Volume 10, No. 04,
April 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 APRIL 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

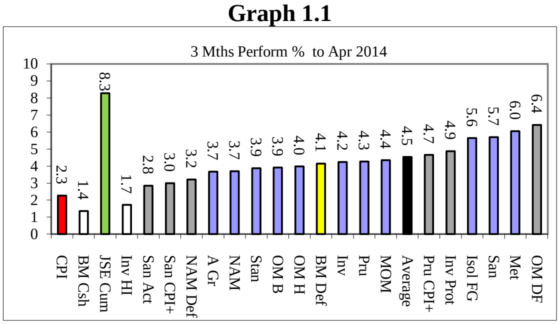
In **April** the **average prudential balanced portfolio** returned 1.36% (March: 0.86%). In a turn of tables, Sanlam, for once in a long time takes top spot (2.02%), while Namibia Asset Managers (0.73%) has taken up the bottom spot. For the 3 month period Metropolitan is top performer outperforming the 'average' by roughly 1.5%. On the other end of the scale Allan Gray underperformed the 'average' by 0.8%.

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.

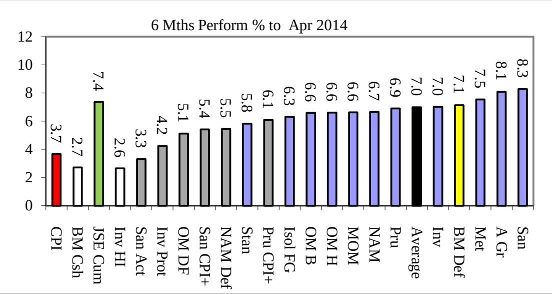
Below is the legend to the abbreviations reflected on the graphs:

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)

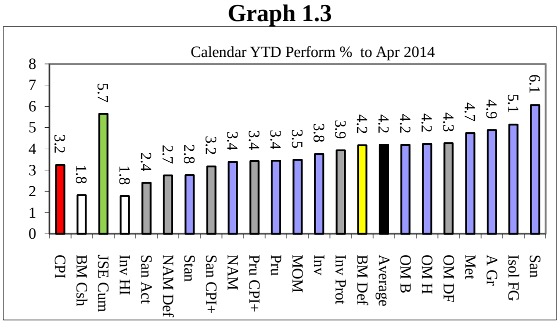
Graph 1.1



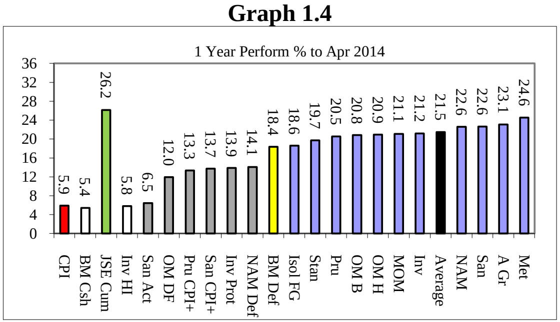
Graph 1.2



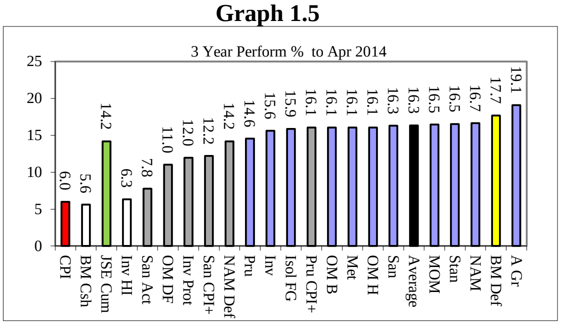
Graph 1.3



Graph 1.4



Graph 1.5



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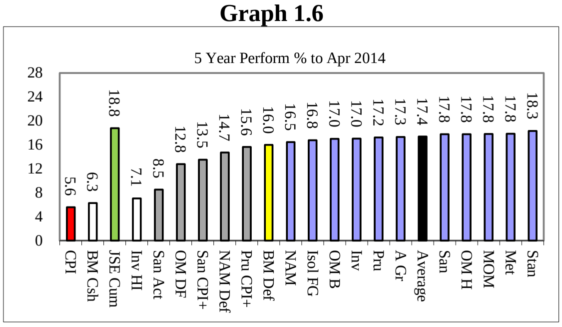
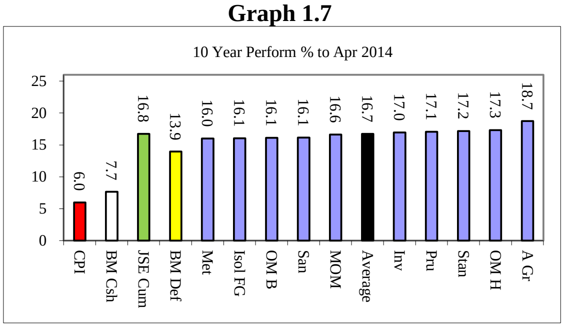
Graph 1.6

