Volume 12, No. 9
Sep 2016

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 SEPTEMBER 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

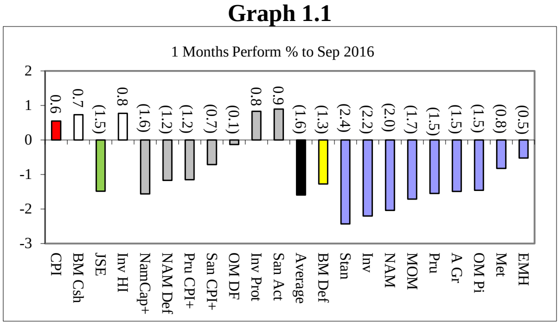
In **September** the **average prudential balanced portfolio** returned -1.59% (August: 1.86%). Top performer is EMH Prescient (-0.52%); while Stanlib (-2.43%) takes the bottom spot. For the 3 month period Metropolitan, takes top spot, outperforming the 'average' by roughly 1.5%. On the other end of the scale Stanlib 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.

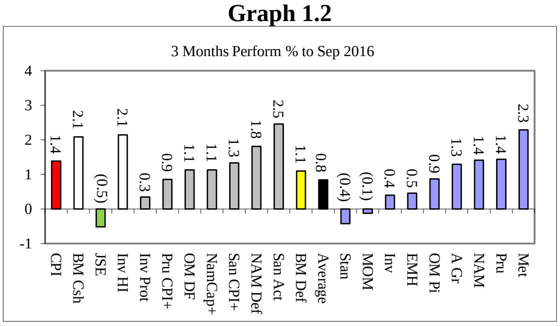
Below is the legend to the abbreviations reflected on the graphs:

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)

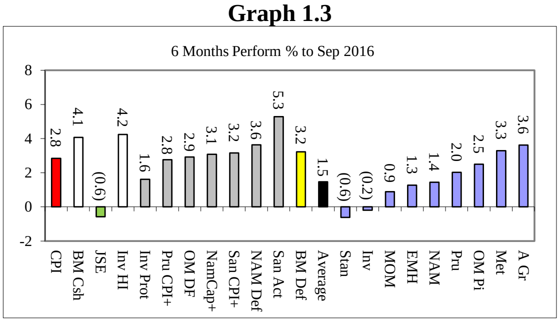
Graph 1.1



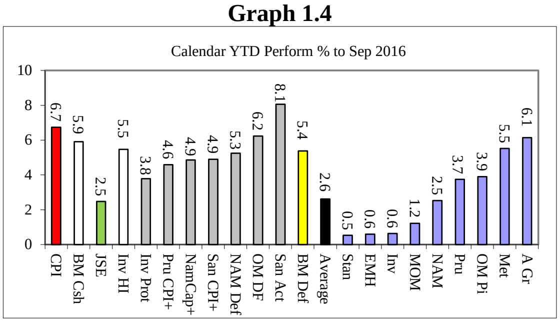
Graph 1.2



Graph 1.3



Graph 1.4



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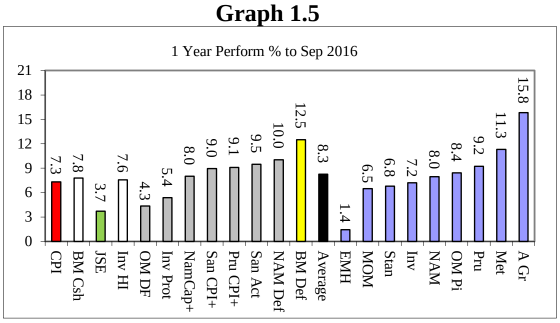
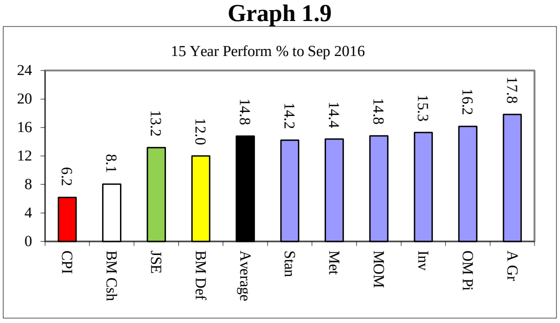
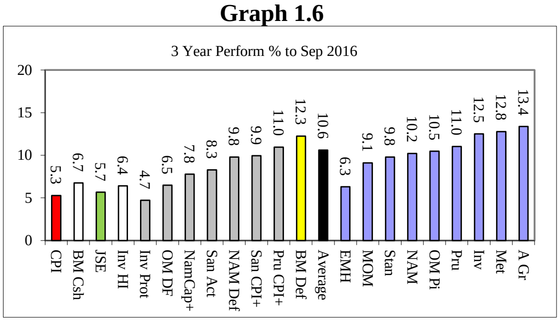
Graph 1.5



