Volume 12, No. 7
July 2016

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JULY 2016

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

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1. Review of Portfolio Performance

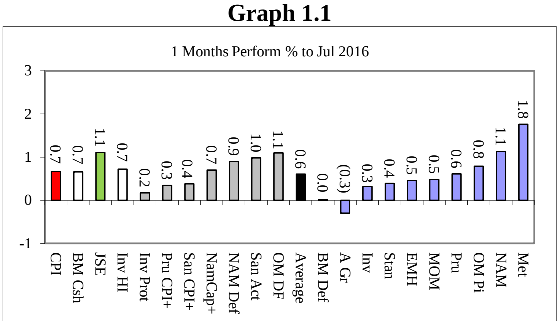
In **July** the **average prudential balanced portfolio** returned 0.61% (June: -2.85%). Top performer is Metropolitan (1.76%); while Allan Gray (-0.30%) takes the bottom spot. For the 3 month period Old Mutual, takes top spot, outperforming the 'average' by roughly 1.2%. On the other end of the scale Investec underperformed the 'average' by 0.9%.

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.

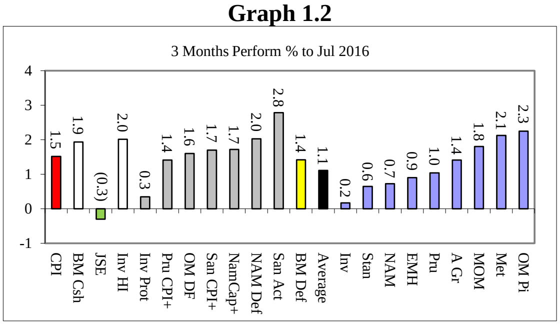
Below is the legend to the abbreviations reflected on the graphs:

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)

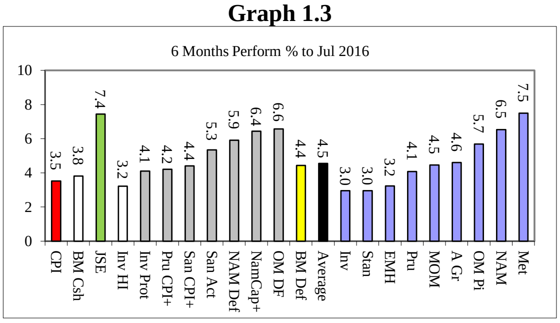
Graph 1.1



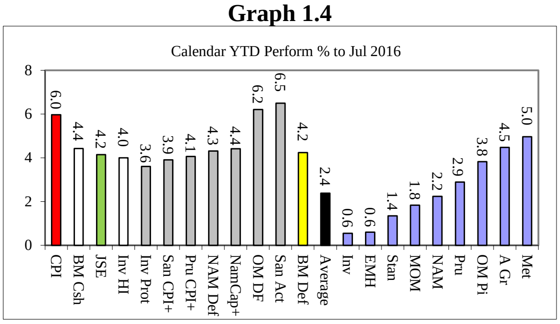
Graph 1.2



Graph 1.3



Graph 1.4



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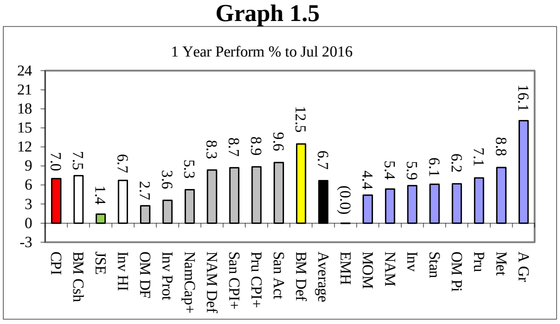
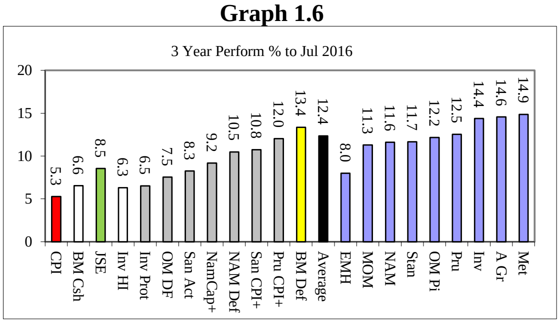
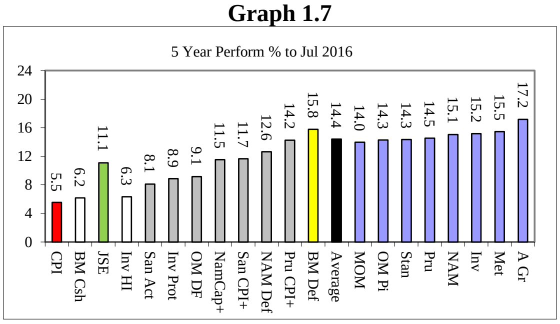
Graph 1.5



