Volume 14, No. 5
May 2018

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MAY 2018

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

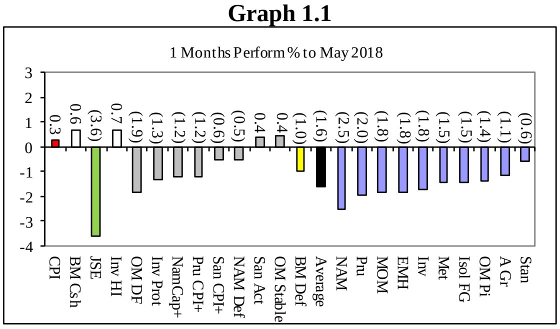
In May 2018 the average prudential balanced portfolio returned -1.61% (April 2018: 3.4%). Top performer is Stanlib (-0.56%); while Namibia Asset Management (-2.52%) takes the bottom spot. For the 3 month period, EMH Prescient takes top spot, outperforming the 'average' by roughly 1.09%. On the other end of the scale Momentum underperformed the 'average' by 0.75%.

Graphs 1.1 to 1.10 reflect the performance for periods from 1 month to 20 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, Sanlam Inflation Linked and Allan Gray Namibia Balanced Funds.

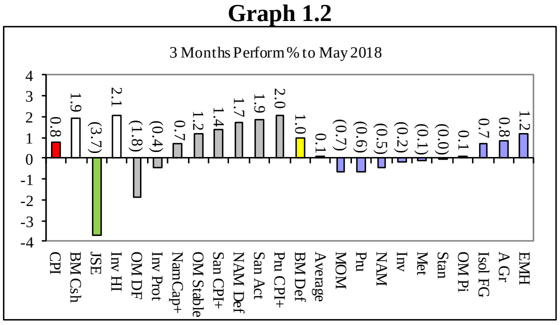
Below is the legend to the abbreviations reflected on the graphs:

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)

