Volume 14, No. 10
October 2018

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 OCTOBER 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

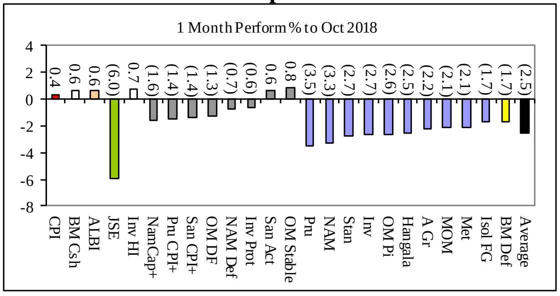
In October 2018 the average prudential balanced portfolio returned -2.53% (September 2018: -2.00%). Top performer is Investment Solutions (-1.66%); while Prudential (-3.51%) takes the bottom spot. For the 3-month period, Investment Solutions takes top spot, outperforming the 'average' by roughly 1.67%. On the other end of the scale Nam Asset underperformed the 'average' by 2.09%.

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.

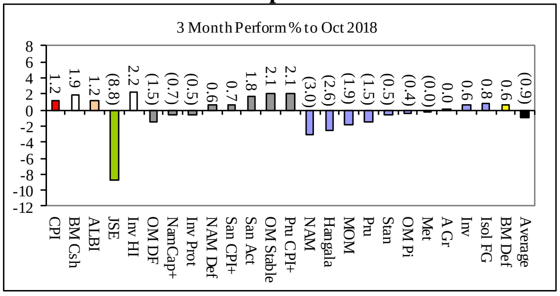
Below is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Consumer Price Index	CPI (red)
All Bond Index	ALBI (orange)
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 Namibia Growth	MOM (blue)
Stanlib Managed	Stan (blue)
Investment Solutions Bal Growth (multimanager)	Isol FG (blue)

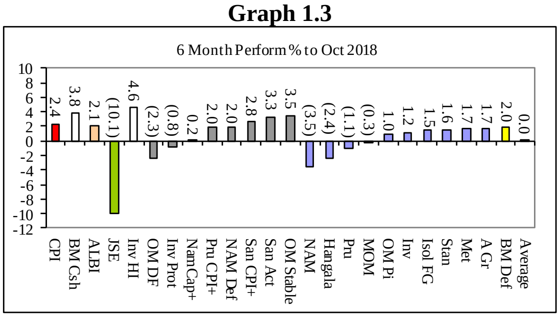
Graph 1.1



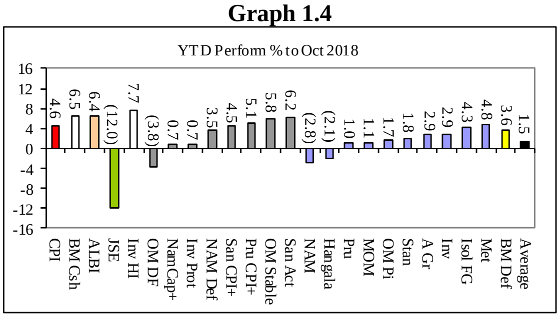
Graph 1.2



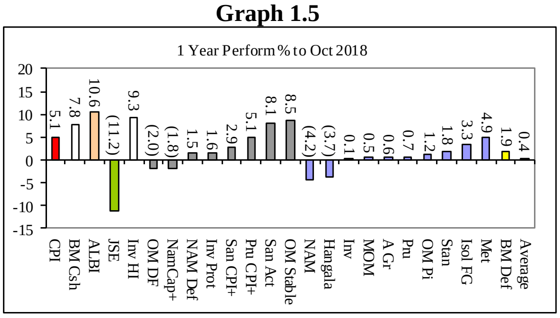
Graph 1.3



Graph 1.4



Graph 1.5



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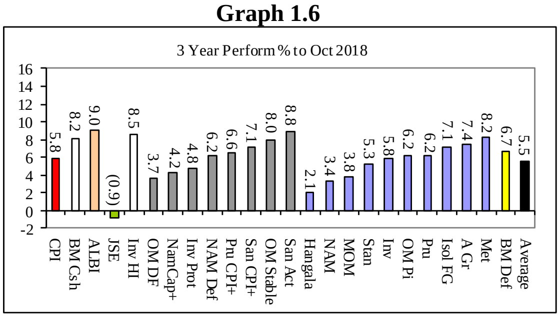
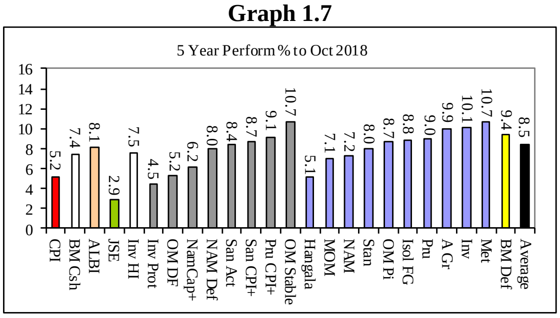
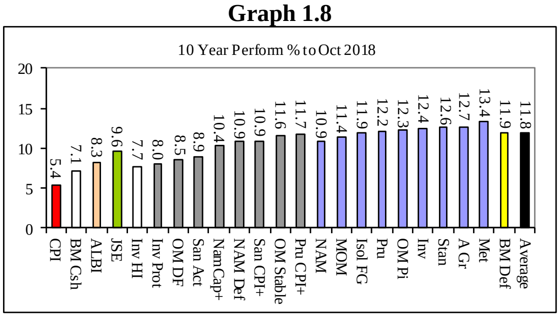
Graph 1.6