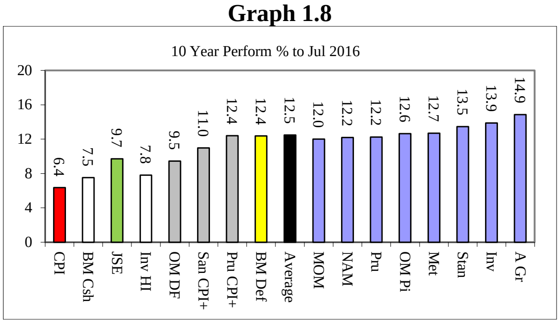
Graph 1.6



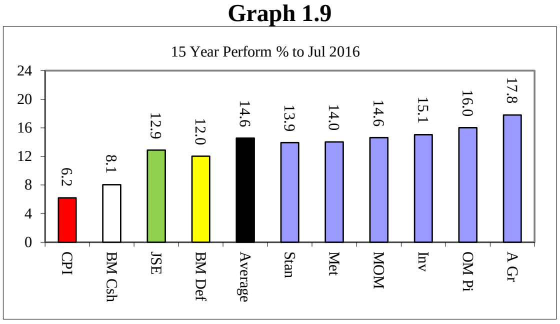
Graph 1.7



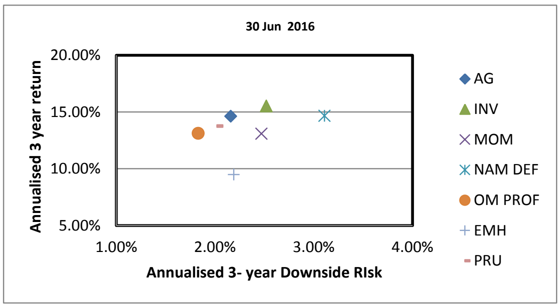
Graph 1.8



Graph 1.9

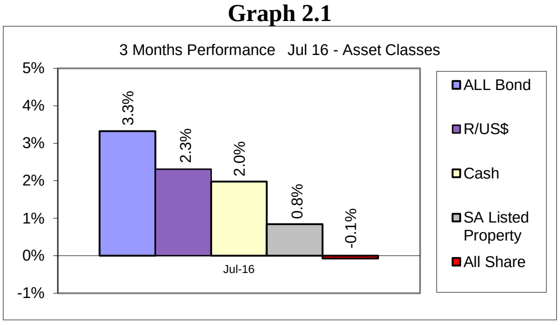


Risk/ Return

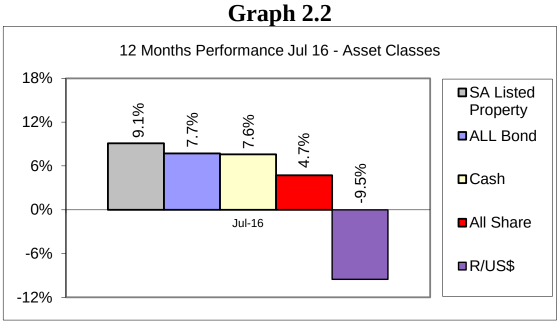


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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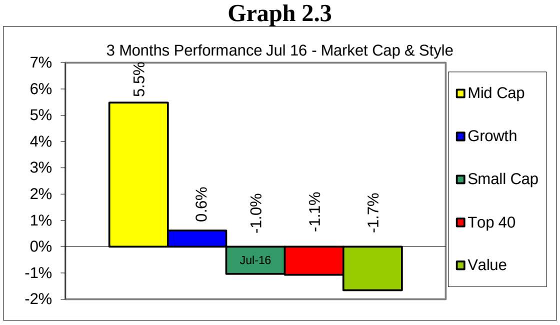
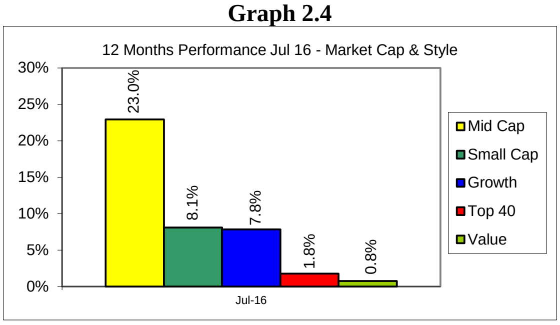
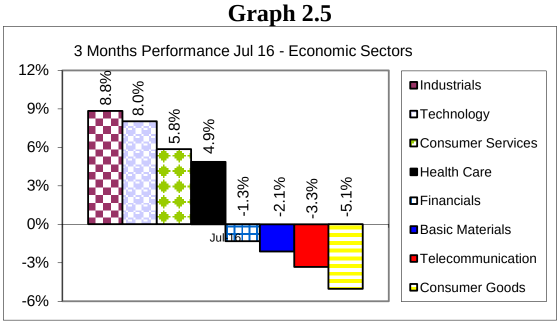
Graph 2.3



