Volume 10, No. 09,
September 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 SEPTEMBER 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

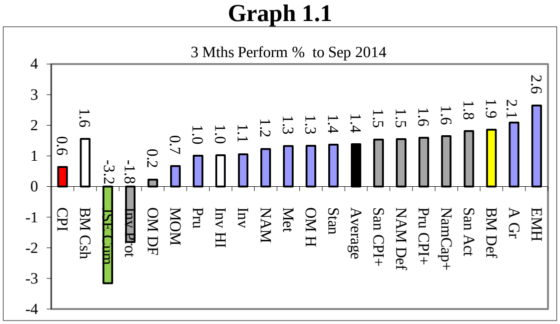
In **September** the **average prudential balanced portfolio** returned 0.25% (Aug: 0.29%). Top performer is Allan Gray (1.23%); while Namibia Asset Management (-0.58%) takes the bottom spot. For the 3 month period EMH Prescient takes top spot for the second consecutive month, outperforming the 'average' by roughly 1.3%. On the other end of the scale Momentum underperformed the 'average' by 0.7%.

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 Balanced Fund.

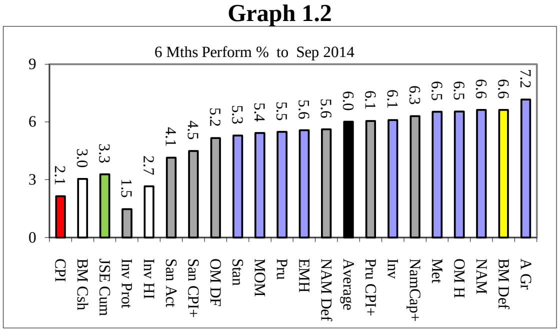
Below is the legend to the abbreviations reflected on the graphs:

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 Linked	San CPI+ (grey)
NAM Capital Plus	NamCap+ (grey)
NAM Coronation Balanced Def	NAM Def (grey)
Market related portfolios	
Allan Gray Balanced	A Gr (blue)
EMH Prescient Balanced Absolute	EMH (blue)
Investec Managed	Inv (blue)
Prudential Managed	Pru (blue)
Metropolitan Managed	Met (blue)
NAM Prudential Balanced	NAM (blue)
Old Mutual Pinnacle Profile Growth	OM H (blue)
Momentum Managed	MOM (blue)
Stanlib Managed	Stan (blue)

