Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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

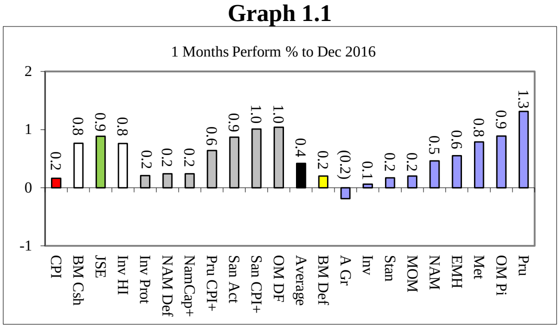
In **December** the **average prudential balanced portfolio** returned 0.42% (November: 0.59%). Top performer is Prudential (1.31%); while Allan Gray (-0.19%) takes the bottom spot. For the 3 month period Prudential, takes top spot, outperforming the 'average' by roughly 1.7%. On the other end of the scale EMH Prescient underperformed the 'average' by 1.3%.

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 represents a combination of Prudential Namibia Inflation Plus and Allan Gray Namibia Balanced Fund.

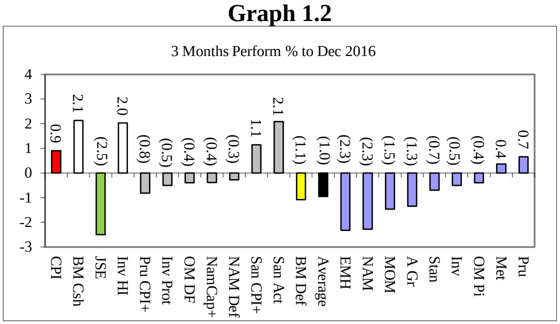
Below is the legend to the abbreviations reflected on the graphs:

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)

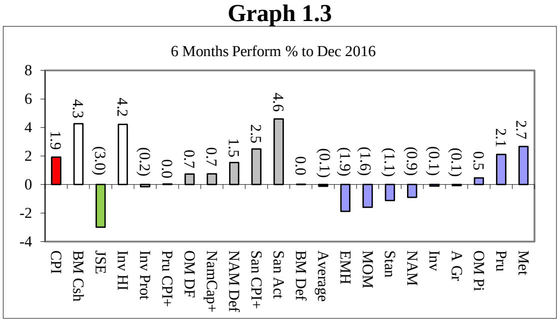
Graph 1.1



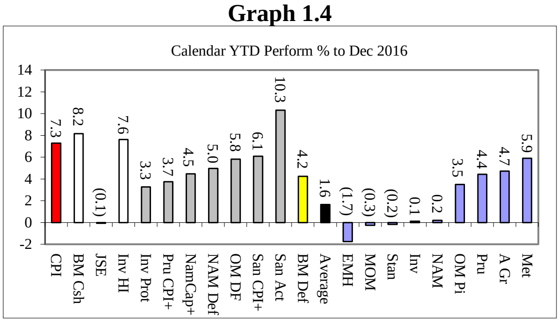
Graph 1.2



Graph 1.3



Graph 1.4



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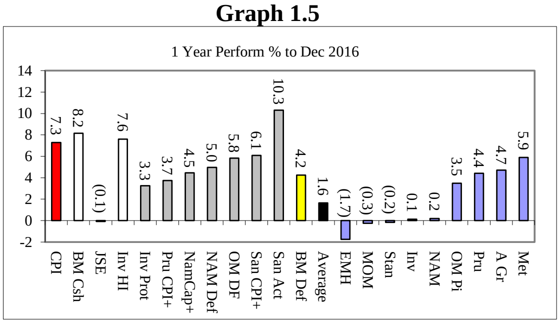
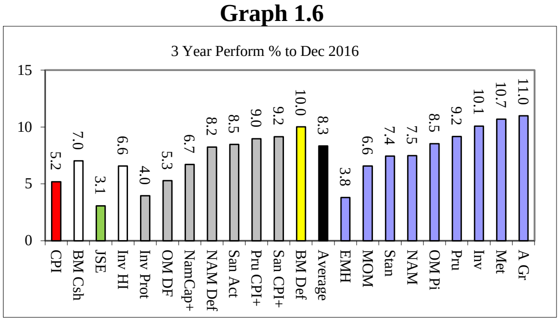
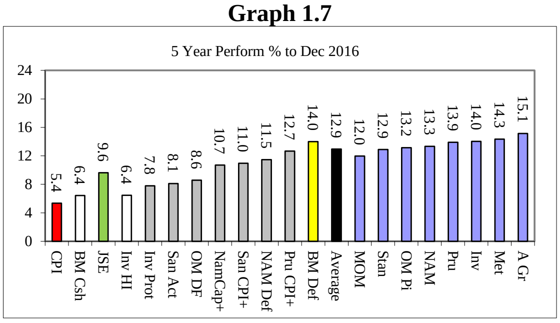
Graph 1.5



