Volume 14, No. 11
November 2018

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 NOVEMBER 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

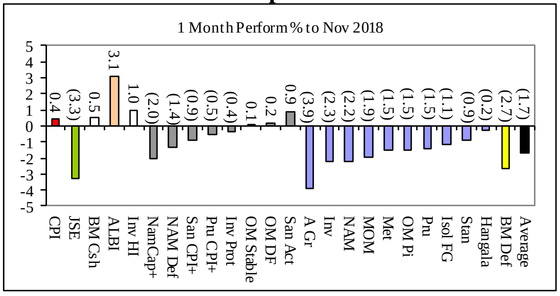
In November 2018 the average prudential balanced portfolio returned -1.73% (October 2018: -2.53%). Top performer is Hangala Prescient Absolute Balanced (-0.24%); while Allan Gray (-3.94%) takes the bottom spot. For the 3-month period, Investment Solutions takes top spot, outperforming the 'average' by roughly 1.94%. On the other end of the scale Nam Asset underperformed the 'average' by 2.15%.

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.

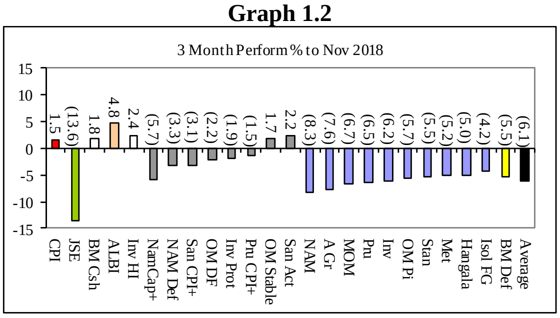
Below is the legend to the abbreviations reflected on the graphs:

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)

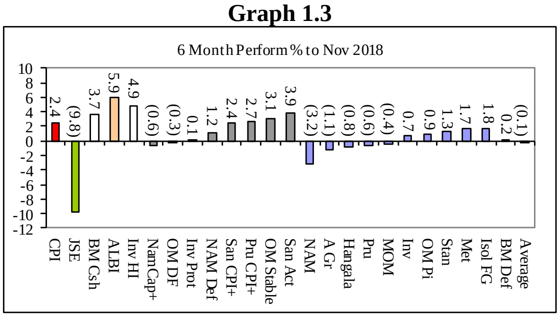
Graph 1.1



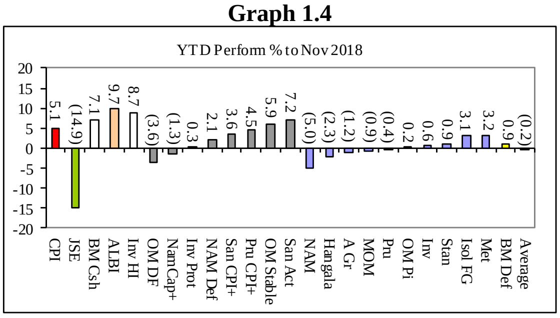
Graph 1.2



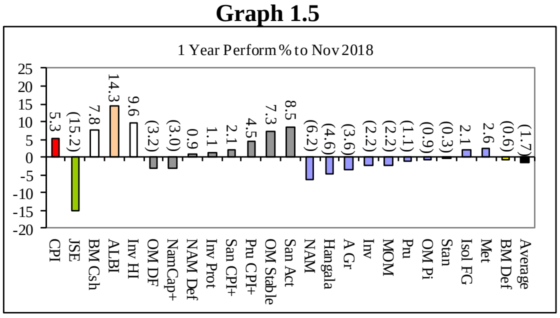
Graph 1.3



Graph 1.4



Graph 1.5



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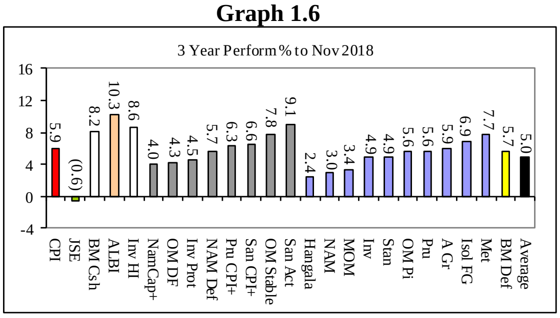
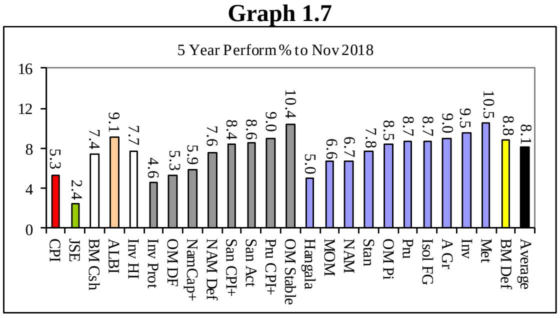
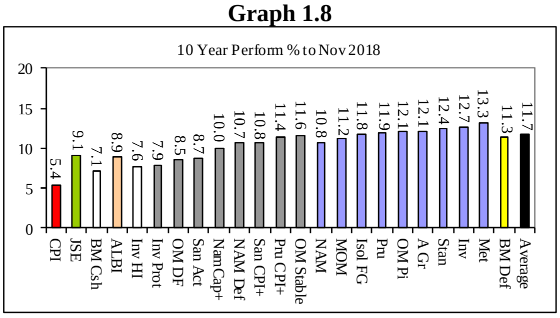
Graph 1.6



