Volume 9, No. 12,
December 2013

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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

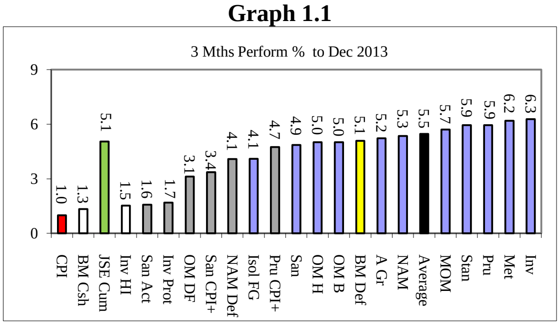
In **December** the **average prudential balanced portfolio** returned 2.77% (November: -0.08%). Top performer is Prudential (3.31%), Investment Solutions (2.06%) takes the bottom spot. Investec, top performer for the quarter outperformed the 'average' by roughly 0.8%, primarily through sector allocation and stock picking. On the other end of the scale Investment Solutions' underperformance of the 'average' by 1.4% was caused primarily by its underweight exposure to offshore assets. Its offshore allocation was 18% versus 30% for the 'average' (end September).

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.

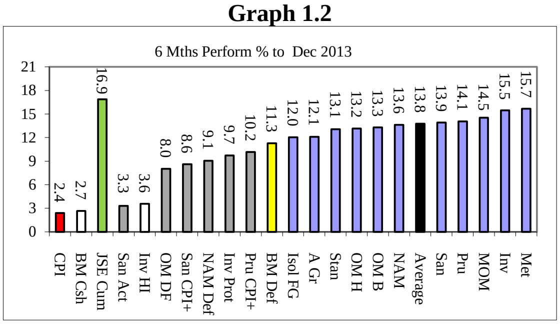
Below is the legend to the abbreviations reflected on the graphs:

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)