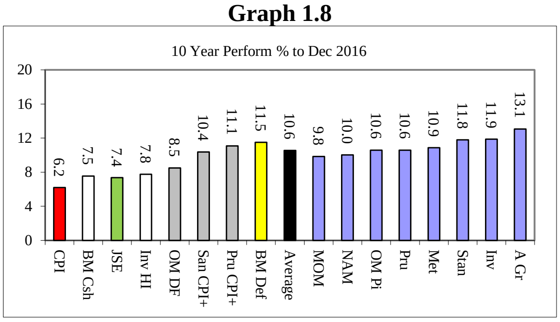
Graph 1.6



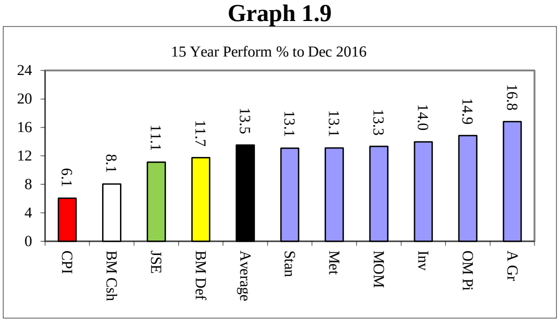
Graph 1.7



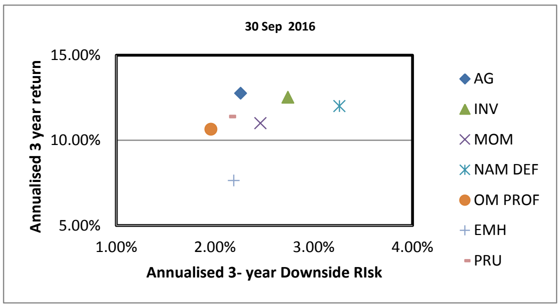
Graph 1.8



Graph 1.9

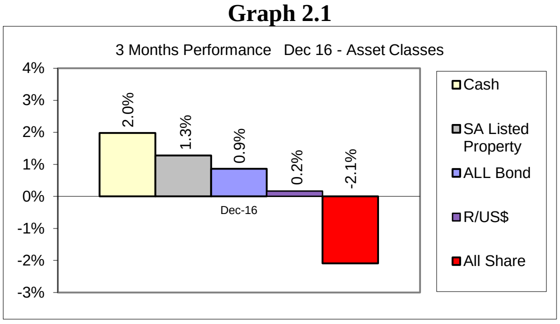


Risk/ Return

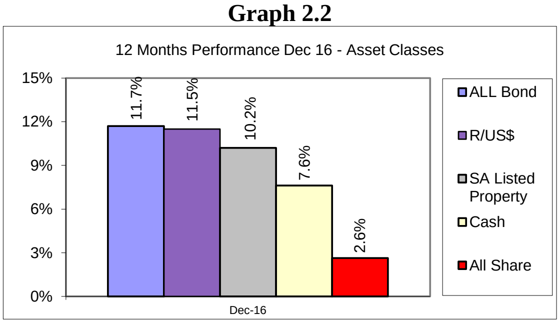


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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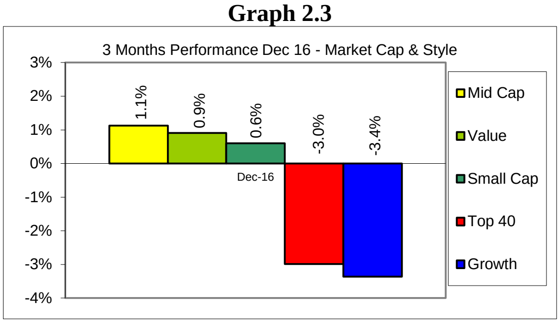
