Volume 9, No. 1, Jan 2013

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JANUARY 2013

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.

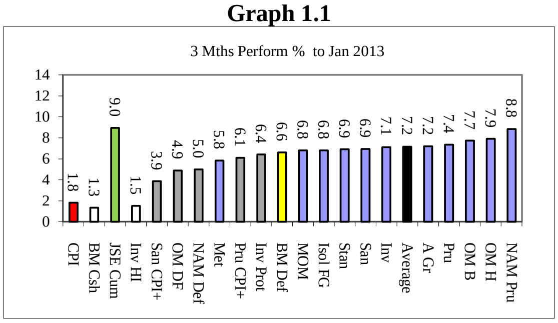
1. Review of Portfolio Performance

In **January** our **average prudential balanced portfolio** returned 3.98% (December 1.24%). Top performer is NAM Prudential Managed (5.69%), Old Mutual (1.41%) takes bottom spot.

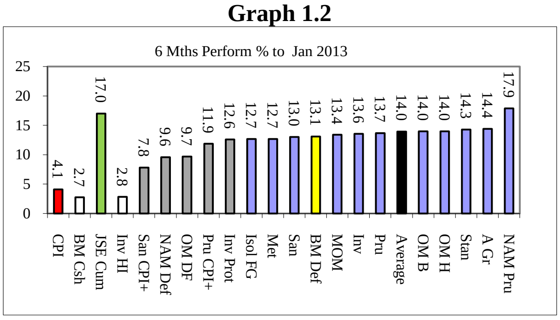
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no color bars), the average of prudential balanced 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 Pru (blue)
Old Mutual Profile Balanced	OM B (blue)
Old Mutual Profile Growth	OM H (blue)
Momentum Managed	MOM (blue)
Sanlam Managed	San (blue)
Stanlib Managed	Stan (blue)

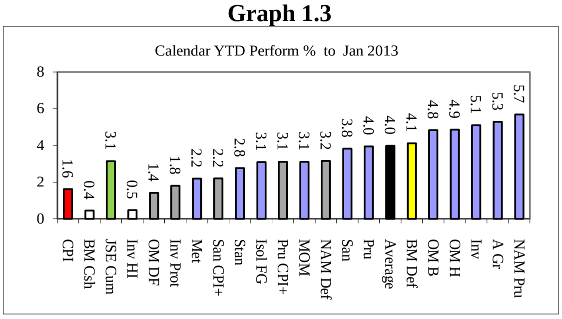
Graph 1.1



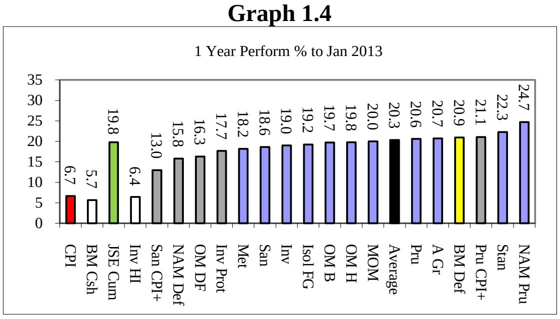
Graph 1.2



Graph 1.3



Graph 1.4



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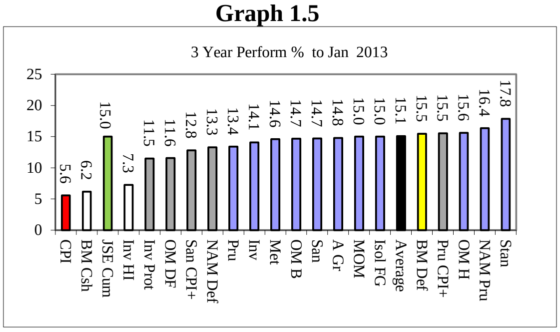
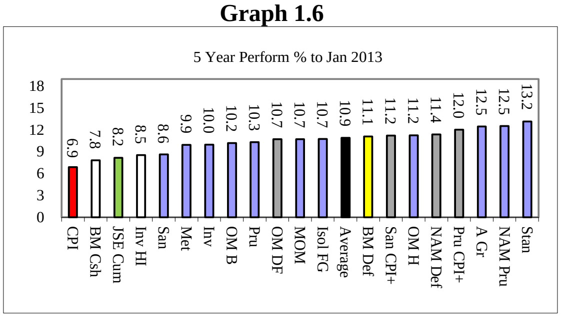
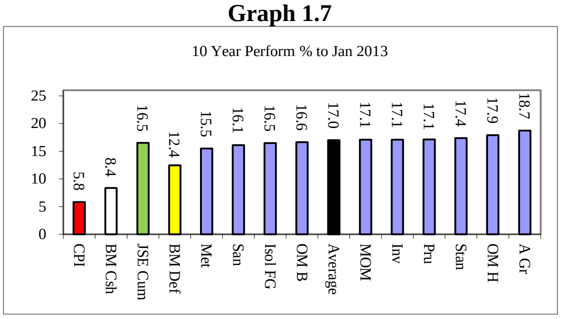
Graph 1.5