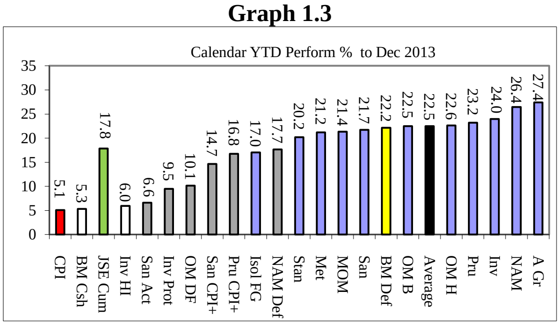
Graph 1.1



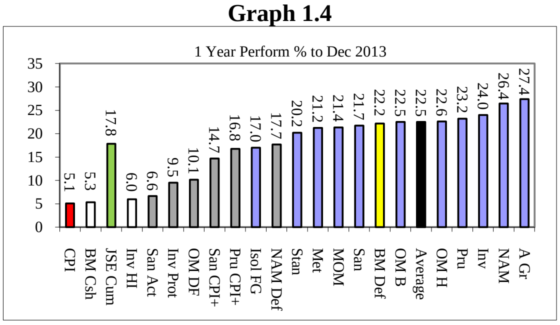
Graph 1.2



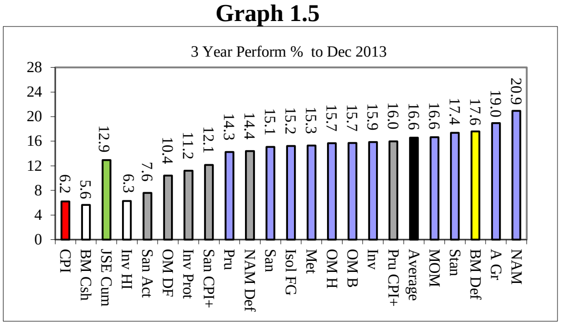
Graph 1.3



Graph 1.4



Graph 1.5



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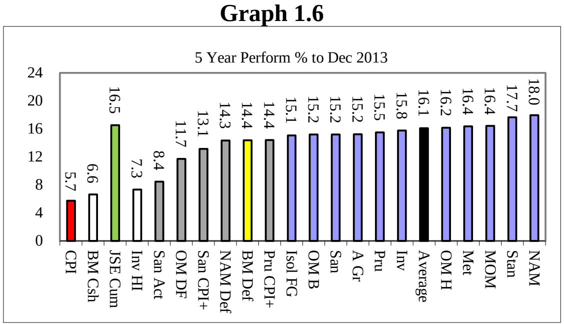
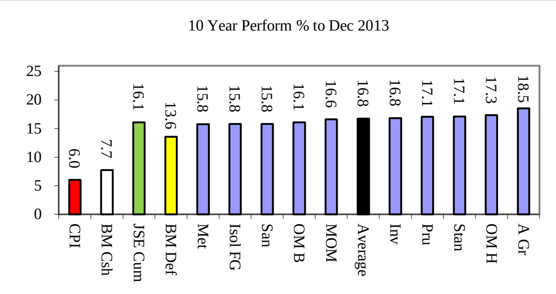
Graph 1.6