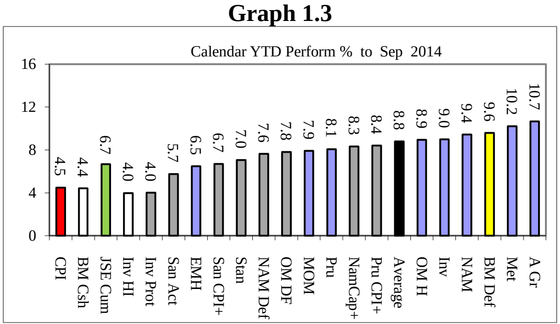
Graph 1.1



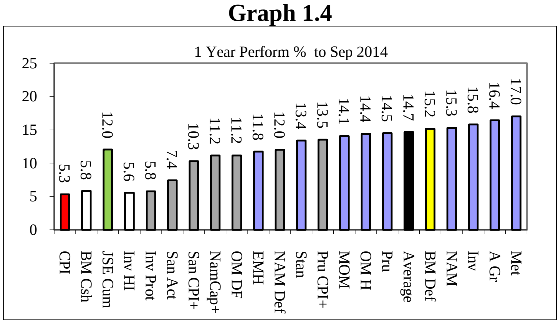
Graph 1.2



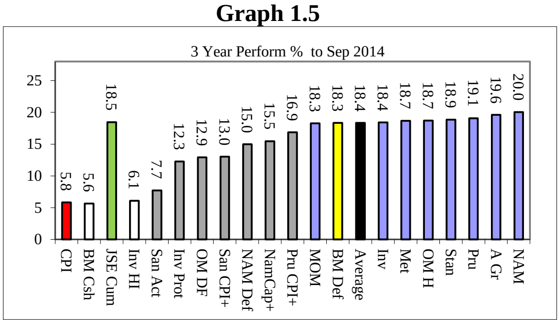
Graph 1.3



Graph 1.4



Graph 1.5



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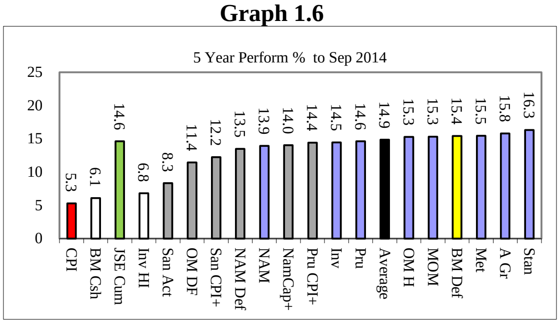
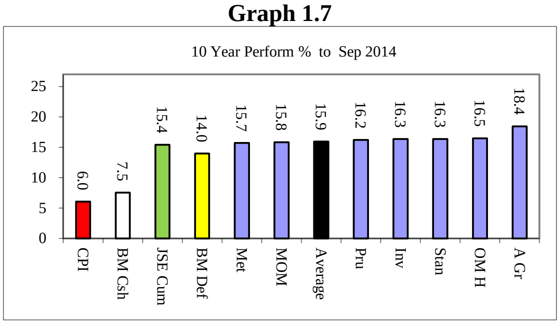
Graph 1.6

