Volume 8, No. 1, Jan 2012

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JANUARY 2012

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.

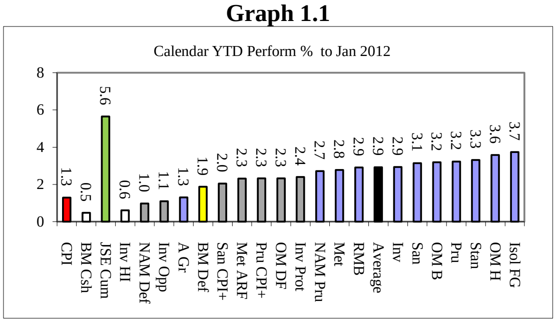
1. Review of Portfolio Performance

In **January** our **average prudential balanced portfolio** returned 2.93% (December minus 0.14%). Top performer is Investment Solutions Multi Manager (3.74%), while Allan Gray (1.31%) takes bottom spot.

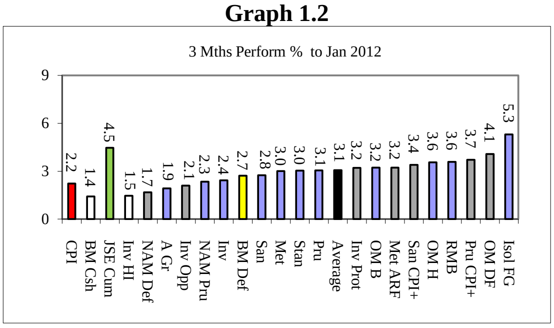
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no color bars), the average of prudential balanced 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)

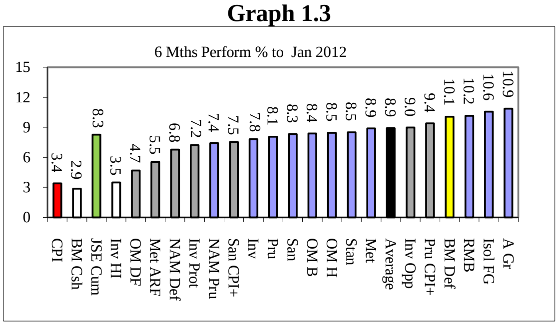
Graph 1.1



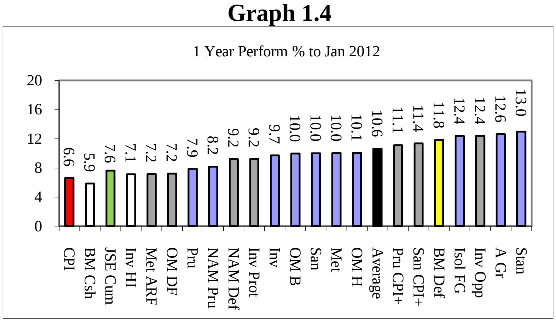
Graph 1.2



Graph 1.3



Graph 1.4



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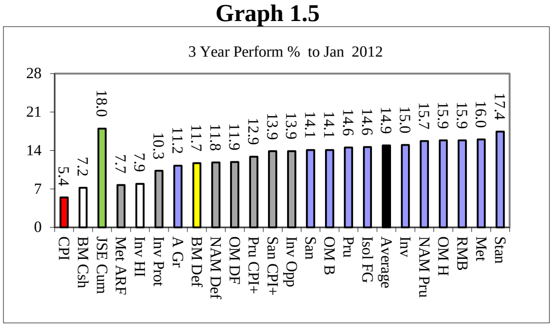
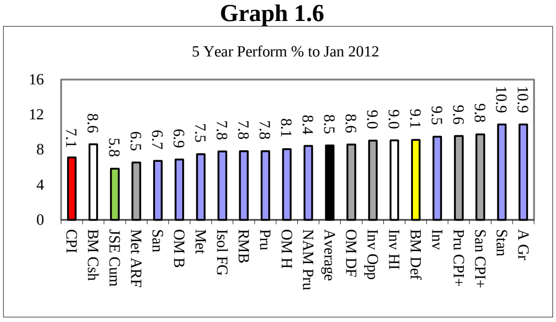
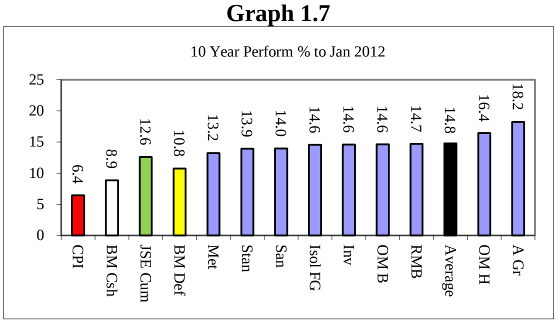
Graph 1.5