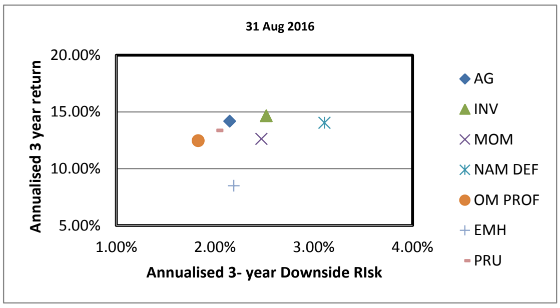
Graph 1.9



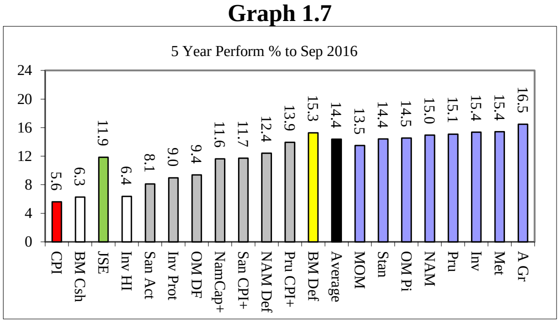
Graph 1.6



Risk/ Return

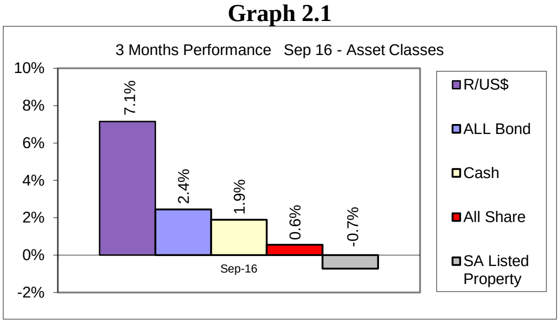


Graph 1.7

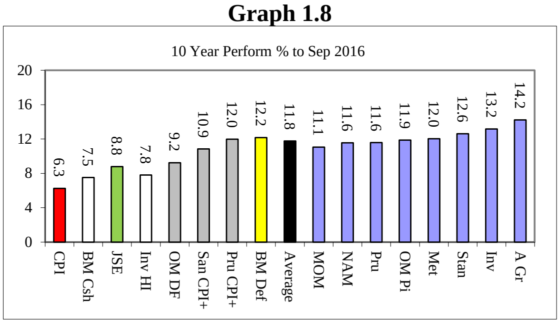


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

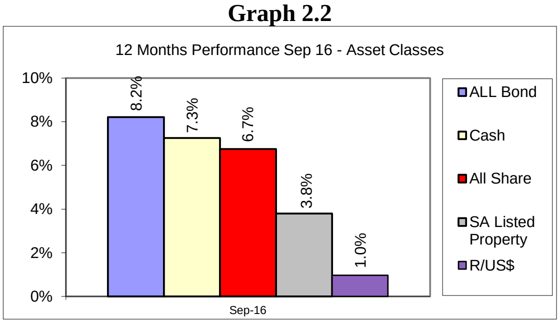
Graph 2.1



Graph 1.8



Graph 2.2



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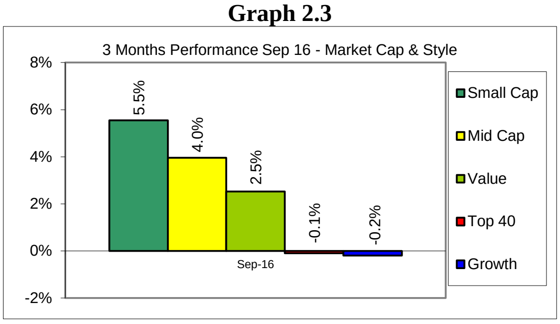
