Volume 8, No. 3, Mar 2012

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MARCH 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.

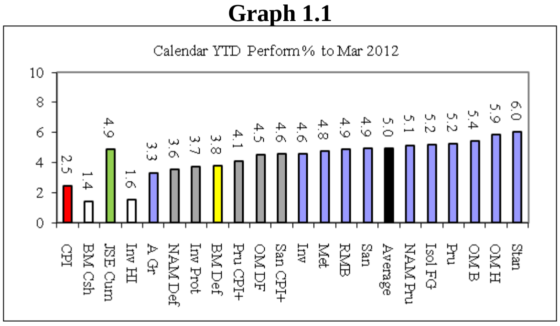
1. Review of Portfolio Performance

In **March** our **average prudential balanced portfolio** returned 0.86% (February 1.12%). Top performer is Allan Gray (1.43%), while Momentum/ Metropolitan (0.44%) takes bottom spot.

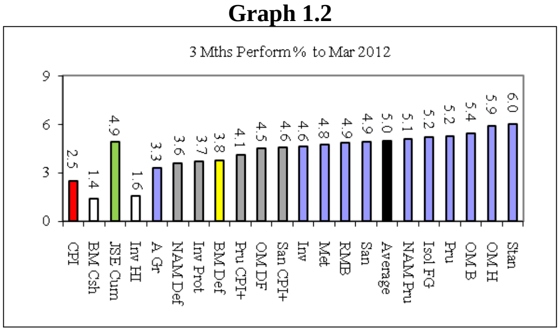
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no color bars), the average of prudential balanced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

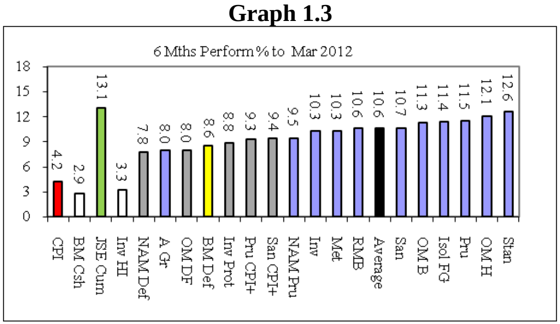
Graph 1.1



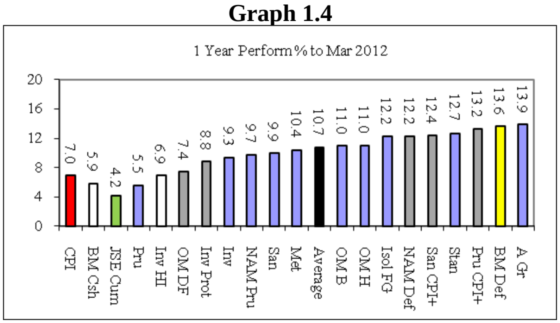
Graph 1.2



Graph 1.3



Graph 1.4



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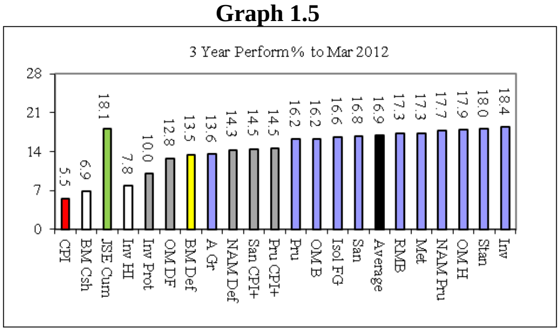
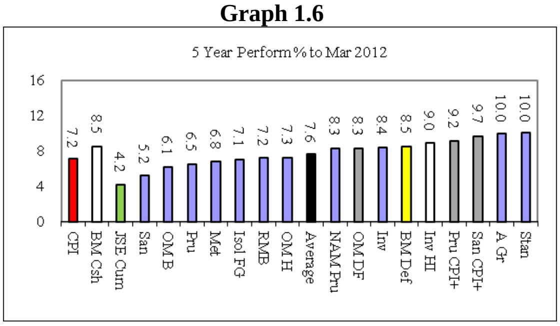
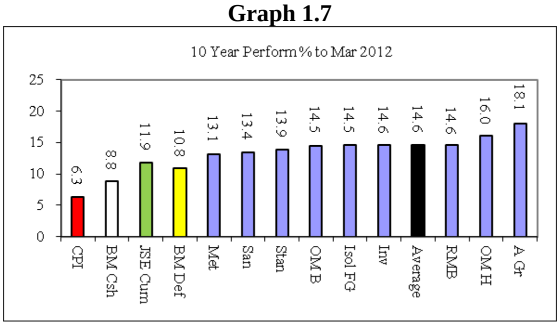
Graph 1.5



