Volume 15 No. 12
December 2019

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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

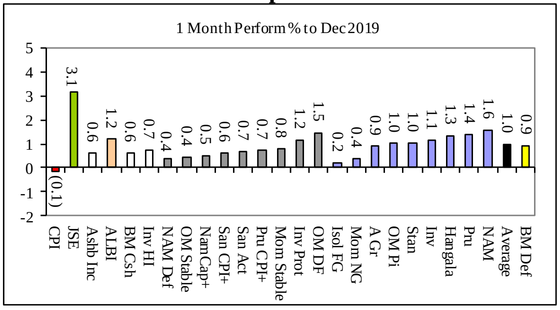
In December 2019 the average prudential balanced portfolio returned 1.0% (November 2019: -0.7%). Top performer is Nam Coronation Balanced Plus with 1.6%, while Investment Solutions with 0.2% takes the bottom spot. For the 3-month period, Namibia Coronation again takes the top spot, outperforming the 'average' by roughly 1.3%. On the other end of the scale Investment Solutions Fund underperformed the 'average' by 1.1%. 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.

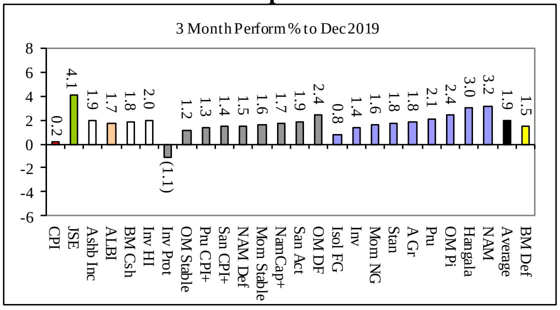
Below is the legend to the abbreviations reflected on the graphs:

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)
Ashburton Namibia Income Fund	Ashb Inc (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)

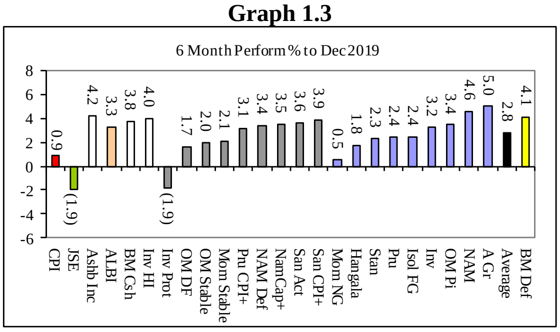
Graph 1.1



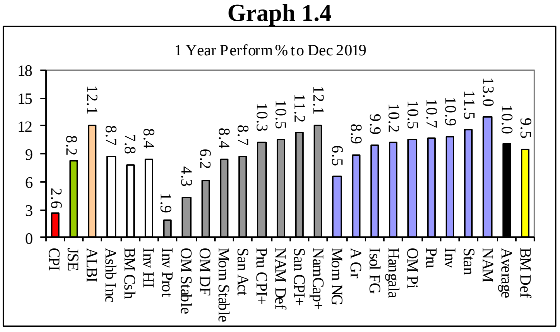
Graph 1.2



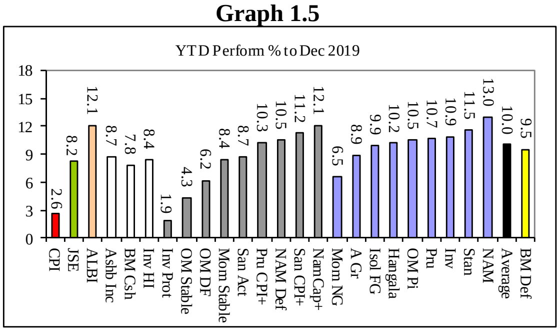
Graph 1.3



Graph 1.4



Graph 1.5



Volume 15 No. 12
December 2019

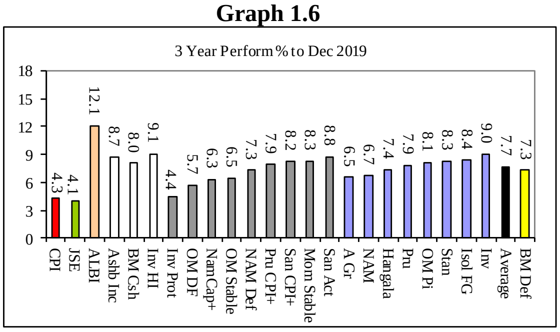
Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 2019

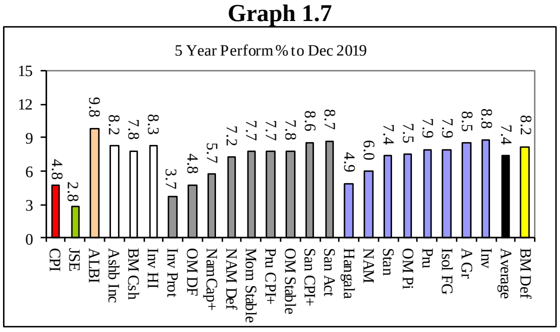
By T H Friedrich – Retirement Fund Solutions Namibia (Pty) Ltd