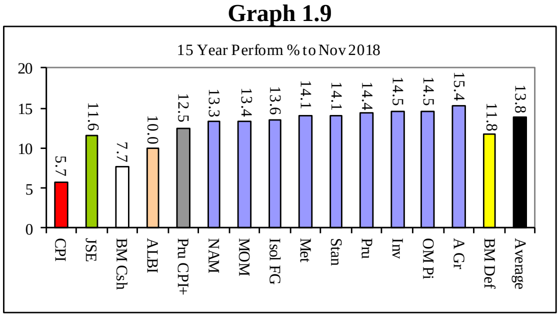
Graph 1.7



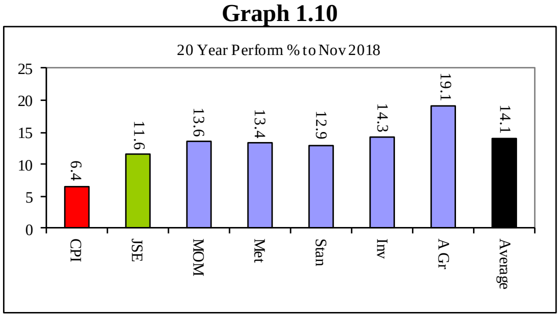
Graph 1.8



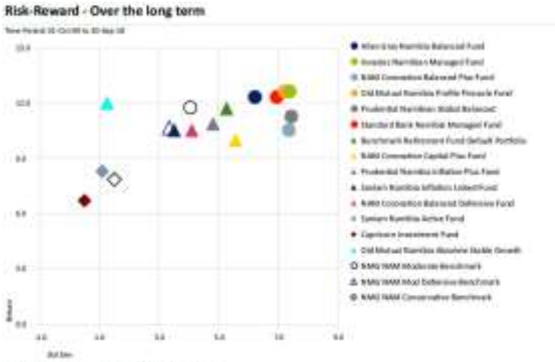
Graph 1.9

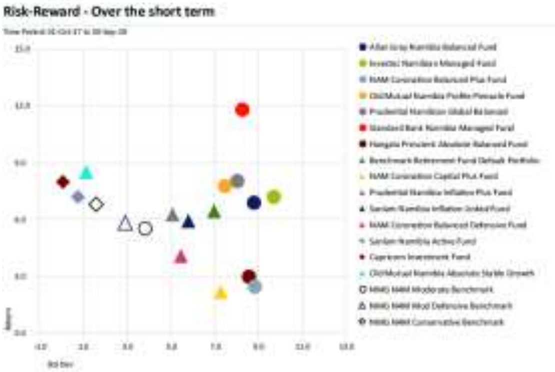


Graph 1.10



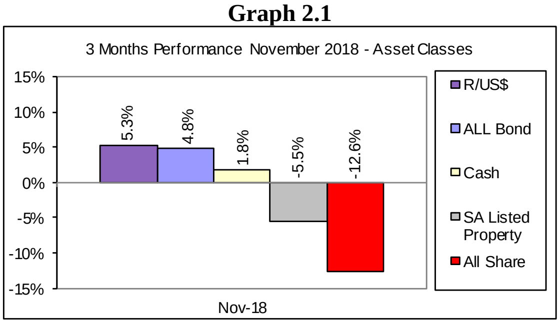
Risk/ Return



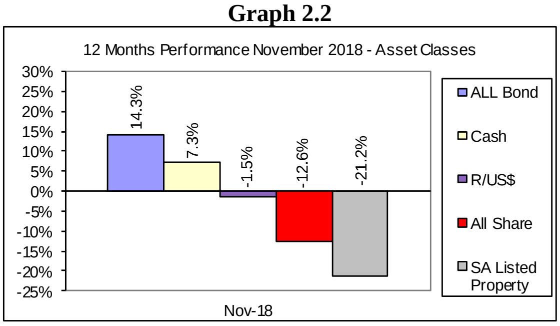


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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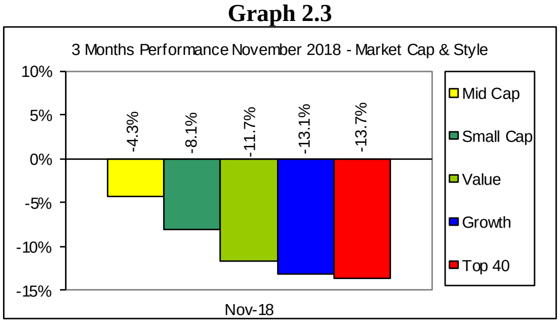