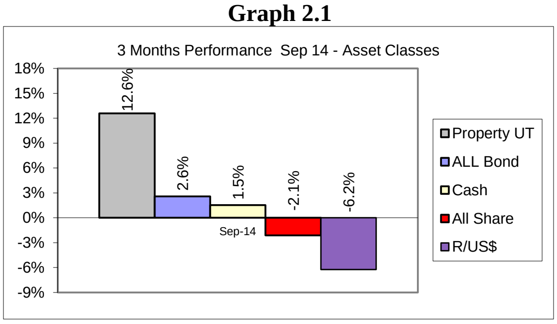


Graph 1.7

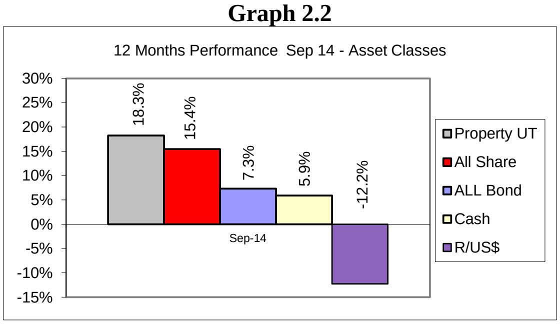


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

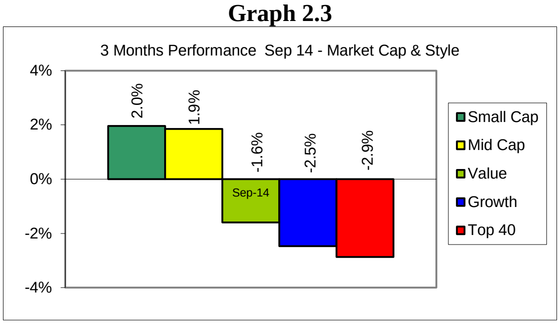
Graph 2.1



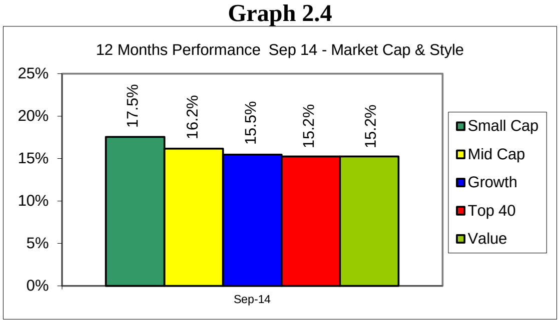
Graph 2.2



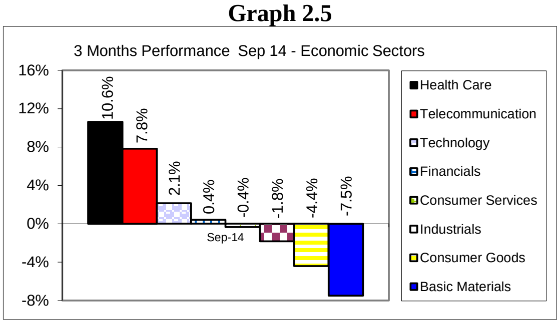
Graph 2.3



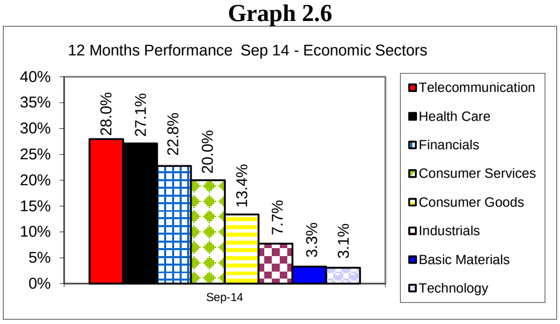
Graph 2.4



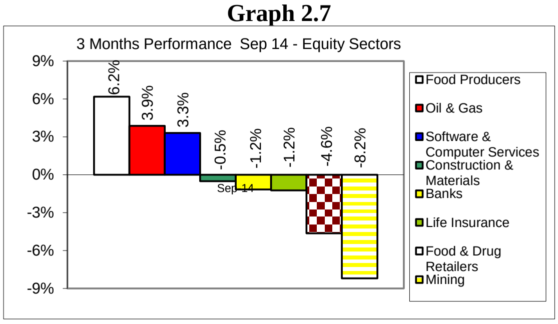
Graph 2.5



Graph 2.6



Graph 2.7



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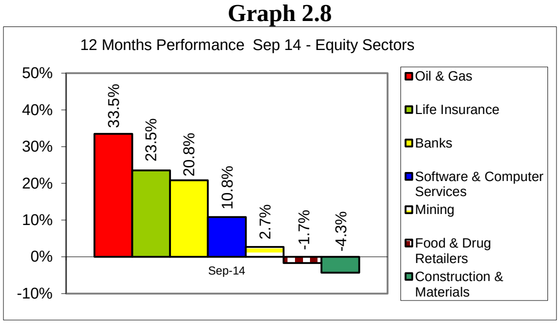
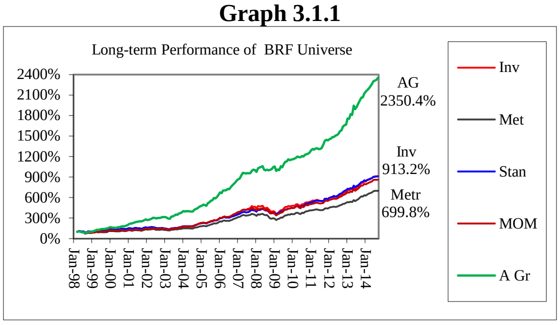
Graph 2.8



3. Portfolio Performance Analysis

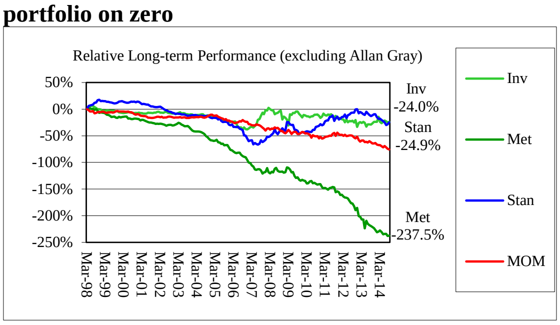
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

