Volume 16 No. 07
July 2020

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 July 2020

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

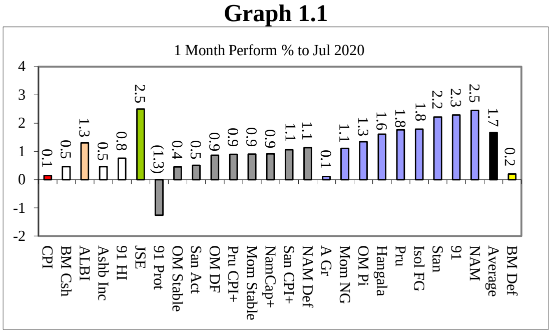
In July 2020 the average prudential balanced portfolio returned 1.7% (June 2020: 2.3%). Top performer is NAM Coronation Balanced Plus Fund with 2.5%, while Allan Gray Balanced Fund with 0.1% takes the bottom spot. For the 3-month period, NAM Coronation Balanced Plus Fund takes the top spot, outperforming the 'average' by roughly 2.2%. On the other end of the scale Allan Gray Balanced Fund underperformed the 'average' by 3.1%. 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.

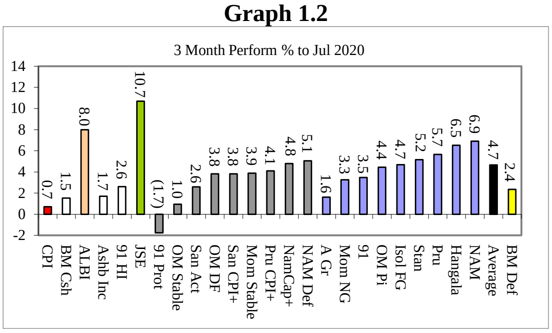
Below is the legend to the abbreviations reflected on the graphs:

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)
NinetyOne Managed	91 (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)

