Volume 10, No. 03,
March 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MARCH 2014

By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

1. Review of Portfolio Performance

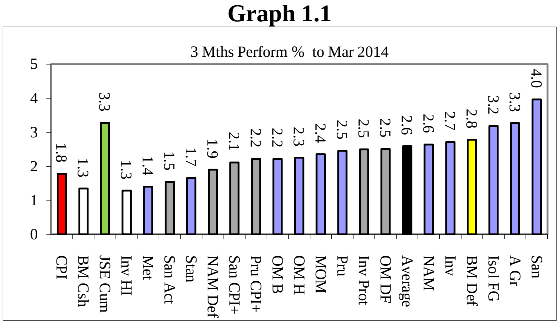
In **March** the **average prudential balanced portfolio** returned 0.86% (February: 2.06%). Top performer is Investment Solutions (1.92%), Metropolitan (-0.19%) takes the bottom spot. For the 3 month period Sanlam is top performer outperforming the 'average' by roughly 1.4%. On the other end of the scale Metropolitan underperformed the 'average' by 1.2%.

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.

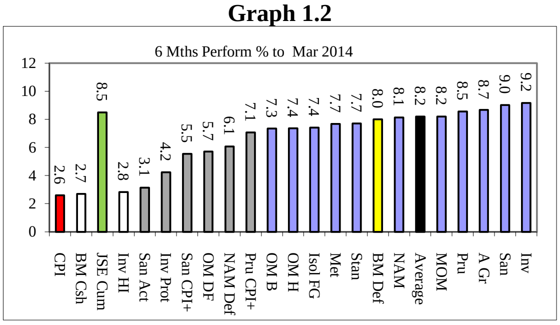
Below is the legend to the abbreviations reflected on the graphs:

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)