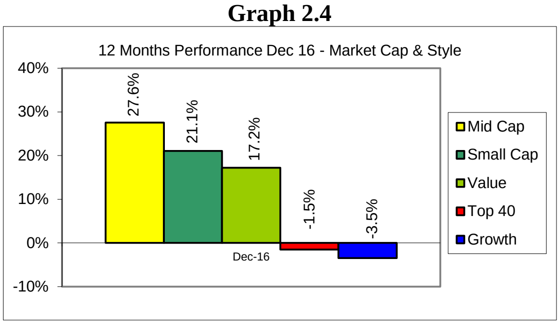
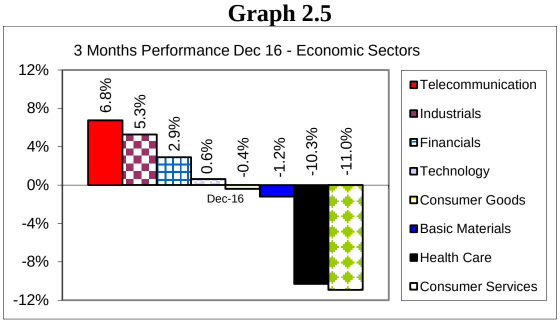
Graph 2.3



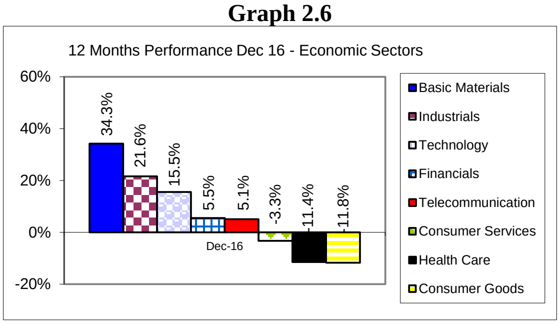
Graph 2.4



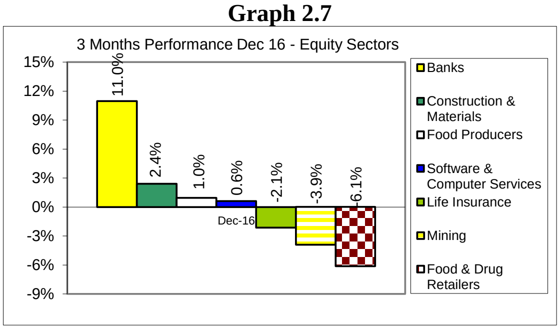
Graph 2.5



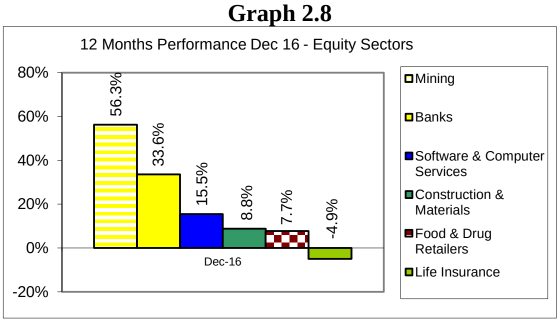
Graph 2.6



Graph 2.7



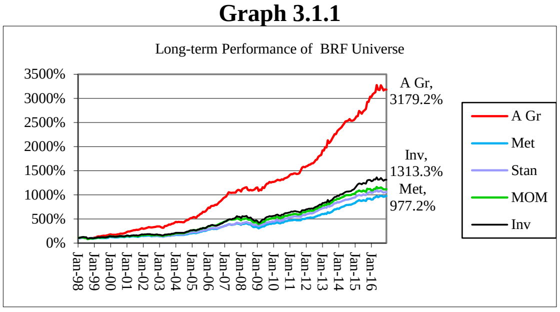
Graph 2.8



3. Portfolio Performance Analysis

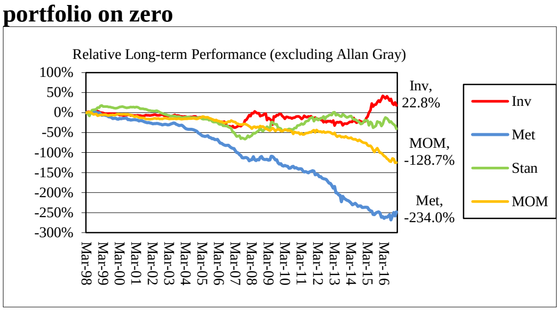
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

