Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 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

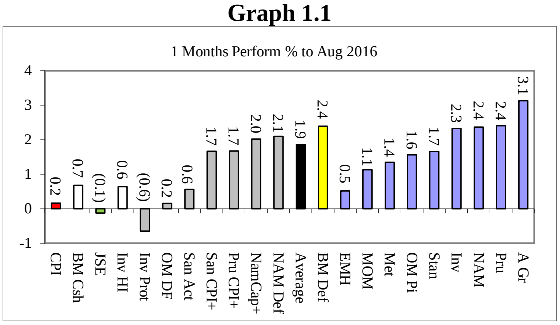
In **August** the **average prudential balanced portfolio** returned 1.86% (July: 0.61%). Top performer is Allan Gray (3.13%); while EMH Prescient (0.52%) takes the bottom spot. For the 3 month period Metropolitan, takes top spot, outperforming the 'average' by roughly 1.0%. On the other end of the scale Stanlib underperformed the 'average' by 1.0%.

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.

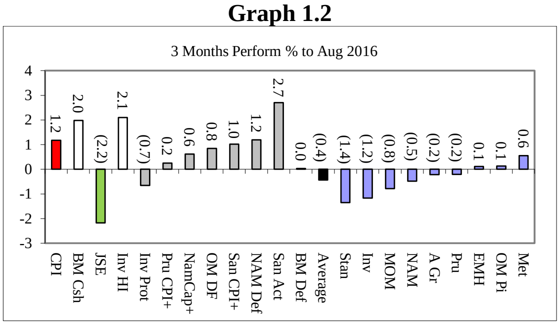
Below is the legend to the abbreviations reflected on the graphs:

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)

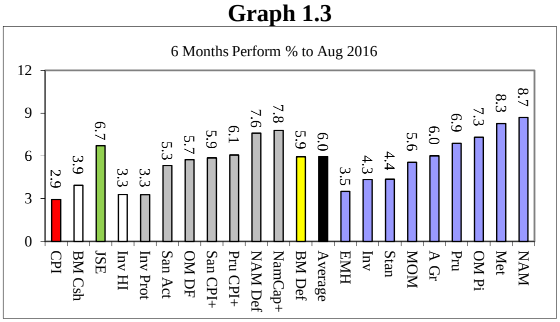
Graph 1.1



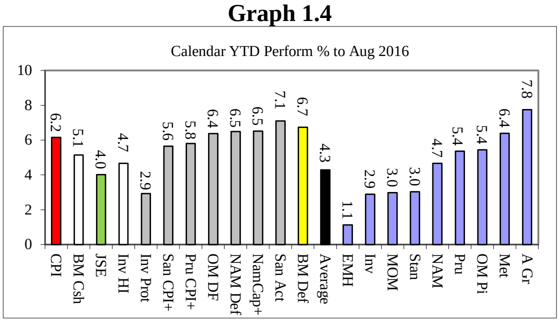
Graph 1.2



Graph 1.3



Graph 1.4



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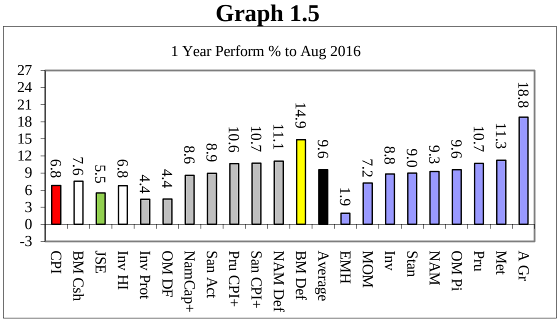
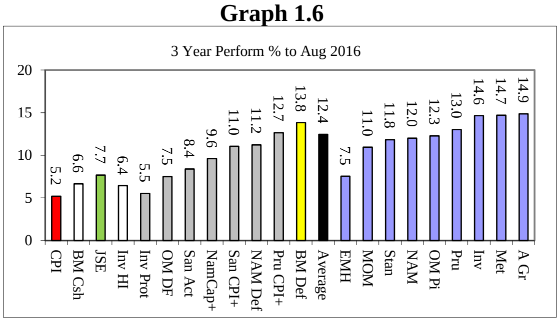
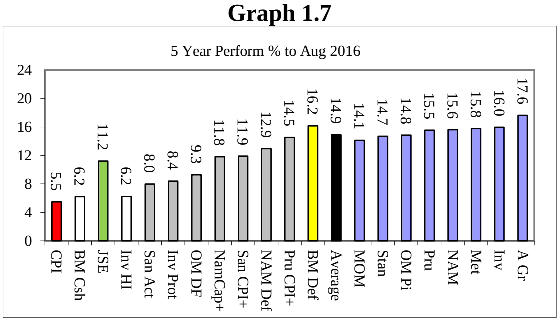
Graph 1.5