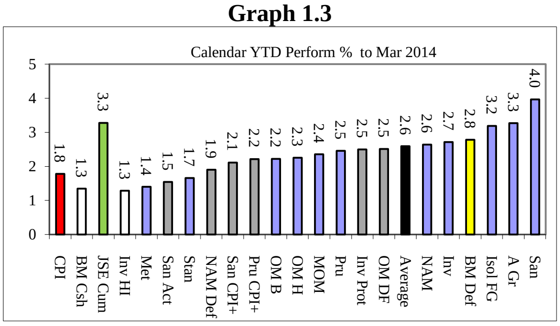
Graph 1.1



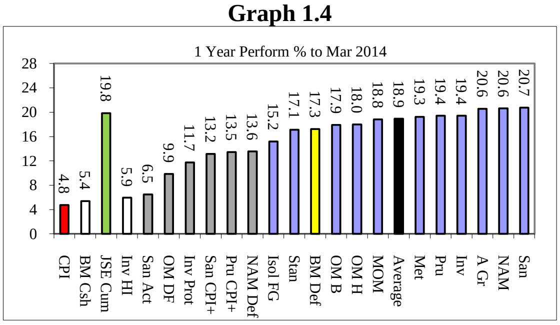
Graph 1.2



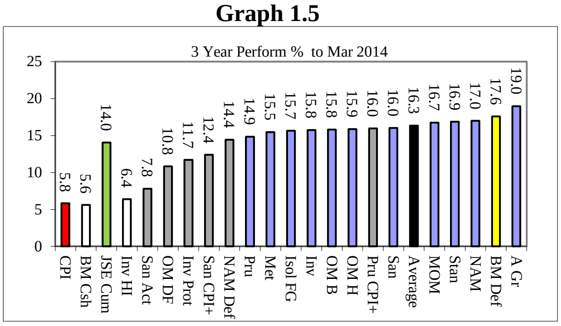
Graph 1.3



Graph 1.4



Graph 1.5



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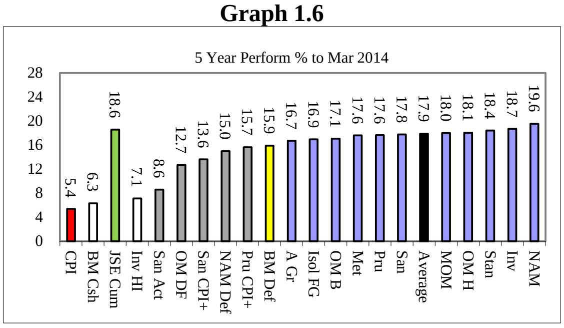
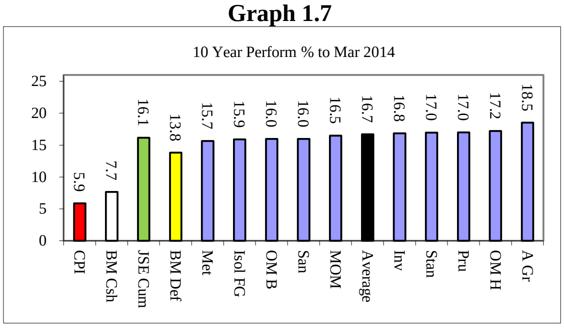
Graph 1.6

