Volume 8, No. 9, Sep 2012

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 SEPTEMBER 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.

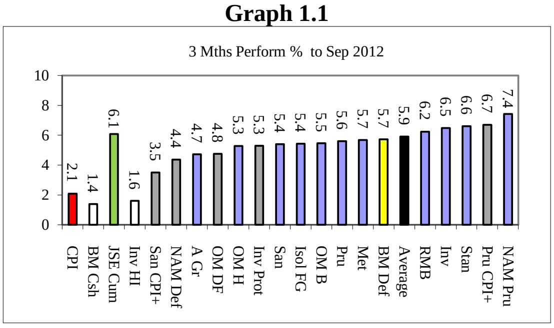
1. Review of Portfolio Performance

In **September** our **average prudential balanced portfolio** returned 1.13% (August 2.30%). Top performer is Namibia Asset Management/Coronation (1.56%), Sanlam (0.37%) takes bottom spot.

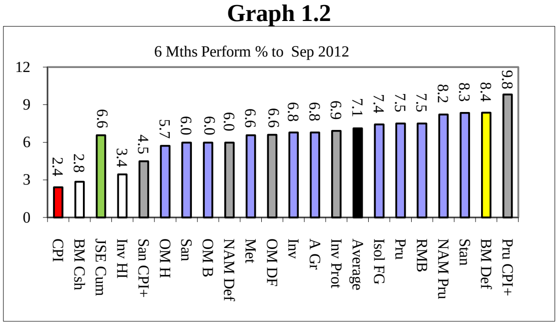
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no color bars), the average of prudential balanced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

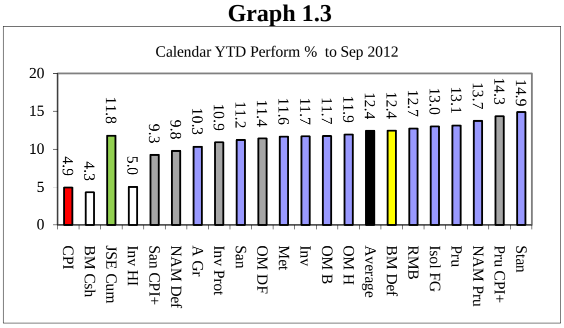
Graph 1.1



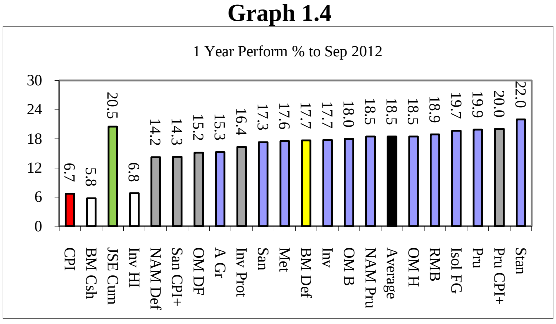
Graph 1.2



Graph 1.3



Graph 1.4



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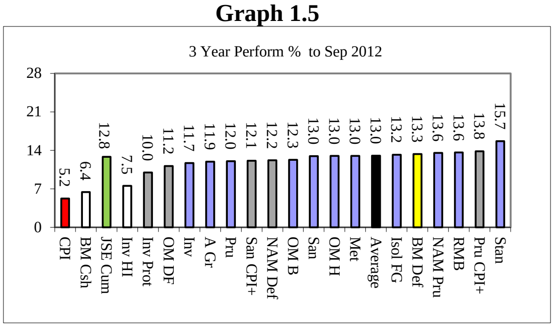
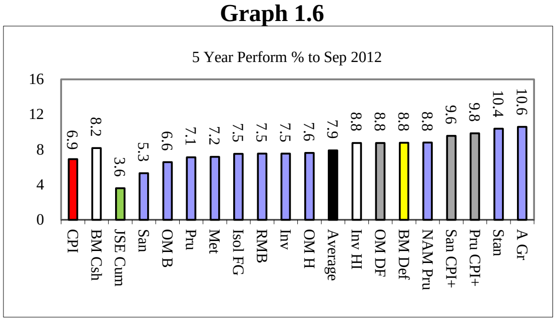
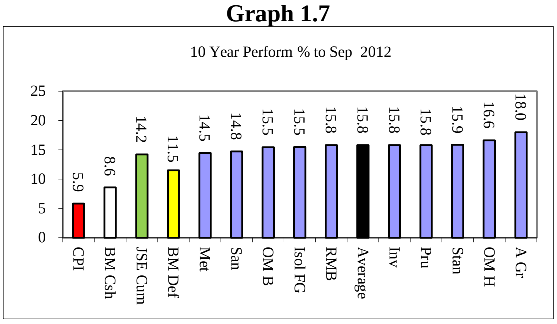
Graph 1.5



