Volume 15 No. 10
October 2019

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 OCTOBER 2019

By T H Friedrich – 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

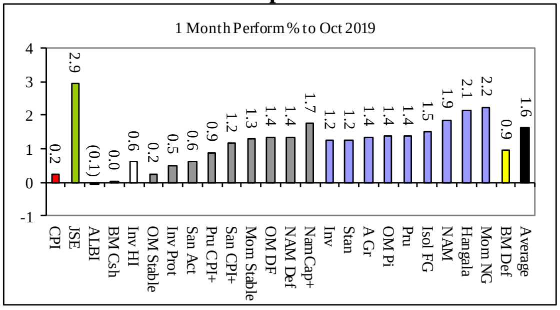
In October 2019 the average prudential balanced portfolio returned 1.6% (September 2019: 1.3%). Top performer is Momentum Namibia Growth Fund with 2.2%, while Investec with 1.2% takes the bottom spot. For the 3-month period, Allan Gray Namibia Balanced Fund takes top spot, outperforming the 'average' by roughly 1.2%. On the other end of the scale Stanlib Managed Fund underperformed the 'average' by 1.2%. Note that these returns are before (gross of) 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.

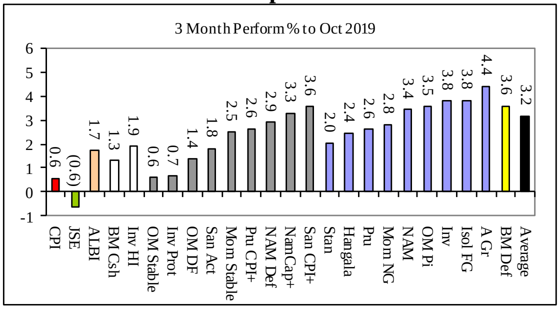
Below is the legend to the abbreviations reflected on the graphs:

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)
Momentum Nam Stable Growth	Mom Stable (grey)
NAM Capital Plus	NamCap+ (grey)
NAM Coronation Balanced Def	NAM Def (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Prudential Inflation Plus	Pru CPI+ (grey)
Sanlam Active	San Act (grey)
Sanlam Inflation Linked	San CPI+ (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)
Investment Solutions Bal Growth (multimanager)	Isol FG (blue)
Momentum Namibia Growth	Mom NG (blue)
NAM Coronation Balanced Plus	NAM (blue)
Old Mutual Pinnacle Profile Growth	OM Pi (blue)
Prudential Managed	Pru (blue)
Stanlib Managed	Stan (blue)