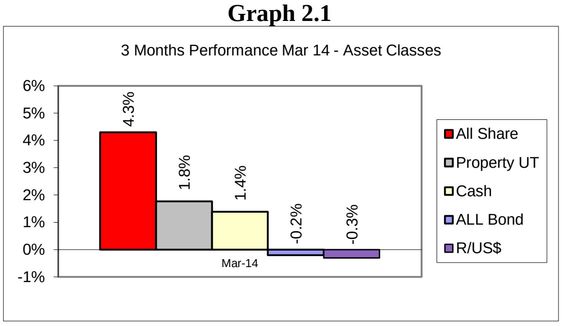


Graph 1.7

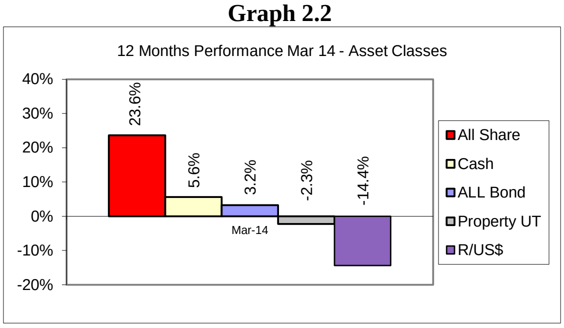


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

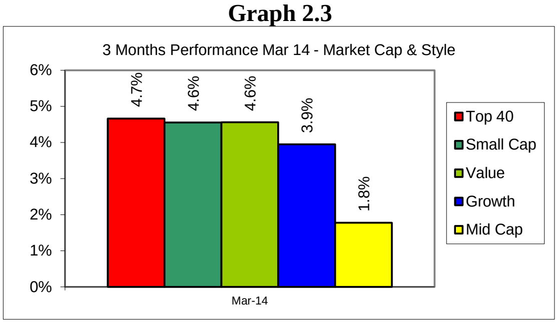
Graph 2.1



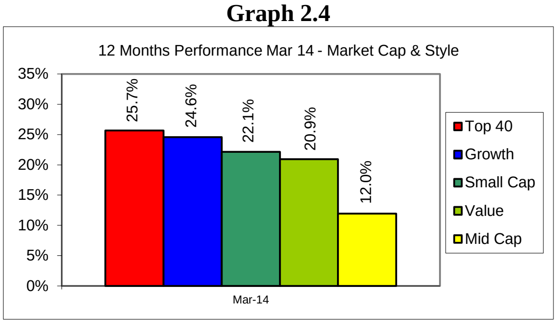
Graph 2.2



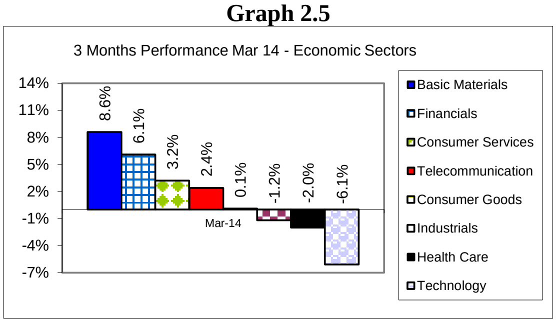
Graph 2.3



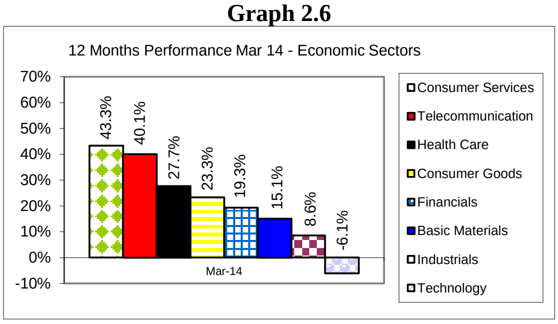
Graph 2.4



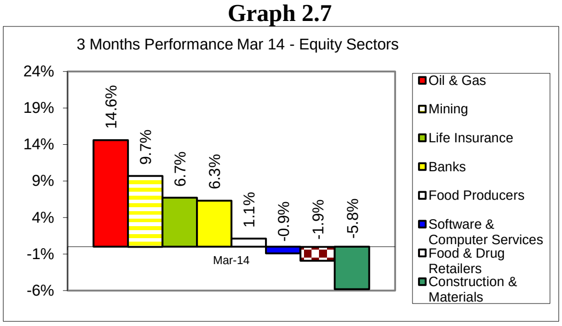
Graph 2.5



Graph 2.6



Graph 2.7



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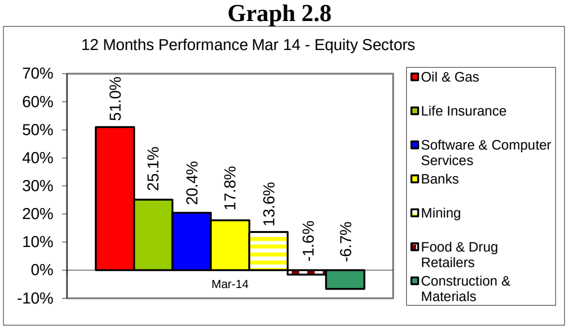
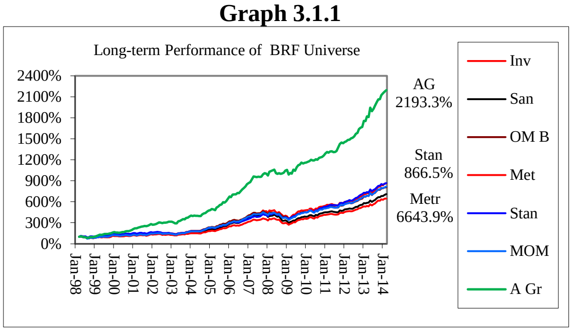
Graph 2.8



3. Portfolio Performance Analysis

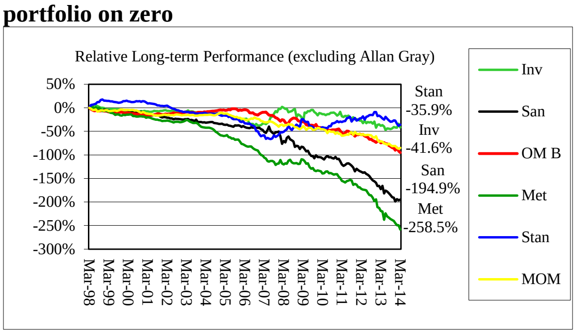
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

