Volume 14, No. 8
August 2018

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 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

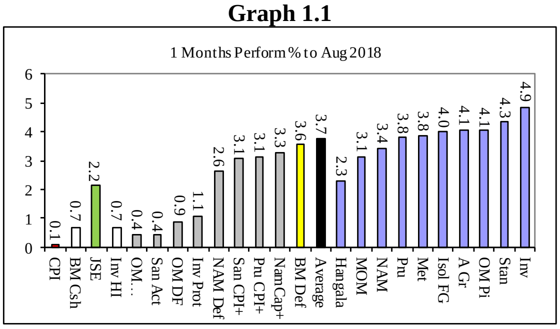
In August 2018 the average prudential balanced portfolio returned 3.75% (July 2018: 0.15%). Top performer is Investec (4.86%); while Hangala Prescient (2.31%) takes the bottom spot. For the 3-month period, Investec takes top spot, outperforming the 'average' by roughly 0.94%. On the other end of the scale Hangala Prescient underperformed the 'average' by 2.07%.

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.

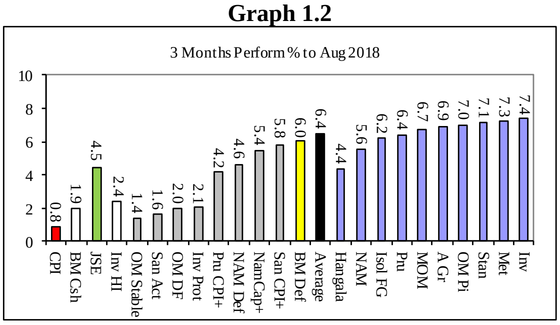
Below is the legend to the abbreviations reflected on the graphs:

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)
Hangala Prescient Absolute Balanced	Hangala (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)