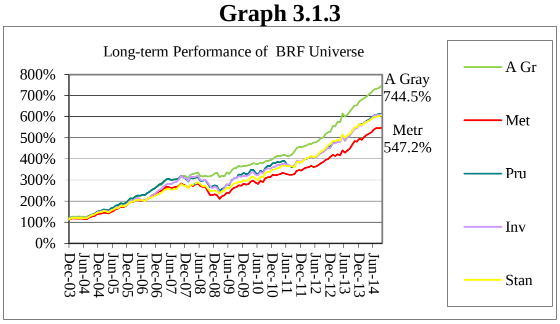


Graph 3.1.2

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

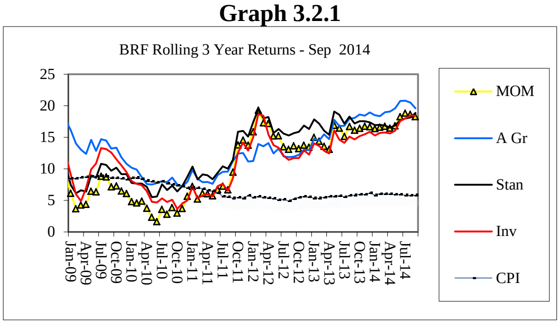


Graph 3.1.3

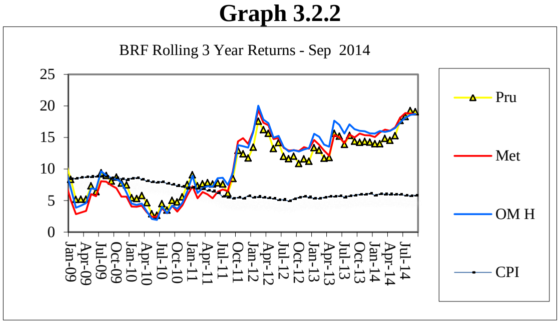


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

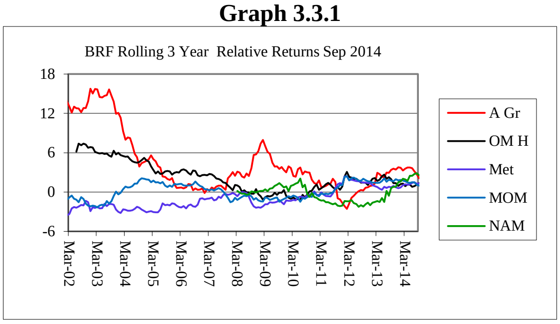


Graph 3.2.2

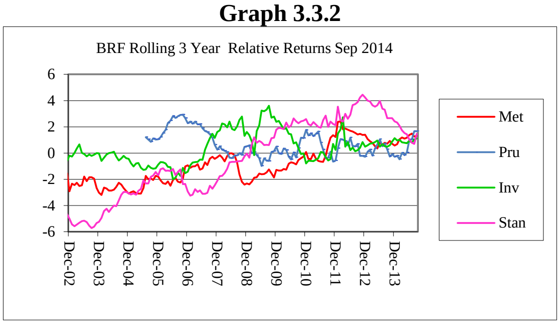


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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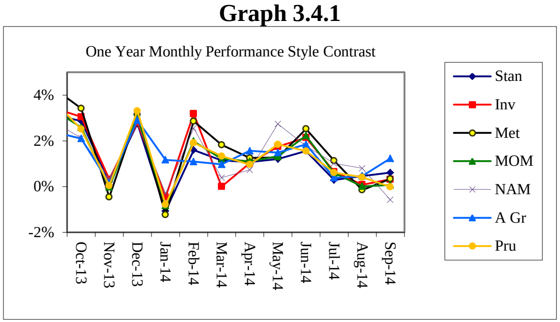
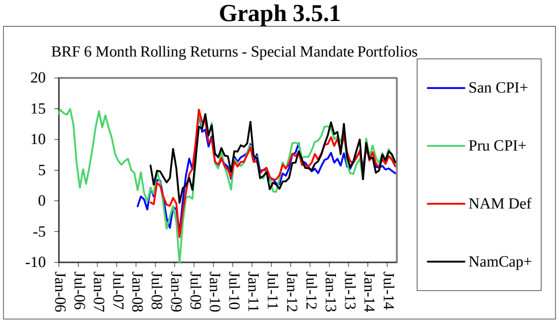
3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