Graph 1.6

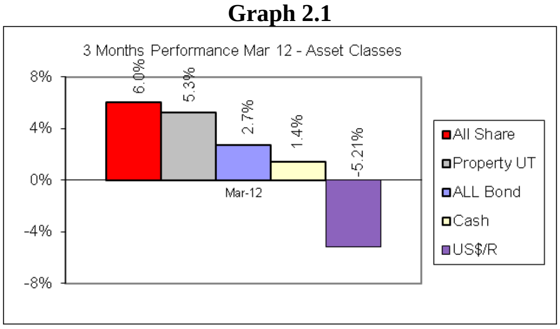


Graph 1.7

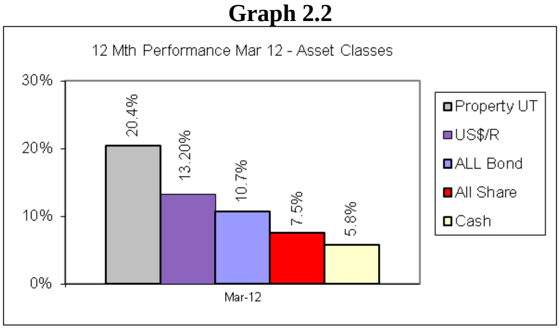


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

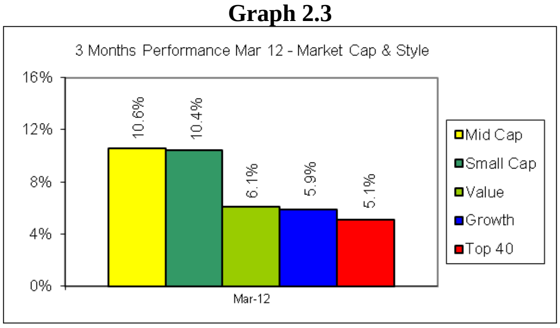
Graph 2.1



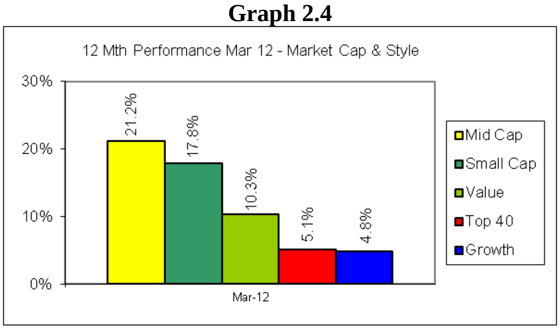
Graph 2.2



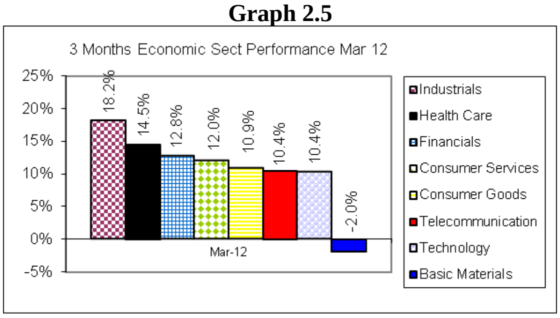
Graph 2.3



Graph 2.4



Graph 2.5



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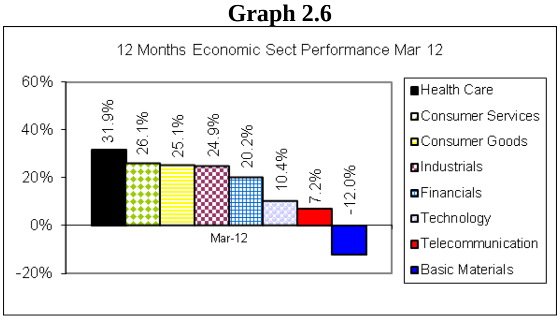
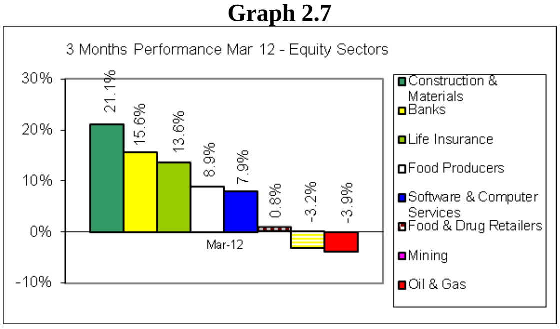
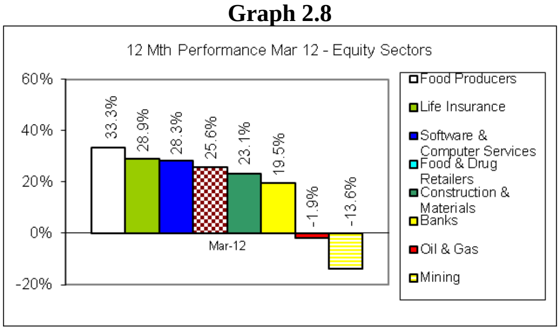


Graph 2.7



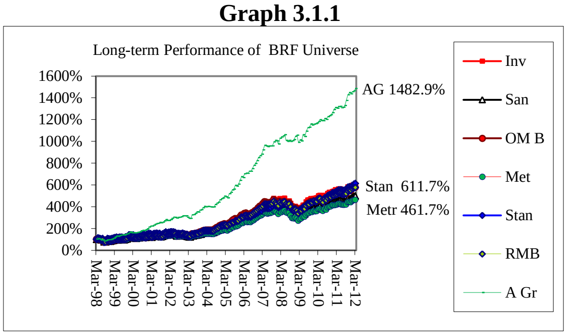
Graph 2.8



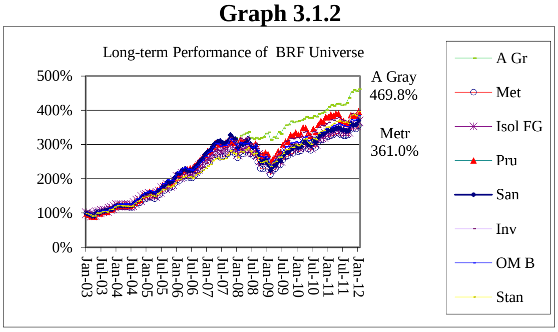
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