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

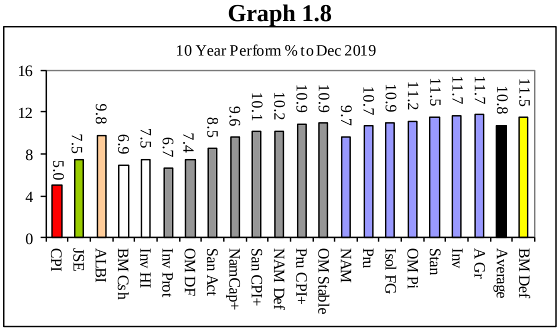
Graph 1.6



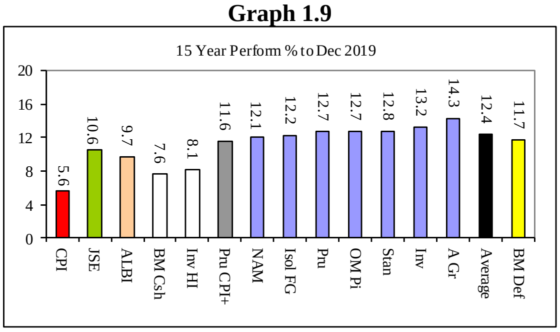
Graph 1.7



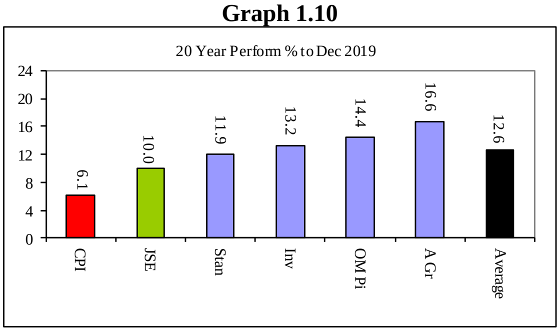
Graph 1.8



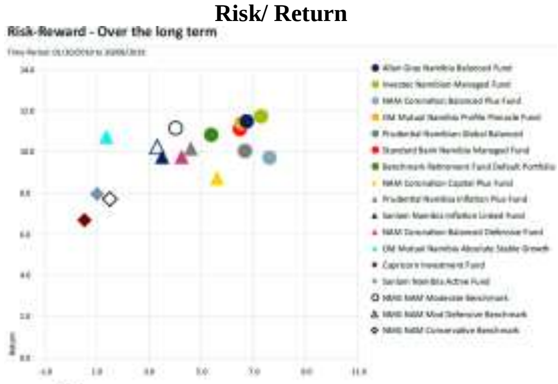
Graph 1.9



Graph 1.10

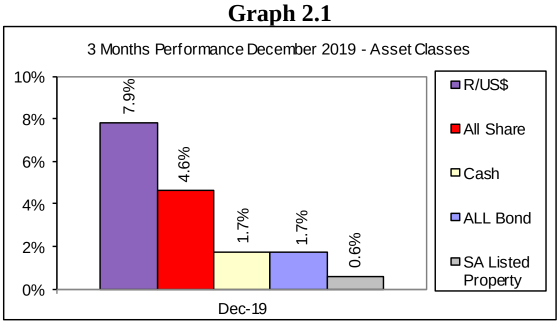


Risk/ Return

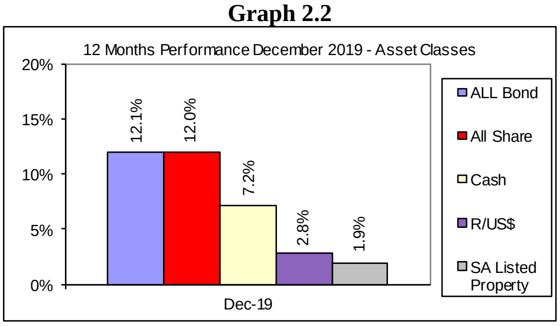


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



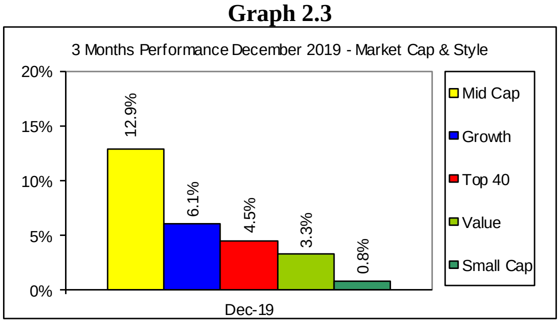
Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 2019

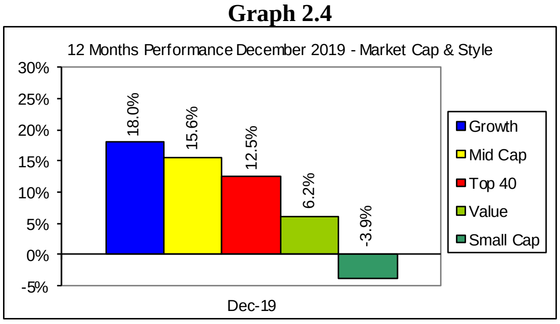
By T H Friedrich – Retirement Fund Solutions Namibia (Pty) Ltd