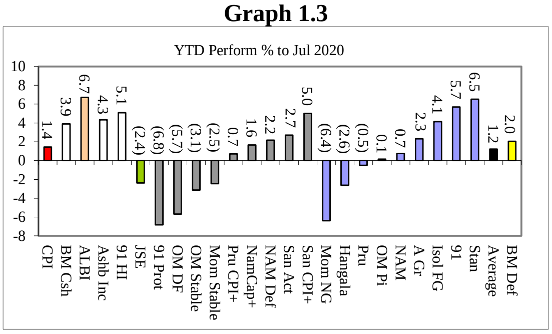
Graph 1.1



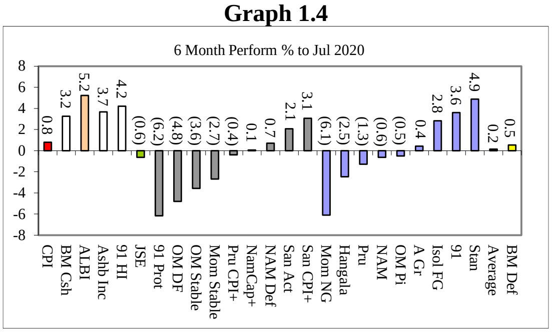
Graph 1.2



Graph 1.3



Graph 1.4



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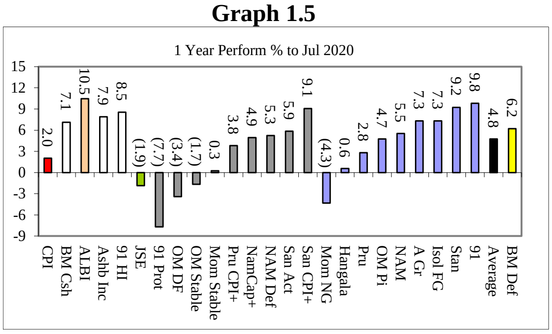
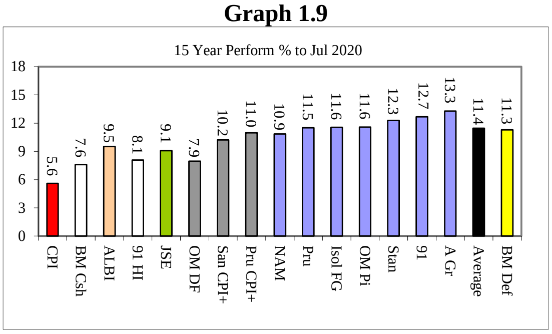
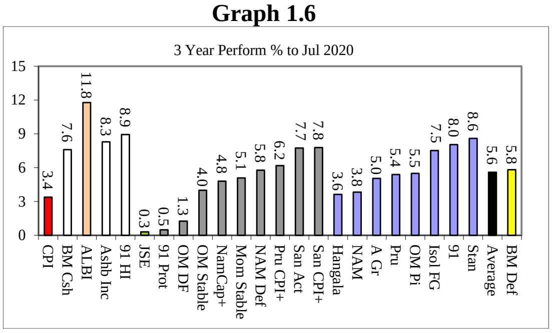
Graph 1.5