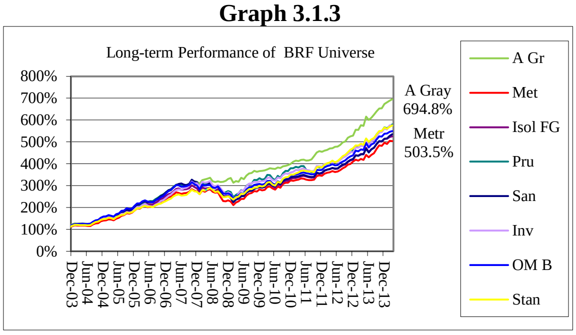


Graph 3.1.2

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

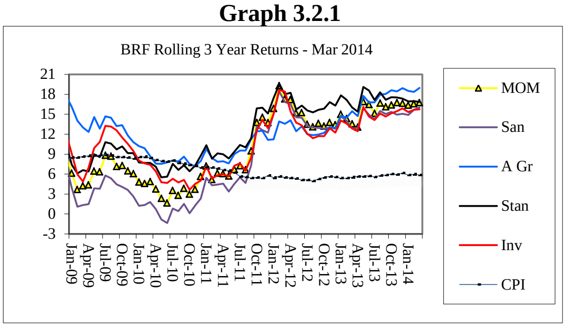


Graph 3.1.3

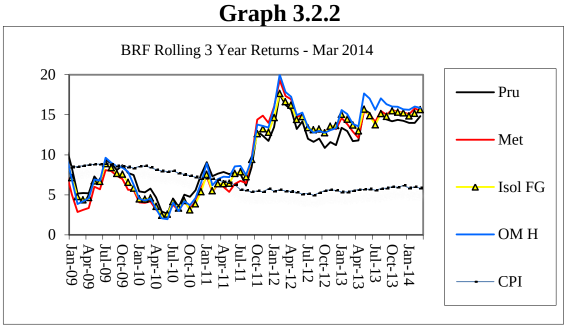


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

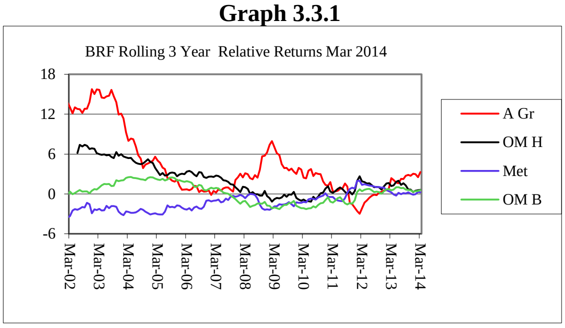


Graph 3.2.2

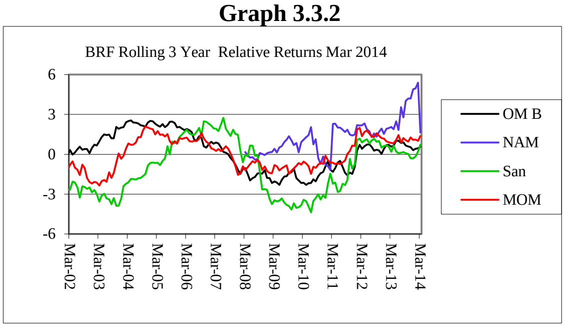


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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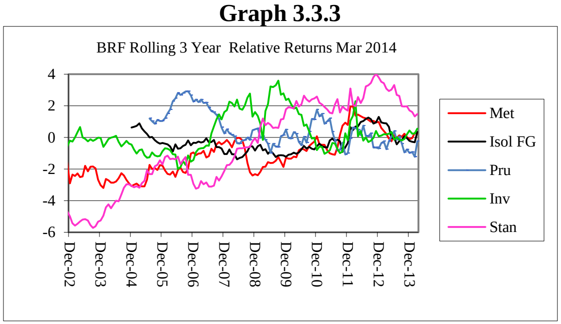
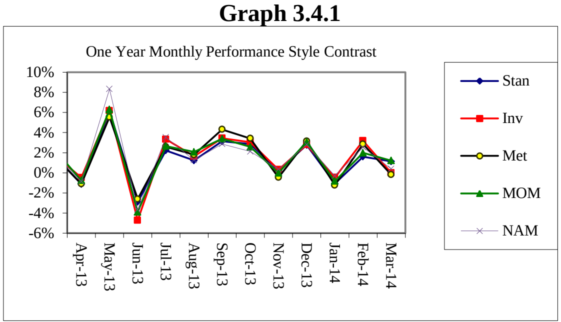
Graph 3.3.3

