Volume 13, No. 08
August 2017

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 2017

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

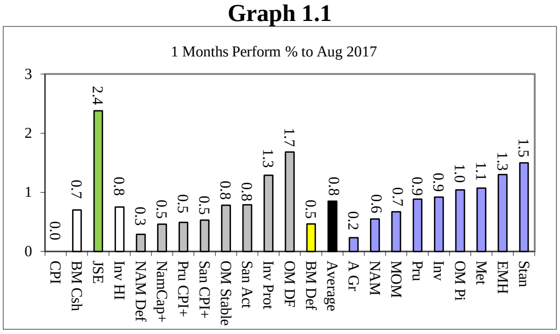
In August the average prudential balanced portfolio returned 0.85% (July: 3.55%). Top performer is Stanlib (1.50%); while Allan Gray (0.23%) takes the bottom spot. For the 3 month period, EMH takes top spot, outperforming the 'average' by roughly 1.10%. On the other end of the scale Allan Gray underperformed the 'average' by 0.93%.

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.

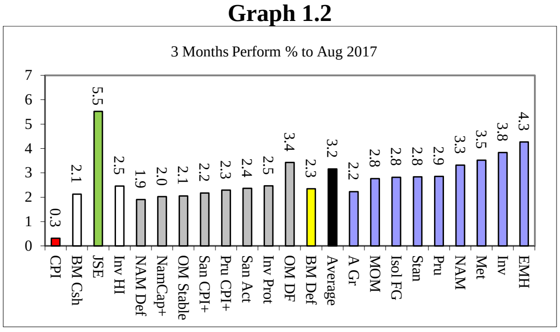
Below is the legend to the abbreviations reflected on the graphs:

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)
Smooth bonus portfolios	
Old Mutual AGP Stable	OM Stable (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)
Investment Solutions Bal Growth (multimanager)	Isol FG (blue)