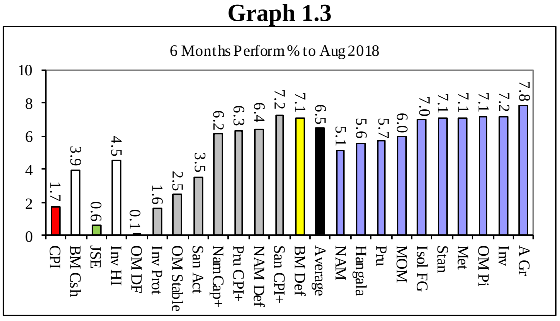
Graph 1.1



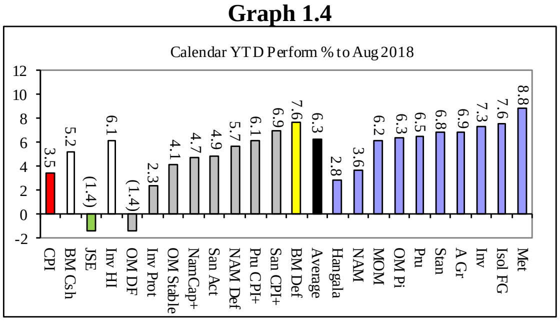
Graph 1.2



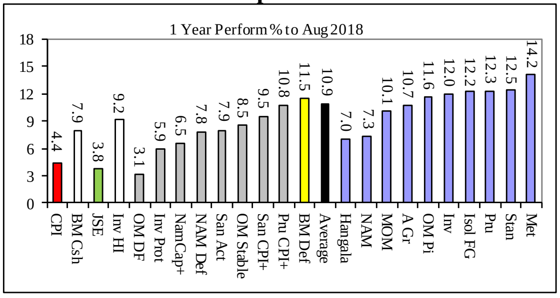
Graph 1.3



Graph 1.4



Graph 1.5



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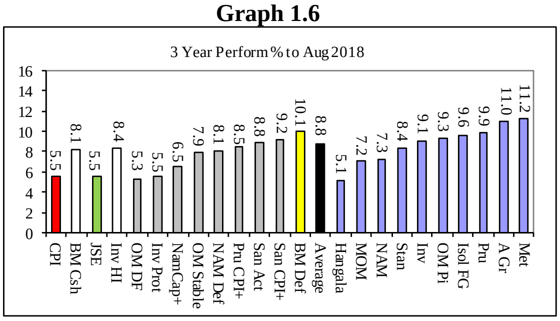
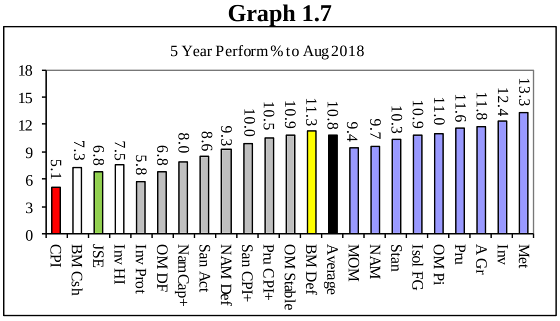
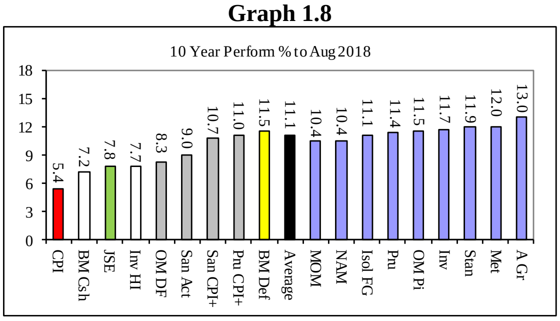
Graph 1.6