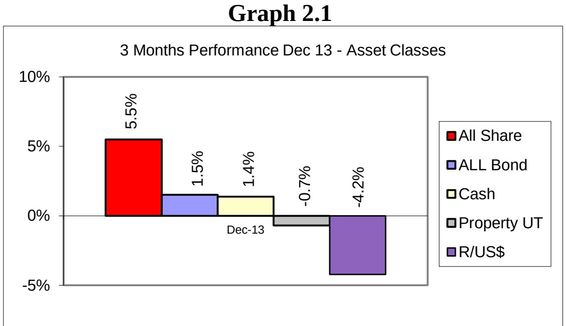


Graph 1.7

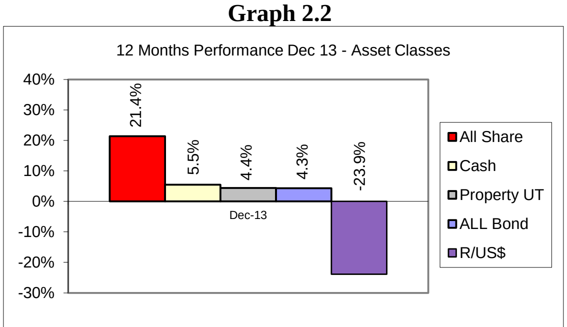


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

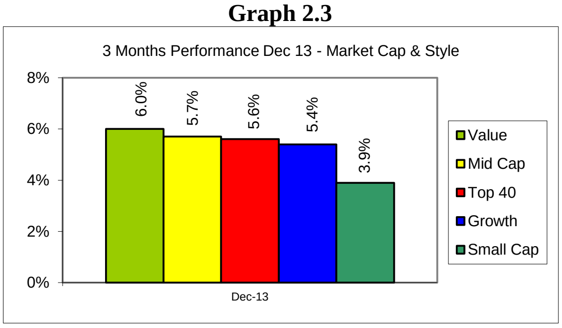
Graph 2.1



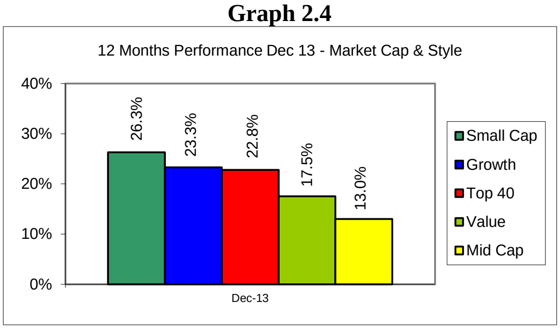
Graph 2.2



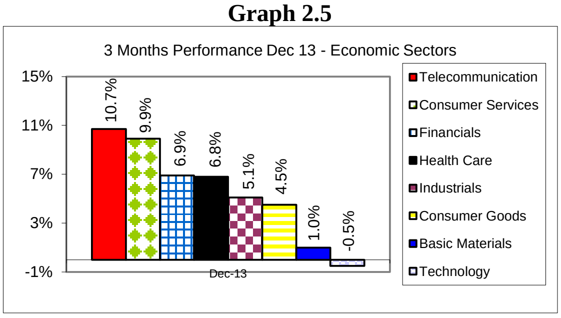
Graph 2.3



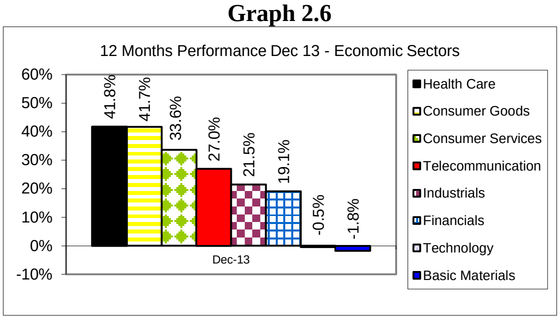
Graph 2.4



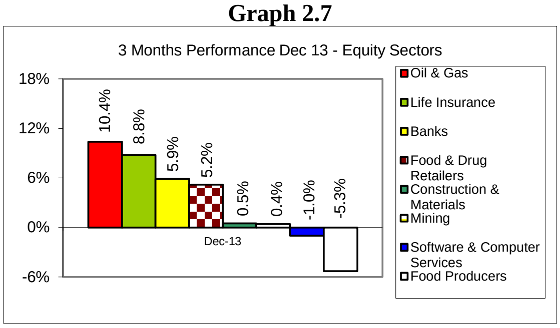
Graph 2.5



Graph 2.6



Graph 2.7



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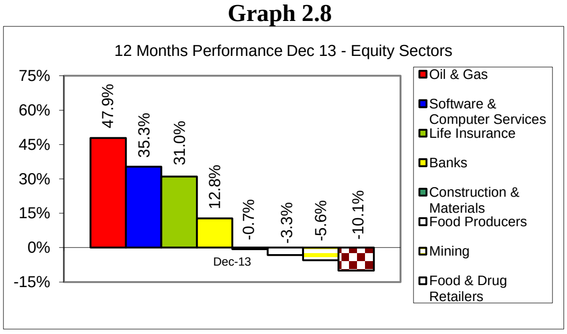
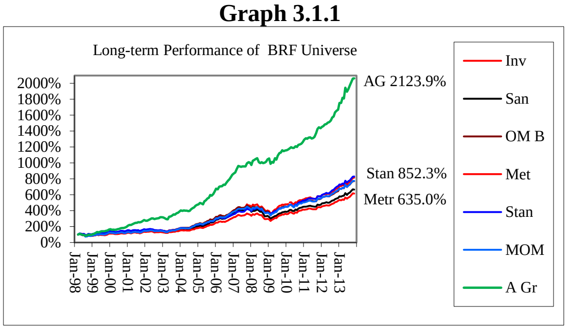
Graph 2.8



3. Portfolio Performance Analysis

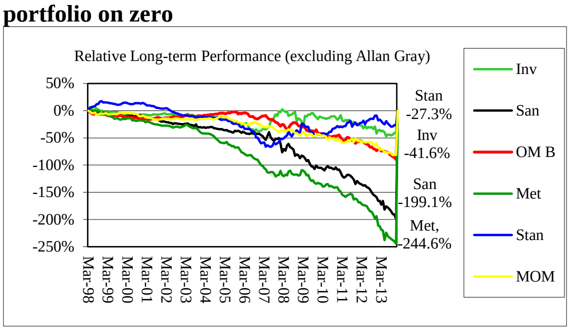
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

