Volume 12, No. 6
June 2016

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 JUNE 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

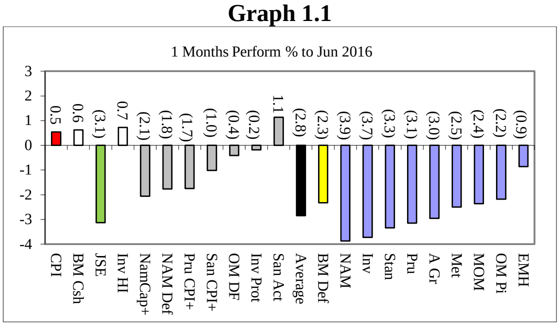
In **June** the **average prudential balanced portfolio** returned -2.85% (May: 3.44%). Top performer is EMH Prescient (-0.86%); while Namibia Asset Management (-3.87%) takes the bottom spot. For the 3 month period Allan Gray, takes top spot, outperforming the 'average' by roughly 1.7%. On the other end of the scale Investec underperformed the 'average' by 1.2%.

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.

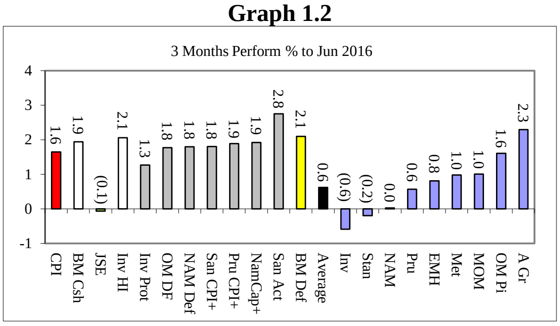
Below is the legend to the abbreviations reflected on the graphs:

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)

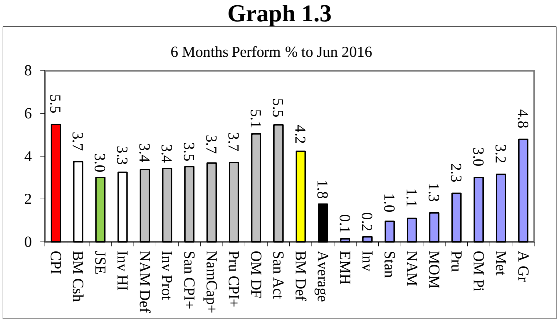
Graph 1.1



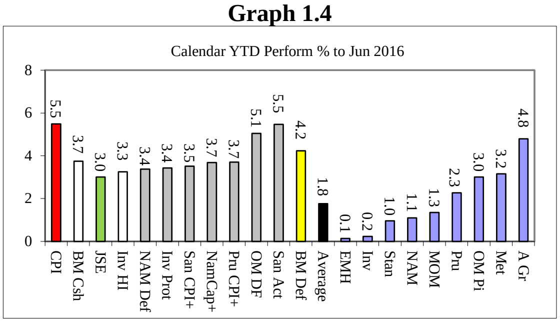
Graph 1.2



Graph 1.3



Graph 1.4



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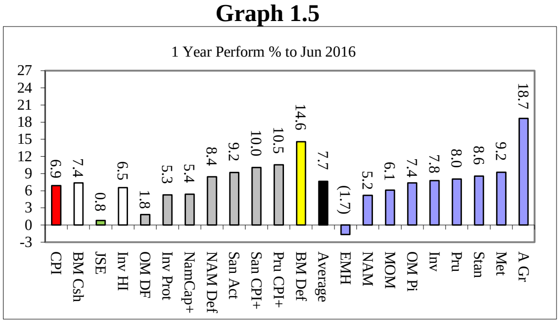
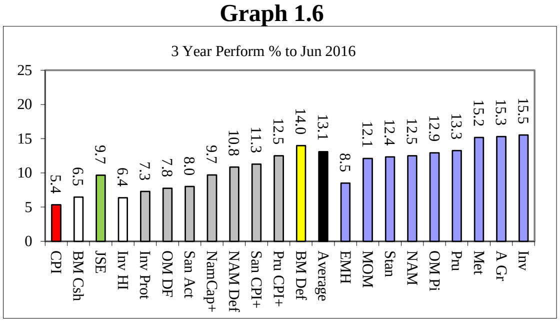
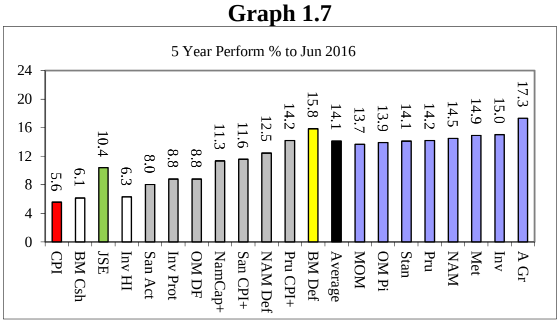
Graph 1.5