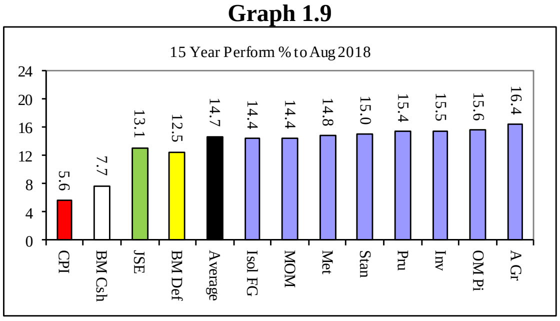
Graph 1.7



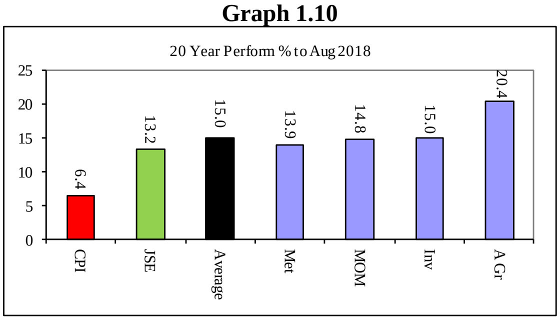
Graph 1.8



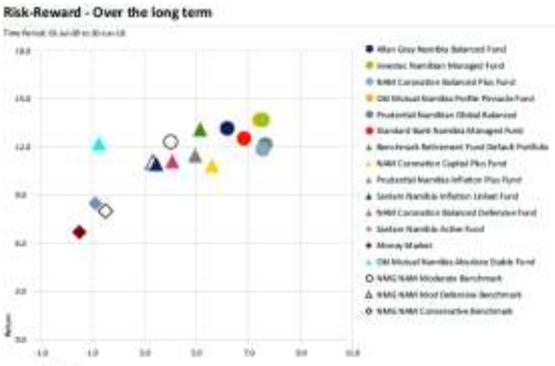
Graph 1.9

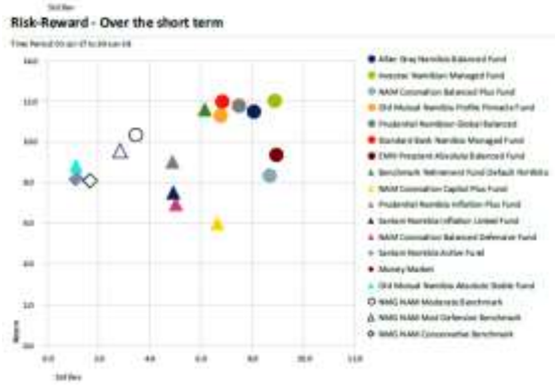


Graph 1.10



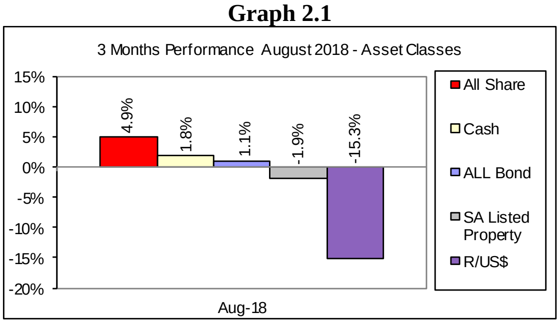
Risk/ Return



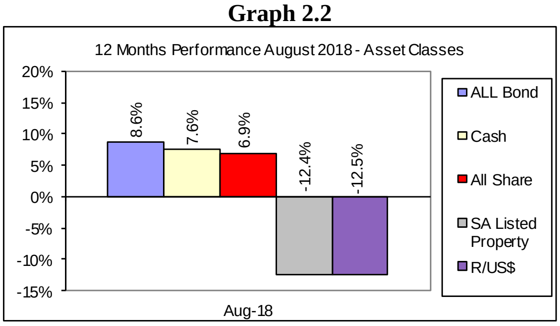


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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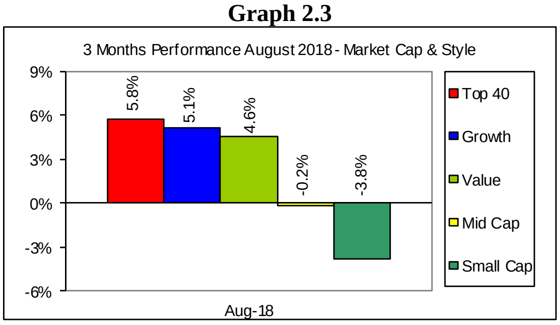
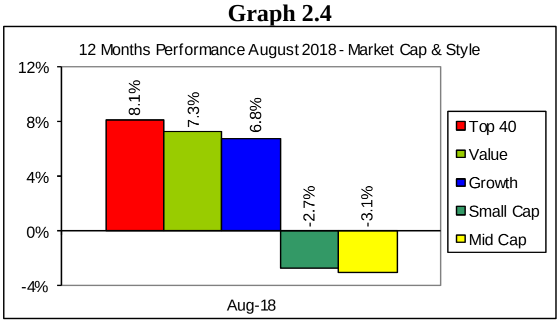
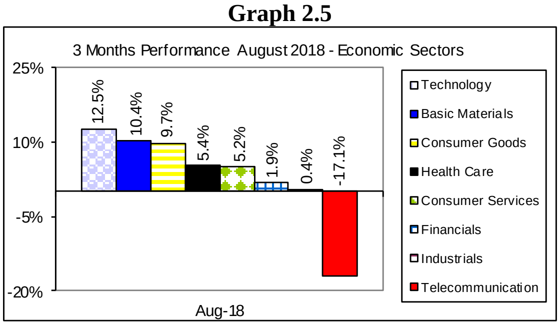
Graph 2.3