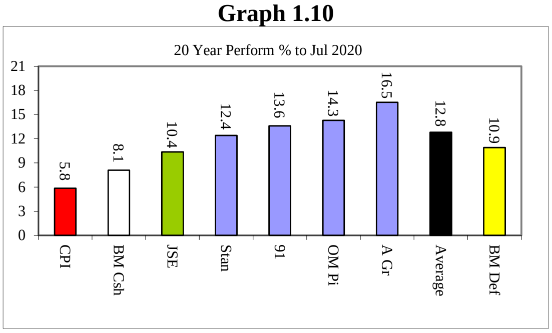
Graph 1.9



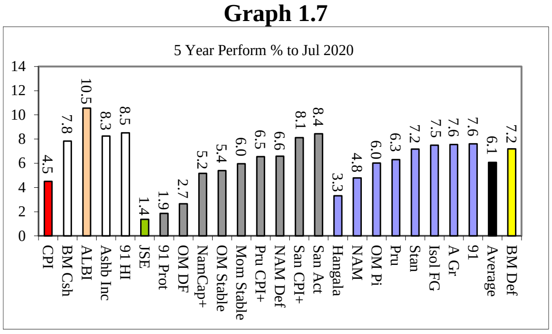
Graph 1.6



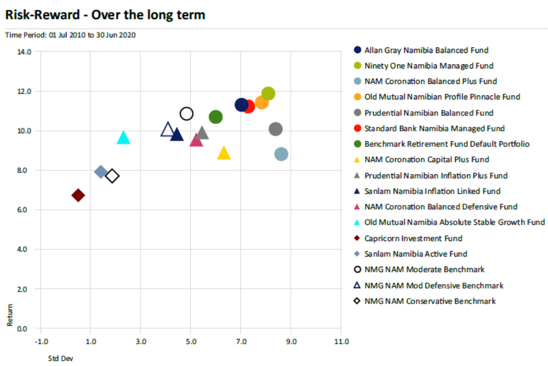
Graph 1.10

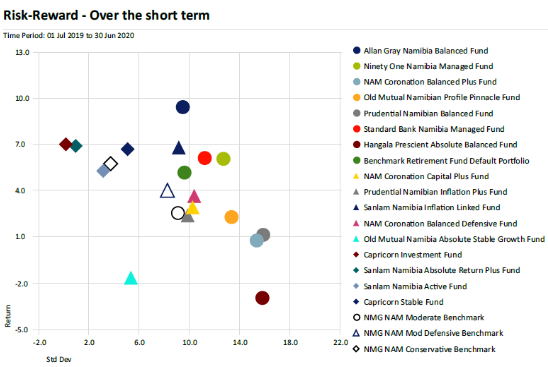


Graph 1.7

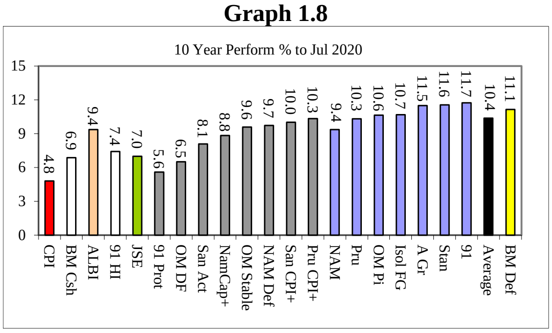


Risk/ Return





Graph 1.8



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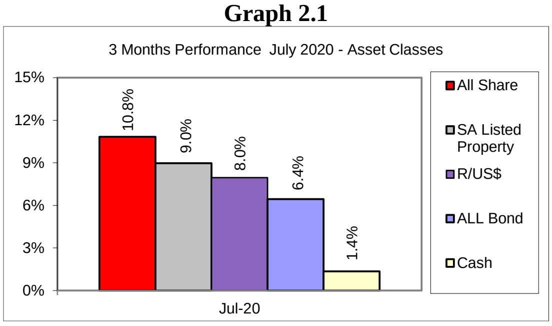
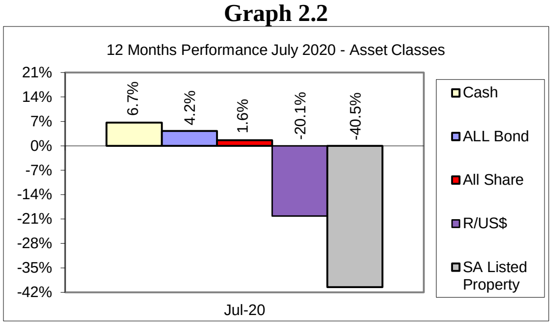
2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

