Volume 4, No. 5, May 2008

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 May 2008

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 now also available on our website at www.rfsol.com.na.

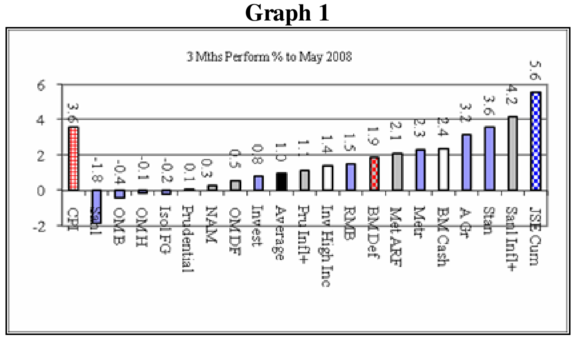
1. Review of Portfolio Performance

In May the average prudential balanced portfolio returned 0.92% (April 1.42%). Best and worst performance **for the month** was delivered by Stanlib (2.07%) and Sanlam (minus 0.82%), respectively.

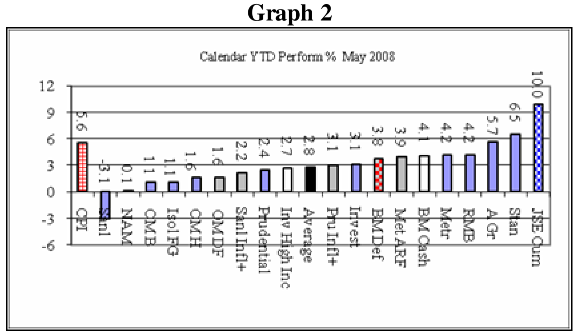
Graphs 1 to 7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential balanced portfolios (black bar) and the CPI (red checked bar). Amongst the prudential balanced portfolios, Allan Gray, Prudential and Sanlam have a value bias, the other are more style neutral portfolios. Benchmark investors should take note of the performance of the default portfolio (red and grey bar), which represents a combination of Prudential Inflation Plus and Metropolitan Absolute Return. Here is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Cons Price Index	CPI Cum
JSE Allshare Index	JSE Cum
Benchmark Default Portfolio	BM Def
Average Portfolio (prudential, balanced)	Aver
Special Mandate Portfolios	
Sanlam Cash	BM Cash (no colour)
Investec High Income (IBA)	Inv High (no colour)
Metropolitan Absolute Return	Metr ARF (grey)
Prudential Inflation Plus	Pru Infl+ (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Sanlam Inflation Plus	Sanl Infl+ (grey)
Namibia Asset Management	NAM (grey)
Market related portfolios	
Allan Gray Balanced	A Gr (blue)
Investec Managed	Invest (blue)
Investment Solutions Focused Growth (multi manager)	Isol FG (blue)
Prudential Managed	Prudential (blue)
Metropolitan Managed	Metr (blue)
Old Mutual Profile Balanced	OM B (blue)
Old Mutual Profile Growth	OM H (blue)
RMB Managed	RMB (blue)
Sanlam Managed	Sanl (blue)
Stanlib Managed	Stan (blue)

