Benchmark Retirement Fund

Volume 9, No. 11,
November 2013

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 NOVEMBER 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

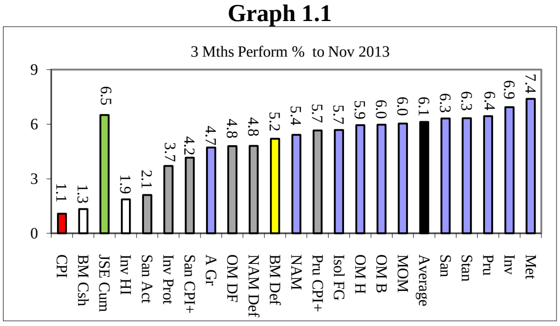
In **November** the **average prudential balanced portfolio** returned -0.08% (October: 2.70%). Top performer is Namibian Asset Managers (0.35%), Investment Solutions (-0.94%) takes the bottom spot.

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 Namibia.

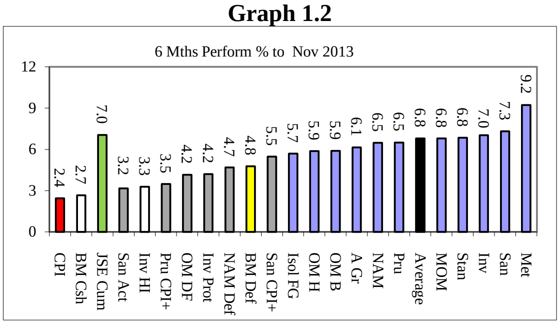
Below is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Consumer Price Index	CPI (red)
JSE Allshare Index	JSE Cum (green)
Benchmark Default Portfolio	BM Def (yellow)
Average Portfolio (prudential, balanced)	Average (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)
Prudential Inflation Plus	Pru CPI+ (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Sanlam Active	San Act (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	Pru (blue)
Metropolitan Managed	Met (blue)
NAM Prudential Balanced	NAM (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)