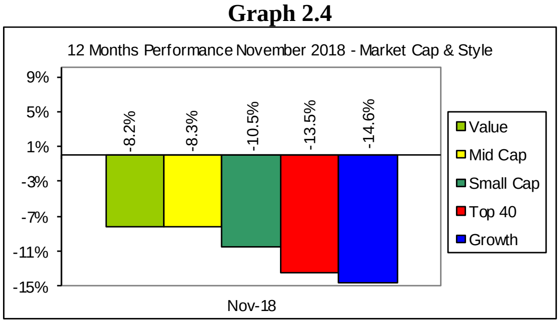
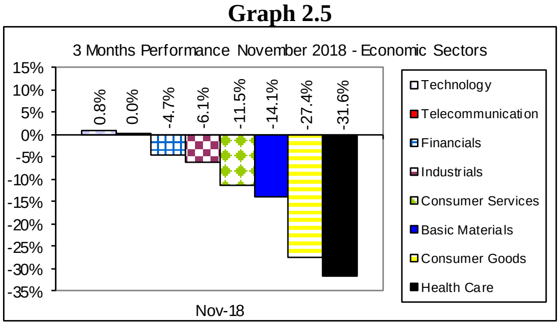
Graph 2.3



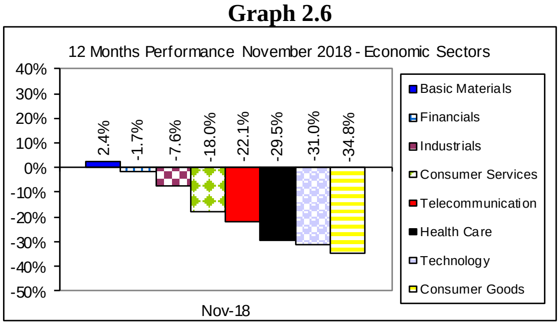
Graph 2.4



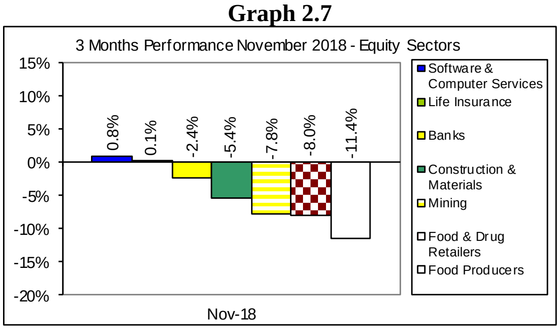
Graph 2.5



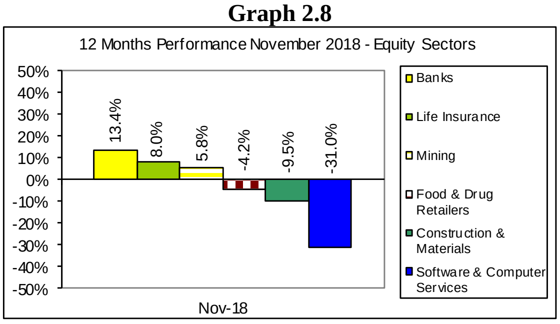
Graph 2.6



Graph 2.7



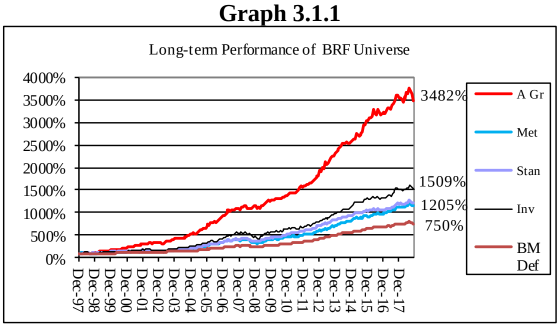
Graph 2.8



3. Portfolio Performance Analysis

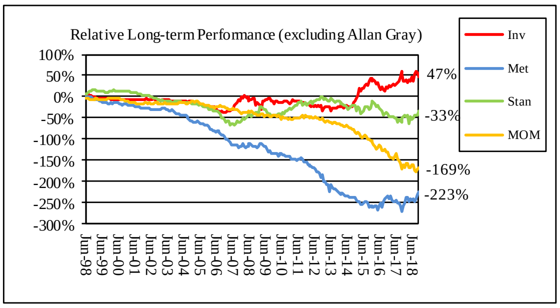
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