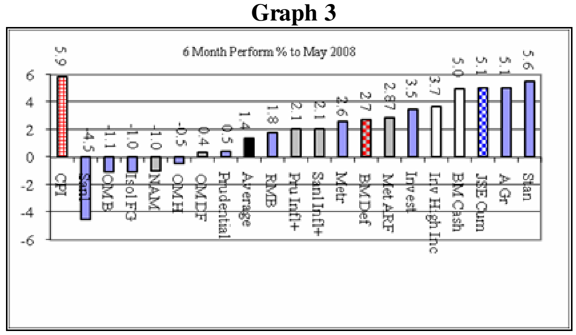
Graph 1



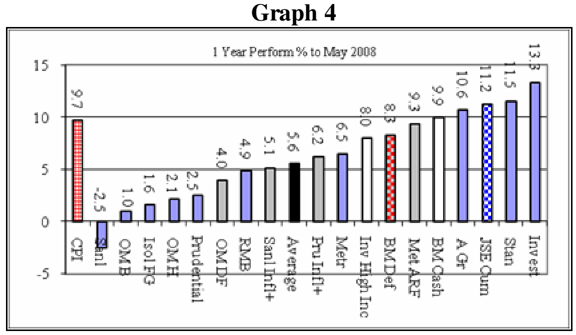
Graph 2



Graph 3



Graph 4



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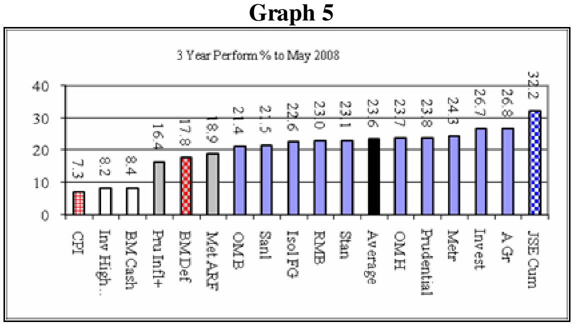
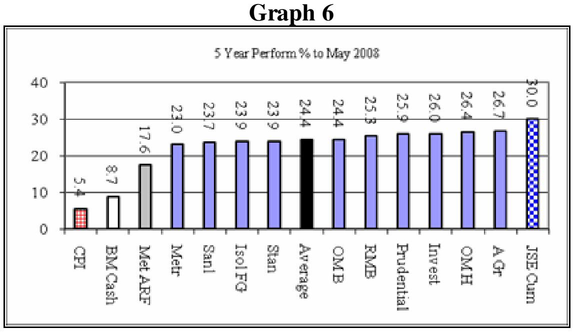
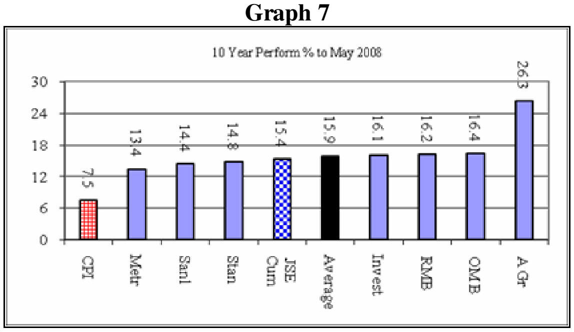
Graph 5



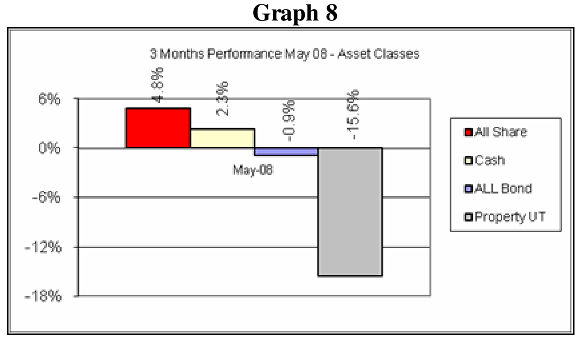
Graph 6



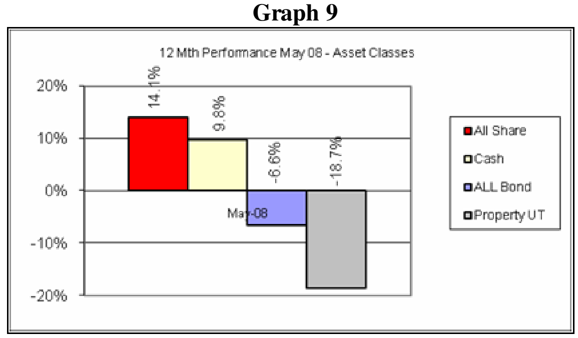
Graph 7



Graph 8



Graph 9

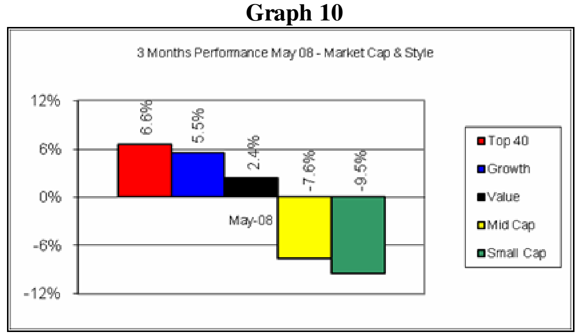


2. **Review of Performance of Key Indices** (index performance by courtesy from pointBreak/Deutsche Securities)

Graph 8 and **graph 9** once again show the same order of asset classes in terms of performance, including dividends, over the quarter and the 12 months. The poor performance of bonds and property can be ascribed to recent increases of the Repo rate by the SARB. Despite difficult conditions, equities still out performed all other asset classes.

