Volume 11, No. 12,
December 2015

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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

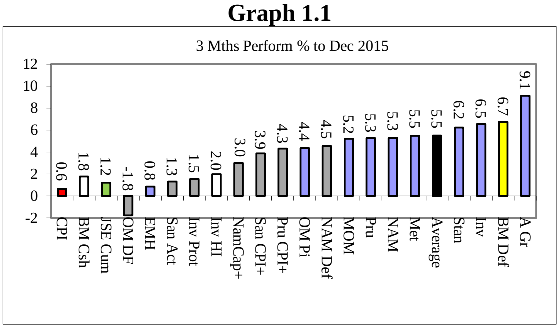
In **December** the **average prudential balanced portfolio** returned 0.57% (Nov: -0.32%). Top performer is Allan Gray (3.69%); while EMH Prescient (-2.05%) takes the bottom spot. For the 3 month period Allan Gray, for the 5th consecutive month takes top spot, outperforming the 'average' by roughly 3.6%. On the other end of the scale EMH Prescient underperformed the 'average' by 7.3%.

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.

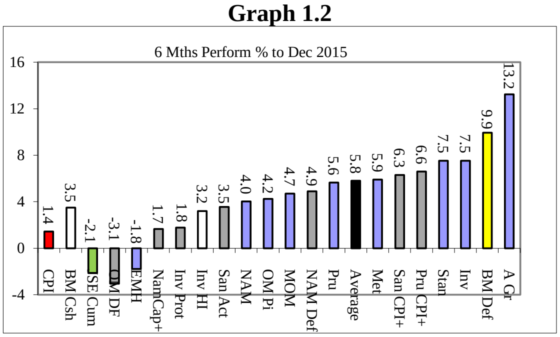
Below is the legend to the abbreviations reflected on the graphs:

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)

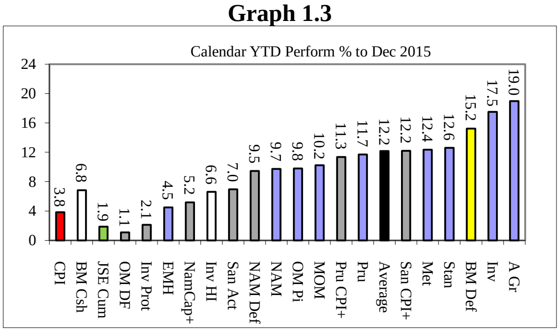
Graph 1.1



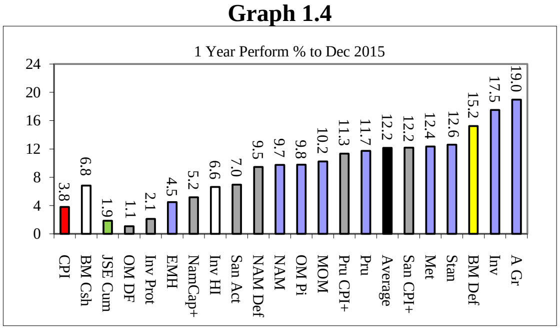
Graph 1.2



Graph 1.3



Graph 1.4



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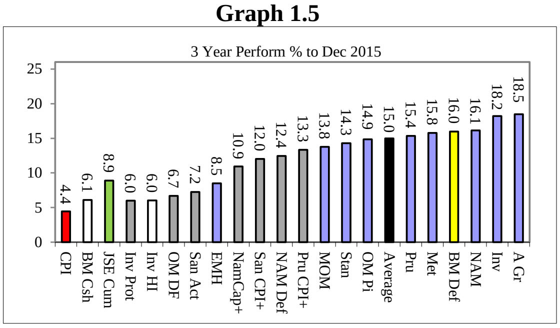
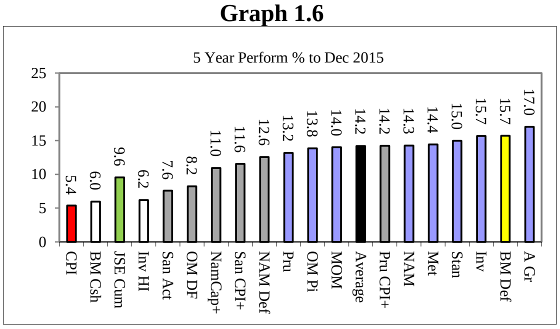
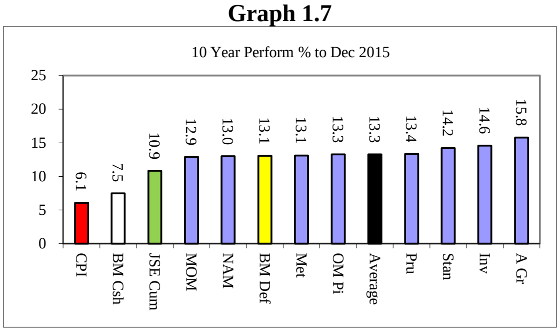
Graph 1.5