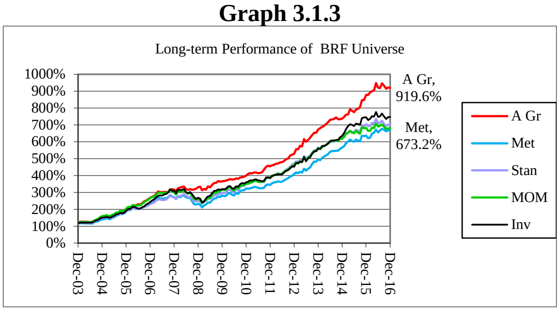


Graph 3.1.2

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



Graph 3.1.3



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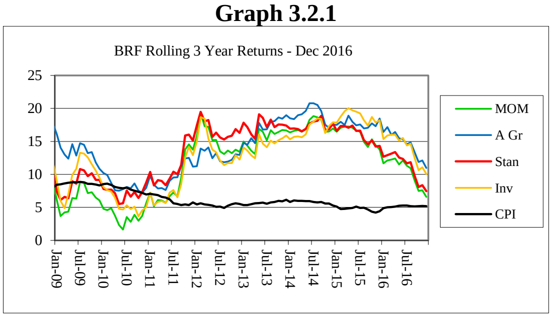
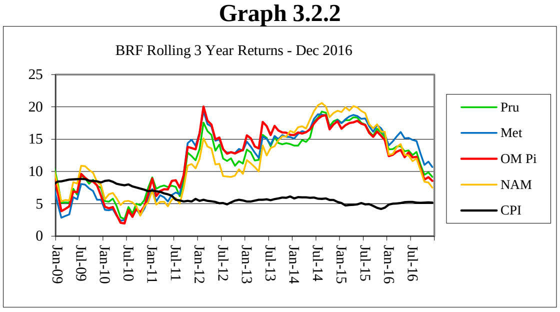
3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