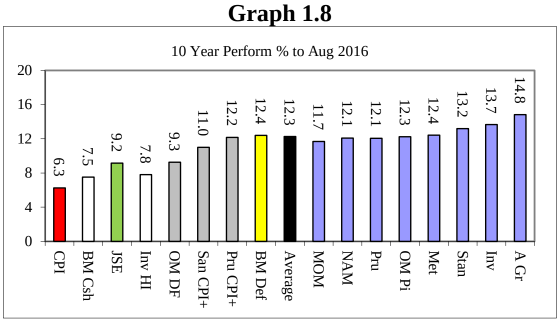
Graph 1.6



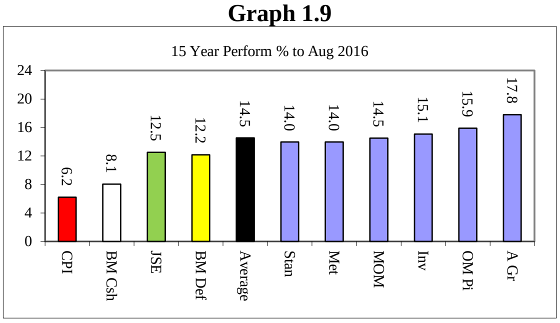
Graph 1.7



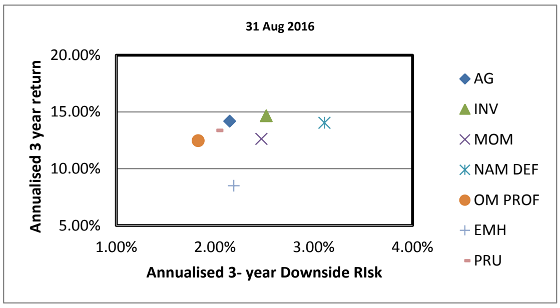
Graph 1.8



Graph 1.9

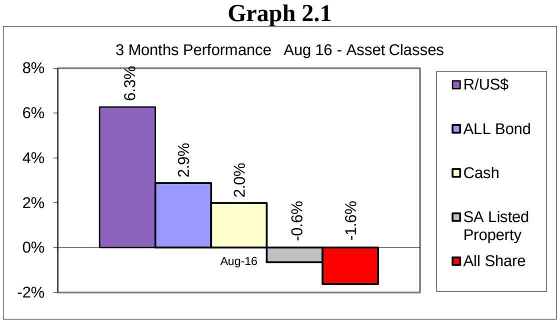


Risk/ Return

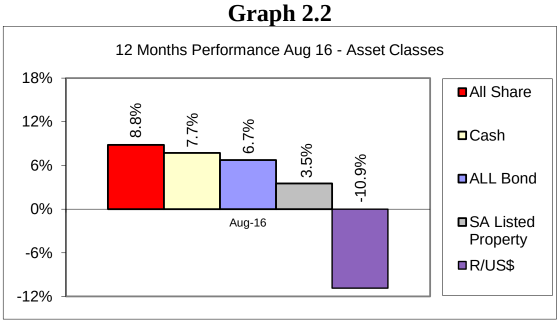


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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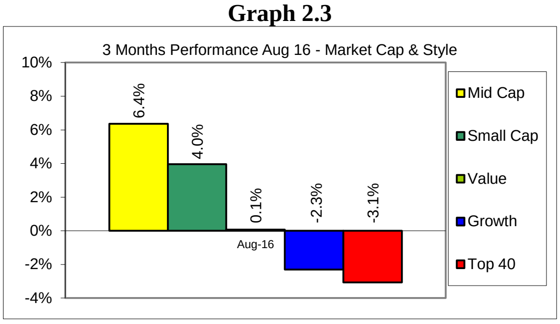