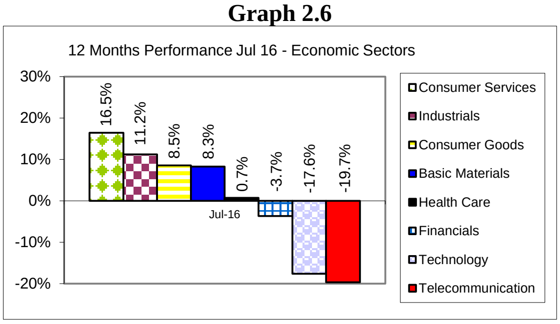
Graph 2.4



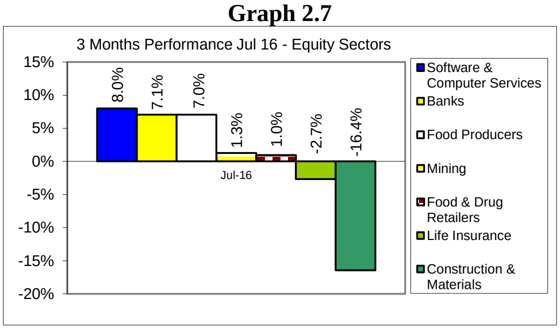
Graph 2.5



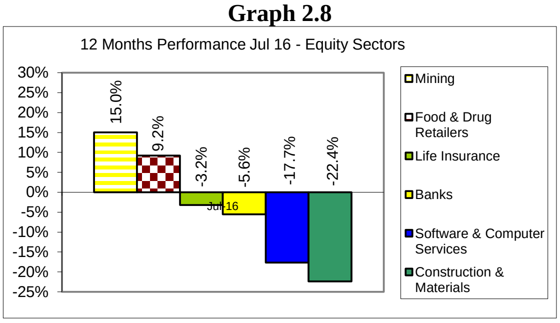
Graph 2.6



Graph 2.7



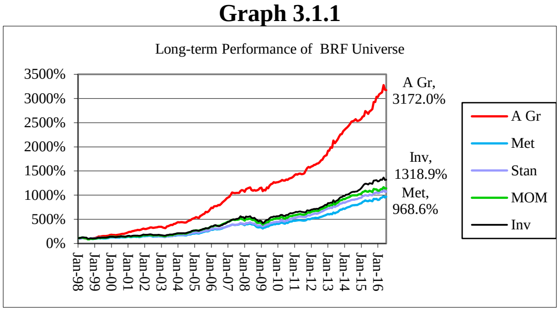
Graph 2.8



3. Portfolio Performance Analysis

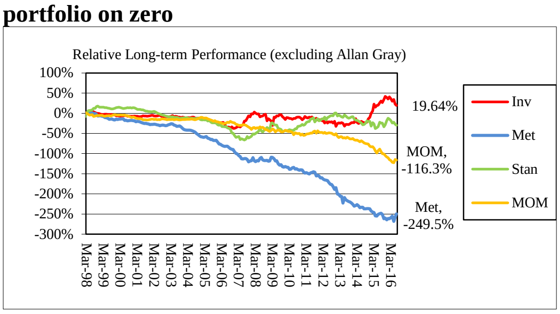
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