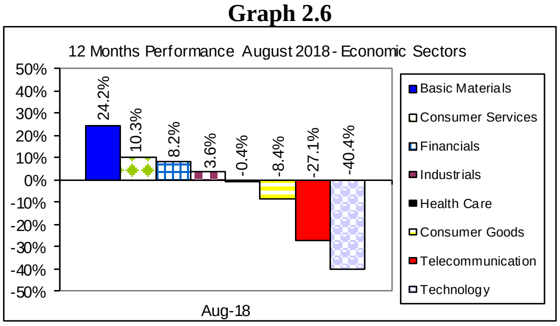
Graph 2.4



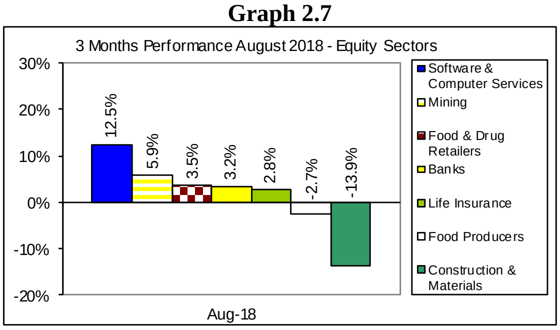
Graph 2.5



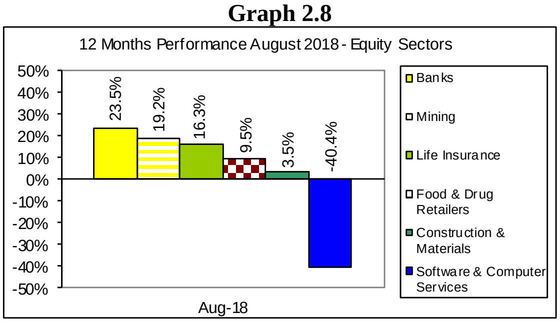
Graph 2.6



Graph 2.7



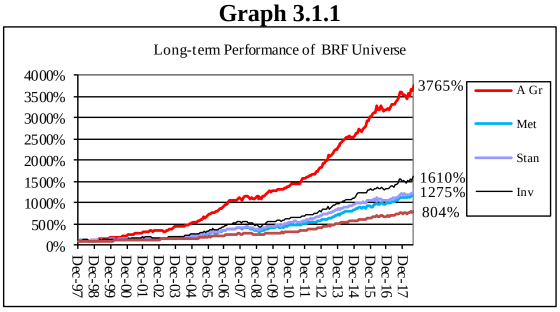
Graph 2.8



3. Portfolio Performance Analysis

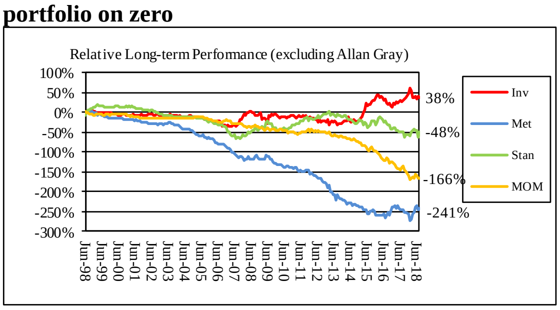
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

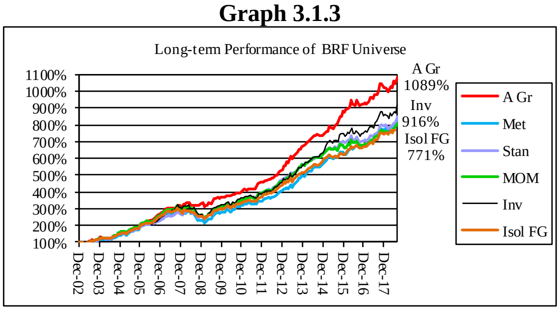


Graph 3.1.2

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



Graph 3.1.3



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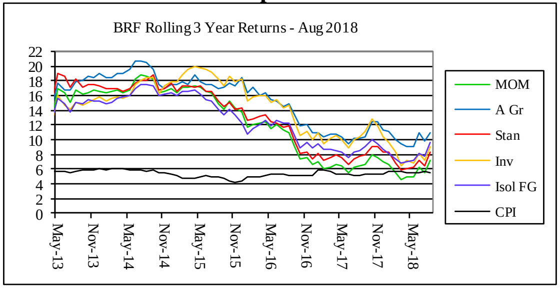
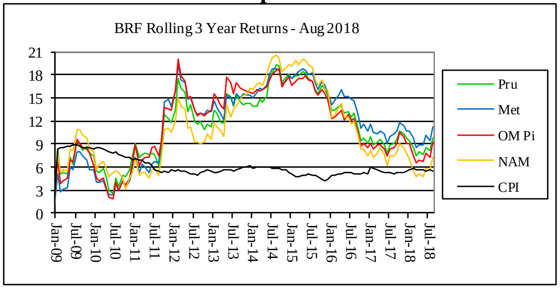
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