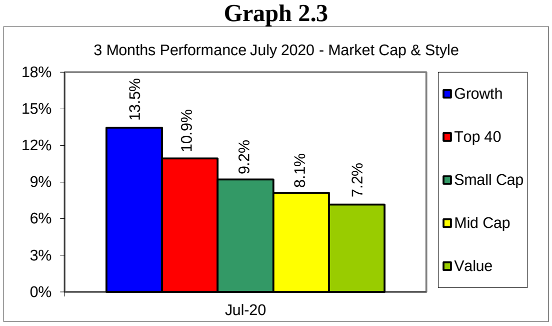
Graph 2.1



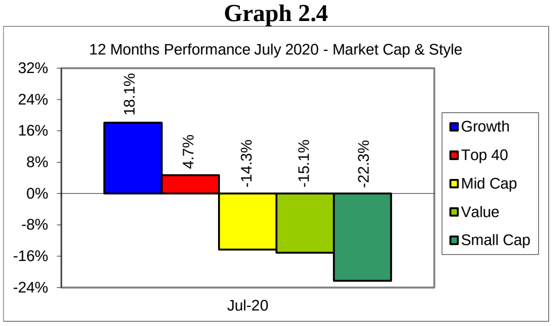
Graph 2.2



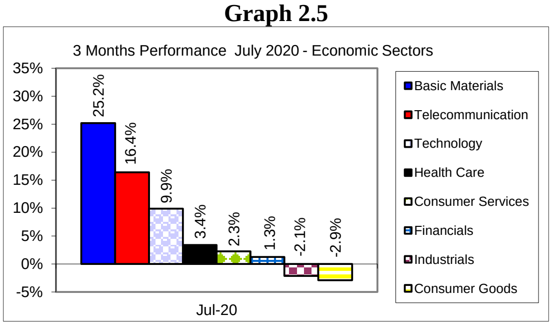
Graph 2.3



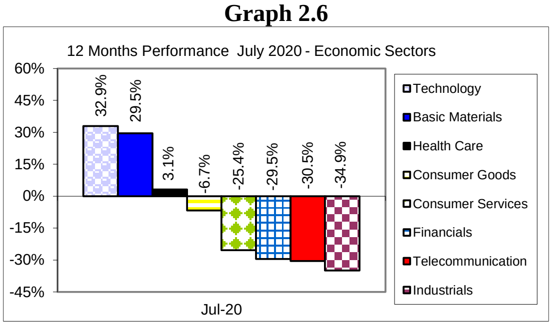
Graph 2.4



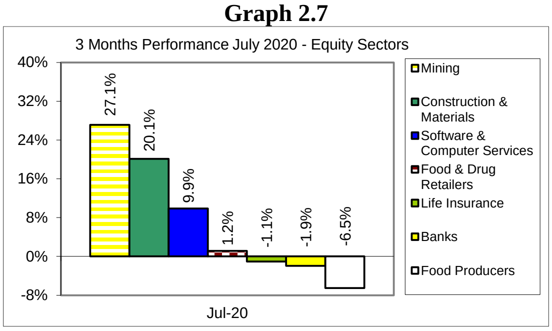
Graph 2.5



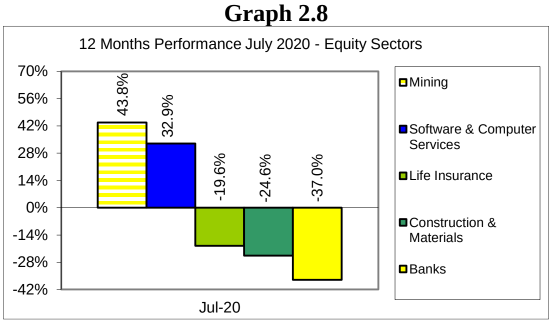
Graph 2.6



Graph 2.7



Graph 2.8



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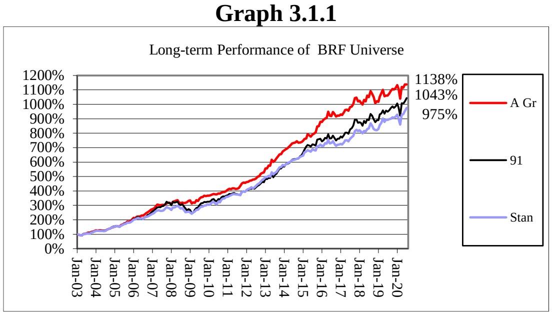
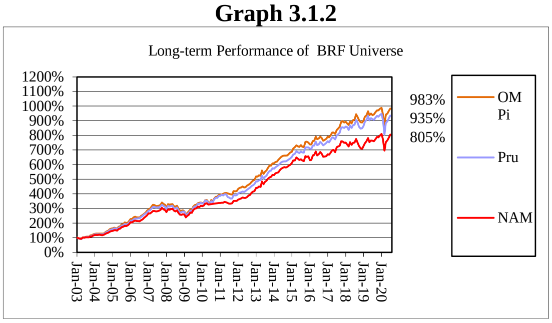
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