Graph 1.6

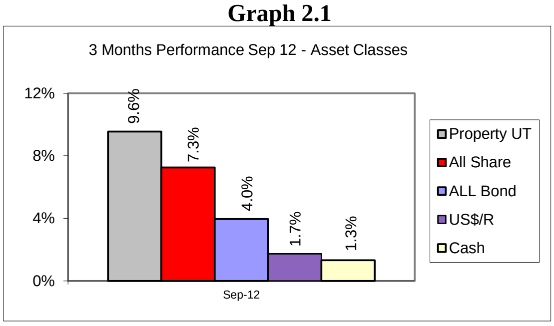


Graph 1.7

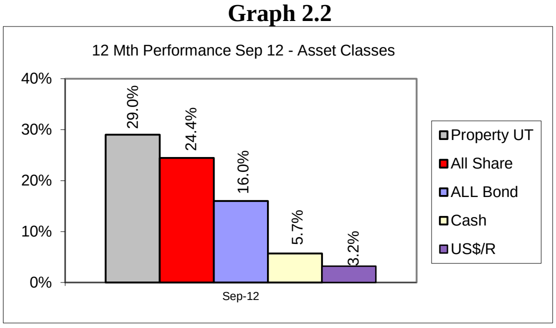


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

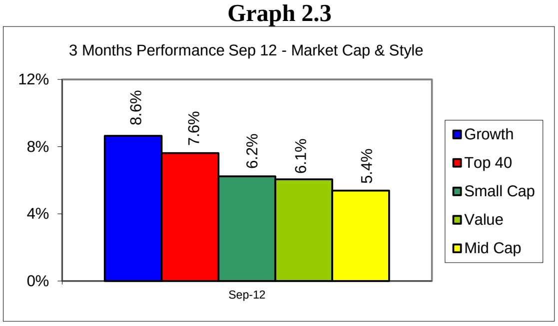
Graph 2.1



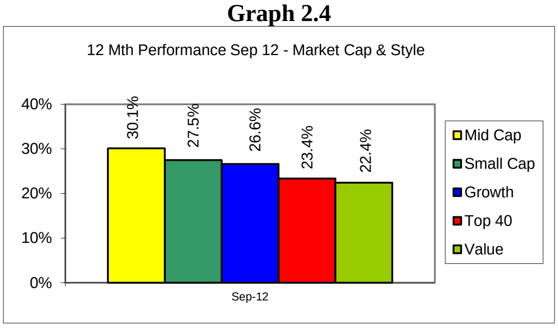
Graph 2.2



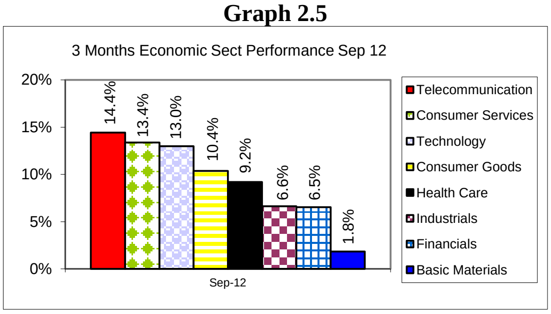
Graph 2.3



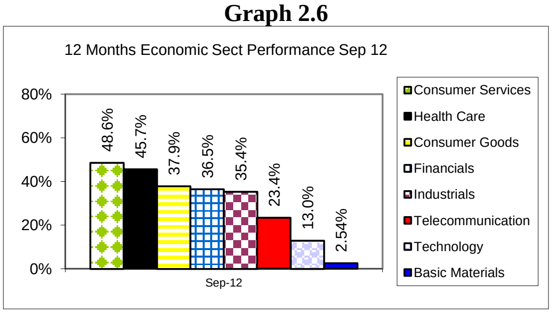