As for the above graphs, **graph 10** and **graph 11** reflect the same order, over 3 and 12 months, of type of company and market capitalization. Only 'mid caps' and 'small caps' have swapped their position. In times of uncertainty and volatility, one would expect large cap companies to do better than the smaller companies, as borne out by these graphs, and one would expect the top performers and the bottom performers to switch position from one quarter to the next.

Graph 10



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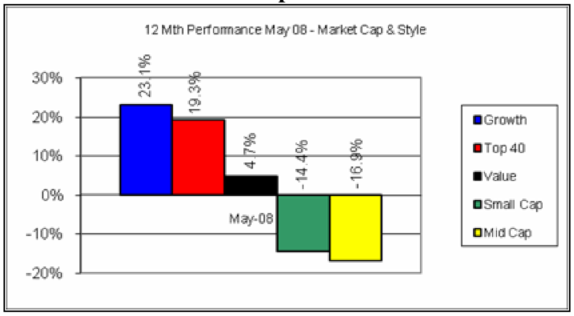
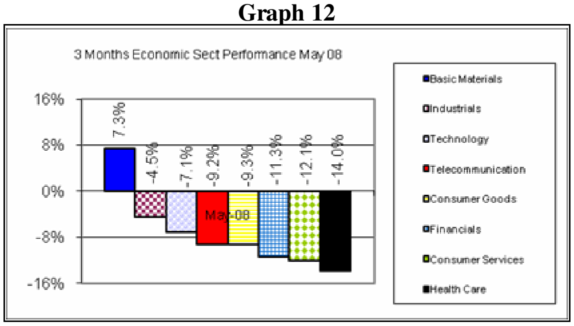
Graph 11

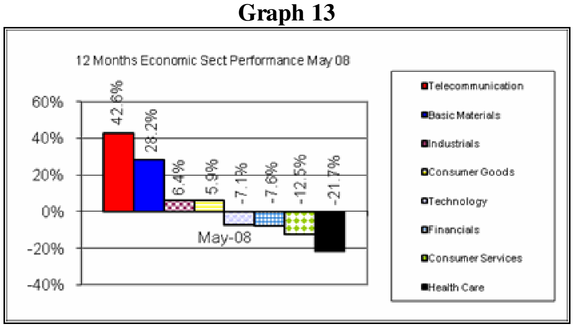


Graph 12 and **graph 13** depict the performance of the main equity sectors. Of the sectors with the highest weights, only basic materials managed to out perform cash over 3 and 12 months, the others being industrials, consumer goods, financials and consumer services.

Graph 12

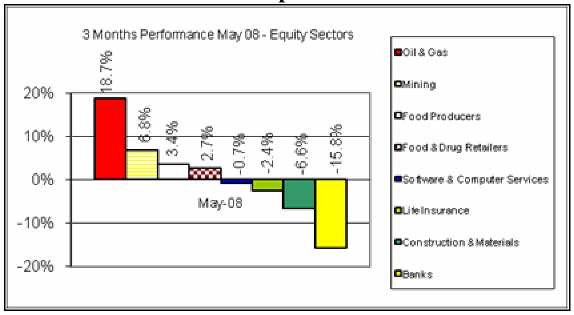


Graph 13

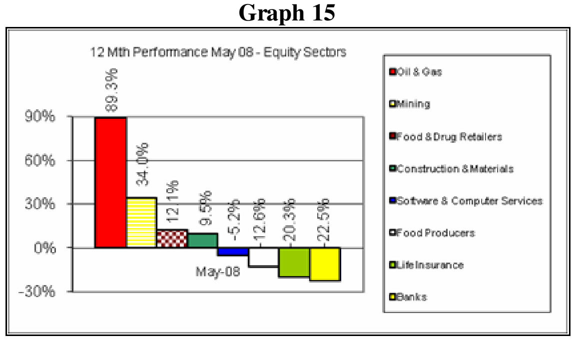


Drilling down one level into the main equity sectors, **graph 14** and **graph 15** shows that resources are still experiencing a bull run, in tandem with the oil price. The construction sector now seems to have run out of steam, producing a negative return for the quarter and only a modest return over the year.