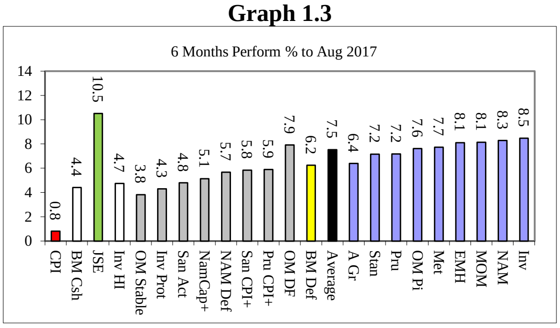
Graph 1.1



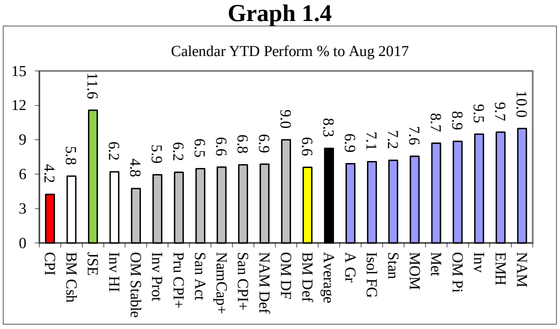
Graph 1.2



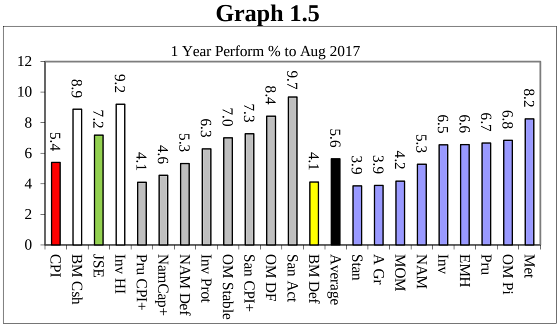
Graph 1.3



Graph 1.4



Graph 1.5



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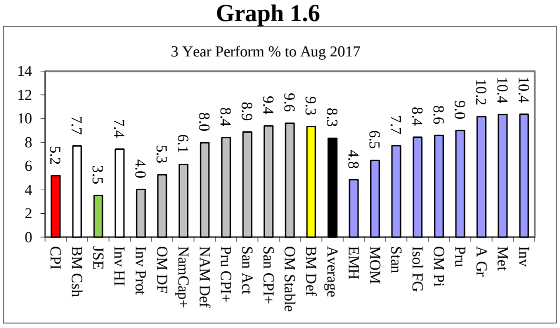
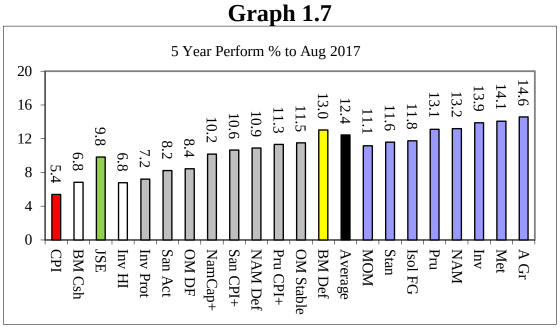
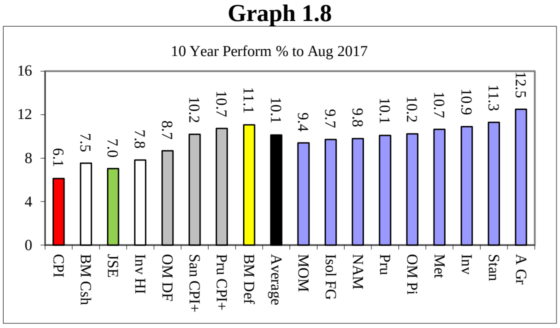
Graph 1.6



