Volume 12, No. 4,
April 2016

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 APRIL 2016

By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

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

1. Review of Portfolio Performance

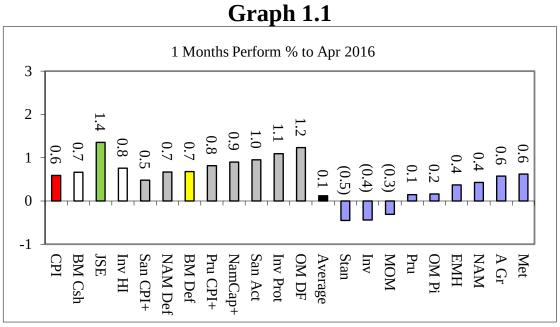
In **April** the **average prudential balanced portfolio** returned 0.12% (Mar: 2.76%). Top performer is Metropolitan (0.62%); while Stanlib (-0.45%) takes the bottom spot. For the 3 month period Namibia Asset Management, takes top spot, outperforming the 'average' by roughly 2.4%. On the other end of the scale Stanlib underperformed the 'average' by 1.1%.

Graphs 1.1 to 1.9 reflect the performance for periods from 1 month to 15 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.

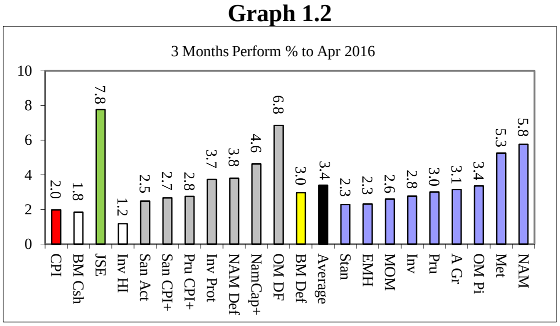
Below is the legend to the abbreviations reflected on the graphs:

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)
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)

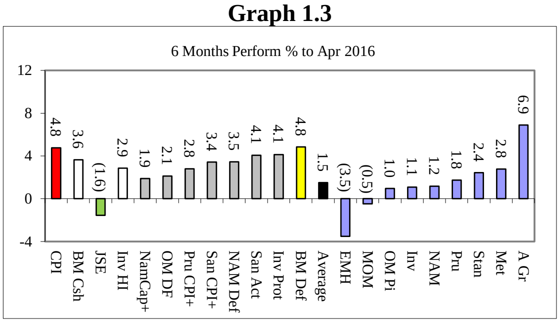
Graph 1.1



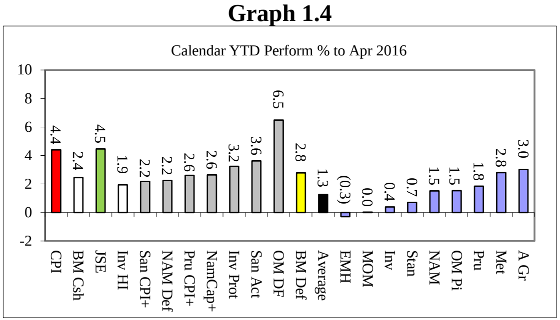
Graph 1.2



Graph 1.3



Graph 1.4



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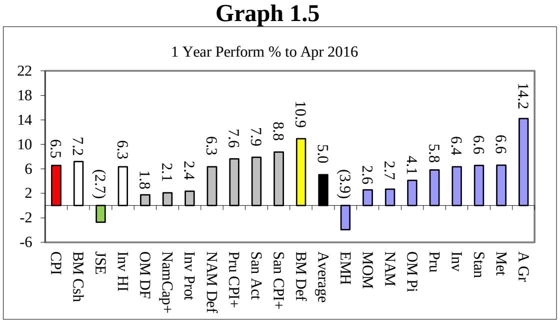
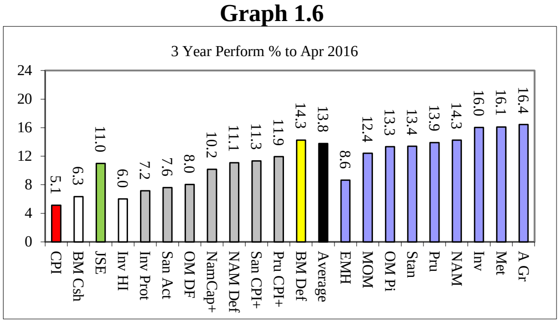
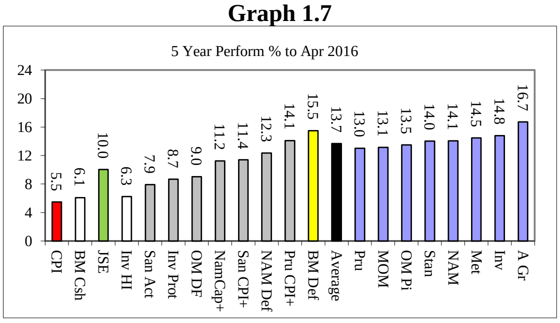
Graph 1.5