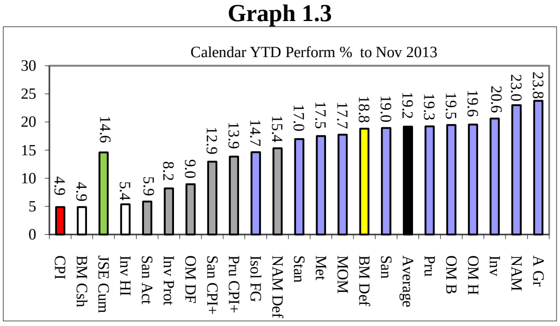
Graph 1.1



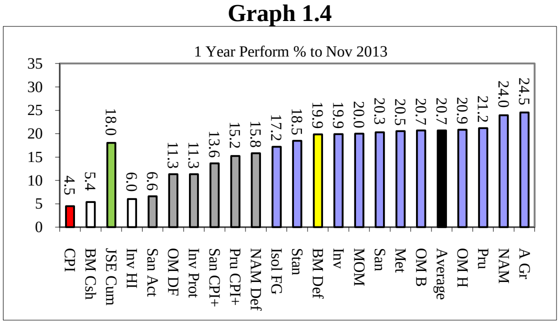
Graph 1.2



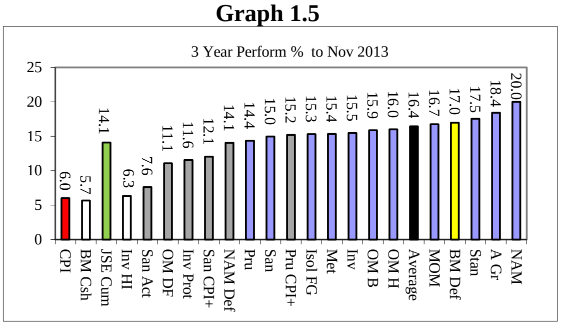
Graph 1.3



Graph 1.4



Graph 1.5



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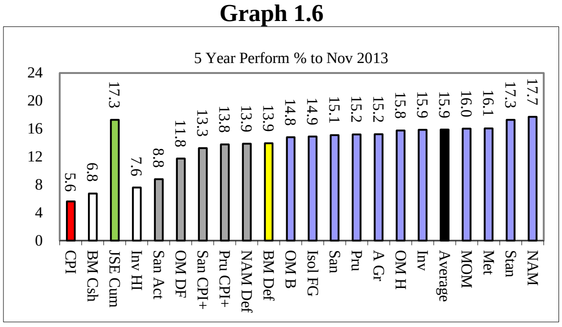
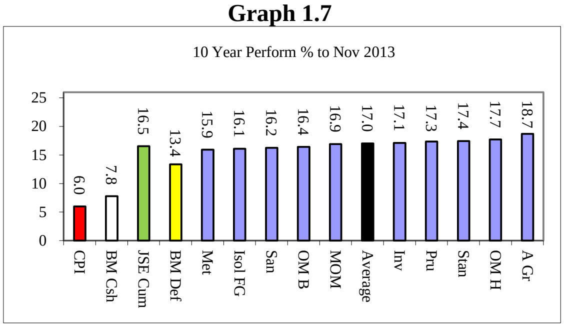
Graph 1.6