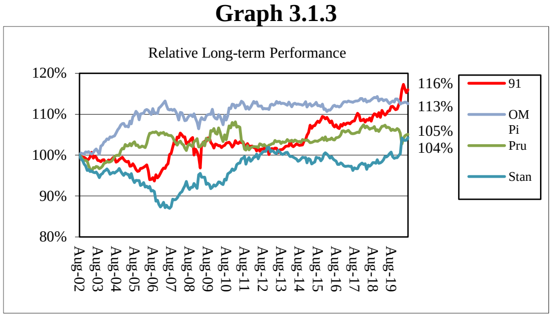
Graph 3.1.1



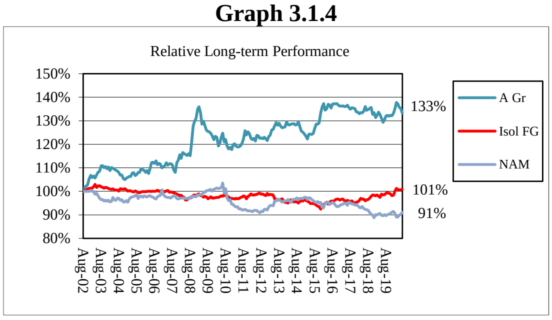
Graph 3.1.2



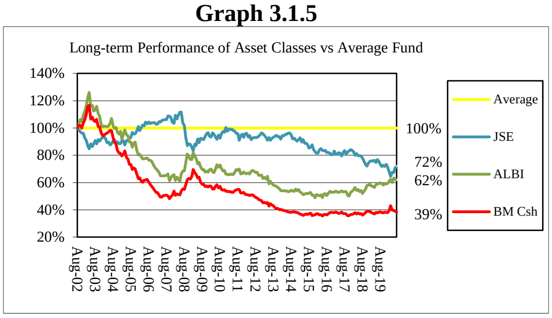
Graph 3.1.3



Graph 3.1.4

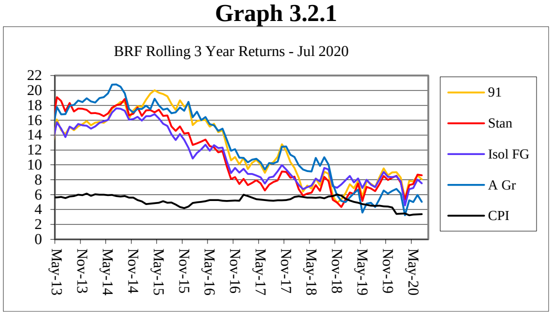


Graph 3.1.5

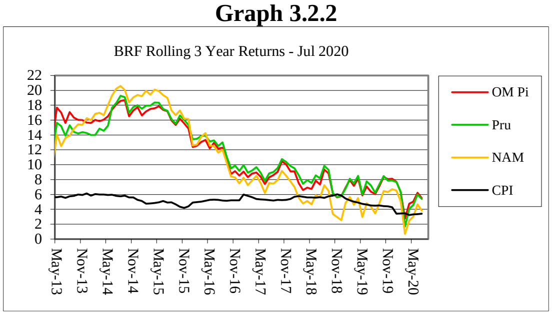


3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

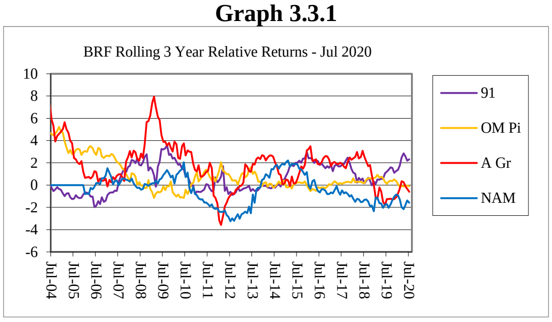


Graph 3.2.2



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

Graph 3.3.1



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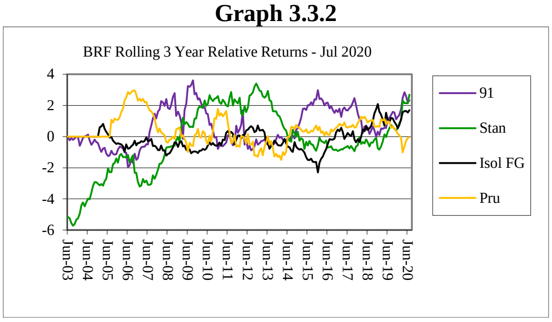
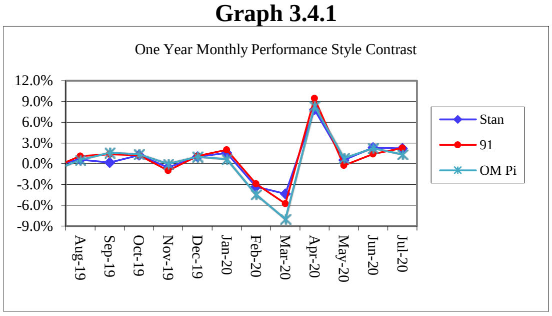
Graph 3.3.2