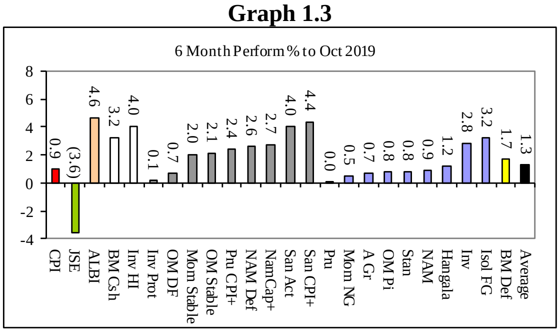
Graph 1.1



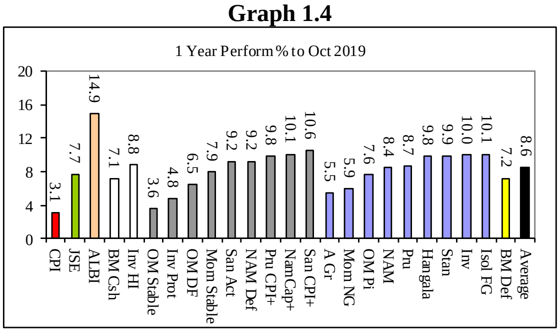
Graph 1.2



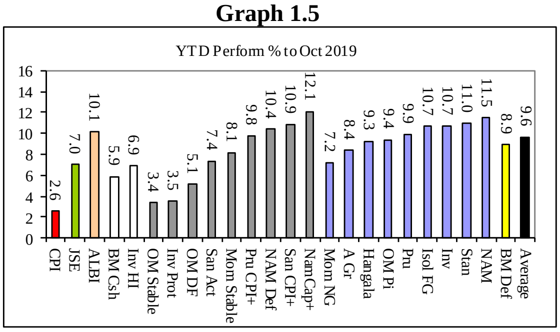
Graph 1.3



Graph 1.4



Graph 1.5



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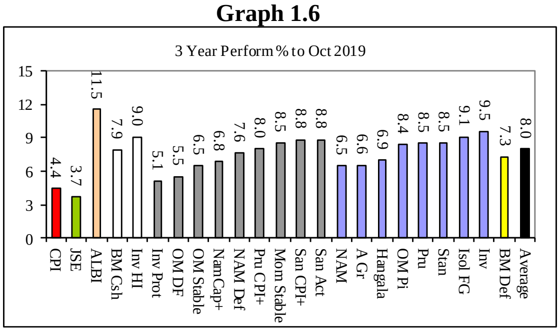
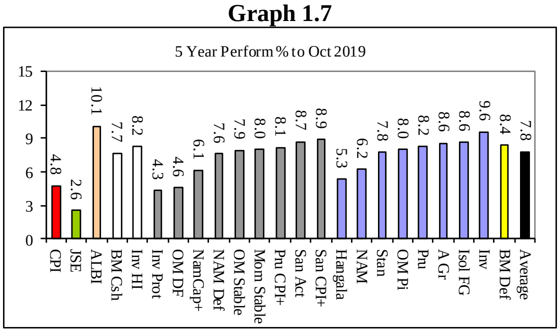
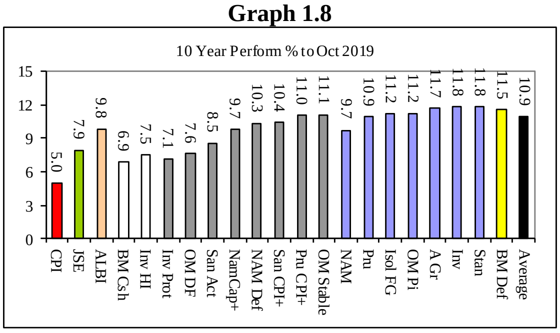
Graph 1.6