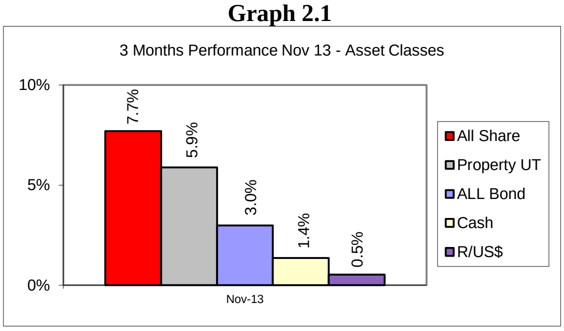


Graph 1.7

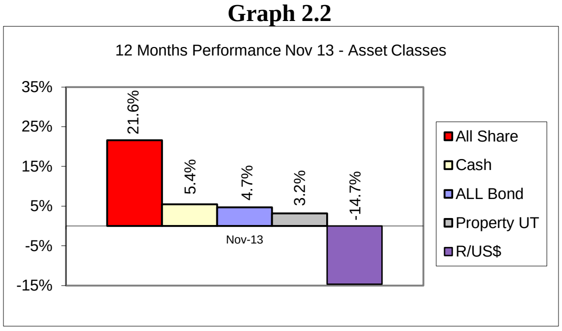


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

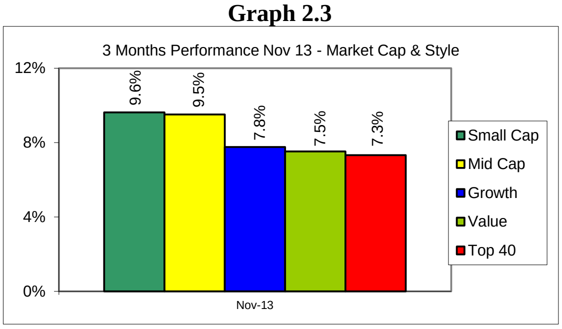
Graph 2.1



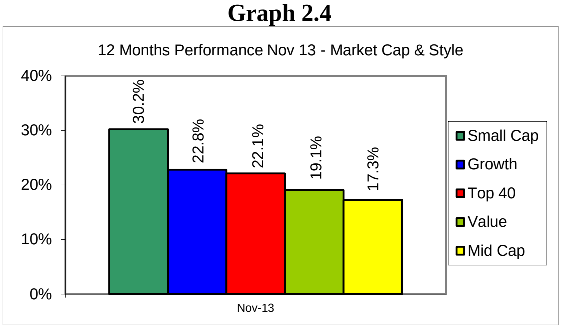
Graph 2.2



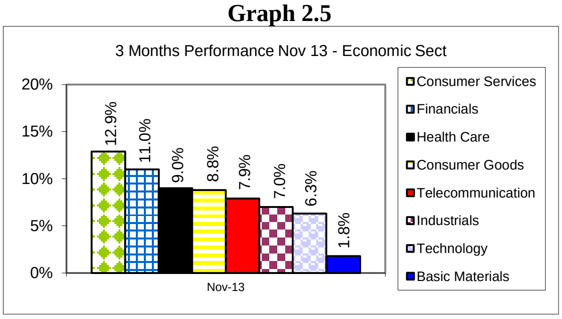
Graph 2.3



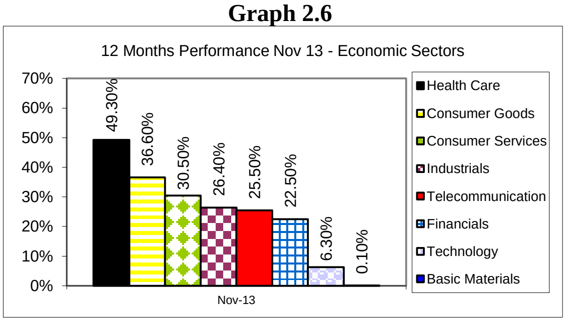
Graph 2.4



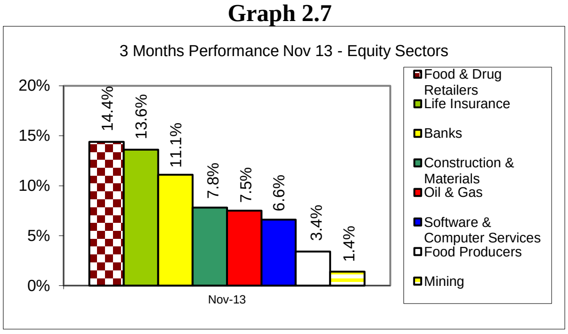
Graph 2.5



Graph 2.6



Graph 2.7



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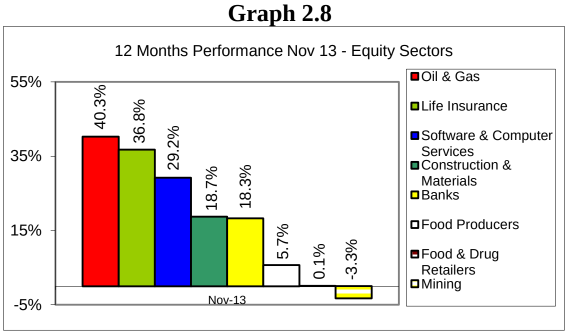
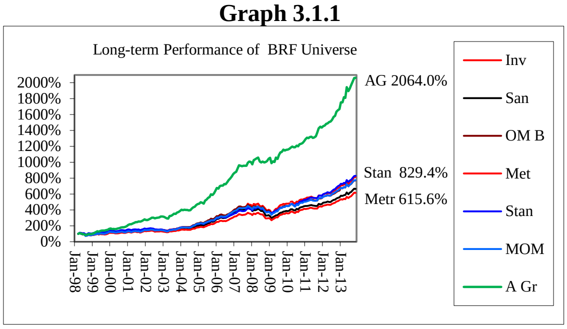
Graph 2.8



3. Portfolio Performance Analysis

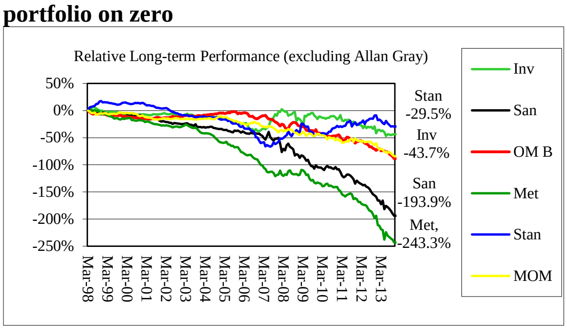
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