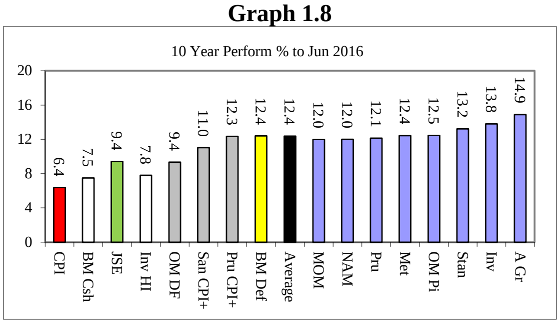
Graph 1.6



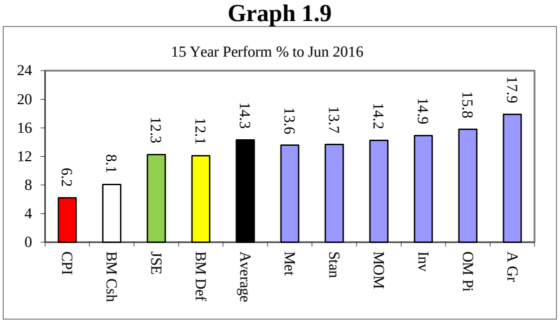
Graph 1.7



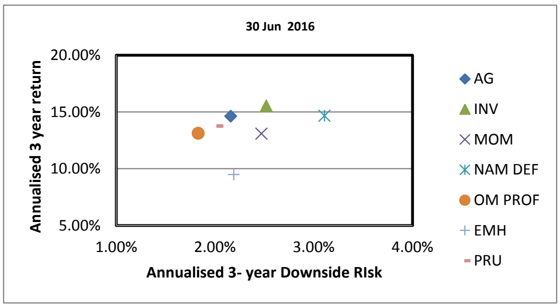
Graph 1.8



Graph 1.9

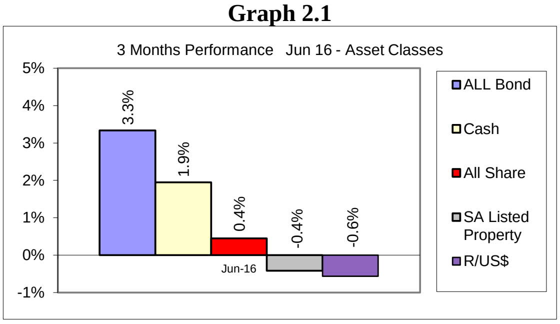


Risk/ Return

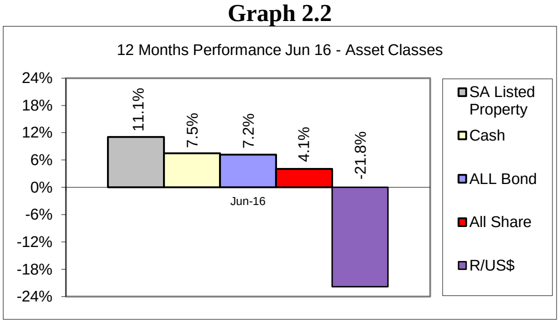


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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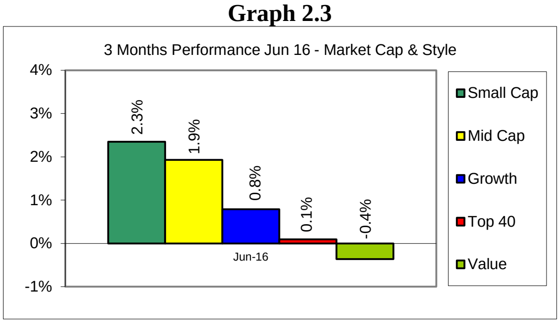
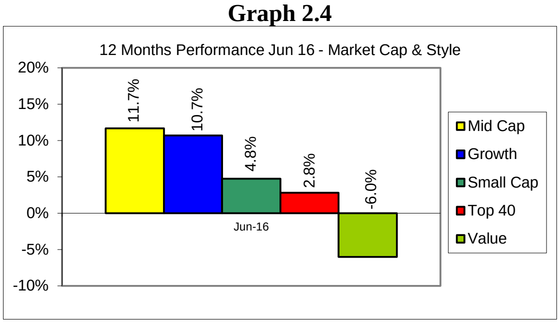
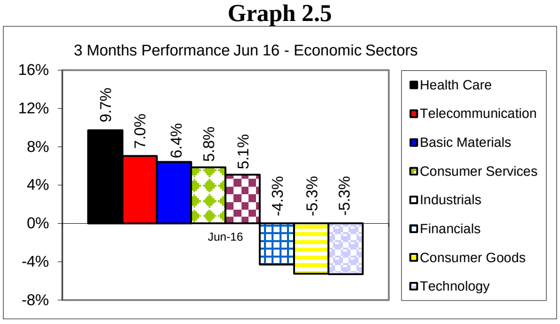
Graph 2.3



