Volume 15 No. 2
February 2019

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 28 FEBRUARY 2019

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

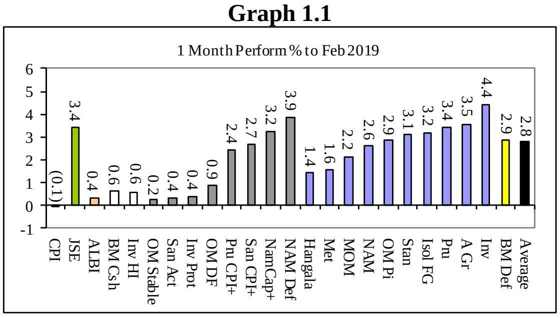
In February 2019 the average prudential balanced portfolio returned 2.8% (January 2019: 1.2%). Top performer is Investec Namibia Managed Fund (4.4%); while Hangala Prescient Absolute Balance Fund (1.4%) takes the bottom spot. For the 3-month period, Investec Namibia Managed Fund takes top spot, outperforming the ‘average’ by roughly 1.4%. On the other end of the scale Momentum Namibia Growht Fund underperformed the ‘average’ by 1.6%. Note that these returns are before asset management fees.

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.

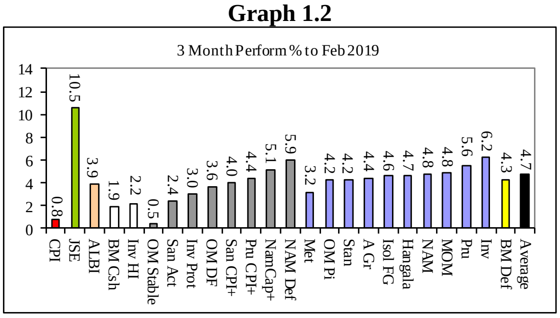
Below is the legend to the abbreviations reflected on the graphs:

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)
Momentum Namibia Growth	Met (blue)
NAM Prudential Balanced	NAM (blue)
Old Mutual Pinnacle Profile Growth	OM Pi (blue)
Stanlib Managed	Stan (blue)
Investment Solutions Bal Growth (multimanager)	Isol FG (blue)