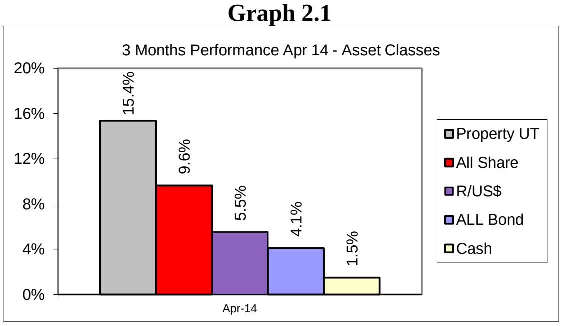


Graph 1.7

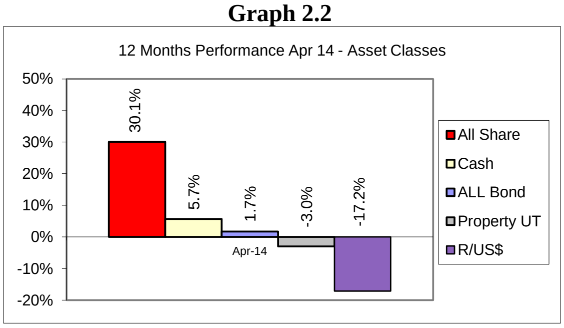


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

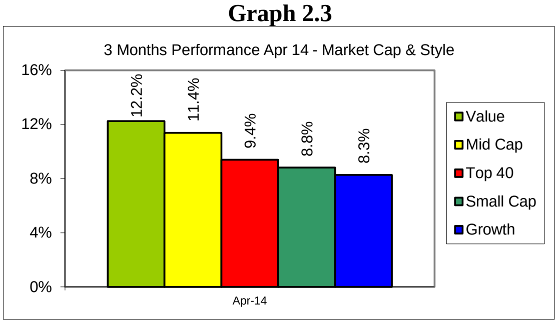
Graph 2.1



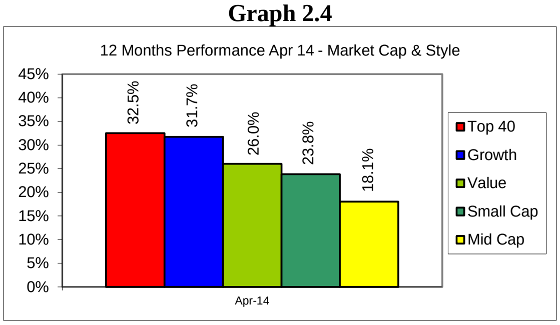
Graph 2.2



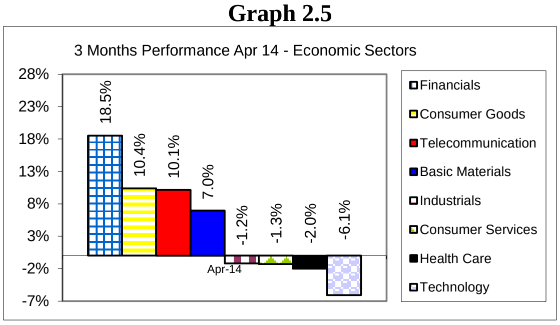
Graph 2.3



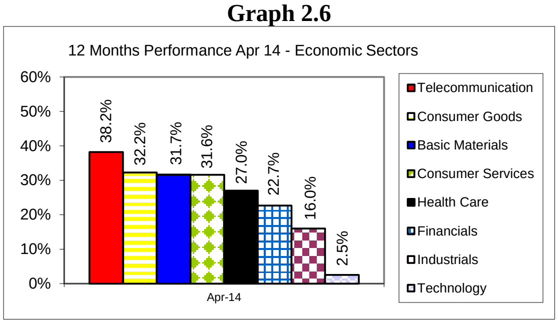
Graph 2.4



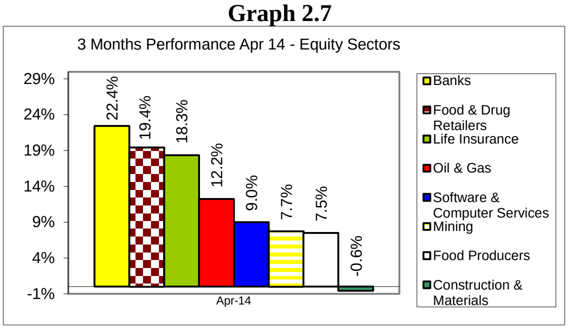
Graph 2.5



Graph 2.6



Graph 2.7



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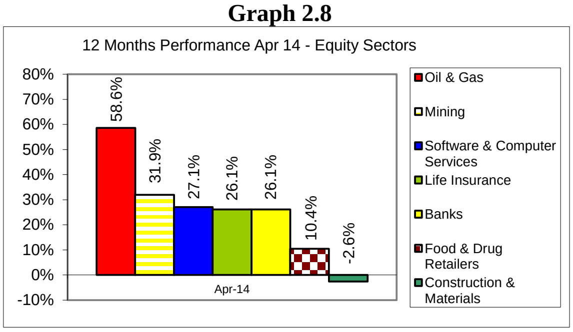
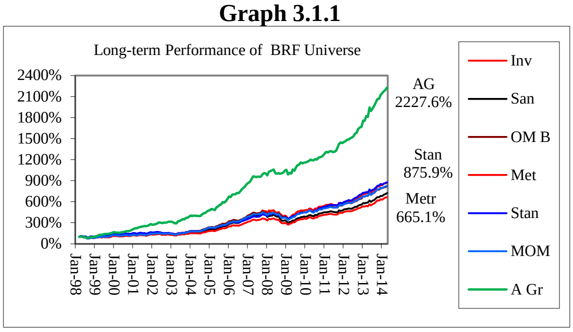
Graph 2.8



3. Portfolio Performance Analysis

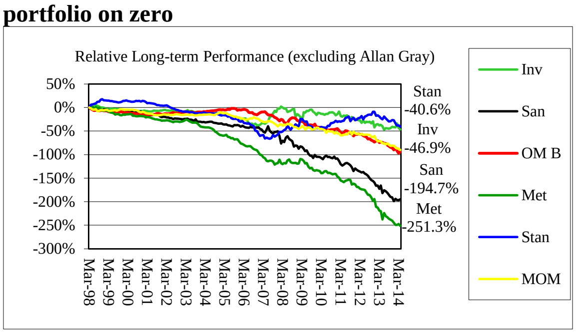
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