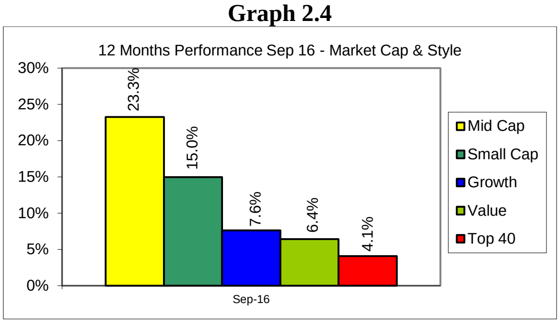
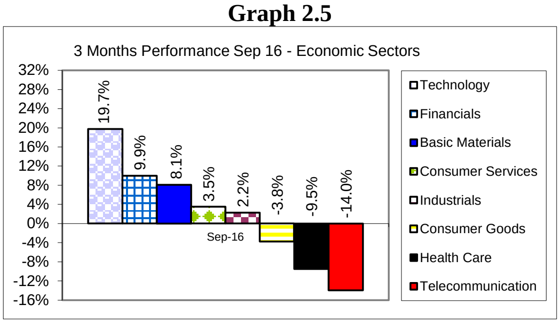
Graph 2.3



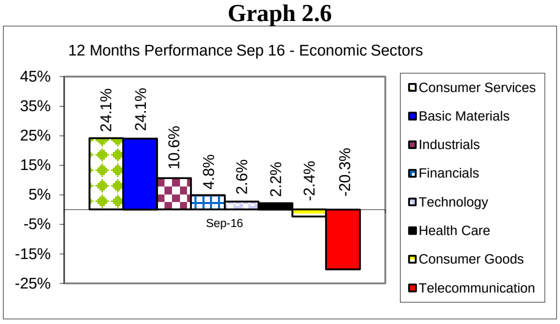
Graph 2.4



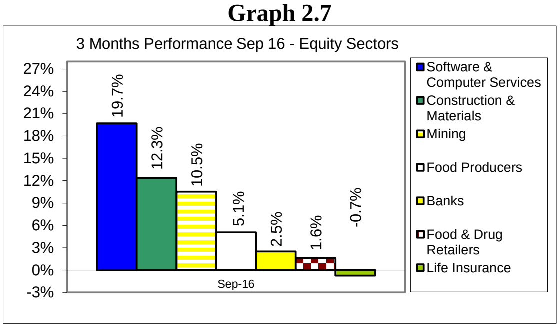
Graph 2.5



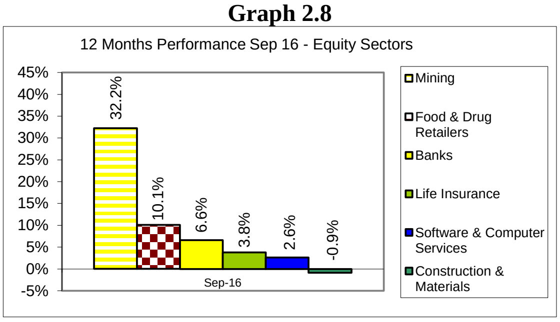
Graph 2.6



Graph 2.7



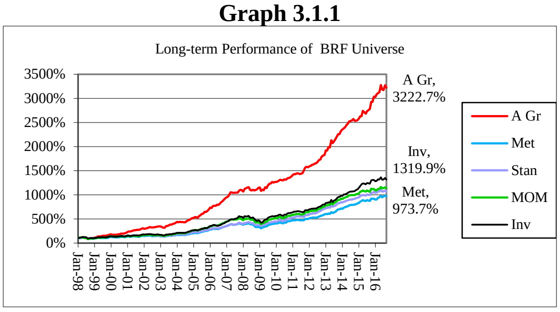
Graph 2.8



3. Portfolio Performance Analysis

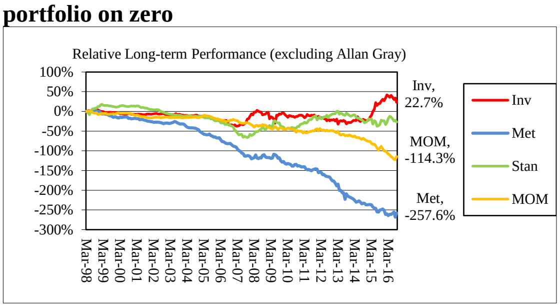
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