Graph 14



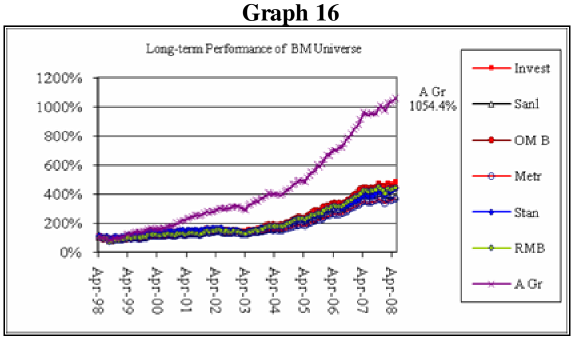
Graph 15



3. Portfolio Performance Analysis

Namibian prudential balanced portfolios essentially only acquired their own identity in 1998 when changes were brought about by regulation 28. **Graph 16** and **graph 17** reflect cumulative performance of these portfolios since April 1998 and since January 2003, respectively. The conclusions should be self evident.

Graph 16



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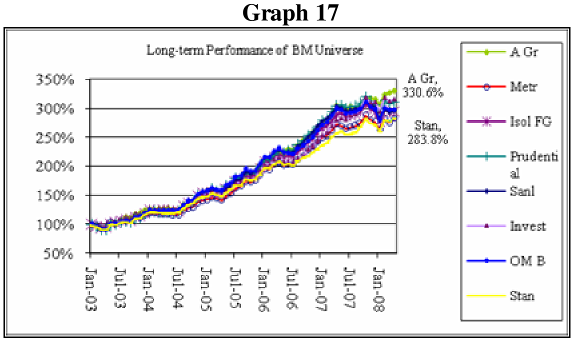
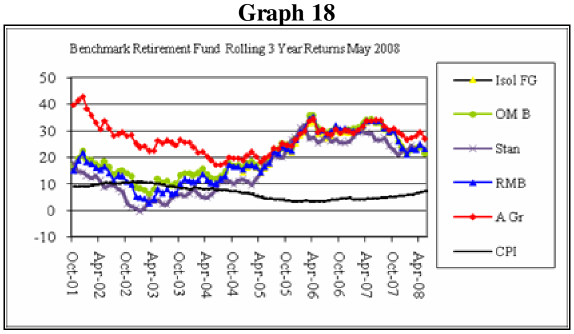
Graph 17

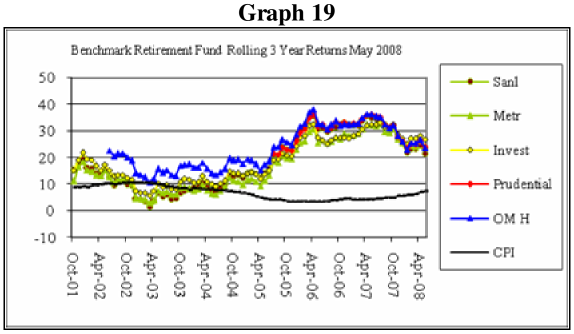


Graphs 18 and graph 19 reflect rolling 3 year returns since October 1998. For long-term projection and planning purposes the general assumption is that prudential balanced portfolios should outperform the CPI by between 3% and 5%, which has over this period only been achieved throughout by Allan Gay.