Graph 1.6

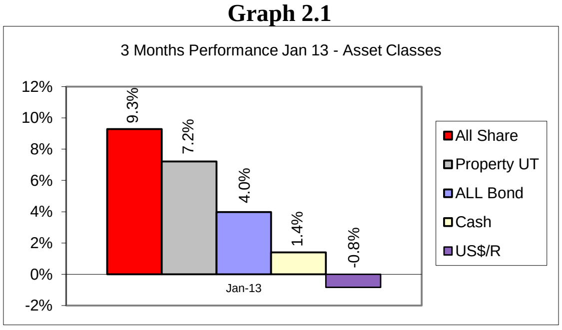


Graph 1.7

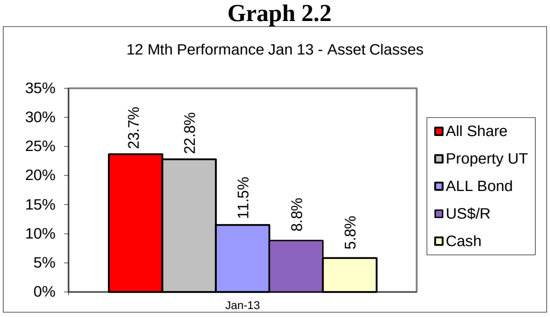


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

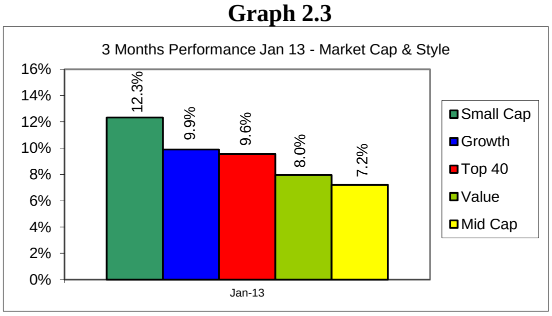
Graph 2.1



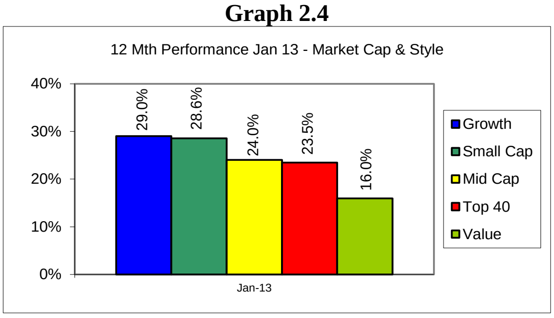
Graph 2.2



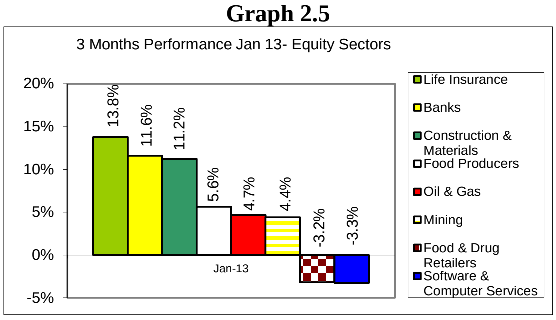
Graph 2.3



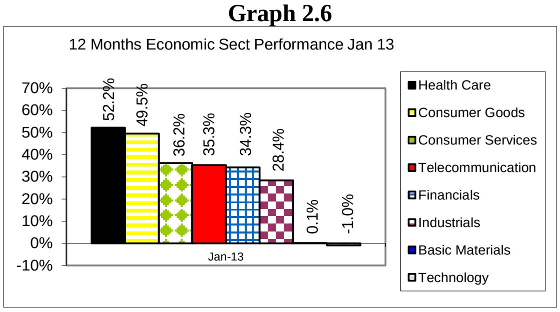