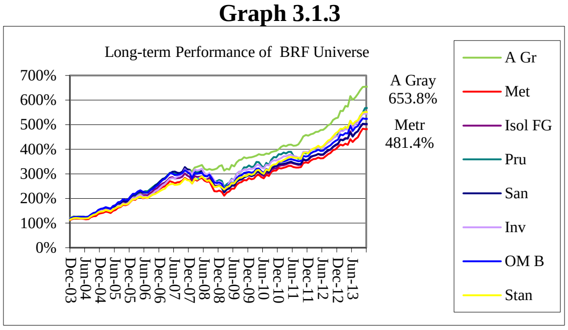


Graph 3.1.2

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

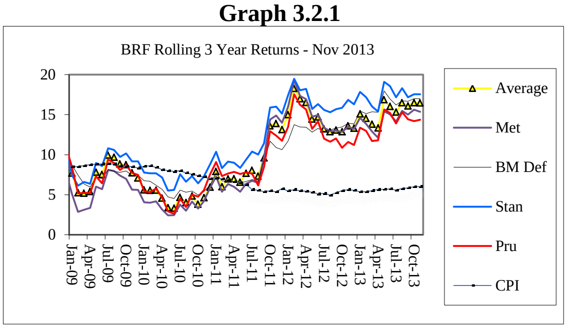


Graph 3.1.3

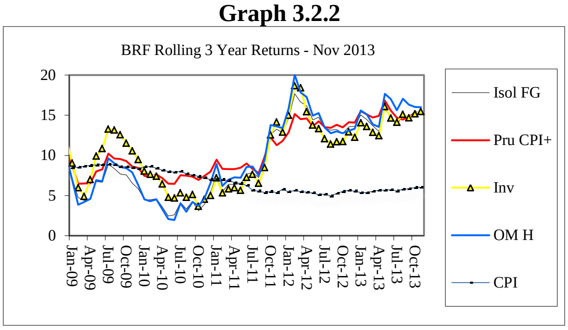


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

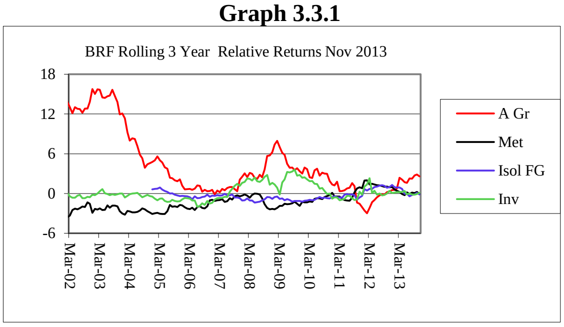


Graph 3.2.2

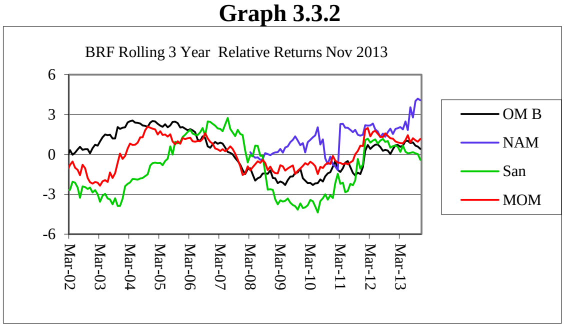


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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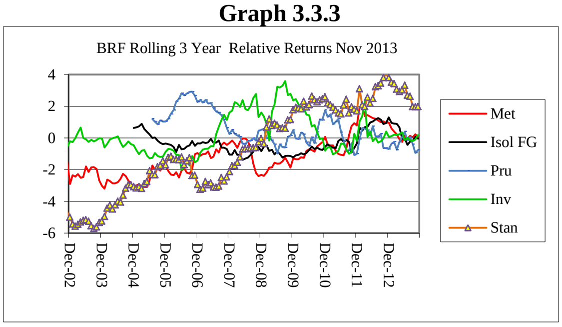
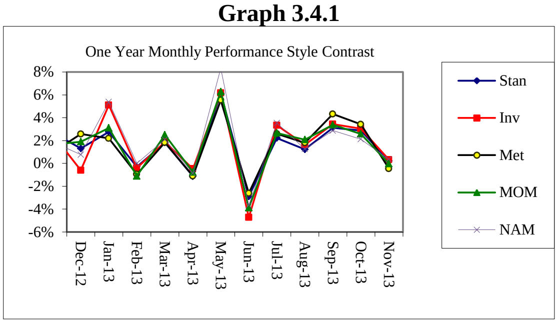
Graph 3.3.3