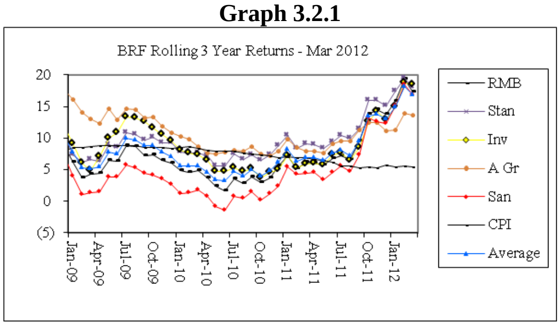


Graph 3.1.2

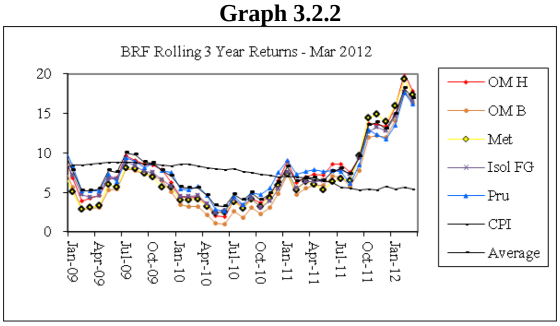


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

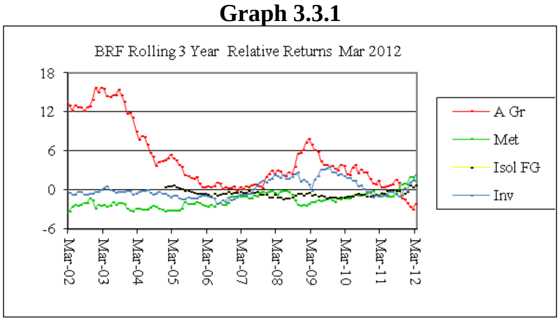


Graph 3.2.2



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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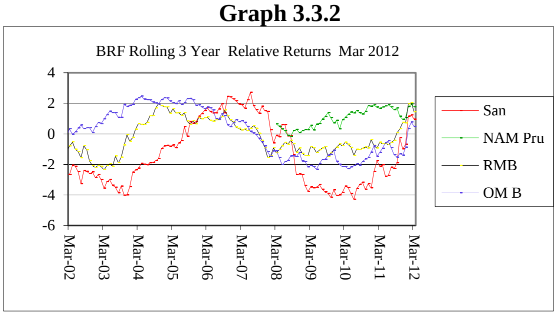
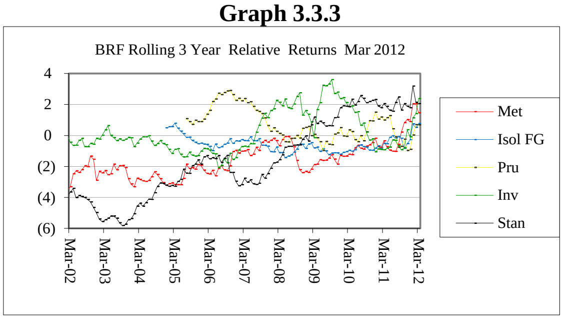
Graph 3.3.2

