Benchmark Retirement Fund

Volume 11, No. 07,
July 2015

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JULY 2015

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

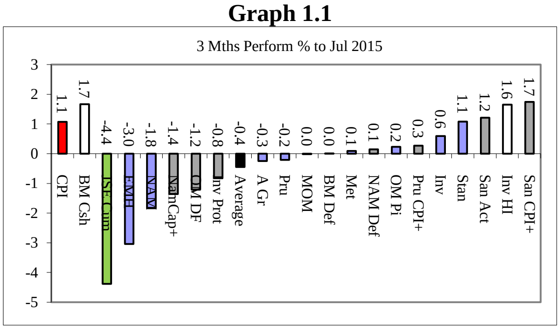
In **July** the **average prudential balanced portfolio** returned 1.53% (June: -0.95%). Top performer is Stanlib (2.69%); while EMH Prescient (-1.18%) takes the bottom spot. For the 3 month period Stanlib takes top spot, outperforming the 'average' by roughly 1.5%. On the other end of the scale EMH Prescient underperformed the 'average' by 2.6%.

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.

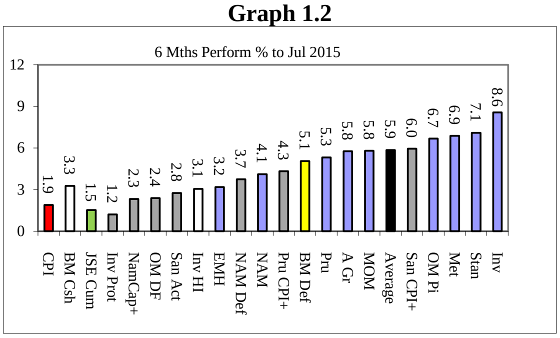
Below is the legend to the abbreviations reflected on the graphs:

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 Pi (blue)
Momentum Managed	MOM (blue)
Stanlib Managed	Stan (blue)

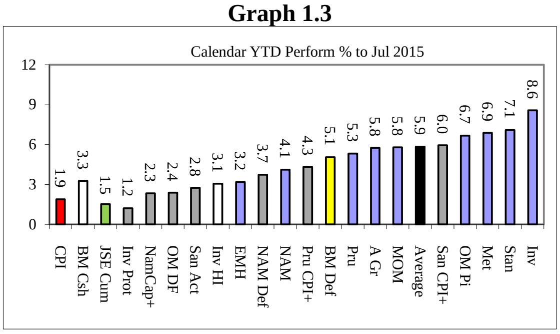
Graph 1.1



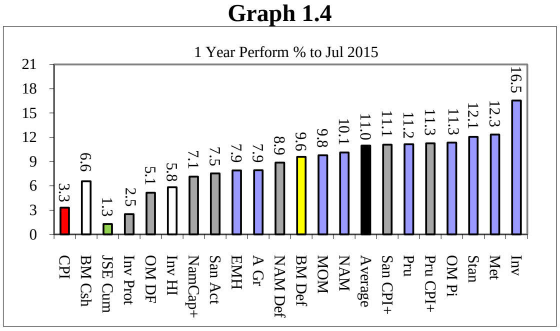
Graph 1.2



Graph 1.3



Graph 1.4



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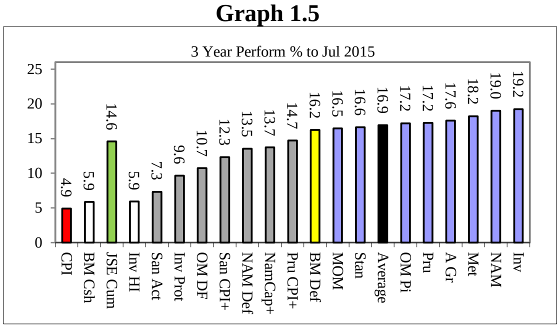
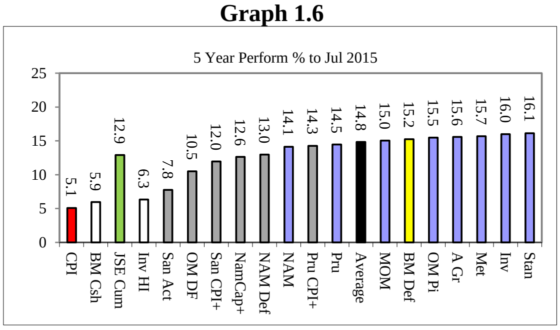
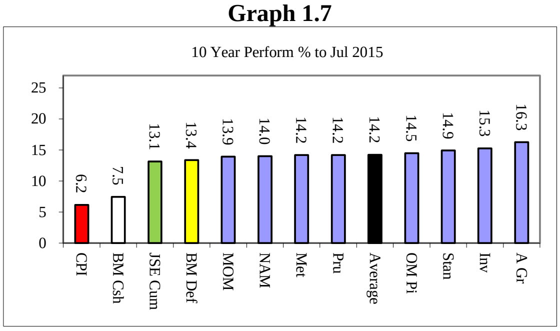
Graph 1.5