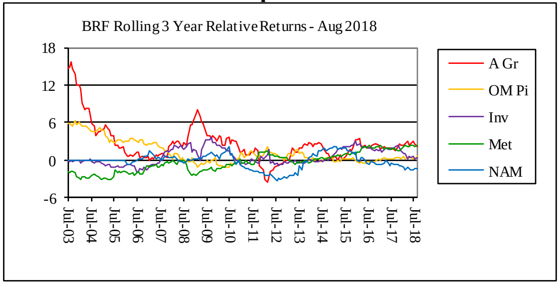


Graph 3.2.2

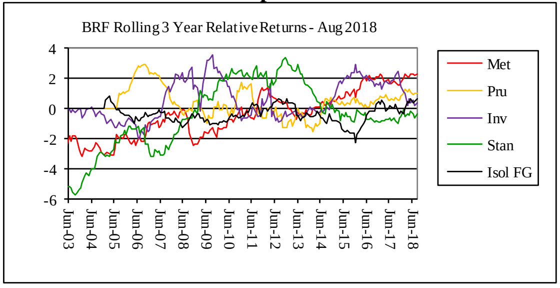


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

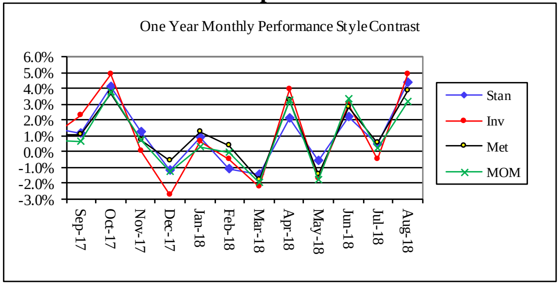


Graph 3.3.2

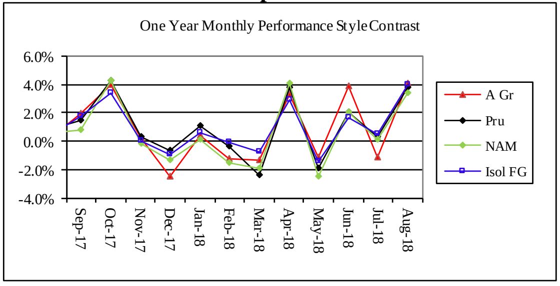


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

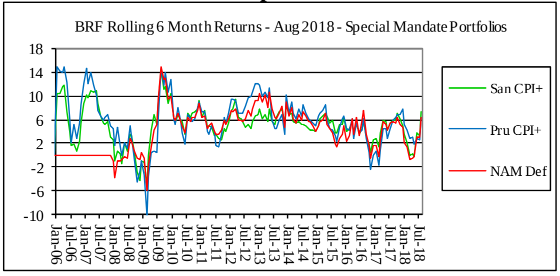


Graph 3.4.2

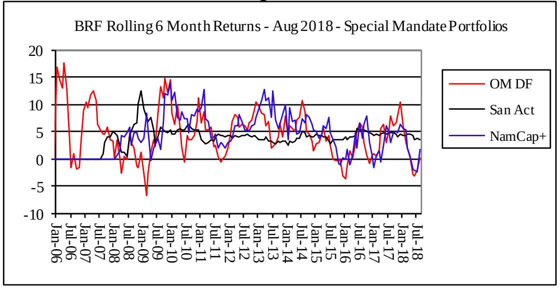


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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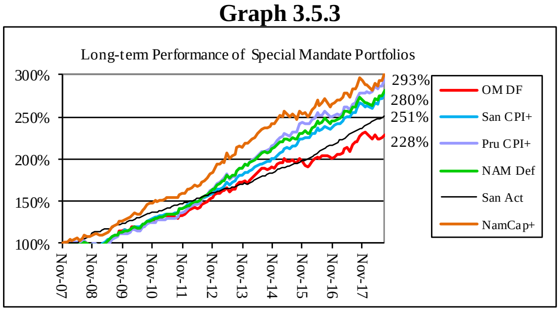
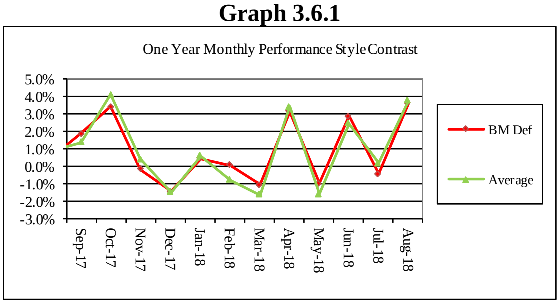
Graph 3.5.3