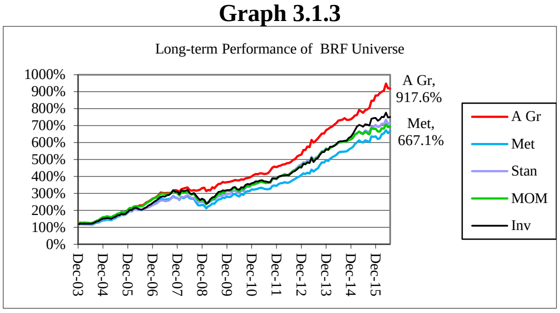


Graph 3.1.2

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



Graph 3.1.3



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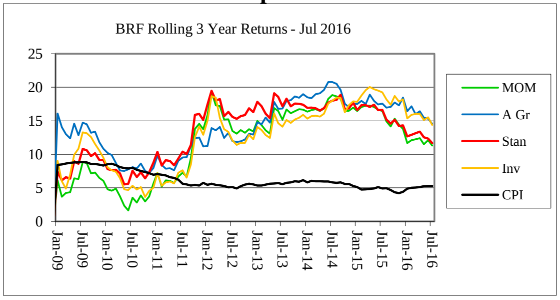
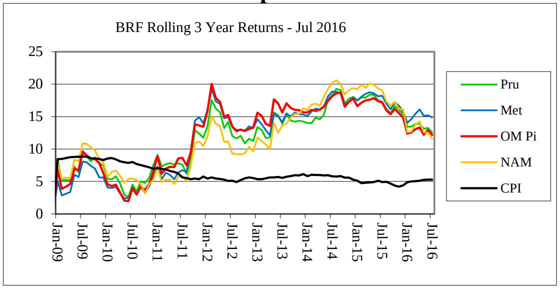
3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