Graph 2.4



Graph 2.5



Graph 2.6



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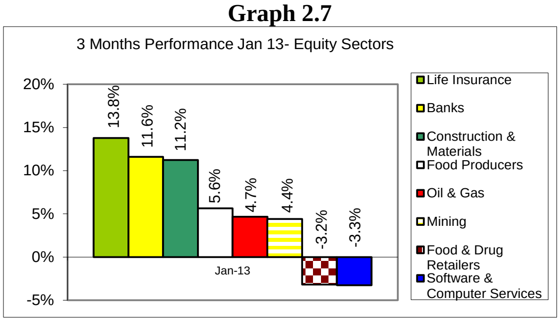
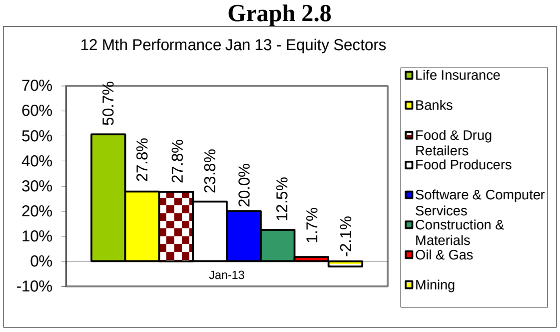
Graph 2.7



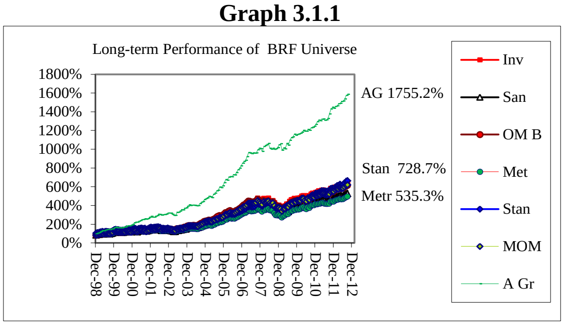
Graph 2.8



3. Portfolio Performance Analysis

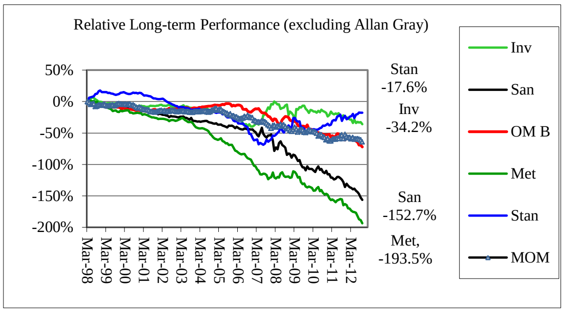
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