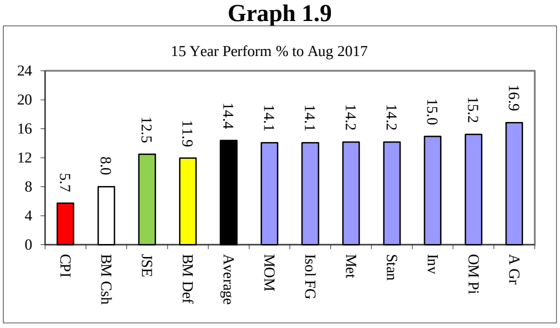
Graph 1.7



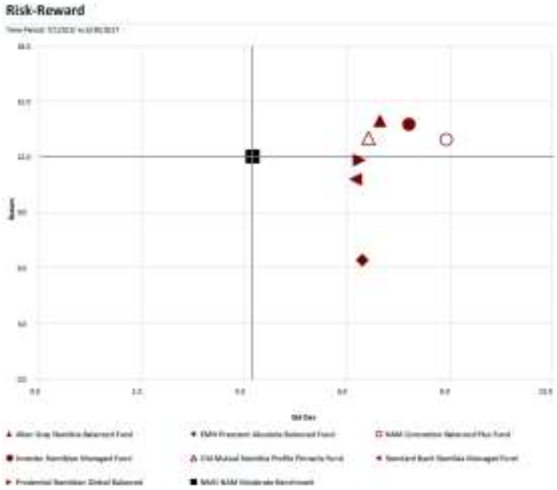
Graph 1.8



Graph 1.9

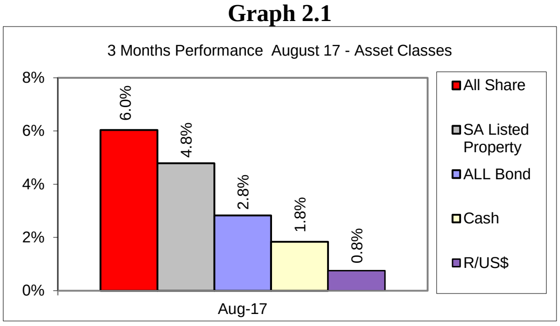


Risk/ Return

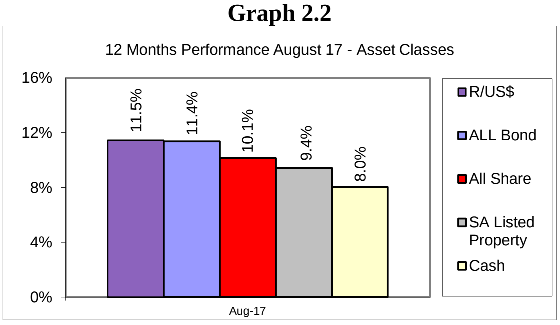


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

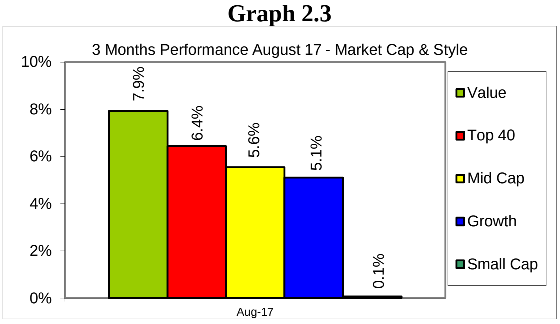
Graph 2.1



Graph 2.2



Graph 2.3



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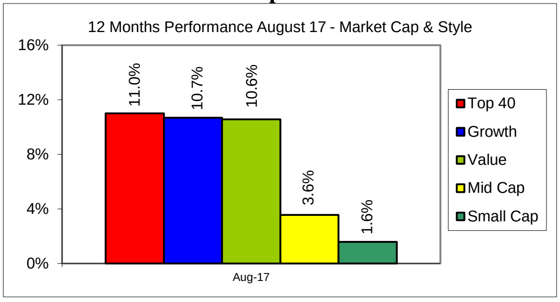
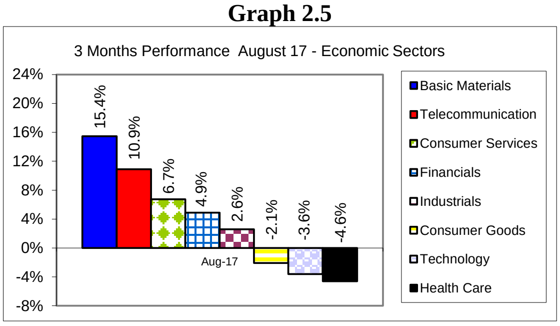
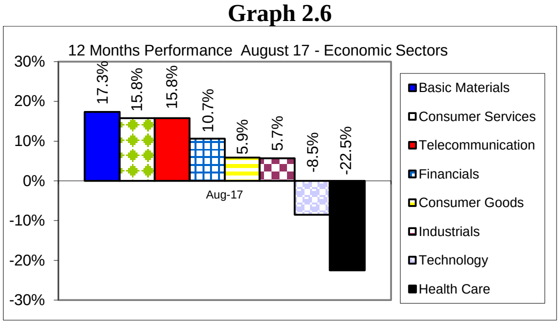
Graph 2.4