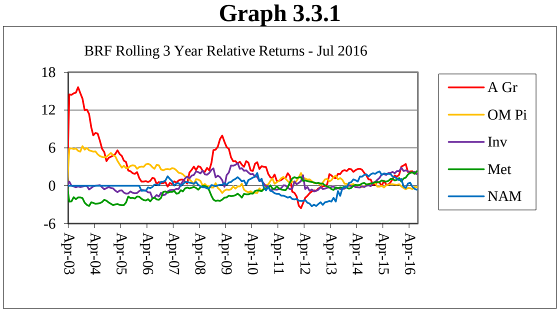


Graph 3.2.2

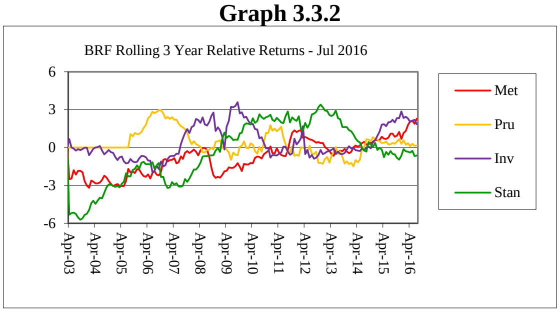


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

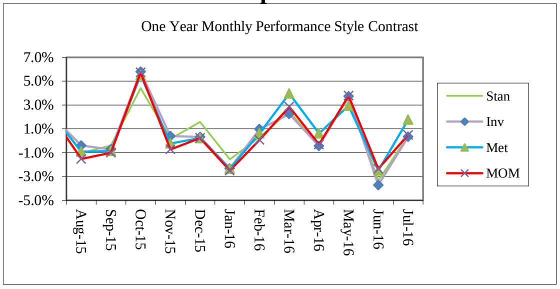


Graph 3.3.2

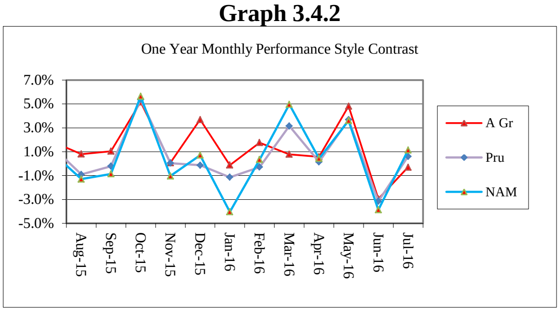


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

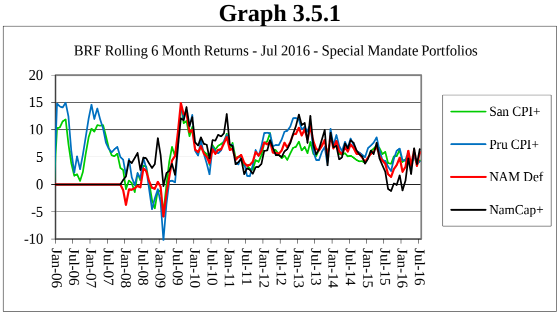


Graph 3.4.2

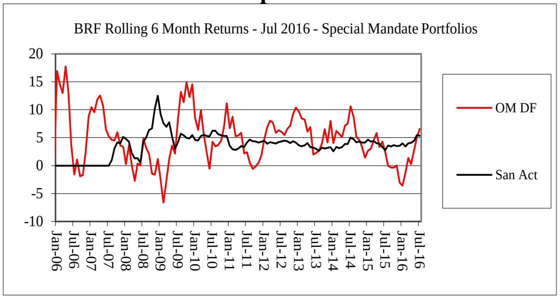


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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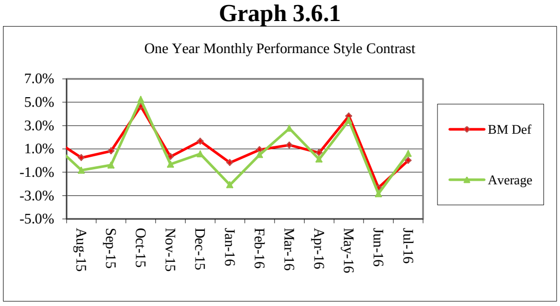
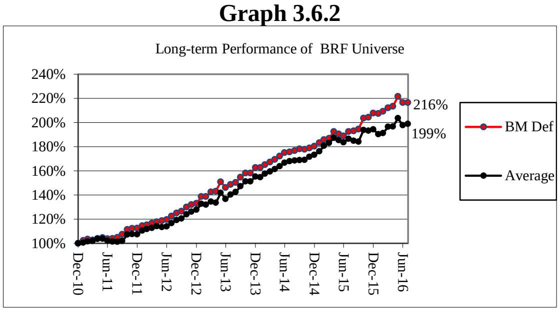
3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