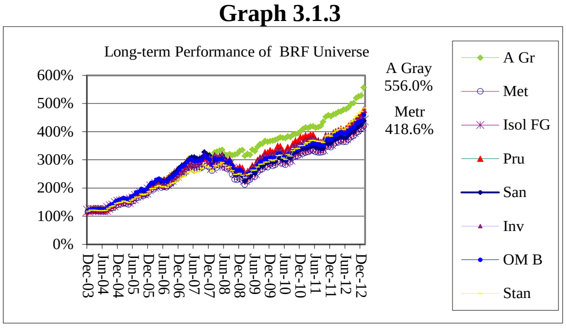


Graph 3.1.2

Cumulative performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

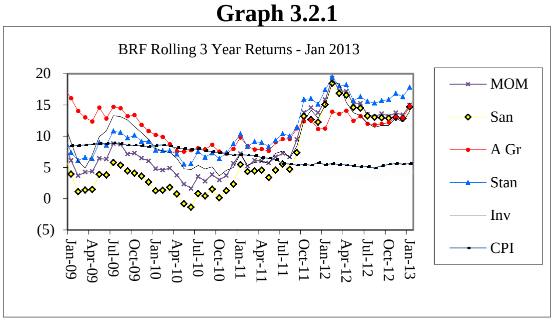


Graph 3.1.3

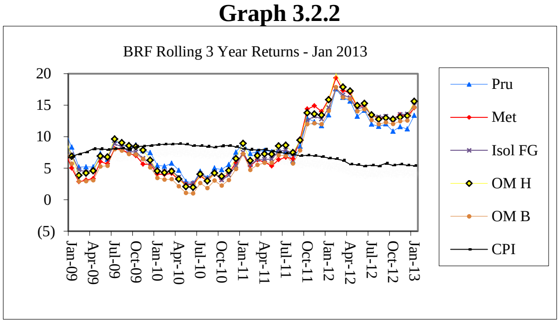


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

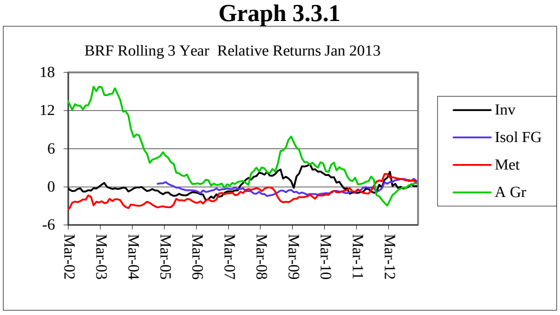


Graph 3.2.2



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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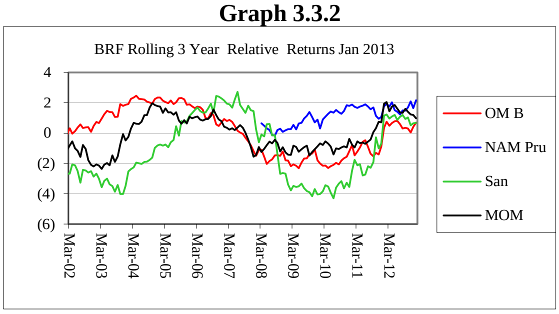
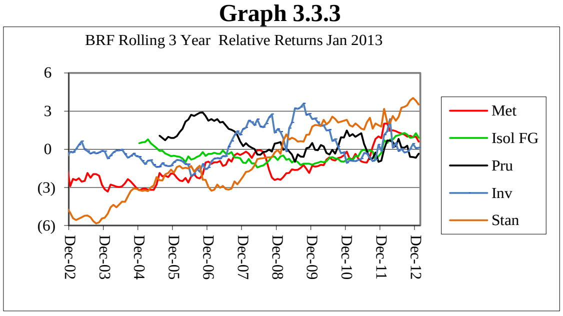
Graph 3.3.2