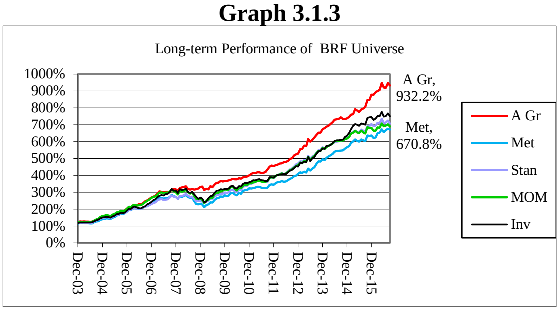


Graph 3.1.2

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



Graph 3.1.3



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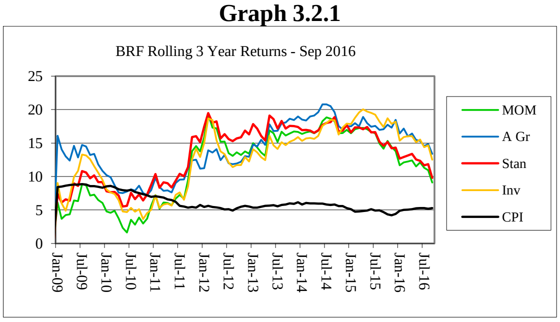
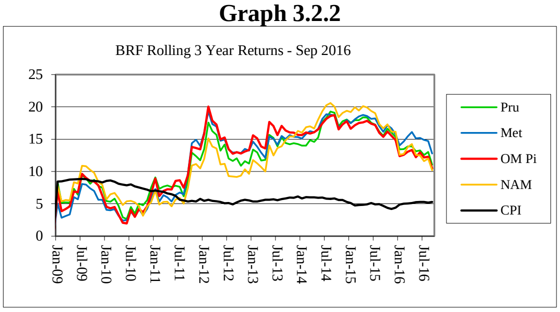
3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