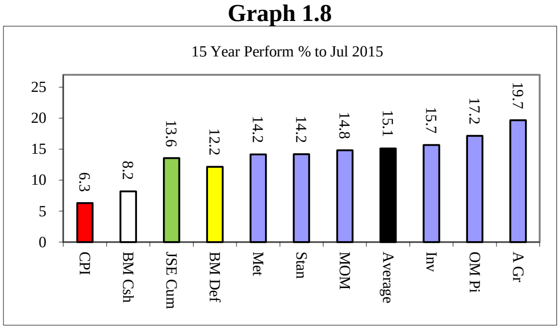
Graph 1.6



Graph 1.7

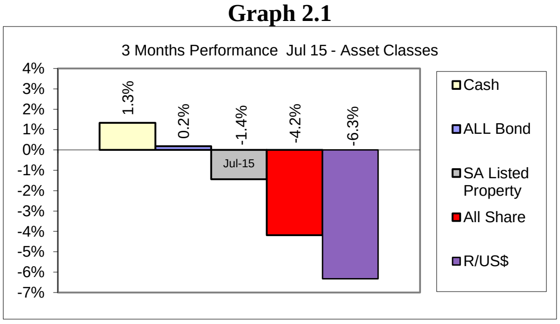


Graph 1.8

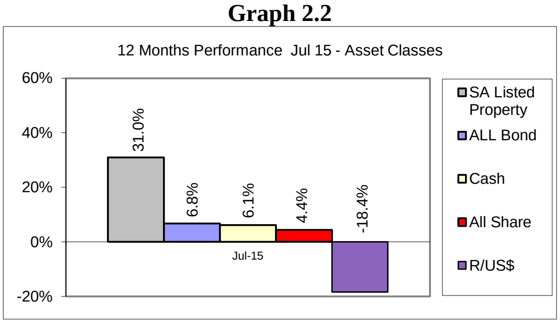


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

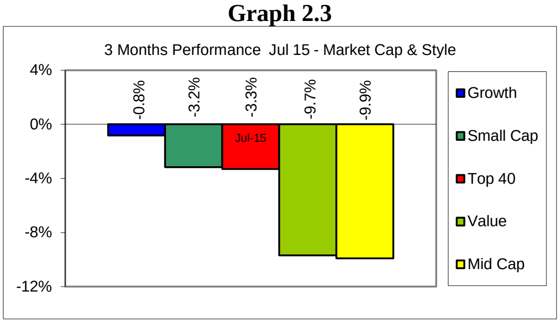
Graph 2.1



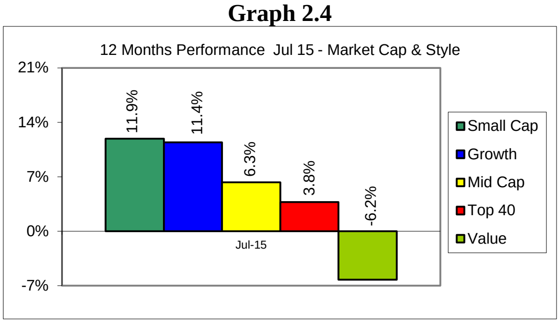
Graph 2.2



Graph 2.3



Graph 2.4



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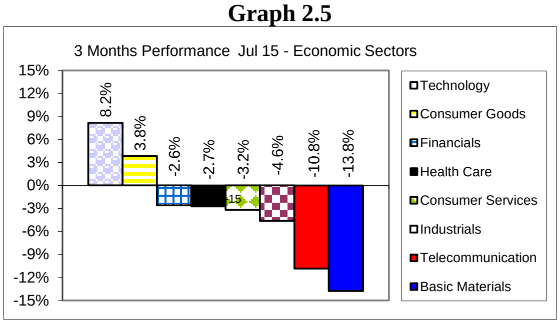
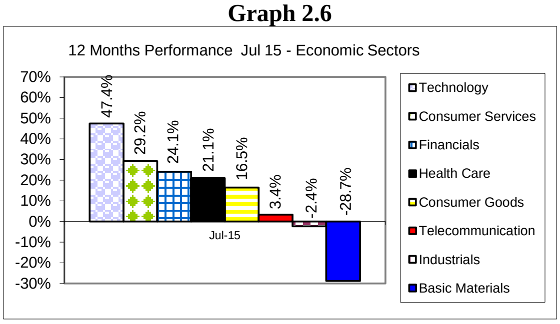
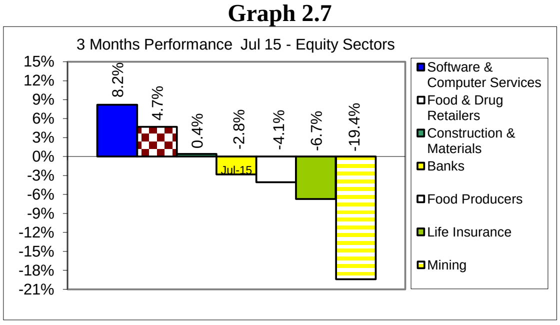


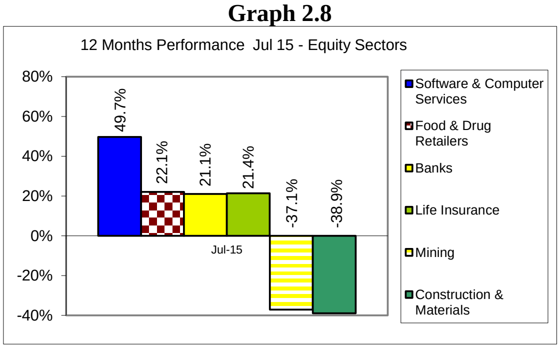
Graph 2.6



Graph 2.7



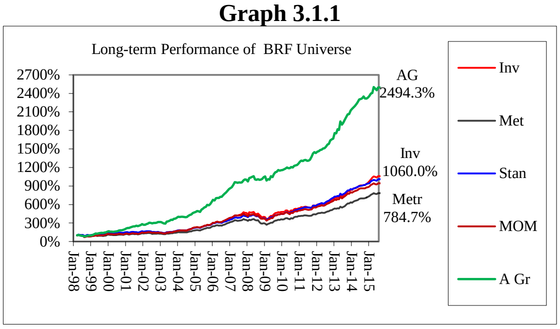
Graph 2.8



3. Portfolio Performance Analysis

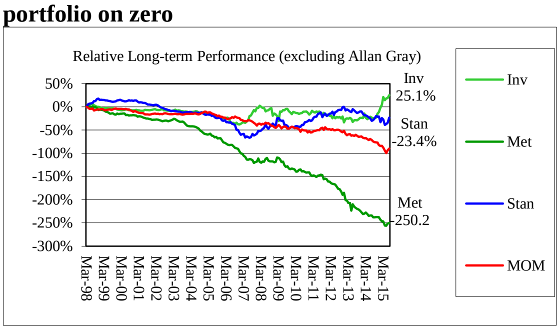
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