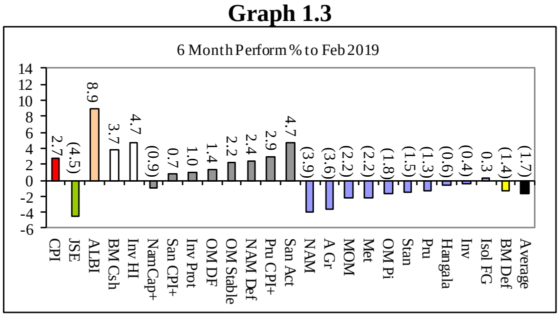
Graph 1.1



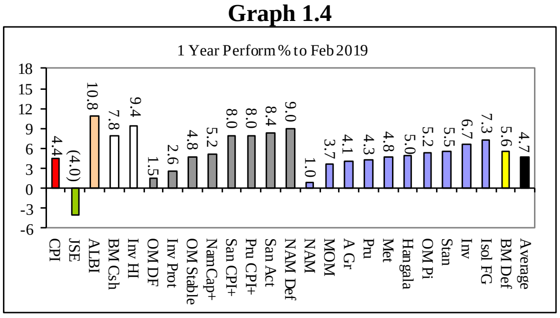
Graph 1.2



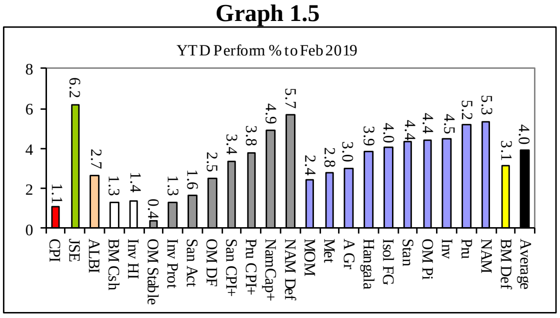
Graph 1.3



Graph 1.4



Graph 1.5



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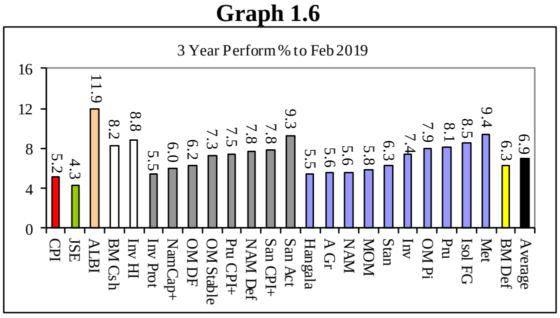
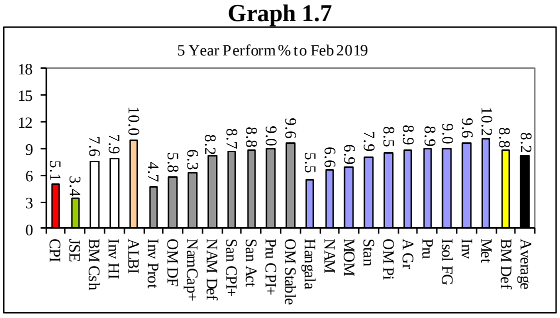
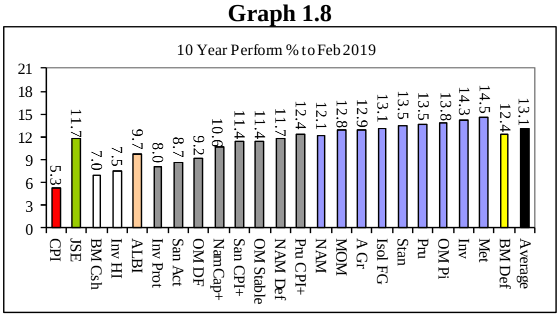
Graph 1.6