Graph 1.6

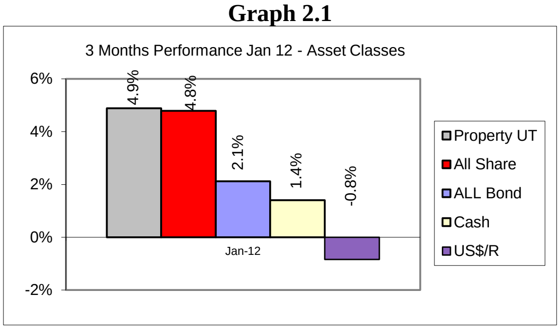


Graph 1.7

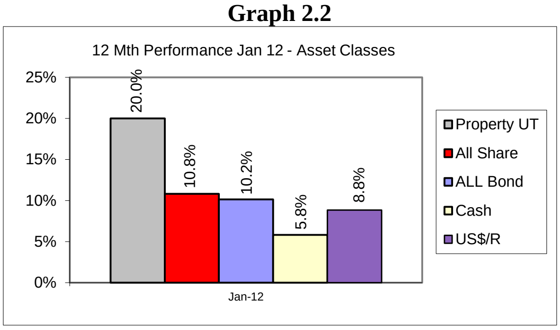


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

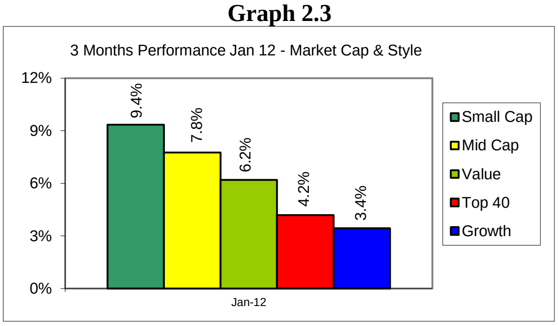
Graph 2.1



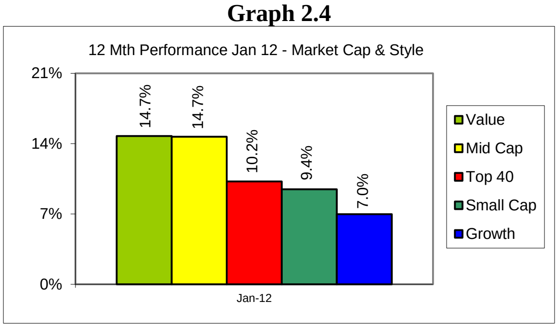
Graph 2.2



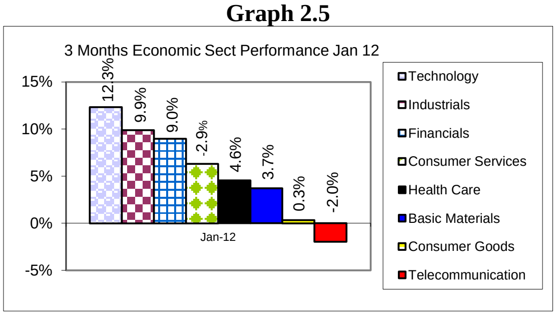
Graph 2.3



Graph 2.4



Graph 2.5