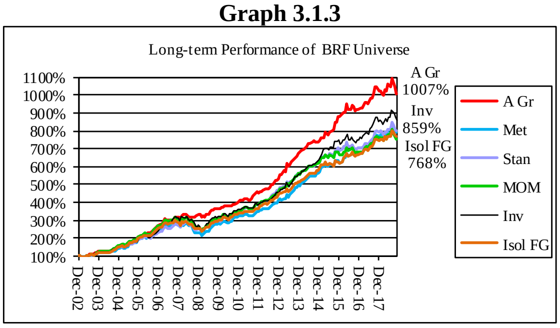


Graph 3.1.2

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



Graph 3.1.3



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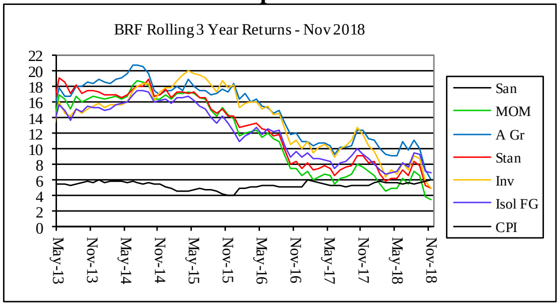
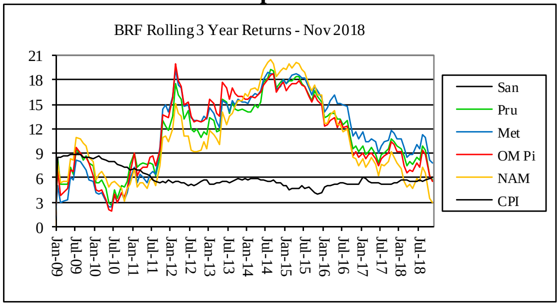
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