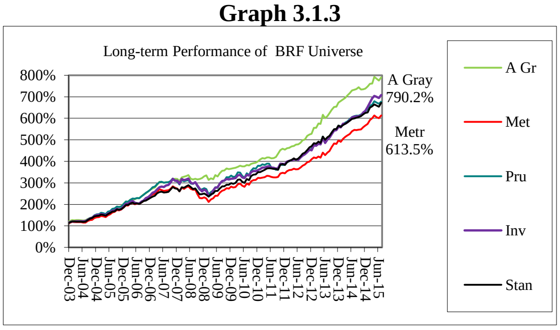


Graph 3.1.2

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

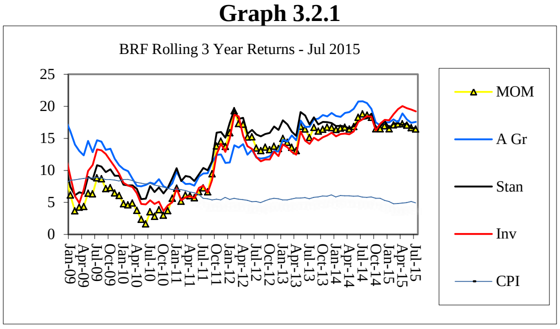


Graph 3.1.3



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

Graph 3.2.1



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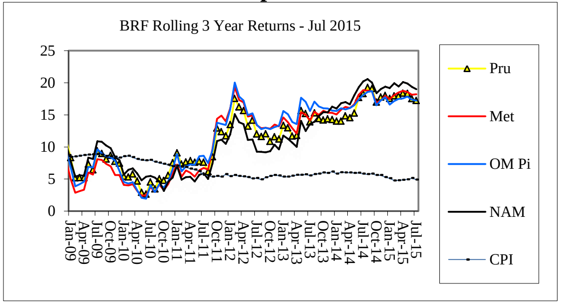
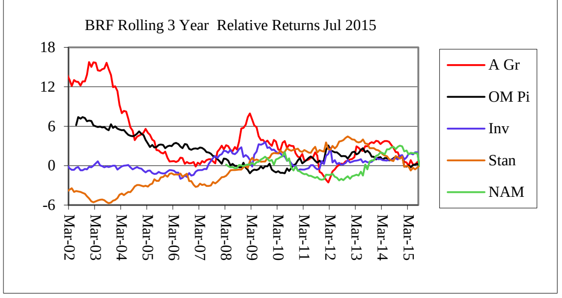
Graph 3.2.2

