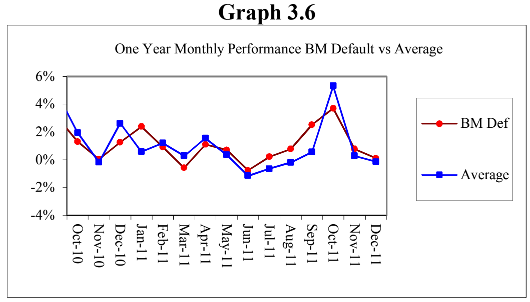


Graph 3.5.2



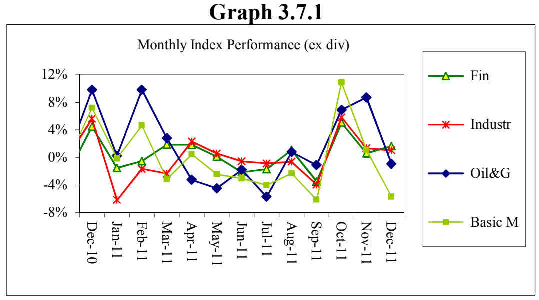
3.6 Monthly performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6



3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

Graph 3.7.1



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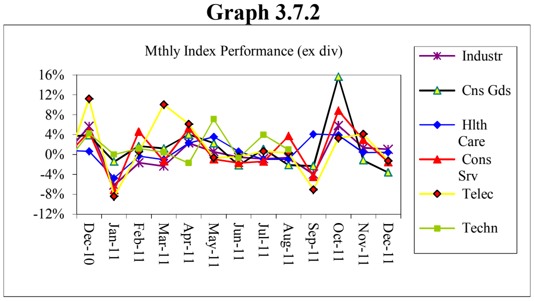
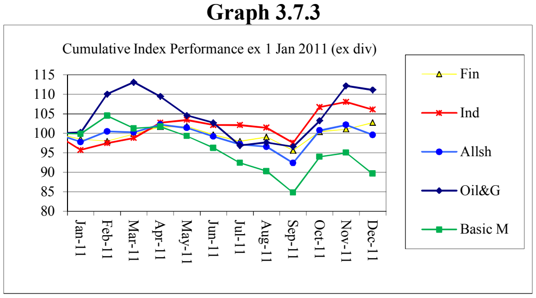
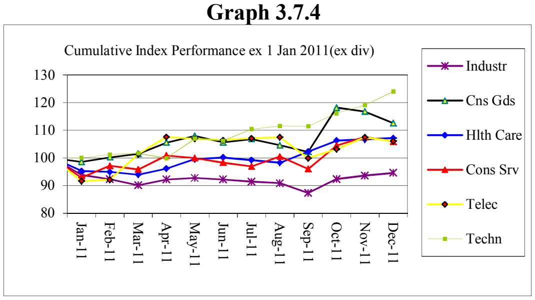
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 8.6% p.a. in nominal terms, or 1.6% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 9.1% p.a. in nominal terms, or 2.1% p.a. in real terms. Considering that the average prudential balanced portfolio should deliver a real return before management fees (typically 0.75%), of roughly 6% per year, these portfolios are currently trailing the expected long-term goal significantly over the past 5 years.

Participating employers who are invested in the Benchmark default portfolio will be aware that we have raised the risk profile of the default portfolio since the beginning of 2011 by replacing Metropolitan ARF with Allan Gray. With this combination, its risk profile is still considerably lower than that of the average prudential balanced portfolio. We would therefore expect the default portfolio to sacrifice around 1% for the benefit of lower volatility, thus an expected real return before management fees (typically 0.75%), of around 5% per year. Since this change was effected, the default portfolio returned 12.5% compared to 8.1% for the average prudential balanced portfolio.

The performance of the prudential balanced portfolios should be more volatile than that of the default portfolio, which produces significantly more volatile performance than the money market portfolio. The table below presents one year performance statistics over the 3 years January 2009 to December 2011:

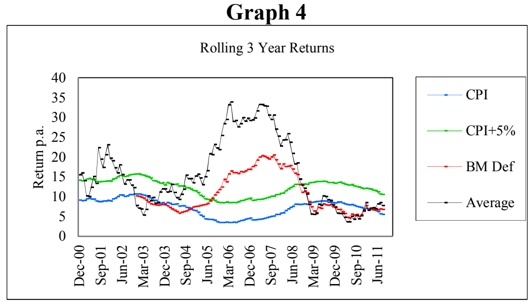
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.9%	- 8.0%	- 19.1%
Best annual performance	12.1%	16.2%	29.7%
No of negative 1 year periods	n/a	6	6
Average of negative 1 year periods	n/a	- 4.6%	- 11.8%
Average of positive 1 year periods	8.4 %	10.9%	14.2 %

The Benchmark Default portfolio is a more conservative investment aimed at reducing negative returns and with a long-term return objective of inflation plus 5% before fees and roughly 4.3% after fees.

At this rate of return, the net contribution towards retirement by both, member and employer should be roughly 13% of remuneration, in order to achieve a reasonable income replacement ratio of 2% per year of service. It is very important that employers invested in the default portfolio are comfortable with these investment characteristics and that they should be able to create comfort amongst their employees as well.