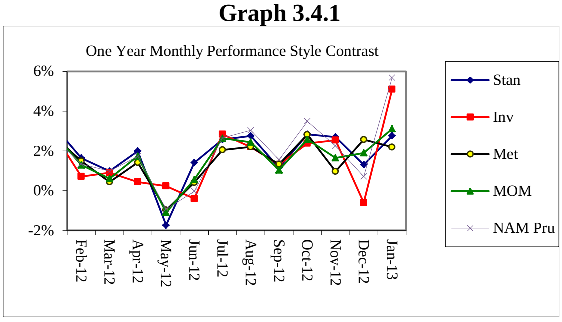


Graph 3.3.3

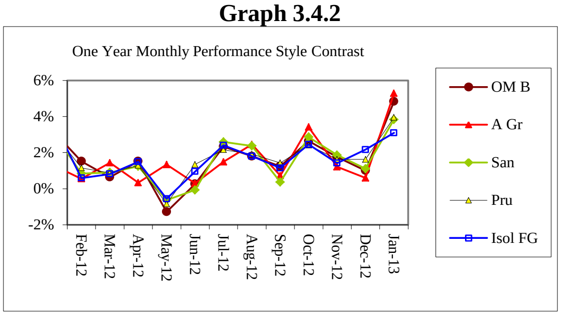


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

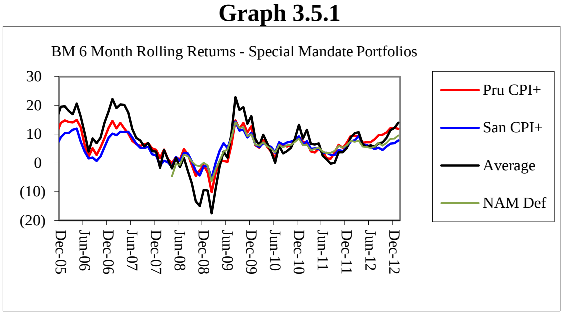


Graph 3.4.2

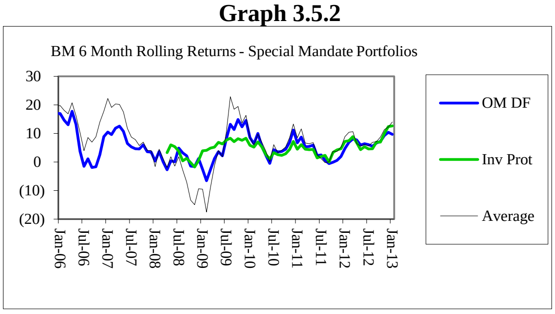


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

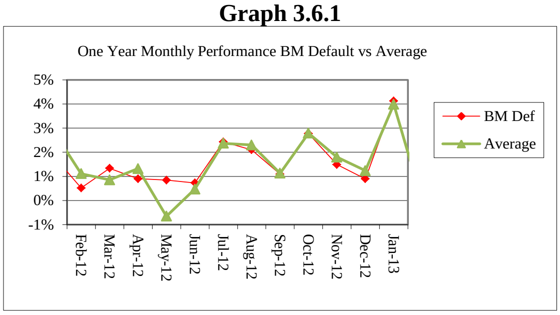


Graph 3.5.2

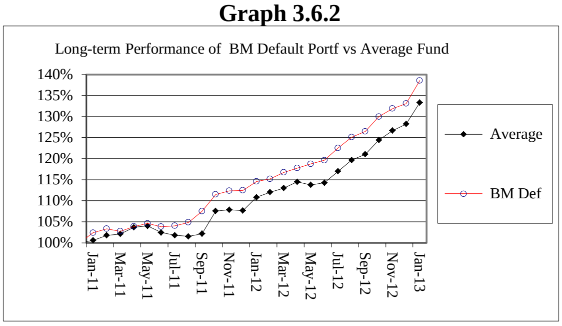


3.6 Monthly and cumulative performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1



Graph 3.6.2



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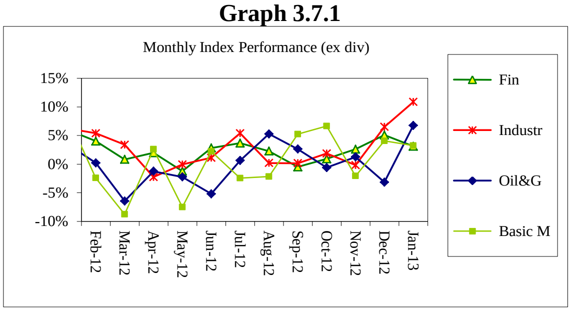
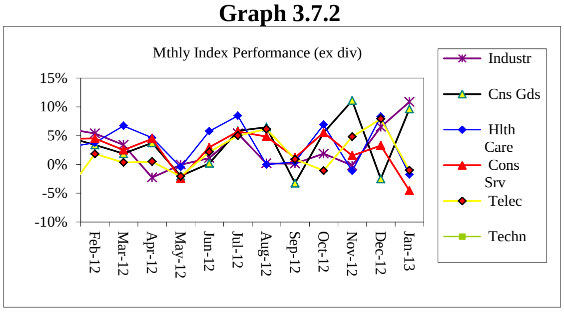
3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