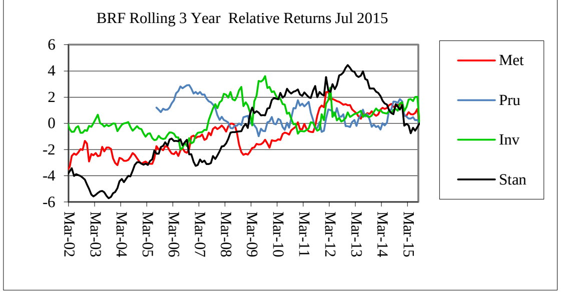


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

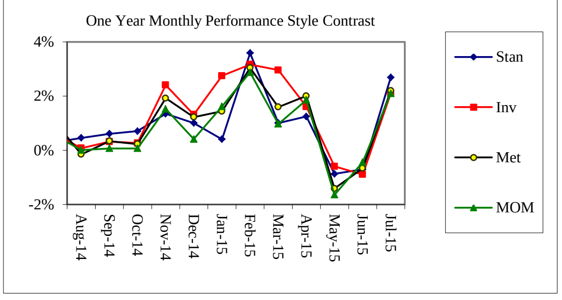


Graph 3.3.2

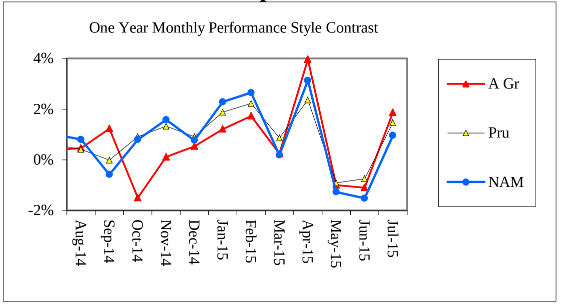


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

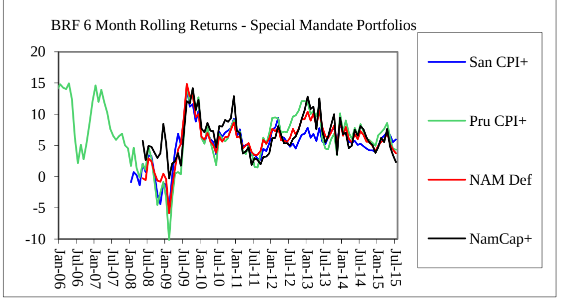


Graph 3.4.2

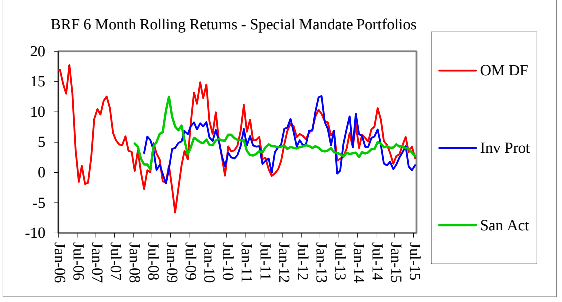


3.5. 6-month rolling returns of ‘special mandate’ portfolios

Graph 3.5.1

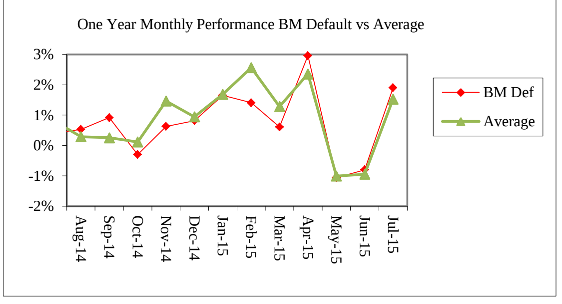


Graph 3.5.2



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

Graph 3.6.1



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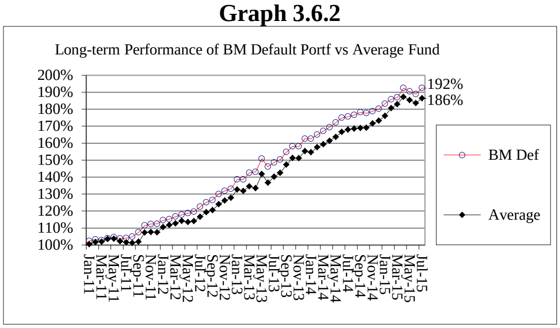
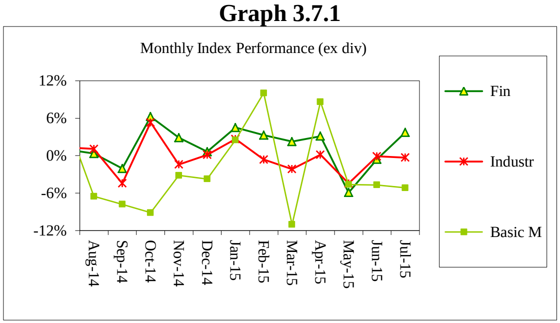
Graph 3.6.2

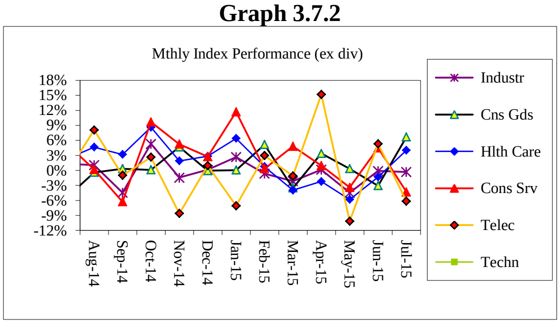