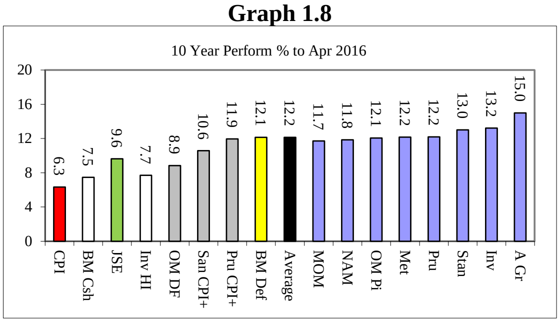
Graph 1.6



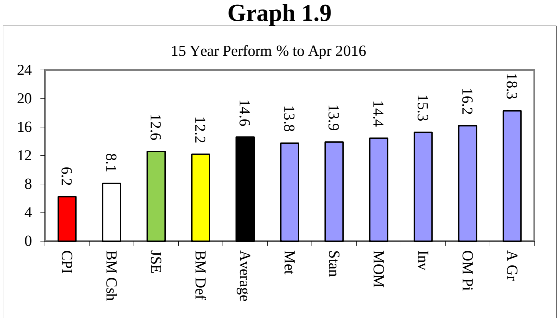
Graph 1.7



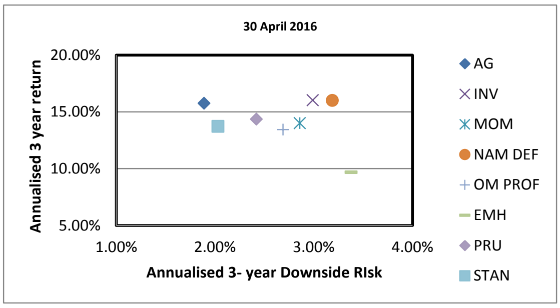
Graph 1.8



Graph 1.9

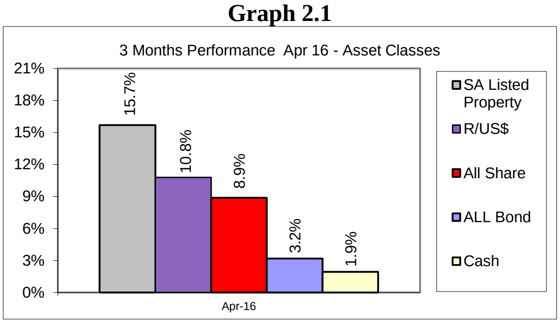


Risk/ Return

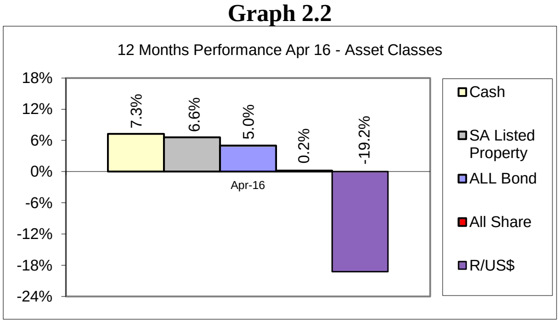


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

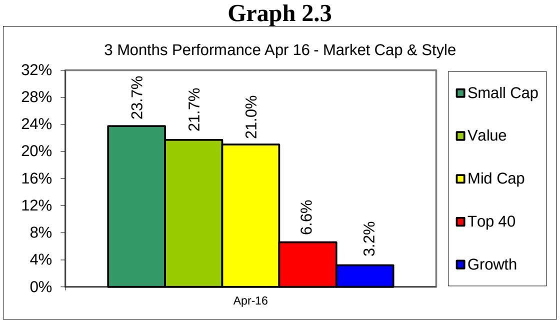
Graph 2.1



Graph 2.2



Graph 2.3