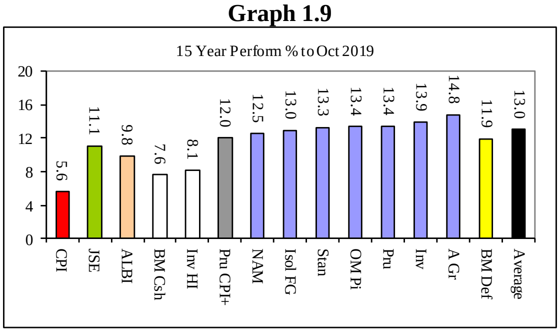
Graph 1.7



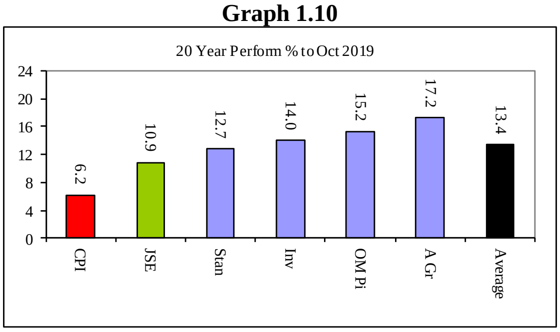
Graph 1.8



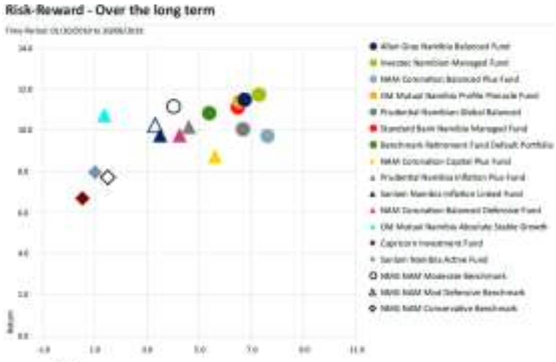
Graph 1.9



Graph 1.10

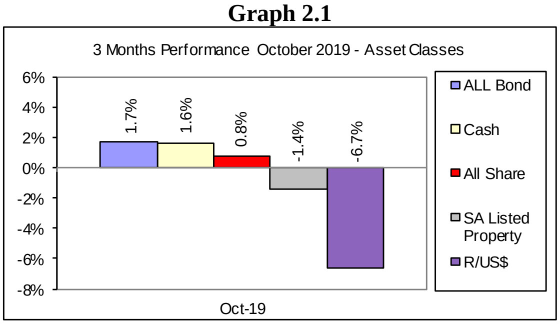


Risk/ Return

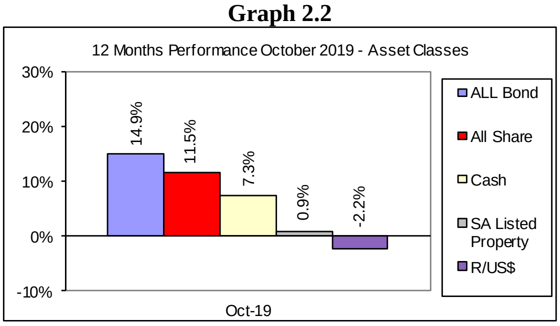


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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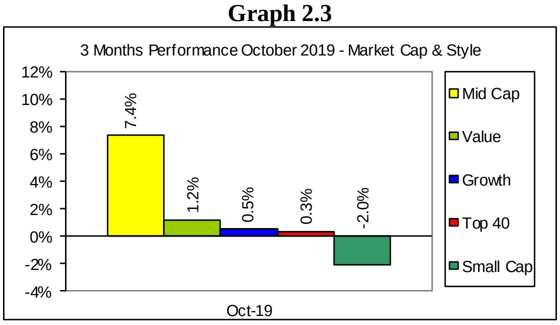
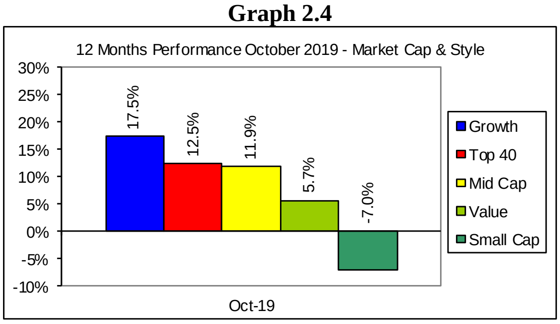
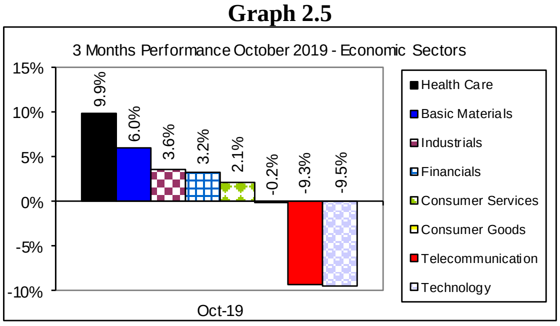
Graph 2.3



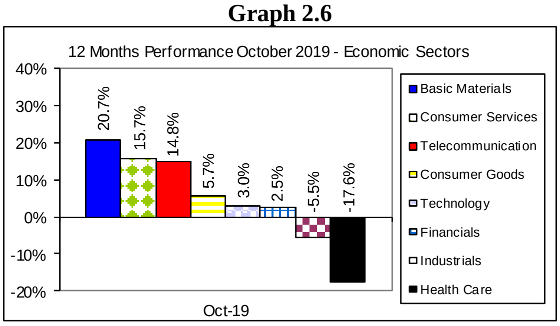
Graph 2.4



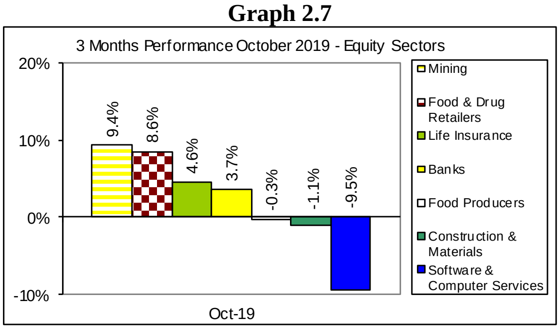
Graph 2.5



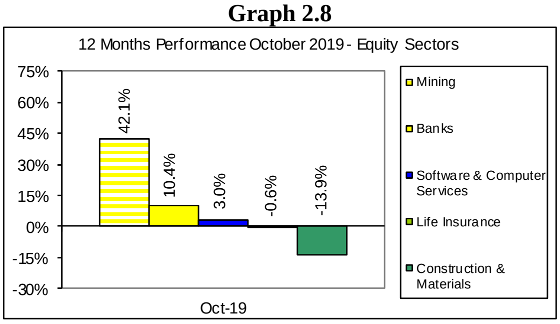
Graph 2.6



Graph 2.7



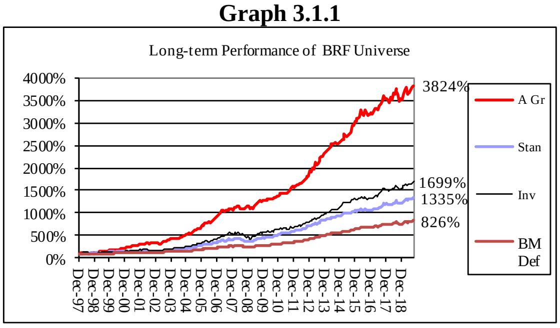
Graph 2.8



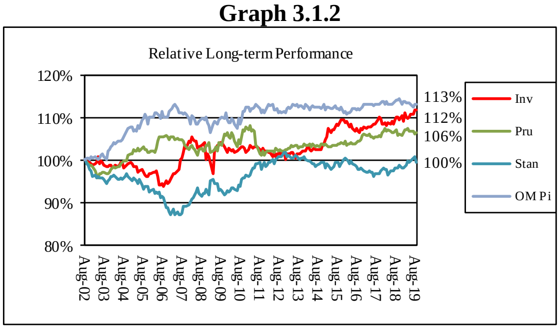
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1