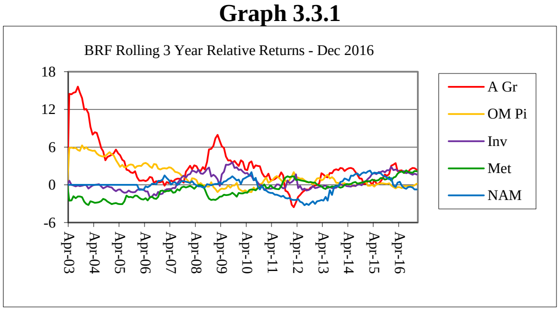


Graph 3.2.2

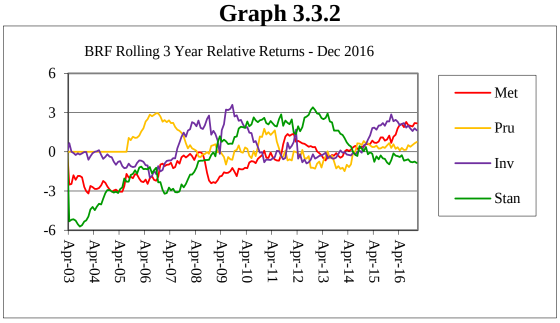


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

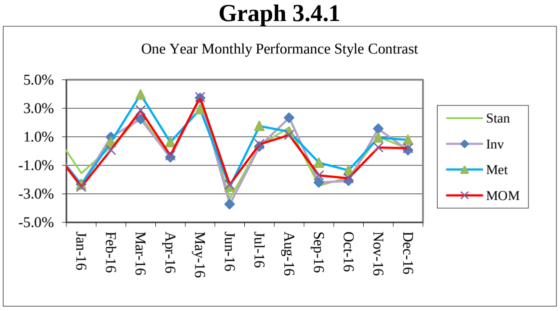


Graph 3.3.2

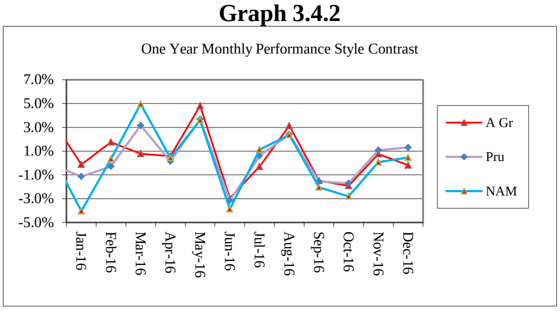


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

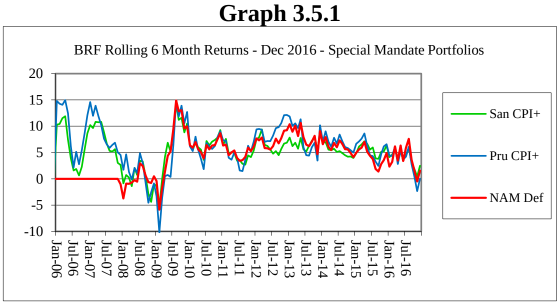


Graph 3.4.2

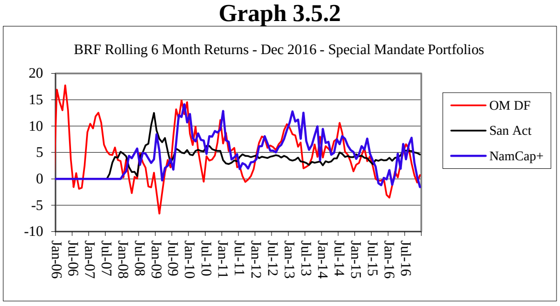


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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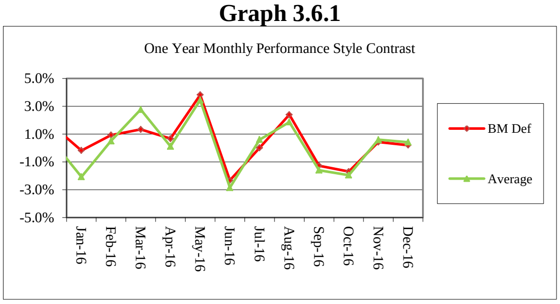
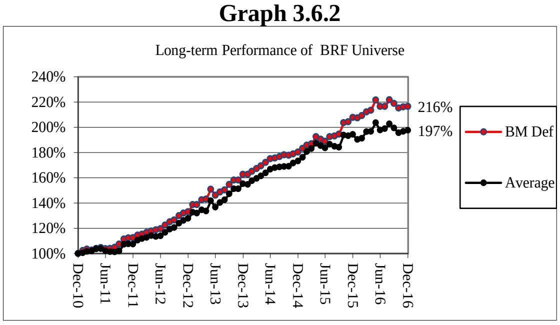
3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

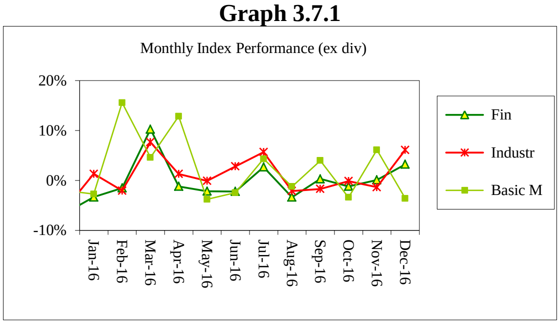


Graph 3.6.2

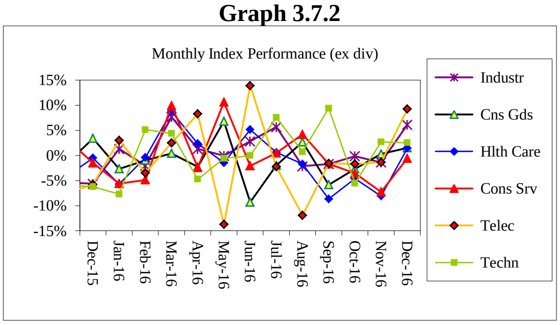


3.7 One year monthly performance of key indices (excluding dividends)

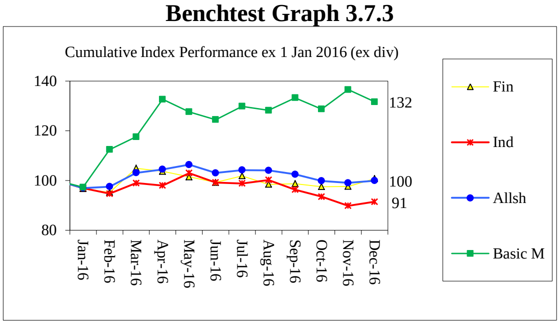
Graph 3.7.1



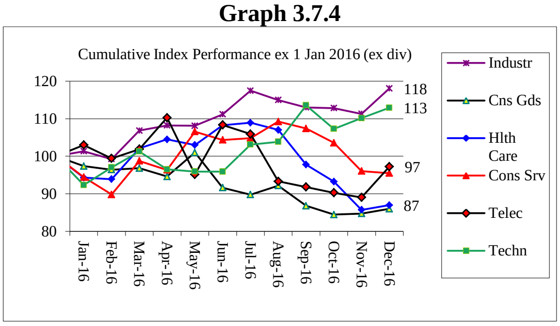
Graph 3.7.2



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.	14.0	12.9
5 year real return - % p.a.	8.6	7.5
Equity exposure - % of portfolio(qtr end)	48.2	55.9
Cumulative return ex Jan 2011	116.5	97.4
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%	10.0%	8.3%
Best annual performance	7.0%	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	6.0%	15.7%	15.1%