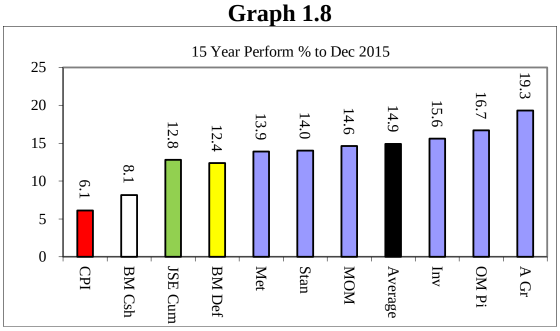
Graph 1.6



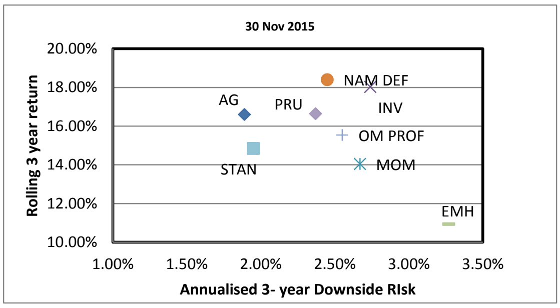
Graph 1.7



Graph 1.8

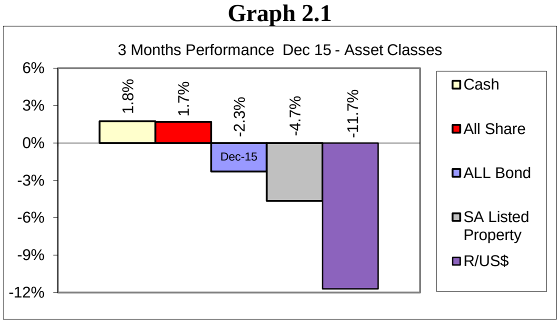


Risk/ Return

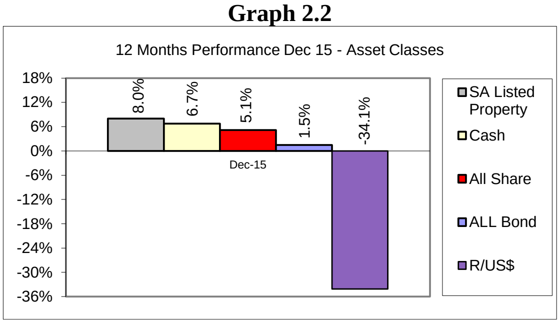


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

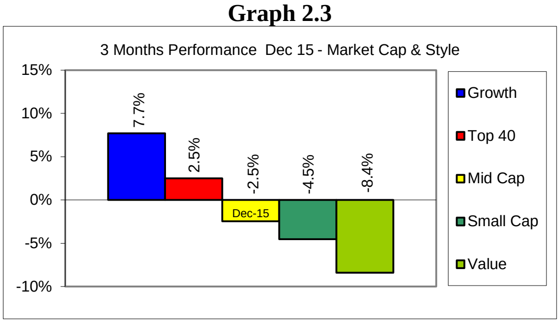
Graph 2.1



Graph 2.2



Graph 2.3



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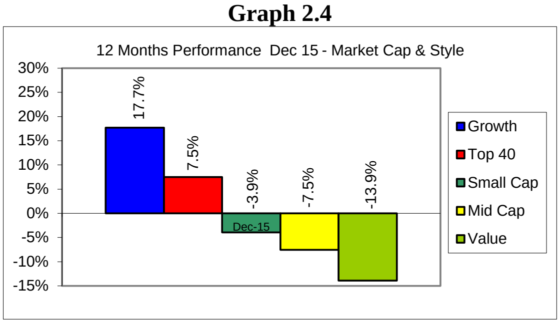
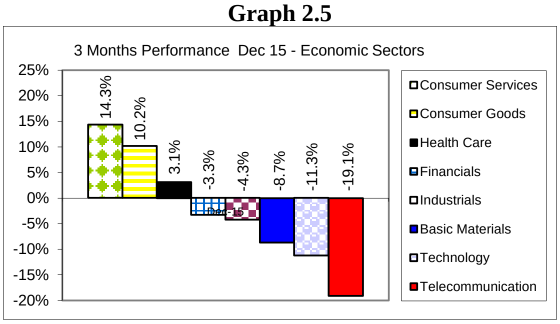
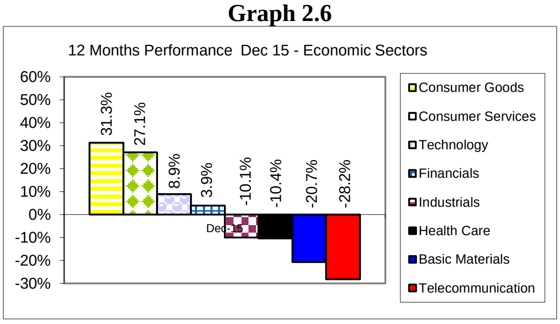
Graph 2.4