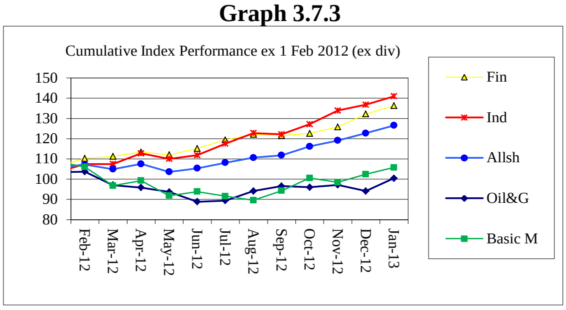
Graph 3.7.1



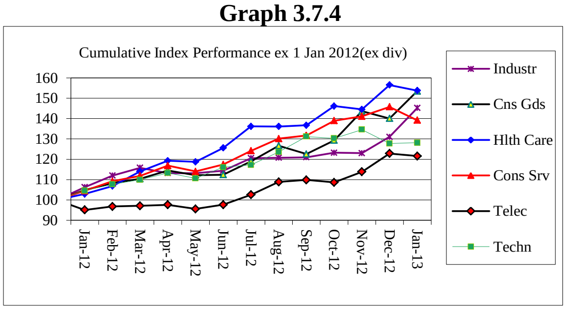
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 10.9 % p.a. in nominal terms, or 4% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 11.1% p.a. in nominal terms, or 4.2% 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 (47.9% vs 61.3% as at the end of December 2012).

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% return for the benefit of lower volatility compared to the average prudential balanced portfolio, 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 38.6% compared to 33.3% for the average prudential balanced portfolio over this 25 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 February 2010 to January 2013:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.7%	9.2%	6.7%
Best annual performance	8.3%	20.9 %	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	6.5%	13.6%	14.6 %

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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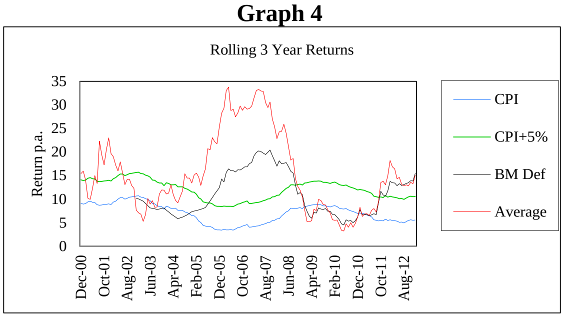
Graph 4



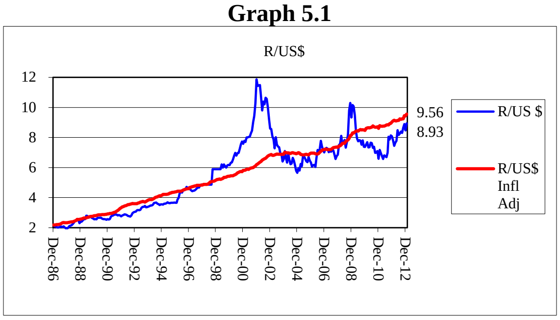
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 2008, both the Benchmark Default portfolio as well as the average prudential balanced portfolio were lagging inflation plus 5% and have surpassed inflation plus 5% since October 2011, Benchmark default portfolio currently on 15.5%, the average on 15.1% vs CPI plus 5% currently on 10.6%.

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 9.56 to the US Dollar while it actually stood at 8.93 at the end of January. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

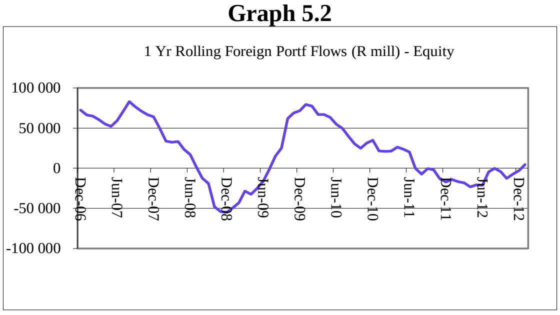


Support of the Rand from foreign capital flows continues, mainly through bond purchases

Graph 5.2 reflects a more steady and slightly positive flow of capital into South African equities on a rolling one year basis, with a net inflow just shy of R 4.5 bn on a year-on-year basis at the end of January (outflow of R 2.9 bn to end December). Since the beginning of 2006, foreign net investment in equities amounts to N$ 170 billion (end December R 168 billion). This represents roughly 2% of the market capitalization of the JSE.