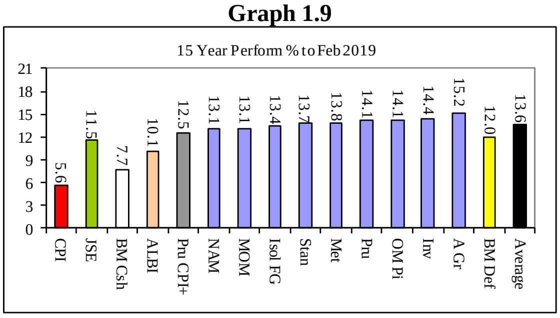
Graph 1.7



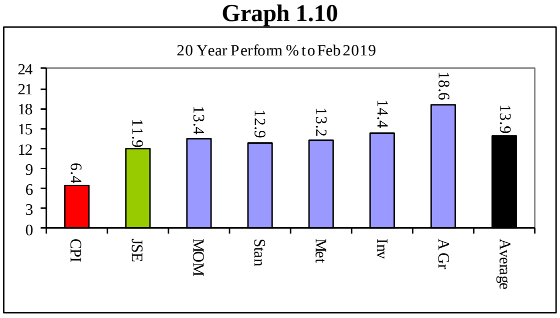
Graph 1.8



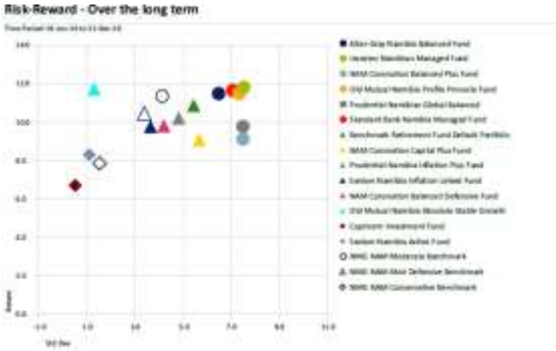
Graph 1.9

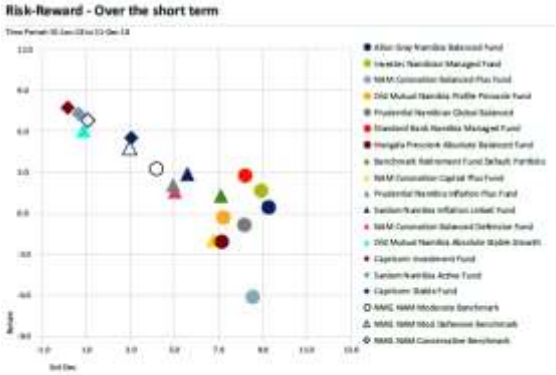


Graph 1.10



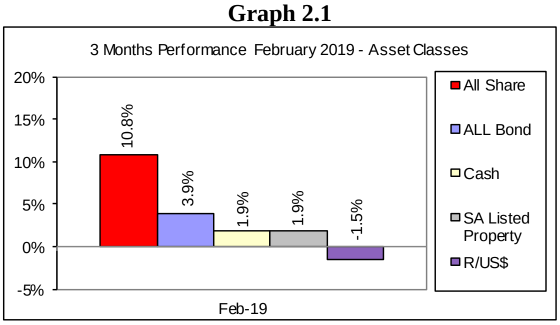
Risk/ Return



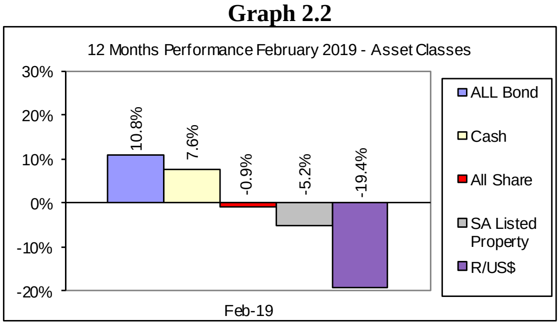


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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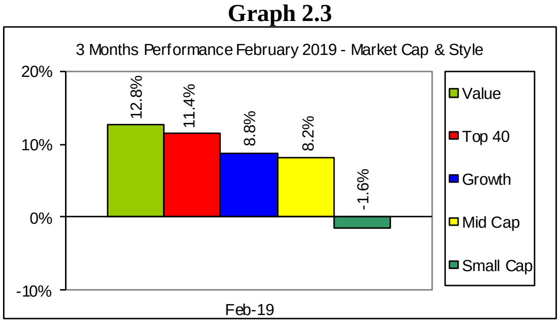
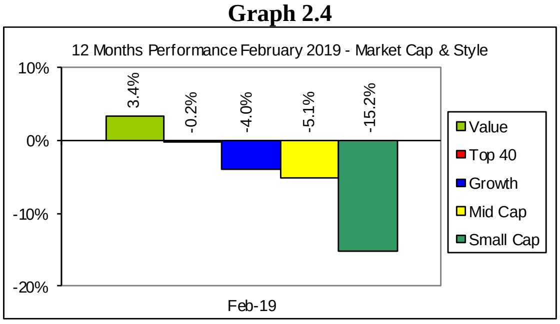
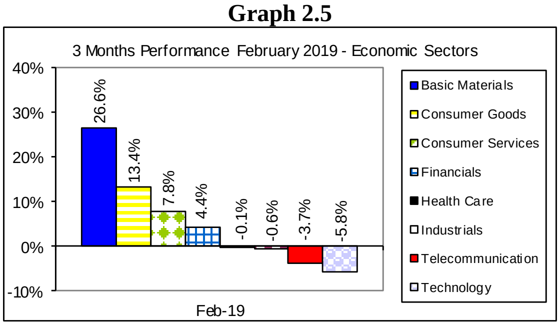
Graph 2.3