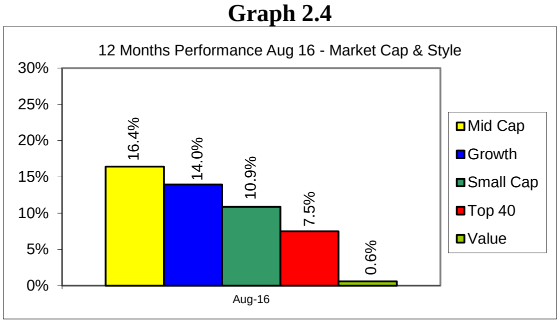
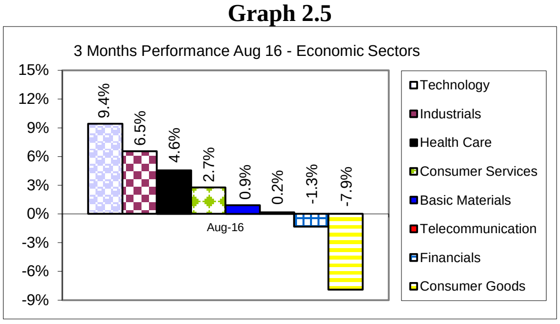
Graph 2.3



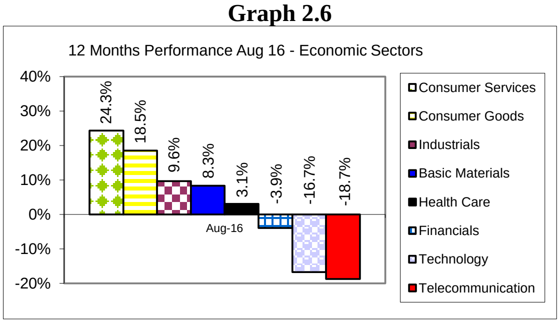
Graph 2.4



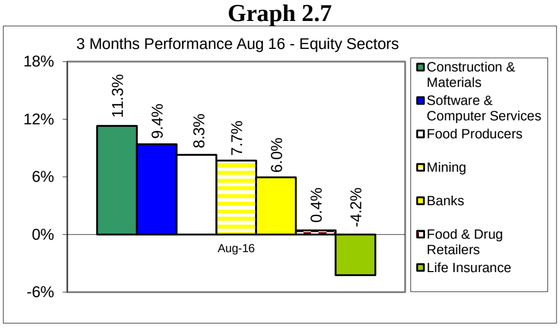
Graph 2.5



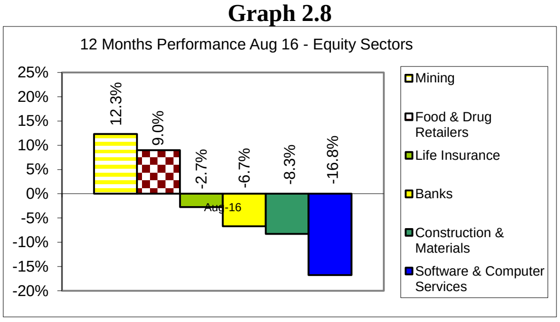
Graph 2.6



Graph 2.7



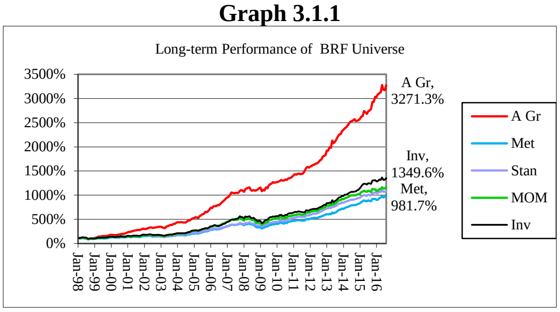
Graph 2.8



3. Portfolio Performance Analysis

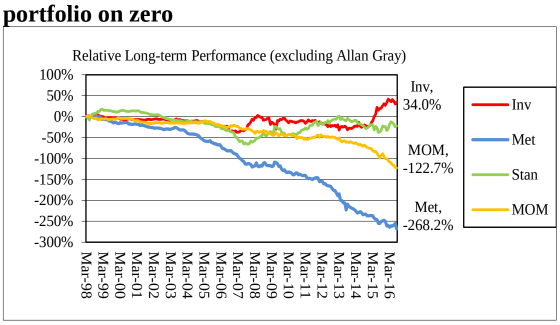
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