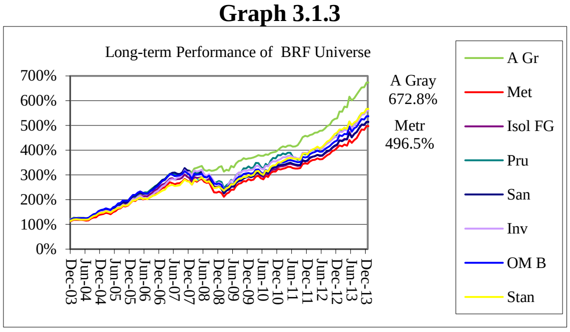


Graph 3.1.2

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

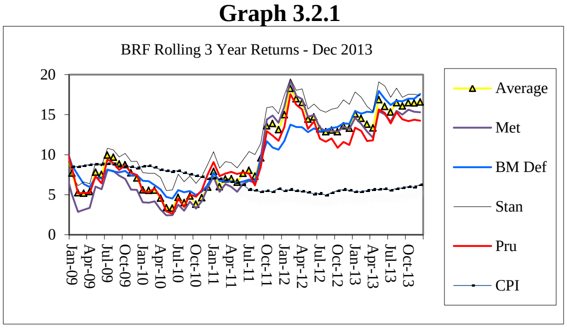


Graph 3.1.3

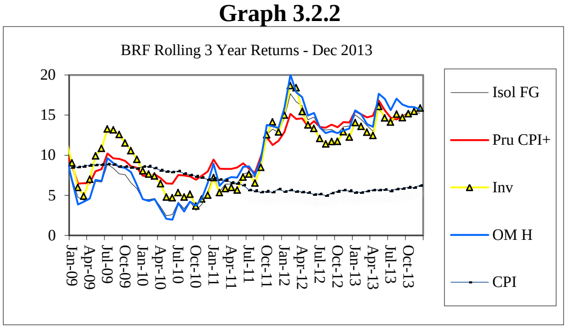


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

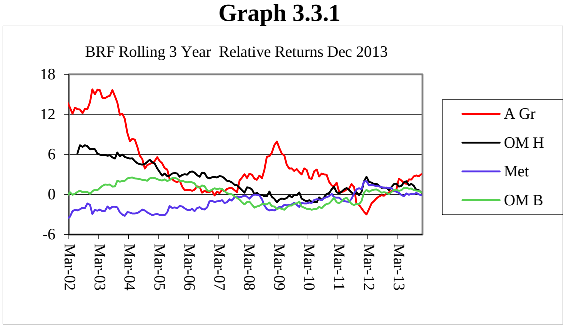


Graph 3.2.2

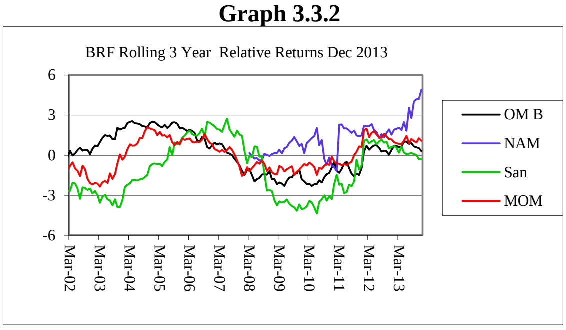


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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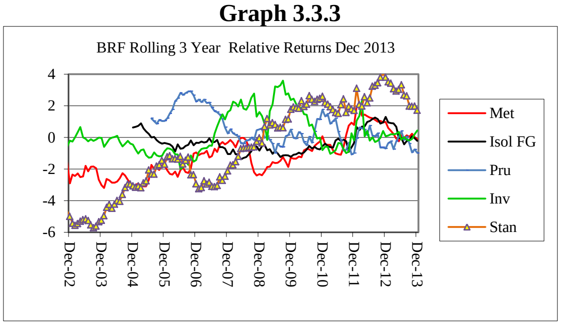
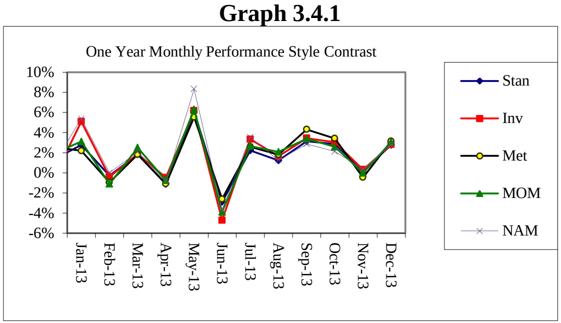
Graph 3.3.3