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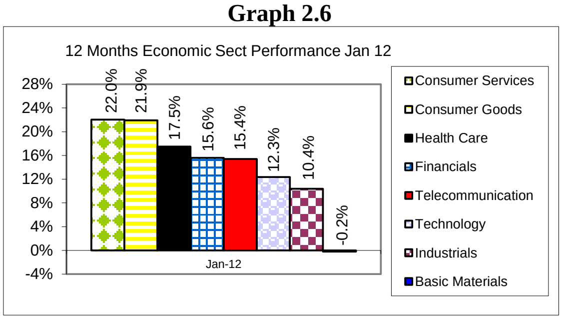
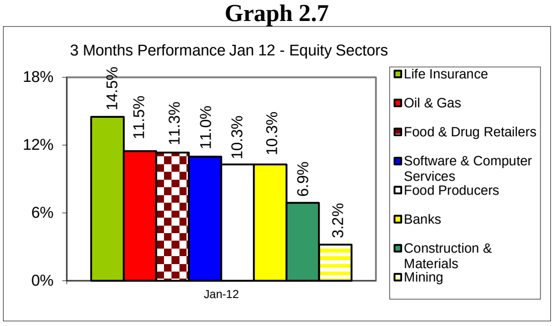
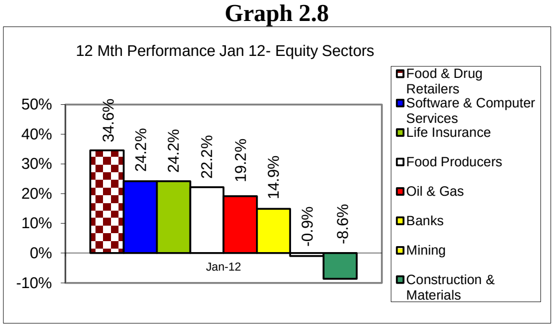


Graph 2.7



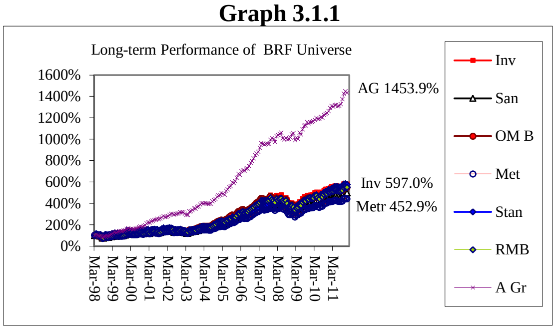
Graph 2.8



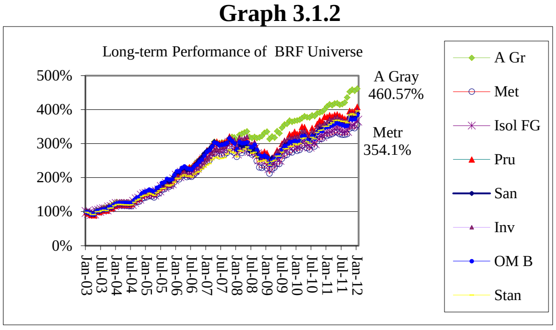
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