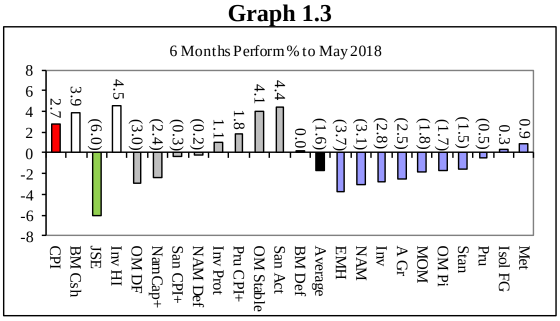
Graph 1.1



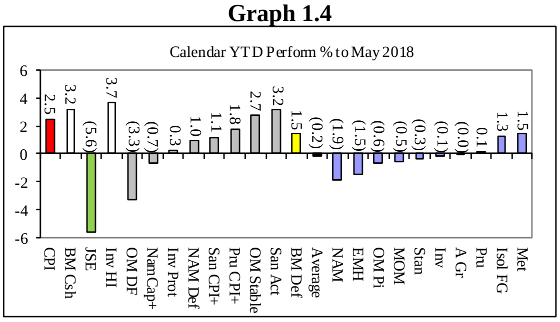
Graph 1.2



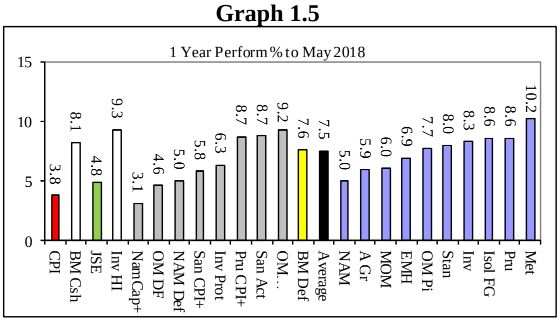
Graph 1.3



Graph 1.4



Graph 1.5



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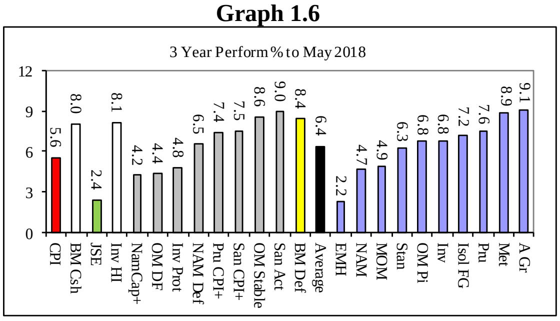
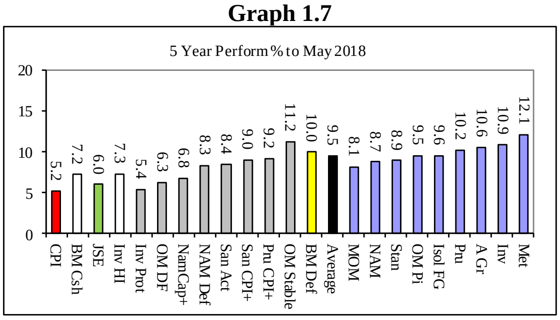
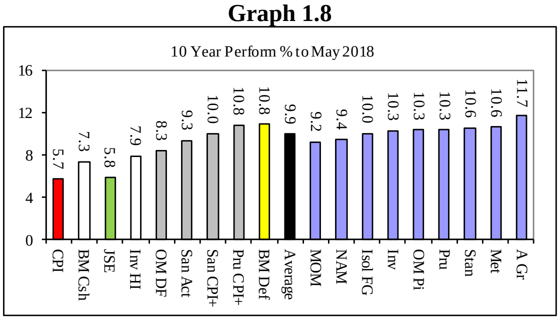
Graph 1.6