Graph 2.4



Graph 2.5



Graph 2.6



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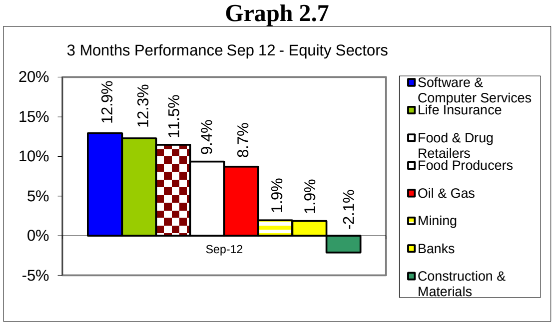
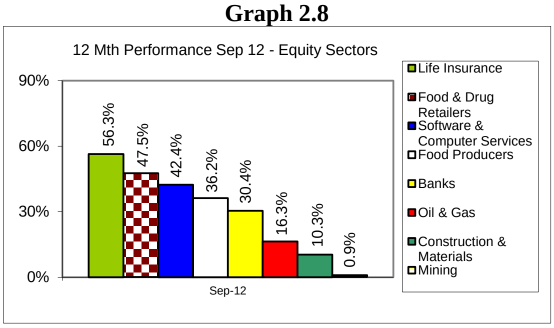
Graph 2.7



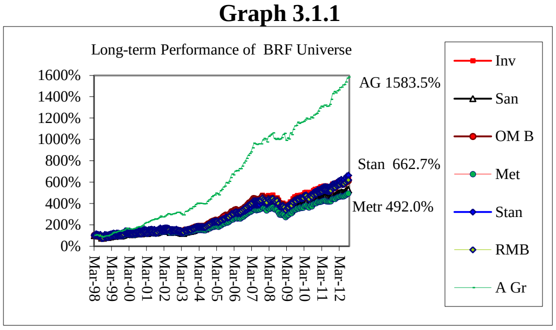
Graph 2.8



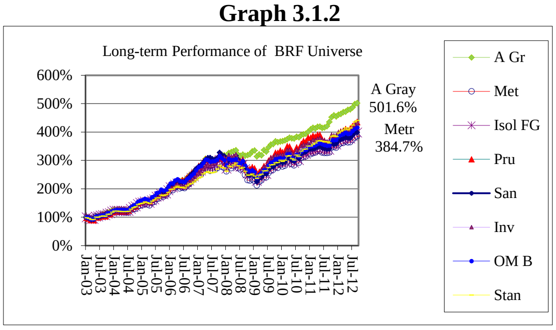
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