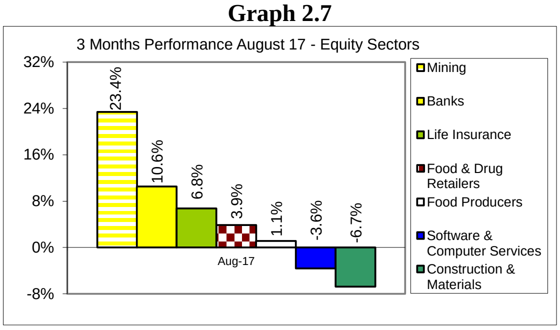
Graph 2.5



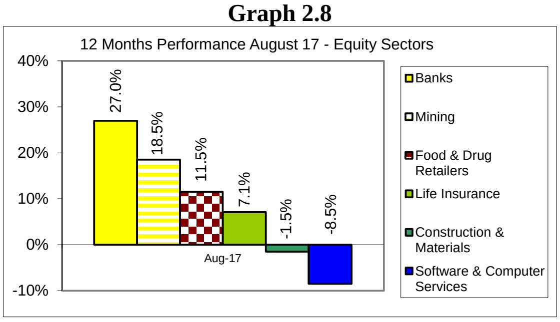
Graph 2.6



Graph 2.7



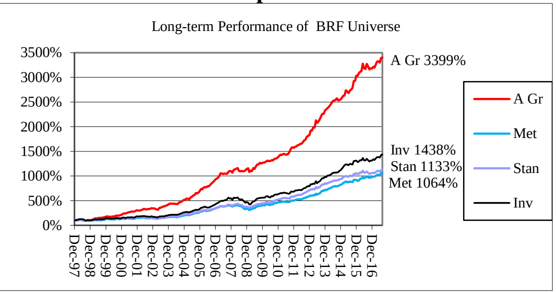
Graph 2.8



3. Portfolio Performance Analysis

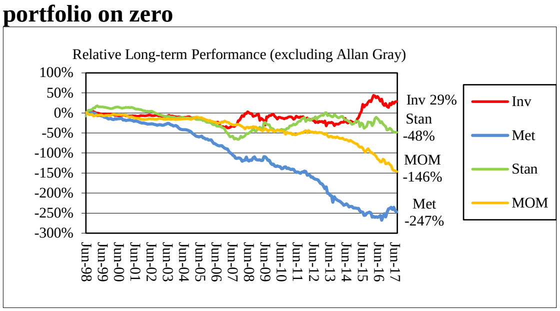
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

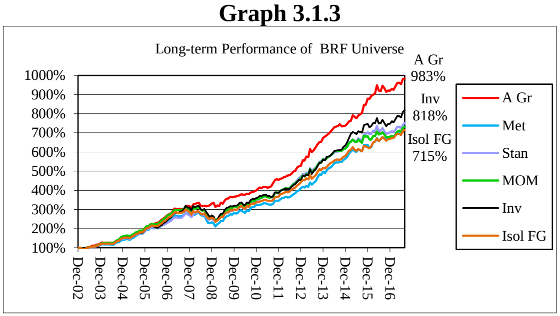


Graph 3.1.2

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

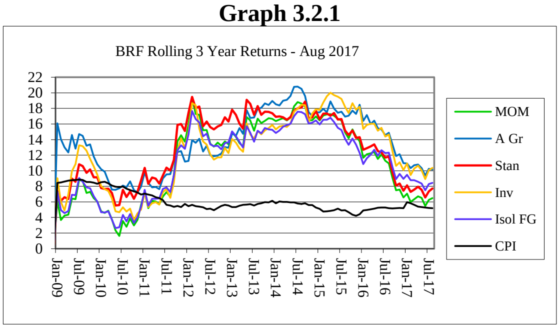


Graph 3.1.3



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

Graph 3.2.1



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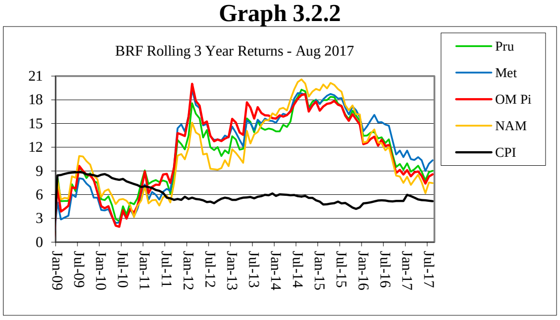
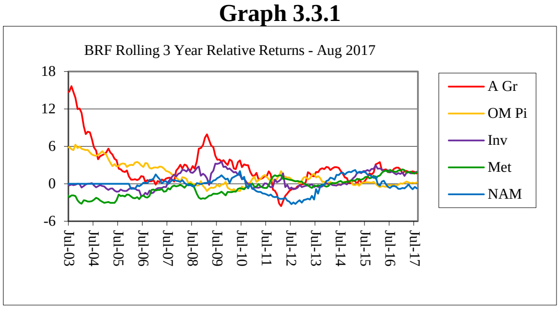
Graph 3.2.2