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

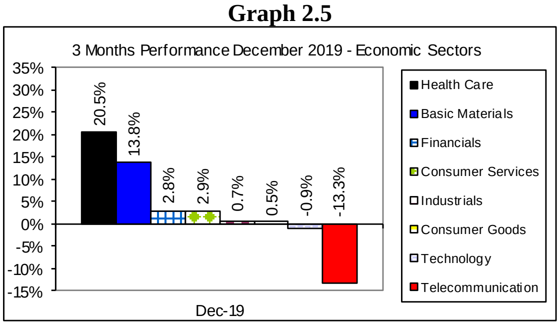
Graph 2.3



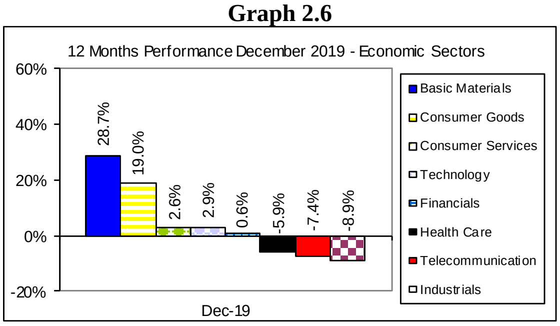
Graph 2.4



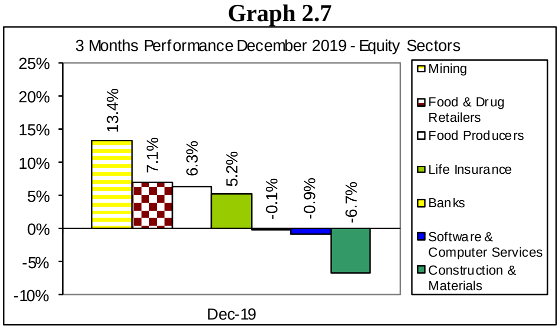
Graph 2.5



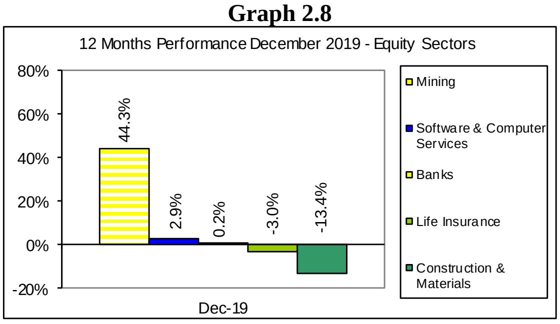
Graph 2.6



Graph 2.7



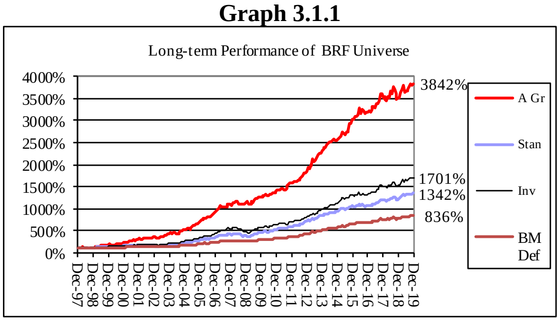
Graph 2.8



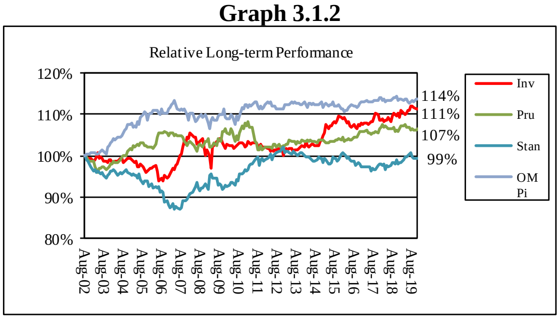
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1



Graph 3.1.2



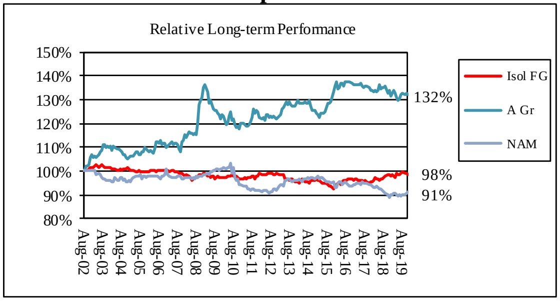
Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 2019

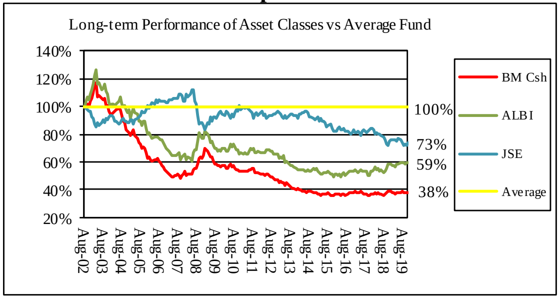
By T H Friedrich – Retirement Fund Solutions Namibia (Pty) Ltd