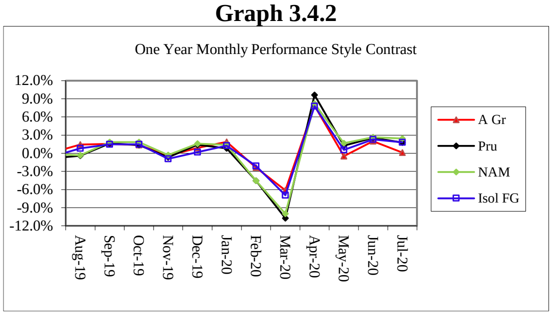


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

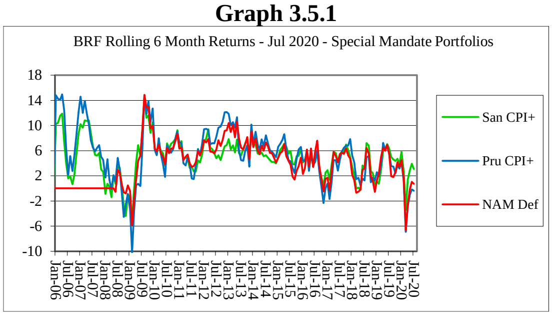


Graph 3.4.2

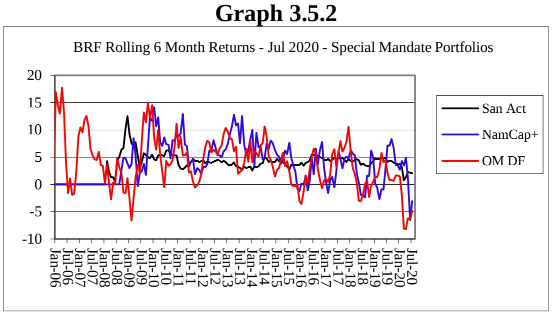


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

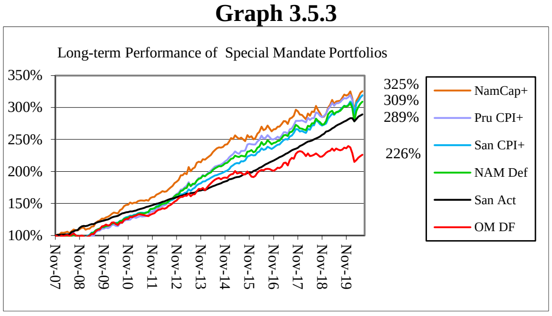
Graph 3.5.1



Graph 3.5.2

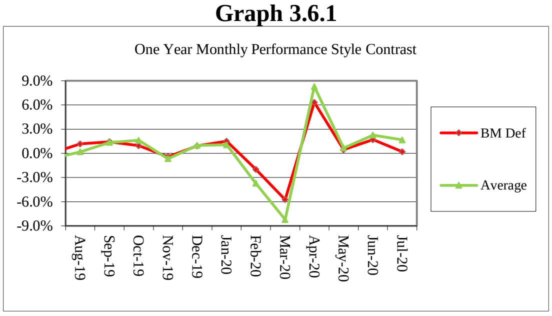


Graph 3.5.3

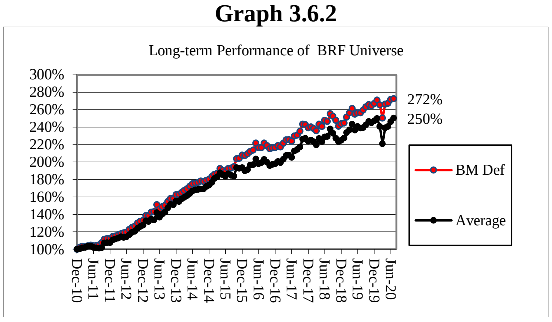


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1



Graph 3.6.2



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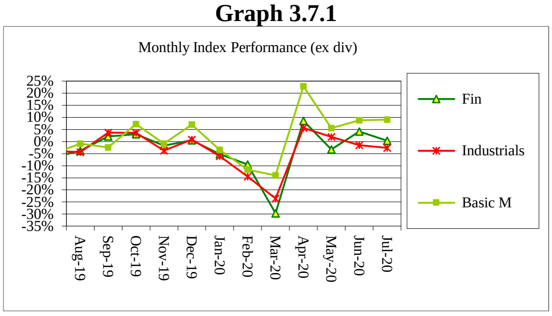
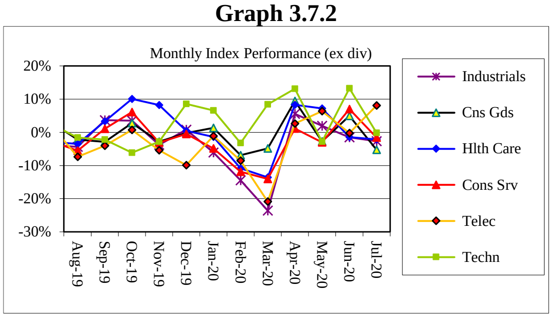
3.7 One-year monthly performance of key indices (excluding dividends)