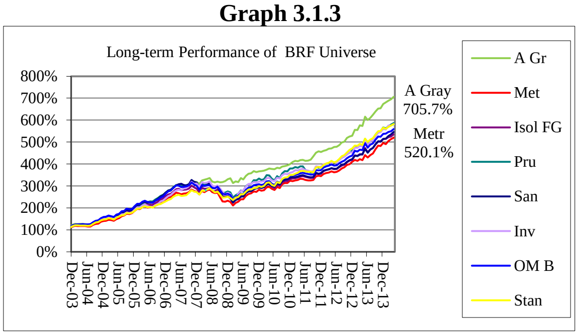


Graph 3.1.2

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

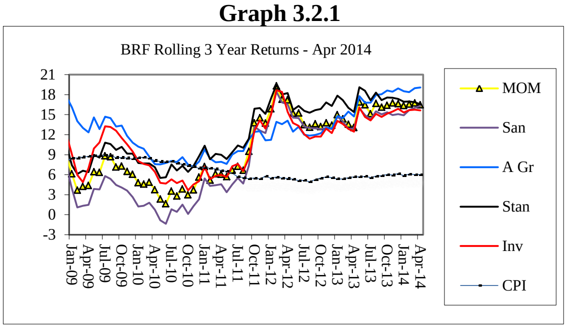


Graph 3.1.3

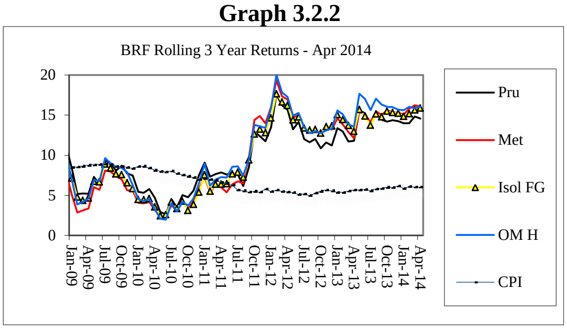


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

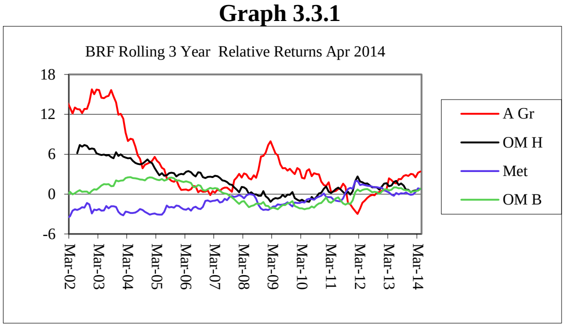


Graph 3.2.2

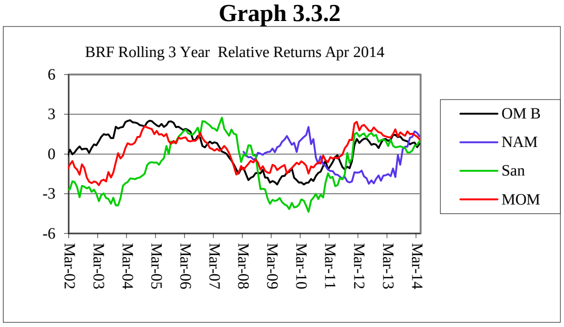


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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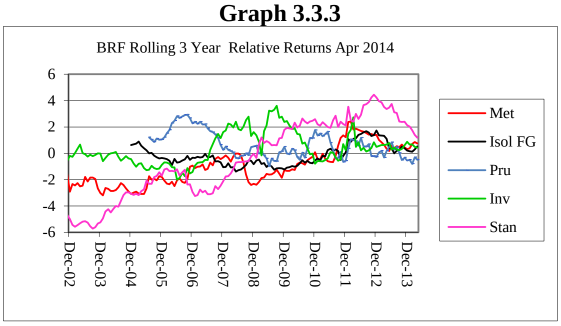
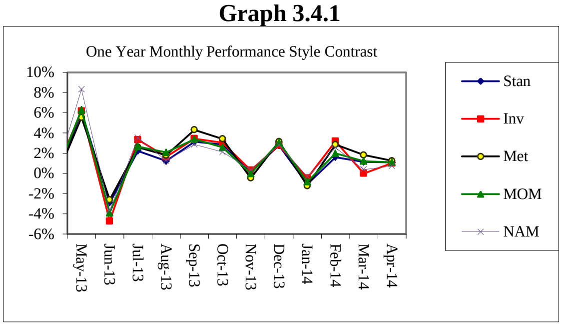
Graph 3.3.3