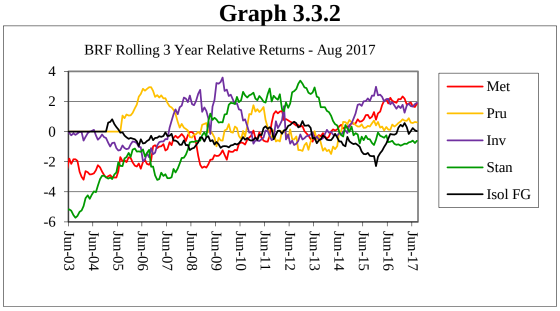


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

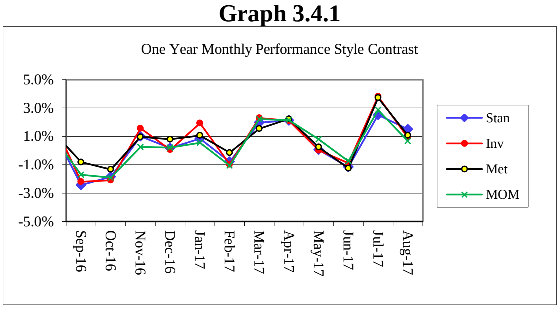


Graph 3.3.2

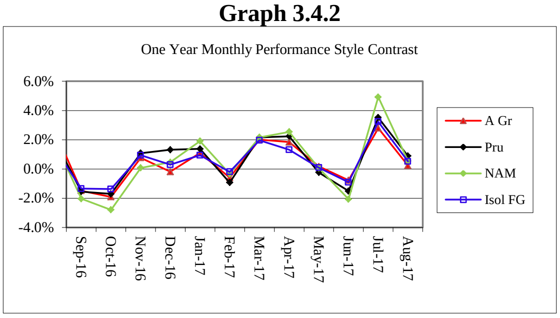


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

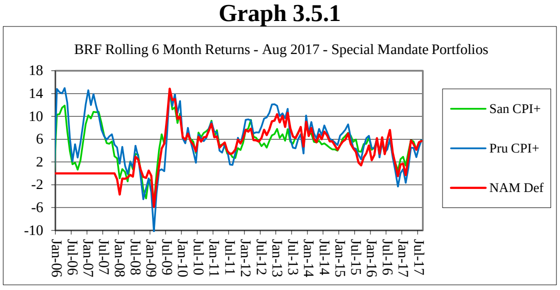


Graph 3.4.2

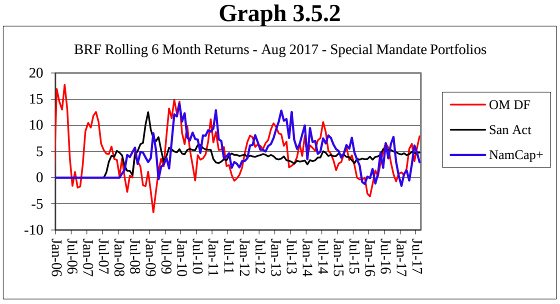


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

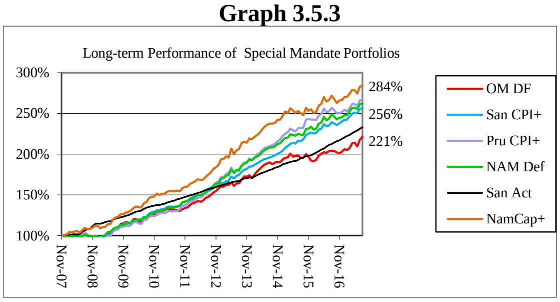
Graph 3.5.1



Graph 3.5.2



Graph 3.5.3



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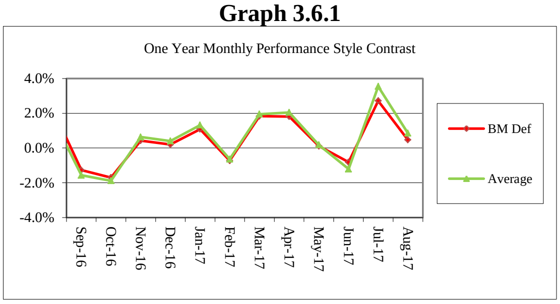
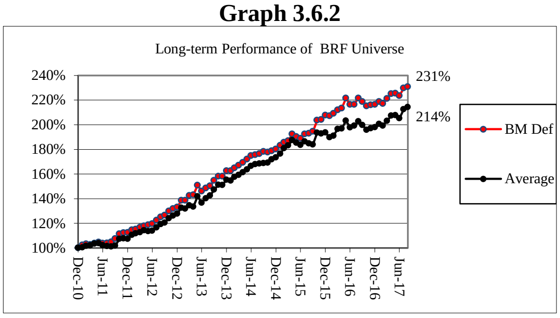
3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