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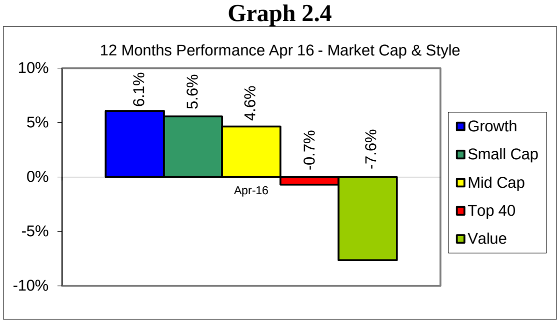
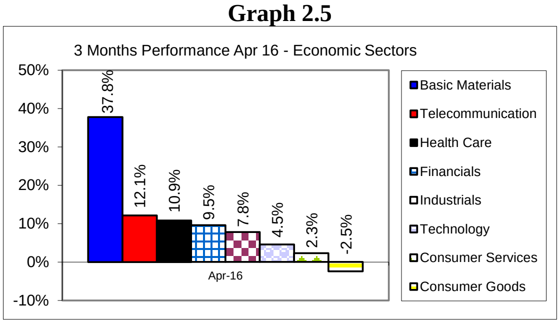
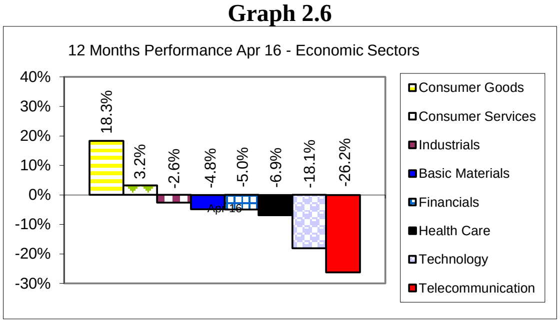
Graph 2.4



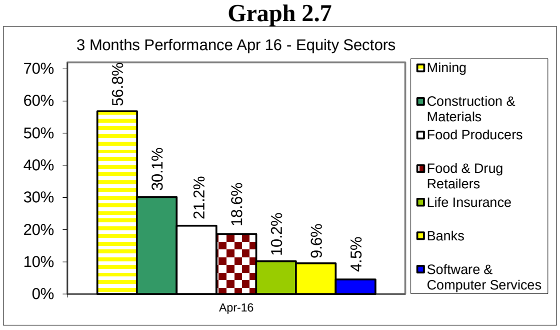
Graph 2.5



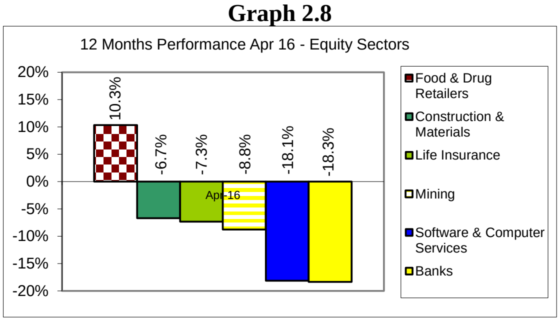
Graph 2.6



Graph 2.7



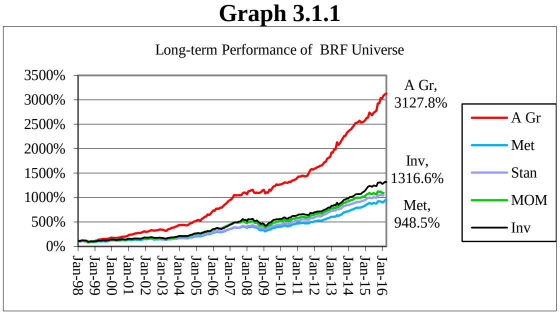
Graph 2.8



3. Portfolio Performance Analysis

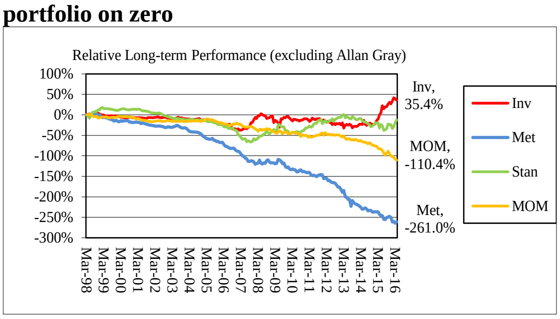
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