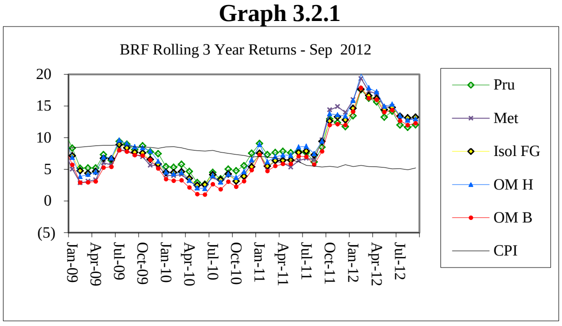


Graph 3.1.2

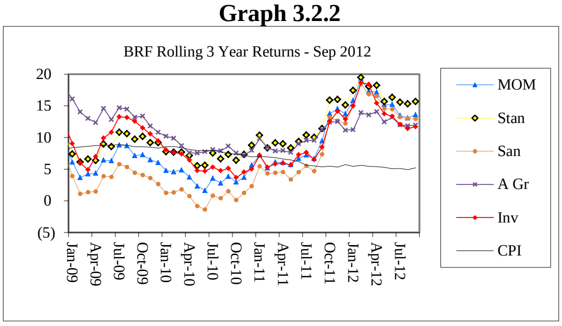


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

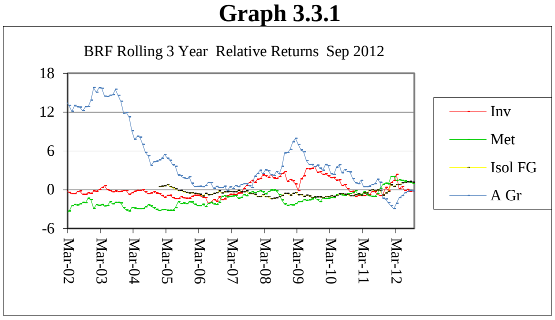


Graph 3.2.2

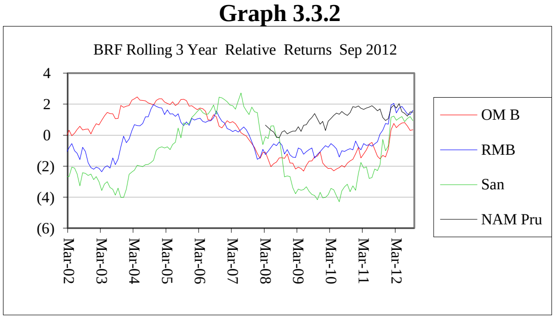


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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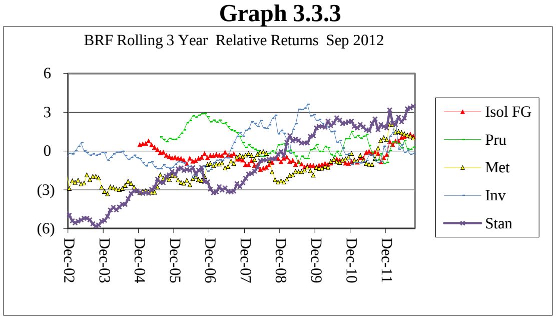
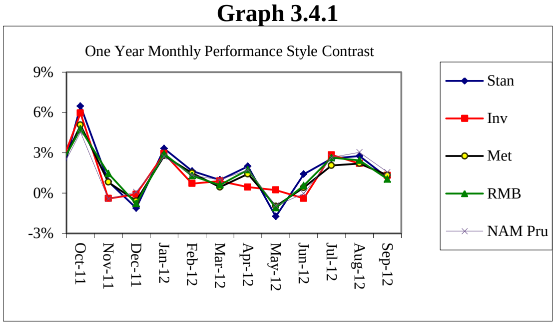
Graph 3.3.3