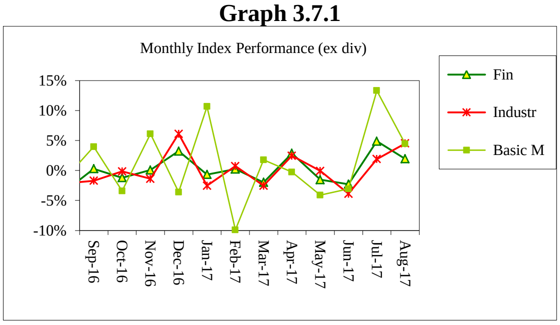


Graph 3.6.2

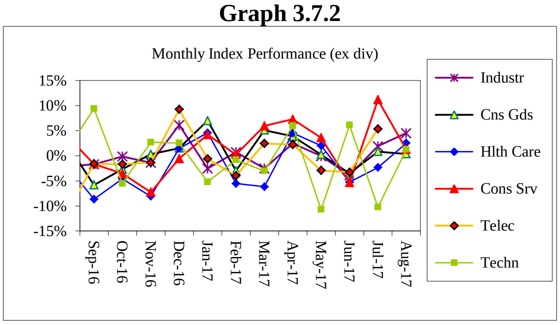


3.7 One year monthly performance of key indices (excluding dividends)

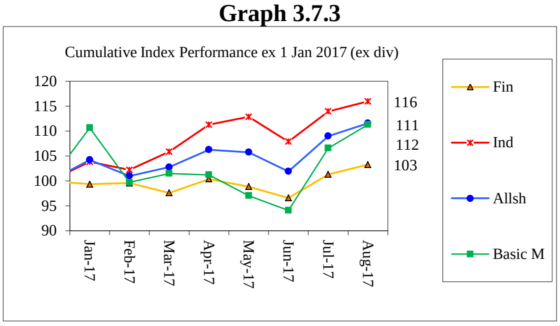
Graph 3.7.1



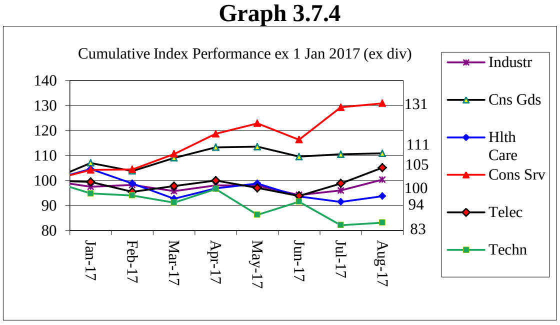
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio – Facts in figures

Table 4.1

Portfolio	Default portfolio	Average Prud Bal
5 year nominal return - % p.a.	13.0	12.4
5 year real return - % p.a.	7.6	7.0
Equity exposure - % of portfolio (qtr end Jun 2017)	50.5	56.2
Cumulative return ex Jan 2011	130.8	114.3
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 of the Default Portfolio 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	5.7%	8.5%	7.2%
Best annual performance	7.7%	18.4%	18.4%
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	7.2%	10.0%	8.6%

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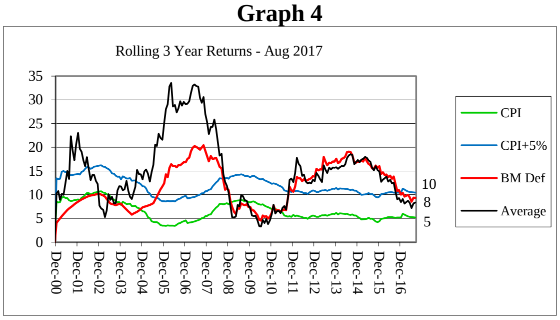
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years September 2014 to August 2017. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



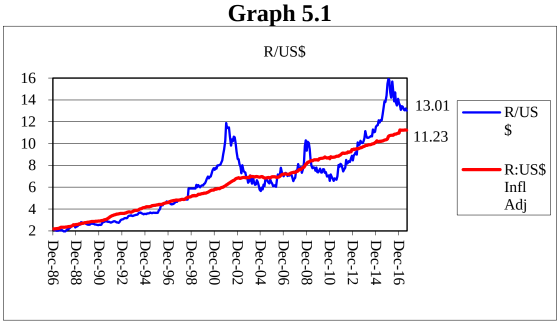
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end August was 9.3%, the average was 8.3% vs CPI plus 5% currently on 9.6%.