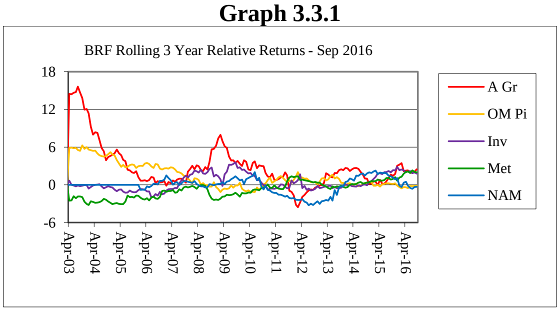


Graph 3.2.2

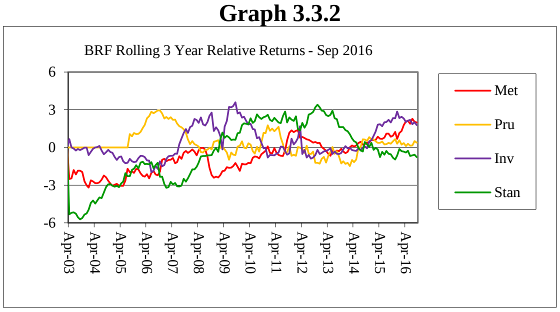


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

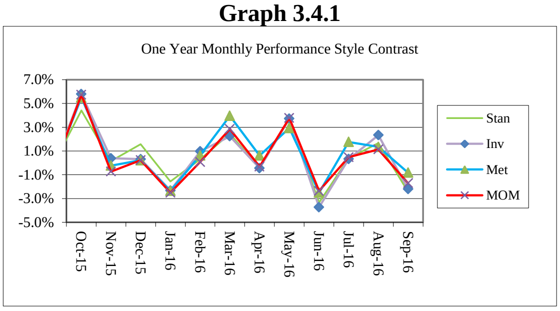


Graph 3.3.2

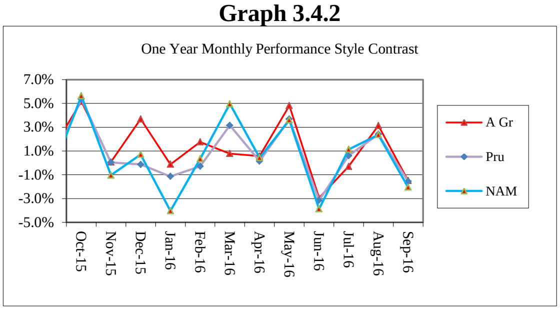


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

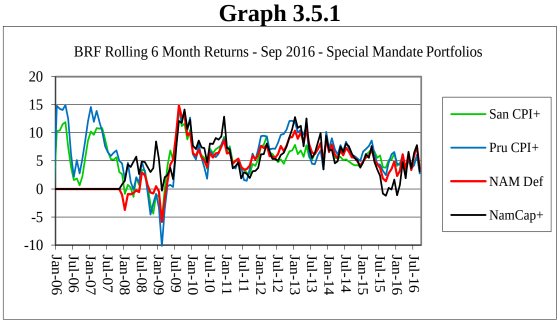


Graph 3.4.2

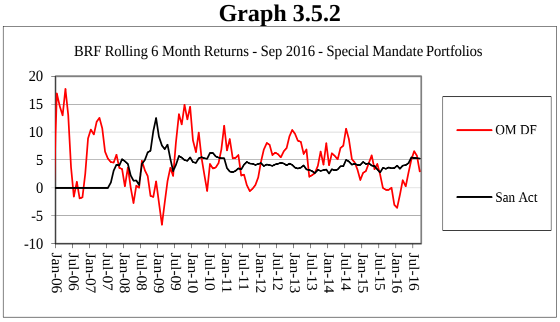


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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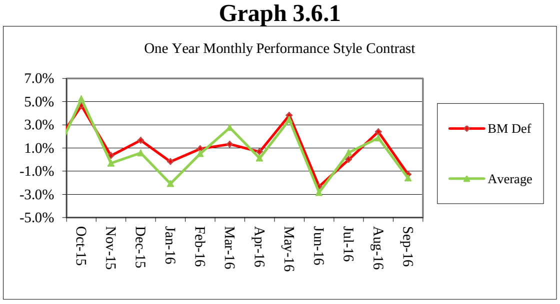
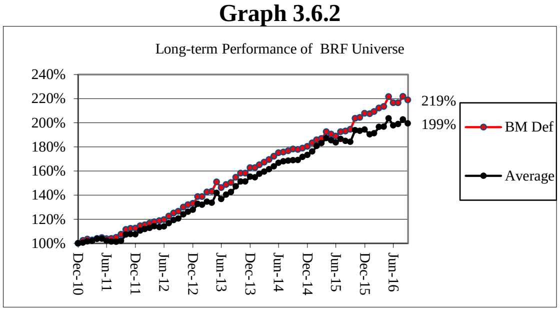
3.6 Monthly and cumulative performance of ‘Benchmark Default’ portfolio relative to average prudential balanced portfolio