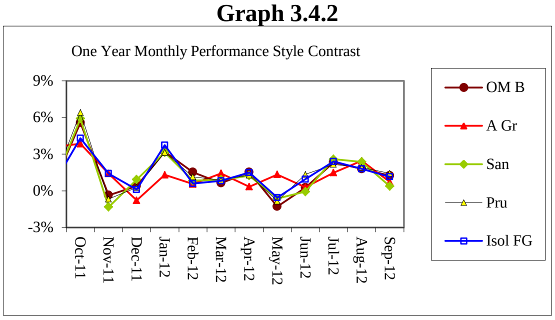


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

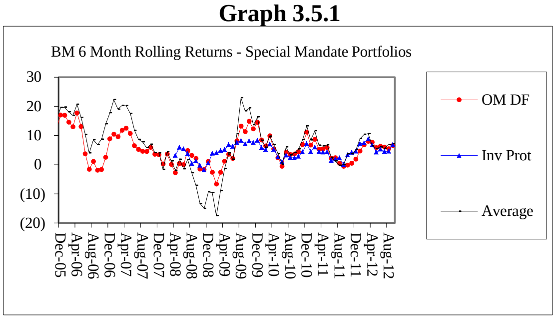


Graph 3.4.2

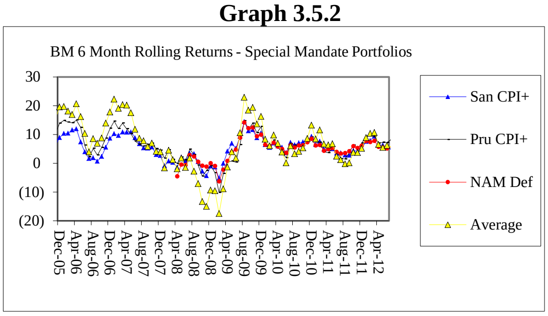


3.5. 6-month rolling returns of ‘special mandate’ portfolios

Graph 3.5.1

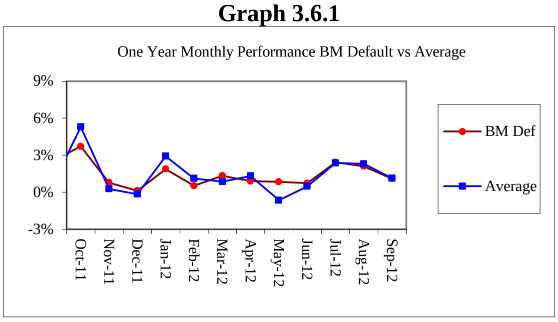


Graph 3.5.2

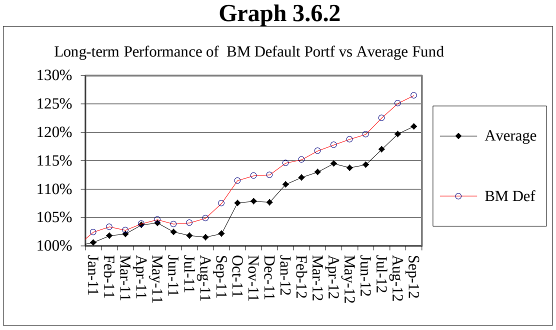


3.6 Monthly and cumulative performance of ‘Default’ portfolio relative to average prudential balanced portfolio

Graph 3.6.1

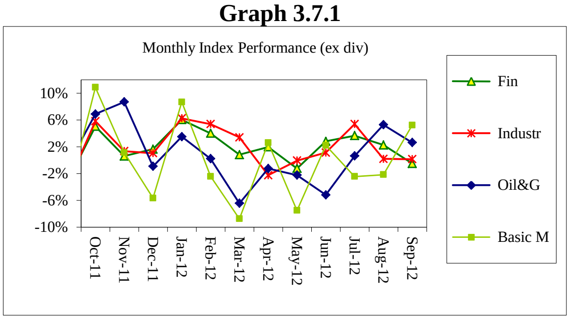


Graph 3.6.2



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

Graph 3.7.1



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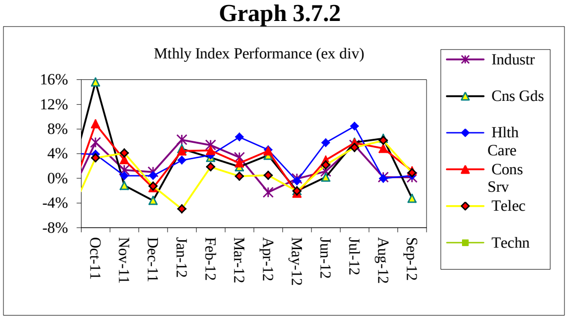
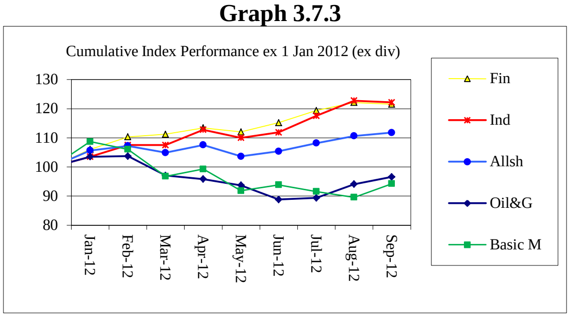
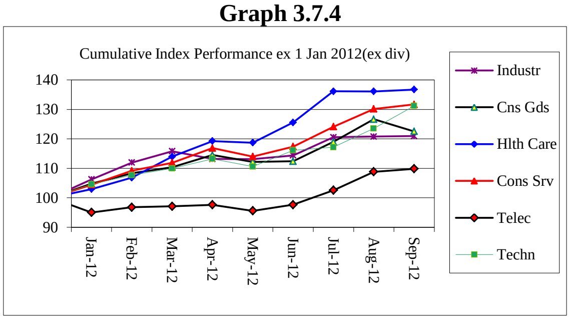
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 7.9% p.a. in nominal terms, or 1 % p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 8.8% p.a. in nominal terms, or 1.9% p.a. in real terms. This outperformance of the average manager by the Benchmark Default portfolio is quite remarkable considering its substantially lower equity exposure (44.8% vs 58.5% as at the end of June).