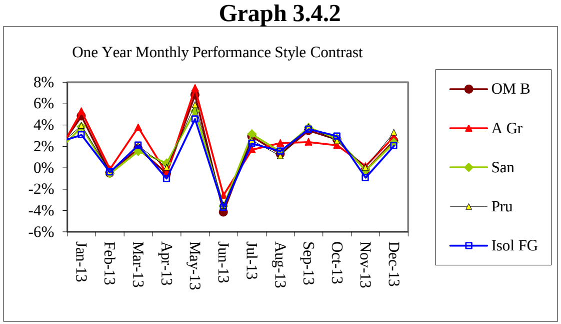


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

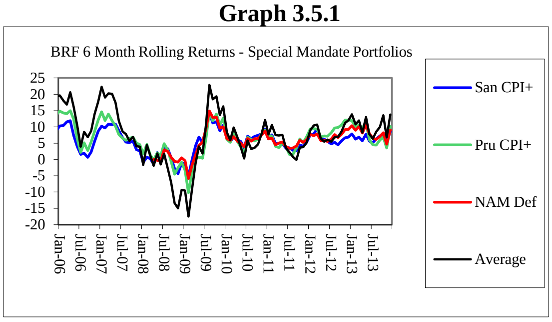


Graph 3.4.2

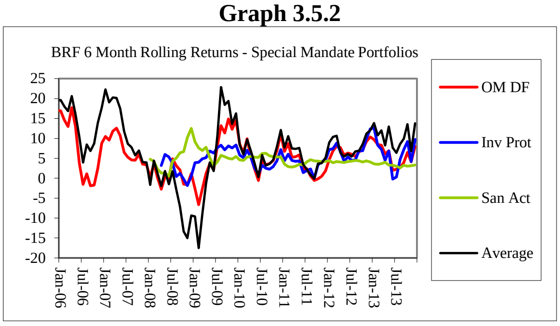


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

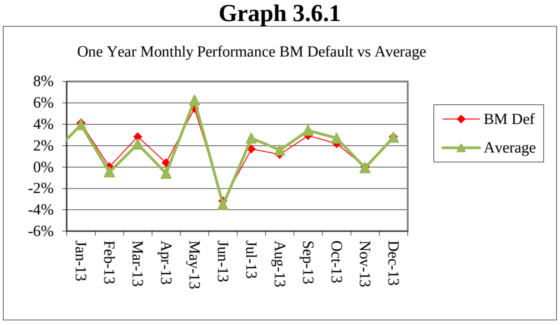


Graph 3.5.2

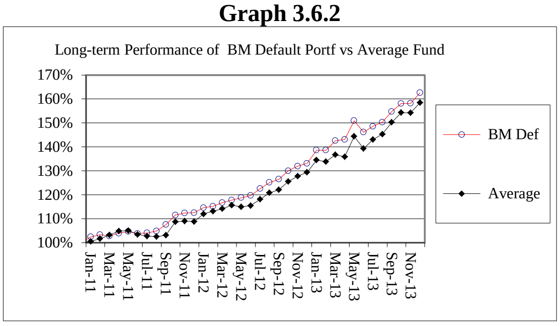


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

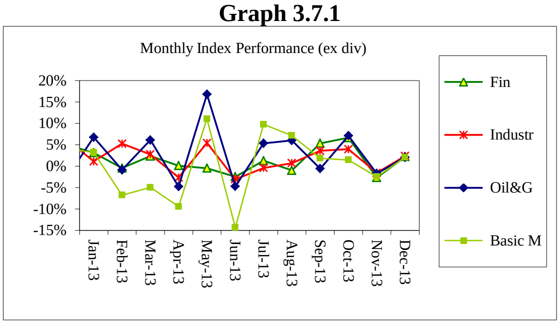


Graph 3.6.2



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

Graph 3.7.1



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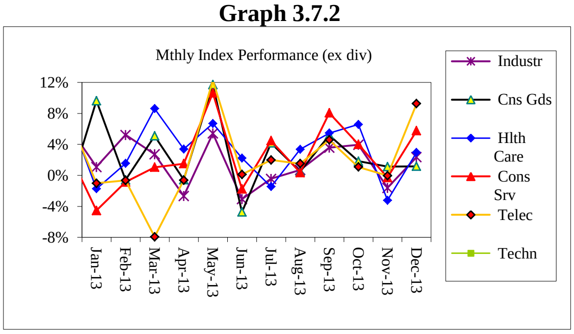
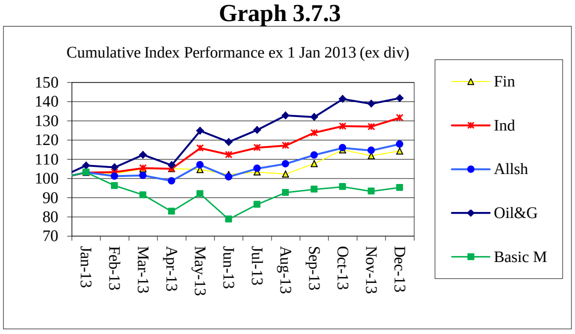
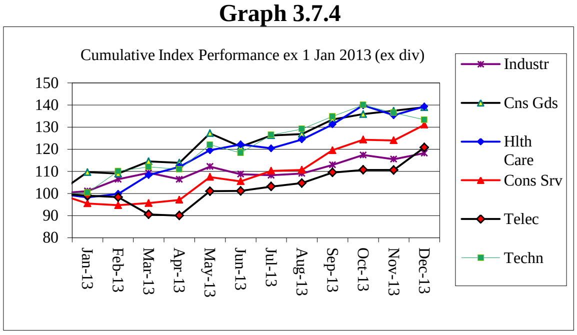
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 16.1% p.a. in nominal terms, or 10.4% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 14.4% p.a. in nominal terms, or 8.7% 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 