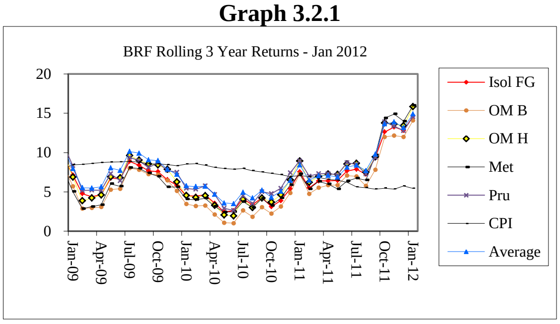


Graph 3.1.2

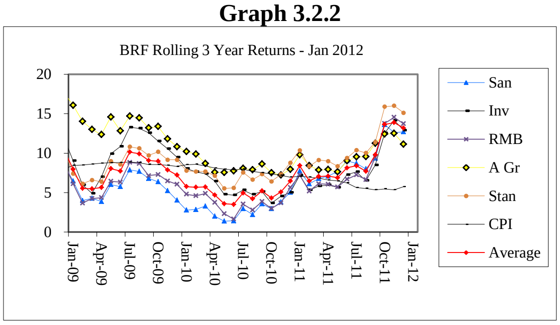


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

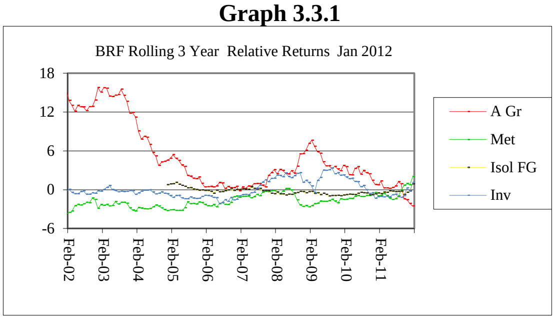


Graph 3.2.2



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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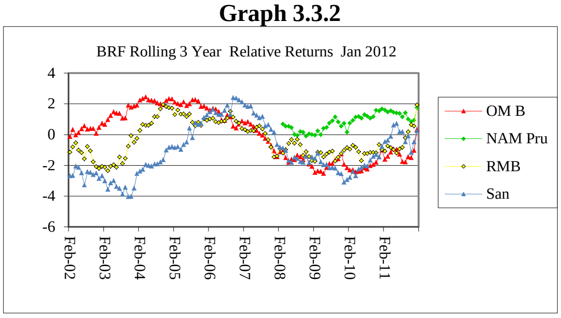
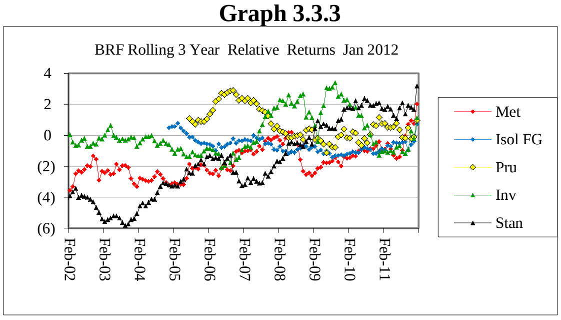
Graph 3.3.2