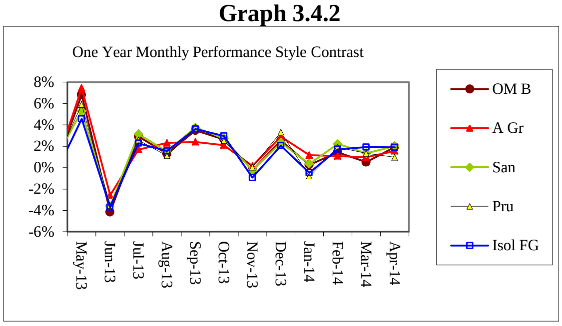


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

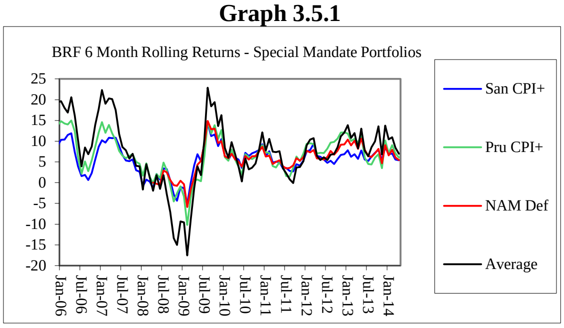


Graph 3.4.2

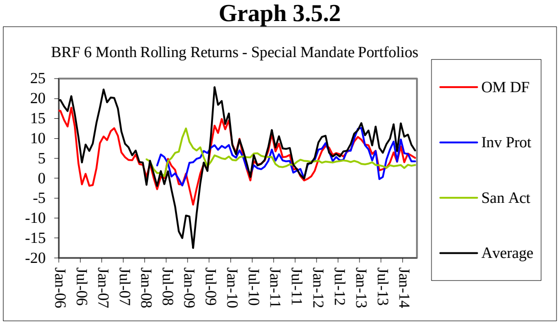


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

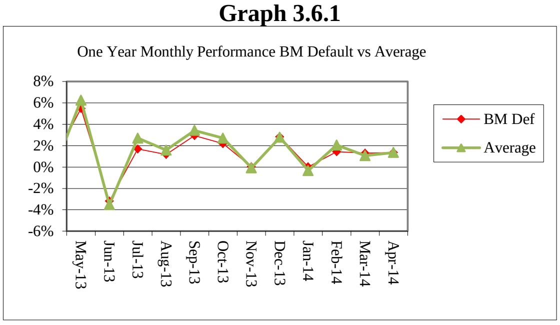


Graph 3.5.2

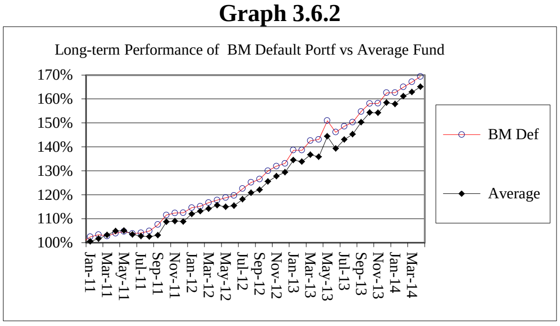


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

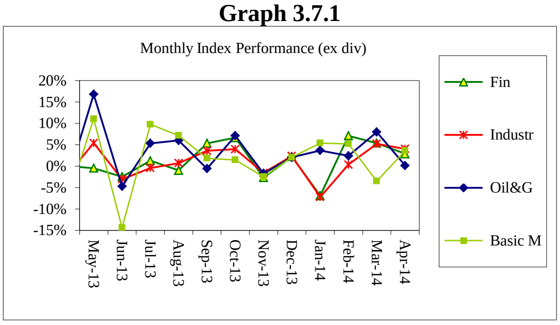


Graph 3.6.2



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

Graph 3.7.1



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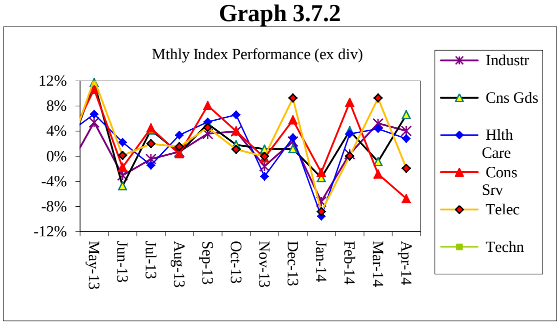
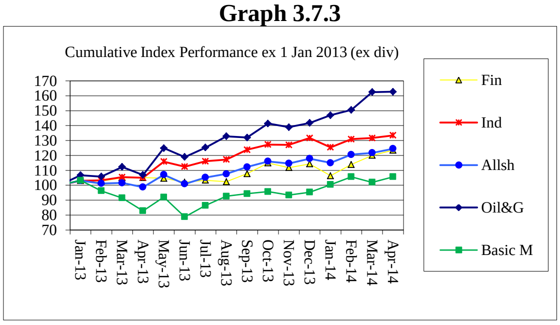
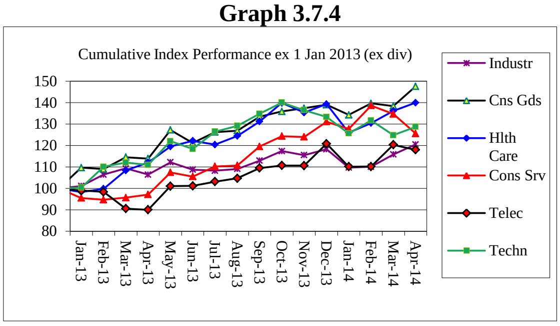
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 17.4% p.a. in nominal terms, or 11.8% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 16.0% p.a. in nominal terms, or 10.4% 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 (48.9% vs. 60.5% of the average prudential balanced portfolio, as at the end of March 2014) 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 Namibia Unit 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 53.5% compared to 49.8% for the average prudential balanced portfolio over this 40 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 May 2011 to April 2014:

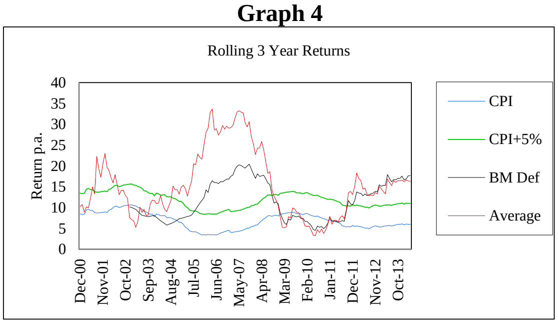
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	9.9%	6.1%
Best annual performance	6.5%	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	5.7%	17.2%	16.0%

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.