Graph 3.1.2



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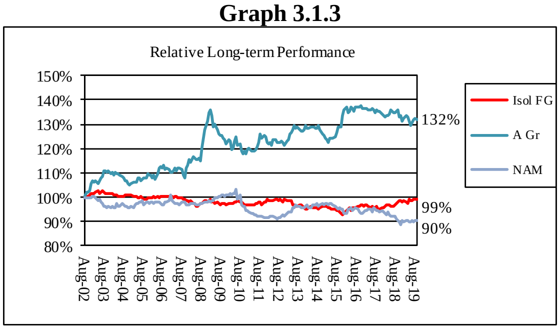
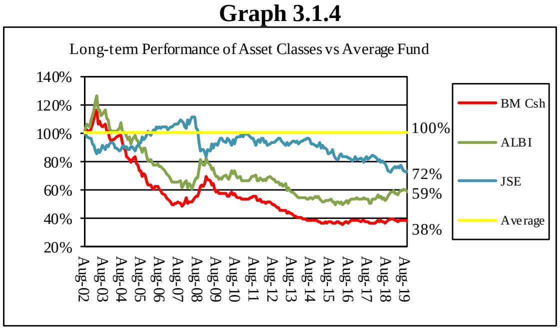
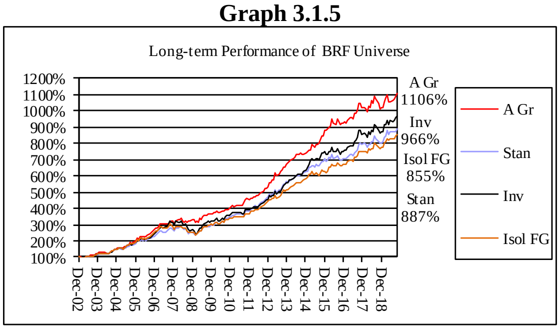
Graph 3.1.3