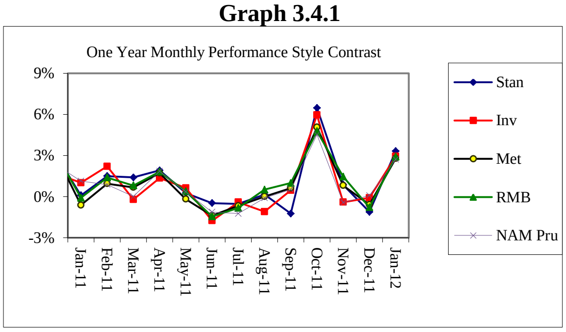


Graph 3.3.3

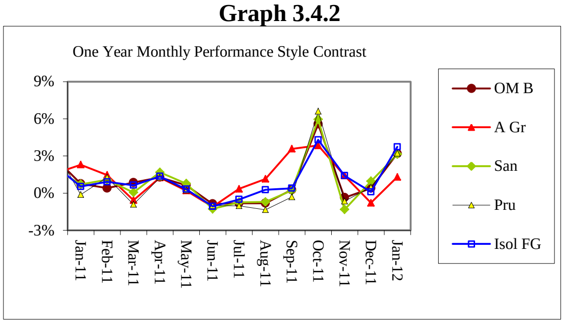


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

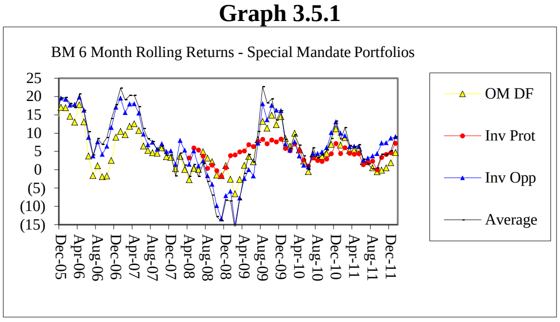


Graph 3.4.2

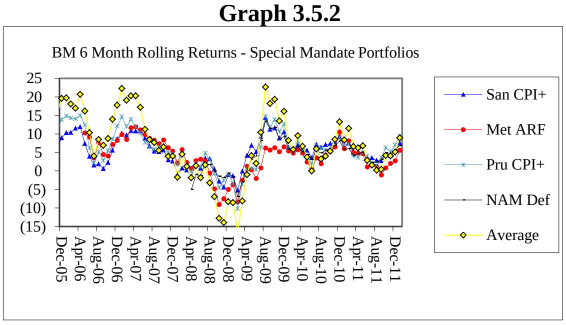


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

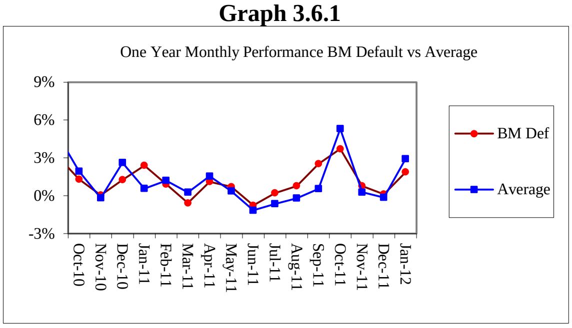


Graph 3.5.2

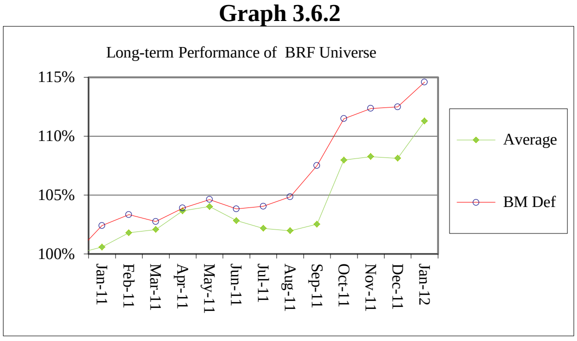


3.6 Monthly and cumulative performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1



Graph 3.6.2



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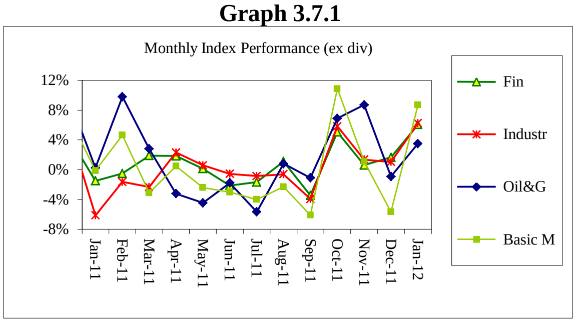
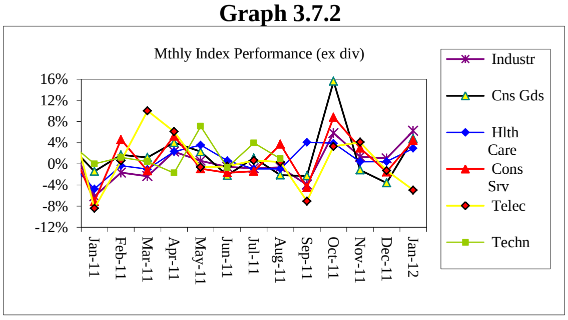
3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