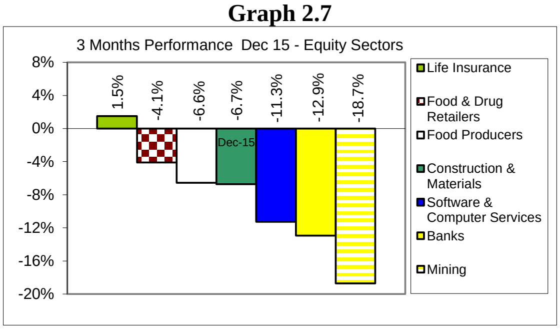
Graph 2.5



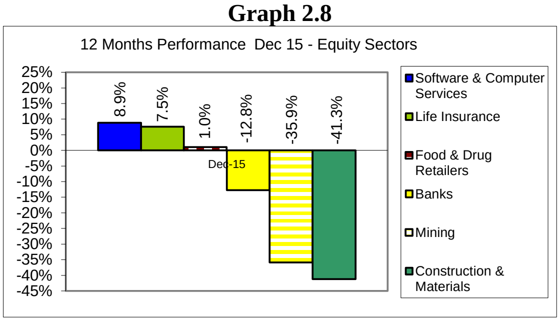
Graph 2.6



Graph 2.7



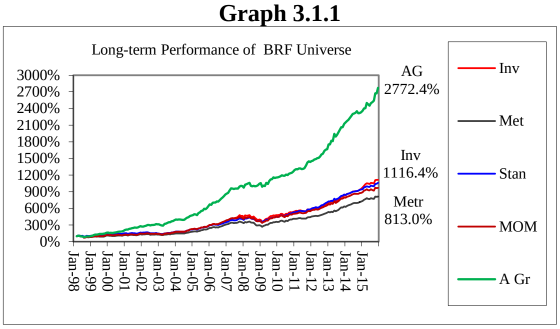
Graph 2.8



3. Portfolio Performance Analysis

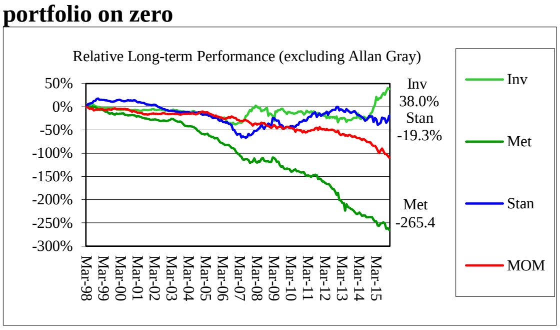
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