Graph 3.1.4

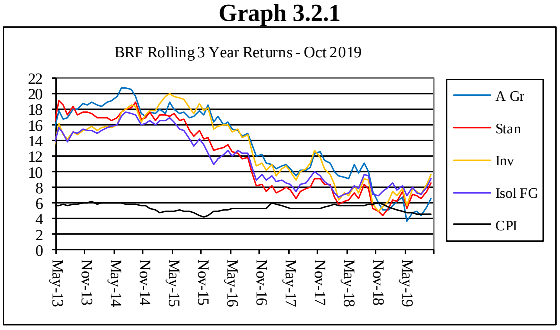


Graph 3.1.5

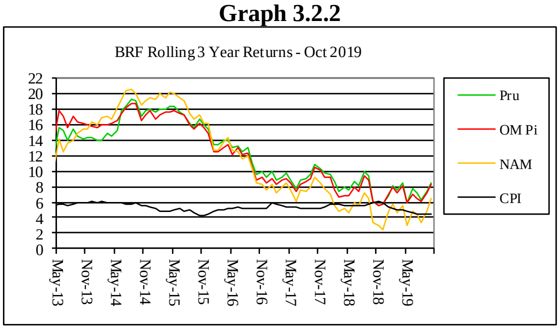


3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

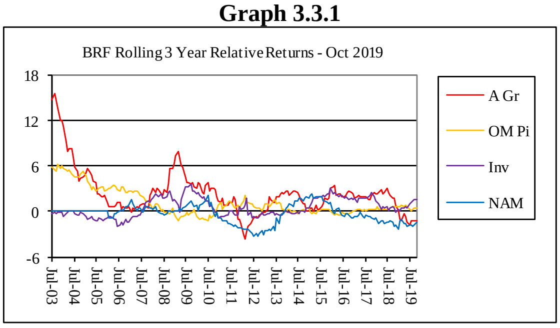


Graph 3.2.2

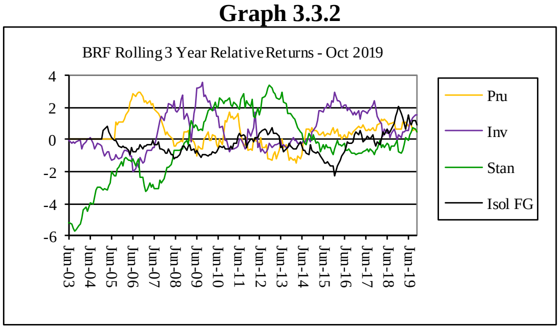


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

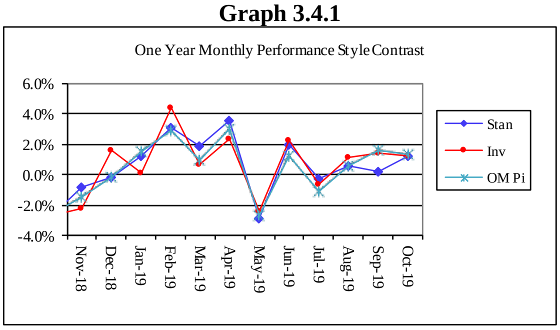


Graph 3.3.2



3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1



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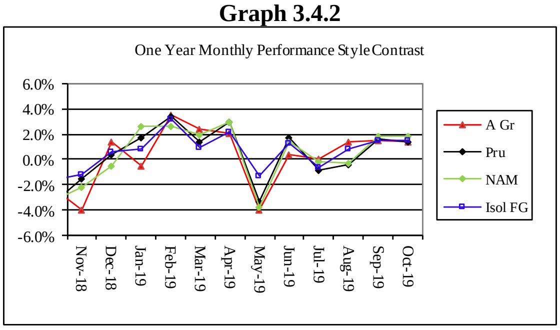
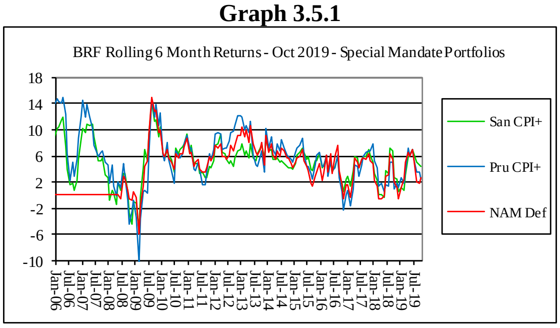
Graph 3.4.2

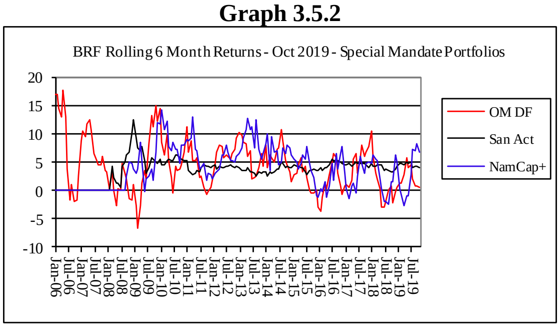


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

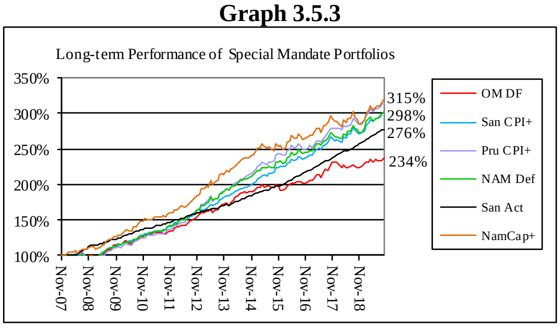
Graph 3.5.1



Graph 3.5.2

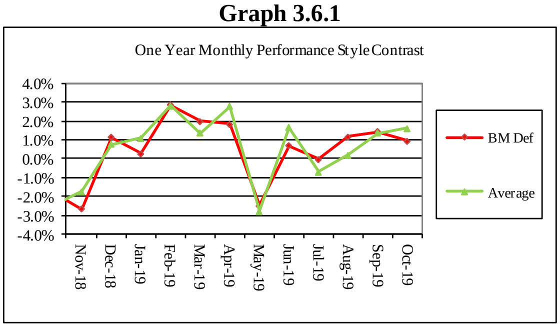


Graph 3.5.3

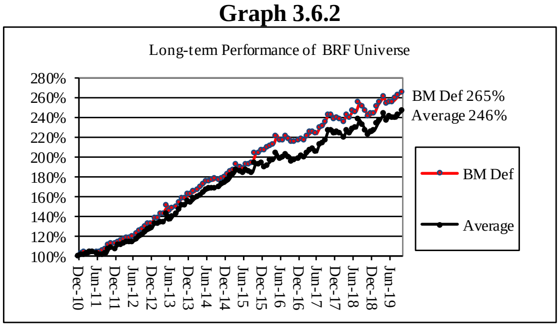


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

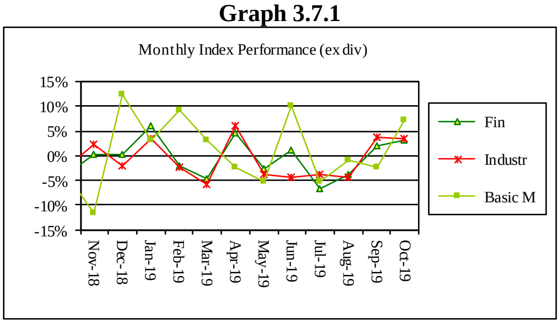


Graph 3.6.2

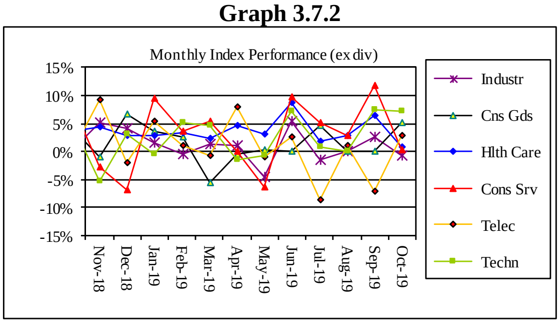


3.7 One-year monthly performance of key indices (excluding dividends)

Graph 3.7.1



Graph 3.7.2



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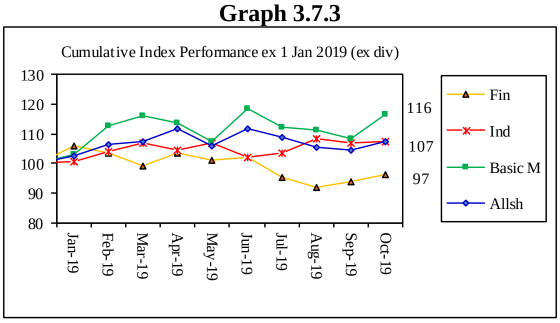
Graph 3.7.3