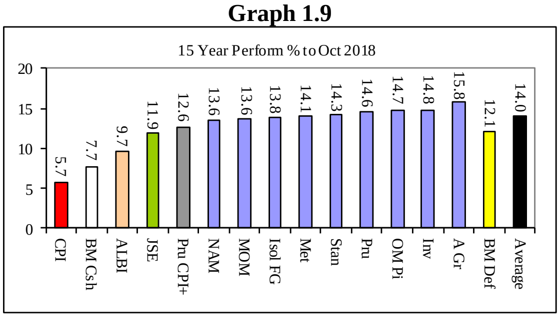
Graph 1.7



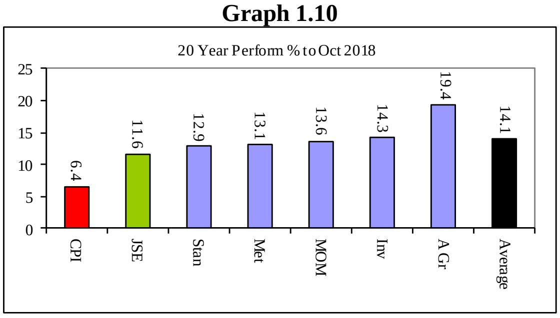
Graph 1.8



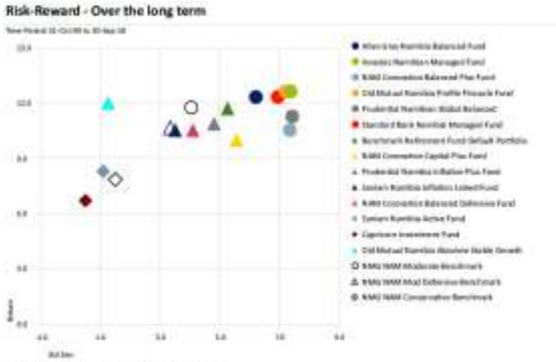
Graph 1.9

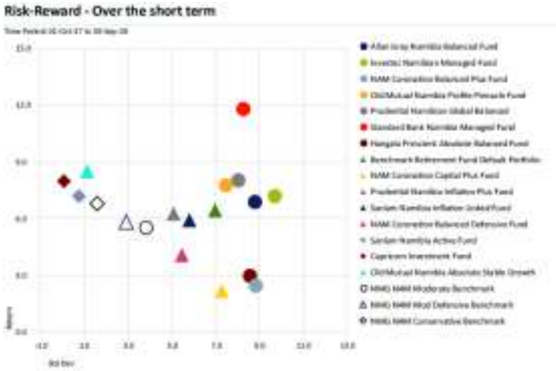


Graph 1.10



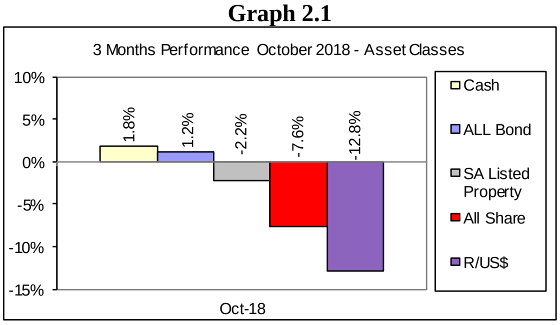
Risk/ Return



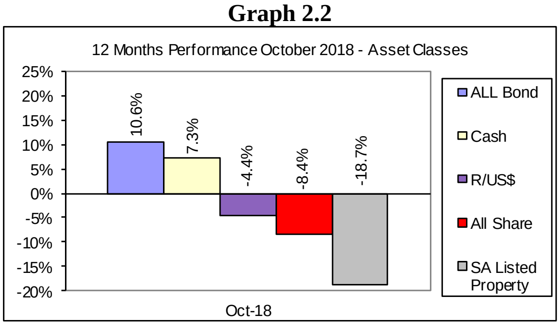


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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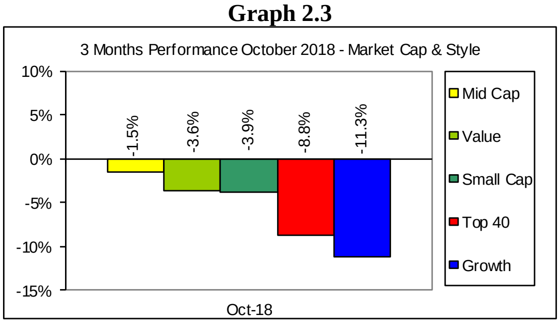