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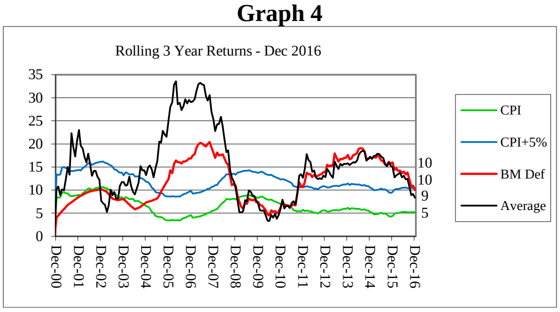
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years January 2014 to December 2016. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



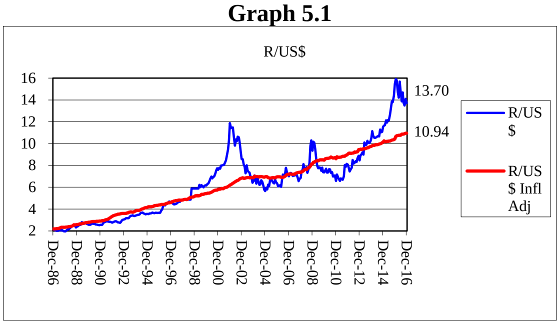
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end December was 10.0%, the average was 8.3% 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 10.94 to the US Dollar while it actually stood at 13.70 at the end of December. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1



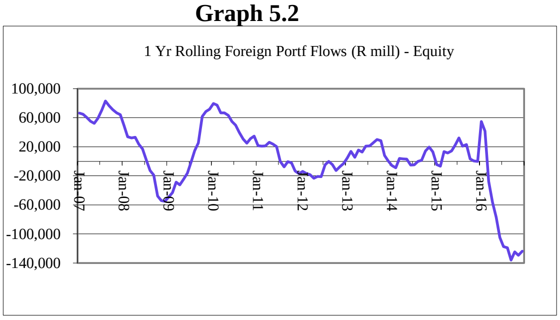
Rand strengthened despite foreign capital outflows in December

The Rand strengthened by 2.76% in December with net foreign investment outflows from bonds and equities of N$ 7.3 bn. Over the past 12 months the Rand strengthened by 11.5% on net outflows of foreign capital from equity and fixed interest securities of R 91.5 bn (outflow of 93.5 bn to end November 2016). This indicates that the weakness of the Rand was driven by negative sentiment rather than by fundamentals and that fundamentals are once again asserting themselves on the Rand.

Over the 12 months to end of December 2015 SA experienced an inflow of R 2.8 bn (outflow of R 8.6 bn to end of November 2015). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 308 bn (November R 315 bn).

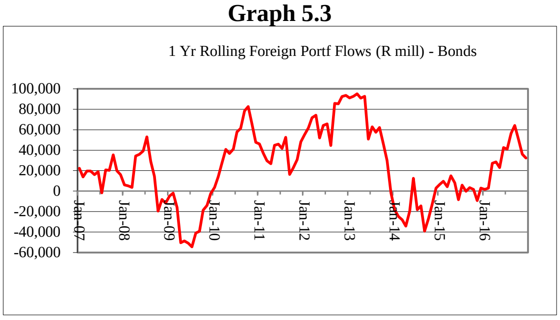
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 124 bn on a year-on-year basis at the end of December (outflow of R 129 bn year-on-year to end November). The month of December experienced a net outflow of R 3.2 bn. Since the beginning of 2006, foreign net investment in equities amounts to R58 bn (end November R 61 bn). This represents roughly 0.4% 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 32 bn over the past 12 months to end of December (inflow of R 36 bn over the 12 months to end of November). Since the beginning of 2006, foreign net investment in bonds amounts to R 250 bn (to November just over R 254 bn). The month of December experienced a net outflow of R 4.0 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 11.4% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.3% per year. This is equivalent to a growth in real terms of 3.1% p.a. over this period, excluding dividends, or around 6.1% including dividends.