Graph 3.6.1

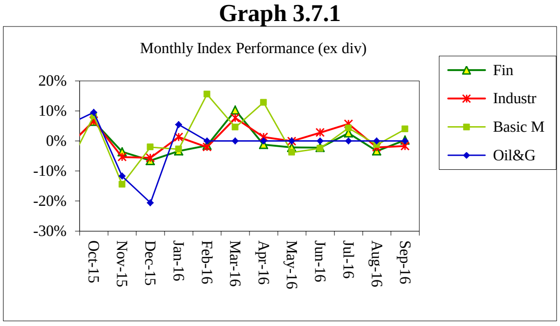


Graph 3.6.2

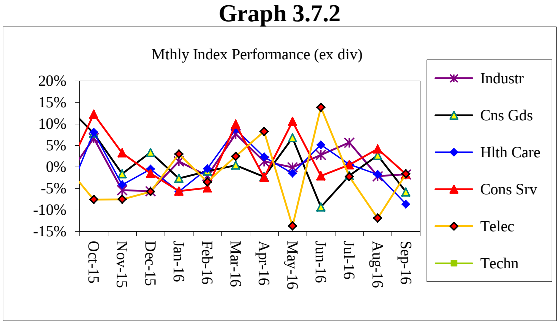


3.7 One year monthly performance of key indices (excluding dividends)

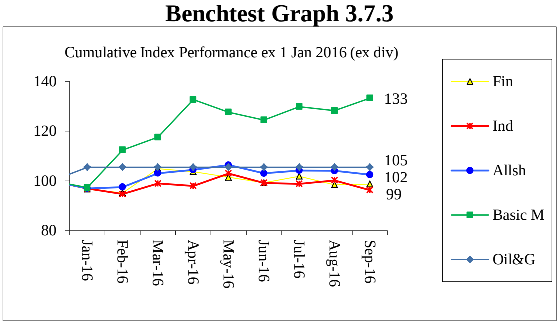
Graph 3.7.1



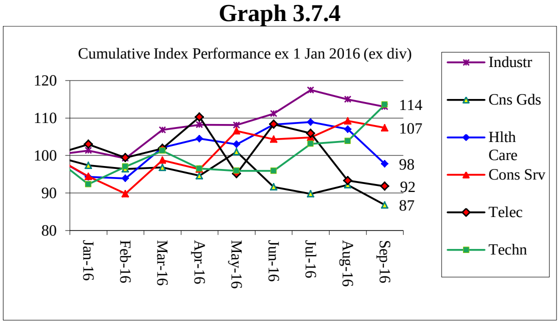
Graph 3.7.2



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.	15.3	14.4
5 year real return - % p.a.	9.7	8.8
Equity exposure - % of portfolio	47.4(June 16)	54.9(June 16)
Cumulative return ex Jan 2011	118.8	99.4
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%	12.3%	10.6%
Best annual performance	6.8%	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%	16.3%	15.6%

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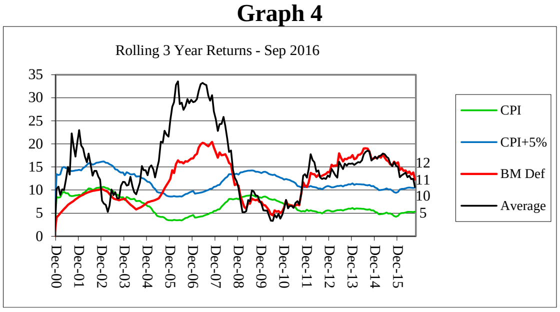
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years October 2013 to September 2016. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



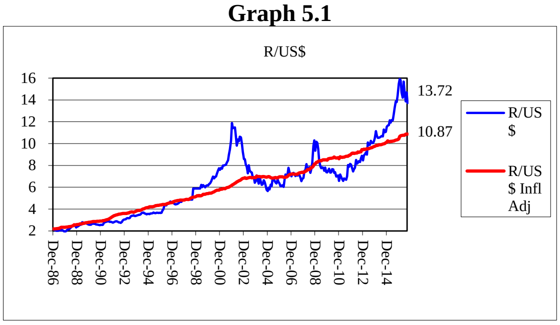
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end September was 12.3%, the average was 10.6% 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 10.87 to the US Dollar while it actually stood at 13.72 at the end of September. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

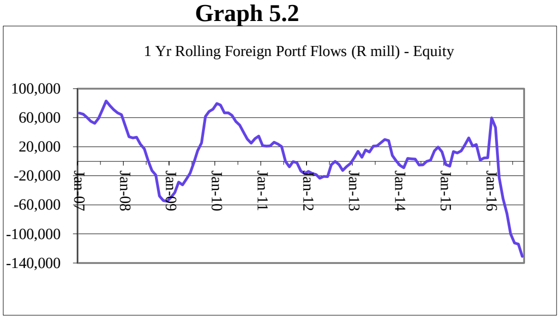


Rand strengthens despite foreign capital outflows

The Rand strengthened by 6.6% in September despite net foreign investment outflows from bonds and equities of N$ 10.7 bn. Over the past 12 months the Rand strengthened by 1% on net outflows of foreign capital from equity and fixed interest securities of R 60.7 bn (outflow of R 51.7 bn to end August 2016). Over the 12 months to end of September 2015 SA experienced an inflow of R 26.4 bn (inflow of R 20.9 bn to end of August 2015). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 380 bn (August R 391 bn).