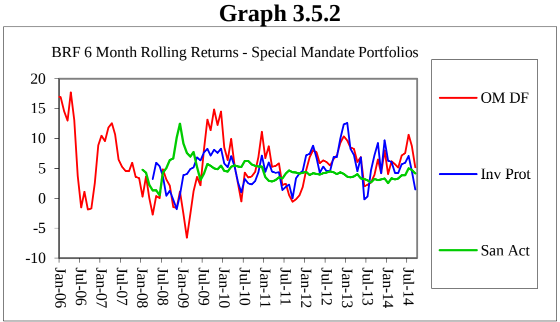


3.5. 6-month rolling returns of ‘special mandate’ portfolios

Graph 3.5.1

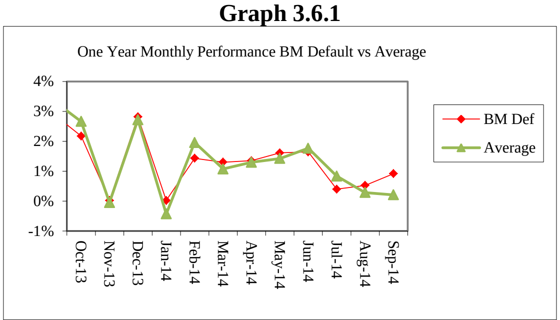


Graph 3.5.2

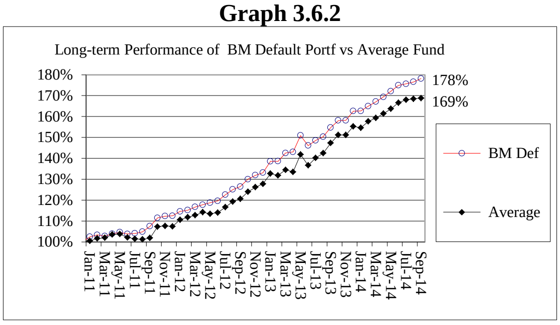


3.6 Monthly and cumulative performance of ‘Benchmark Default’ portfolio relative to average prudential balanced portfolio