3.7 One year monthly performance of key indices (excluding dividends)

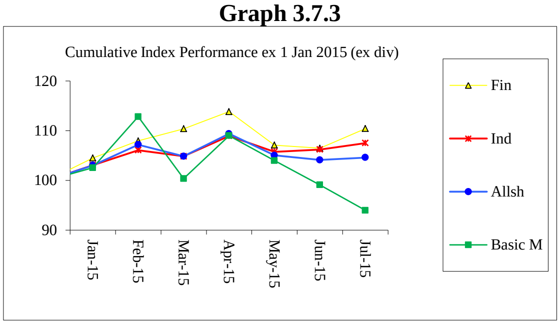
Graph 3.7.1



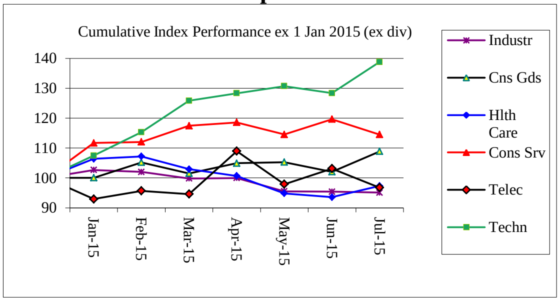
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 14.8% p.a. in nominal terms, or 9.7% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 15.2% 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 (47.3% vs. 62.0% of the average prudential balanced portfolio, as at the end of June 2015) 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.

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. The default portfolio returned a cumulative 92.5% compared to 86.4% for the average prudential balanced portfolio over this 55 month period from January 2011.