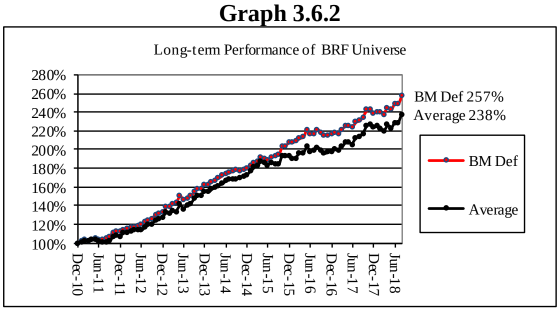


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

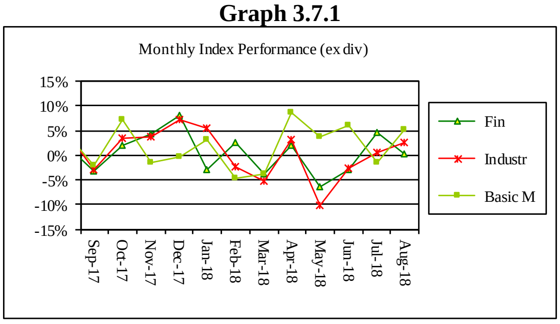


Graph 3.6.2

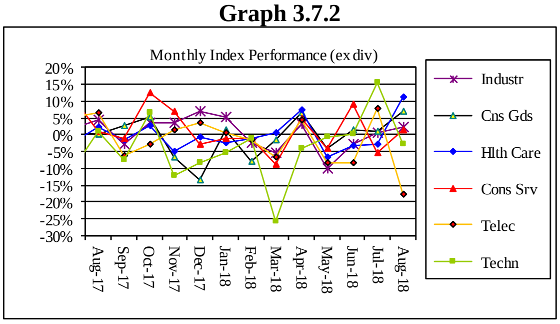


3.7 One-year monthly performance of key indices (excluding dividends)

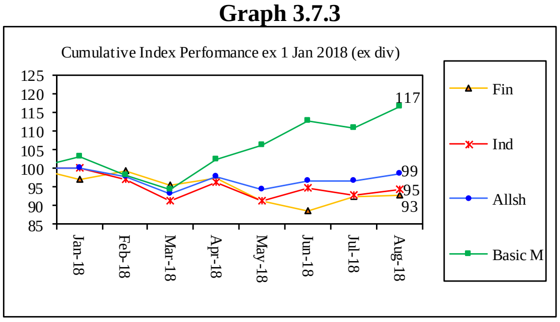
Graph 3.7.1



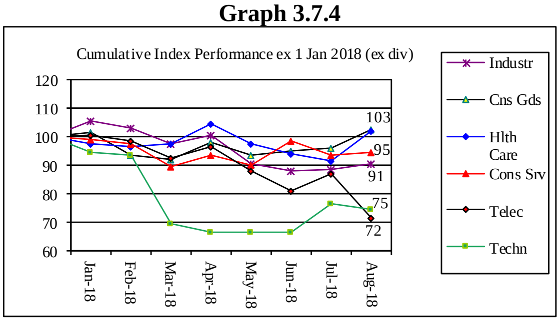
Graph 3.7.2



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.	11.3	10.8
5-year real return - % p.a.	6.2	5.7
Equity exposure - % of portfolio (qtr end June 2018)	46.2	61.8
Cumulative return ex Jan 2011	157.29	137.68
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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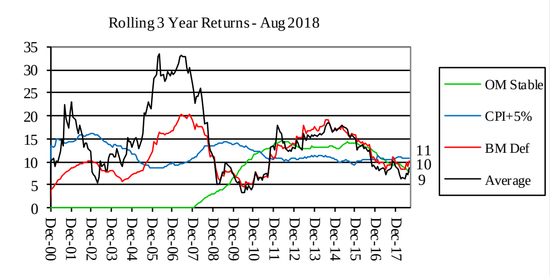
Table 4.2

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%	11.4%	10.1%

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

Graph 4

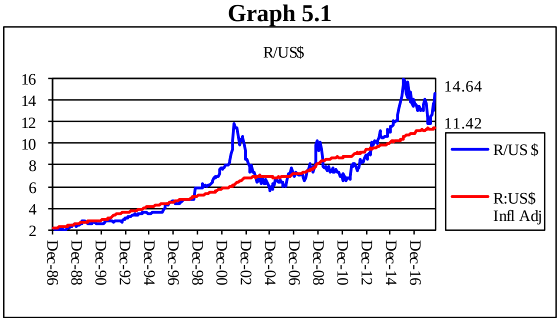


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end August was 10.1%, the average was 8.8% vs CPI plus 5% currently on 10.5%.

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 14.64 at the end of August. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

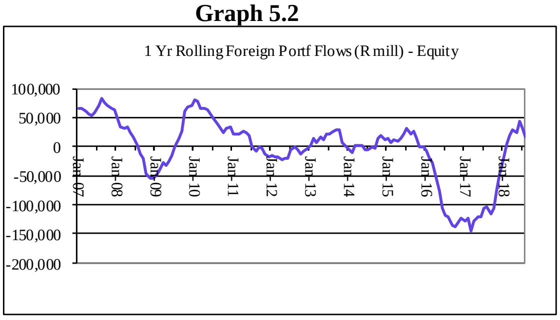


The Rand weakened by 11.75% in August with net foreign investment outflows from bonds and equities of R 33.3 bn. Over the past 12 months the Rand weakened by 12.5%. Net outflows of foreign capital into equity and fixed interest securities over the past 12 months amounted to R 31.5 bn (inflow of R 2.5 bn to end July 2018).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 295bn (July R 328 bn).