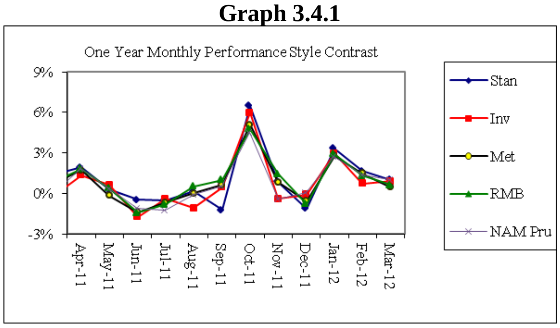


Graph 3.3.3

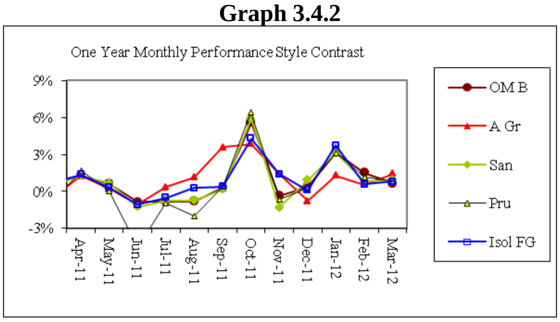


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

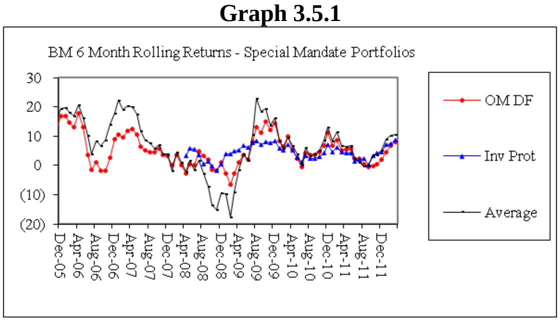


Graph 3.4.2

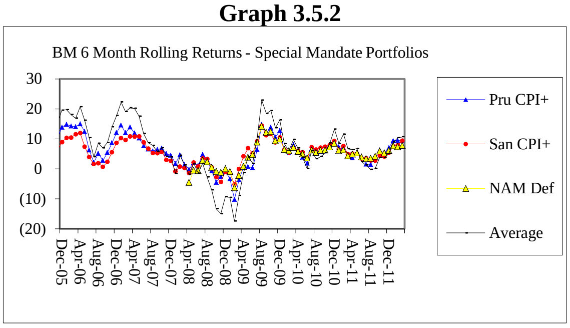


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

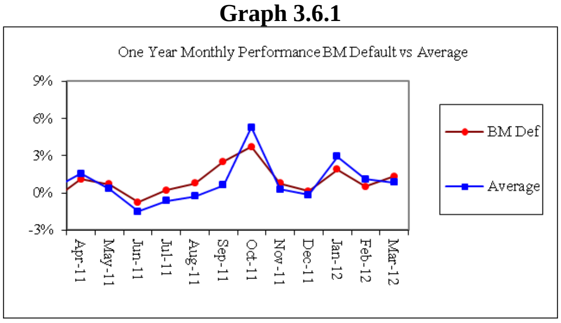


Graph 3.5.2

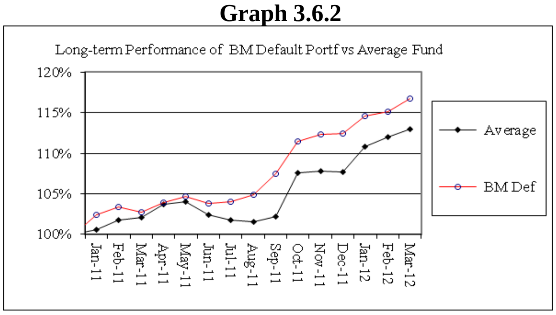


3.6 Monthly and cumulative performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1



Graph 3.6.2



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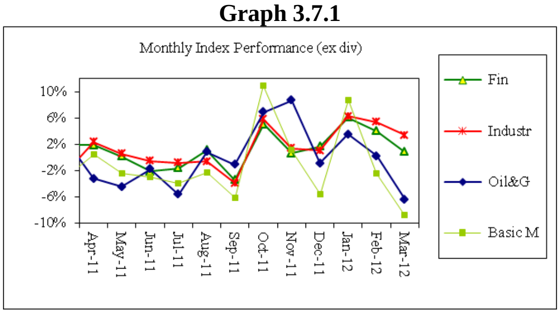