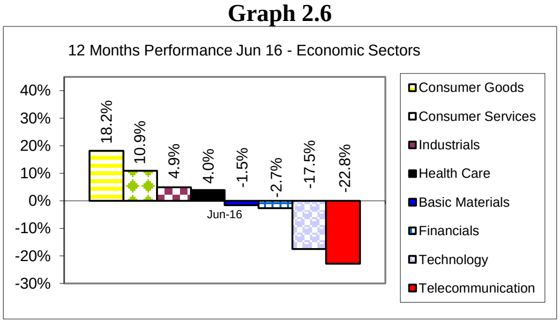
Graph 2.4



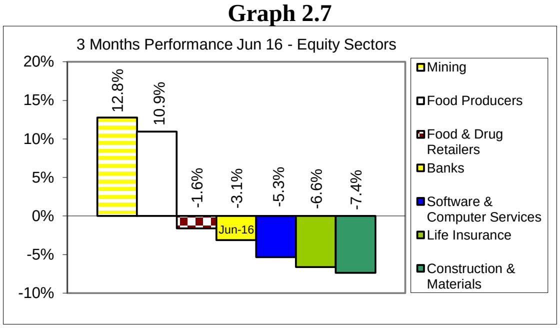
Graph 2.5



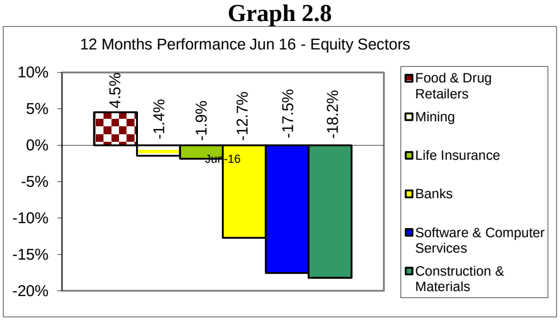
Graph 2.6



Graph 2.7



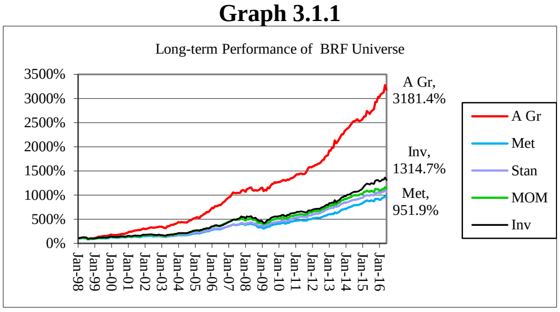
Graph 2.8



3. Portfolio Performance Analysis

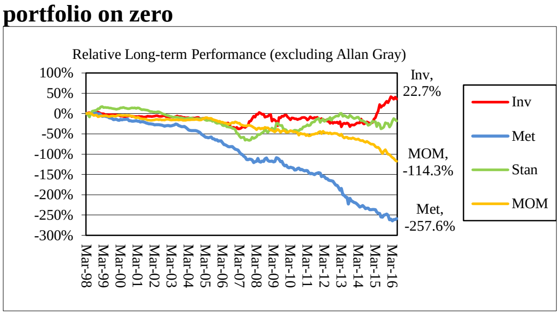
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