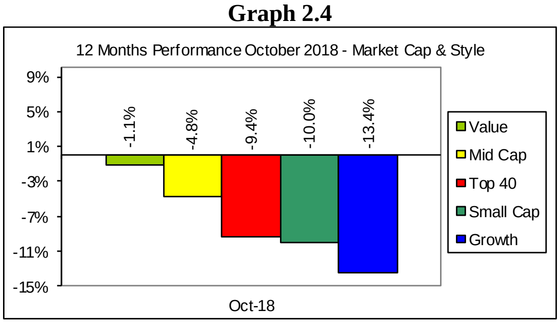
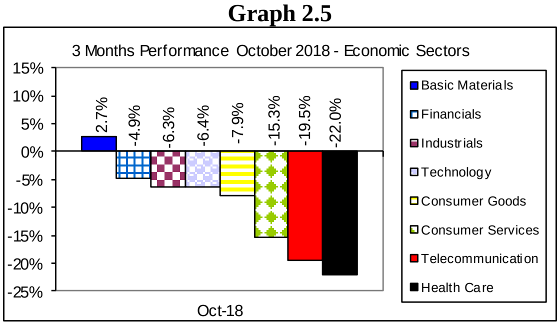
Graph 2.3



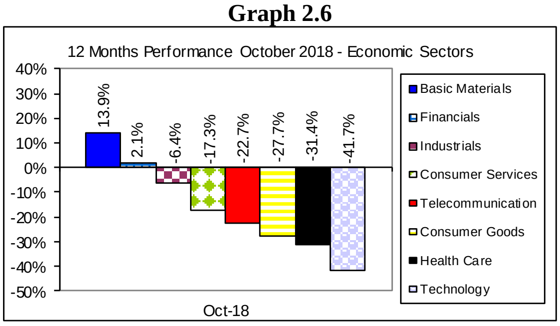
Graph 2.4



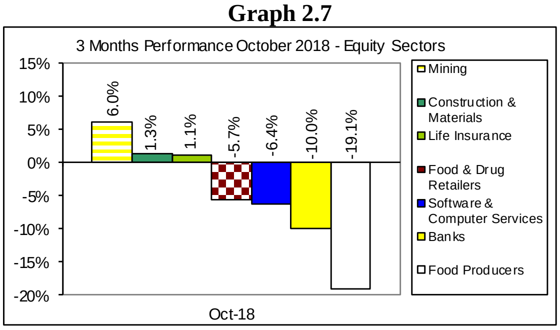
Graph 2.5



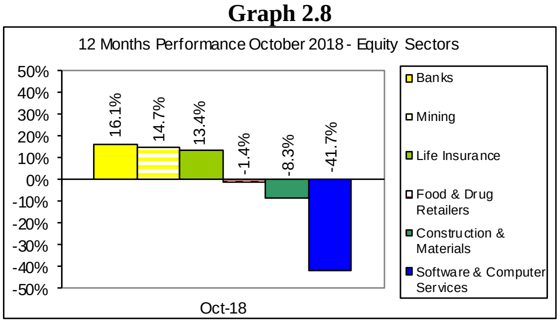
Graph 2.6



Graph 2.7



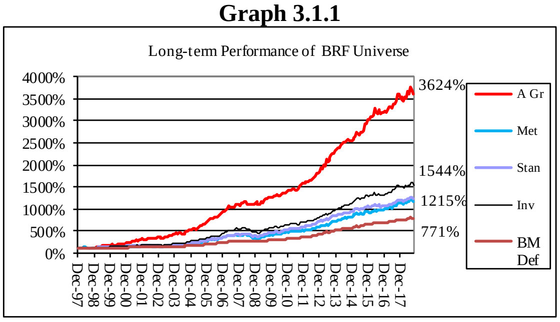
Graph 2.8



3. Portfolio Performance Analysis

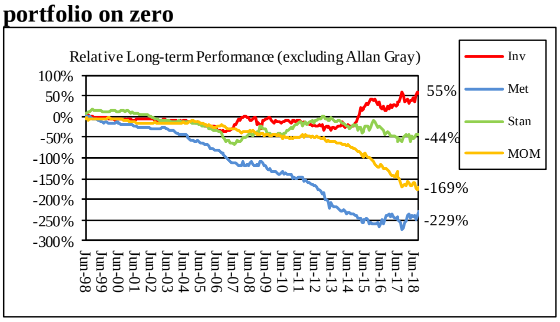
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