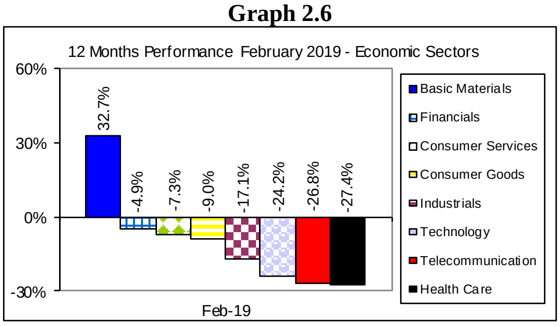
Graph 2.4



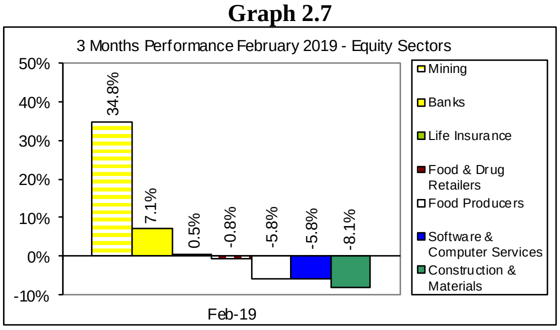
Graph 2.5



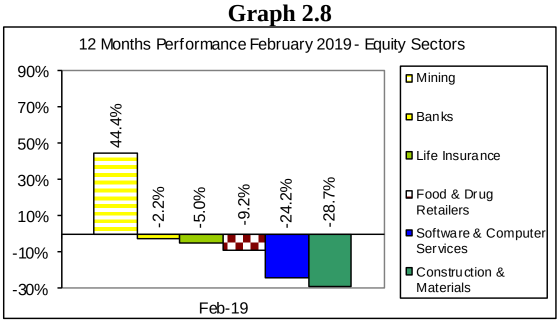
Graph 2.6



Graph 2.7



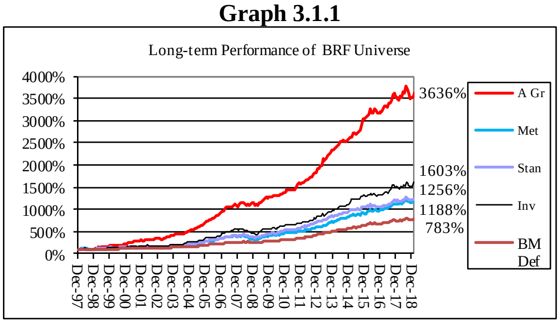
Graph 2.8



3. Portfolio Performance Analysis

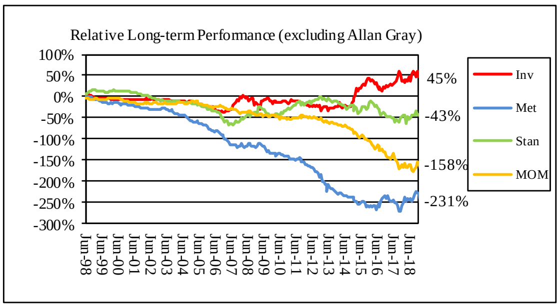
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

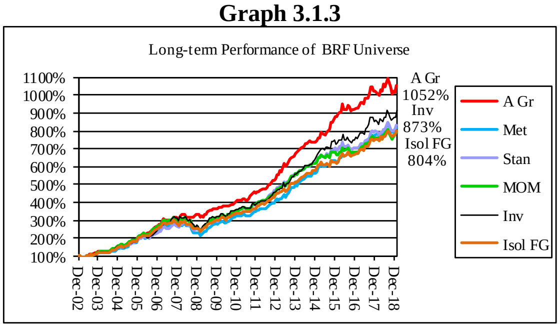


Graph 3.1.2

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



Graph 3.1.3



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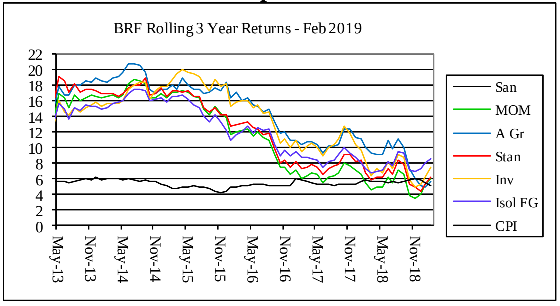
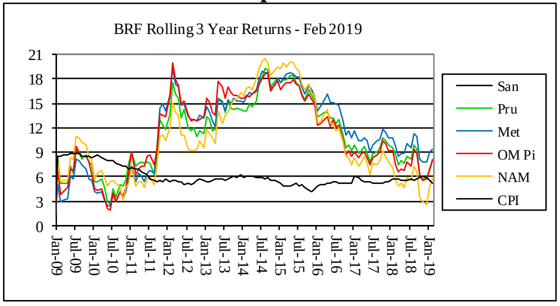
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