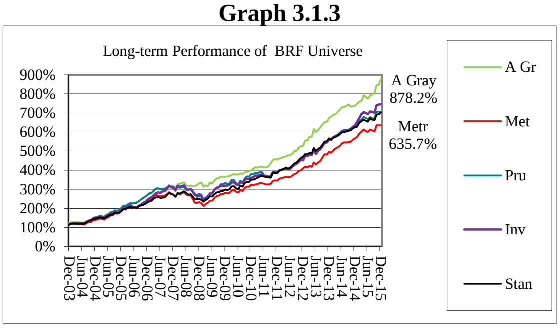


Graph 3.1.2

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

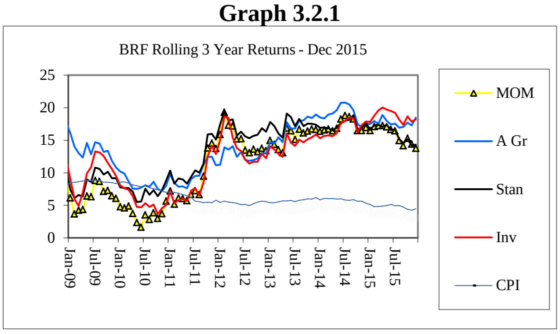


Graph 3.1.3



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

Graph 3.2.1



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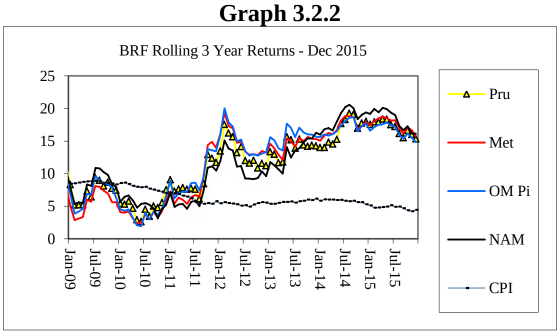
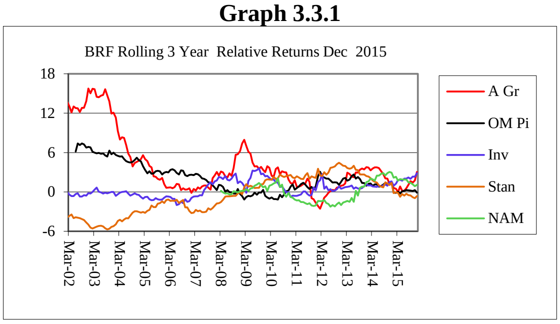
Graph 3.2.2