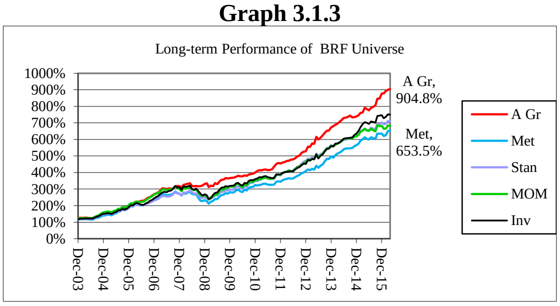


Graph 3.1.2

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

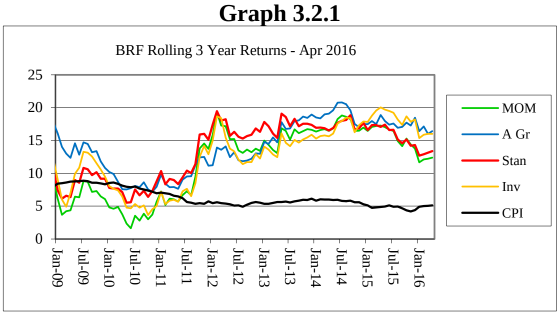


Graph 3.1.3



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

Graph 3.2.1



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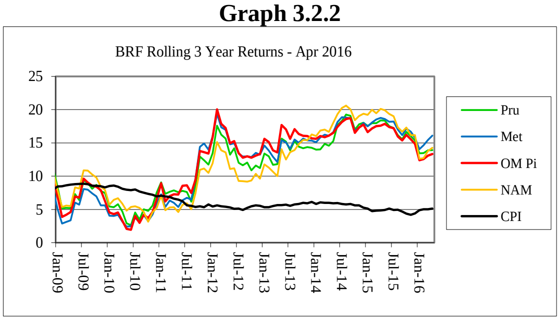
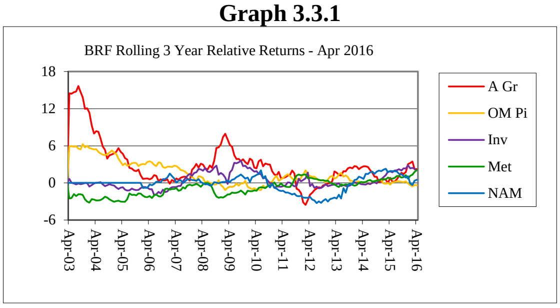
Graph 3.2.2