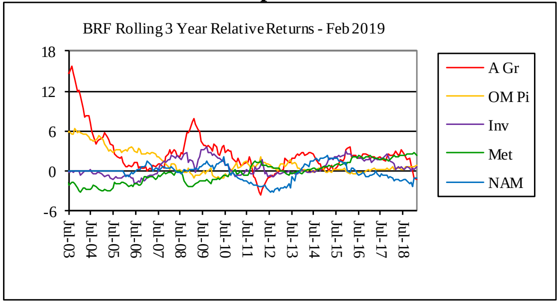


Graph 3.2.2

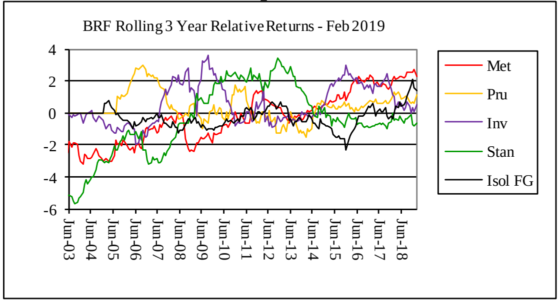


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

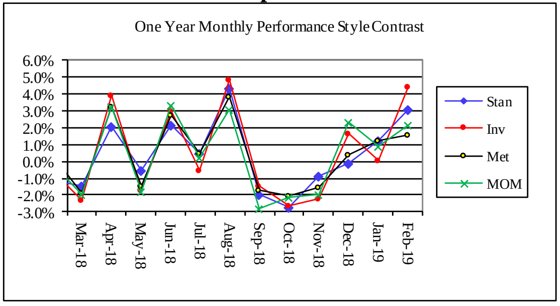


Graph 3.3.2

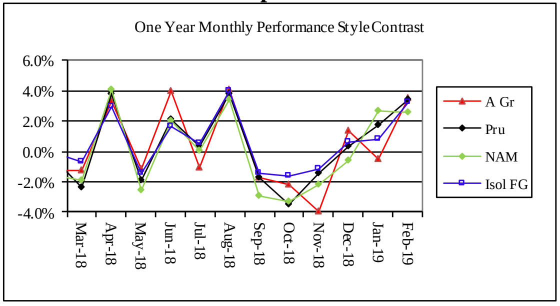


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

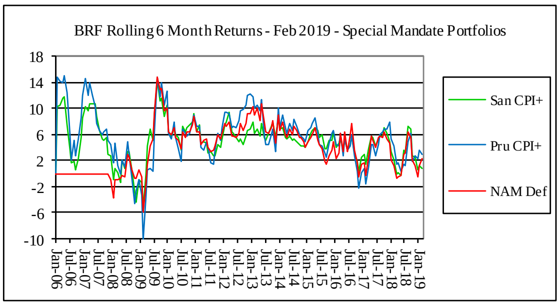


Graph 3.4.2

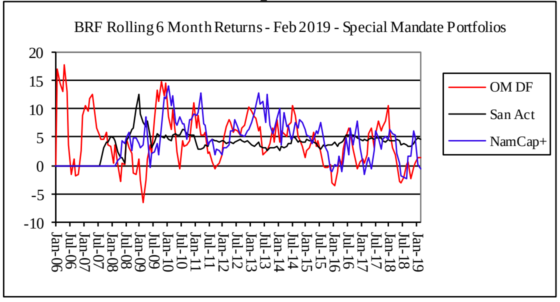


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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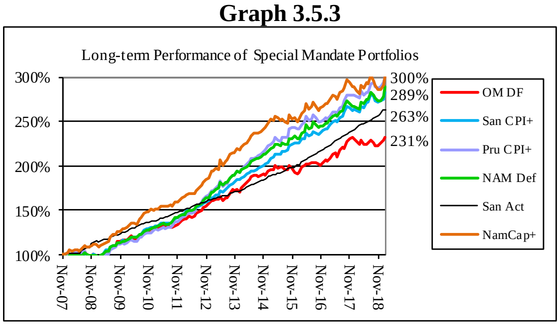
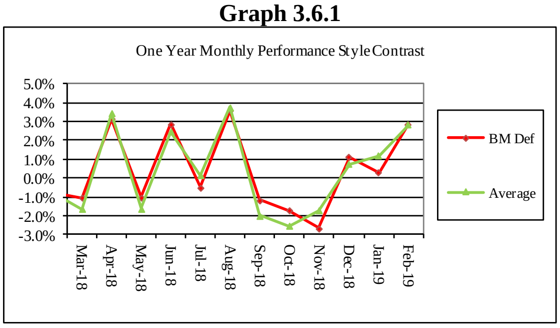
Graph 3.5.3

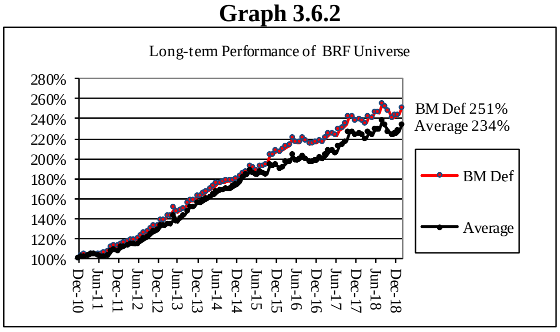


3.6 Monthly and cumulative performance of ‘Benchmark Default’ portfolio relative to average prudential balanced portfolio