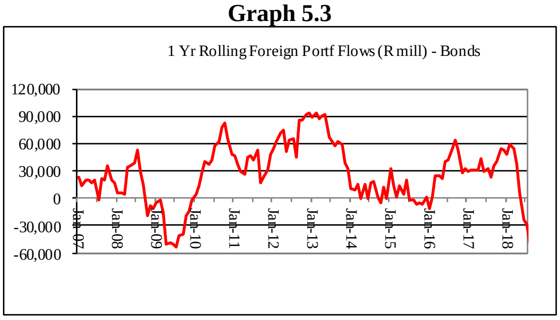
Graph 5.2 reflects a net inflow of capital into South African equities on a rolling one-year basis, of R16.9 bn at the end of August (inflow of R 30.5 bn year-on-year to end July). The month of August experienced a net outflow of R 13.2 bn. Since the beginning of 2006, foreign net investment into equities amounts to R 9.6 bn (end July net investment of R 22.9 bn). This represents roughly 0.06% 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 48.40 bn over the past 12 months to end of August (outflow of R 28.0 bn over the 12 months to end of July). The month of August experienced a net outflow of R 20.1 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 285.4 bn (to July R 305.5 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 11.3% 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 3.2% p.a. over this period, excluding dividends, or around 6.2% including dividends.

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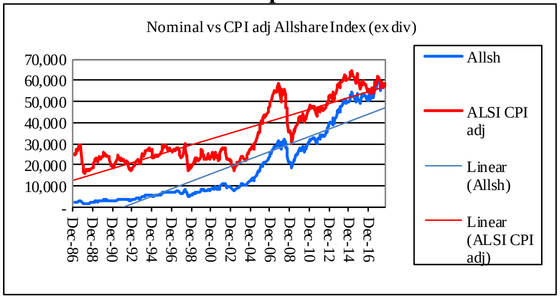
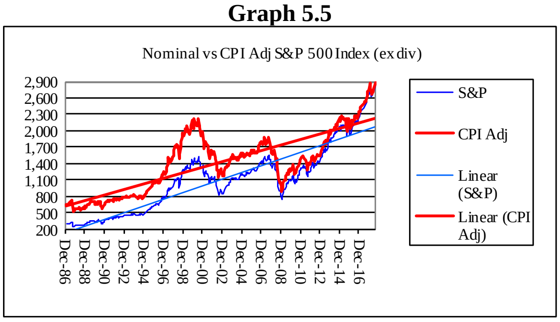
Graph 5.4



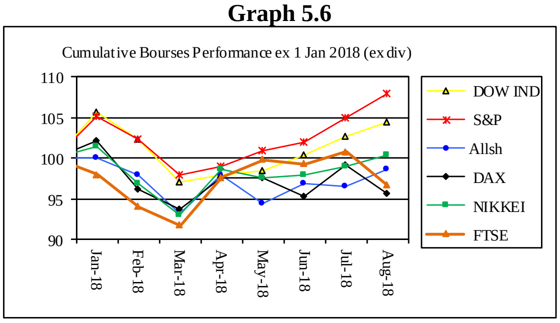
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.7% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 5.1% p.a. over this period, excluding dividends or around 7.1% including dividends.

Graph 5.5



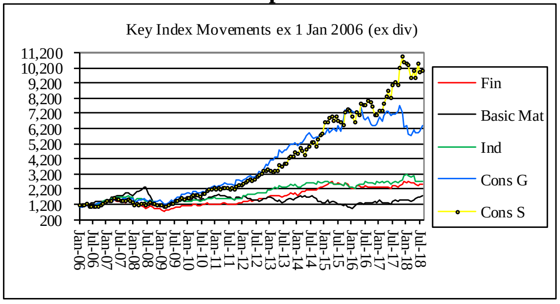
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 15.7%; Industrials: 8.3%; Financials: 7.5%; and Basic Materials: 4.4%.

Graph 5.7



6. Prudential balanced or smooth growth portfolio – what should you expect the difference to be?
by Tilman Friedrich

In this column, we will not discuss market conditions and our expectations as there have been no significant changes that would make us review the state of affairs. So if you want information to guide your decision how to invest, you are referred to this column in last month's report. This month we will once again try to assist investors in their decision whether to choose a smooth growth portfolio or the more conventional prudential balanced type of portfolio.

Smooth growth portfolios are notorious for the lack of transparency. For the employer or individual investor it is really difficult to 'get a feel' for the characteristics of these portfolios vis-à-vis financial markets. Most of us have 'a feel' for and follow financial markets to the extent that one would know whether financial markets are flying, diving or limping along. An investor would understand his portfolio doing badly when markets have tanked. An investor would start getting disorientated and concerned when his portfolio is doing poorly despite flying markets.

Some investors at times believe there are investment products around that defy the 'laws of gravity'. Typically the smooth growth portfolios sometimes portray themselves and are seen as being such type of product. Of course thinking rationally about it, no one would really believe anything on earth can defy the laws of gravity. What goes up will come down again! The fundamental principle of every pension fund investment portfolio is that it invests in mostly conventional and publicly priced asset classes, i.e. equity, property, bonds and cash. The parameters are defined in sections 12 and 13 of part 7 of the schedule of regulations, recently promulgated under the Pension Funds Act (previously referred to as regulation 28).