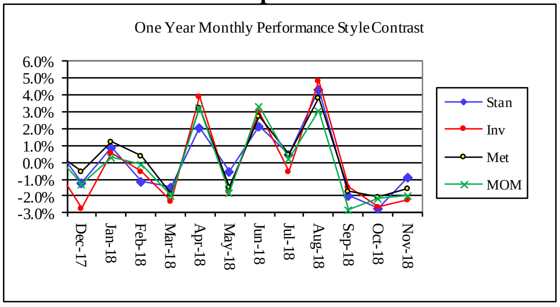


Graph 3.2.2

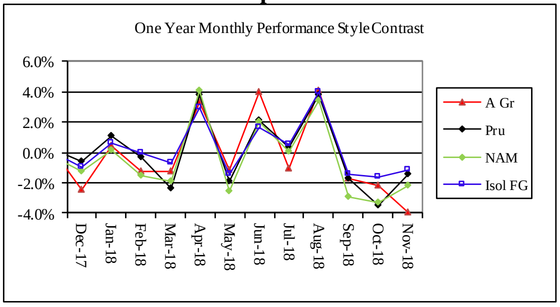


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

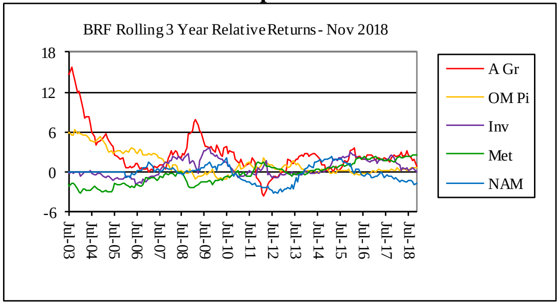


Graph 3.4.2

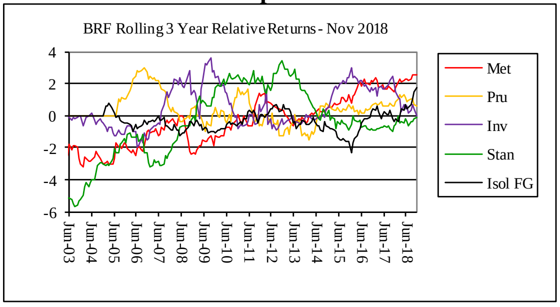


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

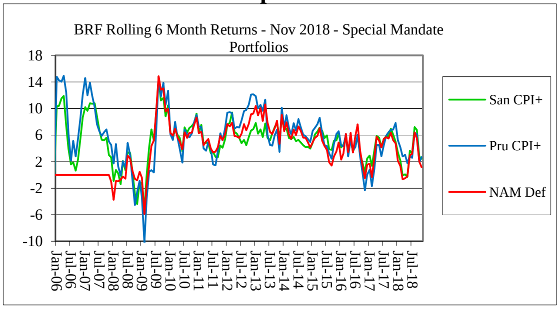


Graph 3.3.2

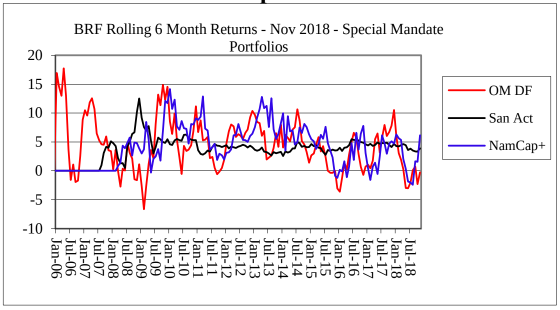


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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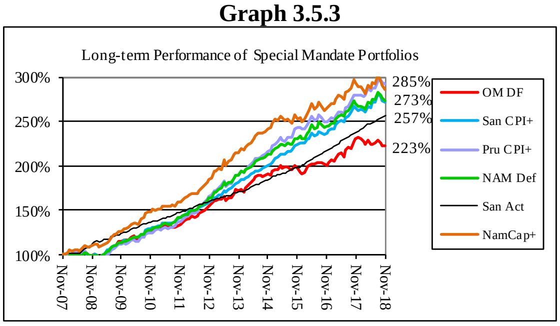
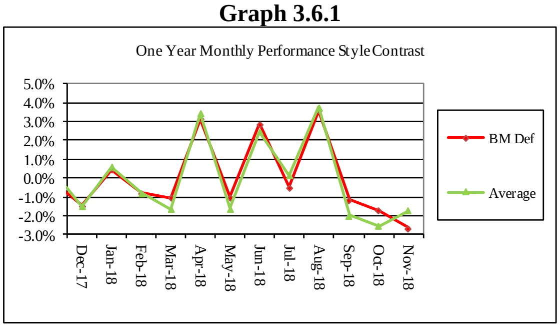
Graph 3.5.3

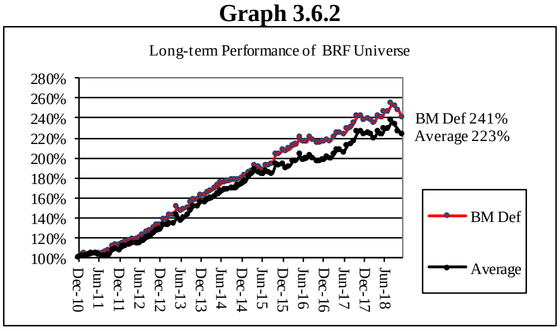


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

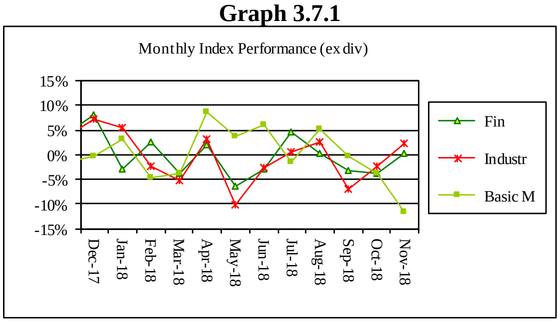


Graph 3.6.2

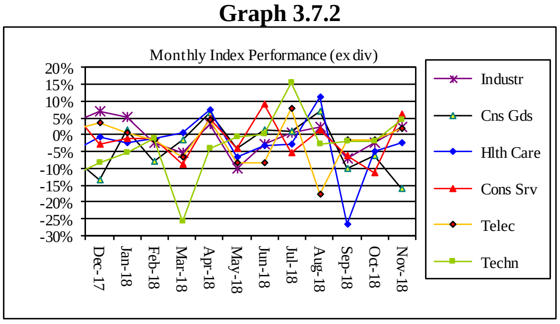


3.7 One-year monthly performance of key indices (excluding dividends)

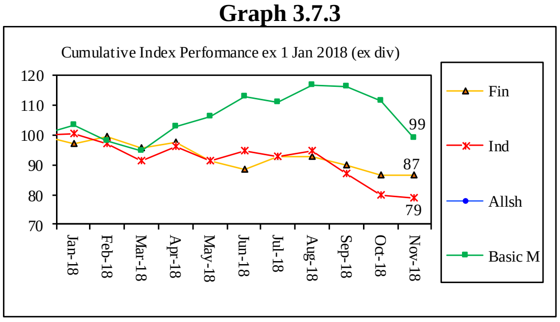
Graph 3.7.1



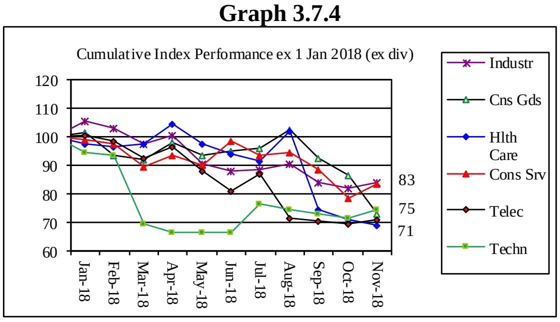
Graph 3.7.2



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.	8.8	8.1
5-year real return - % p.a.	3.5	2.8
Equity exposure - % of portfolio (qtr end September 2018)	45.4	70.2
Cumulative return ex Jan 2011	140.6	123.1
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

