Volume 14, No. 7
July 2018

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JULY 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

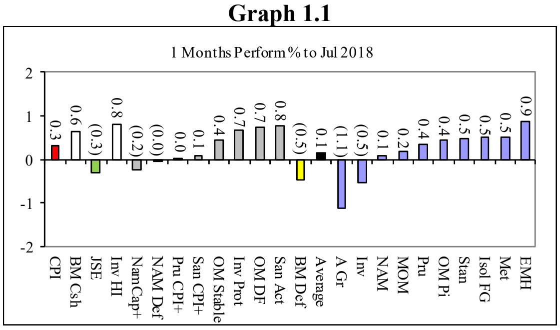
In July 2018 the average prudential balanced portfolio returned 0.15% (May 2018: 2.45%). Top performer is EMH Prescient (0.88%); while Allan Gray (-1.12%) takes the bottom spot. For the 3 month period, Stanlib takes top spot, outperforming the 'average' by roughly 1.15%. On the other end of the scale Namibia Asset Management underperformed the 'average' by 1.43%.

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.

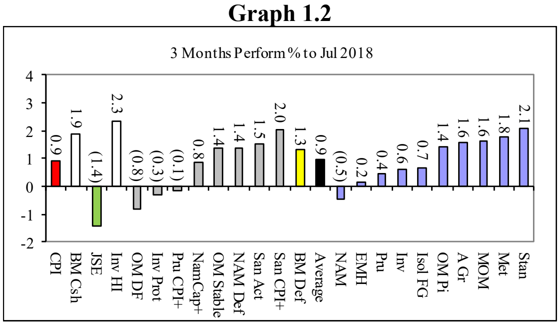
Below is the legend to the abbreviations reflected on the graphs:

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)