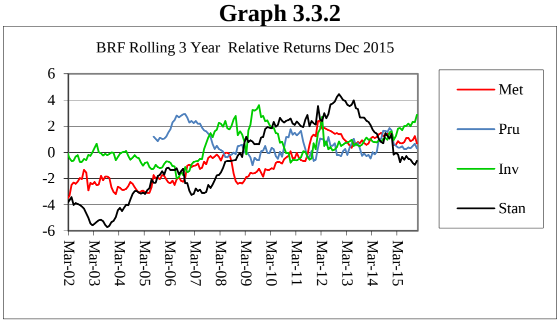


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

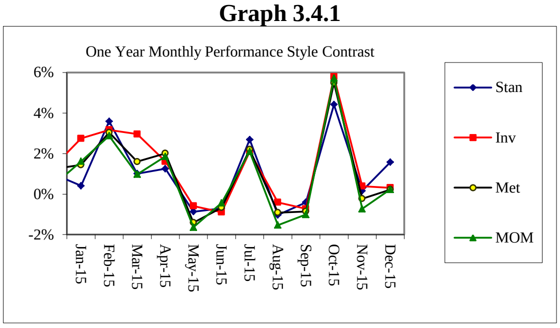


Graph 3.3.2

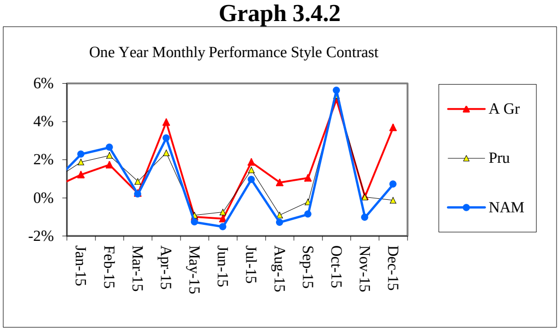


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

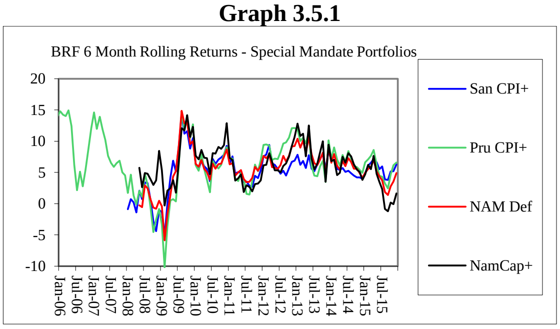


Graph 3.4.2

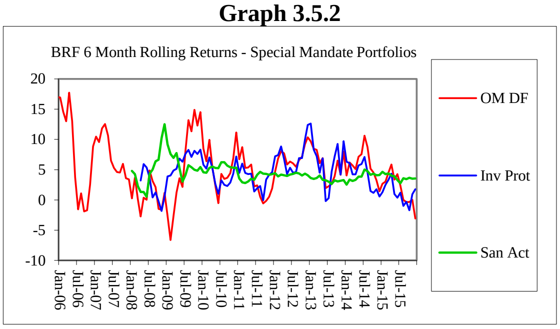


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

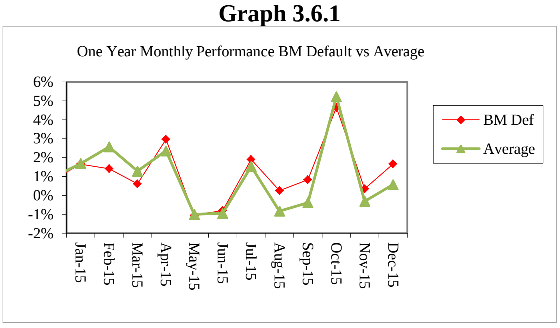


Graph 3.5.2



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

Graph 3.6.1



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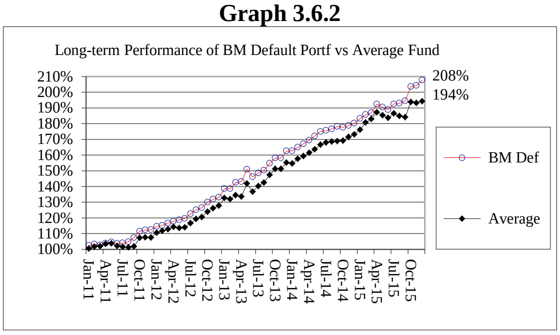
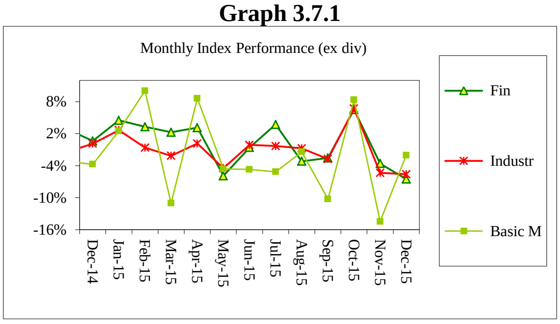
Graph 3.6.2

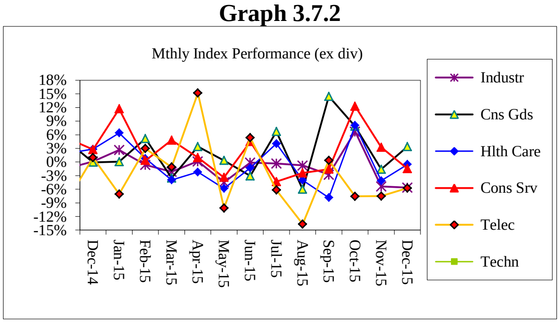


3.7 One year monthly performance of key indices (excluding dividends)

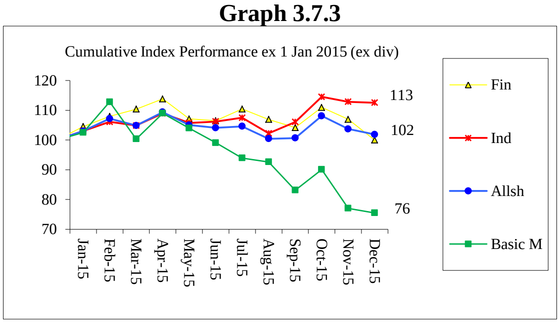
Graph 3.7.1



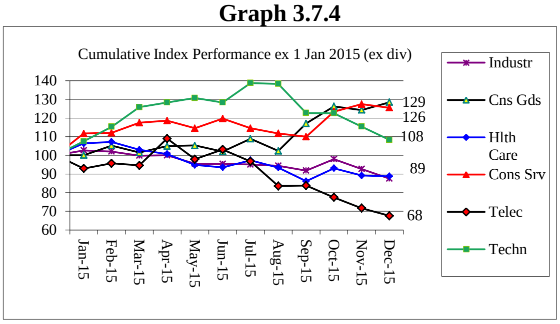
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio – Facts in figures

Table 4.1

Portfolio	Default portfolio	Average pru man portfolio
5 year nominal return - % p.a.	15.7	14.2
5 year real return - % p.a.	10.3	8.8
Equity exposure - % of portfolio	50.2	57.4
Cumulative return ex Jan 2011	107.7	94.37
5 year gross return target - % p.a.	5	6
Target income replacement ratio p.a.	2	2
Required net retirement contribution - % of salary	13.0	11.6

The above table reflects the actual returns versus target returns required to produce an income replacement ratio of 2% of salary per year of fund membership that should secure a comfortable retirement income.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	8.0%	9.0%
Best annual performance	6.8%	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	5.9%	16.6%	16.6%

The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years January 2013 to December 2015. This gives an indication of volatility of the performance of these 3 risk profiles.