4. The Benchmark Default Portfolio – Facts in figures

Table 4.1

Portfolio	Default portfolio	Average Prud Bal
5-year nominal return - % p.a.	8.4	7.8
5-year real return - % p.a.	3.6	3.0
Equity exposure - % of portfolio (qtr end September 2019)	58.3	66.0
Cumulative return ex Jan 2011	165.0	146.5
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. 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.

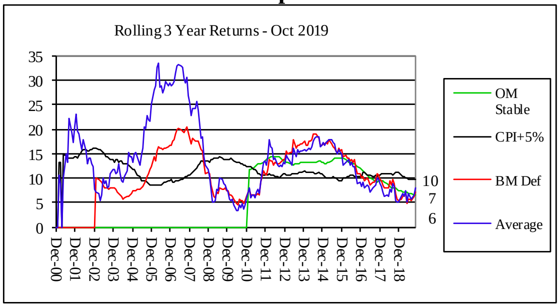
The default portfolio's long-term return must be read in the context of it initially having been managed with a low risk profile that was only changed from the beginning of 2011 when the Metropolitan Absolute Return fund was replaced with the Allan Gray balanced portfolio.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.9%	4.7%	5.0%
Best annual performance	8.2%	11.0%	10.1%
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	7.9%	8.2%	7.5%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years November 2016 to October 2019. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



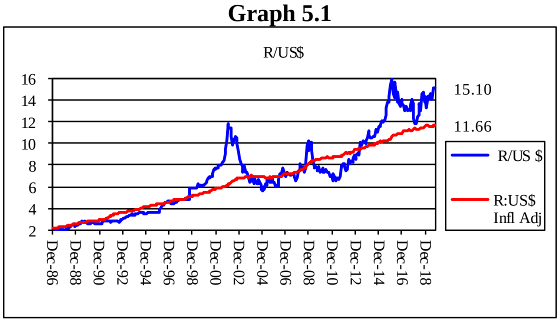
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3-year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end September was 7.3%, the average was 8.0% vs CPI plus 5% currently on 9.4%.

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 11.66 to the US Dollar while it actually stood at 15.10 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 strengthened by 0.44% in October with net foreign investment outflows from bonds and equities of R37.0 bn. Over the past 12 months the Rand weakened by 2.2%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 159.4 bn (outflow of 129.3 bn to end of September 2019).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 110.0 bn (September R 147.0 bn).

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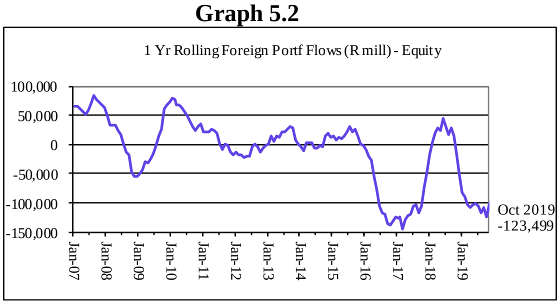
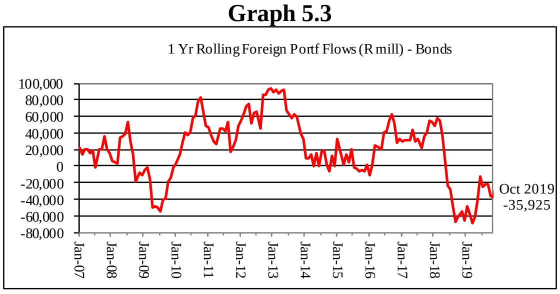
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 123.5 bn at the end of October (outflow of R 107.7 bn year-on-year to end September). The month of October experienced a net outflow of R 22.0 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 135.3 bn (end September net investment outflow of R 113.6 bn). This represents roughly 0.80% of the market capitalization of the JSE.

Graph 5.2



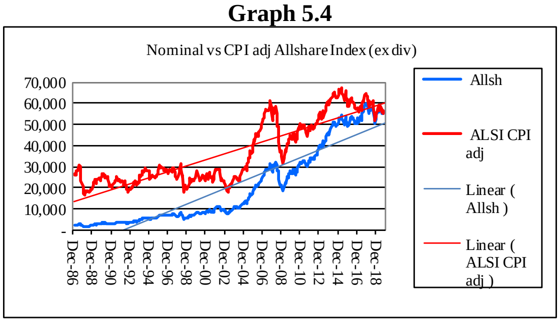
Graph 5.3 on a rolling one-year basis reflects foreign portfolio outflows in respect of SA bonds of R 36.0 bn over the past 12 months to end of October (outflow of R 21.6 bn over the 12 months to end of September). The month of October experienced a net outflow of R 15.2 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 245.3 bn (to September R 260.5 bn).