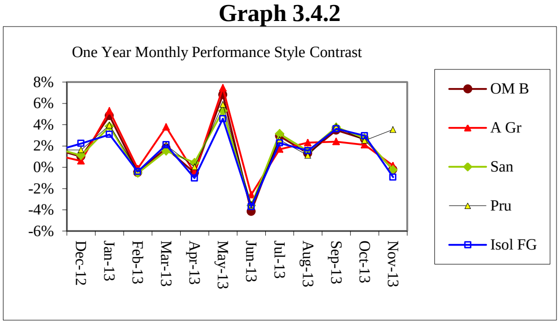


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

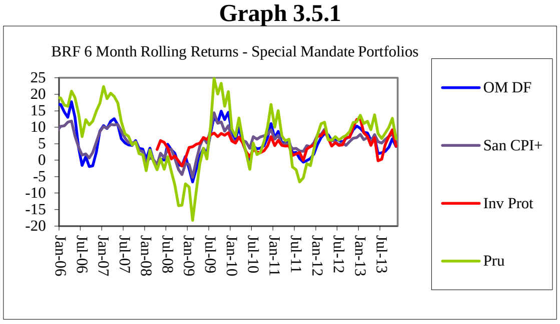


Graph 3.4.2

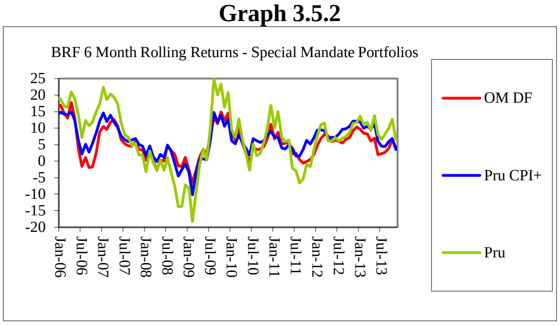


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

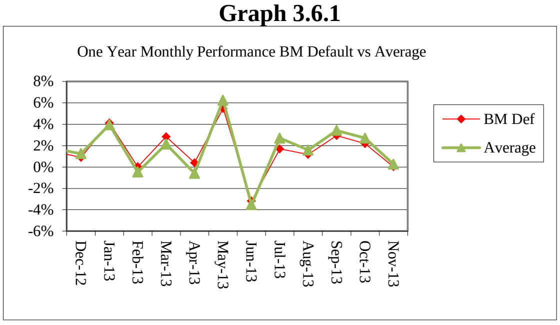


Graph 3.5.2

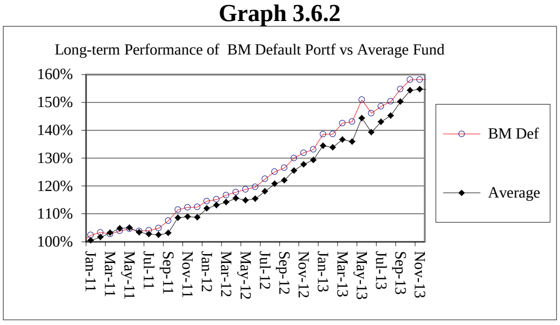


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

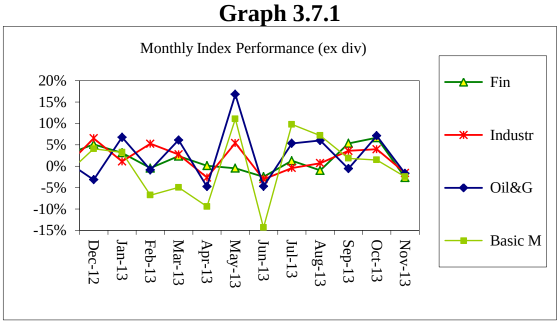


Graph 3.6.2



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

Graph 3.7.1



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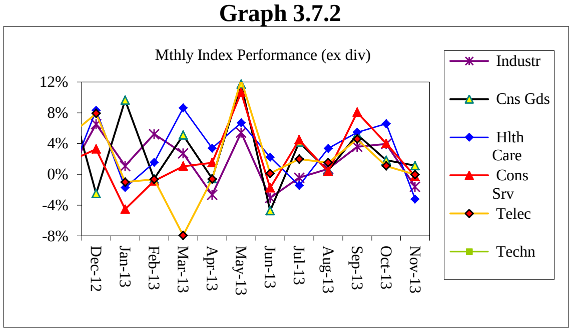
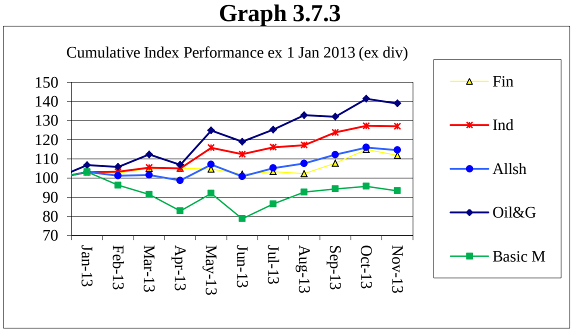
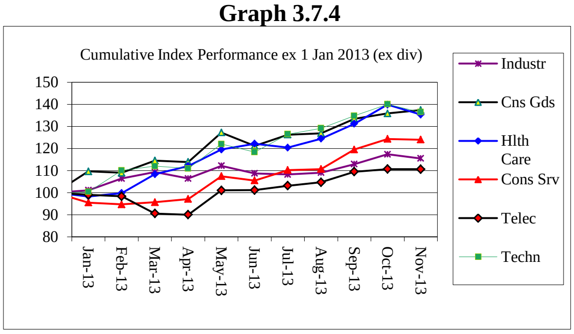
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 15.9% p.a. in nominal terms, or 10.3% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 13.9% p.a. in nominal terms, or 8.3% p.a. in real terms. The Benchmark Default portfolio is designed to produce a less volatile performance but also lower returns than the average prudential balanced portfolios with its significantly lower equity exposure (43.6% vs 62.3% of the average prudential balanced portfolio, as at the end of September 2013) and the lower risk it consequently entails for the investor. It should be expected to underperform the average prudential balanced portfolio at times when shares outperform other asset classes and vice versa.