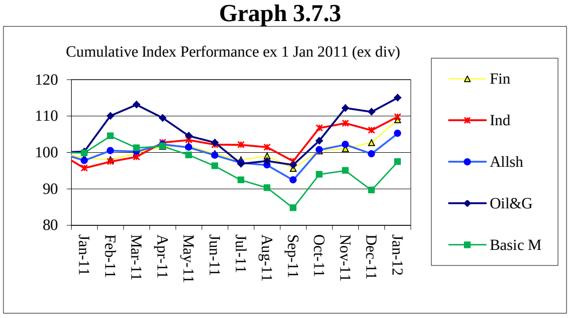
Graph 3.7.1



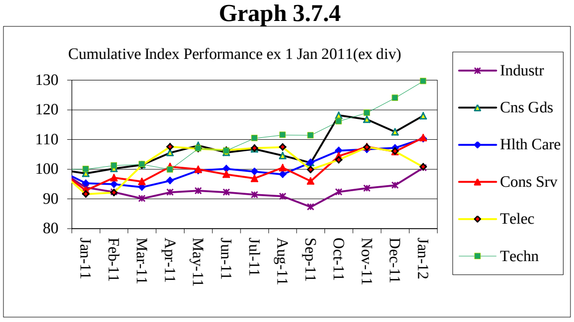
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 8.5% p.a. in nominal terms, or 1.4% 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% 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 a cumulative 14.6% compared to 11.2% for the average prudential balanced portfolio over this 13 month period.

The performance of the prudential balanced portfolios should be more volatile than that of the ddefault portfolio, which produces significantly more volatile performance than the money market portfolio. The table below presents one year performance statistics over the 3 years February 2009 to January 2012:

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	5
Average of negative 1 year periods	n/a	- 4.6%	- 12.8%
Average of positive 1 year periods	8.2 %	11.3%	14.1 %

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 ddefault portfolio are comfortable with these investment characteristics and that they should be able to create comfort amongst their employees as well.

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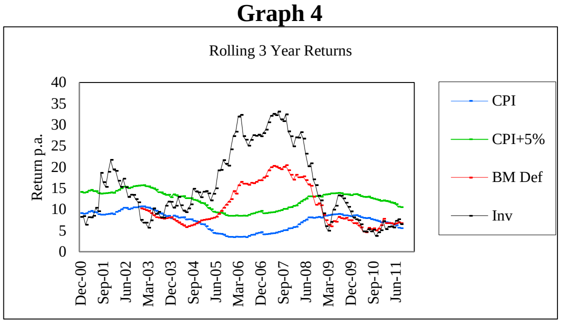
Graph 4



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.

5. What We Expect Of The Next 12 Months

The global back drop

Reaching a level of 33,792 at the end of January, the Allshare Index for the first time since the financial crisis moved to above its month end peak of just below 32,000 at the end of May 2008. Including dividends an investment in the Allshare Index returned 10.8% on a one year basis, up from 2.6% at the end of December. Best performing asset class was Property (20.0%), followed by bonds (10.2%) and cash (5.8%). With an average performance of 10.6% achieved by of our prudential balanced portfolios, Namibian pension funds produced a return on par with the Allshare Index, including dividends for the 12 month period, adding a real return of 4% above inflation of 6.6%. The weakening of the Rand vs the US$ by 8.8% over this 12 month period 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 second best performance for the 12 months of 12.6% before fees.

For 2011, the S&P 500 returned 1.9% excluding dividends (4.2% including dividends) in US Dollar terms. Add the Rand depreciation of 9% and dividends, then one looks at a return of just above 11% for the year. The Dax and the Nikkei, in contrast returned a negative 9% and a negative 14% 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 January 2012, of the SA Allshare stood at 13.4 respectively 10.6, compared to 13.6, respectively 12.6 of the US S&P 500. However, considering the relative position of these two economies, the US having just passed the 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.