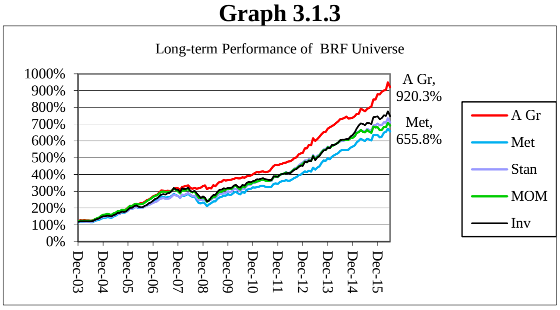


Graph 3.1.2

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



Graph 3.1.3



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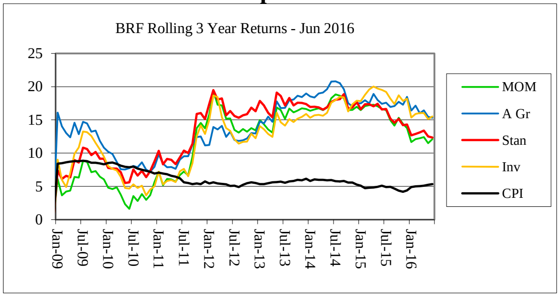
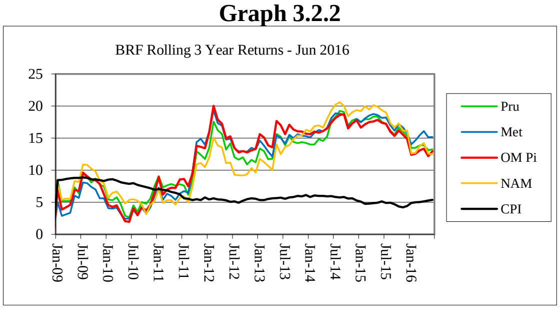
3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