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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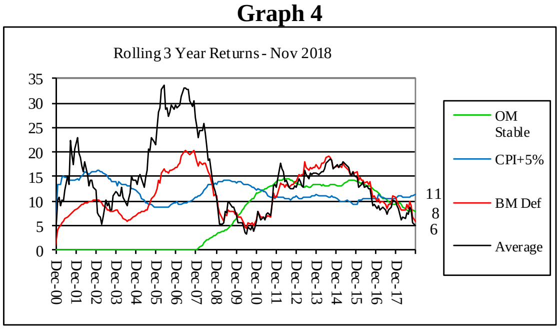
Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.1%	5.7%	5.0%
Best annual performance	8.1%	16.0%	14.9%
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 December 2015 to November 2018. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4

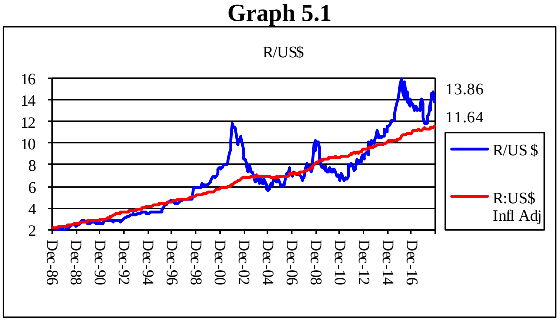


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end November was 5.7%, the average was 5.0% vs CPI plus 5% currently on 11.0%.

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 11.64 to the US Dollar while it actually stood at 13.86 at the end of November. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

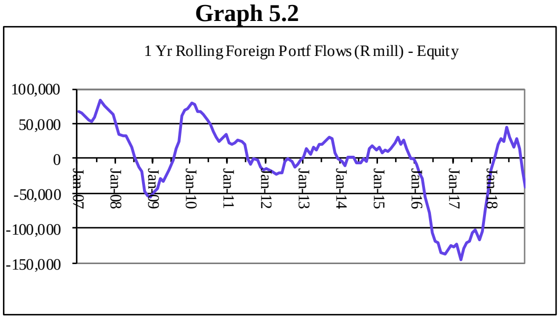


The Rand strengthened by 6.21% in November with net foreign investment outflows from bonds and equities of R 18.9 bn. Over the past 12 months the Rand weakened by 1.48%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 72.4 bn (outflow of R 47.0 bn to end October 2018).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 250.5 bn (October R 269.4 bn).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R16.7 bn at the end of November (inflow of R 14.9 bn year-on-year to end October). The month of November experienced a net outflow of R 20.1 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 31.9 bn (end October net investment outflow of R 11.8 bn). This represents roughly 0.24% 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 55.7 bn over the past 12 months to end of November (outflow of R 61.9 bn over the 12 months to end of October). The month of November experienced a net inflow of R 1.2 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 282.5 bn (to October R 281.2 bn).

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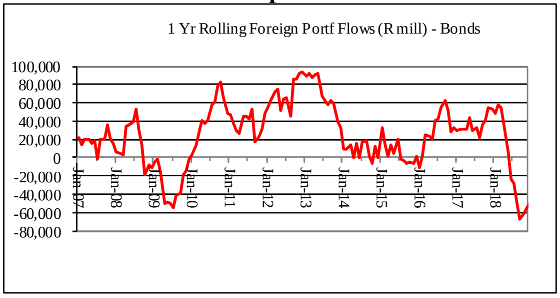
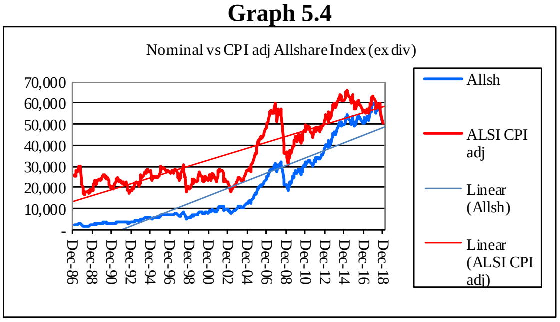
Graph 5.3



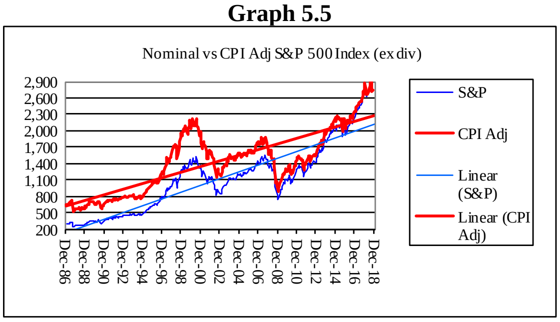
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.7% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.1% per year. This is equivalent to a growth in real terms of 2.6% p.a. over this period, excluding dividends, or around 5.6% including dividends.