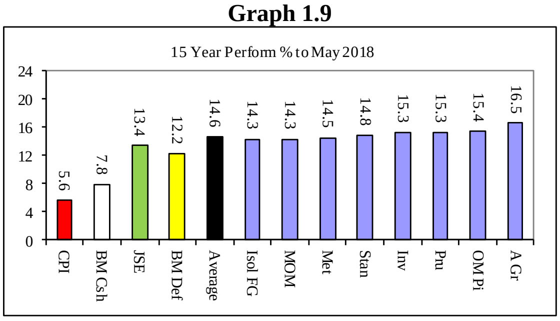
Graph 1.7



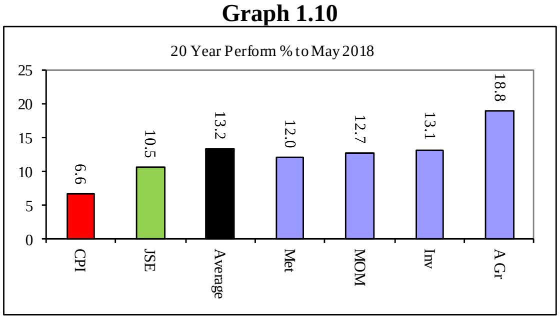
Graph 1.8



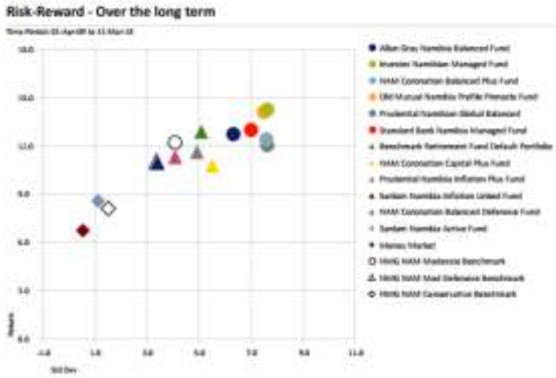
Graph 1.9

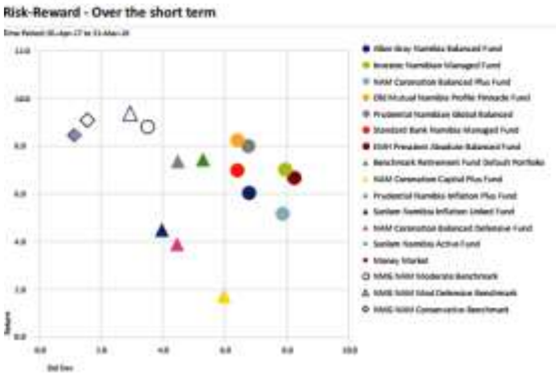


Graph 1.10



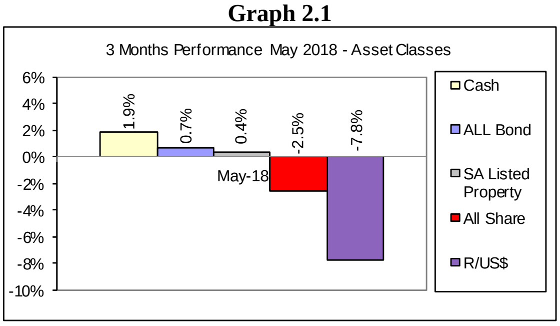
Risk/ Return



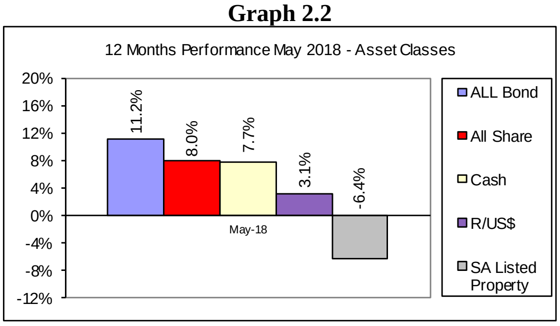


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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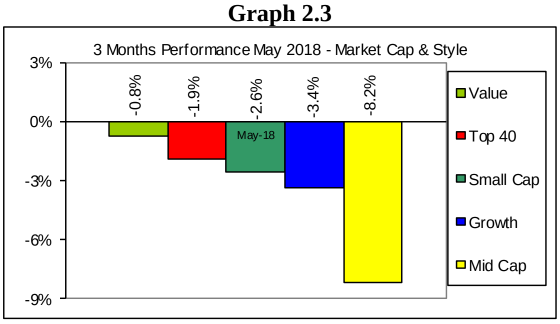
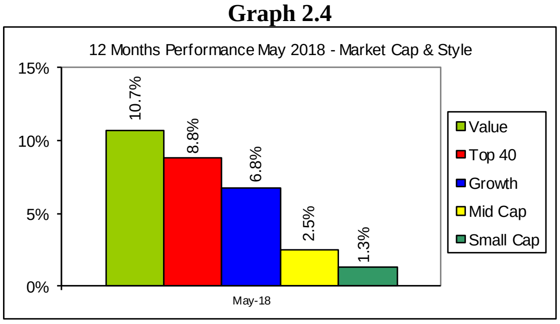
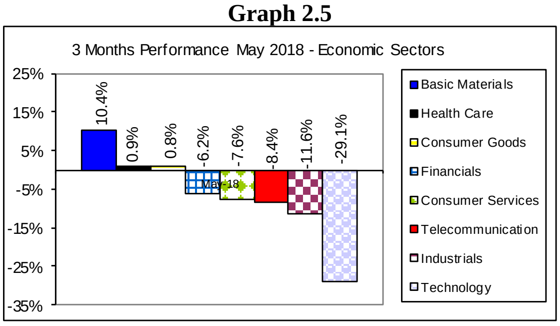
Graph 2.3