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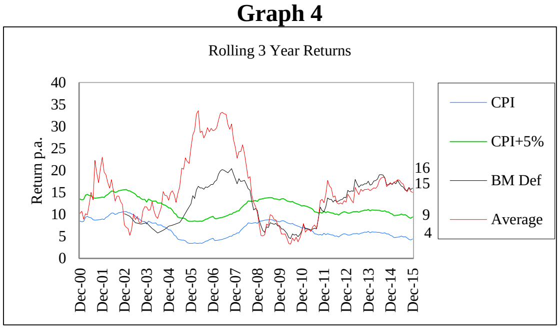
Graph 4



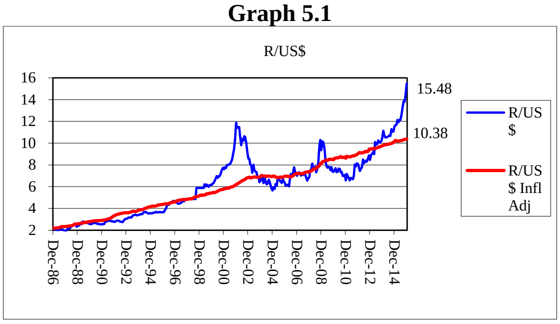
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end December was 15.99%, the average was 14.99% vs CPI plus 5% currently on 9.4%.

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 10.38 to the US Dollar while it actually stood at 15.48 at the end of December. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

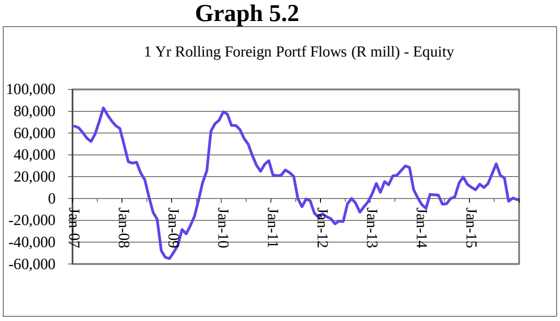
Graph 5.1



Rand weakened with foreign capital outflows

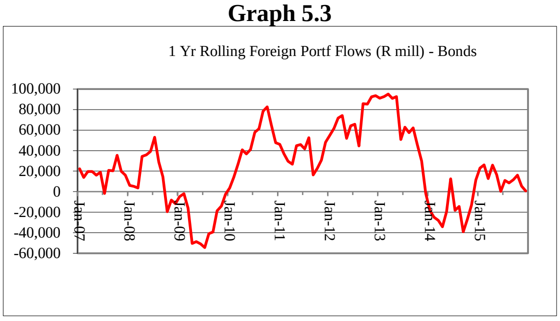
Graph 5.2 reflects an outflow of capital into South African equities on a rolling one year basis, with a net outflow of 0.97 bn on a year-on-year basis at the end of December (inflow of R 0.47 bn year-on-year to end November).The month of December experienced a net outflow of R 9.8 bn. Since the beginning of 2006, foreign net investment in equities amounts to R181 bn (end November R 190 bn). This represents roughly 1.5% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis reflects foreign portfolio inflows in respect of SA bonds of R 0.8 bn over the past 12 months to end of December (inflow of R 5.3 bn over the 12 months to end of November). Since the beginning of 2006, foreign net investment in bonds amounts to R 224 bn (to November just over R224 bn). The month of December experienced a net outflow of R 8.3 bn.

Graph 5.3



The net outflows of foreign capital from equity and fixed interest securities was R 0.19 bn for the rolling 12 months to end December 2015 (inflow of R 5.8 bn to end November 2015), compared to an inflow of R 24.6 bn for the 12 months to end December 2014 (inflow of R 6.6 bn to end of November 2014). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 405 bn (November 423 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 11.8% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of just over 28 years was 8.3% per year. This is equivalent to a growth in real terms of 3.5% p.a. over this period, excluding dividends, or around 7% including dividends.