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 exceeding the expected long-term goal over the past 5 years.

Having raised the risk profile of the Default portfolio effective the start of 2011, by replacing Metropolitan ARF with the Allan Gray Investment Trust, 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. Over the past 5 years this performance objective was achieved. Since this change was effected, the default portfolio returned a cumulative 46.5% compared to 44.2% for the average prudential balanced portfolio over this 35 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 December 2010 to November 2013:

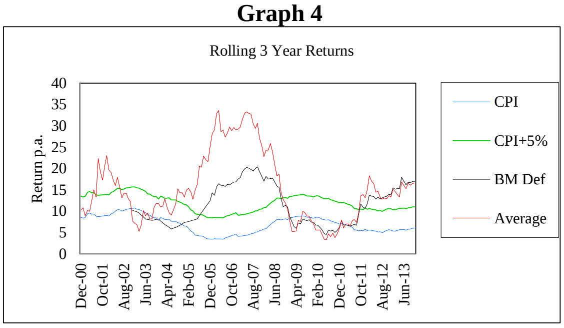
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.4%	9.9%	7.4%
Best annual performance	7.2%	27.1 %	25.6 %
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	5.9%	16.2%	15.4%

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



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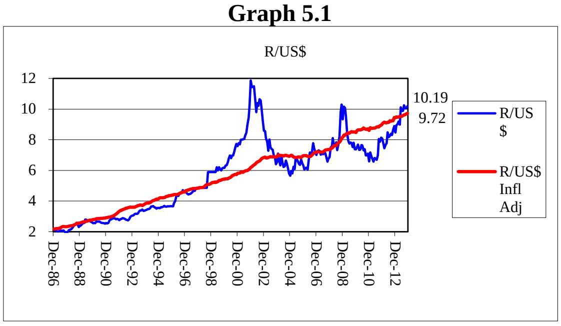
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 17.0%, the average on 16.5% vs CPI plus 5% currently on 10.9%.

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 9.72 to the US Dollar while it actually stood at 10.19 at the end of November. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