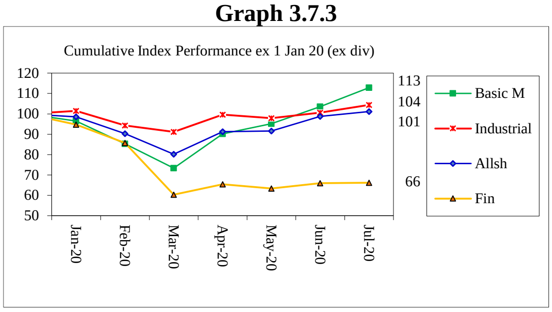
Graph 3.7.1



Graph 3.7.2



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.	7.2	6.1
5-year real return - % p.a.	2.7	1.6
Equity exposure - % of portfolio (qtr end June 2020)	45.8	63.2
Cumulative return ex Jan 2011	172.47	150.38
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.

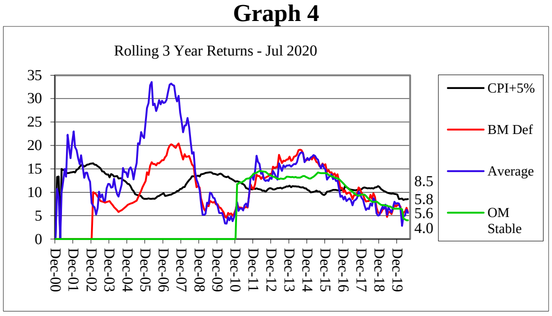
The default portfolio's long-term return must be read in the context of it initially having been managed with a low risk profile that was only changed from the beginning of 2011 when the Metropolitan Absolute Return fund was replaced with the Allan Gray balanced portfolio.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	7.6%	4.2%	2.8%
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	8.0%	7.4%	6.9%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years August 2017 to July 2020. 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 July was 5.8%, the average was 5.6% vs CPI plus 5% currently on 8.5%.

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 11.75 to the US Dollar while it actually stood at 17.01 at the end of July. Our measure is based on

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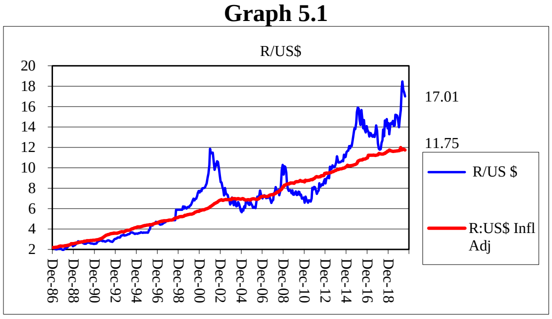
adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

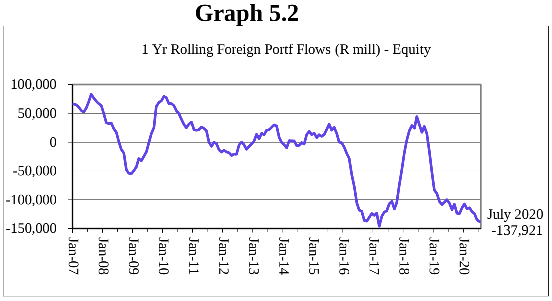


The Rand strengthened by 2.1% in July with net foreign investment outflows from bonds and equities of R14.6bn. Over the past 12 months the Rand weakened by 20.1%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 234.8bn (outflow of R 235.5bn to end of June 2020).

Since the beginning of 2006, total net foreign portfolio outflows amounted to R 37.7bn (June R 23.1bn outflows).