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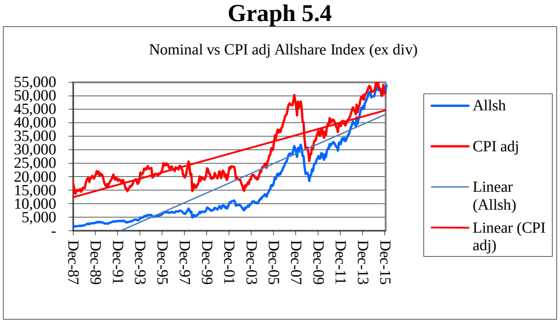
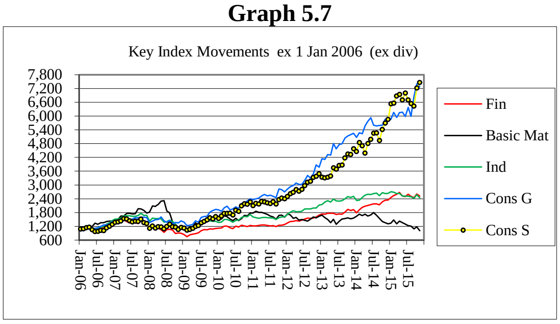
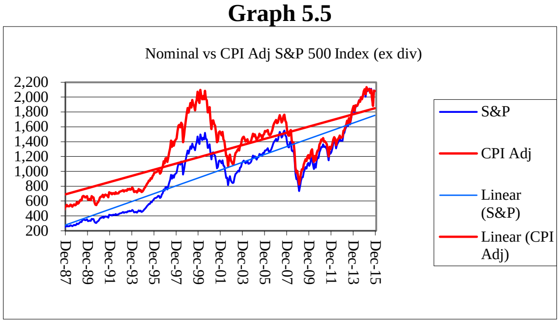


Graph 5.7



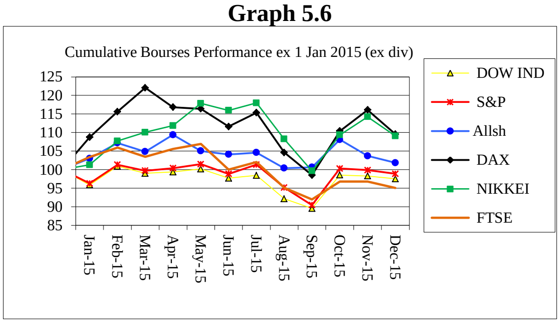
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.2% per annum, over this period of just over 28 years. US inflation over this period was 2.7%. This is equivalent to a growth in real terms of 4.5% 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 DAX and the NIKKEI as the top performing share indices.

Graph 5.6



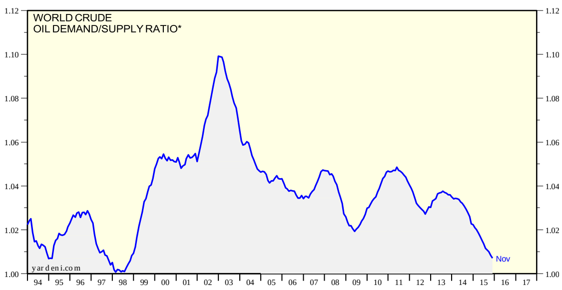
Graph 5.7 provides an overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced. From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals. Annualised returns for these indices since the beginning of 2006 were: Consumer Goods: 22.4%; Consumer Services 22.1%; Financials 8.9%; Industrials 8.7%; and Basic Materials -0.1%.

6. So we are told that the oversupply of crude oil is depressing its price – right?

By Tilman Friedrich

It is a well-known fact that the oil price has a significant impact on global financial markets and hence also on the global investor. It is therefore important to understand what is currently happening and how this may impact markets going forward. Many commentators claim that the collapse of the oil price is due to a global oversupply.

Let us therefore look in more detail at the global supply/ demand situation as illustrated by the below graph. It reflects the 12 month average world oil demand as a ratio of the 12 month average world oil supply, as published in the latest 'Energy Briefing' by Yardeni Research Inc.



Clearly if this information is to be believed there is actually still an oversupply of crude up until November 2015 although clearly on a steeply declining trend. So it is probably true that the oil demand is slowing as the result of slower global economic growth. However, the global economy is still growing even if only at a slower pace - China 'only' at somewhere around 7%, meaning that the global oil demand should still grow and it does rather liberally as reported by Yardeni . What about oil supply which is said to be increasing? This is also not really a convincing story, if one looks at what is happening in Iraq, Syria and Libya. Now lets us look at the relative movement in the spot oil price per below graph and try to overlay this onto the demand vs supply graph above.

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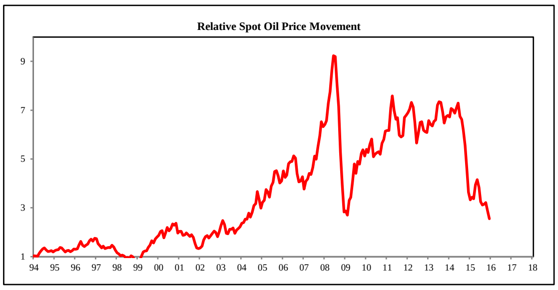

For the first few years from 1994 until 2004, the two graphs show a reasonable correlation between the rate of crude oversupply and its price. When the rate of crude oversupply peaked abruptly in 2002 – 2003, the oil price hardly moved. As the rate of oversupply gradually declined from the end of 2003 to the end of 2013, the oil price peaked and troughed abruptly in the course of 2008 to then continue on a steady upward trend from where it last ended in the middle of 2006, to collapse by the end of 2008. From the beginning of 2009 up until the end of 2014, there appears to be a negative correlation between the rate of oversupply and the price of crude where oversupply declined systematically while the oil price increased systematically. The graph depicting the relative spot oil price movement thus indicates that since 2004 the oil price moved up sharply for reasons unrelated to the rate of crude oversupply, remained at inflated levels barring 2008 and that the more recent collapse of the oil price is merely a correction of an inflated price of crude up until the middle of 2014.