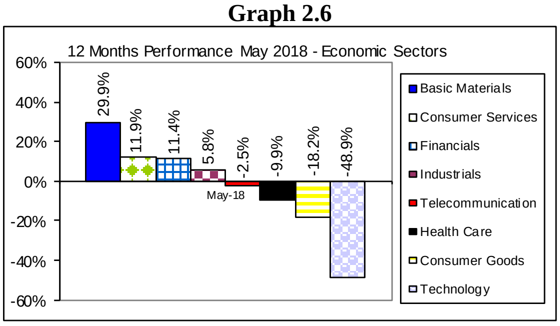
Graph 2.4



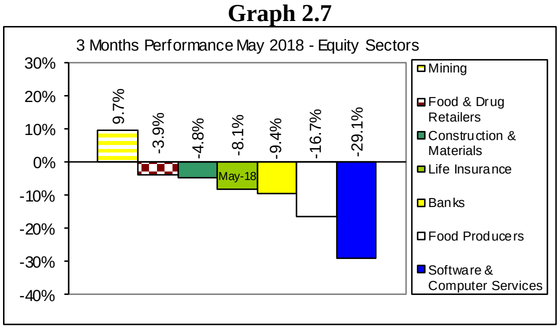
Graph 2.5



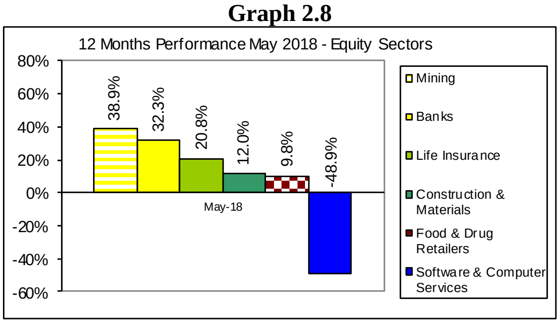
Graph 2.6



Graph 2.7



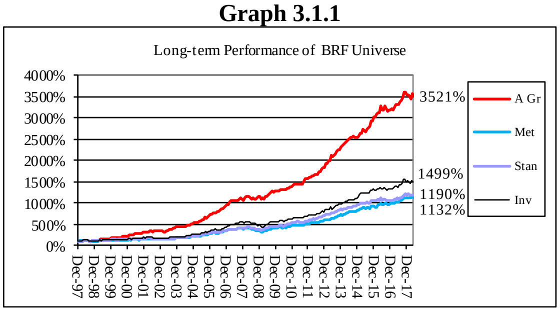
Graph 2.8



3. Portfolio Performance Analysis

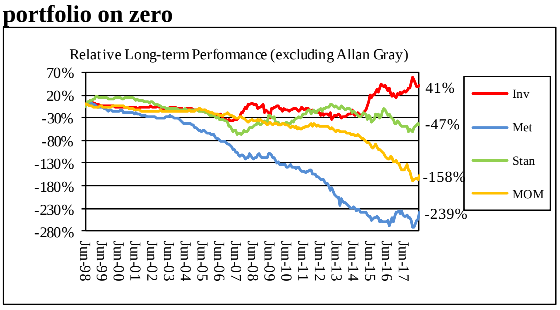
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

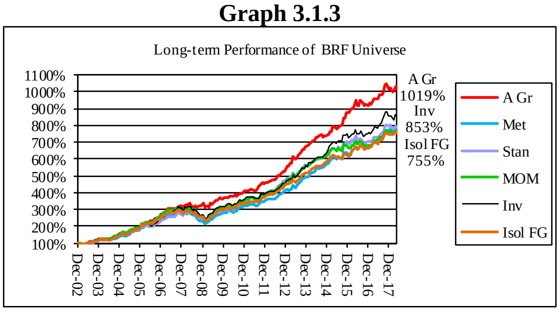


Graph 3.1.2

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



Graph 3.1.3



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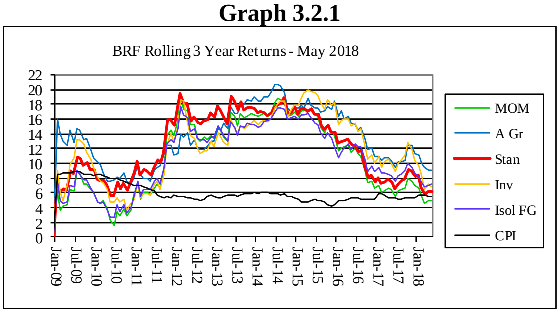
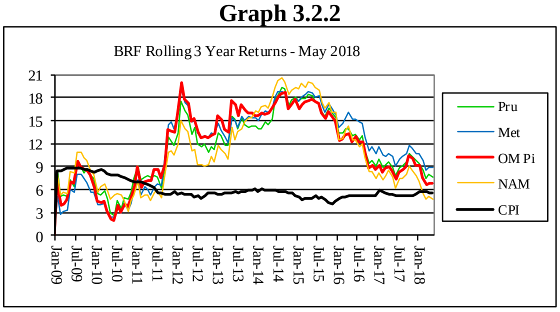
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