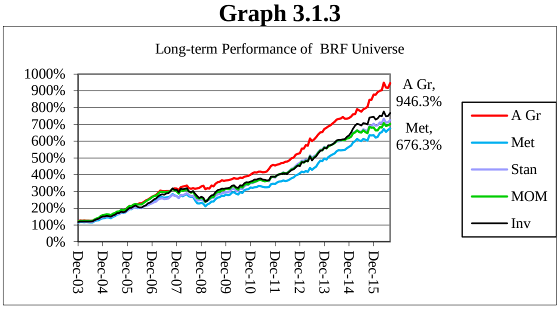


Graph 3.1.2

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



Graph 3.1.3



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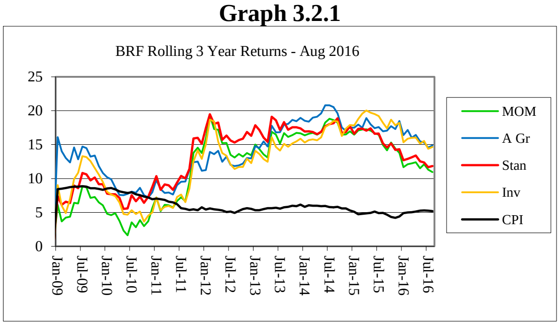
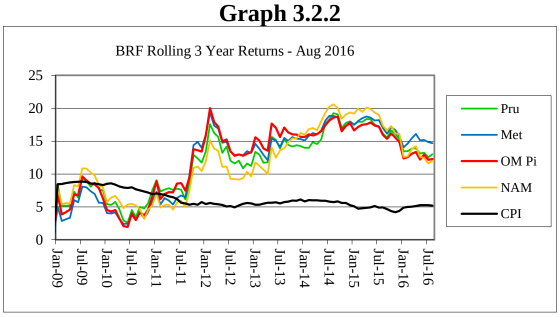
3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