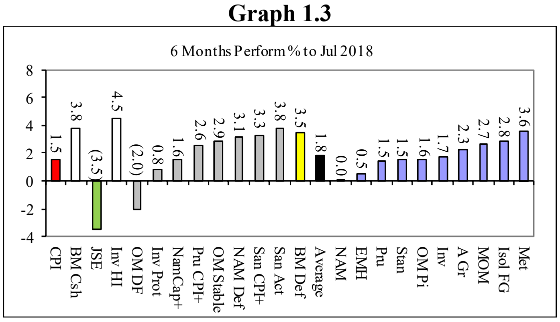
Graph 1.1



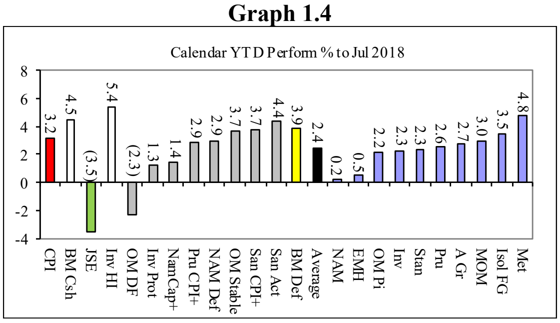
Graph 1.2



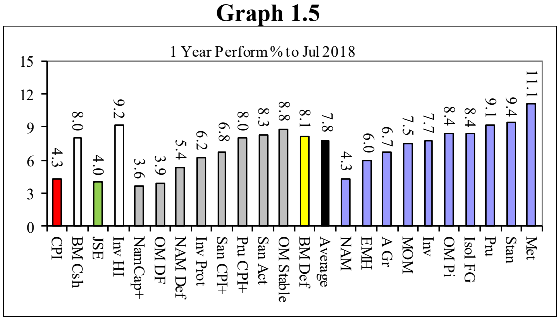
Graph 1.3



Graph 1.4



Graph 1.5



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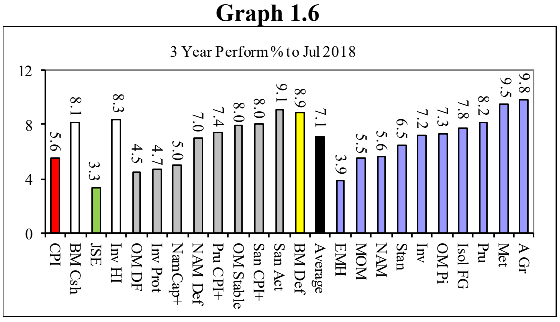
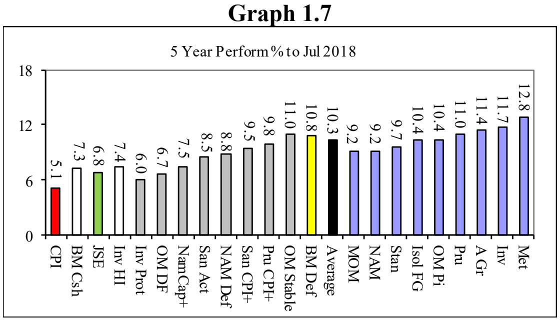
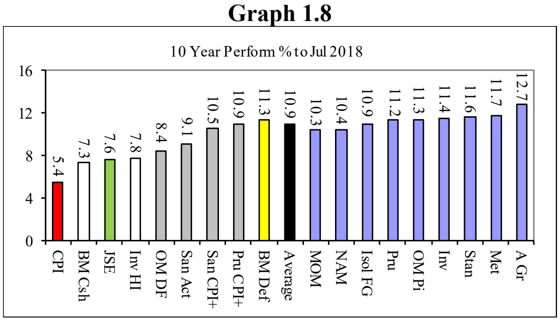
Graph 1.6