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

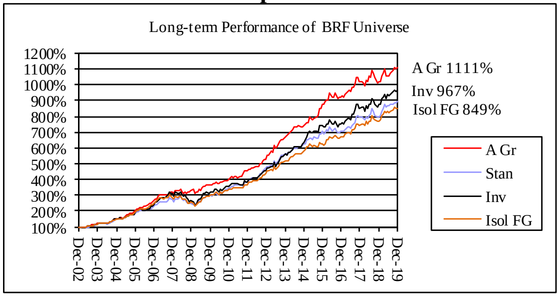
Graph 3.1.3



Graph 3.1.4

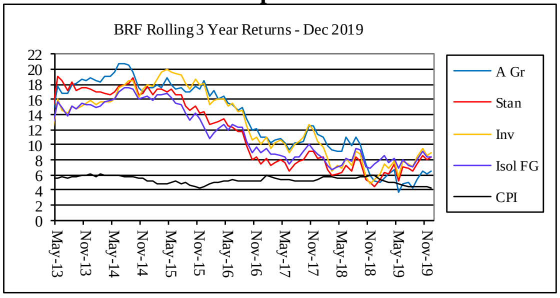


Graph 3.1.5

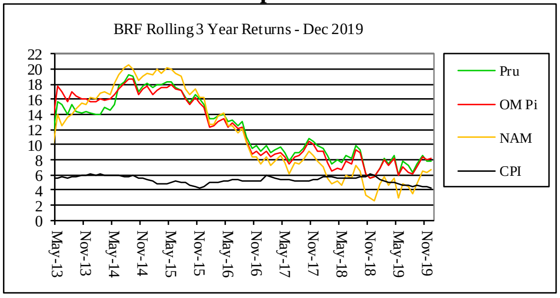


3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

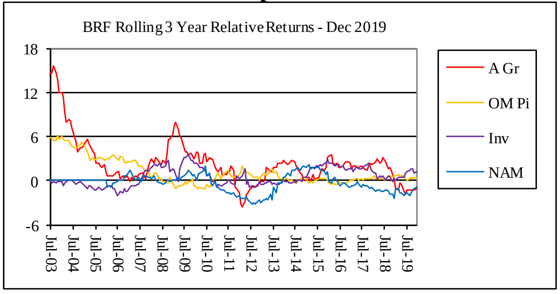


Graph 3.2.2

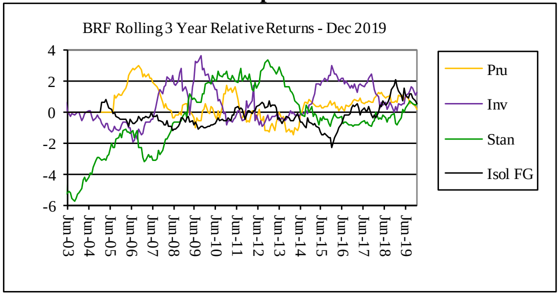


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

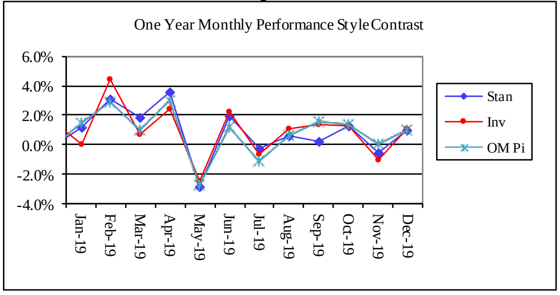


Graph 3.3.2



3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1



Volume 15 No. 12
December 2019

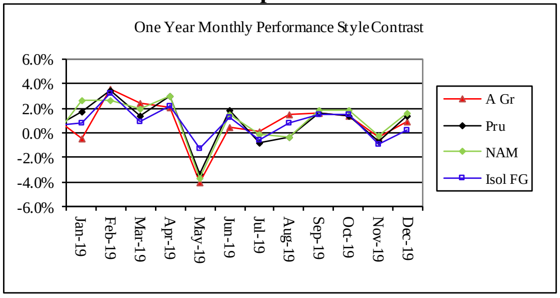
Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 2019

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

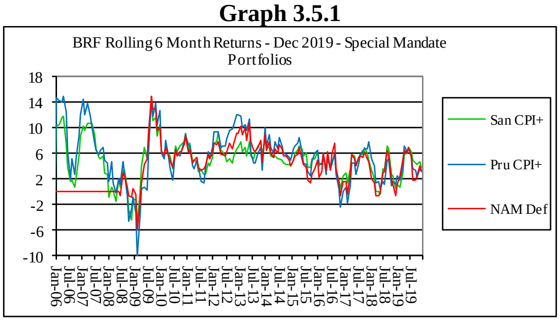
The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