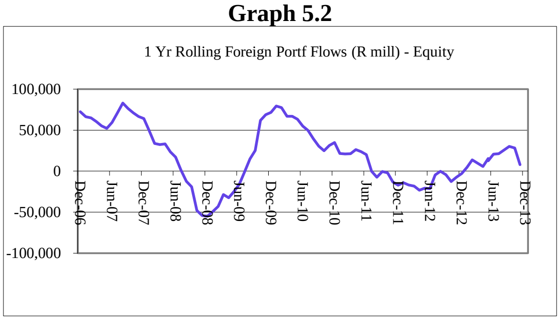
Graph 5.1



Rand supported by foreign capital flows

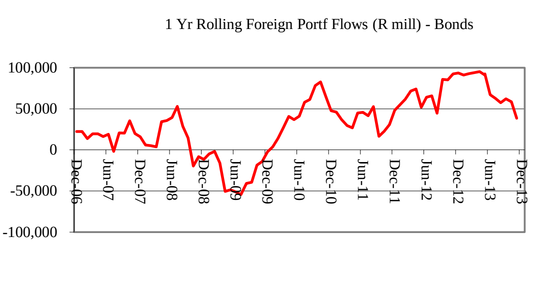
Graph 5.2 reflects a steady positive flow of capital into South African equities on a rolling one year basis, with a net inflow of R 8.0 bn on a year-on-year basis at the end of November (inflow of R 28.3 bn to end October). Since the beginning of 2006, foreign net investment in equities amounts to R 170 billion (end October R 187 billion). This represents roughly 1.65% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects a sharp decrease of foreign portfolio flow into bonds of R 38.5 bn over the past 12 months to end of November (R 58.6 billion over the 12 months to end of October). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 249 bn (to October just over R262 bn).

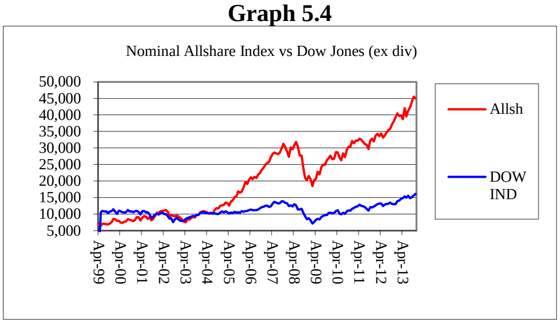
Graph 5.3



The net inflow of foreign capital into equity and fixed interest assets was down to R 46.5 bn for the 12 months to end November 2013 (inflow of R 86.9 bn to end October 2013), compared to R 85.1 bn for the 12 months to end November 2012 (R 72.7 bn to end of October 2012). Since the beginning of 2006, total net foreign portfolio flows amounted to R 419 billion (October R 449 bn).

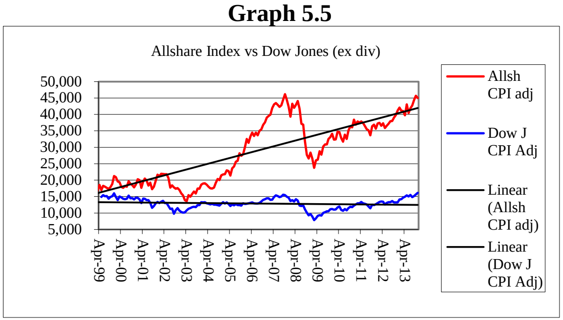
Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms, the JSE grew by 14.2% per year, while the DOW Jones only grew by 2.9% per year, over a period of over 14 years, dividends excluded. Namibian inflation over this period was 6.8% per year in contrast with US inflation of 2.4%.

Graph 5.4



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 6.9% per year above inflation, over this period of over more than 14 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW only managed to match inflation over this period, also excluding dividends.

Graph 5.5



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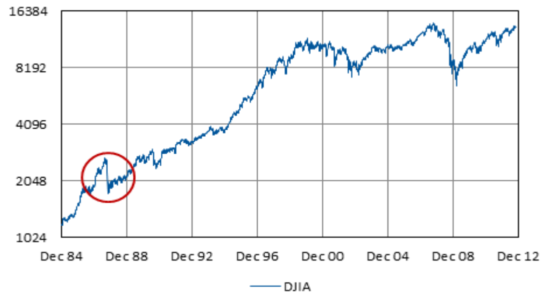
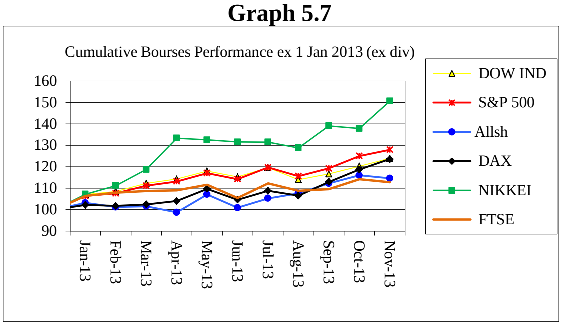
Graph 5.6 places the data as per graph 5.4 into a better perspective, showing that graph 5.4 actually starts measuring the DOW Jones just after it had reached a peak around 1998.