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 August 2012 to July 2015:

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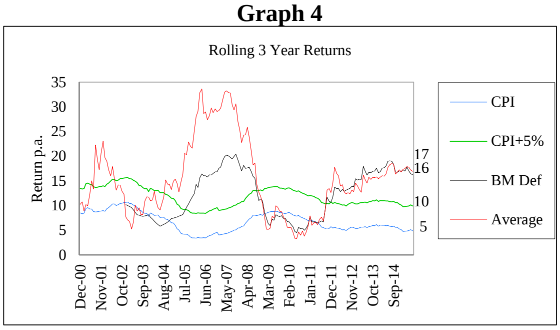
Table 4.1

Measure	**Money Market**	**Default Portf**	**Average Prud Bal**
Worst annual performance	5.3%	8.0%	10.2%
Best annual performance	6.6%	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	5.7%	17.3%	17.4%

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



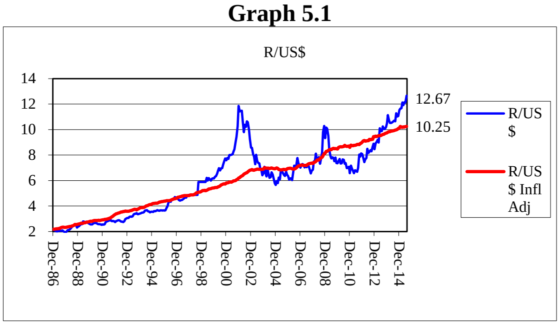
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end July was 16.2%, the average was 16.9% vs CPI plus 5% currently on 9.9%.

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 10.25 to the US Dollar while it actually stood at 12.67 at the end of July. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

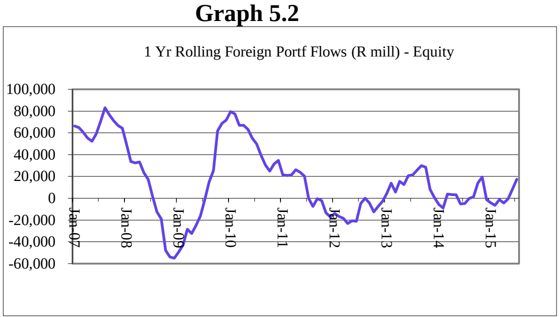
Graph 5.1



Rand weakens despite foreign capital inflows

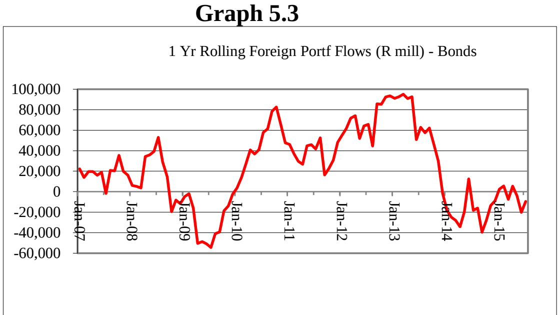
Graph 5.2 reflects a flow of capital into South African equities on a rolling one year basis, with a net inflow of 17.4 bn on a year-on-year basis at the end of July (outflow of R 8.1 bn year-on-year to end June). The month of July experienced a net inflow of R 10.1 bn. Since the beginning of 2006, foreign net investment in equities amounts to R 204 bn (end June R 194 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 9.4 bn over the past 12 months to end of July (outflow of R 20.2 bn over the 12 months to end of June). Since the beginning of 2006, foreign net investment in bonds amounts to R 215 bn (to June just over R 210 bn). The month of July experienced a net outflow of R 5.3 bn.

Graph 5.3



The net inflows of foreign capital into equity and fixed interest securities was R 7.9 bn for the rolling 12 months to end July 2015 (outflow of R 12.0 bn to end June

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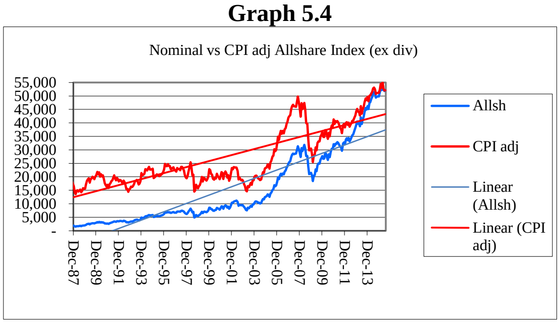
2015), compared to an outflow of R 7.3 bn for the 12 months to end July 2014 (inflow of R 7.3 bn to end of June 2014). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 419 bn (June R 404 bn).