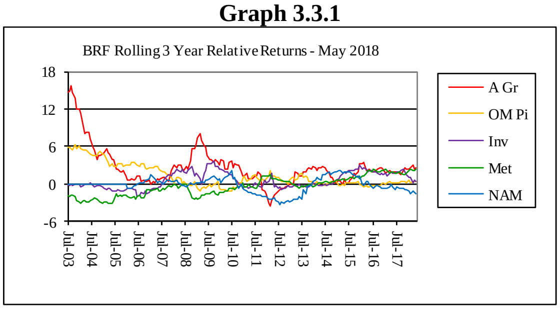


Graph 3.2.2

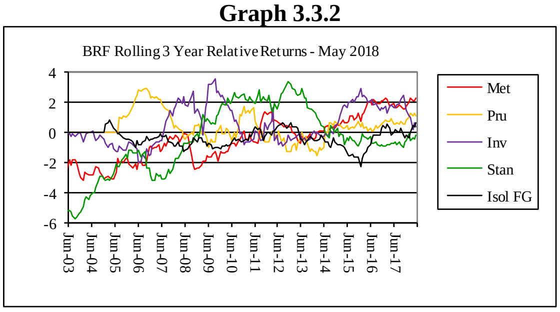


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

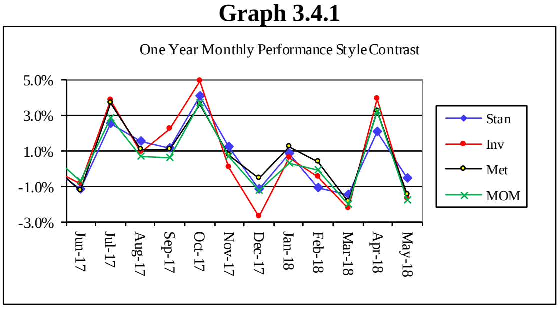


Graph 3.3.2

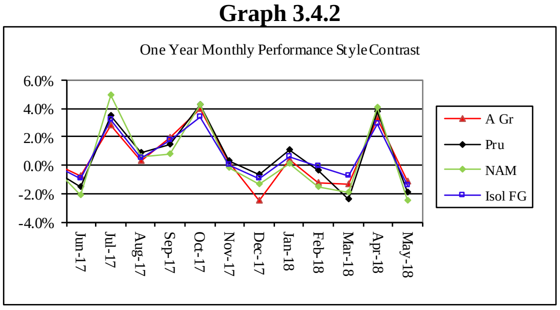


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

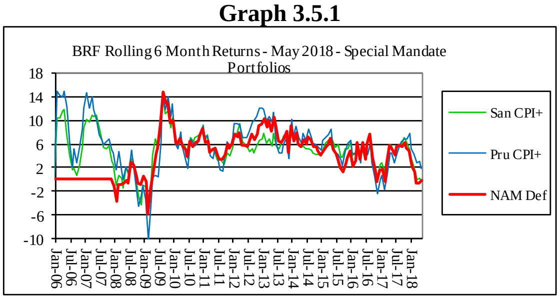


Graph 3.4.2

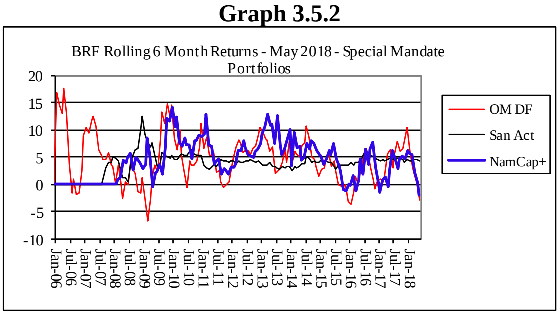


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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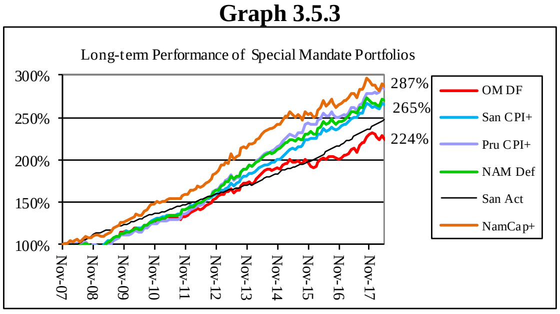
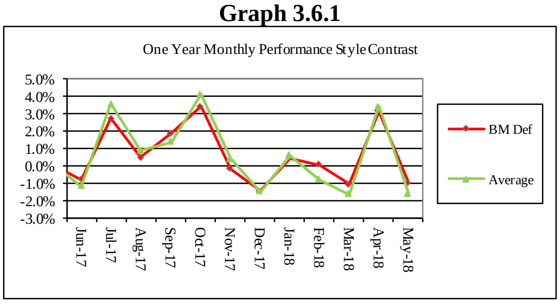
Graph 3.5.3