Graph 3.6.1

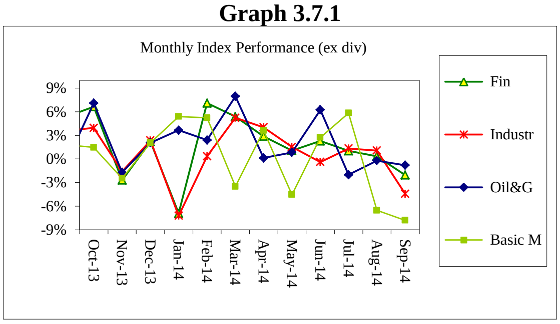


Graph 3.6.2

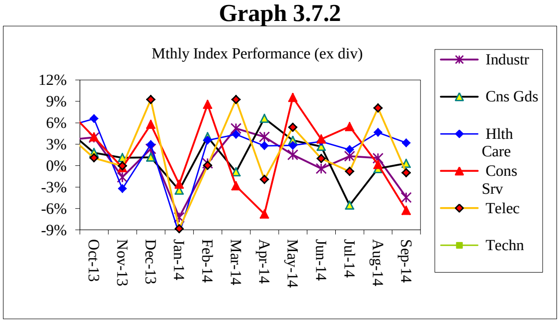


3.7 One year monthly performance of key indices (excluding dividends)

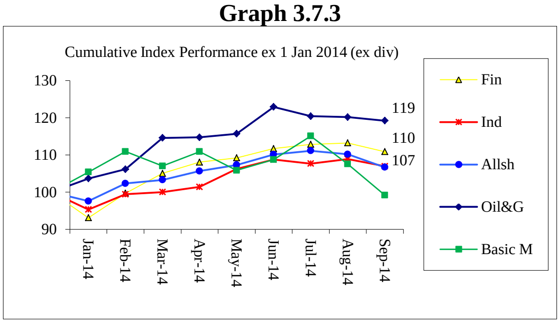
Graph 3.7.1



Graph 3.7.2



Graph 3.7.3



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Graph 3.7.4

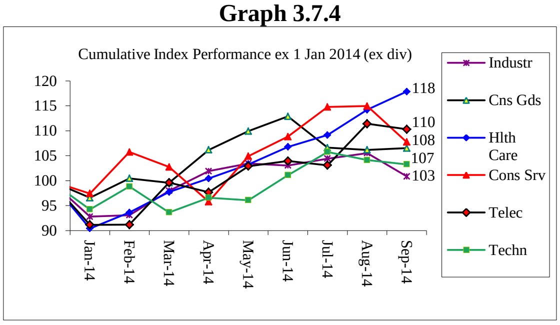


Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	11.5%	7.4%
Best annual performance	6.0%	27.1 %	25.0 %
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	5.6%	17.9%	16.7%

4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 14.9% p.a. in nominal terms, or 9.6% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 15.4% p.a. in nominal terms, or 10.1% 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 (47.8% vs. 59.6% of the average prudential balanced portfolio, as at the end of June 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.

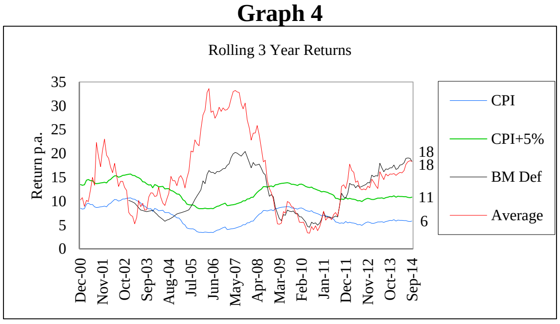
Having raised the risk profile of the Default portfolio effective the start of 2011, by replacing Metropolitan ARF with the Allan Gray Namibia Unit Trust, we would in the long-term expect the Default portfolio to sacrifice around 1% return for the benefit of lower volatility compared to the average prudential 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 78.2% compared to 68.9% for the average prudential balanced portfolio over this 45 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 October 2011 to September 2014:

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



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 18.4%, the average on 18.4% 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 9.97 to the US Dollar while it actually stood at 11.29 at the end of September. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

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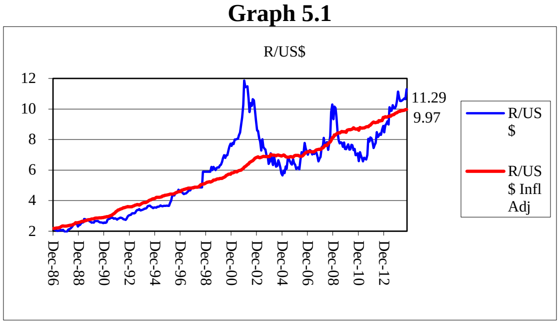
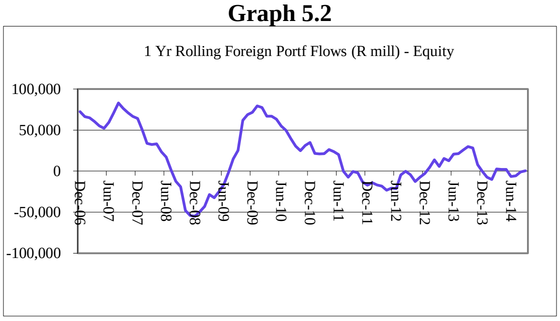
Graph 5.1



Rand weakens with foreign capital outflows

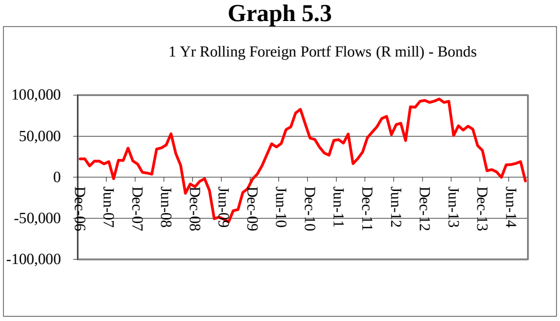
Graph 5.2 reflects a flow of capital out of South Africa on a rolling one year basis, with a net inflow of R 0.4 bn on a year-on-year basis at the end of September (outflow of R 0.9 bn to end August). Since the beginning of 2006, foreign net investment in equities amounts to R 196 bn (end August R 195 bn). This represents roughly 1.7% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis reflects foreign portfolio outflows in respect of SA bonds of R 4.4 bn over the past 12 months to end of September (inflow of R 19.0 bn over the 12 months to end of August). Since the beginning of 2006, foreign net investment in bonds amounts to R 251.5 bn (to August just over R 260 bn).