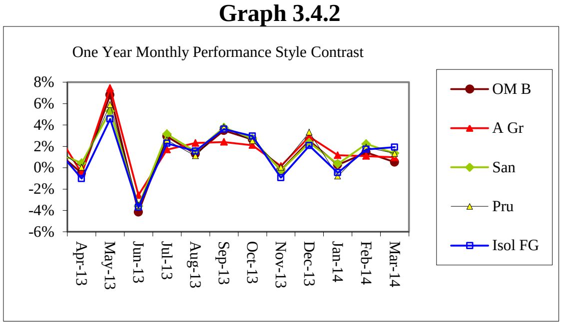


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

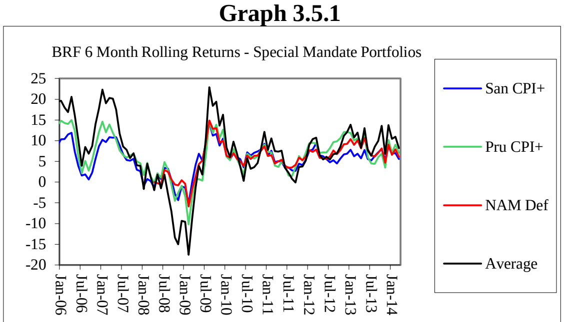


Graph 3.4.2

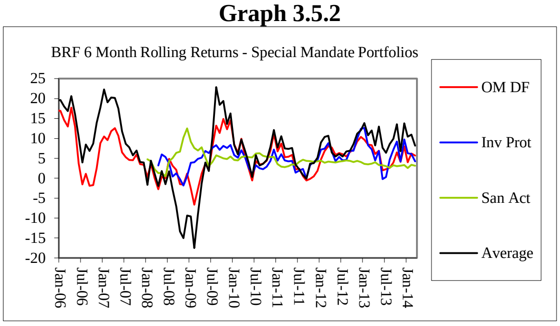


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

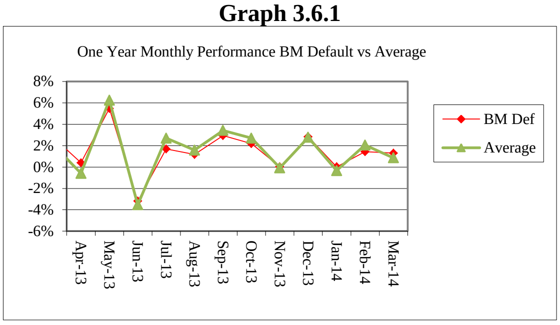


Graph 3.5.2

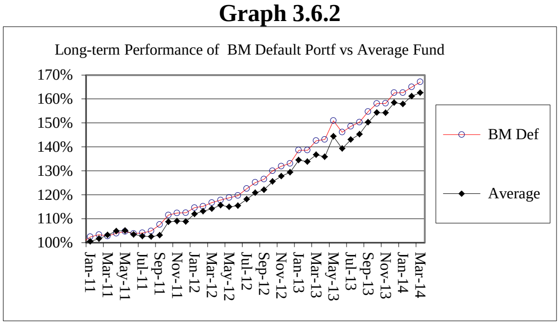


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

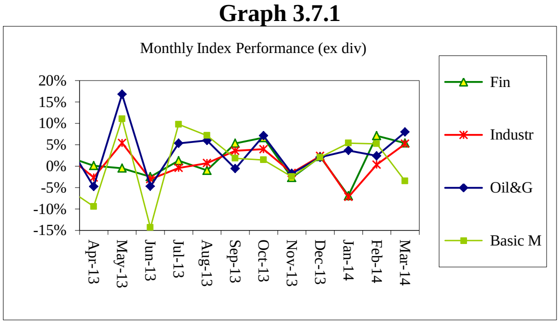


Graph 3.6.2



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

Graph 3.7.1



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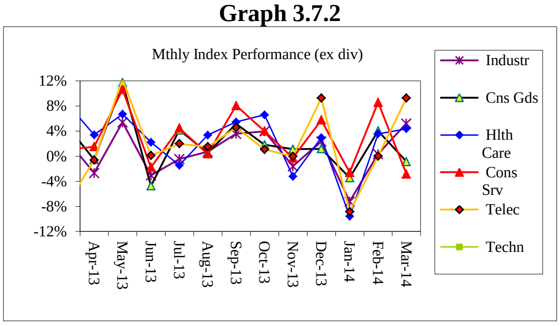
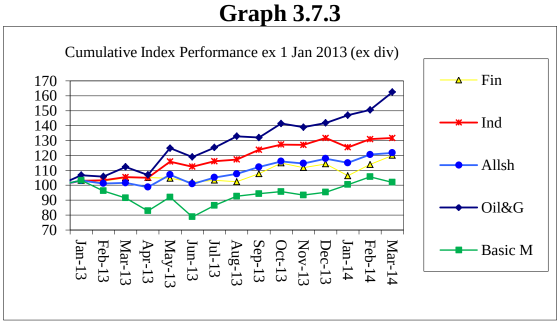
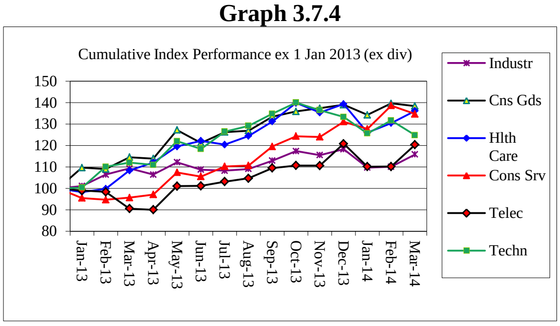
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 17.9% p.a. in nominal terms, or 12.5% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 15.9% p.a. in nominal terms, or 10.5% 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 (47.7% vs. 62.1% of the average prudential balanced portfolio, as at the end of December 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 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 the Allan Gray Investment Trust, we would in the long-term 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 noticeably. Since this change was effected, the default portfolio returned a cumulative 52.1% compared to 49.5% for the average prudential balanced portfolio over this 39 month period.