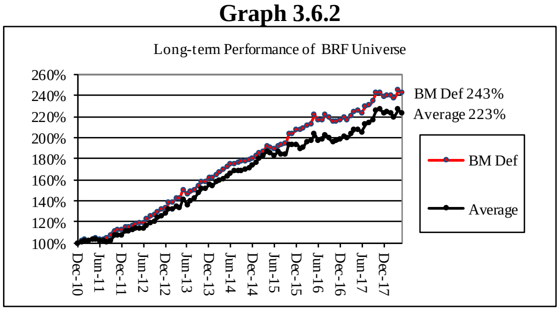


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

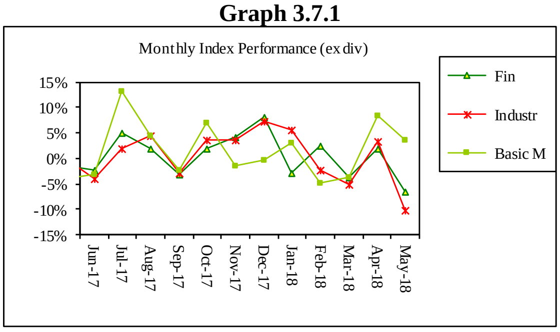


Graph 3.6.2

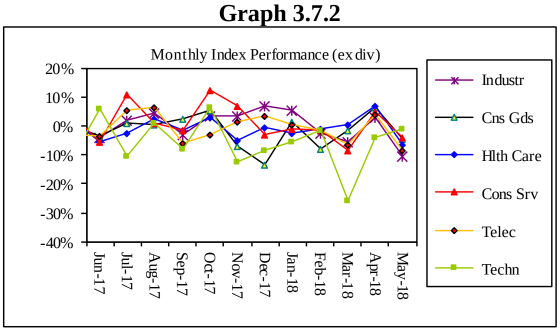


3.7 One year monthly performance of key indices (excluding dividends)

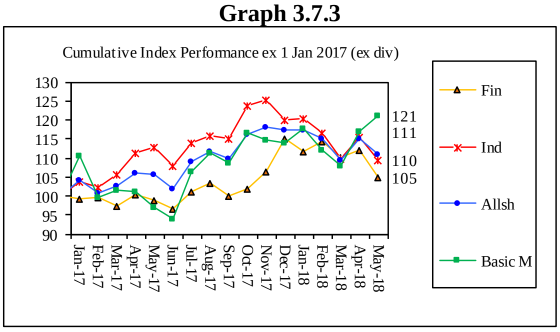
Graph 3.7.1



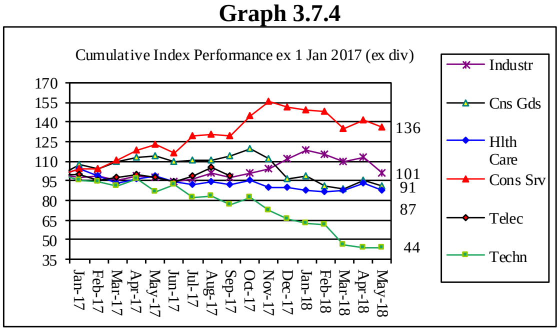
Graph 3.7.2



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.	10.0	9.5
5 year real return - % p.a.	4.8	4.3
Equity exposure - % of portfolio (qtr end Mar 2018)	46.4	66.6
Cumulative return ex Jan 2011	142.63	123.29
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.

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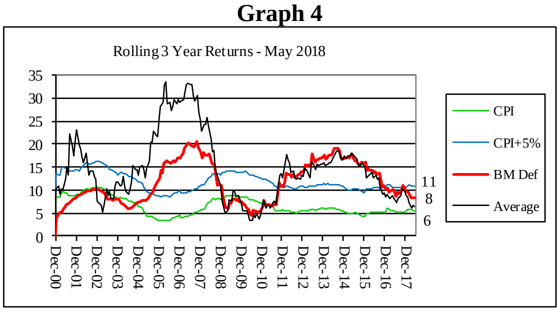
Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.8%	8.3%	6.2%
Best annual performance	8.0%	16.4%	17.2%
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	7.0%	8.4%	6.7%

The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years June 2015 to May 2018. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4

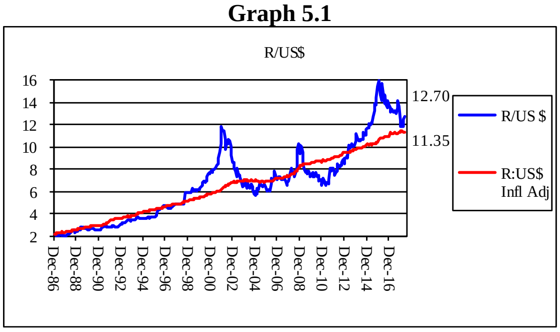


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end May was 8.4%, the average was 6.4% vs CPI plus 5% currently on 10.6%.

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 11.35 to the US Dollar while it actually stood at 12.70 at the end of May. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

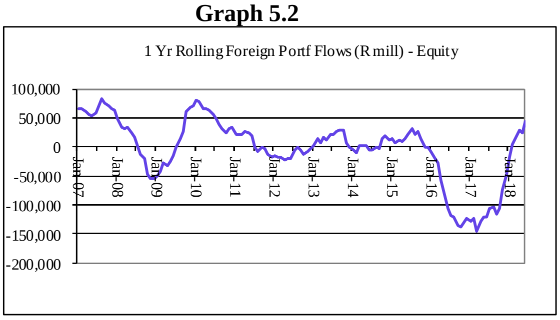


The Rand weakened by 1.98% in May with net foreign investment outflows from bonds and equities of R 35.8 bn. Over the past 12 months the Rand strengthened by 3.1%. Net inflows of foreign capital into equity and fixed interest securities over the past 12 months amounted to R 29.6 bn (inflow of R 65.4 bn to end April 2018).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 354.4bn (April R 390 bn).