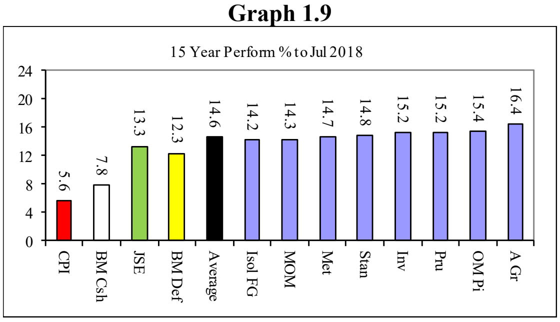
Graph 1.7



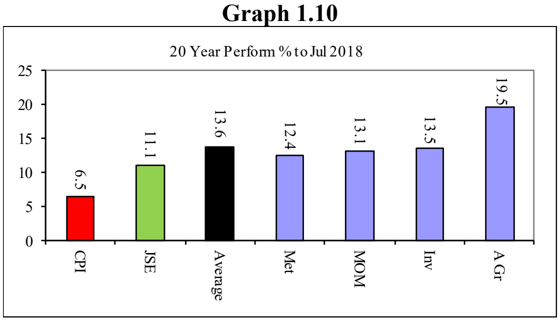
Graph 1.8



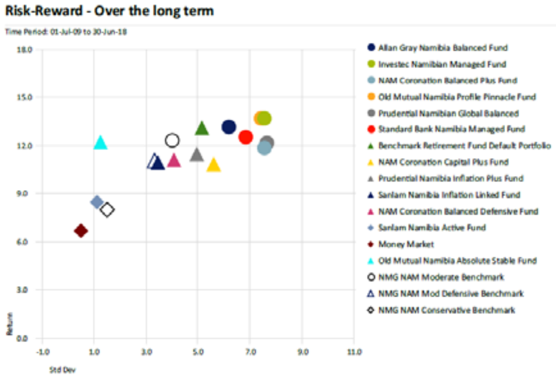
Graph 1.9

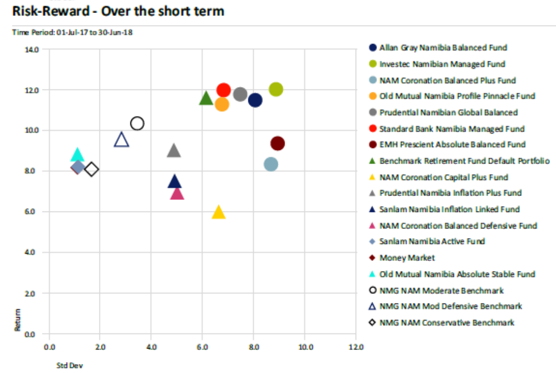


Graph 1.10



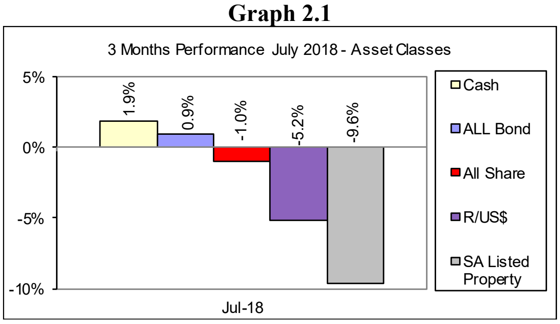
Risk/ Return



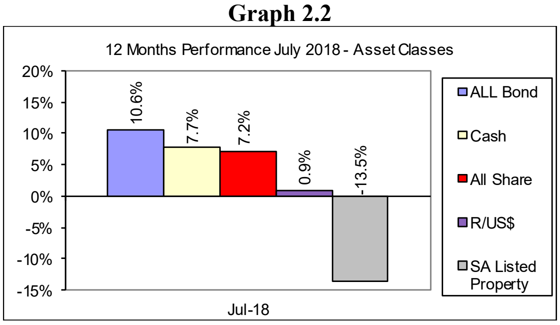


2. **Performance of Key Indices** (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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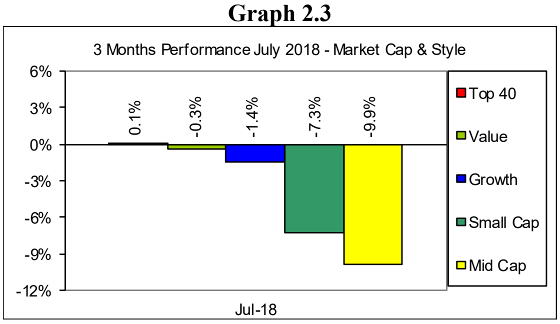
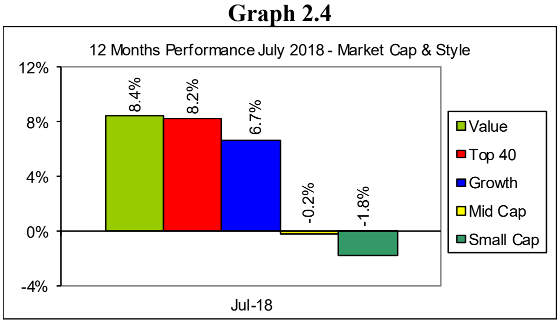
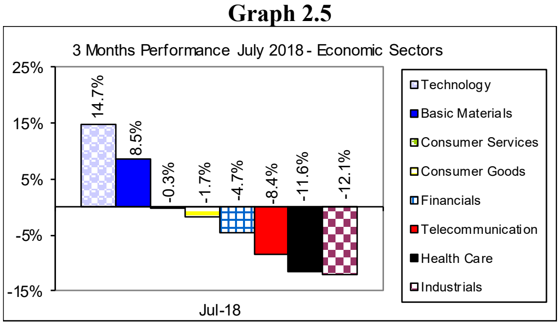
Graph 2.3