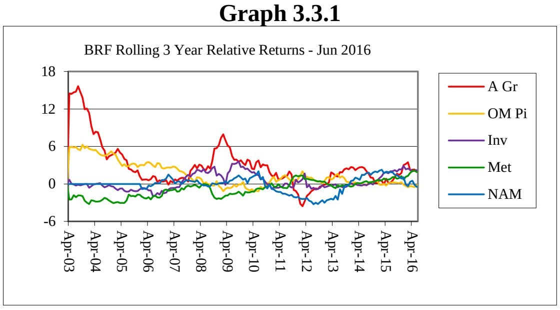


Graph 3.2.2

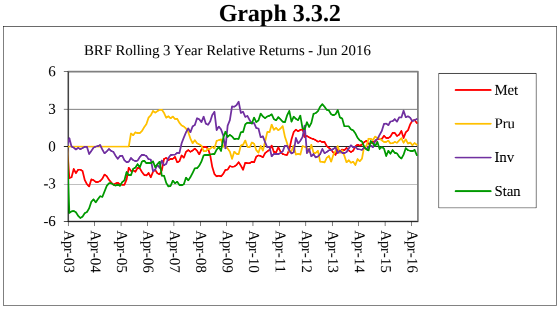


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

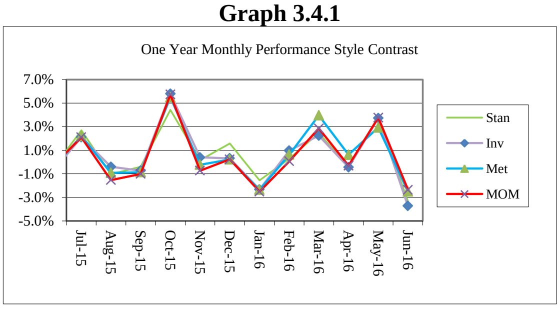


Graph 3.3.2

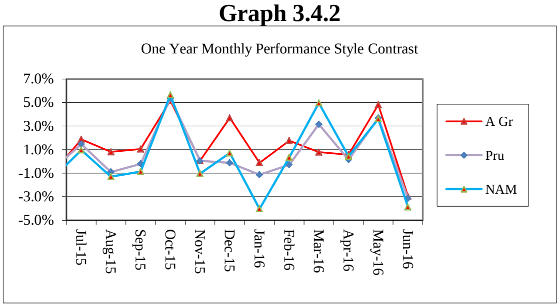


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

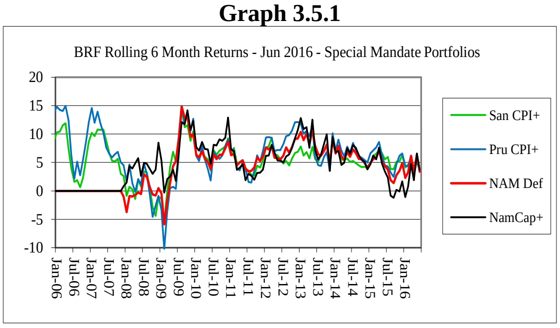


Graph 3.4.2

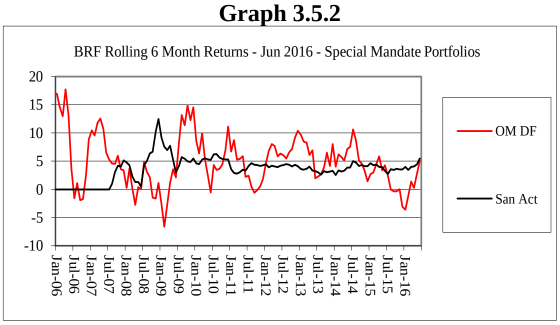


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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

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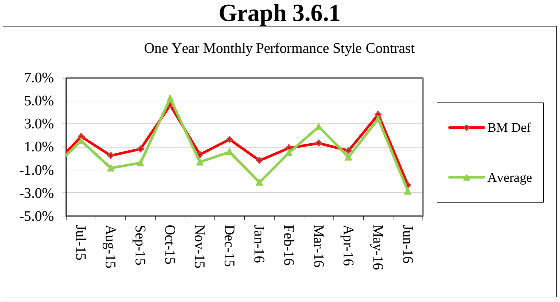
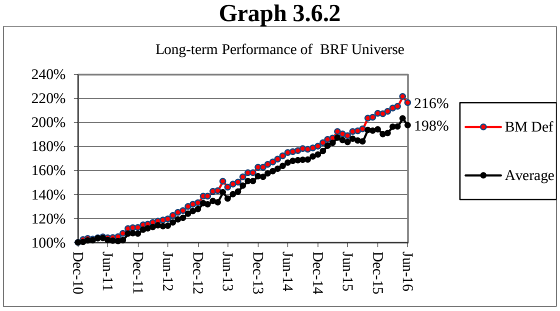
Graph 3.6.1