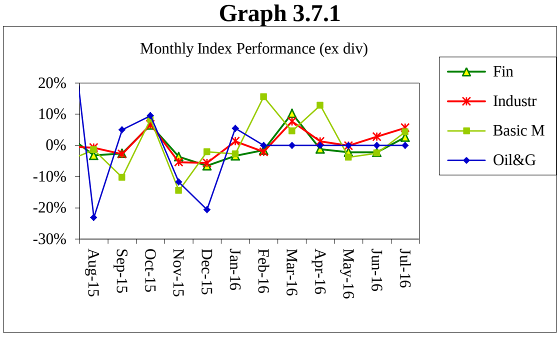


Graph 3.6.2

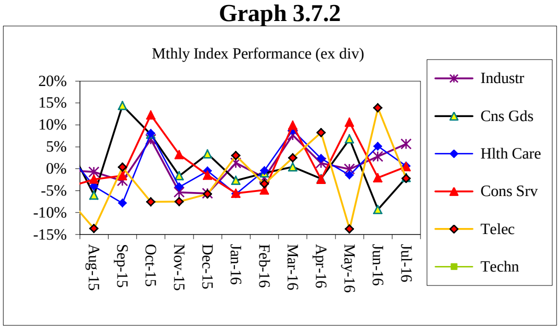


3.7 One year monthly performance of key indices (excluding dividends)

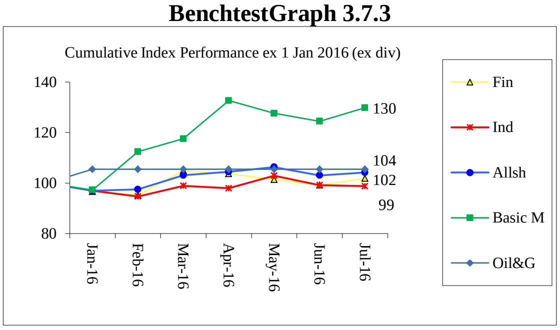
Graph 3.7.1



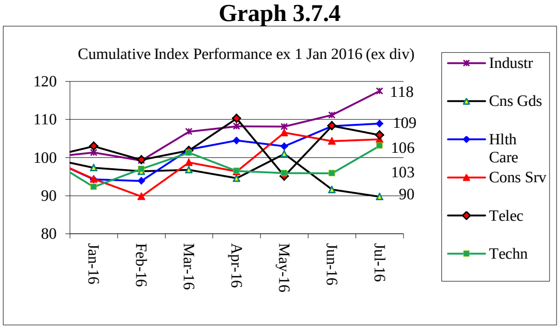
Graph 3.7.2



BenchtestGraph 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	46.6	54.4
Cumulative return ex Jan 2011	116.5	98.9
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%	13.4%	12.4%
Best annual performance	6.6%	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	5.9%	16.5%	15.9%

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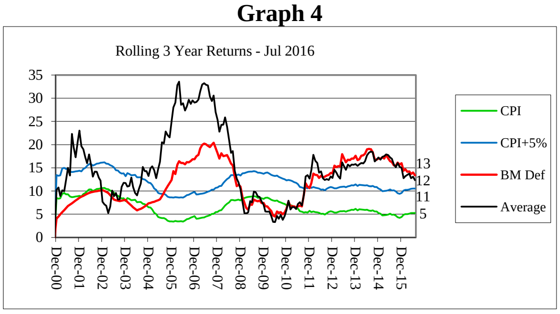
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years August 2013 to July 2016. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



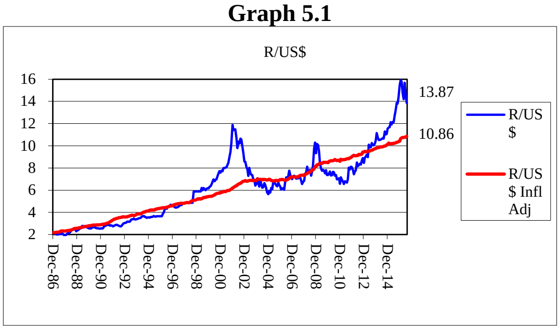
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end July was 13.4%, the average was 12.4% vs CPI plus 5% currently on 10.5%.