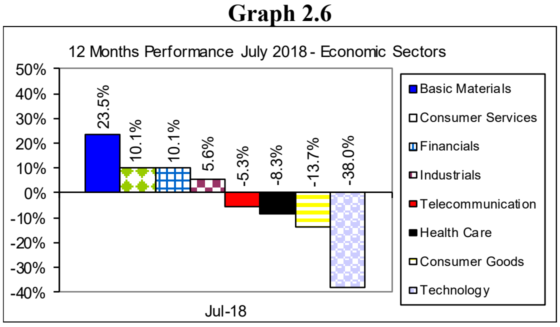
Graph 2.4



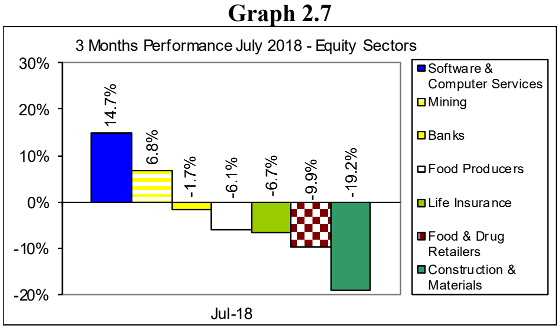
Graph 2.5



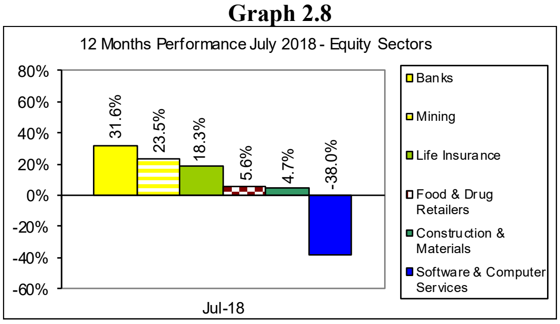
Graph 2.6



Graph 2.7



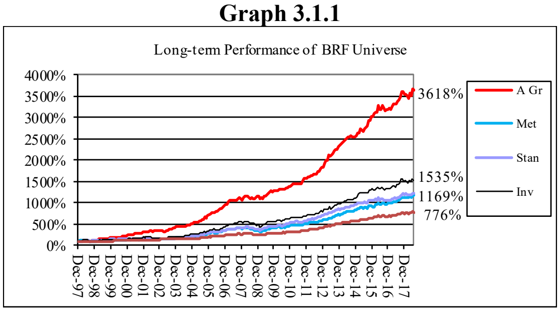
Graph 2.8



3. Portfolio Performance Analysis

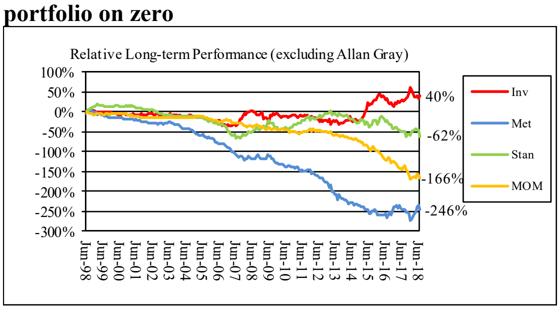
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

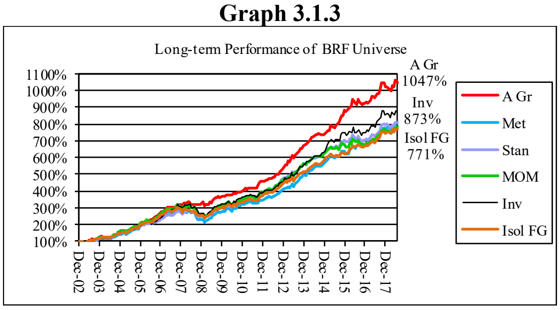


Graph 3.1.2

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



Graph 3.1.3



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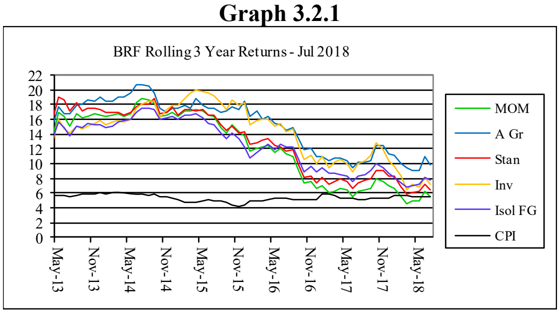
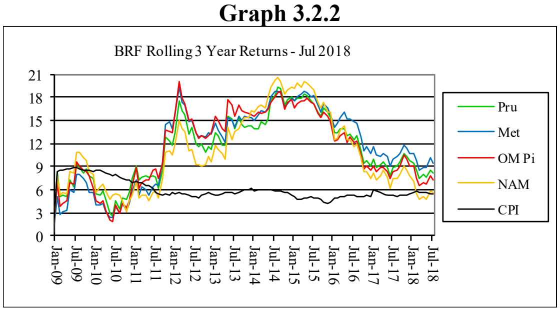
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