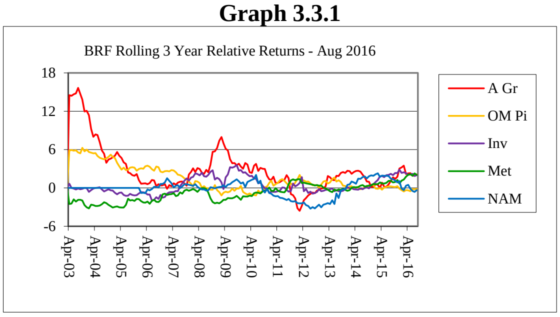


Graph 3.2.2

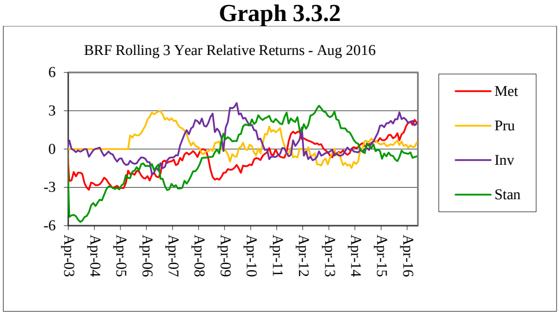


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

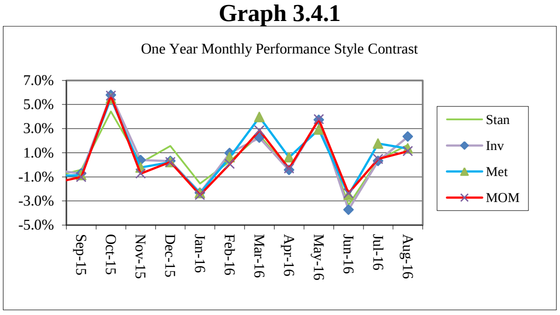


Graph 3.3.2

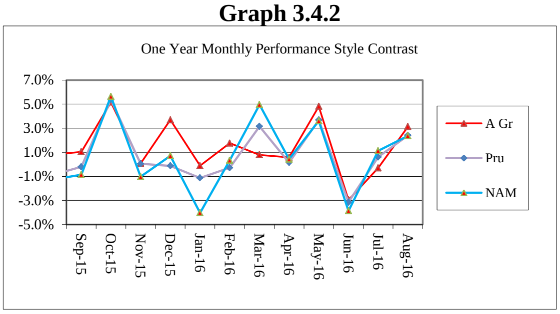


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

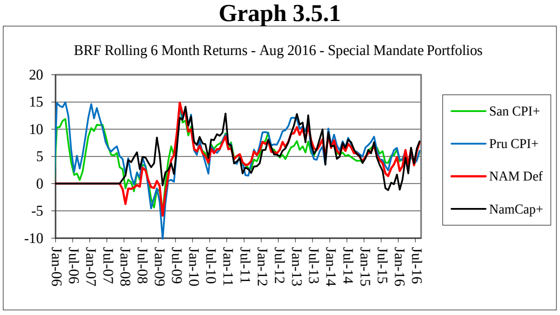


Graph 3.4.2

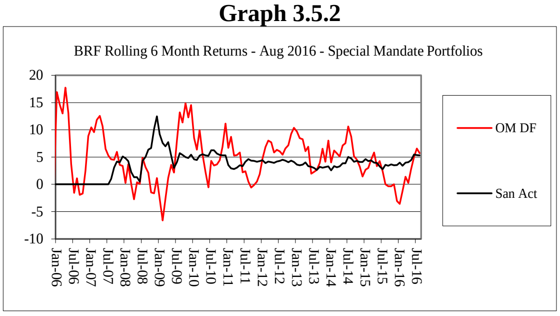


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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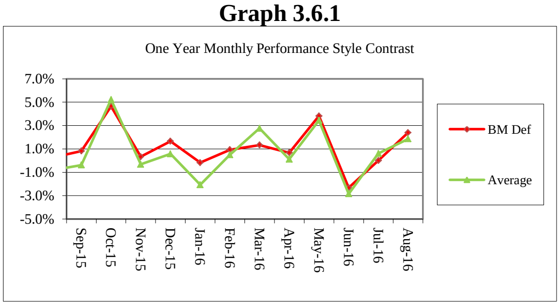
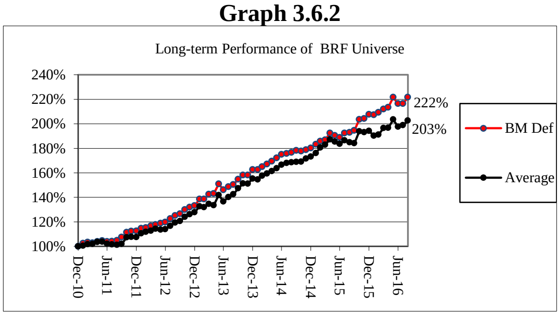
3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