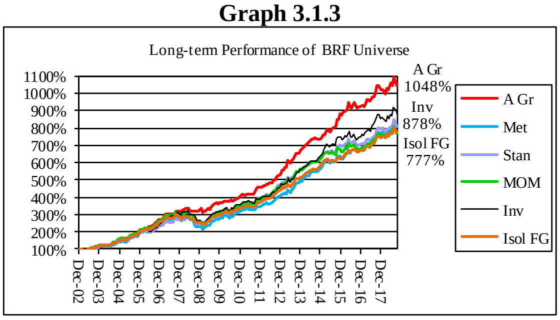


Graph 3.1.2

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



Graph 3.1.3



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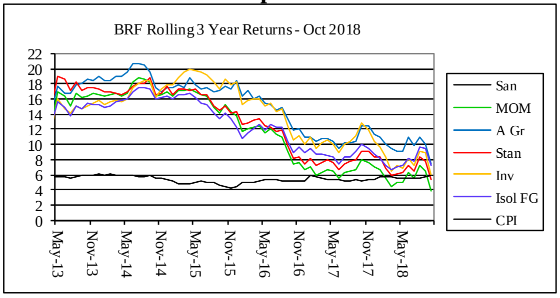
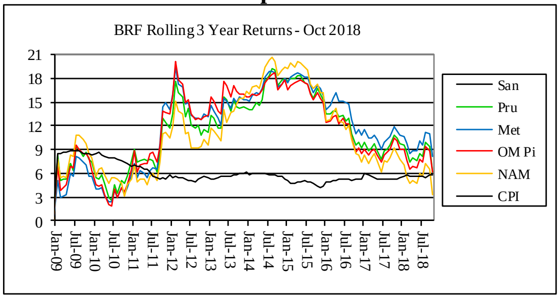
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