exceeded noticably. Since this change was effected, the default portfolio returned a cumulative 49.3% compared to 46.9% for the average prudential balanced portfolio over this 36 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 January 2011 to December 2013:

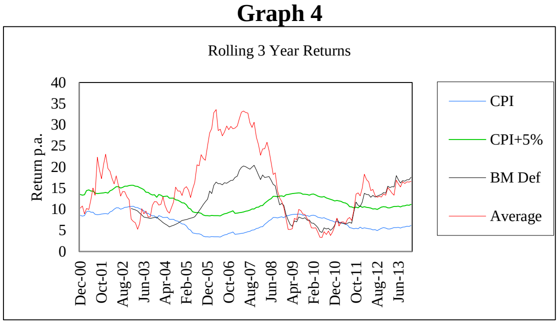
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	9.9%	7.4%
Best annual performance	7.0%	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%	16.5%	15.7%

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



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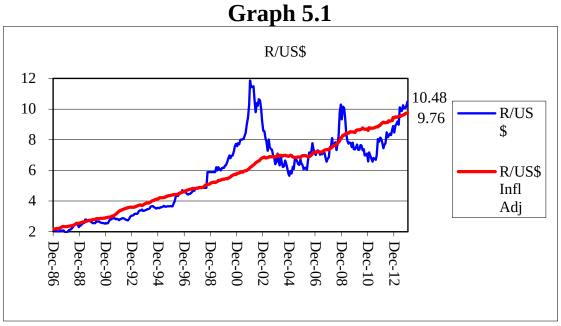
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 17.6%, the average on 16.6% vs CPI plus 5% currently on 11.1%.

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 9.76 to the US Dollar while it actually stood at 10.48 at the end of December. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