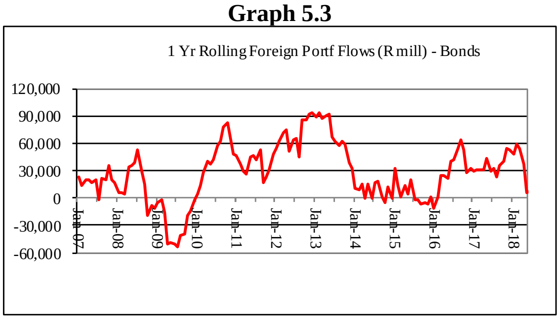
Graph 5.2 reflects a net inflow of capital into South African equities on a rolling one year basis, of R24.1 bn at the end of May (inflow of R 28.9 bn year-on-year to end April). The month of May experienced a net outflow of R 13.7 bn. Since the beginning of 2006, foreign net investment into equities amounts to R 25.1 bn (end April net investment of R 38.8 bn). This represents roughly 0.18% 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 5.6 bn over the past 12 months to end of May (inflow of R 36.5 bn over the 12 months to end of April). The month of May experienced a net outflow of R 22.1 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 329.3 bn (to April R 351.4 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 11.2% 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 3.0% p.a. over this period, excluding dividends, or around 6.0% including dividends.

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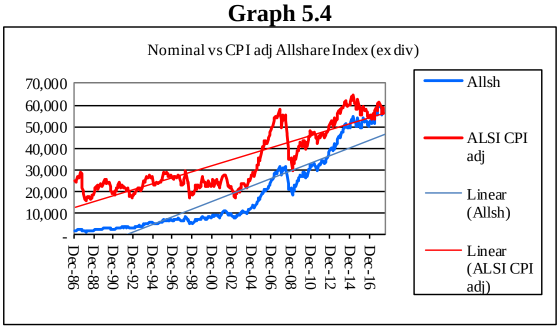
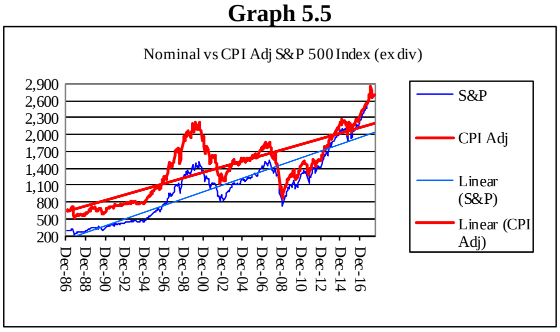
Graph 5.4



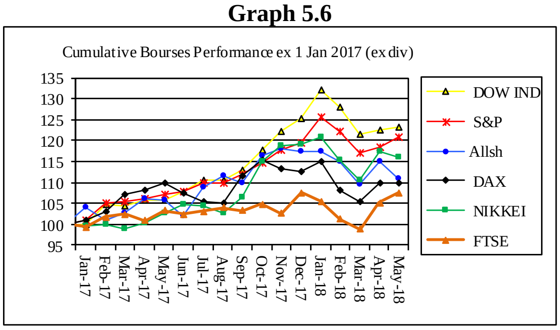
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.6% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 5.0% p.a. over this period, excluding dividends.

Graph 5.5



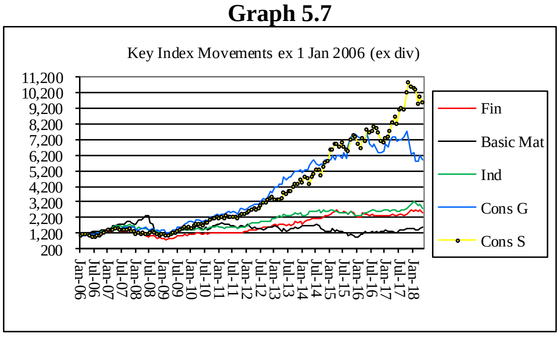
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Dow Jones as the top performing index indices since the start of 2017.

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: 19.8%; Consumer Goods: 15.2%; Industrials: 8.5%; Financials: 7.6%; and Basic Materials: 3.7%.