Graph 3.6.1

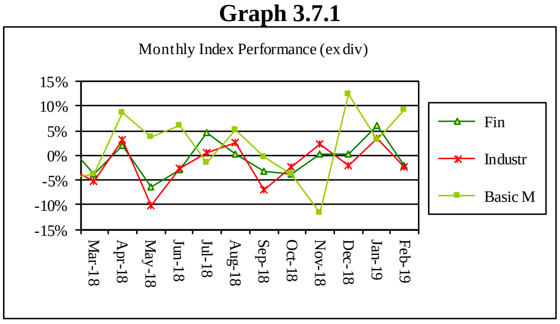


Graph 3.6.2

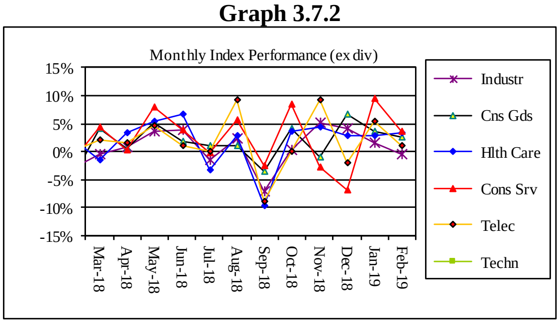


3.7 One-year monthly performance of key indices (excluding dividends)

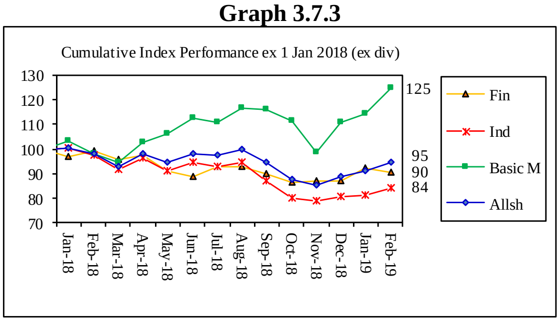
Graph 3.7.1



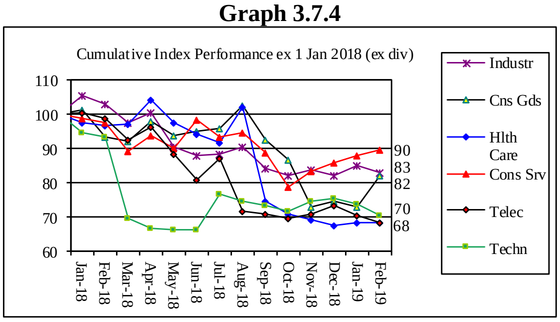
Graph 3.7.2



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.	8.8	8.2
5-year real return - % p.a.	3.7	3.1
Equity exposure - % of portfolio (qtr end December 2018)	45.9	67.7
Cumulative return ex Jan 2011	150.9	133.8
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

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retirement income. It is to be noted that the default portfolio managed to out-perform the average prudential balanced portfolio despite its significantly lower risk profile as represented by its equity exposure.

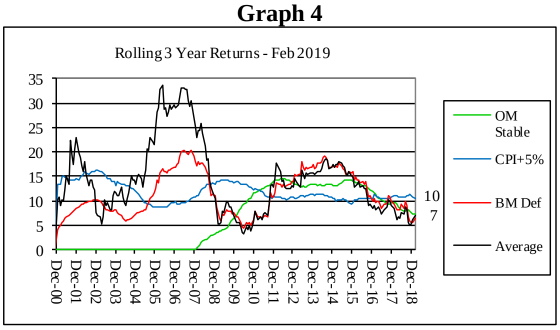
The default portfolio's long-term return must be read in the context of it initially having been managed with a low risk profile that was only changed from the beginning of 2011 when the Metropolitan Absolute Return fund was replaced with the Allan Gray balanced portfolio.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.3%	5.5%	5.0%
Best annual performance	8.2%	14.2%	13.8%
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	7.5%	9.8%	8.7%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years March 2016 to February 2019. 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 February was 6.3%, the average was 7.0% vs CPI plus 5% currently on 10.2%.

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 11.70 to the US Dollar while it actually stood at 14.07 at the end of February. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

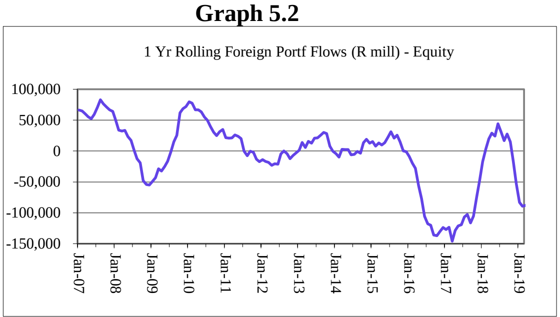
Graph 5.1

The Rand weakened by 5.88% in February with net foreign investment inflows from bonds and equities of R 9.5 bn. Over the past 12 months the Rand weakened by 19.4%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 146.8 bn (outflow of R131.2 bn to end of January 2019).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 226.3 bn (January R 216.8 bn).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R89.2 bn at the end of February (outflow of R 83.3 bn year-on-year to end January). The month of February experienced a net inflow of R 5.5 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 53.6 bn (end January net investment outflow of R 59.1 bn). This represents roughly 0.34% 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 57.6 bn over the past 12 months to end of February (outflow of R 48.0 bn over the 12 months to end of January). The month of February experienced a net inflow of R 4.0 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 279.9 bn (to January R 275.9 bn).