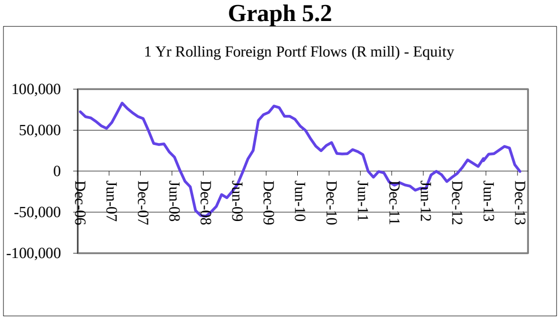
Graph 5.1



Rand supported by foreign capital flows

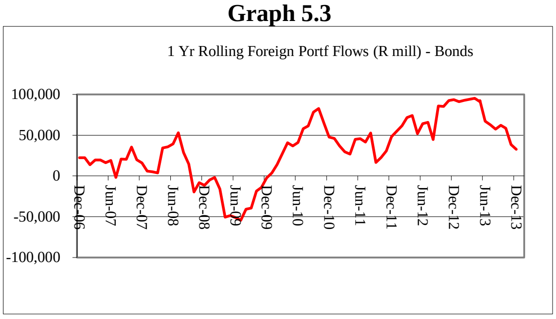
Graph 5.2 reflects a negative flow of capital out of South African equities on a rolling one year basis, with a net outflow of R 0.4 bn on a year-on-year basis at the end of December (inflow of R 8.0 bn to end November). Since the beginning of 2006, foreign net investment in equities amounts to R 168 bn (end November R 170 bn). This represents roughly 1.59% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects a decrease of foreign portfolio flow into bonds of R 32.8 bn over the past 12 months to end of December (R 38.5 billion over the 12 months to end of November). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 247 bn (to November just over R249 bn).

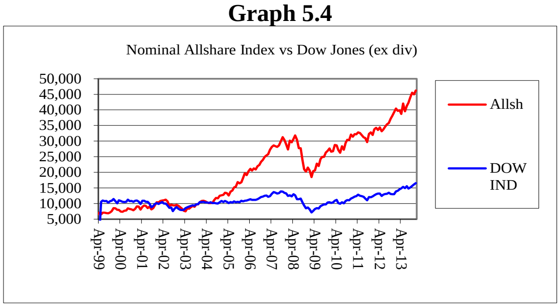
Graph 5.3



The net inflow of foreign capital into equity and fixed interest assets was down to R 32.4 bn for the 12 months to end December 2013 (inflow of R 46.5 bn to end November 2013), compared to R 90.7 bn for the 12 months to end December 2012 (R 85.1 bn to end of November 2012). Since the beginning of 2006, total net foreign portfolio flows amounted to R 414 bn (November R 419 bn).

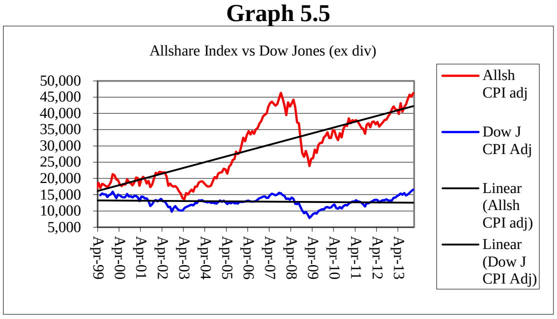
Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms, the JSE grew by 14.3% per year, while the DOW Jones only grew by 3.1% per year, over a period of over 14 years, dividends excluded. Namibian inflation over this period was 6.8% per year in contrast with US inflation of 2.3%.

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 7.1% 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 exceed inflation over this period, also excluding dividends.

Graph 5.5



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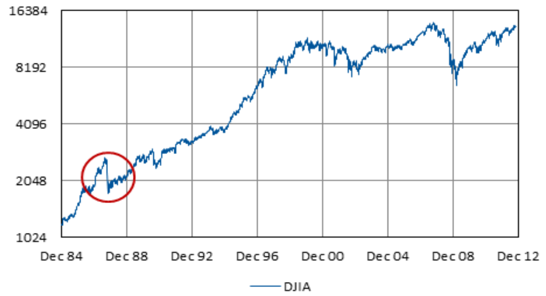
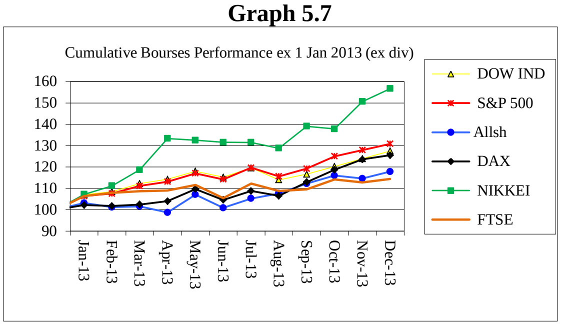
Graph 5.6 places the data as per graph 5.4 into a better perspective, showing that graph 5.4 actually starts measuring the DOW Jones just after it had reached a peak around 1998.