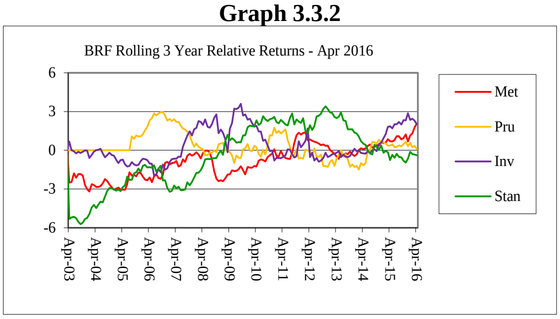


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

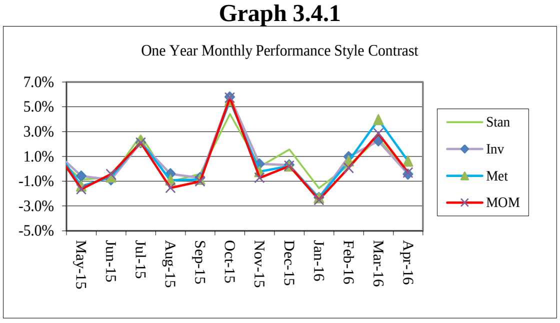


Graph 3.3.2

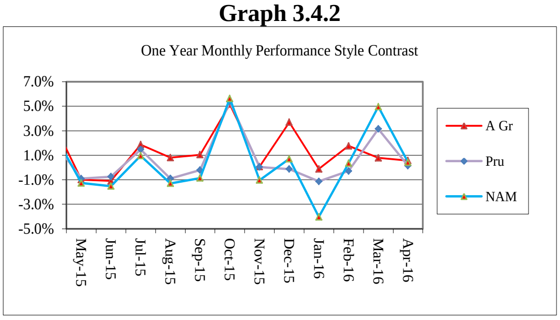


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

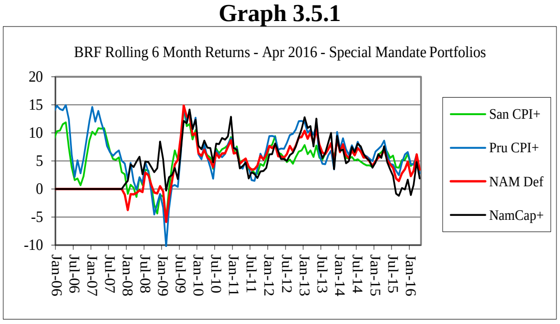


Graph 3.4.2

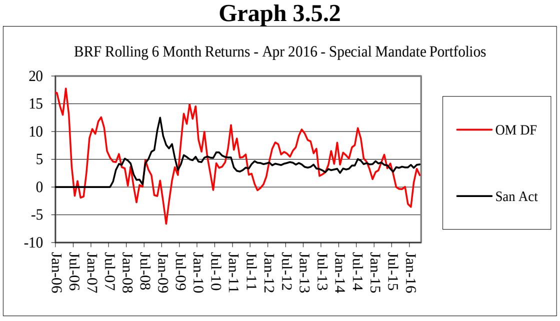


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

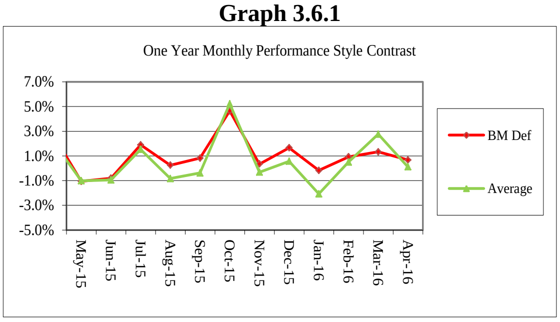


Graph 3.5.2



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

Graph 3.6.1



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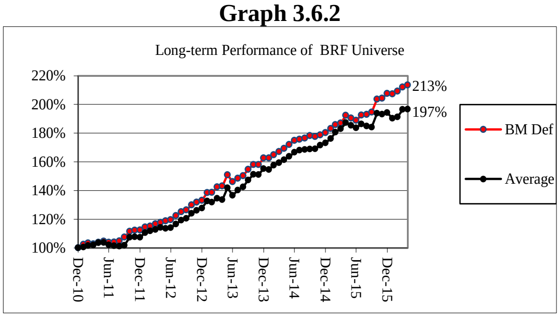
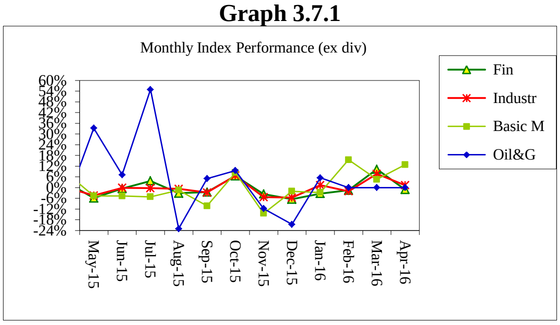
Graph 3.6.2