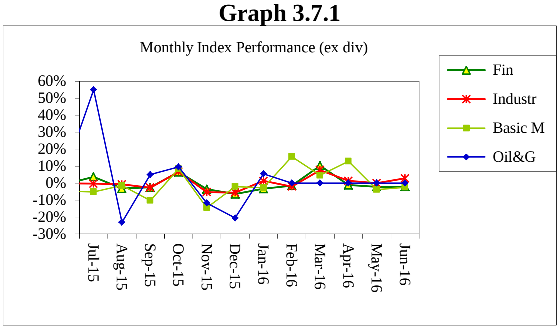


Graph 3.6.2

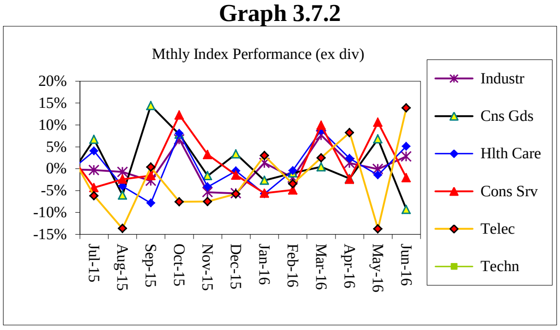


3.7 One year monthly performance of key indices (excluding dividends)

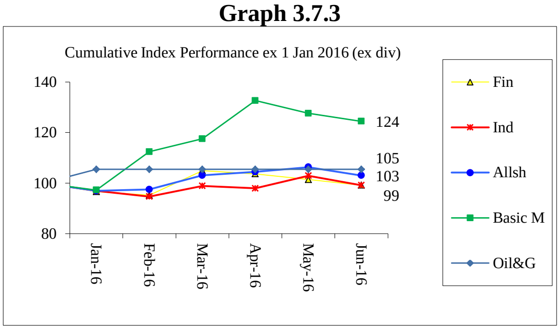
Graph 3.7.1



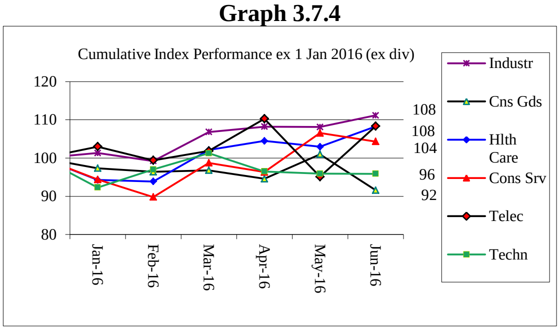
Graph 3.7.2



Graph 3.7.3



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.	15.8	14.1
5 year real return - % p.a.	10.2	8.5
Equity exposure - % of portfolio	49.7	55.9
Cumulative return ex Jan 2011	116.4	97.6
5 year gross real 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%	13.7%	12.8%
Best annual performance	6.5%	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%	16.6%	15.9%

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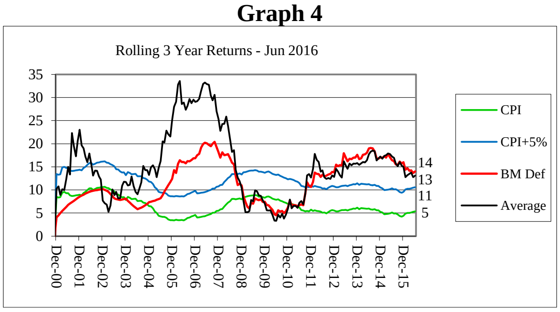
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years July 2013 to June 2016. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4

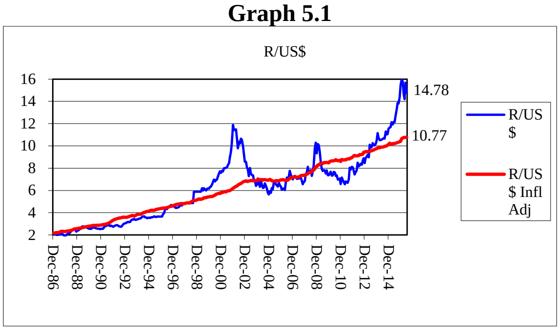


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end June was 14.00%, the average was 13.10% vs CPI plus 5% currently on 10.52%.

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 10.77 to the US Dollar while it actually stood at 14.78 at the end of June. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