So if the oil price is driven by factors other than the rate of oversupply, the obvious question is what drove the oil price to and maintained it at its lofty heights for the 10 years from 2004 to 2014 and what caused the reversion of this? After the oil price started its decline there was wide acknowledgement that hedge funds were largely responsible for its lift-off and it is then also the only plausible explanation for its recent collapse as well. As oil is a significant component of commodity hedge funds, we saw commodities' general lift off until 2014, and we also saw them collapse in unison with the oil price. Since both SA and Namibia are commodity based economies this has already impacted our economies quite badly.

The question arising is whether the current price level of crude is sustainable, whether this state of affairs will continue and if so, for how long we can expect it to continue? We have seen that the speculative underpin of high commodity prices has been sustained for a period of 10 years. This indicates that the reversal of this, assuming a constant crude price of 30 Dollars per barrel, could prospectively also last for a period of 10 years until equilibrium has been reached once again. Our calculations indicate that on a US CPI adjusted basis the oil price should currently be around at least 35 Dollars per barrel. It is to be noted though that this calculation ignores changes in technology on the one side, and the depletion of conventional crude resources on the other side, that impact cost of production. So any price below 35 Dollars per barrel is definitely unsustainable in our view. In fact going by the cost of production in the main oil producing countries as reported in the media, a price below 70 to 80 Dollars is probably unsustainable.

In a previous newsletter we showed that there has been a very close correlation between the Rand/US Dollar exchange rate, the oil price and the SA Allshare index. As the oil price (and commodities in general) rose, the Allshare index rose while the Rand weakened. Now that the oil price (and commodities in general) collapsed, the Allshare index appears to be stagnating where its close correlation with the oil price would have indicated at least a significant decline in the Allshare index. It would have similarly indicated a strengthening of the Rand whereas the Rand has actually weakened significantly. History does indicate though that the Allshare index appears to ignore rapid changes in the oil price and the Rand/US Dollar exchange rate and that the recent swings in their fortunes may not necessarily lead to the index retreating significantly.

As we conclude above, the recent collapse in the oil price does not appear to be justified, which may be the reason for the Allshare index not having tracked this collapse. Similarly it appears that the recent 'collapse' in the Rand/US Dollar exchange rate is not justified.

On this basis, we conclude that the weakness of the Rand is overdone and that the Rand should strengthen on the basis of fundamentals. However this weakness is bound to result in an increase in the SA repo rate sooner and higher than expected. We also believe that it is bound to accelerate the rate of inflation which also will lead to an increase in the repo rate. , Finally, we believe that the weakness of the oil price (and commodities in general) is overdone and should reverse. However this reversal may take quite a while to manifest.

Conclusion
While we are faced with these very negative developments for which it is very difficult to time a correction, the investor should continue to focus on real returns rather than absolute returns to increase his wealth slowly and steadily. With an inflation rate of around 3% one should be quite content if one manages to achieve an investment return around of 8% per annum. As an active fund member one should not shun equities but should be cautious, spread the risks as far as the law allows and focus on stock picking. In terms of equity sectors, depressed commodity markets may offer selective buying opportunities but this may require patience to realise gains, and it may still just be too early. Consumer Goods and Consumer Services had a terrific run since the beginning of 2006, driven mainly by foreign investors. With the severe depreciation of the Rand, foreign investors will have been hurt and their interest is likely to wane. We therefore do not see much potential in these

sectors anymore. This leaves the Financial and Industrial sectors as sectors we believe to offer the best prospects.

In terms of diversification between different asset classes locally, the likelihood of a repo rate increase suggests that interest bearing investments do not hold good prospects at this stage. However the prospect of accelerating inflation favours inflation linked bonds.

Although global diversification must be part of any local investor's investment strategy, the overdone weakness of the Rand suggests that one should currently not move capital offshore. More speculative investors with offshore investments may actually want to consider repatriating capital to capitalise on what we believe to be an unjustifiably weak Rand.

7. Important notice and disclaimer

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