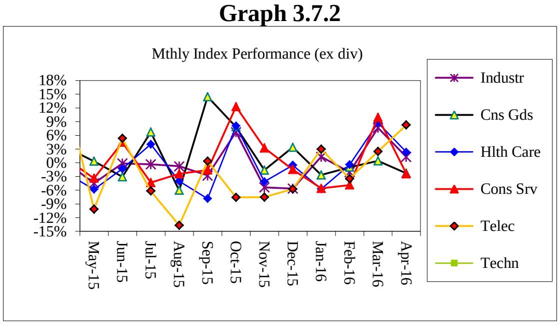


3.7 One year monthly performance of key indices (excluding dividends)

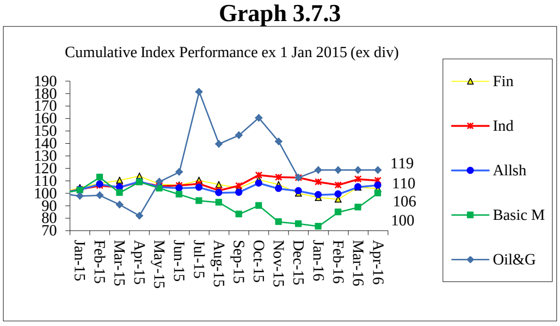
Graph 3.7.1



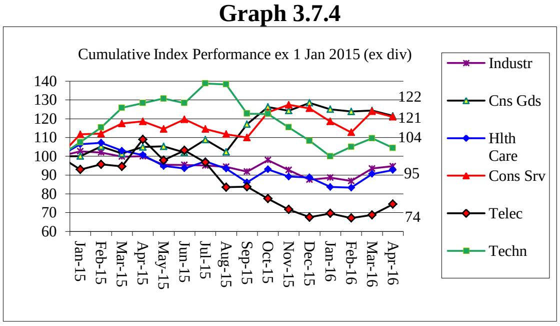
Graph 3.7.2



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.	15.5	13.7
5 year real return - % p.a.	10.0	8.2
Equity exposure - % of portfolio	49.7	55.9
Cumulative return ex Jan 2011	113.4	96.7
5 year gross return target - % p.a.	5	6
Target income replacement ratio p.a. - % of income per year of membership	2	2.4
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	5.6%	14.2%	12.7%
Best annual performance	6.3%	19.1%	18.5%
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	5.8%	16.8%	16.1%

The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years May 2013 to April 2016. This gives an indication of volatility of the performance of these 3 risk profiles.

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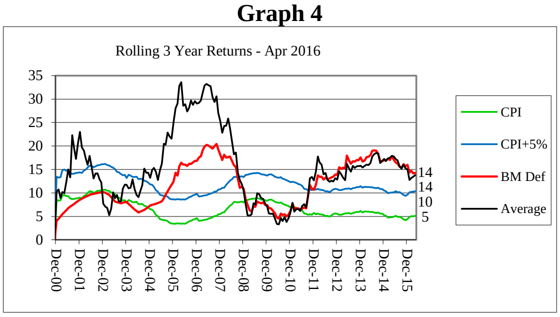
Graph 4



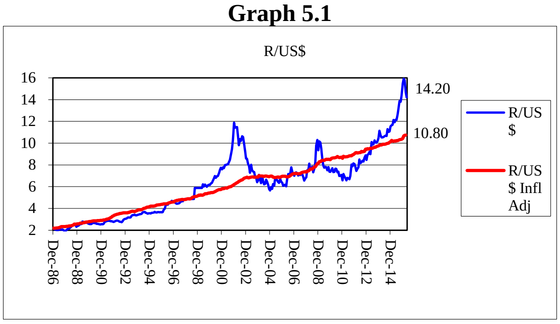
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end April was 14.26%, the average was 13.78% vs CPI plus 5% currently on 10.36%.

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 undervalued at 10.80 to the US Dollar while it actually stood at 14.20 at the end of April. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

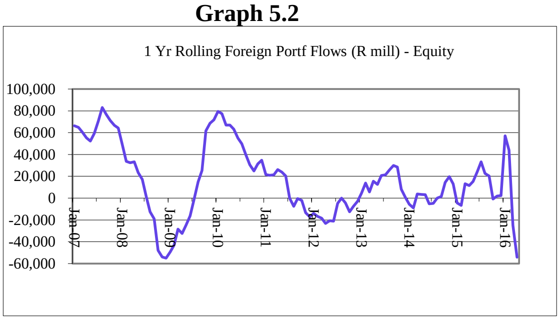
Graph 5.1



Rand strengthened despite foreign capital outflows

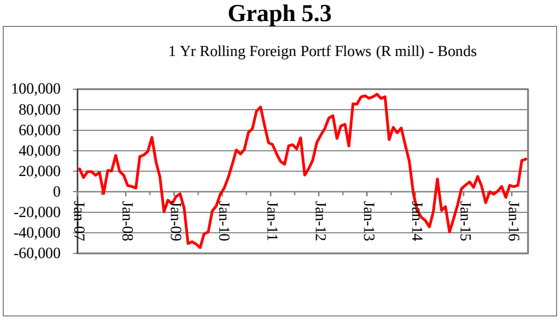
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of 54.3 bn on a year-on-year basis at the end of April (outflow of R 25.0 bn year-on-year to end March). The month of April experienced a net outflow of R 21.6 bn. Since the beginning of 2006, foreign net investment in equities amounts to R143 bn (end March R 163 bn). This represents roughly 0.9% 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 R31.8bn over the past 12 months to end of April (inflow of R 30.5 bn over the 12 months to end of March). Since the beginning of 2006, foreign net investment in bonds amounts to R 258 bn (to March just over R241 bn). The month of March experienced a net inflow of R 16.3bn.

Graph 5.3



The net outflows of foreign capital from equity and fixed interest securities was R22.5bn for the rolling 12 months to end April 2016 (inflow of R 5.5 bn to end March 2016), compared to an inflow of R 26.5 bn for the 12 months to end April 2015 (inflow of R 17.6bn to end of March 2015). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 401 bn (March 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 11.9% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of just over 29 years was 8.4% per year. This is equivalent to a growth in real terms of 3.5% p.a. over this period, excluding dividends, or around 6.5% including dividends.