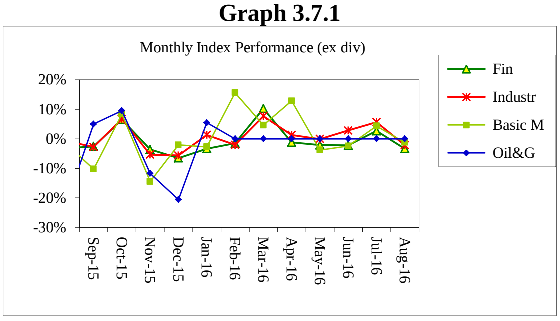


Graph 3.6.2

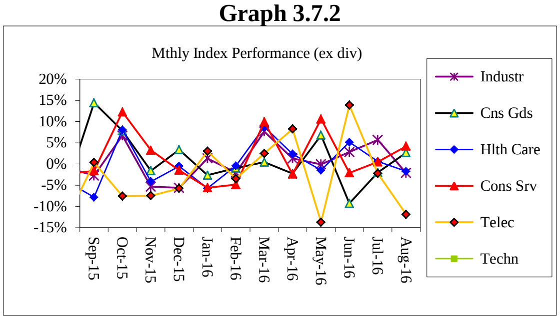


3.7 One year monthly performance of key indices (excluding dividends)

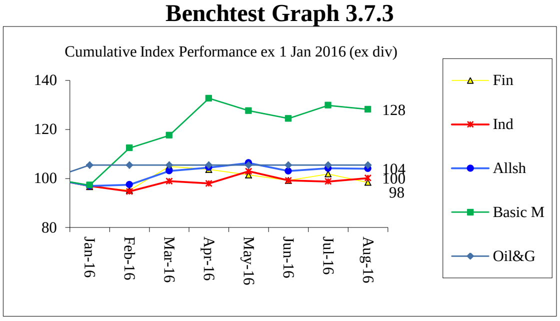
Graph 3.7.1



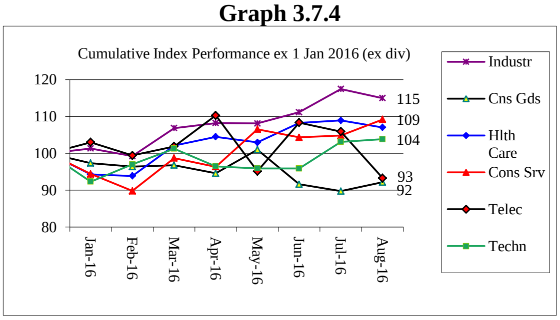
Graph 3.7.2



Benchtest 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.	16.2	14.9
5 year real return - % p.a.	10.7	9.4
Equity exposure - % of portfolio	46.6	54.4
Cumulative return ex Jan 2011	121.7	102.6
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%	13.4%	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%	16.4%	15.8%

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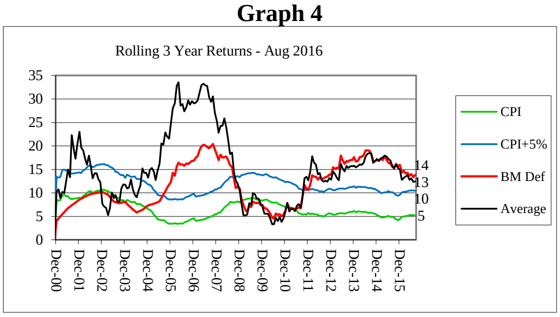
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years September 2013 to August 2016. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



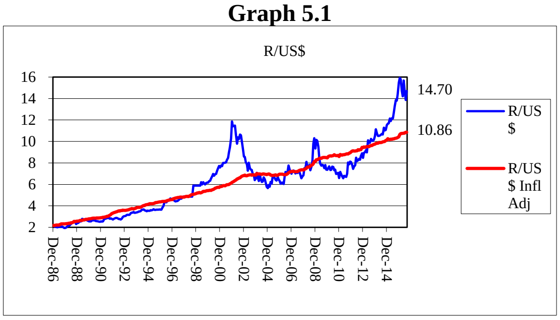
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end August was 13.8%, the average was 12.5% vs CPI plus 5% currently on 10.4%.

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 undervalued at 10.86 to the US Dollar while it actually stood at 14.70 at the end of August. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

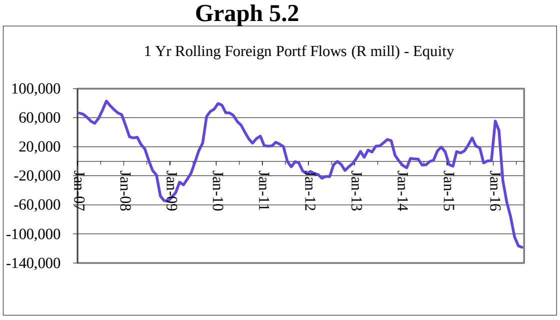


Rand weakens despite foreign capital inflows

The Rand weakened by 6% in August despite net foreign investment inflows into bonds and equities of N$ 7.2 bn. Over the past 12 months the Rand weakened by 11% on net outflows of foreign capital from equity and fixed interest securities of R 56.3 bn (outflow of R 70.1 bn to end July 2016). Over the 12 months to end of August 2015 SA experienced an inflow of R 29.9 bn (inflow of R 38.0 bn to end of July 2015). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 387 bn (July R 379 bn).