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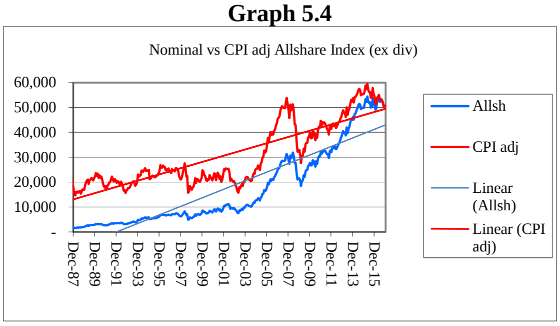
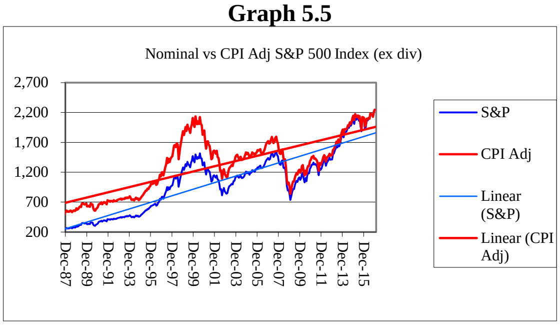
Graph 5.4



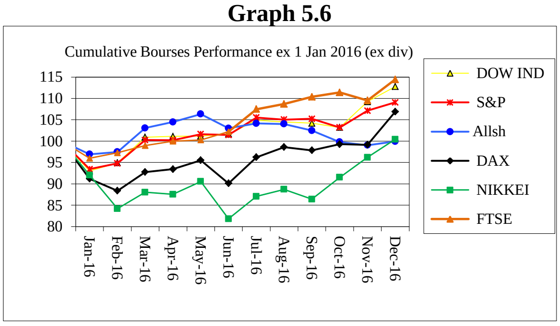
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.3% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.7% p.a. over this period, excluding dividends.

Graph 5.5



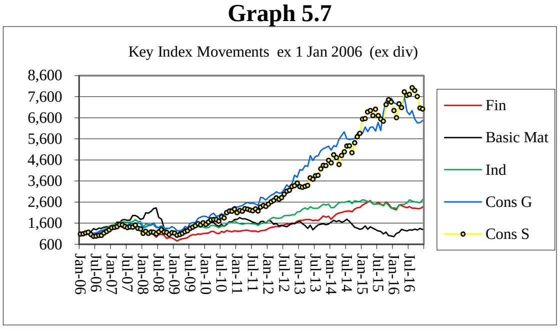
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the FTSE and Dow Jones as the top performing share indices.

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: 19.5%; Consumer Goods: 18.7%; Industrials: 9.6%; Financials: 8.2%; and Basic Materials: 2.4%.

Graph 5.7



6. What will 2017 bring us?

by Tilman Friedrich

In the October 2016 commentary I expressed my opinion that it is unlikely we will see significant changes in the economic and financial environment despite the inauguration of President Trump. John Mauldin summed up the powers of the US president as follows: "…the American president is among the weakest institutional leaders in Euro-American civilization. He can do some things unilaterally, particularly in foreign policy, but Congress can block them. He can do some things by executive order, but the Supreme Court can overrule them. He can pass certain programs that require cooperation from states, but the states can refuse to cooperate. At every step, as the founders intended, his ability to act unilaterally is severely limited. The difference between how presidential power appears and how it is applied in reality is enormous."

The rebalancing of global investment flows has commenced though and will impact returns for the next year and longer as interest rates will start to move back to normal levels ever so slowly. It is inconceivable that an asset class offering negative returns would attract any investor, yet it has over the last few years as the result of massive coordinated central bank intervention in the major global economies, leaving some investors, largely national pension systems with no choice but to accept negative real returns. The consequence of this is that pensioners' standard of living has been declining; alternatively that tax payers have to cough up for funding deficits of their pension system, depending on what mechanism is employed to fund the system.