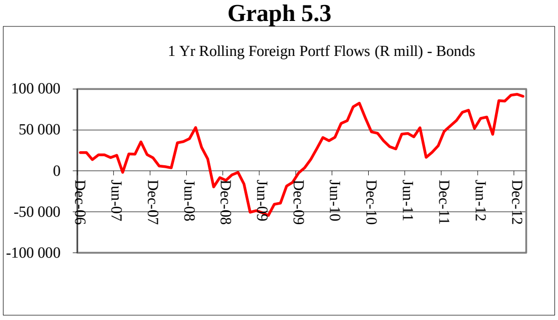
The fiscal easing measures of the Eurozone, the US and with more vigour now by the Bank of Japan, are likely to provide an artificial underpin to the Rand through continued foreign 'hot money' inflows into local financial markets, more specifically into the bond market though.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects a fairly volatile foreign portfolio flow into bonds of R 91.0 bn over the past 12 months to end of January (R 93.6 billion over the 12 months to end of December). Since the beginning of 2006, foreign net investment in bonds amounts to R 217 bn (December N$ 214 bn).

Graph 5.3



The net inflow of foreign capital into equity and fixed interest assets was R 96 bn for the 12 months to end January (inflow of R 91 bn to end December), compared to R 41 bn for the 12 months to end January 2012 (R 31 bn to end December 2011). Since the beginning of 2006, total net foreign portfolio flows amounted to N$ 387 billion (December R 382 bn).

Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms the JSE passed its month end peak of before the financial crisis of 31,841 (May 2008), while the DOW Jones at the end of January for the first time matched its previous peak of 13,896 (Sep 2007). In nominal terms, the JSE grew by 14.2% per year, while the DOW Jones only grew by 1.5% 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 2.4%.

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 7.3% per year above inflation, over this period of close to 14 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW Jones declined by 0.4% per year above inflation over this period, also excluding dividends.

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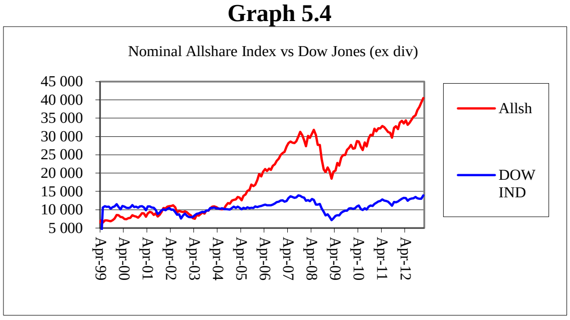
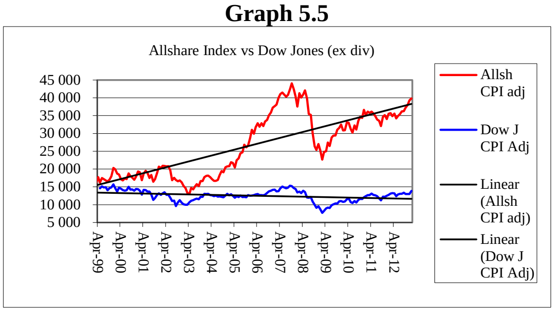
Graph 5.4

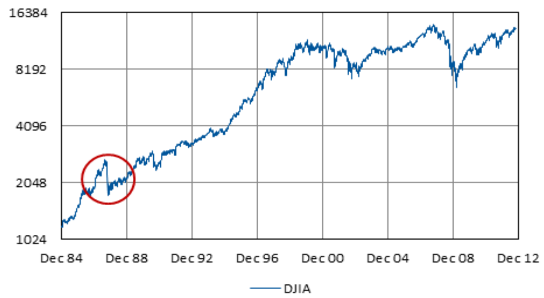


Graph 5.5



Graph 5.6

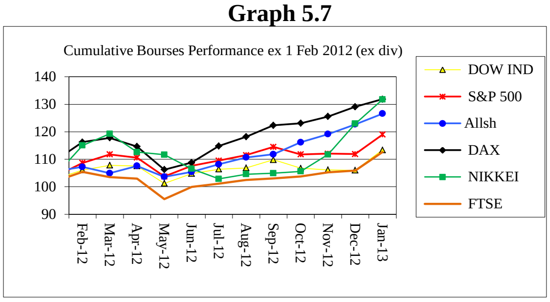
The Dow Jones Industrial Index, over the longer term:



Graph 5.6 places the data as per graph 5.5 into a better perspective, showing that graph 5.5 actually starts measuring the DOW Jones just after it had reached a peak around 1998.