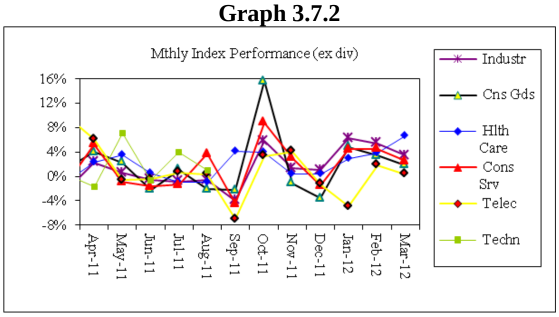
3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

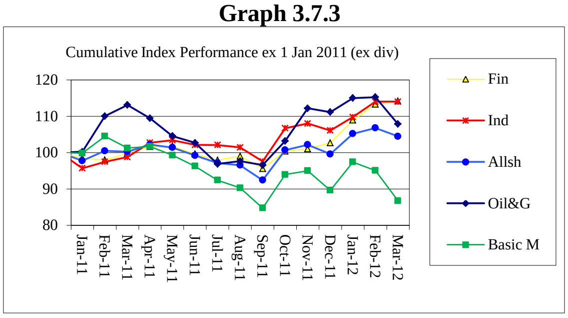
Graph 3.7.1



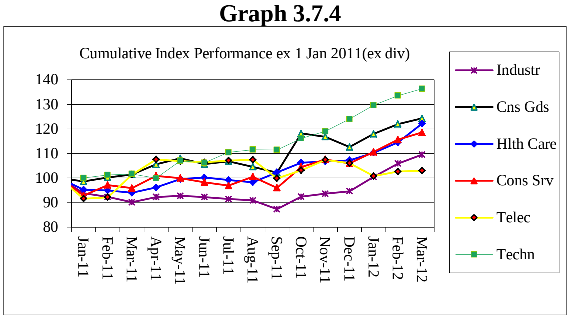
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 7.6% p.a. in nominal terms, or 0.4% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 8.5% p.a. in nominal terms, or 1.3% 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 16.7% compared to 13% for the average prudential balanced portfolio over this 15 month period.