Graph 18

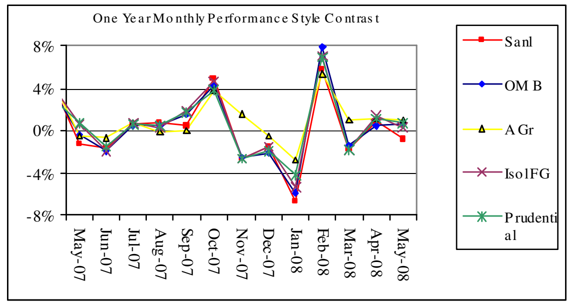


Graph 19

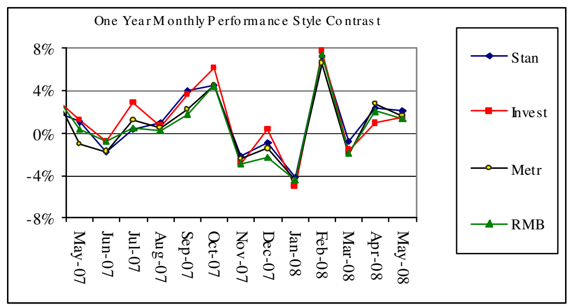


Graph 20 and **graph 21** depict the monthly performance of the prudential balanced portfolios in this survey. What it shows is that managers do generally perform very similarly but it also affords the opportunity to identify odd trends for further investigation and for drawing conclusions about expected future performance and historic skills of the managers. Allan Gray appears to return to a more familiar trend of cutting the peaks and troughs.

Graph 20

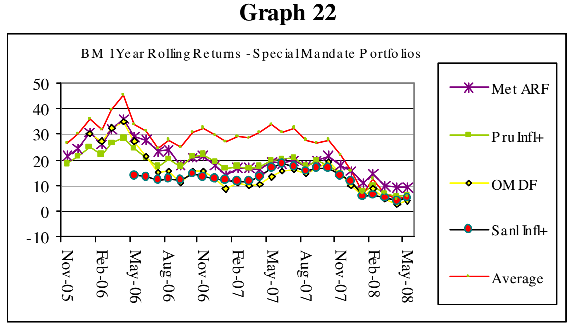


Graph 21



Graph 22 puts some focus on the 'special mandate portfolios' in relation to the average prudential balanced portfolio, in terms of 1 year rolling returns. **Graph 23** depicts the monthly performance of the Benchmark default portfolio in relation to the average prudential balanced portfolio. These graphs should give the investor a pretty good feel for what he can expect in terms of performance volatility and relative performance over the long term.

Graph 22



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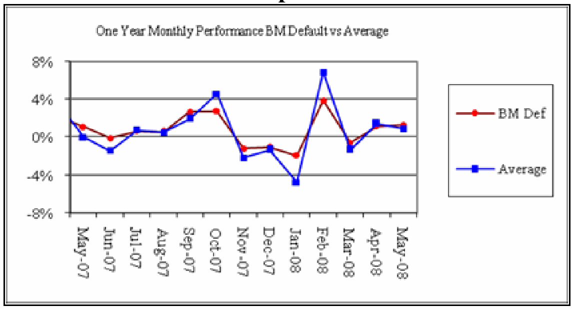
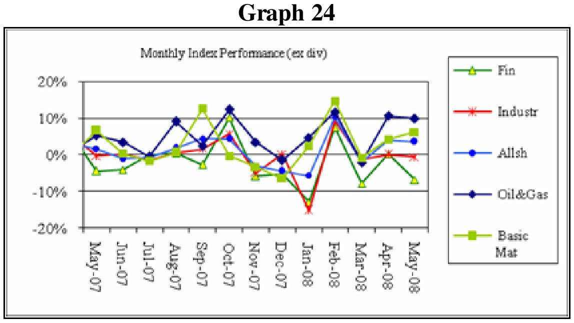
Graph 23

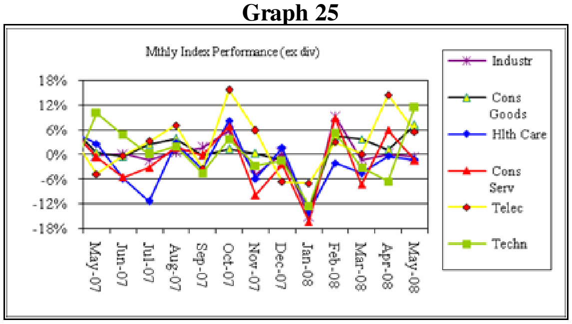


Graph 24 and **graph 25** afford the investor the opportunity to compare managers' monthly performance (as depicted in graph 20 and graph 21) against various equity sectors and to draw his conclusions regarding a manager's investment style and philosophy. **Graph 25** and **graph 26** serve a similar purpose, but with regard to cumulative performance since January 2007.