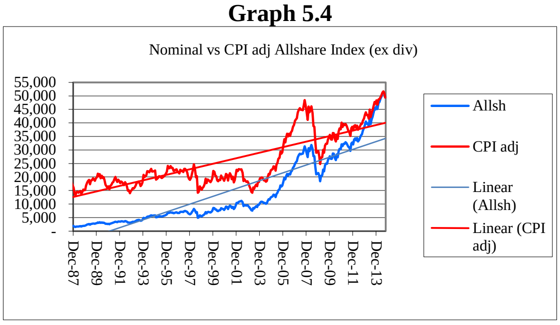
Graph 5.3



The net outflows of foreign capital from equity and fixed interest assets was R 4.1 bn for the 12 months to end September 2014 (inflow of R 18 bn to end August 2014), compared to R 92 bn for the 12 months to end September 2013 (R 83 bn to end of August 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 448 bn (August R 455 bn).

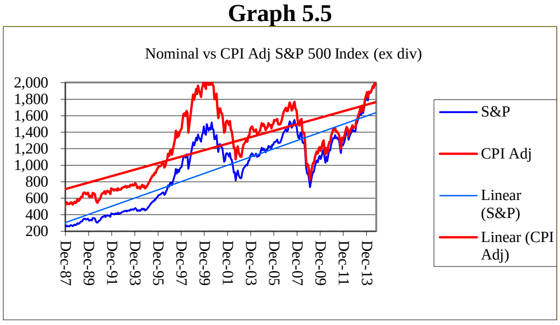
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal terms, adjusted for indigenous inflation, with trend lines for these. In nominal terms, the JSE grew by 12.3% per year since January 1987, and this excludes dividends of somewhere in the region of 2% to 4%. Namibian inflation over this period was 8.6% per year. This is equivalent to a growth in real terms of 3.7% p.a. over this period.

Graph 5.4



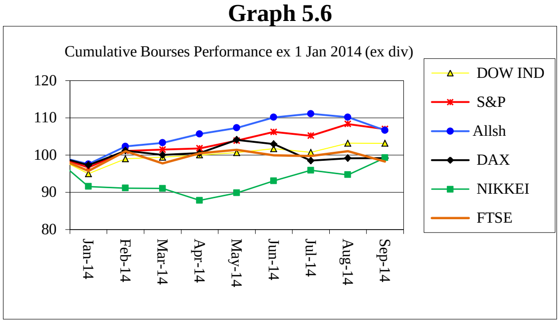
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal terms, adjusted for indigenous inflation, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.4% per, over this period of 27 years. US inflation over this period was 2.8%. This is equivalent to a growth in real terms of 4.6% p.a. over this period.

Graph 5.5



Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Allshare and the S&P 500 as the top performing share indices.

Graph 5.6



Graph 5.7 provides an overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced.

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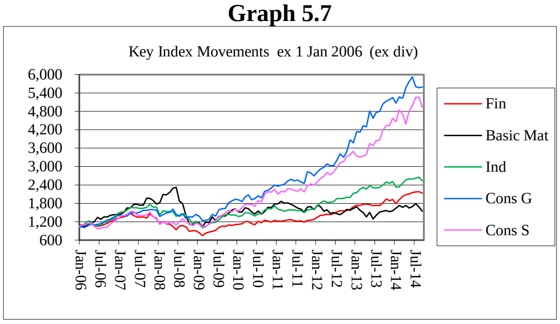
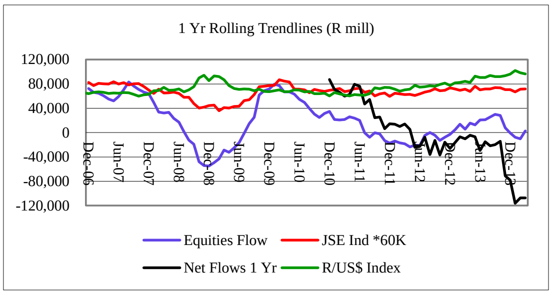
From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals. Annualised returns for these indices since the beginning of 2006 were: Consumer Goods: 21.7%; Consumer Services: 20.0%; Industrials: 11.2%; Financials: 9.1% and Basic Materials: 5.1%.