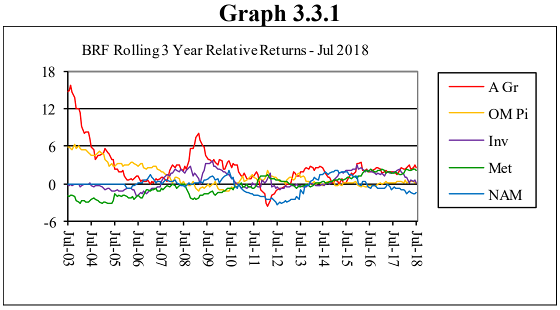


Graph 3.2.2

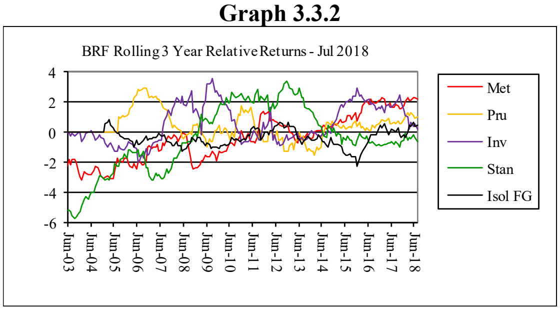


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

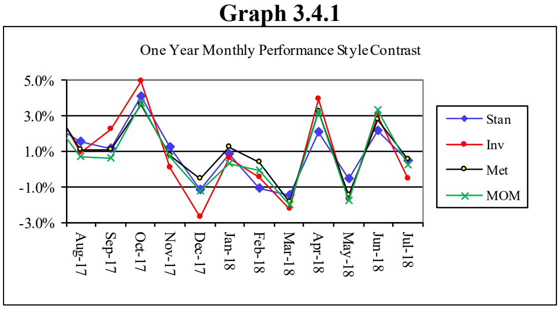


Graph 3.3.2

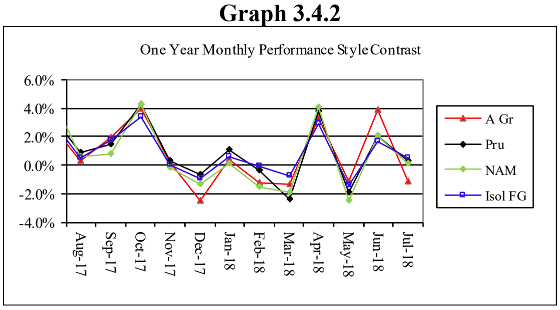


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

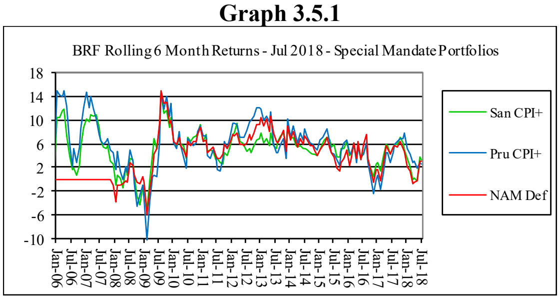


Graph 3.4.2

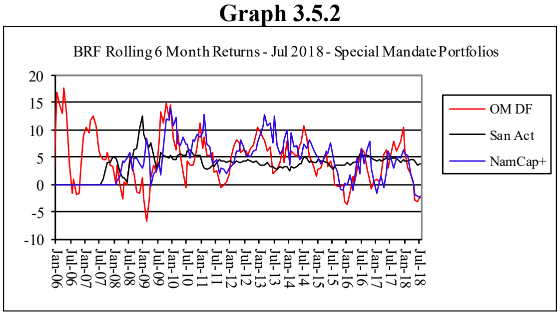


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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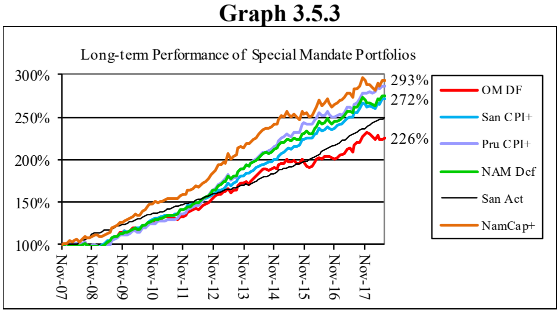
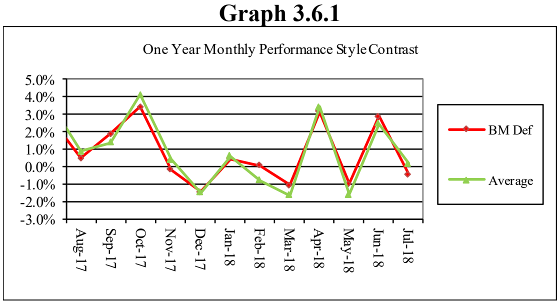
Graph 3.5.3