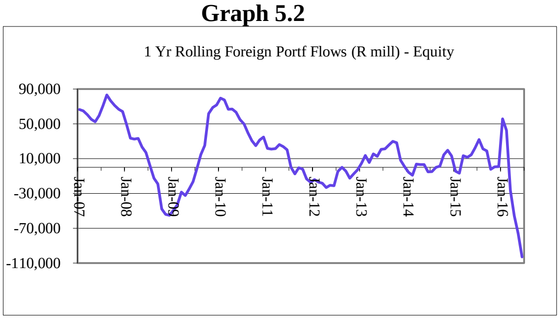
Graph 5.1



Rand strengthens despite foreign capital outflows

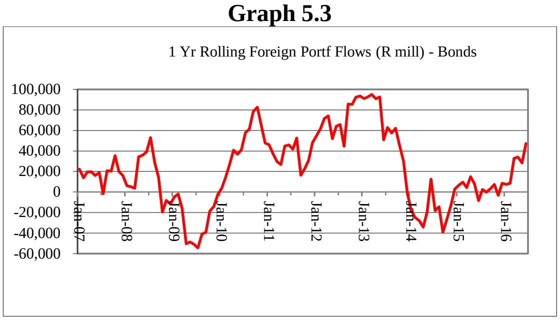
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of 103.0 bn on a year-on-year basis at the end of June (outflow of R 76.0 bn year-on-year to end May). The month of June experienced a net outflow of R 20.3 bn. Since the beginning of 2006, foreign net investment in equities amounts to R105 bn (end May R 125 bn). This represents roughly 0.7% 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 R47.1 over the past 12 months to end of June (inflow of R 28.4 bn over the 12 months to end of May). Since the beginning of 2006, foreign net investment in bonds amounts to R 269 bn (to May just over R257 bn). The month of June experienced a net inflow of R 12.5.

Graph 5.3



The net outflows of foreign capital from equity and fixed interest securities was R55.8 bn for the rolling 12 months to end June 2016 (outflow of R 47.6 bn to end May 2016), compared to an inflow of R 14.3 bn for the 12 months to end June 2015 (inflow of R 22.4 bn to end of May 2015). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 374 bn (May 382 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 29 years was 8.4% per year. This is equivalent to a growth in real terms of 3.4% p.a. over this period, excluding dividends, or around 6.4% including dividends.

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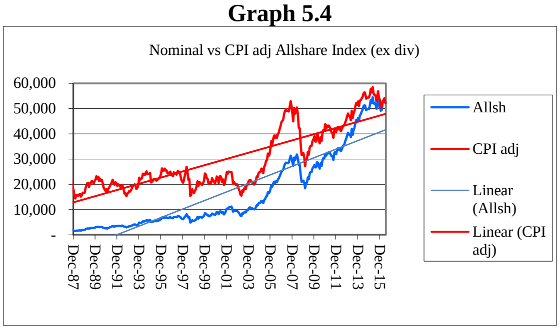
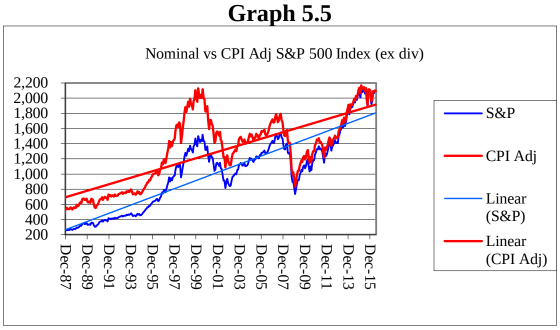
Graph 5.4



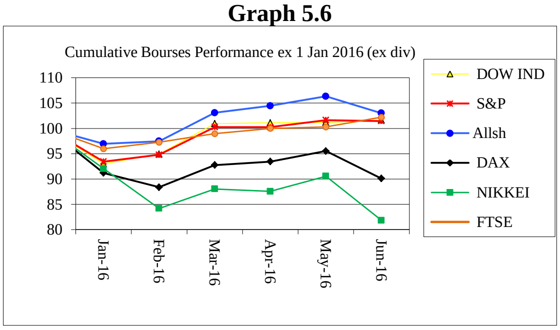
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.2% per annum, over this period of just over 29 years. US inflation over this period was 2.7%. This is equivalent to a growth in real terms of 4.5% p.a. over this period, excluding dividends.