Graph 5.7



6. **Conclusion**

Our graph of the day below depicts a few interesting trend lines. Firstly, the blue line depicts one year rolling foreign investment flows into equities. Do these flows actually impact the JSE Allshare Index? Tracking the red line which depicts a 'blown up' movement of the JSE Allshare Index relative to the blue line, a close correlation between these two trend lines becomes very evident.



When foreigners withdraw from the JSE the JSE declines and vise versa. Foreigners have evidently withdrawn their support of local equities and have taken a neutral position. Can there be any expectation of this changing soon? Our view is that this is unlikely to change soon and will not be impacted even if the SARB raised its repo rate.

Tracking the black line which depicts the one year rolling total of net foreign equity flows, net foreign fixed interest flows and the SA trade balance against the green line that depicts a 'blown up' movement of the Rand: US Dollar index one can also see a correlation between these two trend lines. A negative black trendline lifts the green trend line, meaning that an outflow of capital weakens the Rand relative to the US Dollar. We can also see a decline of these capital flows since the end of the financial crisis and a virtual collapse since October 2013.

This negative trend has been caused for one by a decline in world commodity market but most likely also by a decline in SA's competitiveness as the result of the strong Rand. The decline in commodity markets was clearly impacted by the financial crisis and since then by reduced demand for commodities from China as the result of it restructuring its economy. The Rand of course has been weakening steadily over the past 4 years.

Can there be any expectation of this to improve? We would expect the sudden collapse in the trade balance to reverse and to it recovering to more normal levels. It is unlikely though that the trade balance will move into positive territory soon. It is also unlikely that global commodity markets will be what they have been before the financial crisis, as the result of the revolution we are currently witnessing in the energy sector.

Our conclusion from this analysis is that the Rand will remain under pressure for some time to come, however we would expect it to recover some lost ground in the short term if the trade balance improves as we would expect it to do. We would expect it to return to around 10 to the US Dollar but to trend weaker with little support from foreign investors.

Any upward movement of interest rates in the US will expedite the demise of the Rand if this is not matched by a significant increase in local interest rates. Such upward movement in the US is imminent although we would expect it to be in very small steps. The SARB will probably pre-empt this, raising the repo rate sooner but in digestible steps.

While the exaggerated weakness of the Rand would dictate not to further diversify offshore until the Rand has recovered meaningfully the steep decline in foreign bourses in October makes up for more than the depreciation of the Rand and supports a strategy of moving to full offshore exposure. Full offshore exposure makes sense on the basis of the expected continued weakening of the Rand and relatively expensive local equities that are likely to under perform foreign bourses in the absence of strong foreign inflows.

Extremely depressed global interest rates have produced generally elevated equity prices across the globe. As the result, the most likely prospect is that this imbalance will start to reverse as we will see the first increases in US interest rates coming through over the next few years. In this adjustment phase it is principally tough to find value in either equity or fixed interest investments.

Having said this, some foreign bourses are still suffering from the financial crisis and should have upward potential. It is those bourses and picking the right stocks that can produce reasonable returns for an investor, probably nowhere close to what we have seen over the past few years. Assets with low exposure to the interest rate risk, high cash flows and dividend yields should produce satisfactory returns.

Locally we expect the consumer to suffer as interest rates will continue to drift upwards. From a macro economic perspective the weakening Rand should advantage Rand hedge shares, exporters and manufacturers locally. An investment in depressed foreign economies and bourses should be biased towards the consumer while any investment in stocks on bourses already at high levels should focus on finding value rather than on any particular sector. These expectations would shape our local and foreign asset and sector allocation views.

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.