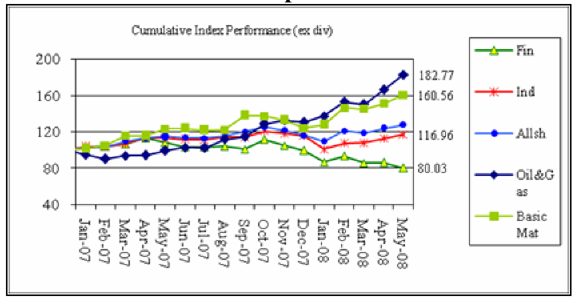
Graph 24



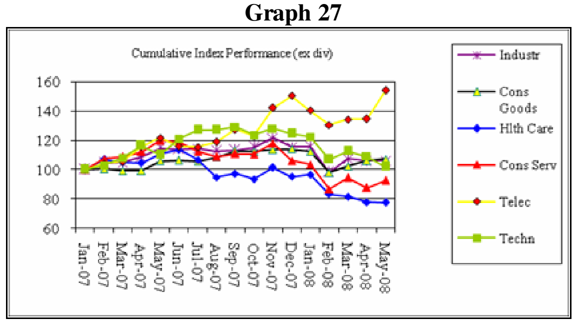
Graph 25



Graph 26



Graph 27



4. A Contrarian Preview Of The Next 12 Months

Some readers may expect to read something new and different about our views in every edition which would of course only be the case if circumstances changed. This time around nothing much has changed and so our views have not really changed much either.

As suggested last month, financial markets are slowly recovering from the sub-prime crisis, but its knock-on effects, including the impact on sentiment, are still to be felt for some time to come. The US Federal Reserve lending rate is currently at 2% after a bout of reductions. Recent remarks by the Federal Reserve, however, indicate that the next move in interest rates will be upward rather than any further reduction in view of inflation picking up pace. This should strengthen the US Dollar and indicates that it is probably around its trough at present.

The avalanche of money flowing from the rest of the world to oil producing countries and those in the distribution channel continues unabated despite global efforts to find a solution to the dilemma.

Governments around the world benefit significantly through direct and indirect taxes. This should allow governments, including our own, to give some reprieve to its tax payers in such a manner as to reduce the distorting impact of the high fuel prices. Unfortunately, this income has already been factored into most budgets and there is little chance of this wish coming true, although it has to be said to the credit of our own government, that it recently

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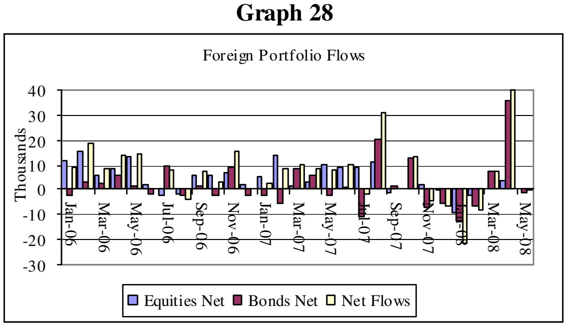
announced a few sacrifices with regard to VAT on certain basic foodstuffs.

As we pointed out before, the huge global redirection of money flows in essence constitutes printing of money that will fuel global inflation towards the point of equilibrium. Price bubbles will in the mean time be blown up as the result of such flows. These will have to eventually burst which will continue to cause upheaval, pain and suffering around the globe.

For the investor it is really a question of being a 'small fish' trying to swim with the 'big fish' and hoping for the best, or simply sit back and wait for markets to return to normality. There will be opportunities to make huge gains, but also huge losses depending on where you enter and exit a bubble. Try and identify the next bubble in the making, set your return objective, get out when you have achieved this and never look back, for better or for worse! The speculator should look at commodities and precious metals. For the conservative investor obvious ones must be alternative energy sources, industrial metals and minerals, new compound materials, energy saving technology and property.

In South Africa we have seen equity markets, and other asset classes for that matter having been boosted by massive inflow of foreign capital which also lent support to the Rand, despite SA's pretty significant current account deficit. **Graph 28** shows a steady reversal in these flows into equity since February 2007, having turned negative by and large, since October last year. Evidently the flow into bonds is highly volatile and is purely a function of interest rate arbitrage.