Relative to the default portfolio, the performance of the prudential balanced portfolios should be more volatile due to a significantly higher equity exposure and its performance should be much closer correlated to that of the overall equity market. The default portfolio should produce a significantly more volatile performance than the money market portfolio. The table below presents one year performance statistics over the 3 years April 2009 to March 2012:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.9%	- 5.7%	- 14.5%
Best annual performance	12.1%	16.2%	30.2%
No of negative 1 year periods	n/a	4	4
Average of negative 1 year periods	n/a	- 3.5%	- 8.5%
Average of positive 1 year periods	7.9%	11.3%	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.

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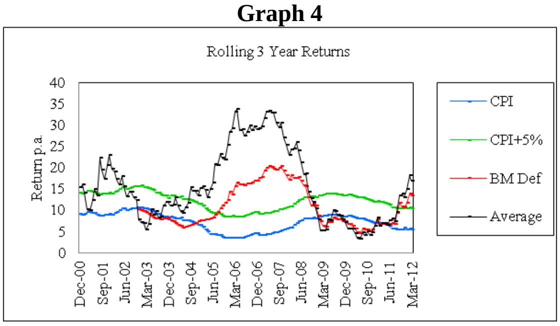
Graph 4



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 were lagging inflation plus 5% and at times even inflation but have surpassed inflation plus 5% since October 2011.

5. What We Expect Of The Next 12 Months

The global back drop

Taking a longer term view, the SA Allshare Index has grown by 12.6% p.a. since March 1997, not taking into account dividends of somewhere between 2% and 4% p.a. Namibian inflation over this period was 7.2% p.a. Evidently, the SA Allshare Index has grown in real terms over this nearly 15 year period by around 5.4% excluding dividends and by between 7% and 9% p.a. including dividends, which is representative of the long term real return of around 8% p.a. For a local investor this indicates that the SA Allshare Index is currently around its long-term trend line which is not a particularly compelling case for investing in this index but promises long-term returns equal to what the market is expected to deliver.

A US investor in the SA Allshare Index would have suffered a loss through the depreciation of the Rand by 3.2% p.a. over this period, still earning a total return including dividends of more than 10% p.a. Considering that Namibian inflation over this period was 7.2% p.a., the Rand actually appreciated in real terms against the US$ by around 4% per annum. How can this be rationalised and is this a sustainable trend or should one expect that we will see a reversal in time to come? It is reasonable to place a higher likelihood on the latter scenario, rather than the former scenario.

Taking a shorter term view, the SA Allshare Index has reached and even surpassed its pre financial crisis month-end high of May 2008, growing by 1.45% p.a. excluding dividends. Most other more prominent bourses such as the DOW Jones (1.1% p.a. excl. div.), FTSE (minus 1.2% p.a. excl. div.), DAX (minus 0.5% p.a. excl. div.) and Nikkei (minus 9.6% p.a. excl. div.) have not seen anywhere the same recovery as our local bourses. The question is, what has driven our local markets ahead of many other markets. Considering the extent of foreigners investing in local financial markets, it appears that these flows into our markets are well correlated with the value of the Rand which in turn appears to reflect a fair correlation to the SA Allshare Index. The relationship with the performance of the Basic Materials Index is not as direct and is probably also influenced global by commodity prices.

The next question then is what has driven foreign portfolio flows? This can probably be explained largely by easy money at low interest rates, as the result of quantitative easing programmes of foreign monetary authorities. Foreign investors however, appear to capitalise on the significant interest differentials between the rates at which they borrow and the rates at which they can invest in local fixed interest instruments, rather than investing in local equities. These flows have led to an appreciation of the Rand which again so far benefits foreign investors while these trends last. Local investors finding little value in fixed interest instruments then appear to rather focus on our local equity markets, countering the gradual exit of foreigners from our local equity markets since December 2009.