Discretionary investors in contrast have been scrambling around the globe to find investments offering positive real returns. This benefited commodity based economies in particular where this flood of money has lifted equities and currencies of the countries targeted for positive real return investment. More recently with the prospect of rates being raised further in the US and prospectively now in Europe too, the great rebalancing between fixed interest and other investments has commenced. This is clearly evidenced by the outflow of foreign investor

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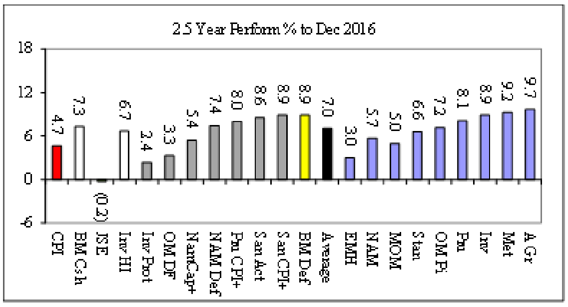
capital from SA that has continued unabated since the beginning of last year reaching the second highest level of R 39 billion in December 2016, topped only by a R 50 billion outflow in October 2008, just after the financial crisis struck. We have seen the Rand weakening as the result but unfortunately we have seen it weakening beyond reason as the result of SA's political turbulences and its economic woes, even though it has recovered quite nicely after the 'Nene gate'.

Since June 2014, the JSE Allshare index made no progress and has been hovering around the 2016 year end level of 50,000. The investor in the JSE Allshare index thus had a return of zero percent. Taking into account dividends of around 3.3% would have still produced a negative return of 1.4% to end of December with an average inflation rate of 4.7%!



Now consider the above graph. This depicts the performance of the more common investment portfolios employed by pension funds in Namibia. The blue bars to the right represent balanced portfolios comprising of a mix of asset classes with an equity exposure of between 60% and 65%. The grey bars represent more conservative portfolios comprising of a mix of asset classes but an equity exposure of mostly below 40%. Bearing in mind that the investor's return on the JSE Allshare index would have been minus 1.4% over the very same period, most pension fund investors should take comfort in the picture presented by the above graph. Over this period the typical balanced pension fund portfolio still returned 2.2% above inflation before asset manager fees, an outperformance of the JSE Allshare index plus dividends by 3.6%. Still, this is a very low real return considering that pension funds are built on the premise of investments returning 5% above inflation, after fees. Clearly this shows that rebalancing is under way in financial markets and this we expect to continue for the next year and longer!

Conclusion

Slowly improving global economic fundamentals, interest rates trending upwards and deflating asset prices as the result of the rebalancing process will continue. For SA it seems that very little foreign capital is still invested in SA equities, but quite a bit is still invested in SA bonds. The pressure on the Rand from foreigners withdrawing their investment from SA equities has probably largely dissipated. SA bonds probably still present good value to foreigner and we do not foresee the same trend as we saw with foreign equity investment in SA. Whilst we do not expect great returns from equities as an asset class equities remain our preferred asset class as it allows you to spread the risk as widely across the world. The wide choice you have also provides the opportunity to find equities that will outperform.

We do have a lot of political turmoil in the world particularly around the Mediterranean and of course an artificially created conflict with Russia. I will never forget the experience of my former boss who came from Zimbabwe, where he served as government official for all of his working life until around 55. He could not move his assets out of Zimbabwe of course, but worse, his government pension was wiped out by the hyperinflation. His only assets were what he built up while working in Namibia from age 55. As much as one might discount this as a risk for Namibia, one should not ignore it totally.

One would expect that Namibians' investments are largely concentrated in Namibia and these cannot be spread globally. Liquid discretionary capital should however rather be moved outside Namibia for the sake of spreading risk. Any money transfer off-shore should be spread over time for the benefit of Rand cost averaging to limit the currency risk. 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.

Rand hedge shares not only protect against a weakening currency, they also provide a further diversification into foreign economies. Export orientated companies and the tourism sector should also benefit from a weakening Rand. Increasing interest rates will put pressure on the local consumer and on local banks and companies dependent on the local consumer while a slowly improving global economy and increasing crude price should start to impact positively on commodities.

Finally, for most of us it will be difficult in practice to invest offshore. As the graph above shows, balanced unit trusts are an appropriate vehicle for the passive investor. Local balanced unit trusts would offer currency protection as well as spreading of risk globally. Offshore unit trusts are also fairly accessible. The beauty of this investment vehicle is that it really reduces your investment risk to zero and it is very liquid should you ever need to realise capital. And another benefit of investing in local unit trusts is that this investment will not be subject to foreign taxes on estates despite the underlying asset being invested in a foreign jurisdiction that employs estate taxes (e.g. SA).

7. Important notice and disclaimer

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