Graph 5.6



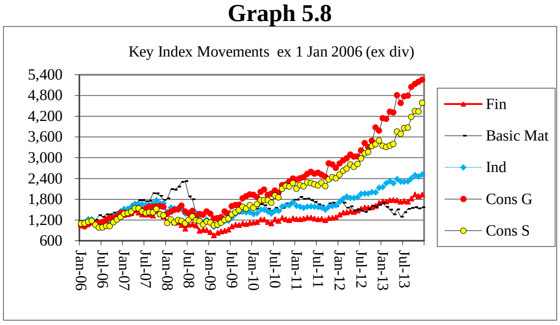
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the S&P 500 as the top performing share indices.

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

'Tapering' is now with us and talk by some Fed governors hints towards faster tapering than cautiously proposed last year by Ben Bernanke. Graphs 5.2 and 5.3 clearly show the response of foreign investors in local equity and bond markets, that has also been a major cause for the depreciation of the Rand. Foreigners' investment capital that is being withdrawn from financial markets in developing countries, is now flowing into financial markets of developed countries as evidenced by graph 5.7.

Despite strongly declining inflows of foreign investment capital from local markets in 2013, its impact was neutral on equities, but still provided good support to the local fixed interest markets, thereby aiding a low local interest rate environment. Graph 5.7 shows that the FTSE/JSE Allshare returned 18% ex dividends (21.4% incl dividends). Around 6% of the total equity performance of 2013 resulted from the rerating of equities while the balance of 15% represents earning growth. For this year we would not see foreign portfolio flows to produce much downward pressure on local equities, currently being at around zero. However, a rising interest rate environment, the advent of which may well be forced by further weakening of the Rand, should put a damper on local equity markets as the result of which we would not expect any further rerating of equities in 2014, as we have seen in 2013. We see no reason at this stage though why company earnings growth in 2014 should not equal the 15% of 2013. As the result, we would expect local equities to return around 15% in 2014, with some upside potential.

Local fixed interest markets are not expected to produce returns of much above inflation with downside potential, in the face of the likelihood of the Repo rate being raised in the course of this year, probably earlier rather than later in the year.

Graph 5.1 shows that the Rand weakness, by our measure, is overdone and is driven by negative sentiment that is likely to prevail for a while, where we believe the SA Reserve Bank may want to counter act this by an increase in the Repo rate if it continues to weaken the Rand.

Offshore equity markets should produce much more muted real returns of between 5% and 10% off expected earnings growth in 2014. As the result of tapering of the Fed's quantitative easing programme, investment capital will continue to flow from developing markets back into developed markets and should support these markets. Despite some markets such as the US market being overvalued (S&P 500 being on a 1 year forward P:E of 17), a de-rating is not expected to occur in the course of 2014. 1741AM (former Wegeling Private Bank) Fair Value Analysis as at 31 December 2013, shows world equity markets being overvalued by 15%, the US being overvalued by 45%, Europe undervalued by 2%, the EMU undervalued by 17%, the UK overvalued by 6% and Japan undervalued by 25%

The Fed appears to consider positive equity markets to be a requirement for economic recovery and may be expected to manage its monetary strategy in such a manner as to support the equity market until it starts developing its own momentum.

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 few years since the financial crisis and before the financial crisis. As we expect the Rand to weaken further, for the more speculative investor 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 9.76 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. Resource stocks, having been in the doldrums since their peak in May 2008, should also offer buying opportunities despite our expectation of muted global commodity prices. 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 the investor should start moving towards a more balanced structure of foreign equity versus local equity. Since pension fund members would generally hold the major portion of their other assets locally, the pension fund asset allocation should preferably maximise its offshore allocation.

7. Important notice and disclaimer

Whilst we have taken all reasonable measures to ensure that the results reflected herein are correct, Benchmark Retirement Fund and Retirement Fund Solutions Namibia (Pty) Ltd do not accept any liability for the accuracy of the information and no decision should be taken on the basis of the information contained herein before having confirmed the detail with the relevant portfolio manager. The views expressed herein are those of the author and not necessarily those of Benchmark Retirement Fund or Retirement Fund Solutions.