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 at fair value at 11.23 to the US Dollar while it actually stood at 13.01 at the end of August. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

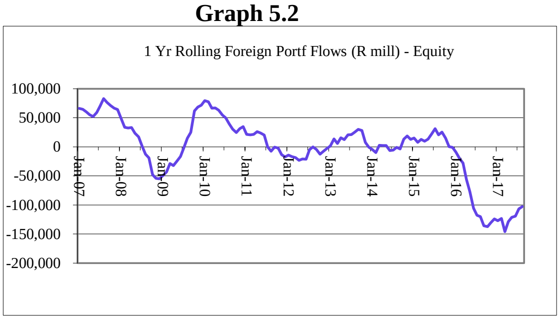


The Rand strengthened by 1.52% in August with net foreign investment inflows from bonds and equities of R 0.668 bn. Over the past 12 months the Rand strengthened by 11.46%. Net outflows of foreign capital from equity and fixed interest securities amount to R 80.4 bn (outflow of R 74.0 bn to end July 2017).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 327bn bn (July R 326 bn).

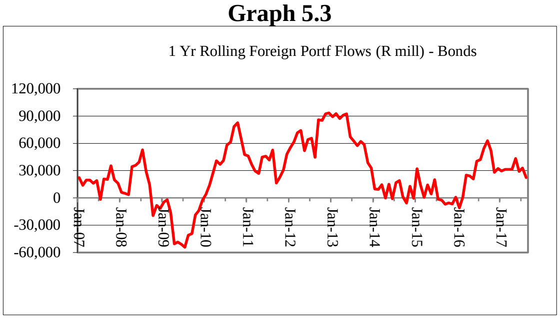
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 103 bn on a year-on-year basis at the end of August (outflow of R 107 bn year-on-year to end July). The month of August experienced a net inflow of R 0.4 bn. Since the beginning of 2006, foreign net disinvestment from equities amounts to R 7.3 bn (end July net investment of R 7.7 bn). This represents roughly 0.05% of the market capitalization of the JSE.

Graph 5.2



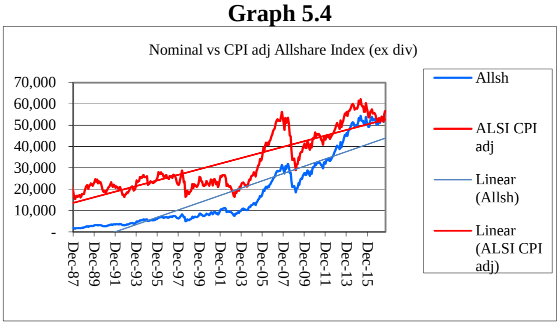
Graph 5.3 on a rolling one year basis reflects foreign portfolio inflows in respect of SA bonds of R 22 bn over the past 12 months to end of August (inflow of R 33 bn over the 12 months to end of July). The month of August experienced a net inflow of R 0.3 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 333.8 bn (to July R 333.5 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 11.5% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.2% 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.

Graph 5.4



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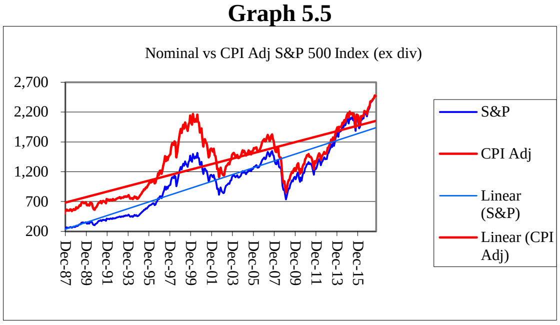
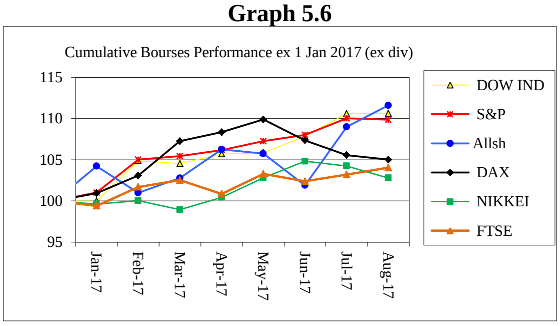
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.4% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.8% p.a. over this period, excluding dividends.