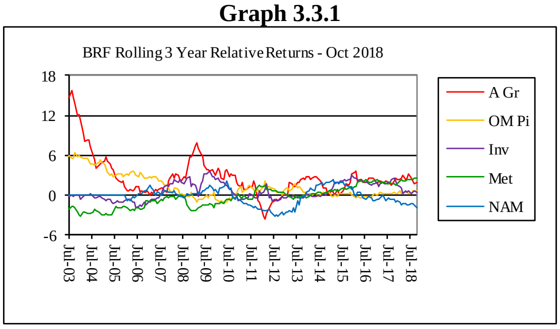


Graph 3.2.2

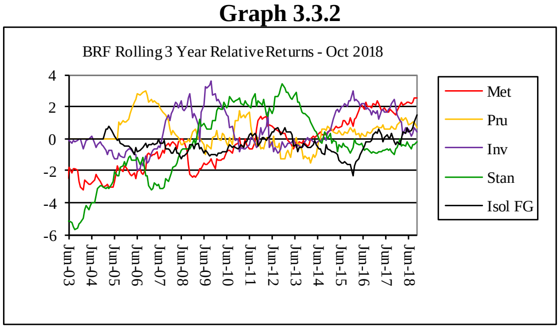


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

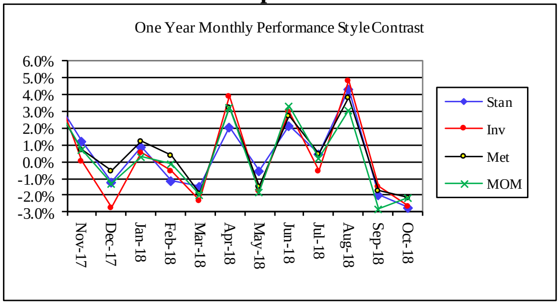


Graph 3.3.2

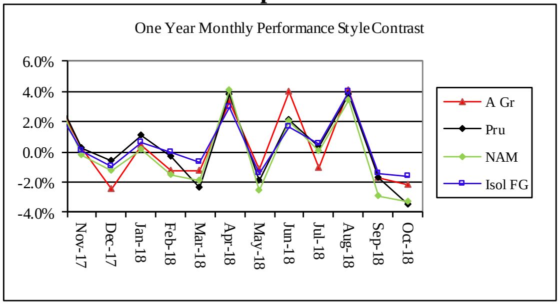


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

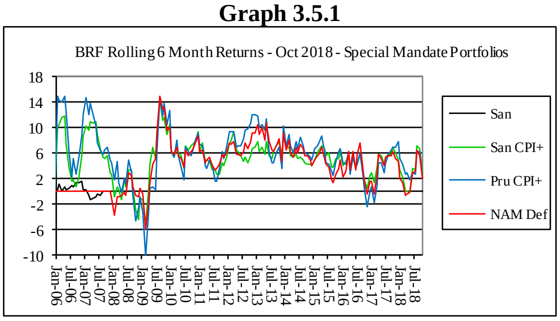


Graph 3.4.2

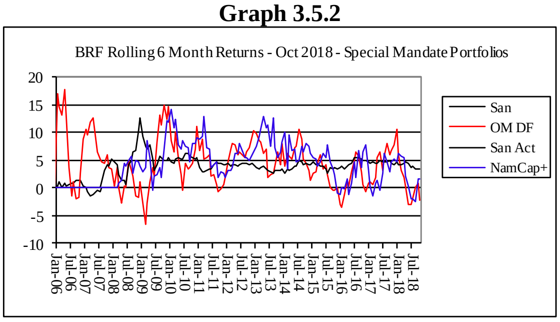


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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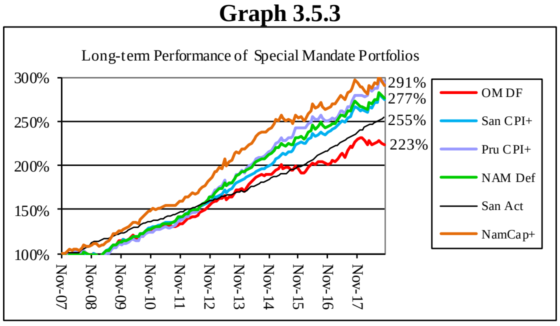
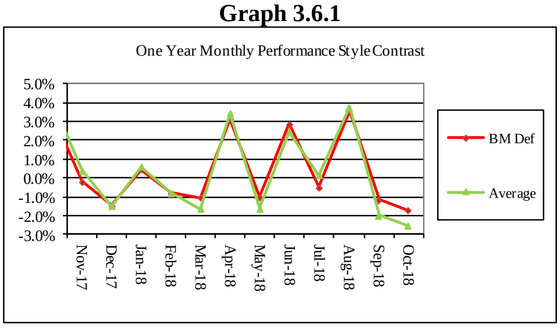
Graph 3.5.3

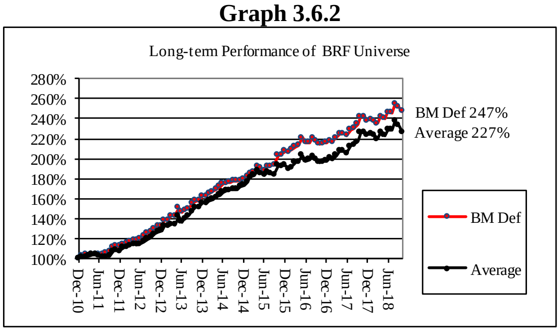


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

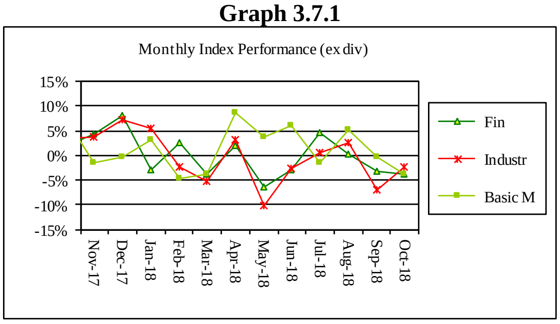


Graph 3.6.2

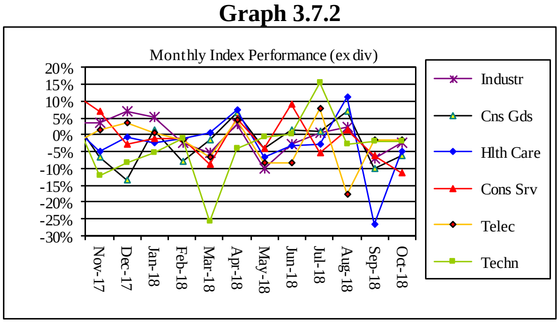


3.7 One-year monthly performance of key indices (excluding dividends)

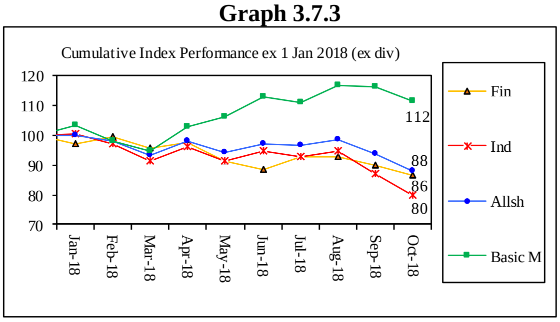
Graph 3.7.1



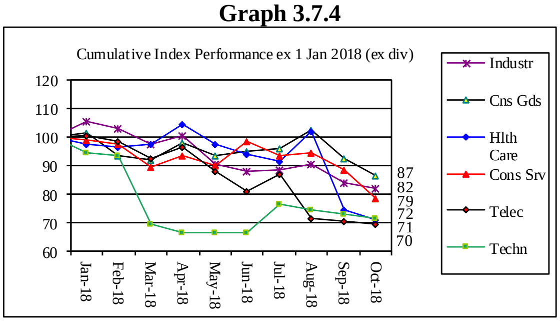
Graph 3.7.2



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.	9.4	8.5
5-year real return - % p.a.	4.2	3.3
Equity exposure - % of portfolio (qtr end September 2018)	45.4	70.2
Cumulative return ex Jan 2011	147.2	127.1
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