President Obama's was reported to intend offering incentives to US business to repatriate manufacturing activities in order to create more jobs in the US. On that topic, it is interesting that the large scale loss of jobs in the US may well have been caused at least to some extent, by a strong Dollar, or as the Americans prefer to see it, by an artificially weak Chinese currency. In a previous newsletter we have commented on the monopoly of the US Dollar in global trade and expressed our view that this has led to easy money in the US which in turn has blown up a property bubble that set off the financial crisis when the bubble eventually burst. We suggested that this monopoly cannot be healthy for the global economy. Some readers may remember that China and Iran mooted their intention to address this concern, Iran by trading its crude in other currencies and China by investing in other currencies, specifically in the Euro. Watching recent global developments one may be forgiven for suspecting that the US was not exactly impressed with such intentions.

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 economy 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.

For equities, Europe has now taken over the responsibility from the US of creating a massive fiscal stimulus in order to try to grow the economy out of its debt. As the result we will continue to see foreign capital chasing returns across the globe. This will extend the period of relative strength of currencies and equity markets of resource based developing countries such as South Africa.

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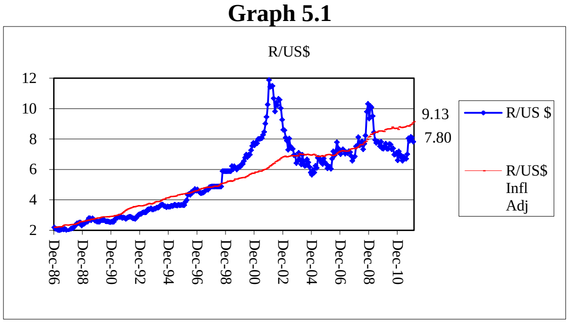
How is the Rand doing?

Graph 5.1 indicates that the Rand is fairly valued at 9.13 to the US Dollar while it actually stood at 7.80 at the end of December. This is based on adjusting the two currencies by the respective domestic inflation rates.

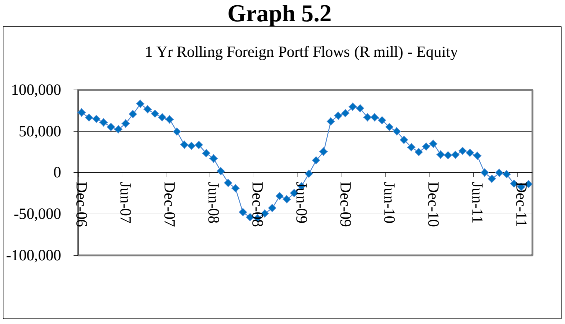
Graph 5.1



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

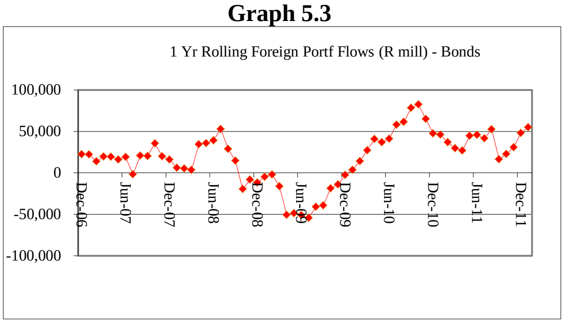
Graph 5.2 reflects a significant decline in the flow of capital into South African equities to a net outflow of R 14 bn on a year-on-year basis at the end of January (outflow of 17 bn to end December), the trend having been downward since peaking in January 2010 with a one year inflow of R 79.5 billion. As pointed out above the fiscal easing measures of the Eurozone is likely to once again reverse the declining trend as can be detected for the month of January already.