Graph 4



Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 2008, both the Benchmark Default portfolio as well as the average prudential balanced portfolio are lagging inflation plus 5% and at times even inflation but are currently just ahead of inflation over the latest 3 year period.

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5. What We Expect Of The Next 12 Months

The global back drop

As at the end of December, the Allshare Index was on par with its month end peak of just below 32,000 at the end of May 2008, and on par with its level at the end of 2010. Including dividends an investment in the Allshare Index returned 2.6%, essentially representing dividends only. Best performing asset class was Property (12.2%), followed by cash (5.8%) and bonds (5.7%). With an average performance of 8.1% achieved by of our prudential balanced portfolios, Namibian pension funds have returned a satisfactory result for the year, even though this just matches inflation, once investment management costs are deducted. The weakening of the Rand vs the US$ by 23% no doubt contributed to this positive result and more specifically to that of managers with a high off-shore exposure, such as Allan Gray, which produced the best performance for the year of 13.7% before fees.

For 2011, the S&P 500 returned about 0% in US Dollar terms. Add the Rand depreciation of 23% and dividends, then one looks at a return of just above 30% for the year. The Dax and the Nikkei, in contrast returned a negative 15% and a negative 17% respectively, before any dividends.

In terms of price: earnings ratios which is an indicator of the state of the economy and investor sentiment, the 1 year trailing and 1 year forward p:e as at the end of December 2011, of the SA Allshare stood at 12.7 respectively 10.1, compared to 13.2, respectively 12.7 of the US S&P 500. However, considering the relative position of these two economies, the US having just passed bottom of the cycle, while the SA economy is lingering on the opposite side of the cycle, we would expect the US market to outperform the South African market over the medium term. It will also be interesting to see whether President Obama's declared intention to offer incentives to business to repatriate manufacturing activities will be implemented and will be effective. If so, it will not doubt provide impetus to job creation which in turn should lead to improved consumer sentiment.

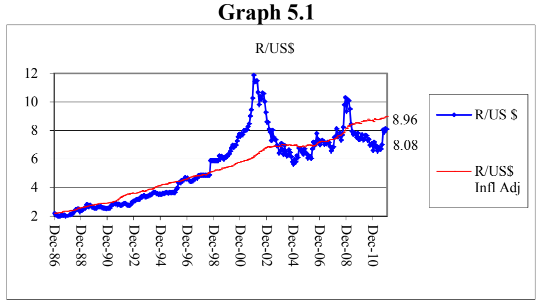
The green shoots that were detected in the Eurozone appear to be withering as Europe tries to contain its debt crisis. We do not believe that fiscal easing through printing of money will solve the problem. At best it will only ease the pain but extend the period of suffering. The same of course applies to the US. In other words as the US economy may start improving from this year onwards and the Eurozone economy may follow this trend from 2013 or 2014, governments will have to reign in much of the momentum through raised taxes and interest rates in an effort to pay down their debts and to constrain any exuberance.

For us this will mean lower demand for our exports, less tourism, eventually higher inflation and interest rates as Namibia takes course in the same direction as our trading partners in the developed world. While our econmony will be impacted negatively and the tax base is likely to shrink, we will have to face higher interest rates and higher debt repayment obligations. This is not exactly a good cocktail for a rosy economic outlook or for a strong Rand.

How is the Rand doing?

Graph 5.1 indicates that the Rand is fairly valued at 8.96 to the US Dollar while it actually stood at 8.08 at the end of December. This is based on adjusting the two currencies by the respective domestic inflation rates. Admittedly, this is only one measure and there are other measures such as the 'big Mac index', and of course the point at which one starts measuring is also critical to the outcome. The 'big Max' index for example considers the Rand under valued. Our conclusion from this graph, however, is that the likelihood of the Rand depreciating is significantly greater than the opposite.

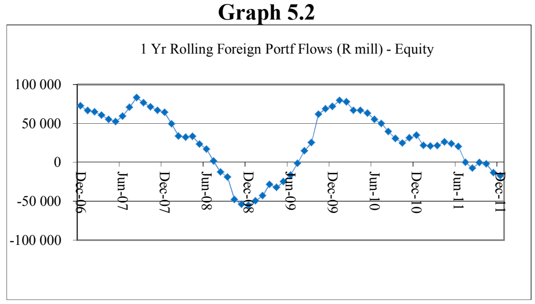
Graph 5.1



Support of the Rand from foreign capital flows as expected, continues to fade

Graph 5.2 reflects a significant decline in the flow of capital into South African equities to a net outflow of R 17 bn on a year-on-year basis at the end of December, the trend having been downward since peaking in January 2010 with a one year inflow of R 79.5 billion.

Graph 5.2



Graph 5.3 also reflects a much more volatile but declining trend of foreign portfolio flows into bonds to R 48.2 billion year-on-year at the end of December, from a peak of R 82.6 billion in October 2010.