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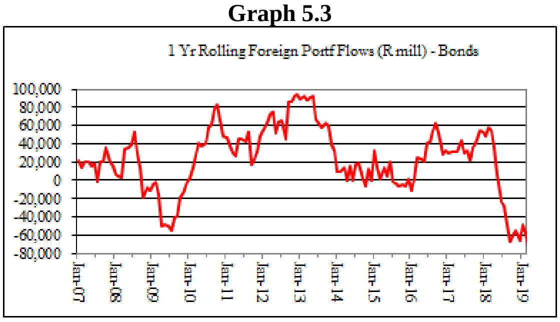
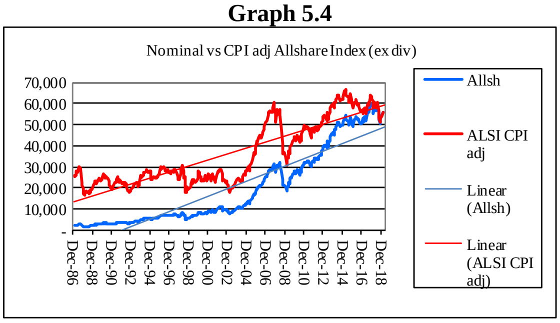
Graph 5.3



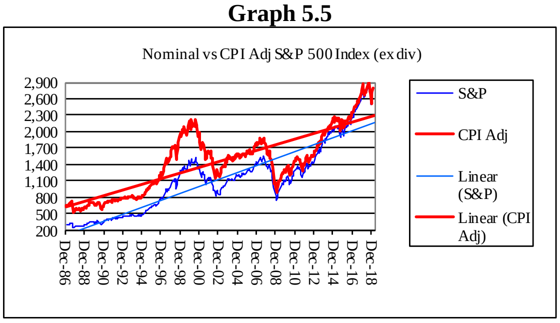
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.9% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.1% per year. This is equivalent to a growth in real terms of 2.8% p.a. over this period, excluding dividends, or around 5.8% including dividends.

Graph 5.4



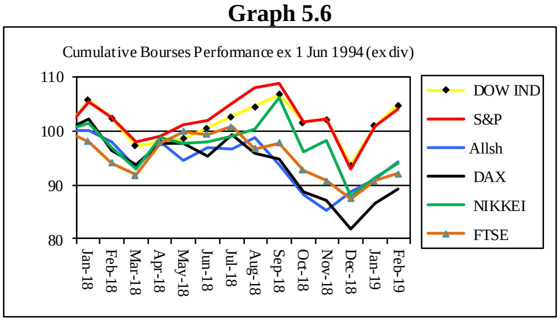
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.5% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a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

Graph 5.5



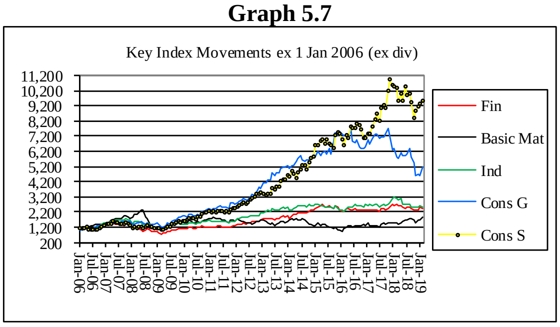
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 18.5%; Consumer Goods: 13.2%; Industrials: 7.3%; Financials: 7.0%; and Basic Materials: 4.8%.

Graph 5.7



6. **The Pension fund returns have been poor, but our concern is about an ever increasing dilution of returns!**
by Tilman Friedrich

Investors in general and pension fund members more specifically will not be happy with the returns their investments have generated. Up to the end of December 2018, the average prudential balanced portfolio's return of 7.7% has barely outperformed inflation of 5.2% and has just managed to match the money market return of 7.5% over a 5 year period but fell far short of both the money market return and its long-term performance objective over any shorter periods. It only really managed to achieve its long-term objective of inflation plus 5.5%, before fees, over 10 years and longer.

Now consider the same parameters to the end of January 2019 where the average prudential balanced portfolio's return of 8.0% represents a slightly improved the outperformance inflation of 5.2% and of the money market return of 7.5% over a 5 year period but still falling far short of both the money market portfolio and its long-term performance objective over all shorter

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periods, once again only really managing to achieve its long-term objective of inflation plus 5.5% over 10 years and longer.

Finally let's move the goal post by another month to the end of February 2019. Now the average prudential balanced portfolio's return of 8.2% represents a slightly improved outperformance of inflation of 5.1% and of the money market return of 7.6% over a 5 year period but still falling far short of both the money market portfolio and its long-term performance objective over any shorter periods. It only managed to achieve its long-term objective of inflation plus 5.5% over 10 years and longer.