Graph 5.5



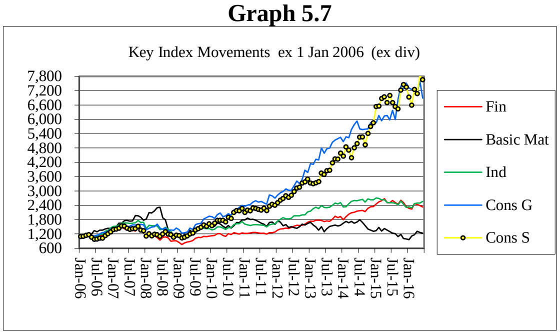
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Allshare, FTSE, Dow Jones and S&P 500 as the top performing share indices.

Graph 5.6



Graph 5.7 provides an overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced. 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: 21.6%; Consumer Goods: 20.4%; Industrials: 9.4%; Financials: 8.5%; and Basic Materials: 2.0%.

Graph 5.7



6. **Is a bad weather warning on the horizon?**
(by Tilman Friedrich)

The 'ZIRP', acronym for zero interest rate policy, that has been applied by many of the large global economies since the financial crisis, projects some bad weather warnings on the screen of pension investors the consequences of which are not all that clear.

More directly it has been eroding the social security systems of these countries as these systems are to a large extent dependent on fixed interest instruments delivering real returns. Those that are still actively contributing towards their social security systems will be on the losing end of this equation and will either have to pay in ever more or will experience ever declining old age provision and will have to make supplementary provision. Those that are already receiving benefits will be faced with a steadily declining standard of living as the result of the systems not earning real returns anymore.

More indirectly, savers have been turning their backs on fixed interest bearing assets in favour of equities, property and other assets that generate real returns. As the result global equity markets, property and a number of other markets are bloated. At some point in time this imbalance has to correct as no one can afford to invest in an asset returning negative yields in the long-term while flows into such assets will eventually dry up.

When the inevitable turning point comes, any investor who has placed his reliance on capital appreciation of his investments – caused by the search for yield in areas other than fixed interest assets – will experience disappointment from a decline in the valuation of equities, property and other bloated assets.

An analogy to a decline in market value of equities that the man in the street is probably more familiar with is a decline in the property market. If you own a property and you live in that property, a decline in its market value is unlikely to be of concern to you, unless you leveraged on the increasing value of the property to incur debt. The value of any debt will not change of course, no matter what happens to the value of your property and debt typically must be repaid. If you wanted to sell your

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property in order to purchase shares or other assets, a general decline in bloated asset values will mean that you will now get less for your property, but at the same time you will probably be able to purchase another asset that has also declined in value.

Similarly, if you bought the property to generate an income for you to live off, a decline in the market value will not impact immediately on your rental income but as tenants find alternative shelter whose rent is now calculated on a lower capital value, you will eventually be forced to reduce the rental on your property as well.
So why should your share investment be different? If you are not required to sell you shares, a change in their value will not affect you, alternatively you will be able to exchange value for value, be it at a lower level. But why does a pension fund investor invest in equities at the end of the day? You require an income to live off when you retire. If you have to sell to survive, you will have a problem because you will get less than what you had bargained on. What you will be left with is the dividends generated by your shares. And of course we are aware of inflation so your dividends should not remain constant but grow with or above inflation.

In summary, if we are facing declining markets, selling lower without simultaneously buying lower will realise investment losses that would otherwise not have been a problem for the investor. A pensioner who needs to live of his pension investment will be selling if he draws at a rate higher than the dividends and other income generated by the pension investment and will be realizing losses as he continues to sell down his investment into declining markets. This should be avoided at all cost. Furthermore when choosing his investments, he should look out for investment generating high and growing income.

Unlike property, where your income is a function of the market values in the long-term, dividends are not a function of the underlying market value of the share but are a function of the turnover generated by the company and the expenditure incurred by the company to generate the turnover.

Conclusion
In view of our expectation of a continued sluggishness of the global economy and the risk of rebalancing between fixed interest assets and equities, primarily, yield will be hard to get by. The basic principles are to spread risk and to look for value in assets that generate high yields with superior growth prospects. The pension fund investor should continue to focus on achieving real returns of inflation plus 4% to 5%, i.e. be content with returns of between 10% and 12% for the next 12 months. Ideally this yield should be generated by your dividend to avoid being dependant on selling assets to realise capital gains.

7. Important notice and disclaimer

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