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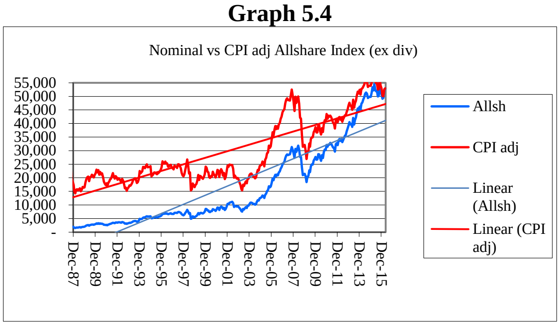
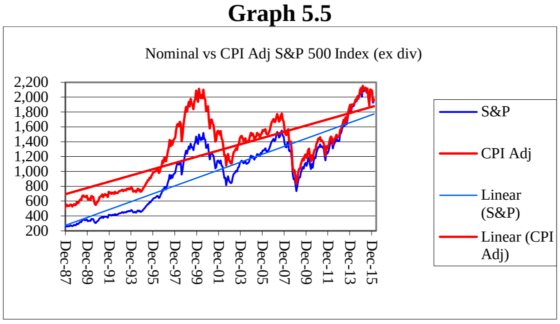
Graph 5.4



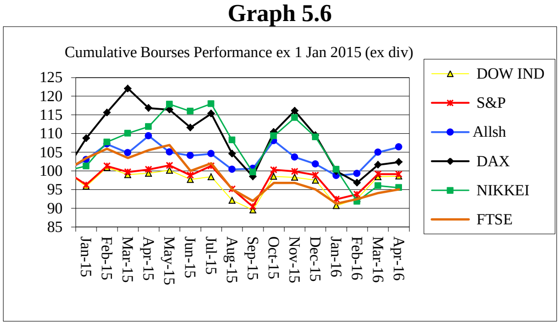
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.1% per annum, over this period of just over 29 years. US inflation over this period was 2.7%. This is equivalent to a growth in real terms of 4.4% p.a. over this period, excluding dividends.

Graph 5.5



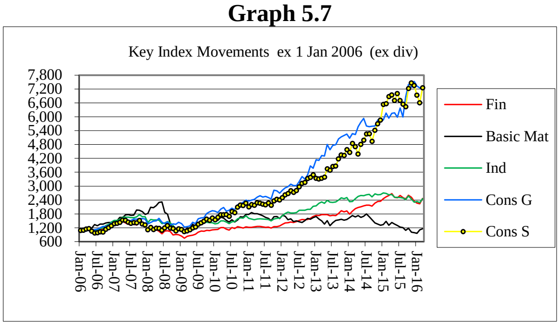
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Allshare and the DAX as the top performing share indices.

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 Goods: 21.1%; Consumer Services 21.0%; Industrials 9.3%; Financials 9.1%; and Basic Materials 2.7%.

Graph 5.7



6. Conclusion

Volatility in global equity markets has declined substantially since the advent of the global financial crisis. The US S&P 500 moved from as high as 80 points volatility to hovering around 20 points since 2012. This indicates that investors believe markets are stable - or does this indicate that we are in the eye of the storm? Well looking at what is happening in the world around us we note that the Chinese economy is slipping further. Interest rates have not turned the corner and are at unsustainably low levels. This in our view is indicative of trouble brewing somewhere in investment markets. There is upheaval all around the Mediterranean, there is the threat of a Brexit, there is the European refugee crisis, an economic and political crisis in Brazil, the Ukrainian crisis, the US presidential elections, the unpredictability of the oil price and more. All of these present uncertainty and thus risk for the investor that should manifest in market volatility. This is not the case though and it appears that investors are unperturbed by all this uncertainty, going by the subdued equity market volatility. Price: earnings ratios in the US and SA continue to climb, meaning that investors are paying ever more for the same profit generated by companies. The US S&P 500 1 year trailing p:e was at 19.2 at the end of April, which is the highest level since April 2010, after it had declined to 12.4 in September 2010. SA Allshare 1 year trailing p:e was at 21.3 at end April, after it had declined to 12.1 in September 2010. SA equity investors are thus prepared to pay on average 21 times companies' annual earnings.