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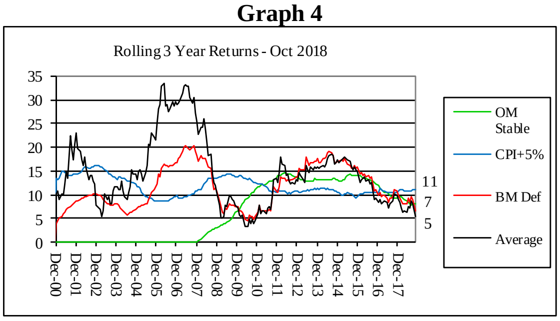
The above table reflects the actual returns of the Default Portfolio versus target returns required to produce an income replacement ratio of 2% of salary per year of fund membership that should secure a comfortable retirement income.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.0%	6.7%	5.5%
Best annual performance	8.1%	16.0%	15.2%
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	7.3%	11.0%	9.6%

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

Graph 4

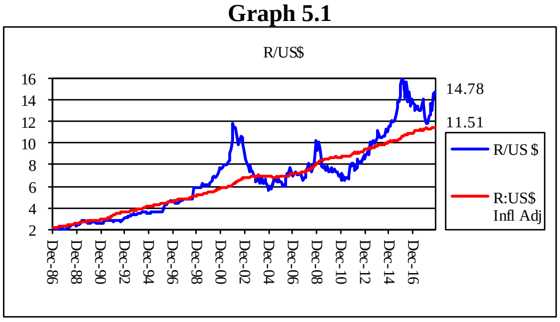


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end October was 6.7%, the average was 5.5% vs CPI plus 5% currently on 10.8%.

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 11.51 to the US Dollar while it actually stood at 14.78 at the end of October. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

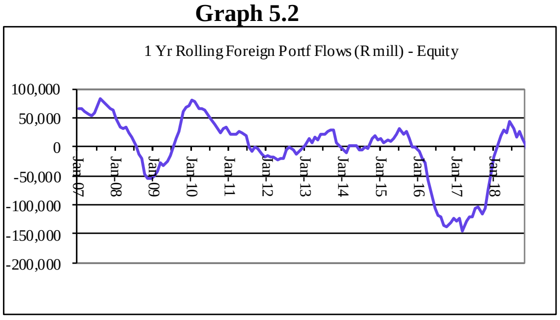


The Rand weakened by 4.51% in October with net foreign investment outflows from bonds and equities of R 6.9 bn. Over the past 12 months the Rand weakened by 4.44%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 47.0 bn (outflow of R 39.7 bn to end September 2018).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 269.4bn (September R 276.3 bn).

Graph 5.2 reflects a net inflow of capital into South African equities on a rolling one-year basis, of R14.9 bn at the end of October (inflow of R 27.5 bn year-on-year to end September). The month of October experienced a net outflow of R 5.9 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 11.8 bn (end September net investment outflow of R 5.9 bn). This represents roughly 0.09% 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 61.9 bn over the past 12 months to end of October (outflow of R 67.1 bn over the 12 months to end of September). The month of October experienced a net outflow of R 0.9 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 281.2 bn (to September R 282.2 bn).

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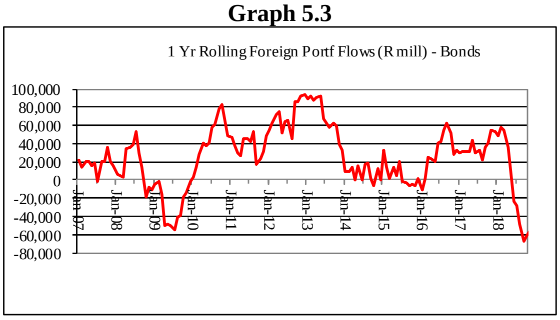
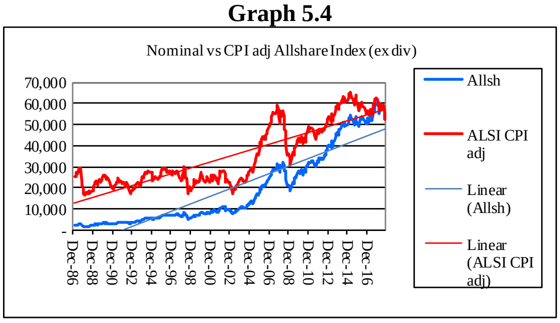
Graph 5.3



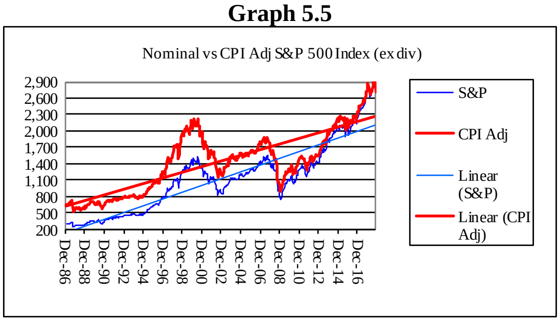
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.8% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.1% per year. This is equivalent to a growth in real terms of 2.7% p.a. over this period, excluding dividends, or around 5.7% including dividends.