Graph 5.6



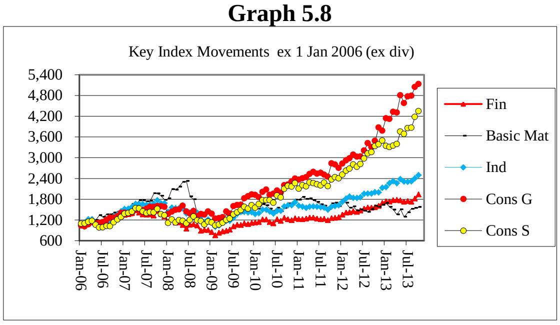
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the S&P 500 as the top performing share indices.

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

In the world of investments 'tapering' will easily win the 'word of the year' award for 2013. The first time it was uttered by the Fed's Ben Bernanke, investment markets went into panic mode and the markets dropped by around 6% month-on-month in June only to recover very rapidly when the Fed back-tracked. Tapering of the Feds asset purchase programme is pretty much a given, only the time is still a bit nebulous at this stage although consensus is that it will commence in 2014.

To counter another panic reaction when this happens, the Fed has already indicated that it will maintain an accommodative monetary policy and that it will continue with its zero interest rate policy. Markets seem to have started to discount these developments towards the end of November. As the result the SA Allshare index hardly moved in November and declined by nearly 6% from end of October to middle of December. Graphs 5.2 and 5.3 clearly evidence the panic response of foreign investors in local markets and indicate an 'overshoot' scenario that has also lead to the Rand being undervalued at 10.19 to the US$, by our measure

How much further markets may decline is anybody's guess. The Fed does not seem to be keen on equity markets turning negatively as this will impact negatively on consumer sentiment, which in turn will counter its intention of boosting the US economy. In such a situation however, sentiment is likely to lead to markets overshooting to then correct again after a while when the real impact of the tapering combined with a low interest rate environment filter through.

We would expect the current negative trend in equity markets and the depreciation of the Rand to continue for a couple of months as the result of prevailing negative sentiment and the uncertainty about the impact of the tapering on financial markets.

With an expectation that this will correct again, we believe that it will not be the right time to get out of the equity market now without a very clear objective when to get back into the market, or for the specific purpose of short-term parking of money. It is usually easier to foresee a decline in the equity market, other than as the result of panic reaction by investors, than it is to foresee a correction. Corrections typically happen rather rapidly. Missing out on a correction can seriously affect investment returns.

Although foreign investment flows into local equity markets are likely to recede the low interest rate environment is still supportive of foreigners investing in local interest bearing assets in order to leverage their returns. Indirectly this will still result in an investor equity bias of local investors.

In our previous newsletter we have presented some graphs that reflect a close correlation between the global commodity index, the SA ALSI 40 and the Basic Materials indices. We expressed our opinion that global commodity prices are at fairly elevated levels and that global commodities are likely to move sideways over the medium term, particularly also in view of the fact that no major global economy shows any sign of rapid recovery yet. The support of local equities by foreign investors is expected to decline, particularly as the US economy is strating to gain traction, while the indicators are that global commodity prices are also unlikely to come to the rescue of our local equity markets.

The investor should thus not expect returns on equities in the medium term to be anywhere close to what we have seen over the past 10 years and more. As we expect the Rand to weaken further, there is still a short-term opportunity to invest offshore, the risk of a significant correction of the exchange rate being considered low in the short-term. In the longer term we expect the Rand to revert to fair value, which we currently believe is at 9.72 to the US$.

A globally well diversified portfolio, comprising of value companies in the industrial, financial and technology sectors with strong cash flows and high dividend yields remains our call. Listed property is likely to track the performance of equities in the short-term, implying short-term opportunities but is likely to feel the impact of an increase in interest rates more severely than equities. In terms of the weighting of the equity exposure we believe that foreign equity should be overweight relative to local equity, considering that local investors will hold the major portion of their assets locally.

7. Important notice and disclaimer