And what about any risk of deflation? With interest rates as low as they are and have been since the end of the global financial crisis without having achieved the desired result of creating consumer demand and creating inflation with increasing demand, deflation could actually do the job of letting the air out of asset bubbles that were blown up by the artificially low interest rates. This would be bad news for owners of shares, property and other assets and could impact negatively on consumption. If you will be able to buy more for your Namibia Dollar in 6 months' time than you can today, you will no doubt delay buying, particularly when its non-essential purchases such as capital goods. Sellers would obviously have the opposite purpose which will lead to declining demand and increasing supply and to further deflation. Now what about fixed interest assets? The intervention of central banks has disabled the free market mechanism and has caused investors to ditch fixed interest investments for other assets, primarily equities. Pensioners whose capital is locked up in annuity funds so far had to bear the brunt of this distortion of market forces.

But why should the risk of deflation concern us here in Southern Africa where our inflation is running 'nicely' at around 7% now? Our governments certainly will not complain as there takings from the tax paying populous increases while the real value of their obligations is shrinking. The problem is that our economies will not evade the knock-on effect of deflation in the US and elsewhere, if it happened. Consider you owning a US Dollar asset of 1,000 that has decreased in value to 800. At an exchange rate of 15 the asset that was worth N$ 15,000 will now only be worth N$ 12,000.

If I as investor in a share considered the value of my N$ 1,000 in that share to be equivalent to the value N$ 1,000 invested in a bond yielding say 1%, I should be happy to buy the same quantity of bonds for say N$ 800 if my shares had declined in value to N$ 800 as the result of deflation. I would earn interest of N$ 10 on my bonds that I would purchase for N$ 800, which now represents a yield of 1.25%. This effect could correct the imbalance between fixed interest assets and other assets over a period and lead to the downward adjustment of equity prices. For the issuer of the bond this would of course have the opposite effect as his interest cost will increase.

With monetary aggregates being at historically high levels, interest rates at historically low levels and asset values being artificially inflated as the result of money printing by many reserve banks across the world, equilibrium will only be attained either through a slow adjustment in the value of fixed interest assets relative to that of other assets over a very protracted period or through another crisis that will lead to a rapid correction. Latter is similar to the cycles companies typically go through. Their share price increases rapidly above all fundamentals (and with it the CEO's compensation) until they reach a point where the CEO's run out of ideas to push the price any further. The result will be the departure of the CEO. The new CEO will now clean up by writing down inflated asset values, writing off doubtful amounts etc. that caused the artificial growth in the share price immediately. The share price will consequently drop steeply and the new CEO will now once again be able to push the share price and consequently his compensation package too.

What should we expect to happen? A distinct possibility is that a Donald Trump as next US president, and as a political outsider, may well have the courage to act as if he is the new CEO of company America, not being loaded with the political baggage of the candidates that participated in so many previous elections – take the pain now and move forward! Such a scenario really spells doom for debtors whose liabilities of course will retain their value while their assets will experience a decline in value.

Conclusion

Considering the risks looming for investors in global financial markets as sketched above, first and foremost, one should get rid of debt as quickly as one can. There is nothing one can do about a decline in asset values and if this happened as the result of deflation and also caused a decline in the cost of goods and services and the cost of living, one should be o.k. A deflation would impact all assets and there will be nowhere to hide. The best the investor can do is to invest selectively in high yielding assets that should be impacted less by a rapid de-rating. At the end of the day it's the income you get from your investments that will determine whether you will survive or not, not the underlying value of the asset. Investors should thus be extremely cautious under current circumstances and protection against downside may not be a bad strategy.

Barring a shock to the global financial system that will lead to a rapid correction of the prevailing imbalances, we expect to see significantly lower returns on all asset classes than we have seen over the past 5 years and it should be quite difficult to achieve real returns over a protracted period.

A more conservative absolute return portfolio will offer better protection against any shock if this were to happen. We believe this is the less likely scenario though and therefore favour a prudential balanced portfolio with a low draw down and the emphasis on high yielding assets. Fixed interest investments do not fall into the high yielding category. Since global economies must be looking for correcting the prevailing imbalance, interest rates must be in line for correction, posing further risk to the investor in fixed interest assets. Investors must be content with lower absolute returns and should focus on real returns instead. In our opinion the Rand is undervalued as also shown in graph 5.1 above as the result of political factors. It may take quite some time to correct though. The point is that it is not the right time to move money offshore now, rather the converse, given that it is not so easy to move money in and out of the country, which militates against short-term strategies.

7. Important notice and disclaimer