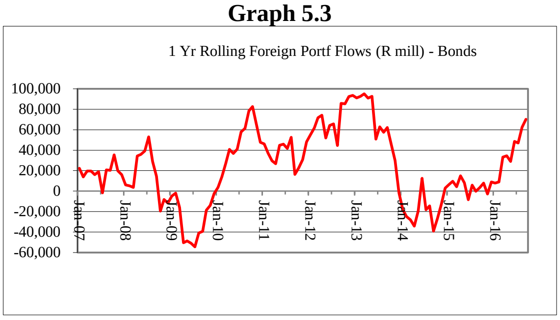
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 131 bn on a year-on-year basis at the end of September (outflow of R 114 bn year-on-year to end August). The month of September experienced a net outflow of R 12.7 bn. Since the beginning of 2006, foreign net investment in equities amounts to R90 bn (end August R 103 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 70 over the past 12 months to end of September (inflow of R 62 bn over the 12 months to end of August). Since the beginning of 2006, foreign net investment in bonds amounts to R 290 bn (to August just over R 288 bn). The month of September experienced a net inflow of R 1.9 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 11.6% 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 3.2% p.a. over this period, excluding dividends, or around 6.2% including dividends.

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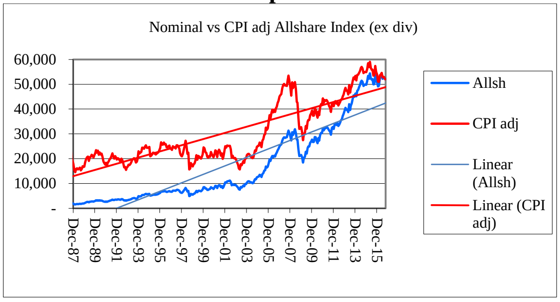
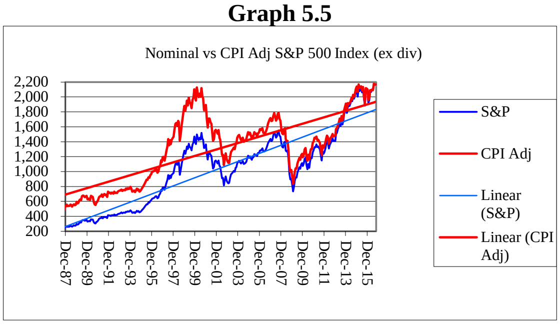
Graph 5.4



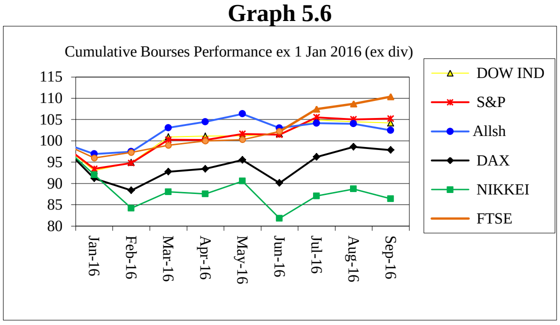
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.2% per annum, over this period of just over 29 years. US inflation over this period was 2.7%. This is equivalent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

Graph 5.5



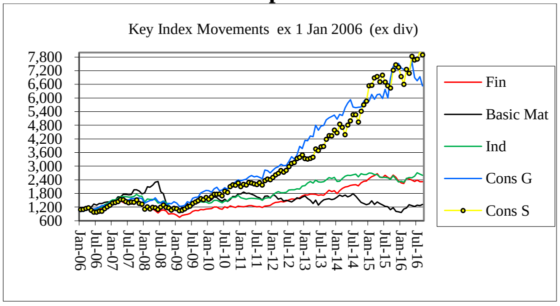
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the FTSE, and S&P 500 as the top performing share indices.

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: 21.4%; Consumer Goods: 19.2%; Industrials: 9.4%; Financials: 8.2%; and Basic Materials: 2.6%.

Graph 5.7



6. Does only your grandmother and a burglar still need cash?

by Tilman Friedrich

This was the topic of the speech of Carsten Lange of Delta Secondary School who won this year's German speakers' competition held amongst various schools in Namibia. He went through various arguments for and against cash as legal tender. He correctly pointed out that internationally crime is generally not committed by means of cash and concluded in saying that for his part, he would like to continue being able using cash.