Graph 3.4.2

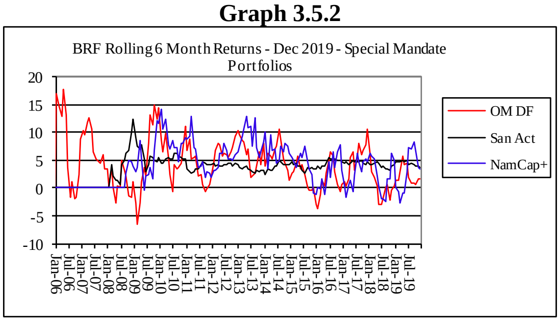


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

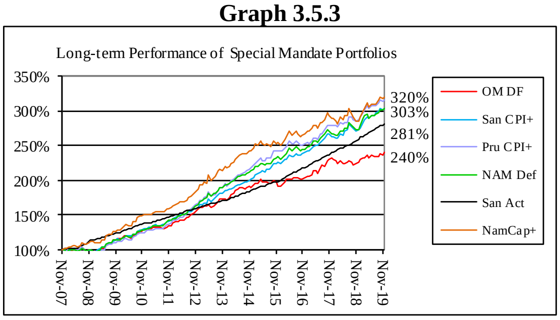
Graph 3.5.1



Graph 3.5.2

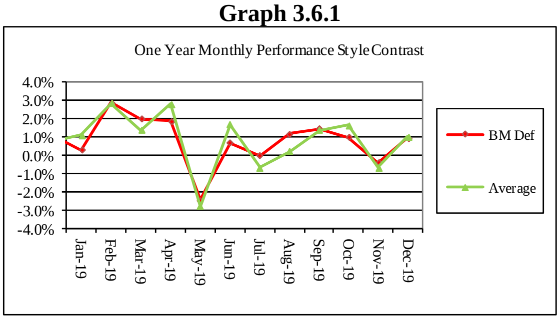


Graph 3.5.3

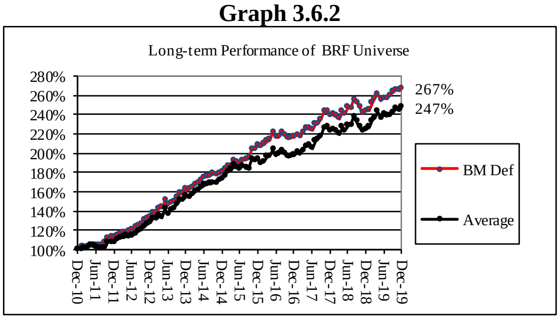


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

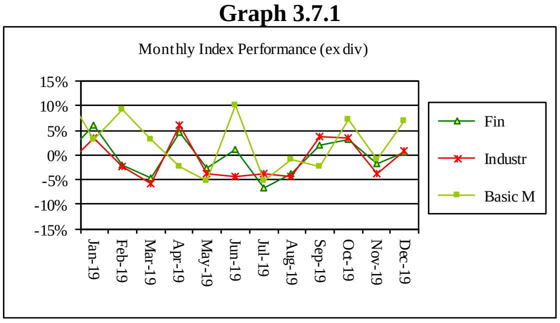


Graph 3.6.2

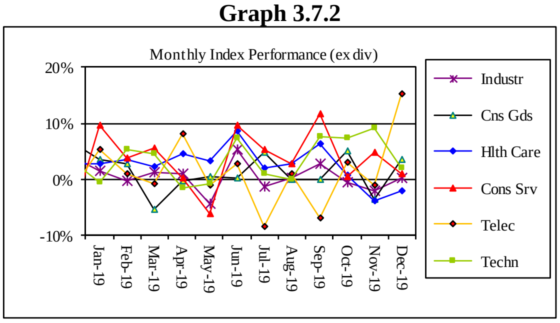


3.7 One-year monthly performance of key indices (excluding dividends)

Graph 3.7.1



Graph 3.7.2



Volume 15 No. 12
December 2019

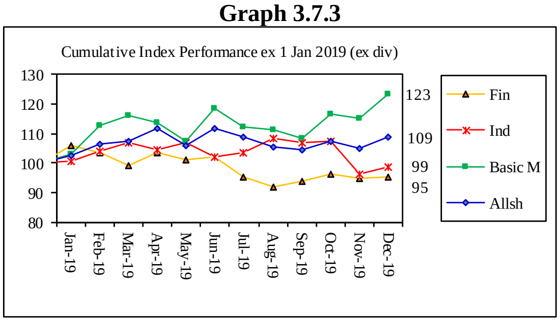
Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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.

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.	8.2	7.4
5-year real return - % p.a.	3.4	2.6
Equity exposure - % of portfolio (qtr end September 2019)	48.3	66.0
Cumulative return ex Jan 2011	167.4	147.3
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.