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.

Having raised the risk profile of the Default portfolio effective the start of 2011, by replacing Metropolitan ARF with Allan Gray, we would 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 26.5% compared to 21.0% for the average prudential balanced portfolio over this 21 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 October 2009 to September 2012:

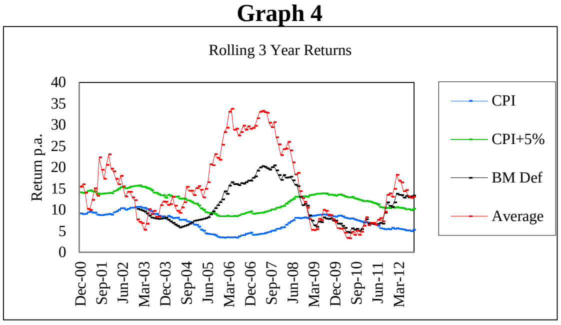
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.8%	8.3%	7.7%
Best annual performance	10%	19.3 %	30.2%
No of negative 1 year periods	n/a	0	0
Average of negative 1 year periods	n/a	n/a	n/a
Average of positive 1 year periods	7%	12.6%	14.7 %

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

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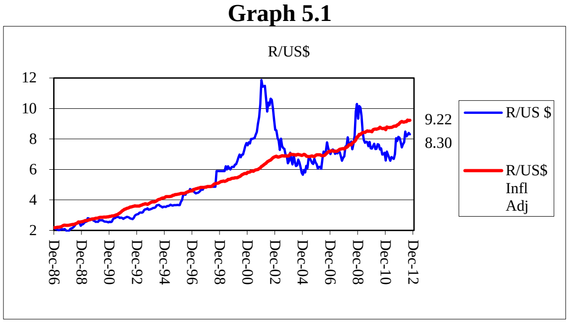
5. Review of Foreign Portfolio Flows and the Rand

How is the Rand doing?

Graph 5.1 indicates that the Rand by our measure is fairly valued at 9.22 to the US Dollar while it actually stood at 8.30 at the end of September. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

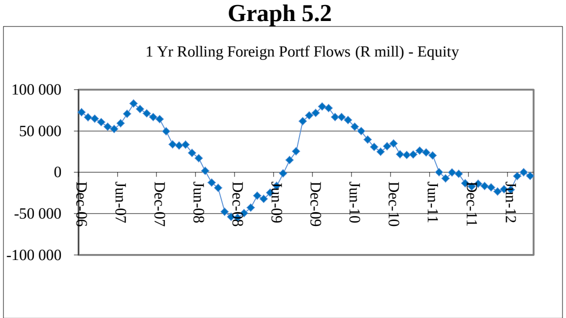


Support of the Rand from foreign capital flows continues, mainly through bond purchases

Graph 5.2 reflects a more steady but still slightly negative flow of capital out of South African equities on a rolling one year basis, with a net outflow of R 4.3 bn on a year-on-year basis at the end of September (outflow of 40 m to end August), the trend having been downward since peaking in January 2010 with a one year inflow of R 79.5 billion. Since the beginning of 2006, foreign net investment in equities amounts to N$ 167 billion. This represents roughly 2.5% of the market capitalization of the JSE.

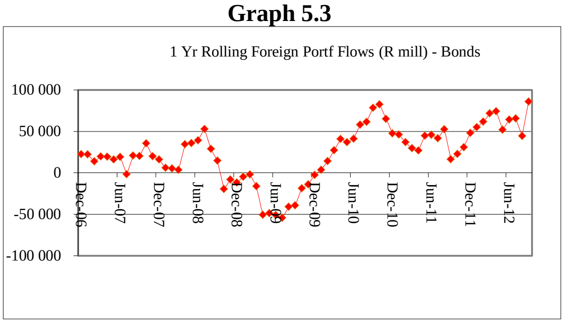
The fiscal easing measures of the Eurozone and again by the US are likely to provide an artificial underpin to the Rand through continued foreign inflows into local financial markets, more specifically into the bond market though.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects a much more volatile foreign portfolio flow into bonds, which has reached a new peak since October 2010, of R 85.8 bn over the past 12 months to end of September (R 44.6 billion over the 12 months to end of August). Since the beginning of 2006, foreign net investment in bonds amounts to N$ 194 billion. Interestingly this inflow has increased in September despite a depreciating Rand and the fact that interest differentials between foreign and local rates having declined.