Graph 28



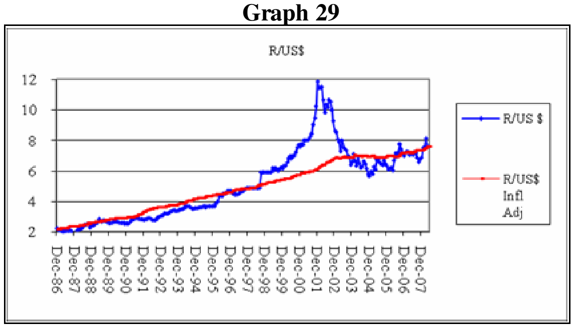
Graph 29 indicates that on the basis of fundamentals, the Rand was overvalued in US$ terms since 2003, probably driven by high commodity prices and high foreign portfolio flows chasing primarily our resources stocks. Currently the Rand stands at around 7.61, representing fair value per **graph 29**. At the current inflation differential between the US and SA, i.e. 4% vs 9%, the Rand should weaken slightly from its current level to 7.8 by the end of the year.

Since the commodity run was closely aligned to the oil price the Rand maintained relative stability despite the huge increase in the oil price. For SA and Namibia the biggest risk for the local currency, our markets and the economy would be a de-linking of resources from the oil price. To some extent this is what happened recently when resources took a breather while oil continued to rise. It is our conviction that as long as the oil price continues to rise, global price levels will continue to rise, in search for equilibrium. As the result we will continue to import inflation even if the Rand remains stable. The increase in interest rates in SA, whilst attracting hot money and supporting the Rand in the short-term, is unlikely to have any significant impact on consumer demand, the consumer already being under pressure from general price increases as the result of a weaker Rand and the increase in food prices and in fuel cost. We do not believe that interest rate s are an effective mechanism under these circumstances for keeping inflation at bay.

Should the oil price start do decline, one may expect commodities to decline in tandem, as happened on the way up. This is likely to then lead to an outflow of investment capital that will put the Rand under pressure. This scenario we do not consider realistic though and at best, we will probably see the oil price stabilizing.

Either way, we would expect inflation in SA and Namibia to outpace inflation in the developed economies which will cause the Rand to depreciate in the medium term.

Graph 29



Graph 30 shows clearly to what extent the South African share market has departed from the US market, despite the recent correction, far off its US peer. Does this represent one of the bubbles that are waiting to burst or does it simply represent one asset category that has moved towards price equilibrium more instantaneously? Many analysts do not believe this to be a bubble though and we would agree, provided the oil price will remain stable or continue to rise.

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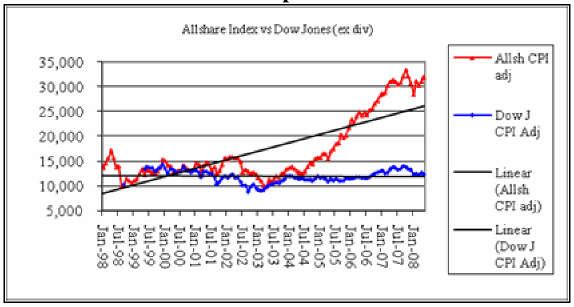
Graph 30



5. Conclusion

In our opinion, the higher inflation era we have entered is here to stay for quite some time and more so in developing countries. We believe that the Rand and interest rates are likely to remain fairly stable from here on although we expect the higher local inflation rate to result in ongoing slow depreciation of the Rand. We also believe that high volatility in markets will remain for the time being. In this environment, the pressure on consumers will remain. Given the uncertainty whether the oil price will continue on its current trajectory, remain stable or whether it will return to more rational cost based levels, being conservative and taking a long-term view, we would invest in real assets, deep value and inflation hedged shares, such as the typical pension fund should take.

Cash currently hardly produces any real return, in Namibia at least, and has lost much of its attraction. In view of our expectation for inflation to remain at its recently found levels, with a slight risk of it still trending upward and fairly stable interest rates going forward, bonds in our view start becoming more attractive. Property represents a real asset and should do well as an inflation hedge, given that it may still experience a short-term negative impact should interest rates increase. Weighing up foreign markets against local markets, we expect our markets to bear more negative potential than foreign markets, excepting commodities that are likely to track the movement in the oil price. Developing countries should experience the increase in energy and food prices more negatively than developed countries where in the latter case, a smaller portion of disposable income is applied to consumption. A logical consequence of these expectations is that one should be fully invested offshore. Locally, these expectations would favour selective high yielding equity, property (industrial) and some exposure to bonds.

6. 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.