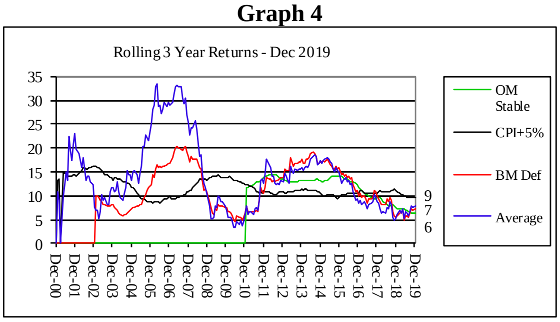
The default portfolio's long-term return must be read in the context of it initially having been managed with a low risk profile that was only changed from the beginning of 2011 when the Metropolitan Absolute Return fund was replaced with the Allan Gray balanced portfolio.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	7.1%	4.8%	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%	8.1%	7.4%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years January 2017 to December 2019. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



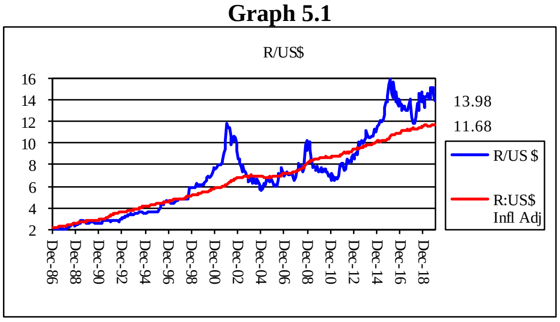
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3-year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end December was 7.3%, the average was 7.7% vs CPI plus 5% currently on 9.3%.

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 11.68 to the US Dollar while it actually stood at 13.98 at the end of December. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1



The Rand strengthened by 4.6% in December with net foreign investment inflows into bonds and equities of R5.4 bn. Over the past 12 months the Rand strengthened by 2.9%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 136.0 bn (outflow of R 169.0 bn to end of November 2019).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 86.9 bn (November R 81.5 bn).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 114.0

Benchmark Retirement Fund

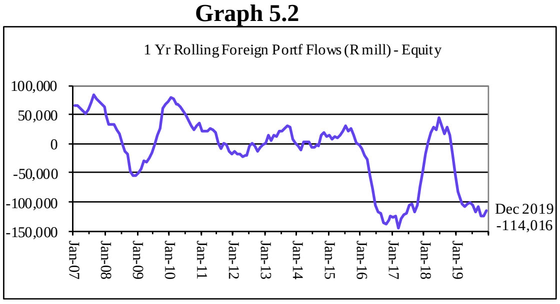
MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 2019

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.

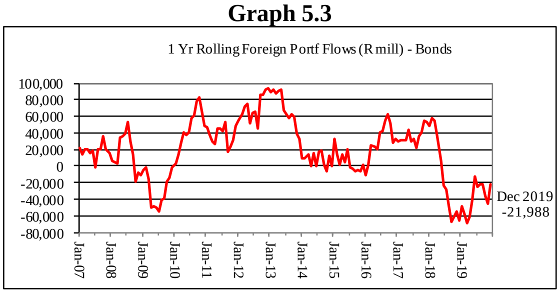
bn at the end of December (outflow of R 124.2 bn year-on-year to end November). The month of December experienced a net outflow of R 2.0 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 158.1 bn (end November net investment outflow of R 156.1 bn). This represents roughly 0.90% of the market capitalization of the JSE.

Graph 5.2



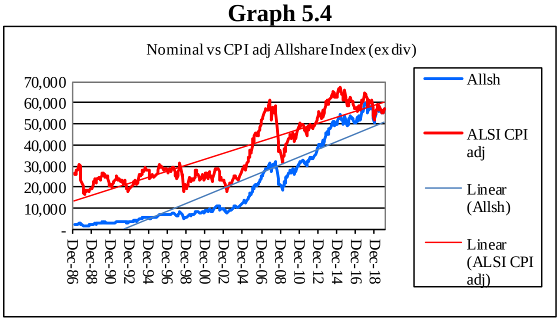
Graph 5.3 on a rolling one-year basis reflects foreign portfolio outflows in respect of SA bonds of R 22.0 bn over the past 12 months to end of December (outflow of R 44.8 bn over the 12 months to end of November). The month of December experienced a net inflow of R 7.3 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 244.9 bn (to November R 237.7 bn).

Graph 5.3



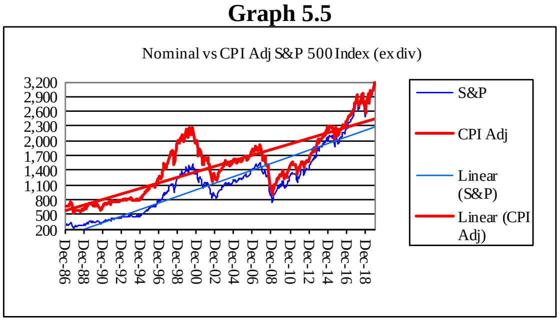
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.7% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 7.9% per year. This is equivalent to a growth in real terms of 2.8% p.a. over this period, excluding dividends, or around 5.9% including dividends.

Graph 5.4



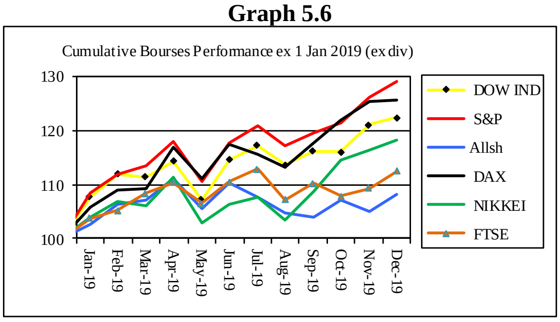
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.7% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 5.1% p.a. over this period, excluding dividends or around 7.3% including dividends.