Graph 5.3

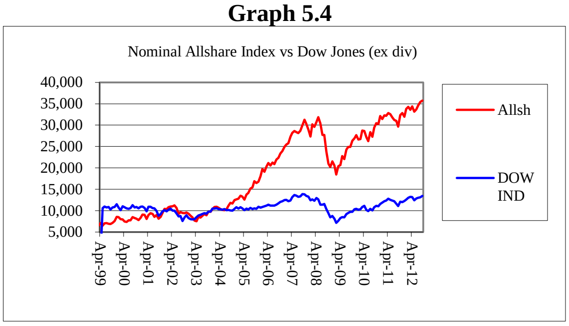


The net inflow of foreign capital into equity and fixed interest assets was R 82 bn for the 12 months to end September (inflow of R 45 bn to end August), compared to R 16 bn for the 12 months to end September 2011 (R 45 bn to end August 2011). Total net foreign portfolio flows amount to N$ 364 billion since the beginning of 2006.

Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999, 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. In nominal terms, the JSE grew by 13.7% per year, while the DOW Jones only grew by 1.8% per year, over this period of just over 13 years, dividends excluded. Namibian inflation over this period was 7% per year in contrast with US inflation of 2.5%.

Graph 5.5 reflects the same statistics but adjusted for US and SA inflation respectively. Since May 1999 the JSE Allshare Index has grown by 6.7% per year above inflation, over this period of just over 13 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW Jones declined by 0.7% per year above inflation over this period, also excluding dividends.

Graph 5.4



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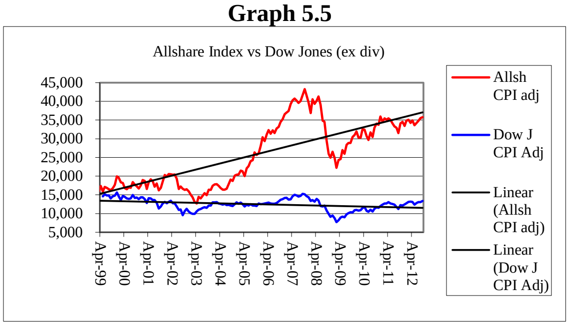
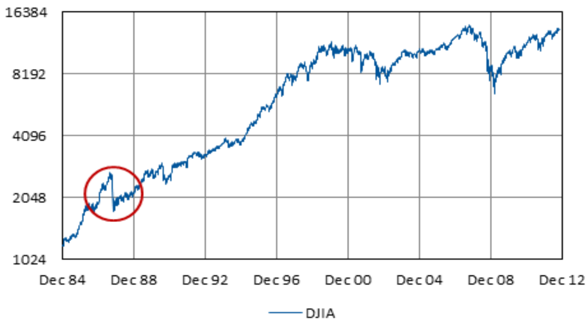
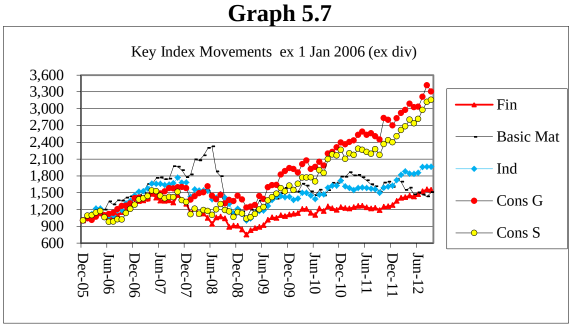


The Dow Jones Industrial Index, over the longer term:



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

A concerted effort by global monetary authorities to stimulate their economies through printing of money, also referred to as stimulus measures or packages, failed to achieve the desired result so far. What it has achieved is to protect stock exchanges from implosion as the result of excessively negative investor sentiment. These short-term paper gains may have prevented a further decline in consumer sentiment, however, at the same time the extremely low interest rates over the past 3 years have caused massive deficits in social security systems and pension arrangements overseas, that are modelled on an environment of real interest rates. 3 years' of assumed real returns have so far not materialised and someone will have to bear the brunt of this. As we have seen, many western countries have started to cut on their pension promises and future generations already been called upon to contribute through so-called 'austerity measures', and will no doubt have to make further contributions towards these deficits.

These stimulus measures have also resulted in an avalanche of hot money into developing economies in search of yields. This has depressed interest rates in these economies and inflated their currencies. Strong currencies in turn have impacted negatively on the competitiveness of developing economies and retarded their economic development. The strong demand in commodities pre financial crisis that has substantially lifted their market prices, were effectively squandered by commodity based economies such as ours, as the result of their appreciating currencies. So these economies never really benefited from that erstwhile boom while prevailing global monetary policy again catches them on the wrong side of the fence.

For investors the question one needs to find an answer for is how all this will pan out. Stimulus measures will remain in place until such time as developed economies start picking up steam again and this will not be soon. Until then consumer sentiment in the developed world will remain low. Demand for our resources in the developing world, including our natural heritage, will thus remain depressed for some time to come. The economic growth government had bargained on, and which is necessary to contain our debt and sustain its servicing, will not be as rosy as hoped for. Austerity measures will not be avoidable even for us in Namibia and is likely to become a necessity as from 2013 onwards, to last for a while.

When developing economies eventually start picking up steam again in the next two years their tax payers will have to be called to account in an effort to deleverage national balance sheets. This will likely be a long and steep road before the consumer in the developed world will start experiencing an improvement in his personal financial position. At that time stimulus measures will be phased out. The flow of money into developing economies will reverse and their currencies will depreciate. This will improve their global competitiveness and will lead to their economies starting to grow again.

Until then we will experience an environment of low interest rates. Whether we can still expect further reductions, will depend on inflation. We do not believe inflation will decline much from current levels for another year, but rather to move in the opposite direction. This means that interest rates will not be reduced further over the next 12 months but that there is a fair chance of an increase. While global economies are in the doldrums, we will experience a slow reversal of foreign capital flows and a continued depreciation of the Rand. For the next year, returns on local bonds are consequently expected to be subdued to negative should interest rates increase, while equities should experience a 'double whammy', firstly from investors in search of yields, but also because low interest rates with inflation at current levels, impact positively on the bottom line of companies.

Offshore equity markets that were particularly hard hit by negative sentiment rather than economic fundamentals, still offer compelling investment opportunities despite the fact that they have already started to recover. Very interesting statistics published by 1741 Asset Management (previously Wegelin Asset Management), the MSCI Europe offered a discount to fair value of 22%, compared to a discount of 9% of the MSCI World, and a premium of 18% of the US MSCI. Worst hit bourse of all was Italy with a discount of 60% of the MSCI Italy, all values as at end of August.

On the basis of fundamentals and the prevailing economic environment, foreign equities should outperform foreign bonds and property and in addition, a number of foreign bourses offer high discounts on fair value for political reasons that should fade away. In the face of a depreciating Rand, such investments would of course experience that benefit as well. Locally we would expect equity to remain the top performing asset class, followed by property, bonds and cash over the next one to two years. Bonds and cash face the real prospect of negative returns should interest rates be raised over the next 1 to 2 years.

In terms of local equity sectors, we remain concerned about the significant growth SA Consumer Goods and Consumer Services have seen, returning 19.4% and 20.5% per year, respectively, since December 2005, excluding dividends. We do not believe this is sustainable. Financials and Industrials have returned much more modest growth rates of 6.7% and 10.5%. Over the same period, the Namibian CPI grew by 6.8% per annum. Basic Materials that have grown by a meagre 6.3% per year since the beginning of 2006, should also offer some buying opportunities although as a sector we do not foresee it showing any significant recovery in the medium term.

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

7. Important notice and disclaimer