Relative to the default portfolio, the performance of the prudential balanced portfolios should be more volatile due to a significantly higher equity exposure and its performance should be much closer correlated to that of the overall equity market. The default portfolio should produce a significantly more volatile performance than the money market portfolio. The table below presents one year performance statistics over the 3 years April 2011 to March 2014:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	9.9%	7.4%
Best annual performance	6.6%	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	5.8%	17.0%	16.2%

The Benchmark Default portfolio is a more conservative investment portfolio 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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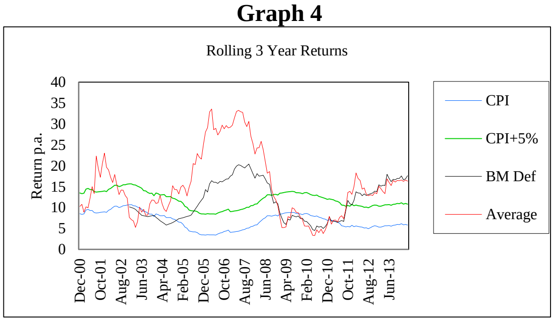
Graph 4



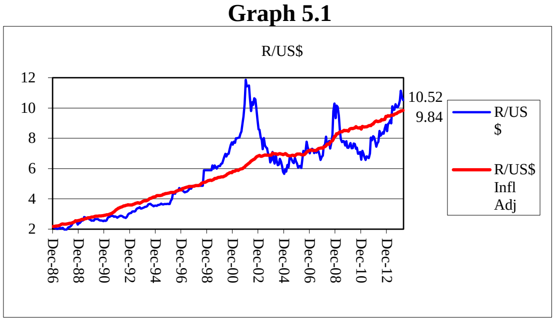
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 17.6%, the average on 16.3% vs CPI plus 5% currently on 10.8%.

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 9.84 to the US Dollar while it actually stood at 10.52 at the end of March. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

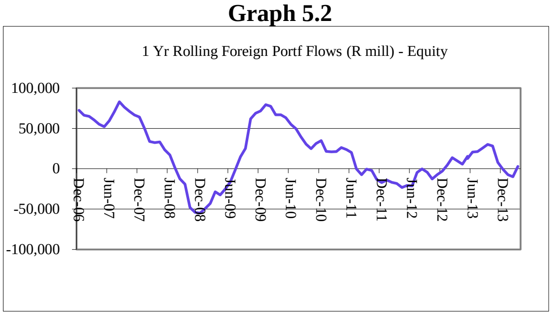
Graph 5.1



Rand strengthens through foreign capital inflows

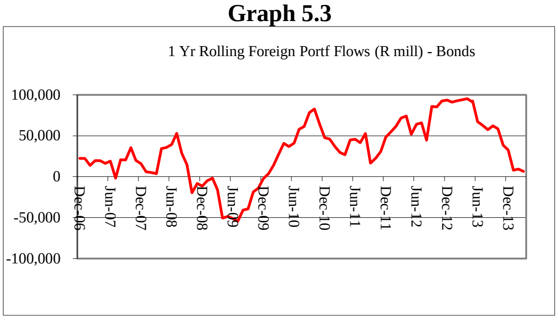
Graph 5.2 reflects a positive flow of capital into South African equities on a rolling one year basis, with a net inflow of R 2.8 bn on a year-on-year basis at the end of March (outflow of R 10 bn to end February). Since the beginning of 2006, foreign net investment in equities amounts to R 175 bn (end February R 168 bn). This represents roughly 1.57% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects an increase of foreign portfolio flows into bonds of R 6.6 bn over the past 12 months to end of March (R 9.3 bn over the 12 months to end of February). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 241 bn (to February just over R 233 bn).