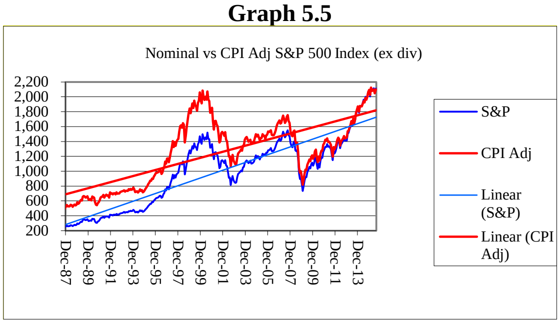
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 12.1% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of just over 28 years was 8.4% per year. This is equivalent to a growth in real terms of 3.7% p.a. over this period, excluding dividends, or around 7% including dividends.

Graph 5.4



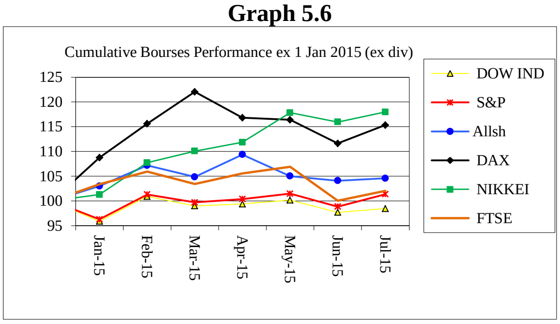
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.4% per annum, over this period of just over 28 years. US inflation over this period was 2.7%. This is equivalent to a growth in real terms of 4.7% p.a. over this period, excluding dividends.

Graph 5.5



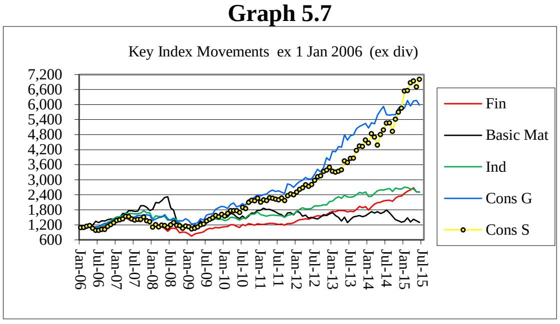
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the DAX as the top performing share indices.

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. 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 Services: 22.0%; Consumer Goods 21.3%; Financials 10.5%; Industrials 10.1%; and Basic Materials 2.2%.

Graph 5.7



6. The Tides Have Changed
By Tilman Friedrich

Undoubtedly the two subjects that currently feature most prominently in financial circles, is the rapid depreciation of the Rand and the dramatic decline in the price of oil. For the investor, these are important indicators and the question begs to be answered whether we will see a reversal of these developments or whether these represent new norms.

The below graph depicts the depreciation of the Rand against the Euro, the British Pound and the US Dollar since October 2000. Over this period to end of July the Rand depreciated by 67% against the US Dollar, by 80% against the British Pound and by 117% against the Euro.

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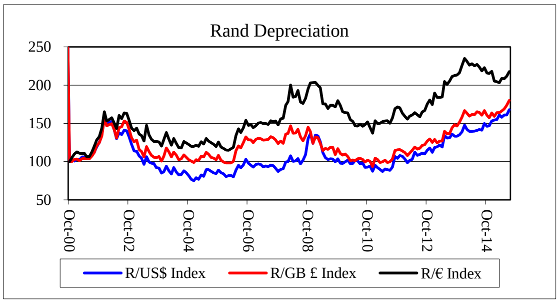
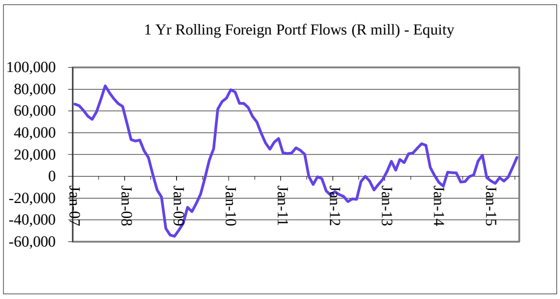
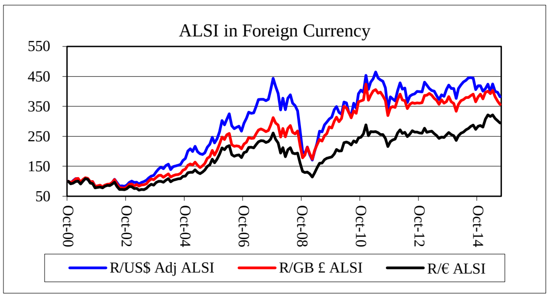


The depreciation of the Rand occurred despite continued foreign investment capital inflows, specifically into equities as depicted in the following graph.