Graph 5.5



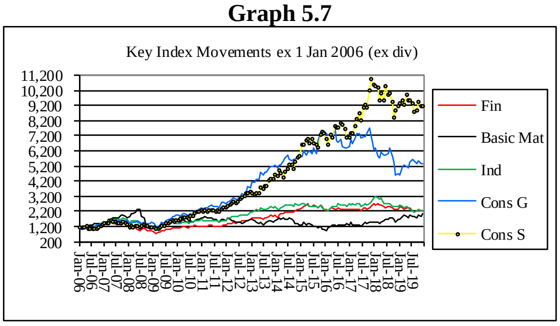
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2019.

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: 17.0%; Consumer Goods: 12.7%; Financials: 5.9%; Industrials: 5.8%; and Basic Materials: 5.2%.

Graph 5.7



Volume 15 No. 12
December 2019

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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.

6. How to invest in 2020?

by Tilman Friedrich

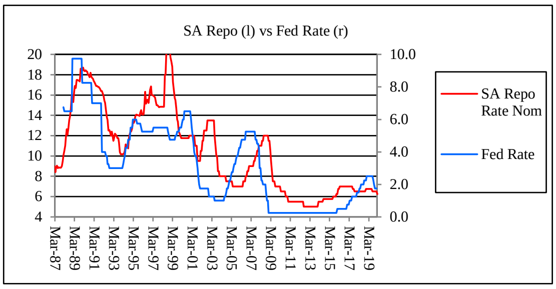
In last month's investment commentary we expressed our opinion that there will be no return to a normal interest rate environment in 2020 but rather expect real interest rates to decline further some into more negative territory. Over the month to end December, the US repo rate in real terms declined another 0.25% into negative territory thus presenting a negative real return of 0.5%. Investors thus actually pay the borrower (the US Fed in this instance) for the privilege of lending money to the Fed. This is not sustainable in the long-run as investors will always be looking for opportunities to earn positive real rates in order to be compensated for the risk of not receiving back the money lent. While we linger in such an abnormal interest rate environment, valuations of all other assets are skewed. If you have to pay for lending money to government you will be prepared to accept a lower return on alternative investments, as long as the risk-adjusted return beats the return on money lent to government. The consequence of the lower return expectation is that the underlying investment will have a higher value, i.e. you will be prepared to pay more for the same annual dividend or annual interest return you will get from that investment.

At this point in time therefor, investors are paying more for their investments than fundamentals would normally dictate. Investors will be watching out for any signs of interest rates moving back to a normal situation in order not to be caught off-guard. Company earnings of course determine how much the investor is prepared to pay for the share as they ultimately determine the dividend the company will be able to pay. In this regard it is important to understand whether company earnings are likely to rise or to decline.

Interest rates

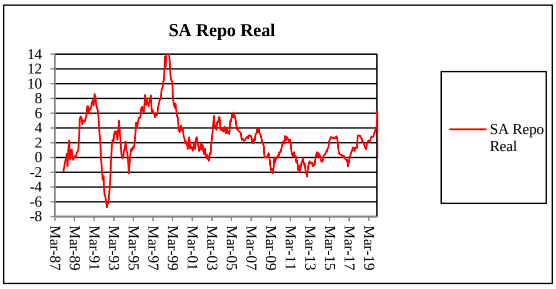
In last month's newsletter we expressed our view that global consumer and investor sentiment should stand a fair chance of improving rather than declining further taking into account good early rains, a possible settlement of the US/ China trade war and the fact that the SA economy is about as low as it can go. We also expressed our expectation that the trend in interest rates to be downward. We would ascribe this primarily to the fact that the US will be holding presidential elections this year and that president Trump considers the US stock market as a measure of his success. Low interest rates are good for equities. At least for 2020, we are unlikely to see an increase in the Fed rate. Whatever the US does will be mirrored in other economies. Graph 6.1 substantiates this, showing a very close correlation between the SA repo rate and the Fed rate over this 30 year plus period. Interestingly, this graph indicates that the risk premium attaching to SA interest rates is around 5% as represented by the differential in the scale on the left, and the right hand axis. As we know, SA Reserve Bank just lowered the repo rate by 0.25% as from 16 January 2020, after the Fed had lowered its policy rate by 0.25% at the end of October last year.

Graph 6.1



Graph 6.2 shows a real SA repo rate of 3.9% at the end of December. The cut of 0.25% effective 16 January will result in a slight reduction of the real repo. On average the SA Reserve Bank maintained a real repo of around 3.5% until the global financial crisis and around 1% since then. At its current level, there is probably not much scope for a further reduction unless SA inflation was to decline further relative to US inflation or the Fed was to reduce its repo rate further.