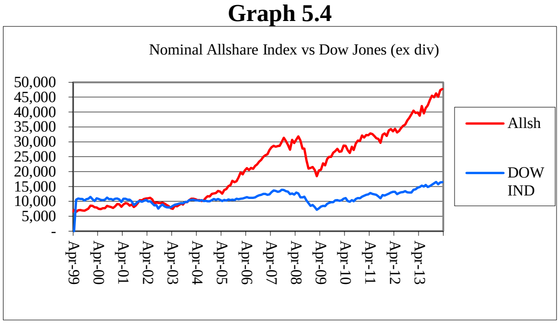
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was R 9.4 bn for the 12 months to end March 2014 (outflow of R 0.7 bn to end February 2014), compared to R 100.8 bn for the 12 months to end March 2013 (R 106.5 bn to end of February 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 417 bn (February R 400 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 3.0% per year, over a period of almost 15 years, dividends excluded. Namibian inflation over this period was 6.8% per year in contrast with US inflation of 2.3%.

Graph 5.4



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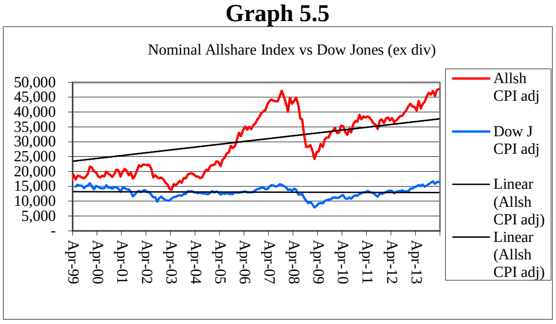
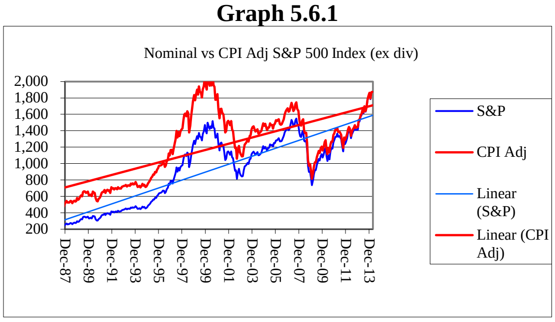
Graph 5.5 reflects the same statistics but adjusted for US and SA inflation respectively. Since May 1999 the JSE Allshare Index has grown by 7.1% per year above inflation, over this period of almost 15 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW only managed to keep pace with inflation over this period, also excluding dividends.

Graph 5.5

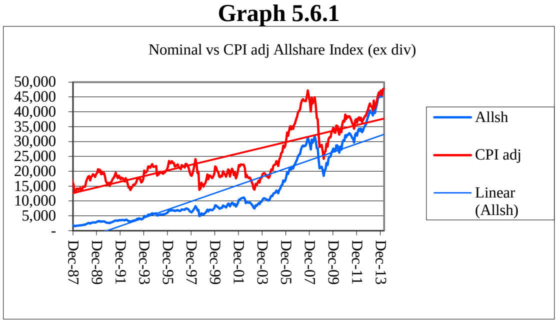


Graphs 5.6.1 and 5.6.2 reflect the more representative S&P 500, and the JSE Allshare Index since the start of 1988 in nominal terms, adjusted for indigenous inflation, with trendlines for for these.

Graph 5.6.1

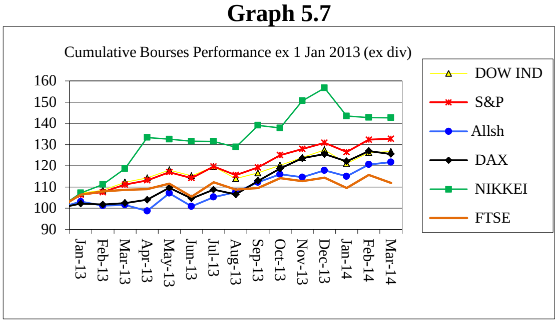


Graph 5.6.1



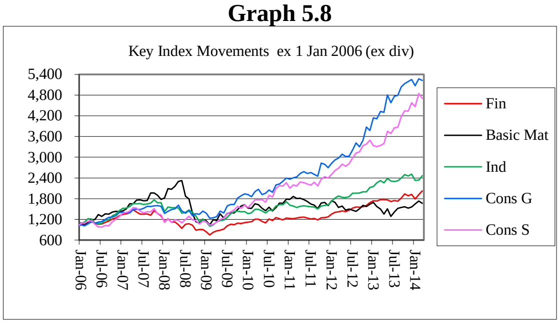
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the S&P 500 as the top performing share indices.