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 10.86 to the US Dollar while it actually stood at 13.87 at the end of July. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

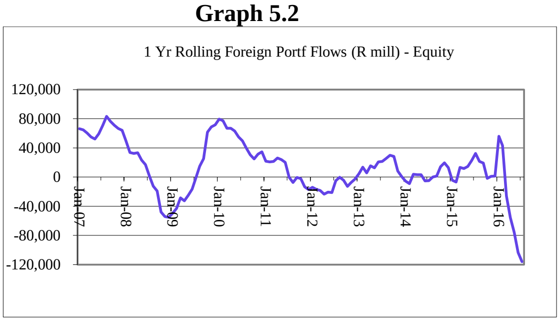
Graph 5.1



Rand strengthens despite foreign capital outflows

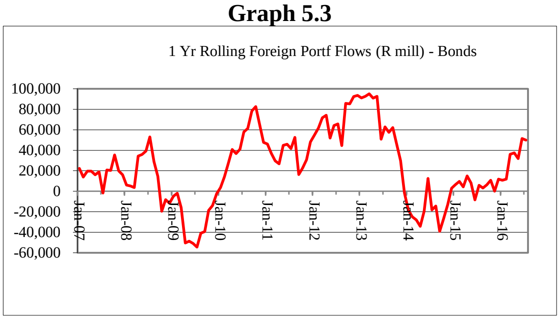
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 116.0 bn on a year-on-year basis at the end of July (outflow of R 103.5 bn year-on-year to end June). The month of July experienced a net outflow of R 2.1 bn. Since the beginning of 2006, foreign net investment in equities amounts to R103 bn (end June R 105 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 R 50 over the past 12 months to end of July (inflow of R 52 bn over the 12 months to end of June). Since the beginning of 2006, foreign net investment in bonds amounts to R 281 bn (to June just over R 274 bn). The month of July experienced a net inflow of R 7 bn.

Graph 5.3



The net outflows of foreign capital from equity and fixed interest securities was R 66.2 bn for the 12 months to end July 2016 (outflow of R 52 bn to end June 2016), compared to an inflow of R 38 bn for the 12 months to end July 2015 (inflow of R 14.3 bn to end of June 2015). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 383 bn (June R 378 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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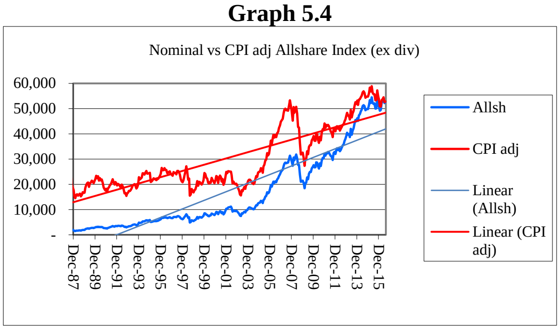
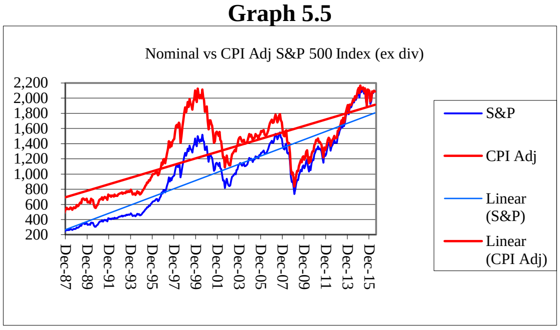
Graph 5.4



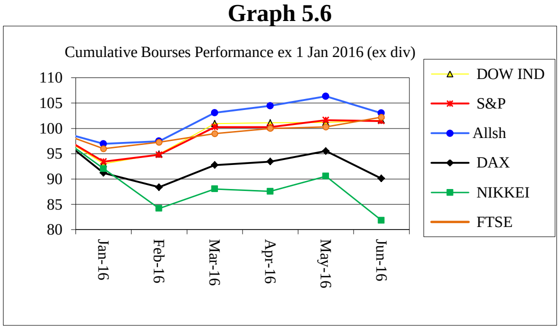
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.3% per annum, over this period of just over 29 years. US inflation over this period was 2.7%. This is equivalent to a growth in real terms of 4.6% p.a. over this period, excluding dividends.