Graph 6.2



Exchange rates

In graph 6.3 we see that the differential between the real repo rate and the real US Fed rate (red line) was varying widely up until about 1999 to become more confined to a narrower band between minus 6% and 4%. We also see that since 1999 the graph displays a high correlation between the R: US$ exchange rate (blue line) and the differential in real interest rates up until the end of 2012. Up to then a decline in the red line (SA real interest rate increases relative to the US Fed rate) went along with a strengthening of the Rand and vise-versa. As from the end of about 2012 we see a disconnection between these two lines. SA real interest rate relative to US real interest rate increased consistently while the Rand weakened consistently against the US$. Graph 5.1 above indicates by the measures applied that the Rand is undervalued and that the exchange rate should rather be 11.68 then 13.98 at the end of December. Graph 6.2 thus corroborates this

Volume 15 No. 12
December 2019

Benchmark Retirement Fund

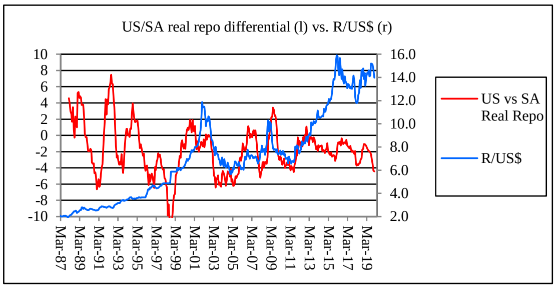
MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 2019

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.

conclusion. The red line of course does not recognise the cumulative effect of an inflation differential as the blue line does. A continuously higher inflation rate in SA relative to the US should lead to a continuous depreciation of the Rand, as graph 5.1 above does portray better.

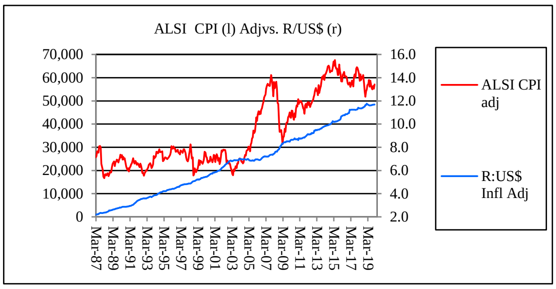
Graph 6.3



The stock exchange

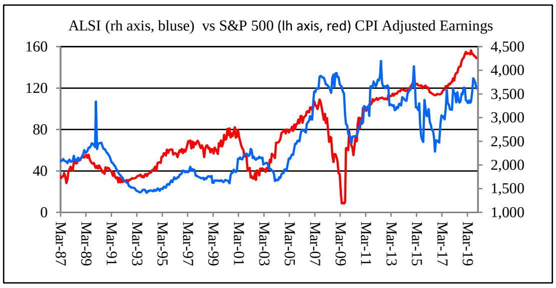
Graph 6.4 shows a very similar trend of the blue line (the inflation adjusted R: US$ exchange rate) and the red line (JSE ALSI, inflation adjusted). Over the first 14 years to the beginning of 2001, the ALSI basically moved sideways while the inflation adjusted exchange rate played catch-up. Since then the ALSI initially 'went ballistic' to early 2007, just to revert back to normal by early 2009 as the result of the global financial crisis. It then turned sharply up again until early 2014, to move onto a downward slide where it is currently not far off the blue line that can probably be considered 'ground zero'.

Graph 6.4



Graph 6.5 shows a correlation of SA and US CPI adjusted earnings over the 30 plus year period. From the end of 2016 however, SA CPI adjusted earnings moved sideways while US CPI adjusted earnings continued to increase. Both lines show a decline in CPI adjusted earnings over the past 3 months. Average US CPI adjust historic earnings over this 30 year plus period were 75 whereas at the current level of around 150, they are now about twice their historic average. Average SA CPI adjust historic earnings over the same period were 2,500 whereas at the current level of around 3,600, they are now about 45% higher than their historic average. This could at least partially be due to a change in the economies and consequent the make-up of the earnings.

Graph 6.5



Conclusion

Based on our above analysis, we see no increase in interest rates for 2020 in the US or in SA, everything being equal, perhaps still another reduction. We also believe there is not much scope for further reductions in the SA repo rate except if SA inflation dropped relative to US inflation or if the US reduced the Fed rate further. The Rand is currently noticeably undervalued. This is probably due to the poor shape of the SA economy which of course is unlikely to improve much over the medium term, particularly in the absence of another commodity run. That also does not seem to be on the horizon. We rather see a slow improvement on the back of a slow improvement in global economies and the settling of the US: China trade dispute. The Rand is thus likely to remain under valued in the medium term. We certainly do not see a rapid correction. Company earnings being as high as they are both in SA and much more so in the US, there is little support of equities deriving from improving company earnings but to some extent by declining interest rates.

Equities will unlikely deliver the two-digit returns we have seen in the past, in 2020, but are expected to out-perform cash returns slightly, i.e. in the region of 7% to 10%. Since we do not expect interest rates to decline much further, and certainly not to increase, bonds should deliver a return of around 10%, i.e. above that of equities and cash. Property is likely to remain in the doldrums for next year. Our expectations of the returns on the various asset classes for 2020 would suggest a conservative portfolio with a fair spread across global investment markets.

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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.