Graph 5.3



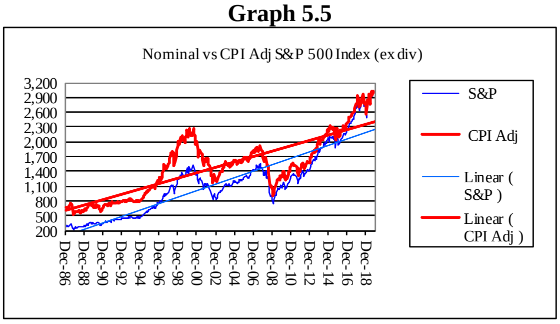
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.7% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.0% per year. 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



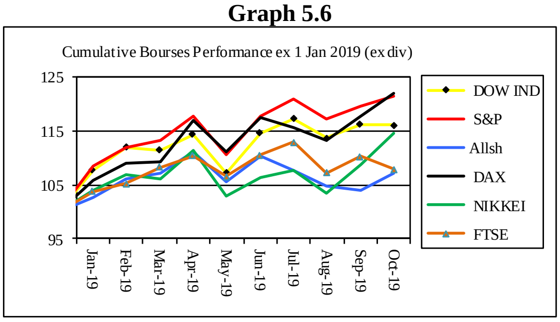
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.6% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 5.0% p.a. over this period, excluding dividends or around 7.2% including dividends.

Graph 5.5



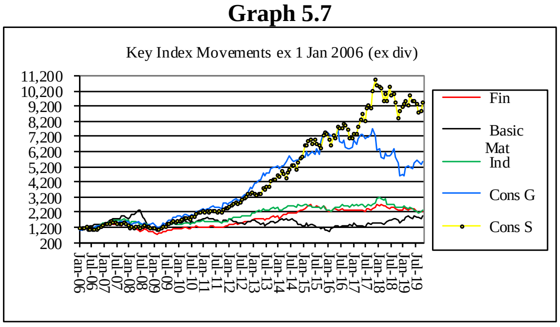
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 17.5%; Consumer Goods: 13.1%; Financials: 6.1%; Industrials: 6.2%; and Basic Materials: 4.8%.

Graph 5.7



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6. Evaluating your investment managers and your investment portfolio

by Tilman Friedrich

When evaluating investment managers, the text books will tell you that you should consider the 6 P's:-

- the people responsible for managing the portfolio;
- the philosophy applied in managing the portfolio;
- the process followed in managing the portfolio;
- the characteristics and composition of the product or products available for investment;
- the price charged for managing the portfolio;
- the performance track record of the portfolio.

Of these, only performance is an objective measure. All the other criteria are subjective and require the person who evaluates them to apply his personal judgment in order to reach a conclusion. If one uses a team of people to individually apply their personal judgment in order to arrive at a team conclusion, the end result will be a moderated average of the judgment of each team member. One may apply weightings to these criteria to give the individual, subjective assessment an additional subjective twist. To be honest though, the fact that a manager has a track record and has demonstrated resilience through different economic cycles should offer sufficient comfort that all of the above P's other than performance track record can be ticked off.

When one considers performance track record, every expert will tell you that you cannot place any value on this criterium as historic performance gives no reliable indication of future performance and this has been shown to be true by just about every piece of research that has ever been published on this topic, but it is the only measurable criterium. When you consider all the criteria, aren't you also only looking at historic evidence in any event, even if it was obtained a minute ago – it is history when you look at it and there is no way you can be sure that what you have seen today will be the same you will see tomorrow, as long as you consider anything that involves people.

One may try to bring the historic track record of a manager into the context of economic and other environmental factors in an effort to use the deductions from the associations one believes to have identified to refine one's own view of their implications for the future. At the same time one would need to have a view on the future to bring these deductions into the right context with regard to the manager being evaluated. In the final analysis one will always look at history whenever one is evaluating an investment manager. One would have to be able to foresee the future if one wanted to avoid considering history but such skill is not bestowed upon any of us.

When evaluating an asset manager, one has to take comfort in only having a rear view mirror to decide on the way forward. One of the most common ways of evaluating a manager it to measure the manager's performance against that of other managers operating within the same mandate, also referred to as 'peers'. For pension funds the typical mandate is a balanced prudential mandate, in other words, the manager has to observe the maximum and minimum exposures to certain asset classes and assets defined by the regulator.

Graphs 6.1 and 6.2 below measure peer performance of 7 prudential balanced portfolios. More specifically it measures the cumulative out- or underperformance of the managers relative to the average prudential balanced portfolio. The average balanced portfolio is represented by the straight horizontal line at 100%.