Graph 4



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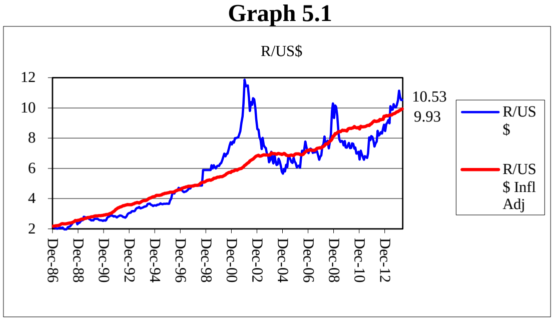
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 17.7%, the average on 16.3% vs CPI plus 5% currently on 11.0%.

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 9.93 to the US Dollar while it actually stood at 10.53 at the end of April. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

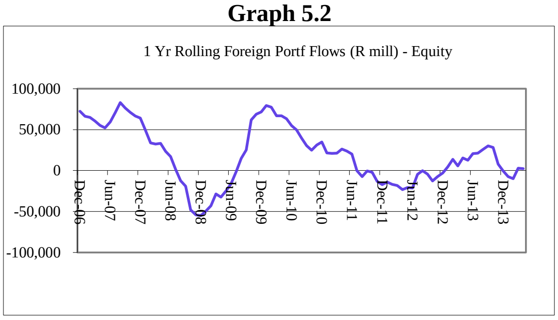
Graph 5.1



Rand strengthens through foreign capital inflows

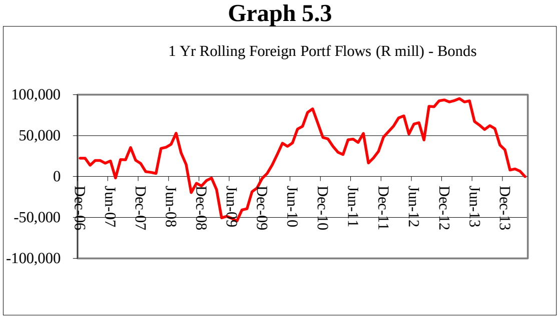
Graph 5.2 reflects a positive flow of capital into South African equities on a rolling one year basis, with a net inflow of R 2.3 bn on a year-on-year basis at the end of April (outflow of R 2.8 bn to end March). Since the beginning of 2006, foreign net investment in equities amounts to R 185 bn (end March R 175 bn). This represents roughly 1.61% 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 flows into SA bonds to a mere R 0.2 bn over the past 12 months to end of April (R 6.6 bn over the 12 months to end of March). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 245 bn (to March just over R 241 bn).

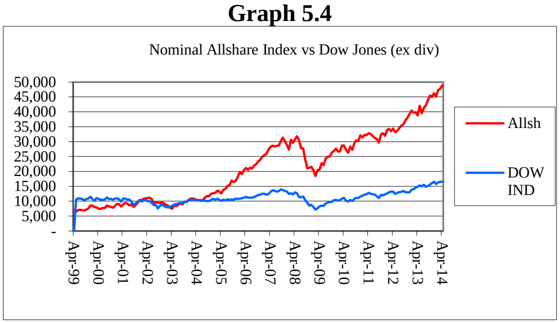
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was R 2.1 bn for the 12 months to end April 2014 (inflow of R 9.4 bn to end March 2014), compared to R 106.5 bn for the 12 months to end April 2013 (R 100.8 bn to end of March 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 430 bn (March R 417 bn).