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Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 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.

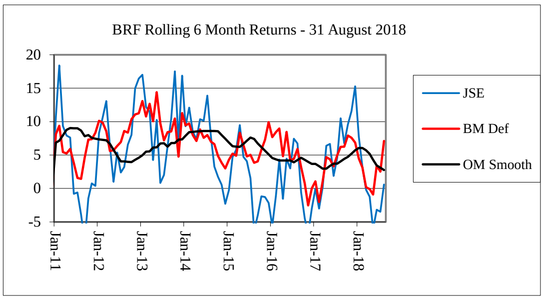
Period	OM AGP	Average	BM Default	JSE Allshare
1 month	0.4%	3.7%	3.6%	2.2%
3 months	1.4%	6.4%	6.0%	4.5%
6 months	2.5%	6.5%	7.1%	0.6%
Calendar y-t-d	4.1%	6.3%	7.6%	-1.4%
1 year	3.8%	10.9%	11.5%	3.8%
3 years	7.9%	8.8%	10.1%	5.5%
5 years	10.9%	10.8%	11.3%	6.8%

The table above sets out the returns of the Old Mutual AGP (Stable) portfolio, the average prudential balanced portfolio, for the sake of our Benchmark members the Default portfolio and the Allshare Index over various periods as also displayed in graphs 1.1 to 1.7 above. It is to be noted that the OM AGP has not been around for 10 years yet. A few interesting conclusions can be drawn from this table.

1. The average prudential balanced portfolio has outperformed the JSE Allshare index over all periods above and also over the 10 (graph 1.8), the 15 (graph 1.9) and the 20 (graph 1.10) year period. This is the result of portfolio managers moving between asset classes based on market conditions and expectations.
2. The BM Default portfolio tends to under-perform the average portfolio when equities outperform the other asset classes and vise-versa. This is the result of it having a lower equity exposure than the average prudential balanced portfolio.
3. The OM AGP performance does not really show any consistent performance relative to the other indicators in the table.

In order to get a 'better feel' for the OM AGP characteristics relative to the other indicators we have produced the below graph that shows 6 month, one month shifting rolling returns of the JSE the BM default portfolio and the OM AGP (stable) portfolio. Carefully tracking the lines one will note the following:

1. OM AGP line shows the least volatility, no negative returns over any 6 month period and lower maximum returns over any 6 month period. The movement of this line appears to be consistently trailing the movement of the JSE by a few months given that it takes out quite a bit of the oscillation of the JSE line.
2. The BM default portfolio shows similar volatility to the JSE, lower peaks and lower troughs over all 6 month periods, and much fewer negative 6 month periods than the JSE. Interestingly it actually has periods of rising returns when the JSE returns decline while the opposite has not occurred.



Conclusion

Understanding the characteristics of the smooth growth portfolio should make it easier for the investor to decide whether he should invest in a prudential balanced portfolio or a smooth growth portfolio and to then also be comfortable with the results in terms of the portfolio's performance relative to the market and relative to the typical prudential balanced portfolios without continuously looking over his shoulder and getting uneasy about any under-performance of his portfolio, which is certain to happen from time to time.

So which portfolio should one expect to produce higher returns in the long-term? The old adage of higher risk, higher return will apply, not necessarily to you as an investor because of the fact that timing plays an important role and can distort the results for you. Evidently, a portfolio that does not produce negative returns, presents a lower risk to the investor than one that does and hence should produce lower returns. Now, if the investor is faced with a lower return in one portfolio, it means his counter party is assuming this risk. Given this wisdom, the counter party will charge a premium for assuming this risk. Again in your particular case you may have paid a premium without having had the benefit or vise-versa. That is what insurance is about. You cannot have your cake and eat it, be happy that life treated you well in terms of investment returns and do not expect to get back your premium!

The smooth growth portfolio through 'manipulation' of investment returns exposes itself to 'mispricing' when prospective returns are likely to be higher or lower than a market value priced portfolio. This is particularly important when the investor considers moving from one type of portfolio to the other. It affords the investor to exploit any mispricing. Smooth growth product providers are quite aware of this risk and have built in terms that try to reduce this risk. In the light of our expectation of markets limping along for quite some time to come, smooth growth portfolios will have little opportunity to prop up returns and to absorb severe negative movements from accumulated reserves. They are thus more likely to track the performance of prudential balanced portfolios, minus the risk premium for some time to come.

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