Graph 5.4



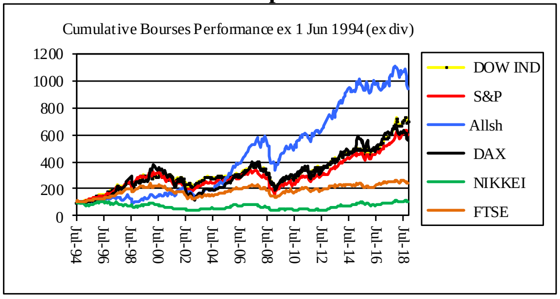
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.5% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a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

Graph 5.5



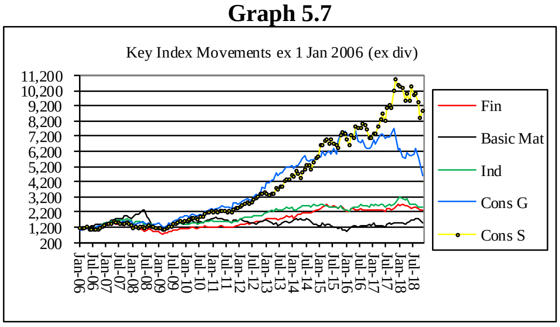
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 18.3%; Consumer Goods: 12.4%; Industrials: 7.5%; Financials: 6.8%; and Basic Materials: 3.0%.

Graph 5.7



6. It's the dog that wags the tail – how the US economy impacts SA (and Namibia)

by Tilman Friedrich

The US Repo rate is currently 2.25%.While the US annual CPI has steadily been creeping up from around 0% in January 2015 to 2.95% at the end of July, it has been on the decline again since then, contrary to the Fed's expectation, to reach 2.18% at the end of November. This means that any US citizen investing in US treasuries is now for the first time since November 2015, earning a positive real interest rate. If this trend continues, the appetite of US investors for equities is likely to wane, removing the underpin of equities in the US and globally.

The declining inflation in the US is probably also at least part of the reason why the Fed has no raised the repo rate at its last sitting, contrary to a general expectation that it would. The US needs inflation to deflate its huge debt burden and expected quantitative easing to do this job. It seems though that this strategy has not worked and the risk of deflation is on the rise. This may present major structural challenges and may result in us treading a very uncertain path and in increased market volatility.

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MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 NOVEMBER 2018

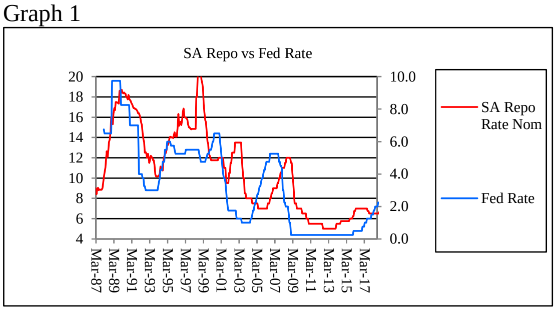
By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

A negative real interest rate is clearly not sustainable and is the cause of artificial imbalances in asset valuations that are due to correct once the situation returns to normal as we are starting to see now. The US repo rate should be around 1.5% higher than US CPI, going by historic evidence stretching back to 1988 and up to the onset of the global financial crisis.

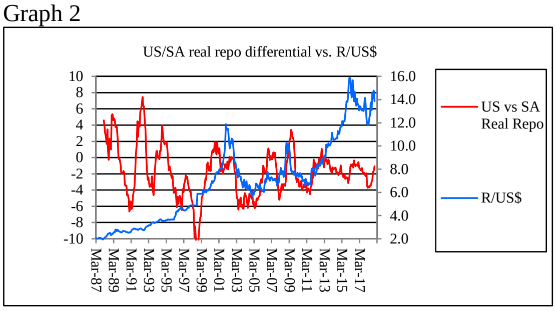
Based on current US CPI of 2.2%, the US repo rate should be around 4%. Once the repo rate offers a real return of 1.5% or reaches 4% under current inflationary conditions, it would indicate a normalised interest rate environment. At the more recent rate of upward adjustment of the US repo rate and the state of the global economy we are once again looking at around 3 to 4 years now until we reach this point given that we saw 6 increases of 0.25% each over the past 4 years. This of course assumes that the global economy will pick up at the speed it has over the past 4 years, whereas at the moment it could go in either direction. So where will this leave SA?