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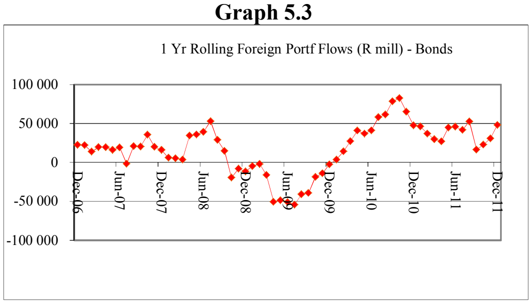
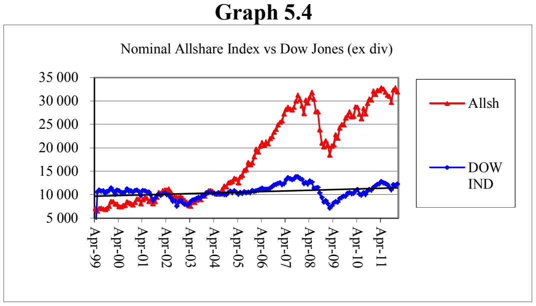
Graph 5.3



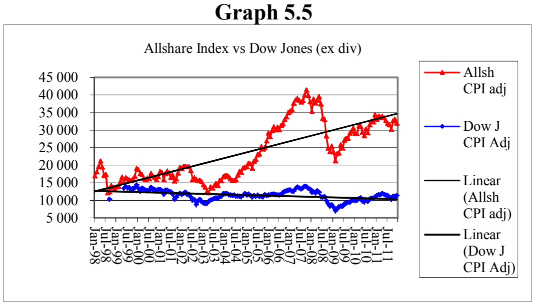
The net inflow of foreign capital into equity and fixed interest assets was R 31 bn for the 12 months to end December (inflow of R 17.4 bn to end November), compared to R 82.4 bn for the 12 months to end December 2010 (R 96.4 bn to end November 2010).

Graph 5.4 reflects the movement of the JSE and the DOW Jones since December 1997, the financial crisis being clearly visible. In nominal terms the JSE passed its month end peak of before the financial crisis, while the DOW Jones is still substantially below its previous peak. **Graph 5.5** reflects the same statistics but adjusted for US and SA inflation respectively. The JSE has accordingly grown by 5.2% per year above inflation over this period of 14 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW Jones declined by 1.2% per year above inflation over a slightly shorter period of 12.5 years, also excluding dividends.

Graph 5.4

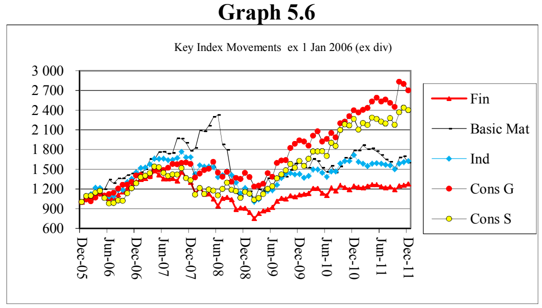


Graph 5.5



Graph 5.6 provides an interesting overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced. From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals.

Graph 5.6



6. Conclusion

In summary, we do not see much excitement coming from our local financial markets over the next year or two. Under these circumstances, diversifying offshore, more specifically to the US would appear worth a consideration. European markets also offer great opportunities if you are brave and if you can be patient.

For the next year or two, interest rates and inflation in the developed world are likely to remain at current levels. Bourses and economies will be sluggish, particularly in the Eurozone while there is a fair chance of US rates to start rising over the course of the next year. As US consumer sentiment improves, taxes are likely to be raised dampening any renewed interest in investment markets and equities.

Investments offering high yields are likely to be the winners while we would expect gold to lose more of its glamour as the developed world starts getting to grips with its financial crisis.

Locally we would expect the Rand to depreciate further, while interest rates and inflation may well pick up over the course of the next year or two.

Graph 5.6 indicates that local consumer goods and consumer services had an excellent run over this period of nearly 6 years but lost some of the momentum over the last 3 months, relative to the other sectors. We do not expect too much more joy out of Consumer Goods and Consumer Services anymore and these should hence be underweight.

On the basis of fundamentals, one should now move to an overweight position in local Industrials and Financials that have not seen the growth of the consumer sectors. Industrials should, of course, also benefit from a weaker Rand. Basic Materials should also benefit from a weaker Rand and should start offering buying opportunities. An expected further depreciation of the Rand in the medium term would favor exposure to Rand hedge shares locally and an increase in foreign holdings.

With a medium- to long-term investment horizon, equities should ensure that the value of the investment will at least keep pace with higher trending inflation in the medium to longer-term, and should also produce a real return in excess of inflation in the medium to long-term. Equities in general should outperform the other conventional asset classes such as cash and bonds. Property on the other hand should benefit from low long-term interest rates. Companies with a low gearing, high dividend yield and those offering a hedge against a depreciating Rand would be our preferred targets.

In view of prevailing uncertainties, we still prefer a conservative balanced portfolio with a fair spread across equities, bonds and property, but moving towards a more assertive position over the next year. A high foreign equity exposure, particularly to industrialized western countries is our call for the next year.

7. Important notice and disclaimer