Graph 5.4



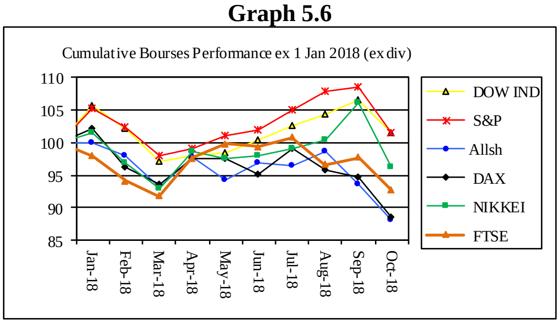
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.5% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.9% p.a. over this period, excluding dividends or around 6.6% including dividends.

Graph 5.5



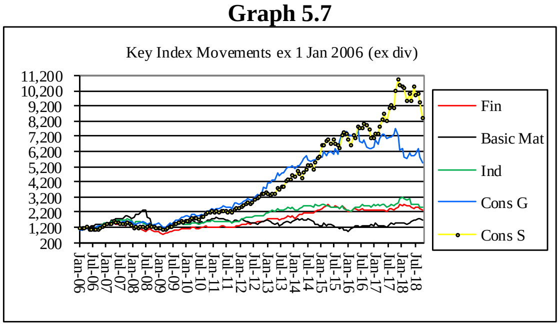
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 17.9%; Consumer Goods: 14.0%; Industrials: 7.4%; Financials: 6.9%; and Basic Materials: 3.9%.

Graph 5.7



6. The mainstay of pension investments is failing its duty!

by Tilman Friedrich

Equities are the mainstay of pension fund investments and comprise the bulk of the investments of the typical prudential balanced portfolios. Equities are expected to return around 6% before asset manager fees. However, when we consider graphs 1.1 to 1.10 in the Monthly Review of Portfolio Performance to the end of October 2018, covering various periods from 20 years to the latest month, it appears that other than the 15 and the 20 year periods, equities have not been able to achieve their expected real return. Adding dividends of around 3% to the returns reflected in these graphs, equities will also have achieved their goal over the 10 year period, the point at which equities had 10 years ago just recovered the losses sustained as the result of the global financial crisis. For all other periods, equities have fallen severely short of their return expectation. Fortunately the prudential balanced portfolio managers move pension fund investments between asset classes by buying in market troughs and selling when markets peak. Looking at the same graphs again it will be noted that the average prudential balanced portfolio has in most instances

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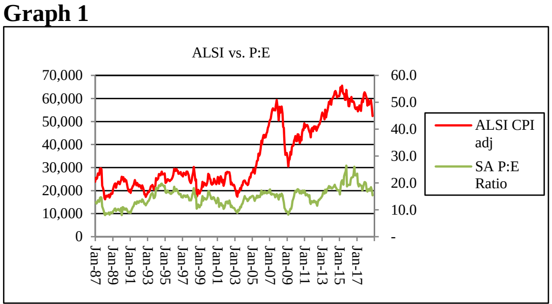
returned more than inflation plus dividends of around 3% p.a. Still the average prudential balanced portfolio did not return inflation plus 6% for any period up to and including the past 5 years.

It will be no secret to most that the poor performance of prudential balanced portfolios over the past 5 years is the result of the slow unwinding of the global low interest rate environment, which in turn was the result of quantitative easing through large scale asset purchasing programmes of the main central banks in the world. These programmes are being phased out now as the result of which we will see a normalization of the interest rate environment. Interest rates will go up until they represent a fair risk adjusted return relative to equities. In this adjustment phase global equities will remain under pressure.

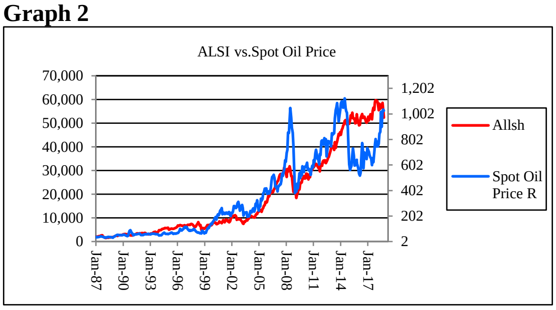
Looking at various economic metrics it seems like global equity markets have run way ahead of themselves since the global financial crisis and that there is certainly lots of room for adjustment.