Graph 1



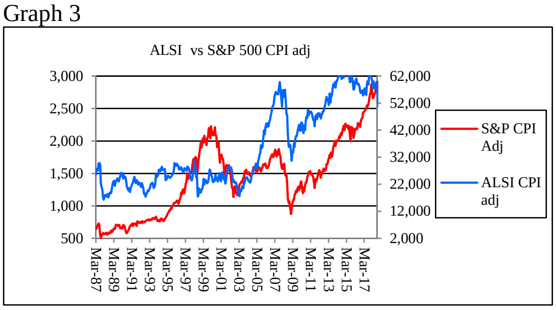
Graph 1 above shows how closely correlated the SA and the US repo rates have been over the past 30 years plus, the SA repo (measured on the left vertical axis) generally lagging the movement of the US repo (measured on the right vertical axis). With an expectation that the Fed is unlikely to raise its repo rate given the current state of affairs, the SA Reserve Bank is unlikely to lift its repo further any time soon unless forced to do so because of a declining positive differential between US and SA real repo rates.

Graph 2



Since one would expect the interest rate to impact the exchange rate an interesting question is whether this is indeed the case. Graph 2 above measures the differential between the US and the SA real repo rate, i.e. the nominal repo rate minus annual inflation (the red line measured on the left vertical axis) and the Rand: US Dollar exchange rate (the blue line measured on the right vertical axis). Tracking the red line against the blue line, one will note a fairly distinct decline in the real repo rate differential (i.e. SA offers a higher real repo rate than the US) up until around 1994, coincidentally the time of the democratization of SA, despite a growing gap in real repo rates in favour of SA. There is hardly any correlation between these two lines over this initial period. Over this period the Rand weakened steadily against the US Dollar. From the beginning of 1999 up until about 2012 a relatively higher real repo rate in the US is accompanied by a weakening of the Rand and vise-versa, and we see much closer correlation between the red line and the blue line. Since 2012 the real repo differential hovered between minus 4% and 0% in favour of SA while the Rand continued to weaken significantly against the US Dollar from about 9 to its current level of around 14. It would be interesting to overlay political events in SA onto this graph such as the election of president Zuma and the end of his term. This graph does indicate that the Rand is currently excessively weak relative to the real repo rate differential between the US and SA, possibly for political reasons. This is also borne out by graph 5.1 in paragraph 5 above. Looking at the last few months, the real repo rate differential is closing in favour of the US and we simultaneously see a weakening of the Rand. This indicates that SA will be under pressure to raise its repo rate if the US inflation continues to drop or if the US lifts its repo rate.

Graph 3



As illustrated in graph 3 above, both the S&P 500 and the ALSI have grown strongly in real terms since the beginning of 1987. While the current S&P 500 price: earnings ratio at 18.9 is well below its 30 year average of 22.3, the current ALSI price: earnings ratio of 14.9 is now on its 30 year average of 14.7.

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Benchmark Retirement Fund

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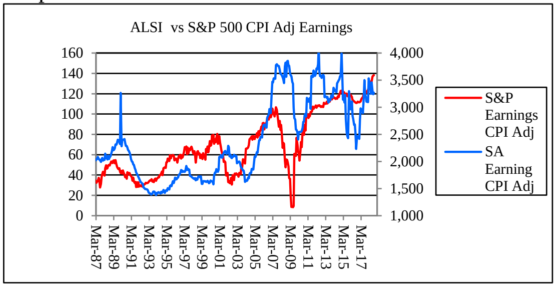
Graph 4



However looking at graph 4 above, the S&P 500 CPI adjusted earnings (measured on the left vertical axis) of currently 145 are twice its 30 year average of 71. The ALSI CPI adjusted earnings (measured on the right vertical axis) of currently 3,411 are 40% higher than is 30 year average of 2,400. This also indicates a risk of earnings declining to more normal levels and a consequent risk of equity markets adjusting downward.

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. Equity markets are exposed to the risk of a downward adjustment. Low returns on equities and rising interest rates will also impact negatively on the consumer. On the flipside, a weak Rand should promote exports and support Rand hedge shares that benefit from the weak Rand and should promote local manufacturing and exports which should eventually create jobs and lead to improved consumer sentiment.

Conclusion

Equities remain in a phase of a long drawn-out correction to last another three to four years, all else remaining equal, as real 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, particularly companies on high dividend yields. 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 weak Rand currently speaks against further diversification offshore but this should be monitored and any strengthening of the Rand should be exploited for further offshore diversification. 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 now be expatriated to improve this imbalance one Rand strength offers an opportunity.

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.