Evidently, foreigners still seem to find value investing in local equities, having invested close to R 20 billion over the past 12 months of which R 10 billion was invested in July alone.

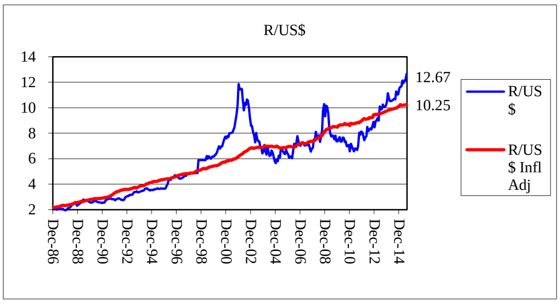
So why have foreigners kept on investing despite the severe depreciation of the Rand? Well the following graph may provide the answer to this question showing the growth of the FTSE/JSE Allshare index since October 2000 in foreign currency.



Despite the recent decline of the ALSI, expressed in foreign currency, as the result of the depreciation of the Rand, the ALSI still delivered a return of 9.5% per annum in US Dollar terms, 9% per annum in British Pound terms and 7.6% in Euro terms over this period of close to 15 years. To this return can still be added the dividend yield of close to 3% per annum. Comparing this to the Dow Jones' 3.4% per annum over the same period, the British FTSE's 0.3% and the DAX's 3.2%, it should become self evident why foreigners still keep investing in local equities.

As we know foreign interest rates are at, or around zero percent in the US and other developed economies, and in cases even negative when inflation is brought into the equation. Investors can thus borrow cheaply and invest in our local bourses for a decent yield they will not find at home.

For foreign investors the question is whether the Rand will continue to weaken to the extent is has of late or whether it will actually move in the opposite direction. The following graph shows to what extent the Rand is currently under valued by the measure applied in this graph. The red line depicts the Rand: US Dollar exchange rate adjusted by the inflation differential of local and US inflation.



By this measure, the exchange rate should be 10.25 rather than the rate of 12.67 at the end of July, let alone the more recent 13.14 which represents an under valuation of close to 30%.

Considering the fundamentals, there is no reason why the Rand should have weekend so rapidly. Foreigners remain net investors in local financial markets while the SA trade balance has also been positive of the past 2 months in a row. The only conclusion is that this is driven by currency speculation that will not persist. Our expectation is thus that the Rand should strengthen in time although it is impossible to foresee when this will happen.

For the local investor this means that investing offshore now is not the right time in the light of the likelihood of the Rand strengthening again.

Other key economic variables the local investor should bear in mind are the oil price and interest rates. The oil price is important because oil is a core commodity in many commodity hedge funds and therefore also drives the price of other commodities. In the light of the shale gas 'revolution', shale gas can in many cases be produced profitably at today's oil prices, while technology is improving rapidly and its market share of global energy production is growing steadily. It is therefore likely that the oil price will remain at its current levels with little prospect of any significant increase but rather a long-term declining trend. At the same time the expectation would then be that commodities in general will remain at low levels for some time to come. This in turn will impact negatively on the SA and Namibian economies that are commodity driven.

Turning to interest rates, it is likely that the US Fed will start raising the repo rate in the foreseeable future. However this will probably be done in very small steps and over a protracted period. We believe this expectation has already been discounted by financial markets and an announcement of an increase is therefore unlikely to impact financial markets. As things stand with the US Dollar as strong as it currently is, any significant rate increase would further strengthen the Dollar and would harm the US economy.

Conclusion

Monetary policy in a number of developed economies has driven capital out of interest bearing investments into equity. As the result global price levels of equities and interest bearing investments are artificially inflated while global interest rates are artificially deflated. This imbalance between interest rates and asset prices is due to reverse as the US starts lifting interest rates and as other countries will do the same. As pointed out, this will happen over a protracted period of time during which investors are likely to experience pedestrian investment returns. Double digit returns over extended periods, as we have seen in the past are a matter of the past. The investor's benchmark should thus move from high absolute returns to only out performing inflation by between 3% and 6%. With inflation running at just over 3%, the investor should be comfortable with investment returns of between 6% and 9%. We believe that under these conditions, equities are still the preferred asset class offering the best prospect of sustainably yielding these returns in the long term. As pointed out before, it will be very important to pick the right stocks.

7. Important notice and disclaimer