Graph 5.2



Graph 5.3 also reflects a much more volatile and once again an increasing trend of foreign portfolio flows into bonds of R 55 bn over the past 12 months (R 48.2 billion over the 12 months to end of December), still down from a peak of R 82.6 billion in October 2010 though.

Graph 5.3

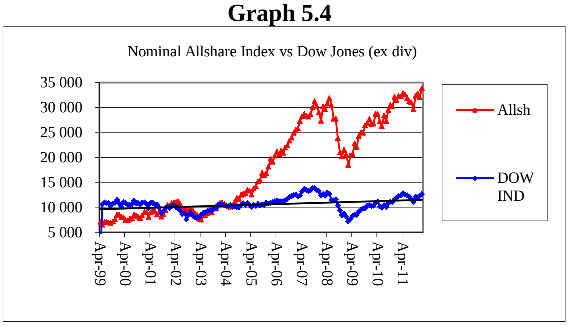


The net inflow of foreign capital into equity and fixed interest assets was R 41 bn for the 12 months to end January (inflow of R 31 bn to end December), compared to R 68 bn for the 12 months to end January 2011 (R 82 bn to end December 2010).

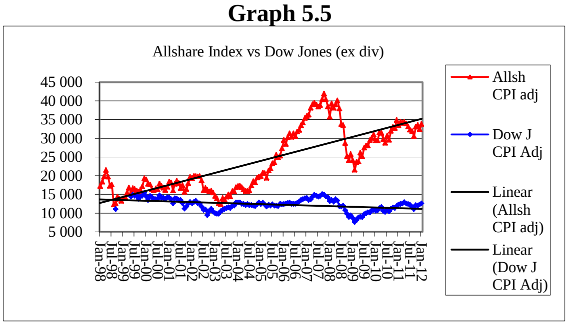
Graph 5.4 reflects the movement of the JSE and the DOW Jones since December 1997, the financial crisis being clearly visible. In nominal terms the JSE passed its month end peak of before the financial crisis, while the DOW Jones is still substantially below its previous peak.

Graph 5.5 reflects the same statistics but adjusted for US and SA inflation respectively. The JSE has accordingly grown by 5.6% per year above inflation over this period of just over 14 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW Jones declined by 1.1% per year above inflation over a slightly shorter period of 12 years and 8 months, also excluding dividends.

Graph 5.4



Graph 5.5



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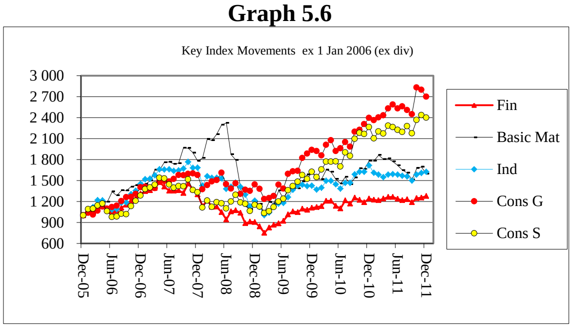
Graph 5.6 provides an interesting overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced. From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals.

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, although an expected continuation of foreign portfolio flows, as the result of the fiscal easing in the Eurozone, is likely to ensure that this asset class should outperform other asset classes. Diversifying offshore, more specifically to the US would appear worth a consideration for the investor with a time horizon of 3 years and longer. European markets also offer great opportunities if you are brave and if you can be patient. In the short term, local equity markets may well still outperform offshore markets over the next 3 years.

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 now expect the Rand to hold its own for the next two to three years but it is likely to depreciate later on, while interest rates and inflation may well pick up over the course of the next two to three years.

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 Rand at its current depreciated level. 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.

We believe an assertive balanced portfolio with an overweight in equities and property and underweight bonds and cash should be appropriate under current circumstances. A high foreign equity exposure, particularly to Eurozone countries where market experienced a dramatic decline as the result of negative investor sentiment, is our call for the next year.

7. Important notice and disclaimer