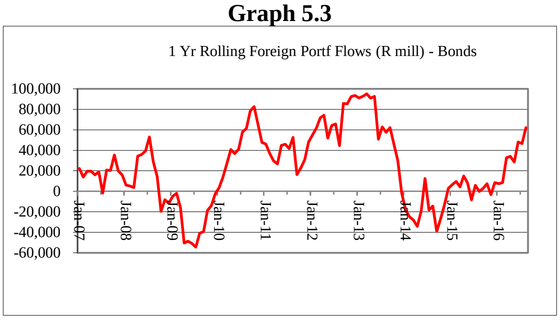
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 118.0 bn on a year-on-year basis at the end of August (outflow of R 117 bn year-on-year to end July). The month of August experienced a net outflow of R 3.7 bn. Since the beginning of 2006, foreign net investment in equities amounts to R98 bn (end July R 102 bn). This represents roughly 0.6% 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 62 over the past 12 months to end of August (inflow of R 47 bn over the 12 months to end of July). Since the beginning of 2006, foreign net investment in bonds amounts to R 288 bn (to July just over R 277 bn). The month of August experienced a net inflow of R 10.8 bn.

Graph 5.3



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 11.7% 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 3.3% p.a. over this period, excluding dividends, or around 6.3% including dividends.

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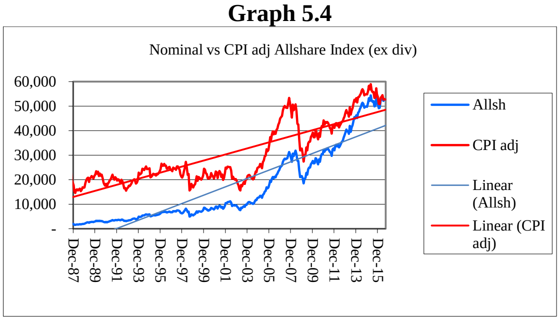
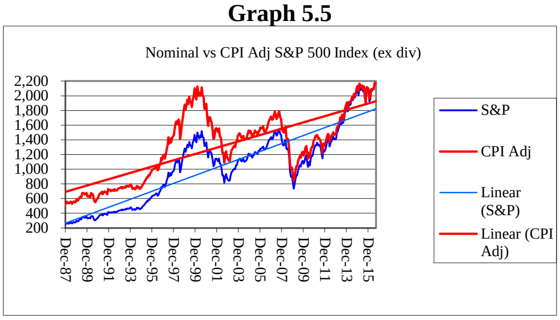
Graph 5.4



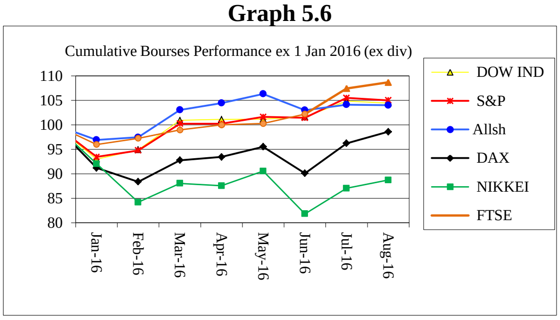
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.2% per annum, over this period of just over 29 years. US inflation over this period was 2.7%. This is equivalent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

Graph 5.5



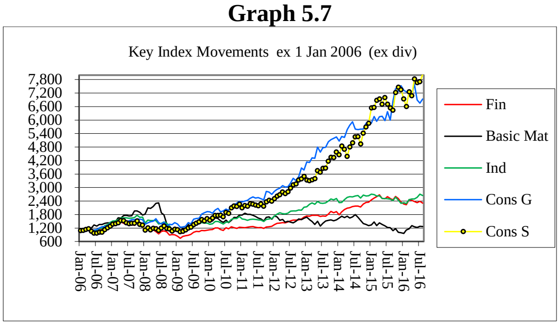
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the FTSE, and S&P 500 as the top performing share indices.

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: 21.7%; Consumer Goods: 20.1%; Industrials: 9.6%; Financials: 8.2%; and Basic Materials: 2.3%.