Differently put, since the financial crisis, political intervention, be it by means of Central Banks, has played a huge role in global capital flows which in turn have impacted significantly on currencies and global financial markets. As pointed out before, such political intervention has unhinged the free market mechanism and under these circumstances it is near impossible to envision what the outcome will eventually be once this intervention ends.

Making investment decisions in the current global market environment becomes very difficult. A disciplined focus on investment fundamentals is likely to prevail in the long-term but can cause the investor quite a bit of anxiety in the shorter term. Ignoring such fundamentals implies taking a high risk, for which the investor may be decently compensated if he is fortunate, but may end in hardship as well.

In the shorter term it appears that the US and Japanese economies and consumer sentiment in the US is improving. The European economy is likely to contract this year while the Chinese economy is experiencing a slowing in its rate of growth.

For us this will mean lower demand for our exports and less tourism. Once quantitative easing programmes end, we are likely to see a reversal of what has been pushing the Rand and driving our financial markets. The demand for equities and bonds should then decline. This should impact negatively on our local equity markets and push up interest rates. In this scenario the Rand should weaken while inflation is likely to accelerate.

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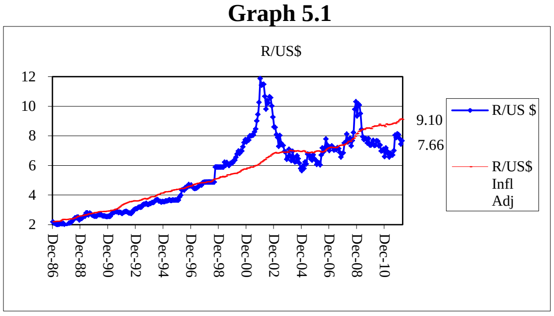
How is the Rand doing?

Graph 5.1 indicates that the Rand by our measure is fairly valued at 9.10 to the US Dollar while it actually stood at 7.66 at the end of March. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

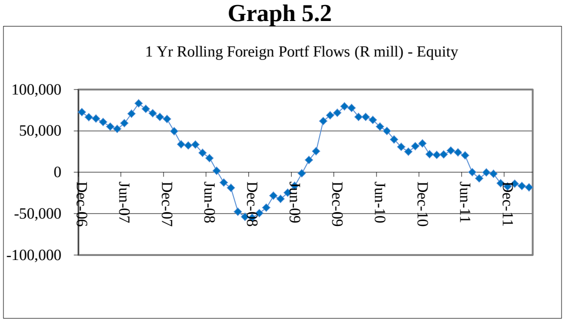
Graph 5.1



Support of the Rand from foreign capital flows continues, mainly through bond purchases

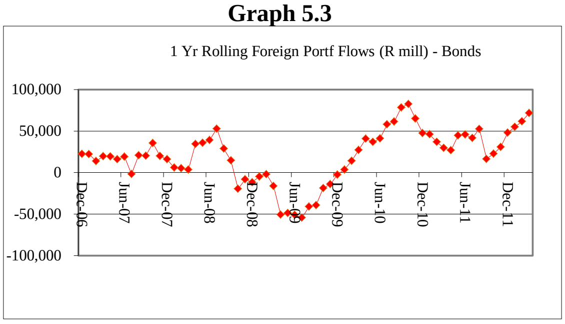
Graph 5.2 reflects a further decline in the flow of capital into South African equities to a net outflow of R 18 bn on a year-on-year basis at the end of March (outflow of 17 bn to end February), the trend having been downward since peaking in January 2010 with a one year inflow of R 79.5 billion. As pointed out above the fiscal easing measures of the Eurozone is likely to once again reverse the declining trend, as evidenced by an inflow of N$ 2.9 bn in the month of March 2012.

Graph 5.2



Graph 5.3 reflects a much more volatile but rising trend of foreign portfolio flows into bonds of R 72 bn over the past 12 months to end of March (R 62 billion over the 12 months to end of February), now approaching the peak of R 82.6 billion in October 2010 though.