Graph 5.5



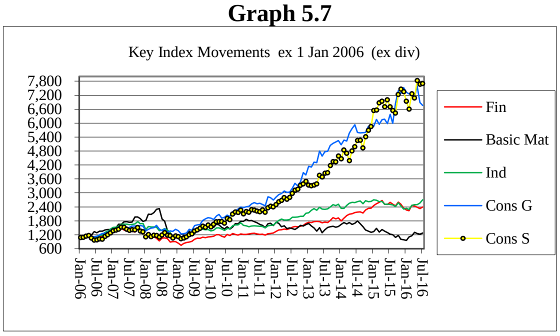
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Allshare, FTSE, Dow Jones and S&P 500 as the top performing share indices.

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: 21.5%; Consumer Goods: 19.9%; Industrials: 9.9%; Financials: 8.7%; and Basic Materials: 2.4%.

Graph 5.7



6. **Interest rates: where are they going?** And which asset classes are the winners or losers?

by **Sasha Planting** in Moneyweb, 24 August 2016

Six months is a long time in economics. In January South Africans were being warned to hunker down in anticipation of the rising interest rate cycle, which was being driven by higher inflation expectations – the weak rand, drought and rising food prices being the chief culprits.

Fast forward to August and the situation is quite different. The rand has strengthened and South Africa's inflation rate expectations have decelerated. While economic growth remains muted, the stable oil price and lack of demand led pressure have combined to reduce inflation forecasts.

For investors this may influence their asset allocation decisions.

Lesiba Ledwaba, a fund manager at Ashburton Investments does not anticipate that the interest rate cycle will change much in the next 12 to 18 months.

"Local rates are also impacted by global trends and global monetary policy is increasingly dovish," he says.

"Expectations are that the US Federal Reserve would hike interest rates gradually over the next 12 to 18 months" says Ledwaba.

In addition, the Federal Reserve is concerned about long-term risks and uncertainty relating to the UK's decision to leave the European Union. Many analysts now do not expect a hike in US interest rates before the next 12 months.

Other central banks are also unlikely to raise rates in the near future. In the UK fears that economic growth could slow have raised the prospect of interest rate cuts. In Europe the European Central Bank, as well as the

Swedish, Danish, German and Swiss central banks have introduced negative interest rates in a bid to force banks to increase their lending or investing. The same applies in Japan where it is hoped negative interest rates will jolt lending, spur inflation and reinvigorate the stagnant economy.

However, all that the monetary policy environment of low or negative interest rates has achieved so far is to drive the carry trade back to emerging markets, strengthening these currencies in the process.

As a result emerging market bonds, more specifically SA government bonds, were a significant beneficiary as the local bond market saw about R 61 billion of inflows so far this year.

The All Bond Index (ALBI) has outperformed other asset classes this year, returning 16% to investors – well ahead cash, listed property and local equities.

However the path forward for the local bond market is not that clear cut, says Ledwaba. “We don’t expect yields to move much higher and if they stay around current levels, then returns from the asset class will be decent.”

For investors who are not currently invested in bonds, he does not advise getting into the market at this point. “Global yields are artificially low and there is very little likelihood of them reducing much further from current levels,” he says.

The low interest rate environment may however create opportunities in the equities markets, which has essentially tracked sideways this year. In particular Ledwaba believes that interest rate sensitive stocks – such as the clothing & furniture retailers and banks – could offer investors some opportunity.

“A low interest rate environment helps moderate the cost of debt and this is positive for consumers who are financing debt repayments to varying degrees. Anything that consumers save in debt repayments, they are likely to spend with retailers,” he says.

There are of course risks to the current inflation outlook, says Ledwaba.

“If the US economy proves to be resilient and we start to see inflation sooner than expected, then it is likely that US Fed will increase rates and this could reverse the flows.”

Portfolio inflows to South Africa (and other emerging markets) are notoriously volatile, driven by market sentiment and so cannot be relied on necessarily for further rand strength.

On the other hand, European and Japanese economies have been slow to respond to quantitative easing, and uncertainty around the impact of Brexit on the UK economy is likely to persist. This should drive the central bankers to keep monetary policy very accommodative.

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