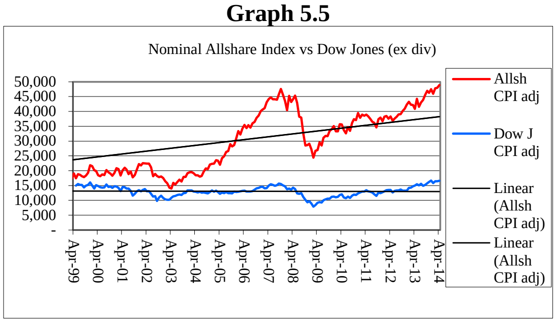
Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms, the JSE grew by 14.4% per year, while the DOW Jones only grew by 3.0% per year, over a period of 15 years, dividends excluded. Namibian inflation over this period was 6.8% per year in contrast with US inflation 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 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



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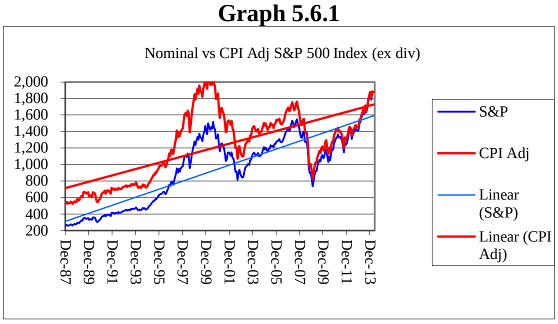
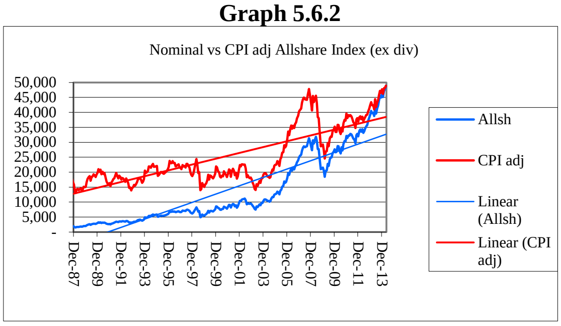
Graphs 5.6.1 and 5.6.2 reflect the more representative S&P 500 and the JSE Allshare Index since the start of 1988 in nominal terms, adjusted for indigenous inflation, with trend lines for these.

Graph 5.6.1

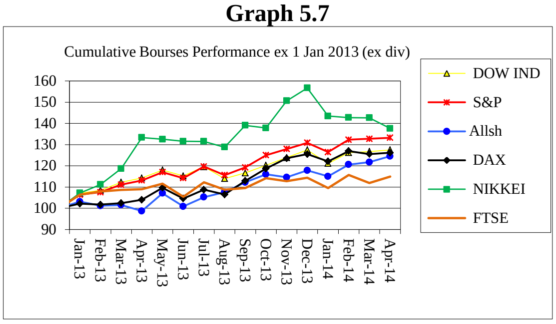


Graph 5.6.2



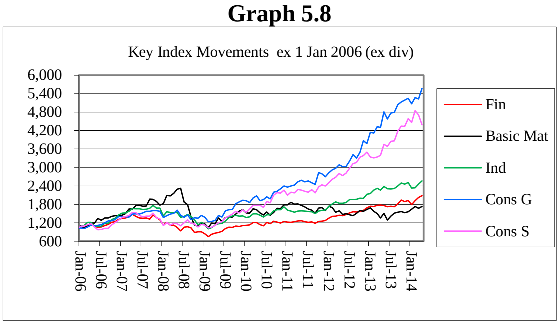
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the S&P 500 as the top performing share indices.

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

Our performance ranking for the 3 months ended 30 April displays a significant change of fortunes of the various managers from just 3 months ago. Under performing managers Metropolitan, Sanlam and Investment Solutions now take top spots while out performing managers Allan Gray and Namibia Asset Management take bottom spots. This begs the question – what has changed in the market?

Comparing various indicators of 3 months ago with the latest ones over a 3 month period in each case, Listed Property was the worst performing asset class (-10%) while it is now the top performing asset class (15.4%). Top performing asset class previously was Bonds (1.5%), while it is now the worst performing asset class after cash (4.1%). Equities previously returned -0.6% compared to 9.6% for the latest 3 month period.

Within the various economic sectors of equities, Basic Materials was the top performing sector (4.9%) while it is now a 'middle of the road' performing sector (7%). Worst performing economic sector previously was Technology (-9.8%). It remained in that position the last 3 months (-6.1%). Top performing economic sector this time is Financials (18.5%), which was previously one of the worst performing sectors (-7.1%).

Within the various equity sectors, Banks (22.4%) and Food and Drug Retailers (19.4%) are the two top performing sectors, while in January 2014 Food and Drug Retailers was the worst performing sector (-16%), Banks occupying third lowest position (11.2%).