Graph 5.5



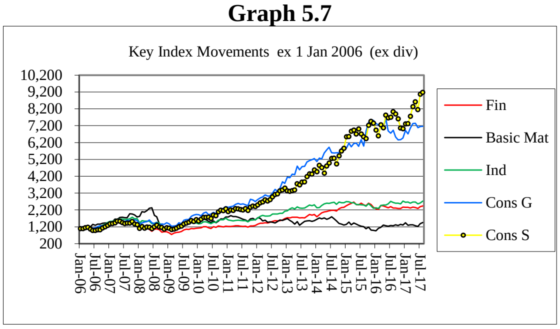
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Dow Jones, DAX, S&P 500 and FTSE as the top performing share indices since the start of 2016.

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: 20.8%; Consumer Goods: 18.3%; Industrials: 8.9%; Financials: 7.9%; and Basic Materials: 3.2%.

Graph 5.7



6. Interest rates are on the way up – tighten your belt and reduce your return expectations!

by Tilman Friedrich

So the US Federal Reserve has laid out a clear course as far as interest rates and bond issues are concerned. As things stand it will raise the interest rate once this year still and twice next year and it will offload treasuries at the rate of US$ 10 billion per month – not a lot if one considers that it was buying them at the rate of up to US$ 90 billion at the peak of the 'large scale asset purchase programme'. We expect the Fed rate to be lifted by at least 2%. If this continues to be done at a rate of increase of 0.25% twice a year, the cycle of rising interest rates should last for a period of 4 years. What will be the likely impact of these developments on global financial markets and on us at the southern tip of Africa specifically and how should we adapt our investment strategy in the light thereof?

Firstly while interest rates are on the way up in the US we should see a slow and protracted reversal of investment capital flows from equity into fixed interest stocks to a point of risk adjusted asset class equilibrium once interest rates have reached normal levels. Carry trade should unwind slowly over a protracted period meaning that global investors will start moving investment capital out of developing economies back into developed economies. Developing countries will have to fall in line with the Federal Reserve to protect their currencies and competitiveness. The SA Reserve Bank in September against the general expectation already held back with another interest rate cut. So our interest rates will be lifted slowly over a protracted period. While we are in this inclining interest rate cycle consumer sentiment will remain bearish and economic growth will be tardy.

Over this period of 4 years we expect equity markets to grow organically at best but with the risk of re-rating to lower price: earnings multiples. Expensive markets like the US will feel more pain than cheap markets. The SA equity market is generally considered to fair value and it should not endure too much pain from a re-rating. We should see bond yields increasing slowly over a protracted period. So returns from bonds and equities should generally be depressed, i.e. no double digit returns on your pension fund portfolio for the next 4 years or so. The expectation is that real returns in the US will dwell around 2% for the next couple of years.

For any investor there is really no escape from these global trends, there is no conventional asset class that will be able to dodge this trend. In the medium term it will be difficult for pension portfolios to achieve their implicit long-term return objective of 5% net after costs.

The scenario we envisage suggests that pension fund portfolios should be invested across all asset classes with a typical balanced structure. Picking the right stocks and

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 2017

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.

the right market on- and offshore will be a key success factor

Conclusion

Since the US Fed has now spelt out the way forward we expect volatility in global financial markets to subside and we expect low real returns he on pension portfolios over the next couple of years. We see no opportunity to leverage returns for a better outcome. What is left to us to do, is to reduce one's return expectations, reduce one's draw-down rate if one is already in that phase of one's life and tighten one's belt.

Offshore diversification remains a must for reducing your chances of losing and improving your chances of better returns. Pension fund investments are contractual obligations and you cannot change certain parameters, such as prescribed investment limits. You are also likely to be overweight Namibia with your total assets so you should use your liquid discretionary capital to diversify your risk away from Namibia. As far as local investments are concerned, in the short-term there is little to choose between the more and the less volatile asset classes in our opinion. We retain our preference for equities over cash and would be wary of bonds in the medium term although there may still be opportunity in the shorter term while SARB may still reduce interest rates against the global trend.

7. Important notice and disclaimer

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