I am not sure whether this learner had in mind Bank of Namibia's declared intention of doing away with cheques when he prepared his talk. Fact of the matter is that internationally central banks are on a mission to do away with cash. Money laundering, crime in general and being in a better position to track the flow of moneys are the arguments used to push this down citizens' throats. But is this the real reason behind efforts to do away with cash?

We do know that many central banks across the world have employed rather unconventional policies since the global financial crisis, to avert a collapse of the global financial system, mostly referred to as QE or quantitative easing. The intention was that these money would flow into the economy to generate economic growth and inflation. In addition interest rates were reduced to near zero percent and today are often in negative territory even.

In the process of quantitative easing, global debt of households, business and government increased from 246% of global GDP in 2000 to 269% just before the financial crisis and to 294% by the middle of 2015.

The intended results however never realised. Economic growth and inflation so far did not manifest. As the result governments have been unable to wither their debt burden through higher tax collection and the decline in the real value of debt through inflation. Consumers

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clearly did not take this bait after the financial crisis had taken its toll on many of them after eight years of these unconventional policies having been put to the test. Instead asset bubbles emerged in many market and asset classes while the debt burden is still on the rise. This state of affairs seriously threatens the stability of the global financial system. In a situation like this any over-indebted person would know that he has little room to maneuver and is very exposed to any negative economic development that can bring him out of balance.

So how will governments now be able to maneuver themselves out of their precarious financial position in the absence of economic growth and inflation? Of course one way is to issue negative interest rate bonds as some governments are already doing. But who is going to buy them if you can keep cash in the bank at no cost? But what about if you now also earn negative interest on your cash, i.e. you pay your bank to hold your cash? Of course you would probably think of buying a safe, drawing all your cash from your bank and storing it in your safe at home. This is in fact has been happening in Japan. Is this then the answer why central banks are in the process of effectively outlawing cash, so as to close this loop hole in the monetary system? This could mean that we are now moving to deflation where price and income levels will start to decline. Negative interest rates will at the same time reduce the value of the debt burden. Whilst this mechanism is the opposite of high interest rates and high inflation, the result is the same. There seems to be no alternative really if governments want to avoid being caught off-guard by another global crisis. The problem with deflation though is that it will also not produce economic growth but is more likely to result in recession with unforeseeable consequences for any government. 'Helicopter money' is a radical monetary policy option that has been raised in financial media as the possible means to re-ignite economic growth in this environment. An example of such a programme was the trade-in premium that the German government paid for a while to people who bought a new car, which was aimed at stimulating the motor vehicle industry in Germany in the aftermath of the financial crisis.

Such policy measures would be charting new waters of which the outcome is unforeseeable. It would undoubtedly cause uncertainty in financial markets and with that, volatility should increase. This backdrop and the possible consequences for global financial market should be taken into account by the investor when redefining his investment strategy.

Conclusion

In considering where to invest in these uncertain times, one can use the analogy of foodstuffs. If you invest in meat you can be fairly certain that you will be able to sell your meat to someone else if you need to sell it. If you invest in an exotic type of fish that only connoisseurs in Japan would eat, you will have to go to Japan to sell your fish or hope to eventually find a customer amongst Japanese tourists visiting your shop. You may then very well make a margin that is much higher than your margin on meat would be. It would require of you that you understand your product and that you know who your customer is. In the same way, an investment in an exotic asset will not really be an option for the 'man in the street'.

Staying with conventional asset classes thus, equities remain our preferred asset class even under this contrarian scenario illuminated above. The old adage of not placing all your eggs in one basket remains as true as ever. Spread the risk as widely as you can across the world and remember that your biggest assets are in Namibia in all probability, and you have no choice of moving these elsewhere. Discretionary capital that you can move you should consider investing outside Namibia for the sake of spreading risk. And here I am not even talking about political or even economic risks within Namibia, but it could be a serious devaluation of the Rand that could make it unaffordable to import any essential needs that you may have. As stated before, avoid politically volatile areas which include China, Japan, Korea, Russia, Turkey, central Europe and of course all other countries bordering the Mediterranean. We also remain of the opinion that an investment in equities should be undertaken on a very cautious and selective basis. The emphasis should be on quality companies generating high cash flows and high yields on your investment with the prospect of high dividends yields. This is really what you need at the end of the day to survive.

7. Important notice and disclaimer

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