As far as global interest rates are concerned, 10 year bonds rates generally reduced marginally over the past 3 months. Over the 3 months to end January 2014, foreign 10 year bond rates had moved up marginally, while the SA rate had moved up noticeably from 7.67% to 8.79%.

Looking at foreign equities, in US$, developed market equities as measured by the MSCI returned 0.2% while emerging market equities as measured by the MSCI returned -9.2% for the 3 month period to 31 January 2014. For the 3 months ended 30 April 2014, developed market equities returned 6.4% compared to 6.9% of

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

emerging market equities.

So while the fortunes of local equity markets improved nicely over the past 3 months, within equities there was a major turnaround in fortunes between different sectors and the fortunes of Listed Property from 3 months ago.

From 3 months ago where the Rand depreciated by 10.9% over 3 months, it has appreciated by 5.5% over the past 3 months. This was largely the result of foreigners moving back into local investment markets - the SA trade balance not having changed much over these two 3 month periods producing a negative trade balance of around R 30 billion over both periods. Over the past 3 months foreign portfolio flows into equities and bonds amounted to R 42.5 billion compared to an outflow of R 61.7 billion over the 3 months to end of January 2014.

As we commented in the previous newsletter, the uncertainty in global investment markets as a consequence of the policy of the US Federal Reserve has subsided and it is now 'back to business' for the global investor community. The result of the turnaround in investor sentiment has evidently also resulted in the turnaround of fortunes of the various portfolio managers as depicted in the 3 month performance ranking graph.

The question now is whether the past 3 months are an indicator of what to expect over the next 12 to 36 months? Will we see the Rand strengthening further and interest rates declining as the result of foreign investment flows, inflation declining and equities continuing to steam ahead?
At this stage, signs are that the US economy is ever so slowly starting to improve, while Europe and China still show little signs of an improvement in their economies. Capital is still pumped into the financial system, less so by the US Fed, but more so by the ECB and the Bank of Japan. The outcome of this colossal first time experiment in monetary policy intervention is difficult to foresee.

The more risk averse investor will remain cautious given the distortion prevailing in global investment markets, while the less risk averse investor will believe that the outcome of the monetary policy intervention will be positive and will invest aggressively in equities.

Our view is that financial markets will have to normalize. What investor in his right mind will accept a negative real interest rate on his fixed interest investment other than under duress? So what is forcing investors to accept negative real interest rates? This is largely the result of the 'save haven' notion of investing in the US, for one, occasioned by its economic and military power but also because of the fact that global trade is mostly denominated in US Dollar.

This status of the US will not change soon although nature dictates that those on the receiving end of continuous pressure will not rest until they have found a way to evade and to overcome the pressure. In the mean time, one will have to work with the realities. These are that interest rates will remain very low to negative for some time, as the result of which investment capital will continue to flow into other asset classes and into developing countries, in search for yield.

At current debt levels an increase in interest levels by 1%, would require the US economy to grow at 4% per annum over 8 years or at 3% per annum over 11 years, for the US government to absorb the interest rate increase without it impacting negatively on its fiscal position. An increase in inflation will of course also achieve the result of the economy growing, if at nominal values only. This should give a fair indication of the time frame over which and the pace at which interest rates in real terms, may drift upwards in the US.

Accepting that the US will 'call the shots' we are thus also likely to see low real interest rates locally for some time to come. This will support the Rand and equities.

An analysis of the S&P 500 versus the JSE Allshare indices in our previous newsletter concluded that SA and US company earnings are 8% and 50%, respectively, above their 26 year trend line. Despite high earnings, South African and US equities are priced at 30% and 8%, respectively, above their 26 year trend line.

On that basis, both the South African and the US equity markets are in risky territory. The likelihood of profits and valuations declining to normal levels is substantial, more so in the US than in SA though. These markets are clearly powered by monetary policy measures of central banks and this will be the case for some time.
In the light of the above analysis, equities remain the asset class to be overweight globally. Offshore diversification spreads investment risk and the current exchange rate offers the opportunity to do so. As consumer demand in the developed world starts to gain traction slowly, we should see consumers in developed economies starting to borrow to spend again. In developed markets offshore this should benefit the consumer sectors, and the financial sectors. Locally, the consumer sectors had a terrific run over the past couple of years. We believe there is not much room for these sectors to move higher and favour the financial and the industrial sectors relative to the consumer goods and services and basic materials sectors.

7. Important notice and disclaimer