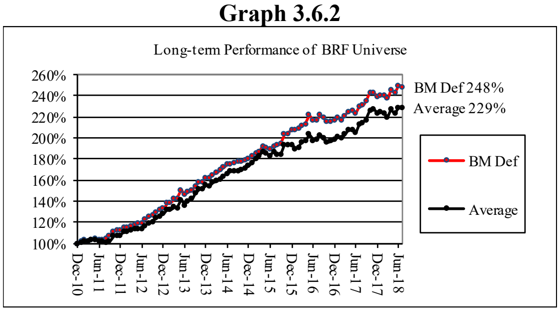


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

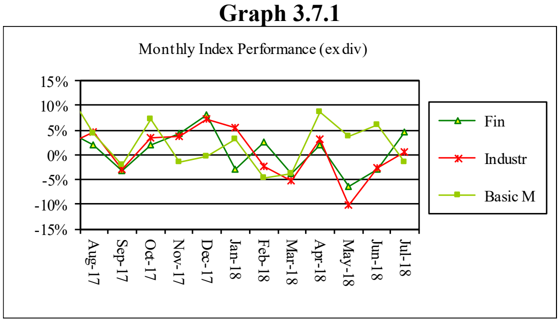


Graph 3.6.2

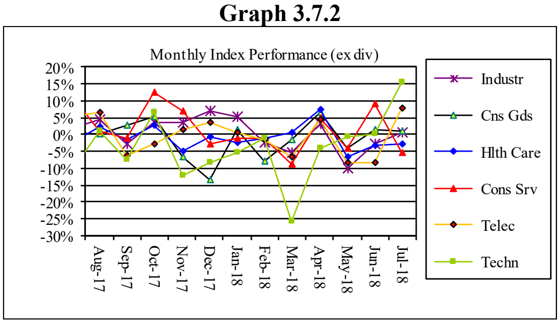


3.7 One year monthly performance of key indices (excluding dividends)

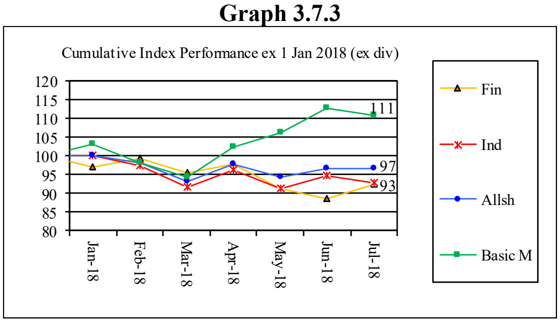
Graph 3.7.1



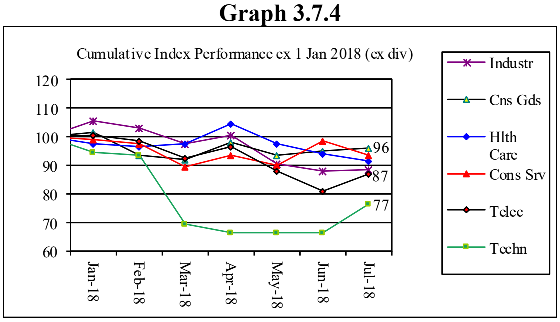
Graph 3.7.2



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.	10.8	10.3
5 year real return - % p.a.	5.7	5.2
Equity exposure - % of portfolio (qtr end June 2018)	46.2	61.8
Cumulative return ex Jan 2011	148.39	129.09
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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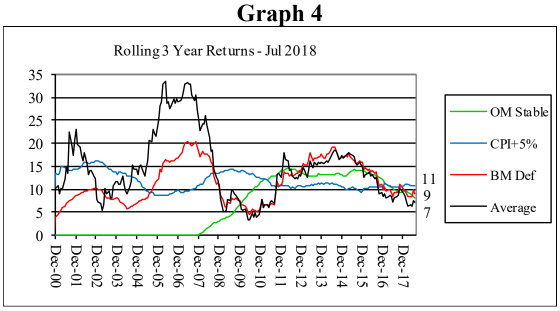
Table 4.2

Measure	**Money Market**	**Default Portf**	**Average Prud Bal**
Worst annual performance	5.9%	8.3%	6.2%
Best annual performance	8.1%	16.1%	16.0%
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	7.1%	11.5%	10.3%

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

Graph 4

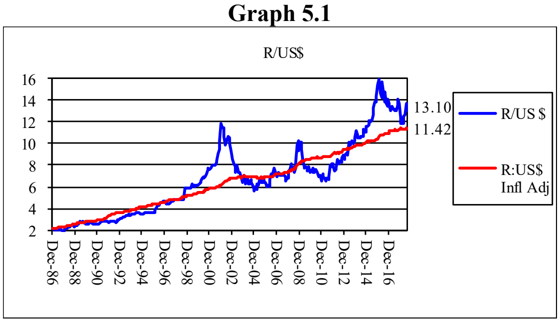


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end July was 8.9%, the average was 7.1% 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 11.42 to the US Dollar while it actually stood at 13.10 at the end of July. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

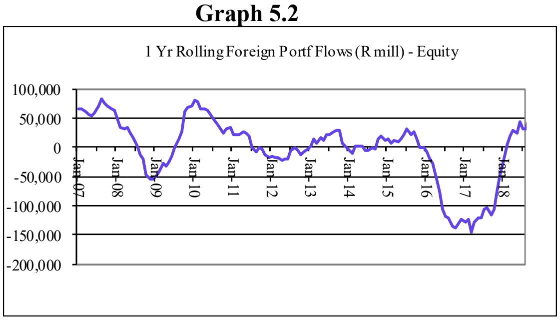


The Rand strengthened by 4.73% in July with net foreign investment inflows from bonds and equities of R 3.29 bn. Over the past 12 months the Rand strengthened by 0.86%. Net inflows of foreign capital into equity and fixed interest securities over the past 12 months amounted to R 2.5 bn (inflow of R 20.7 bn to end June 2018).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 328bn (June R 325 bn).