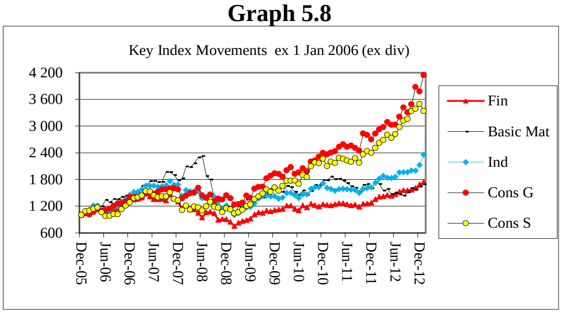
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the DAX and most recently the NIKKEI as the top performing share indices.

Graph 5.7



Graph 5.8 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 5.8



6. Conclusion

The past year to end January, for the first time in a while saw some foreign equity indices outperforming the SA ALSI. In this category fell the Nikkei that produced 26.5%, the DAX produced 20.4% versus the SA ALSI at 19.8%, not far behind the DAX, while the Rand depreciated by 14.4%. Together these two elements would have produced a return of 47.8% and 40.7%, respectively, for an SA investor in the Nikkei, respectively in the DAX, returns that compare favourably with the top performing sectors of the FTSE/JSE. Foreign investors in the SA ALSI in contrast, would have had a return of 2.6% (US investor) and minus 2.9% (Euro investor).

This no doubt hurts when viewed in the context of what a foreign investor could have earned in their local bourses. Foreign portfolio flows into SA equity appear to mirror this disappointment of foreign investors. Since the SA Reserve Bank kept its repo rate unchanged in February, SA also no longer offers such an attractive investment opportunity for foreign investors in SA bonds, who would in fact have experienced negative returns over the past year in most instances. Another factor that has been benefiting SA was the huge demand for its natural resources but with the steep decline in global consumer confidence and consumption, it will take some time before the consumption driven demand for our commodities will recover again.

The question is whether these trends will continue. Our expectation is that they will. This should continue to dampen the enthusiasm of speculative foreign investors as will the continuing negative inflation differential between SA and its major trading partners and the fact that SA Reserve Bank kept the Repo rate unchanged. Foreign investment flows are likely to subside and this should impact negatively on our local equity and bond markets. We therefore expect continued Rand weakness and upward trending inflation that should in time to come lead to inclining interest rate levels locally.

On the basis of fundamentals and the prevailing economic environment, we expect foreign equities to outperform foreign bonds and property. A number of foreign bourses still offer high discounts on fair value occasioned by sentiment that is likely to fade out slowly. According to data produced by 1741 Asset Managment, the MSCI Italy offers a discount of 56% on fair value, Germany 19%, Austria 48% and, believe it or not, Portugal 'only' 26%. The MSCI EMU offers a discount of 31% and MSCI Japan a discount of 37%, compared to MSCI USA with a premium of 22%. In the face of a depreciating Rand, such investments would of course experience that benefit as well. Such discounts must be compelling investment opportunities that should be capitalised on now.

In terms of local equity sectors, we remain concerned about the significant growth SA Consumer Goods and Consumer Services have seen, returning 22.2% and 18.5 % per year, respectively, since December 2005, excluding dividends. Add dividends to this return and the investor would have earned a return close to 25% per year over the past 7+ years! Similar returns were generated by the Health Care and Technology sub-sectors.

We do not believe this is sustainable and that the tide may be about to turn. Financials and Industrials have returned much more modest growth rates of 8.1% and 12.9%. Over the same period, the Namibian CPI grew by 6.9% per annum. Basic Materials that have grown by a similarly modest rate of 7.7 % 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. Inflation linked bonds might offer an exception though. A high foreign equity exposure to particularly Eurozone countries where markets experienced a dramatic decline as the result of negative investor sentiment, remains our call for 2013.

7. Important notice and disclaimer