Graph 5.7



6. Will we see investment markets improving anytime soon?

by Tilman Friedrich

Year-to-date investment returns look rather depressing! Over this 5 month period, the best low equity portfolio produced only 3.2%, the best prudential balance portfolio produced 1.5% while the average prudential balance portfolio produced minus 0.2%. This state of affairs does not come as a surprise. In July 2014, we already expressed our opinion that "…we will see negative short-term interest rates, low to negative returns on longer dated stocks and muted growth in equities that are dependent on a growing economy and low interest rates. We would therefore not expect returns on equities to exceed 4% in real terms over the next 3 years…"

Well we were too optimistic about our expectation of muted returns for the next 3 years. In fact the JSE Allshare index, CPI adjusted produced minus 2.4% per annum over this nearly 4 year period. Adding back dividends of 3.2% the total return of the JSE Allshare index, CPI adjusted produced 0.8% per annum over this period – muted indeed as expected. In contrast the average prudential balanced portfolio returned 7.7% nominal and 2.5% real per annum, outperforming the Allshare index, CPI adjusted by 1.7% per annum. The bond portfolio we are monitoring returned 7.6% per annum in nominal terms, just below the 7.7% produced by the average prudential balanced portfolio. Cash returned 7.7% in nominal terms or 2.1% in real terms. Clearly, in hindsight there was little to choose as between the different asset classes over the past 4 years.

For interest sake, the Benchmark default portfolio produced a return of 8.8% in nominal terms, or 3.6% per annum in real terms, outperforming the average portfolio by more than 1% per annum over this period. Old Mutual AGP stable growth produced a nominal return of 9.7%, equivalent to a real return of 4% per annum. One must bear in mind though that this portfolio employs reserves to smooth returns and the full picture would only emerge if one were to account for the change in the smoothing reserve over this period. We believe the smoothing reserve is currently in negative territory. This means that

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MAY 2018

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.

there is little room for declaring returns on this portfolio above those of the average prudential balanced portfolio. It also means that when markets eventually turn up again over the next two years or so as we are expecting, Old Mutual will first rebuild the smoothing reserve by passing on returns lower than those of the average prudential balanced portfolio.

Given that the implicit assumption of typical pension fund contribution structures is a real return of 6% before fees, or 5.3% after fees, the average prudential balance portfolio under-achieved this target by 2.8% per annum while the Benchmark default portfolio under-achieved this target by 1.7% per annum. It has not been a good 46 month period for equities and fixed interest investments.

So how much longer do we have to endure such pedestrian investment returns? We know that a key driver of poor returns has been the fact that the US Fed is on a mission to lift interest rates to more normalised levels. We believe that a 1 to 2 basis point spread between US inflation and the Fed rate will represent a normalised interest rate environment. Currently US inflation stands at 2.8% while the Fed rate is at 2%. Given the Fed's pointer that it is likely to raise rates at 0.25% at a time and this up to 4 times per year, we are probably looking at another 8 hikes. This means that we would still expect muted returns from all asset classes for at least another 2 years. We are then looking at a cycle of at least 6 years of low returns.

With these expectations, the Rand and local interest rates will remain under pressure for the next 2 years and this will also impact negatively on local inflation. Low returns and rising interest rates will also impact negatively on the consumer.

In last month's column, we expressed concerns about the highly explosive situation in the Middle East referring to a possible military confrontation between Iran and Israel. By now our concerns have subsided somewhat as it appears that Iran has back tracked on its 'ambitions' of a permanent military presence in Syria. It also becomes more evident that the US is intent in drying out Iran financially without delay, with the goal of achieving a regime change.

Conclusion

Although our view of the global political backdrop is now more optimistic since last month's column, the global economic and financial back-drop has not really changed.

We therefore still expect that equities are n a phase of a long drawn-out correction to last at least another two years, as interest rates in the US are moving to more normal levels again. We do not see any conventional asset class that is equities, property, bonds and cash that offers exciting prospects in the near future. Solid companies purchased at fair value should be able to produce reasonable real returns although we retain our equity bias. In this regard we concur with an article in the Benchtest newsletter in this link… that one should not time the market but stay invested. This should be the time for stock pickers who can identify value in the universe of the various asset classes. And, once again we caution investors not to expect double digit returns for the next few years. Rather take comfort with an inflation beating return in the region of 4% to 5% and try to lock in such opportunities when they present themselves.

The relatively strong Rand still offers an opportunity to diversify offshore. In the light of announced changes to regulation 28 that require the Namibian exposure of pension fund investments to be lifted to 45%, the investor faced the dilemma of investments being highly concentrated in Namibia. The SA allocation will effectively be restricted to 25%, the balance of 30% invested offshore. This in itself presents an imbalance in the typical pension fund portfolio, too much being required to be invested in Namibia. Discretionary assets should thus now be expatriated to improve this imbalance.

Amongst the various equity sectors, commodities have been in the doldrums for quite some time now and should benefit from a slowly improving global economy and are thus expected to offer fair prospects for 2018.

7. Important notice and disclaimer

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