Graph 1



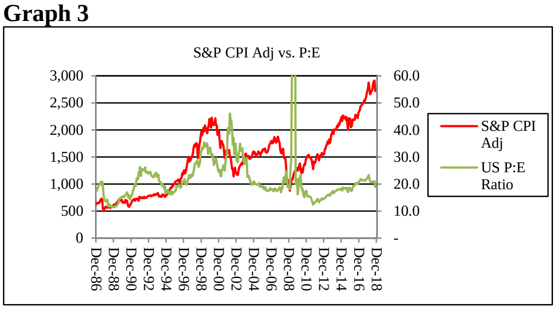
Graph 1 clearly shows that the SA CPI adjusted ALSI has been at dizzy heights relative to its 30 year historic levels, even though it does depict sideward movement since 2014 and a sharp downward correction of late. From 1987 up until 2003 the market and the P:E ratio were very closely correlated and the gap between the two was small. The first run up to the peak of the financial crisis was caused by the commodity run that benefited earnings of SA equities significantly. The subsequent run up to another peak was the result of the low interest rate environment through which the high earnings of the commodity run were largely maintained. Furthermore, the price earnings ratio of 15.4 currently is also still above its long-term average of 14.7. This is the multiple of earnings investors are prepared to pay for a share. Earnings are still high with lots of room for correction while the price investors are prepared to pay for these earnings also implies room for a downward correction of around 5%. Will a recovery of global commodities be the saving grace for SA, offering an underpin to the Allshare Index? Now let's look at some indicators that could provide an answer to this question.

Graph 2



Graph 2 shows how closely correlated the oil price has been to the SA Allshare Index until the bottom fell out of the oil price and other global commodities simultaneously. Since then the gap between these two lines has closed, indicating that at the oil price as at the end of October, commodities and low interest rates provided support to the SA Allshare index.
We know that the US Fed rate is on an incline while at the same time global growth does not show any signs of a synchronized global economic recovery and it is unlikely that global commodity prices will recover soon. SA Reserve Bank increased the repo rate by 0.25% in early November, while the oil price has also fallen sharply since end of October. Both indicators will put pressure on company profits thus offering no reprieve to the SA Allshare Index.

Graph 3



Graph 3 depicts the same metrics in the US and it shows very similar trends. The 30 year average P:E of the S&P 500 is 22.3 which is above its current level of 19. In historic terms it seems that US investors are not as exuberant about US equities as SA investors are about SA equities but earnings are very high, representing the gap between the two lines that has really manifested itself since the introduction of quantitative easing. Again we know that US interest rates are on the rise, putting pressure on company earnings. At the same time it seems that the reduction in company tax rates and other fiscal measures taken by the Trump administration have been factored into share prices and offer no further support to US equities going forward. So the US market is similarly due for a correction. The question is whether a correction of the US market will impact SA equities.

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 OCTOBER 2018

By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

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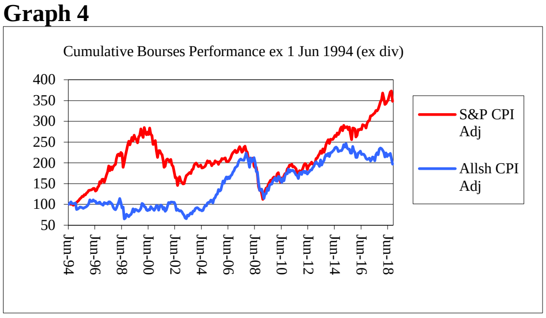
Graph 4



Graph 4 shows that US and SA equities are fairly well correlated. The divergence up to the middle of 200 it to be ascribed to the tech bubble in which SA equities did no really participate either on the up or on the down. Since that bubble burst the markets moved in tandem for a long time until the first utterances in 2014 of the phasing out of quantitative easing and the lifting of interest rates where US equities continued to steam ahead while SA equities limped along. The conclusion one may draw from this is that a correction of the US market will impact the SA market. Although one may expect that the US Fed will try to manage the US economy in such a way that there will not be any rapid correction, it cannot control events happening everywhere in the world that may lead to a panic reaction and a rapid correction of markets.

The Fed rate is at the core of the future movement of global equities until all measures that have been placing a cap on global interest rates have been removed from the system. The US Fed rate is currently at 2.25%, while US CPI has steadily been creeping up to 2.52% at the end of October. Long-term statistics indicate that the Fedrate should be roughly 1% to 2% higher than CPI. Based on current CPI, a US Repo rate of around 1.5% above CPI, or around 4% would indicate a normalised interest rate environment. At the more recent rate of upward adjustment of the Fed rate we are still looking at around 2 to 3 years now until we reach this point. Let's continue keeping an eye on this.

With these expectations, the Rand and local interest rates will remain under pressure for the next 2 to 3 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.

Conclusion

Equities remain in a phase of a long drawn-out correction to last another 2 to 3 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 returns despite the muted investment environment.

The relatively strong Rand still offers an opportunity to diversify offshore. In the light of announced changes to the investment regulation 13 that requires 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 now be expatriated to improve this imbalance.