Graph 5.3

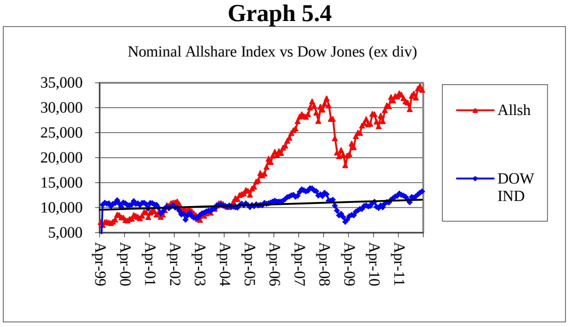


The net inflow of foreign capital into equity and fixed interest assets was R 53 bn for the 12 months to end March (inflow of R 45 bn to end February), compared to R 51 bn for the 12 months to end March 2011 (R 58 bn to end February 2011).

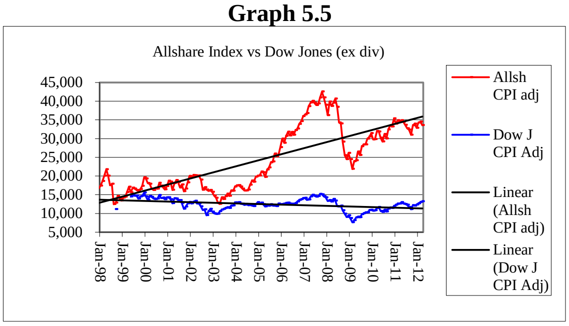
Graph 5.4 reflects the movement of the JSE and the DOW Jones since December 1997, the financial crisis being clearly visible. In nominal terms the JSE passed its month end peak of before the financial crisis, while the DOW Jones is still substantially below its previous peak.

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 9 months, also excluding dividends.

Graph 5.4



Graph 5.5



Graph 5.6 overlays the R/US$ exchange rate, the trendline of 1 year rolling returns of the JSE and of the Basic Materials Index on 1 year rolling total portfolio flows. It does show a correlation between the value of the Rand, the Allshare and the Basic Materials Index and foreign portfolio flows although it appears that the Basic Materials Index is much less correlated than the other indices.

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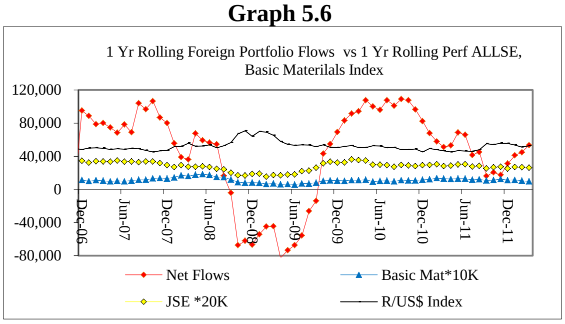
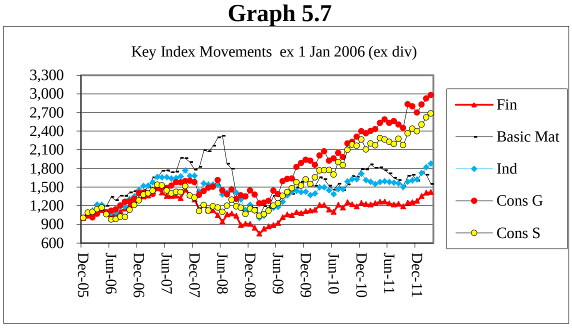


Graph 5.7 provides an interesting overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced. From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals.

Graph 5.7



6. Conclusion

At this stage, there is no end in sight for quantitative easing and the scenario of declining foreign portfolio flows, a weakening Rand and rising interest rates, is therefore likely to only materialise in the next 2 to 3 years. In the meantime there is still potential for our equity markets to produce respectable returns while interest rates are likely to remain low, cash probably negative in real terms. This offers the opportunity to diversify offshore and to invest in equity markets that were particularly hard hit by negative sentiment. These can mainly be found in Europe.

Graph 5.7 indicates that local consumer goods and consumer services had an excellent run over this period of over 6 years relative to the other sectors and are in our view in dangerous territory. 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 be 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 and any further depreciation as we expect to occur. Basic Materials should also benefit from a weaker Rand and should offer buying opportunities.

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 to the US, Japan and particularly 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