What this does show is that fortunes for the more volatile and higher risk prudential balanced portfolios turn rather rapidly and adding two months of positive, just slightly positive returns, add the end of the period and taking off 2 months at the start of the 5 year period can make quite a difference to the end result. We added a cumulative 4% for January and February 2019 and dropped a cumulative 1.5% for January and February 2014.

Can we look forward to the results of the first two months of 2019 signifying a turnaround of the fortunes of equities? Certainly as far as local equities are concerned, they have been far behind the curve in terms of medium term actual yields versus long-term yield expectations. Since the beginning of 1987 the real return was a mediocre 5.8% including dividends – that's over the past 32 years! Compare this to the S&P 500's 6.6% real return over the same 32 year period where one would expect the risk premium to require local equities to produce a higher return than US equities. Compare local equities 32 year return also with long term (116 years) returns of around 7.5% for SA equities and 6.5% for US equities. Of course this is not the only consideration. It is common cause that current low returns are the result of central bank intervention in the markets since the financial crisis and that we are currently en route to a normalization of monetary policy.

In the US, the Fed rate currently represents a real return of 1%, which at times has been negative, so at least a bit of normalization although the gap needs to open up further to around 2% in order to get back to its long-term average. Markets tend to factor in the future to the extent it is reasonably foreseeable, so it is likely that at least some further normalization has already been factored in that is still due to come about. US inflation currently shows a clear downward trend which means that the gap will be opened up as the result of declining inflation, where it was already down to 1.2% recently but has picked up a bit to 1.5% of late.

Our concern is thus not so much that equities may not meet their long-term return expectations going forward. Our concern is much more that pension fund investment returns are diluted ever more by what we have been referring to as a serious onslaught on the pensions industry that seems to be considered a duck that lays the golden egg. Consider the ever increasing cost as a result of increasing regulatory and governance requirements. Consider fiscal and monetary objectives of healing all sorts of ailments government and our national economy are experiencing where pension fund assets are forced into unlisted investments and where the local investment allocation will soon reach 45%, higher caps having been mooted already.

In our commentary in the September column of this investment brief, we speculated that the investment regulations will result in pension funds' equity allocation effectively being capped at 60% as opposed to an implicit allocation of 75% that the current typical pension fund model presupposes. This will dilute expected long-term pension fund returns down form 6.3% to 4.6% before fees. After fees we will thus be looking at a net return of below 4% per annum whereas the pension model requires 5.5%.

We believe that this is a very unfortunate development pension fund members are facing without them being able to do much about it. It seems our government finances are under so much pressure that short-term survival rather than long-term planning defines government policies, to our own detriment. South Africa scores only 52 points on the Melbourne Mercer global pensions index, putting it into the 3rd lowest of 7 categories, where the highest ranked country is Netherlands with a score of more than 80. Namibia will be below SA by some margin just on the basis of our old age grant being quite inferior to that of SA and we are likely to move down further as declining pension fund investment returns will further dilute the overall adequacy of our pension system. The direction should be the opposite and should be driven by supportive national policies. It does not seem we have the means for such policies. What does this mean for Namibia's future credit rating?

Conclusion

What can a pension fund member do about this dilemma? Well the majority of members, particularly on the lower half of the income spectrum will not be able to do anything about this, as they will not be able to afford any other savings. They will have to hope that government will be able to look after them once they have retired and do not have the means of their own to do so. On the upper half of the income spectrum, savers can and must apply their total discretionary capital to make up the effect of declining pension fund investment returns. Unfortunately this will not be possible through investment in Namibia as every conventional savings mechanism is subject to the same or similar dilution. It is common cause that equities are an essential component of every investment strategy and are really the only asset class that offers the opportunity to make good the shortfall experienced on pension investments in Namibia. Consequently investors need to use every opportunity to expatriate their discretionary capital to invest primarily in foreign equities.

Unfortunately the Rand is currently substantially undervalued at around 14.3 to the US Dollar and should be closer to 12. It is thus not a good time to expatriate discretionary capital right now. It is perhaps not a bad idea then to keep this capital in the money market, while it returns a real rate of about 2% p.a., in anticipation of an opportunity to expatriate the capital. As far as our knowledge goes, approved expatriation applications are valid for 6 months. Typically obtaining approval to transfer money offshore is quite a constraining factor, where timing will be crucial, and perhaps one should ensure that one has the approval in your pocket and renew if an opportunity does not arise within the next 6 months.

Important notice and disclaimer