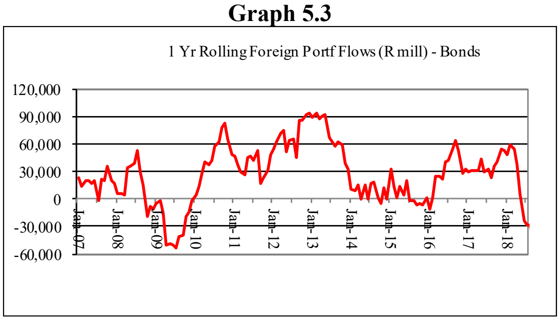
Graph 5.2 reflects a net inflow of capital into South African equities on a rolling one year basis, of R30.5 bn at the end of July (inflow of R 44.3 bn year-on-year to end June). The month of July experienced a net outflow of R 3.3 bn. Since the beginning of 2006, foreign net investment into equities amounts to R 22.9 bn (end June net investment of R 26.2 bn). This represents roughly 0.16% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis reflects foreign portfolio outflows in respect of SA bonds of R 28.0 bn over the past 12 months to end of July (outflow of R 23.6 bn over the 12 months to end of June). The month of July experienced a net inflow of R 6.6 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 305.5 bn (to June R 298.9 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 11.2% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.1% per year. This is equivalent to a growth in real terms of 3.1% p.a. over this period,

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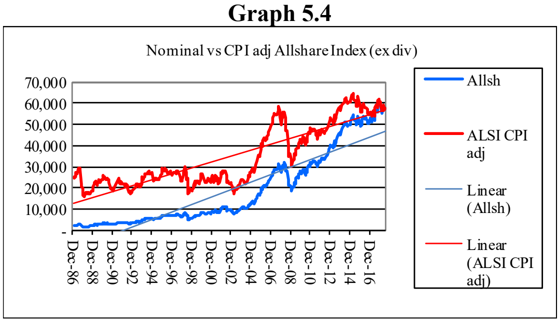
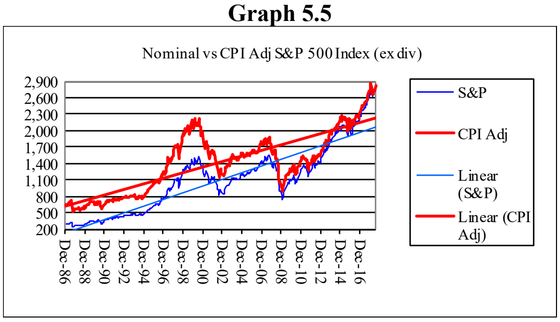
excluding dividends, or around 6.1% including dividends.

Graph 5.4



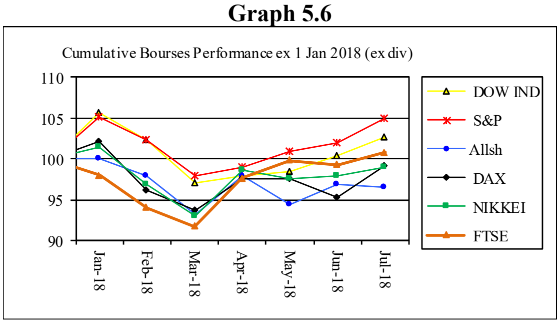
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.6% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a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

Graph 5.5



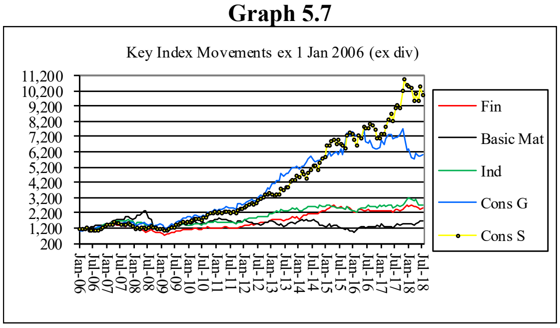
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 8.1%; Financials: 7.6%; and Basic Materials: 4.0%.