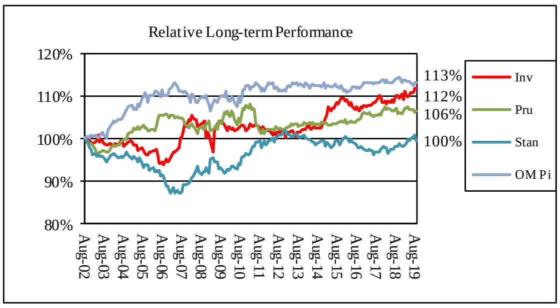
In Graph 6.1 we see that the Old Mutual Pinnacle portfolio incrementally out-performed the average from August 2002 until the end of 2006 and then essentially maintained the gap it had built up over the first 4 years at 13% to October 2019.

Investec underperformed the average for the first 4 years to then start outperforming incrementally, reaching a 12% cumulative out-performance by the end of October 2019.

Prudential initially underperformed for about a year to then maintain a consistent outperformance ending up at 6% at the end of October 2019.

Stanlib underperformed incrementally for the first 5 years, to then pick up to the average and ending up on par with the average at the end of October 2019.

Graph 6.1



In graph 6.2 we see Allan Gray incrementally out-performing the average up to the end of 2015 and from then on losing a little bit of the cumulative outperformance and ending up at an outperformance of 32% at the end of October 2019.

Investment Solutions did quite a good job in performing on the average for the full period. This is a multi-manager comprised of a number of building blocks

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 OCTOBER 2019

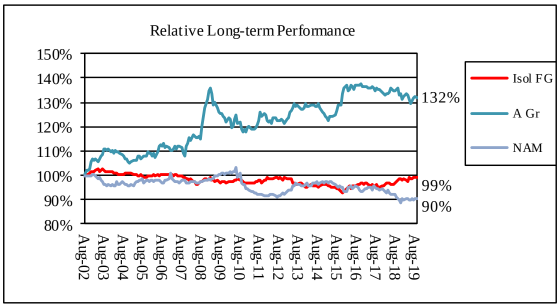
By T H Friedrich – Retirement Fund Solutions Namibia (Pty) Ltd

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

consisting of other managers with a specialist mandate, but in aggregate also representing a prudential balanced portfolio. Interestingly, this picture disproves the claim of multi-managers of achieving an incremental outperformance of the average manager through the intelligent combination of the best managers in different asset classes.

NAM/ Coronation marginally, but incrementally underperformed the average for the whole period ending up at an under-performance of 10%.

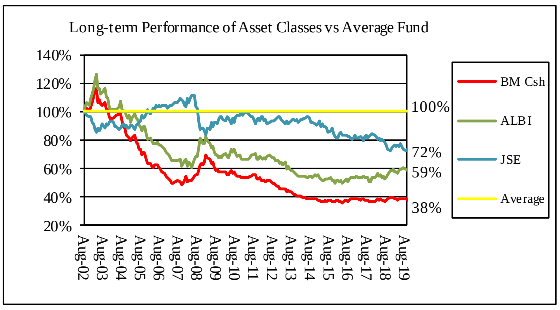
Graph 6.2



For those pension fund members who look at point in time performance of portfolios and might have switched or considered to switch to a money market portfolio in view of the poor performance of the prudential balanced portfolios, graph 6.2 should be an eye opener. This graph again reflects the average prudential balanced portfolio as the horizontal line at 100%. It also reflects the cumulative under- or out-performance of the different asset classes relative to the average prudential balanced portfolio.

It shows that as the result of the poor performance of equities as represented by the 'JSE' for the first 4 years, the all bond (ALBI) and cash indices (BM Csh) out-performed the average prudential balanced portfolio for the first 3 years. Ever since the beginning of 2005 however, the bond and cash indices incrementally underperformed the average prudential balanced portfolio except for a short period from the end of 2007 to the end of 2009, representing the peak of the financial crisis. We see that despite the average prudential balanced portfolio's poor performance over the past 7 years, cash has only been able to maintain the gap over the past 6 years, but has not been able to reduce he gap and ends up with an under-performance of 62% at the end of October 2019! Finally we see that the all bond index actually managed to close the gap slightly since the beginning of 2018 but has still underperformed the average prudential balanced portfolio by 41% at the end of October 2019!

Graph 3



Conclusion

As we and every other commentator have cautioned so often before, the above graphs clearly show that the prudential balanced portfolio is the most appropriate investment portfolio for pension fund members over any period longer than 2 to 3 years. To try and capitalise on the short stints of outperformance of bonds and cash, or to avoid the short stints of underperformance of the prudential balanced portfolio, takes doing. As we see in the graphs above, these are usually very short periods of 2 to 3 years and it then requires the astute fund member to move out of the prudential balanced portfolio and back in again just at the right time. If we assume a 50% probability of each timing decision being spot on, between the two timing decisions, the total probability of picking the right moment for both moves is only 25%. In other words the chance of being wrong is 75%! One should thus never try to time the move and the objective of moving should not be to avoid a short-term blip but rather to avoid only the downside in accordance with the member's long-term financial planning.