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

The uncertainty in global investment markets as a consequence of the policy of the US Federal Reserve, has largely subsided. It's now essentially 'back to business'. This is borne out by the appreciation of the Rand versus the US Dollar by 3% from its trough of 10.73 at the end of February to its current level of around 10.4. By our measure, the Rand at that level is still under-valued, fair value being at 9.84.

Interest rates in the US are still extremely low and money is still pumped into the system on a large scale through the Fed's asset purchase programme, even though this has been reduced from a peak US$ 80 billion per month to now 'only' around US$ 65 billion. This is still a lot of money made available on excessively easy terms, representing around 5% of US GDP, for every 12 months it continues. To put this into a Namibian perspective, it would be like the Bank of Namibia pumping around N$ 7 billion into our financial system every 12 months, to raise its total assets by one third in the coming year!

The implications of this policy of the Fed have been felt in global financial markets since January 2009, are still felt evidently and will continue to be felt for a while. The FTSE JSE Allshare and the S&P 500 indices both raced up by close to 18% per annum, excluding dividends, the

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SA dividend yield currently being at 2.7%. Investors in equities will clearly be delighted about these returns. Interestingly, over the past 12 months the MSCI developed market index returned 16.9%, compared to minus 3.9% for the MSCI emerging market index and a superior performance of the FTSE/JSE ALSI's return of 3.9% relative to its emerging market competitors. These returns are in US Dollars.

Both the S&P 500 and the SA Allshare indices are currently on a one year trailing P:E ratio of around 18. In the case of the latter this is not far off its 26 year peak at 19.4 in May 1994. In contrast the S&P 500 P:E's 26 year peak was 37 in August 2002. Benchmarking against their 26 year trend lines, the SA ALSI P:E is currently around 20% over-priced, while the S&P 500 P:E is around 45% under-priced.

As mentioned in the previous commentary, the growth in the SA Allshare index, adjusted for inflation is now on par with its peak just before the financial crisis struck and is about 30% above its trend line, measuring from a normalised starting point at the beginning of 1988, a 26 year period! The trend line implies a growth in real terms of roughly 3.5% per annum, excluding dividends (nominal growth has been 13% per annum). Contrasting this with the S&P 500, its current level, inflation adjusted, is around 10% above trend line, which implies a growth of 4.5% per annum in real terms, excluding dividends (nominal growth has been 7.5% per annum). In real terms the US market has thus out-performed the SA market by 1% per annum.

If the South African market is currently priced at 30% above its 26 year trend line, while its P:E ratio is 20% above its trend line, it implies that company profits are around 8% above trend line. The US market being priced at 10% above trend line, with a P:E ratio at 40% below its trend line implies that US company profits are around 50% above trend line.

This analysis tells us that both the South African and the US equity markets are in risky territory where the likelihood of profits and valuations declining to normal levels is substantial, more so in the US than in SA though. These markets are undoubtedly powered by monetary policy measures of central banks in the developed world.

Investors in fixed interest instruments however, find themselves on the opposite end of the scale, having had to cope with very low real interest rates. Most notably these investors are pensioners who are in no position to manipulate their returns anymore.

Since the SA economy is commodity based, these contributing around one-third of its GDP, the trend in global commodity prices should also impact noticeably on the local equity market. These are in turn impacted significantly by what is happening in China, which has been the largest importer of a number of base minerals over the past number of years. China is in the process of adapting its economic policies away from its previous export focus. As a result, there will be little support of a return of global commodity prices to previous levels and consequently little support of the Rand from that source.

While central bank policy intervention persists interest rates will remain low and equity markets will continue to thrive. Foreign portfolio flows into developing markets should support the currencies of these markets for the next 12 months and we should thus see a slightly stronger Rand, no tailwinds for the Rand to be expected from global commodity prices.

This environment should give a fair clue of what investors should expect of financial markets over the next 12 months. It favours offshore diversification and equity over fixed interest investments. As pent-up consumer demand starts to unravel slowly, we should see consumers starting to borrow to spend again. This trend should continue to favour the financial and the industrial sectors relative to the consumer goods and services and basic materials sectors.

7. Important notice and disclaimer

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