Graph 5.7



6. How should I secure my retirement nest-egg in the face of volatility and turmoil?
by Tilman Friedrich

Global financial markets are in a sorry state and it is very hard to see a silver lining. The US economy is showing mixed signs, no clear trend to be seen, the European economy is flat, Japan is struggling, so is China, not to speak of Russia and many of the developing countries including South Africa and us. The one thing these countries all have in common is a huge debt burden often substantially higher than the countries' GDP, at historically low interest rates. China, for example has accumulated corporate debt of 171% of GDP while total Chinese debt of US$ 28 trn, had reached 255% of its GDP by the end of 2015, an increase of 107% over the past 7 years. That is 38% of global GDP and as much as the commercial banking loan books of the US and Japan combined! The Bank of International Settlements is warning that China is facing an escalating risk of a major debt and banking crisis. The BIS is also concerned about a possible spillover from China to the global economy.

These are prevailing economic threats to the global economy. Of course with the wars going on around the Mediterranean and on the border between Russia and the Ukraine the economic concerns are reinforced by concerns about a possible major military confrontation between Russia and the US with its European allies. Interestingly in this context, recently a German Minister encouraged the German population to start hoarding non-perishable foodstuffs. I have never in my life heard such official advice before. What does all of this mean other than that we are facing major risks?

Evidently there are lots of alarm bells ringing all over in the media to make the investor very nervous indeed. No-one really knows how this state of affairs may unravel and how such unraveling will affect my retirement nest egg and other investments.

Fact of the matter is that at present savers are effectively robbed of a fair return on their savings for the benefit of borrowers paying exceptionally low interest rates, in

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many instances even negative interest rates. Central banks world-wide have accumulated massive debt and thereby created massive liquidity in the markets. Easy money is flowing into equities in the first instance, but also into property and various other asset classes pushing up their prices artificially to unsustainable levels. Such flows also found their way into emerging economies like SA and Namibia and have strengthened their currencies.

On the basis of fundamentals investing in fixed interest instruments would expose the investor to the risk of interest rates normalizing at some point in time, the point currently not foreseeable though. Equities are generally expensive and equally face the risk of a substantial negative adjustment once interest rates start moving upwards. Other asset classes such as property, would have benefited from the spillover of massive money flows into equities, so property is generally also expensive. In terms of conventional asset classes there is really nowhere to hide once markets start to unravel and reverse the asset bubbles blown up by the easy money policies of central banks world-wide.

What do we do if the bottom falls out of financial markets because of a major military conflict gripping world financial markets?

Gold pundits reckon one should invest in gold, but if I do, how am I going to use the gold to fund my retirement needs? Who is going to buy my gold when I need cash to pay for my groceries and hospital bills? It will not be that easy and it will definitely not be my grocer or my hospital and because it will not be so easy, undoubtedly it will be expensive to try and sell gold.

What will we really need when financial markets are dead and assets have experienced a massive decline in value. No one will want to buy what we own. What we do need is food and water to survive. So even though our assets may be unsellable, if they are productive, they should be able to generate income for me that I can use to pay for my basic needs. What about a property investment that you can rent out to generate an income? Problem with property is that it would typically represent a relatively large investment that will depend on a tenant to pay his rent. However if the economy is in the doldrums and financial markets are dead, chances are that your tenant may lose his job and may not be able to pay your rent. Property always creates that artificial comfort that it is still worth more or less for what you bought is, but unless you actually sell it, you have no clue.

Equities in contract will be shown up in the media how much value they lost. At least you will generally be assured that you will actually be able to sell it at that value. If you are invested in a basket of shares your shares or at least some of them should be able to deliver dividends and the risk of losing a major part of your investment portfolio is much smaller, being spread much wider across different companies, unlike your investment in property.

Conclusion

With these risks the investor is currently facing, equities remain our preferred asset class. Spread the risk as widely as you can across the world. Avoid politically volatile areas. In the final instance this includes China, Japan, Korea, Russia, Turkey, central Europe and of course all other countries bordering the Mediterranean. Generally, we would believe that emerging countries should experience a revival should any major military confrontation materialize. Investment in equities should be undertaken on a very selective basis with the emphasis being on companies generating high cash flows and high yields on your investment with the prospect of high dividends yields, which is really what you need at the end of the day to survive. For those expecting Armageddon, head the advice of the German minister to start hoarding non-perishable foodstuffs!

7. Important notice and disclaimer