Graph 5.7



6. The prudential balanced portfolio – the best choice for an investment horizon of 3 years and longer

by Tilman Friedrich

Graphs 1.7 and 1.8 above depict the 5 year and the 10 year returns of prudential balanced portfolios to the end of July 2018, as blue bars. An article by Patrick Cairns in Moneyweb of 8 August 2018 in this link, shows the SA top-performing world-wide flexible funds for these periods to the end of July 2018. The table below sets out a comparison between the SA and Namibian funds

Category	Top Fund SA %	Top Fund Namibia %	Worst Fund SA %	Worst Fund Namibia %	Allshare Index %
5 year performance – fund	12.9	12.8	9.7	9.2	
5 year performance – category average	8.7	10.3	8.66	10.3	10.0
10 year performance – funds	13.4	12.7	11.85	10.3	
10 year performance – category average	9.4	10.9	9.	10.9	10.8

Interestingly, the Namibian funds have stood their own very well despite the fact that the SA universe of available funds is so much larger than the Namibian universe. The Namibian top performing fund was just slightly behind the top performing SA fund over 5 years and over 10 years. The worst performing Namibian fund outperformed the worst performing SA fund by nearly 2% per annum over the 5 year period as well as over the 10 year period. The Namibian category average also outperformed its SA equivalent over both periods. The JSE Allshare index returned a mere 1.7% above inflation over the 5 year period and 2.2% above inflation over the 10 year period. This is pedestrian performance indeed. Fortunately dividends of around 3% per annum contribute to total return on equities and raises the near zero real return to close to 5% over 5 years and just above 5% over 10 years. These returns are of course before portfolio management fees of around 0.75% on the typical pension fund portfolio. This would produce a real return after portfolio management fees of 4% over the 5 year period and 4.5% over the 10 year period on the typical Namibian pension fund portfolio. In the wake of the financial crisis that slashed the SA Allshare index by 33% from 27,720 in July 2008 down to 18,465 by February 2009, i.e. at the start of the current 10 year period, pension fund members should be quite comfortable with the investment returns they have earned.

Although we expect the pedestrian performance of conventional asset classes, e.g. equities, property, bonds and cash, to continue for the next 4 years or so, the table above shows that prudential balanced portfolios have generally achieved respectable returns despite the pedestrian performance of most asset classes over the past 5 years.

Investors who have an investment horizon of 5 years and longer should be well served by the typical prudential balanced portfolio. It also has to be borne in mind that fund members intending to retire and to arrange a pension or annuity post retirement from their retirement capital, still have a life expectancy until age 80 – a long time - and should not merely consider the time horizon between now and their date of retirement. If the one-third retirement capital is to be commuted at retirement and retirement is less than 5 years ahead, this portion of the total capital should be invested in less volatile asset classes if it is required for paying off debt or purchasing an asset that does not fall into the typical asset classes employed by pension funds, e.g. a retirement home.

The US Repo rate is currently 2%, while US CPI has steadily been creeping up to 2.95% at the end of July. This relationship should be the inverse of what it is meaning that based on current CPI, a US Repo rate of around 1.5% above CPI, or around 4.5% would indicate a normalised interest rate environment. At the more recent rate of upward adjustment of the Repo rate we are still looking at around 4 to 5 years until we reach this point but let's keep an eye on this.

With these expectations, the Rand and local interest rates will remain under pressure for the next 4 to 7 years and this will also impact negatively on local inflation. Low returns and rising interest rates will also impact negatively on the consumer. A weakening Rand should promote exports and support Rand hedge shares that benefit from a weakening Rand.

7. Conclusion

Equities remain in a phase of a long drawn-out correction to last at least another four 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. This remains 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%, which currently means a return of between 8% and 10%. Take comfort with such a return and try to lock in such opportunities when they present themselves. We believe that prudential balanced portfolios, typically offered by pension funds should be able to provide satisfactory return despite the muted investment environment.

Currently Rand weakness is the result of economic sanctions imposed by the US on Turkey, Russia and Iran. We would expect the situation to improve and the Rand to regain some strength despite it being on a medium term weakening path due to economic fundamentals. Once the Rand has regained some territory it should offer 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 faces 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 be expatriated to improve this imbalance as soon as the Rand has regained some composure.

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.