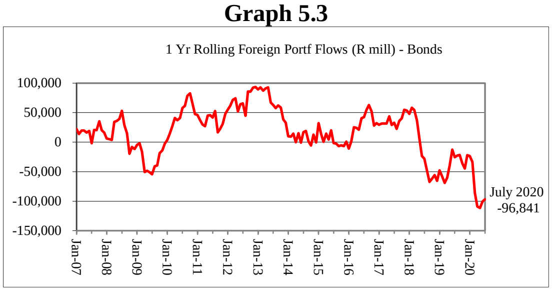
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 137.9 bn at the end of July (outflow of R 134.8 bn year-on-year to end June). The month of July experienced a net outflow of R 12.4 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 221.0 bn (end June net investment outflow of 208.6 bn). This represents roughly 1.29% of the market capitalization of the JSE.

Graph 5.2



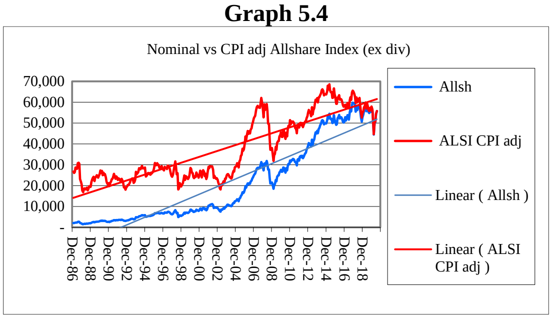
Graph 5.3 on a rolling one-year basis reflects foreign portfolio outflows in respect of SA bonds of R 96.8 bn over the past 12 months to end of July (outflow of R 100.6 bn over the 12 months to end of June). The month of July experienced a net outflow of R 2.2 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 183.3 bn (to June R 185.5 bn).

Graph 5.3



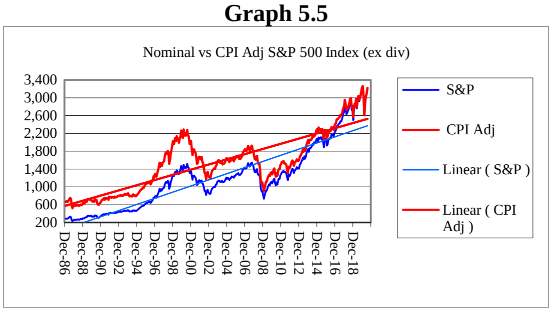
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.4% per year since January 1987, and this excludes dividends of 3.1%. Namibian inflation over this period of 33 years was 7.8% per year. This is equivalent to a growth in real terms of 2.6 % 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 33 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 7.0% 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.

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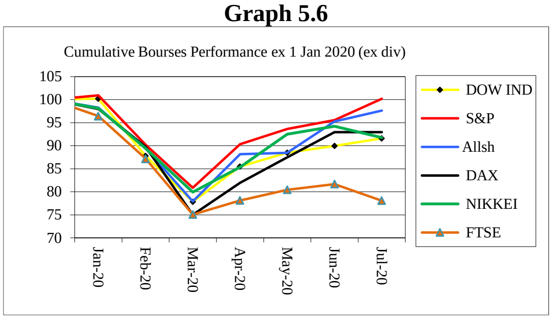
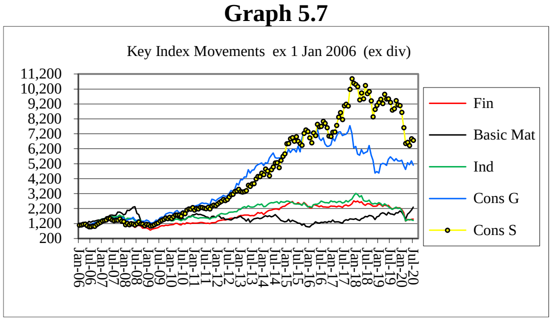
Graph 5.6



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: 14.0%; Consumer Goods: 11.8%; Basic Materials: 5.9%; Financials: 2.8% and Industrials: 2.4%.

Graph 5.7



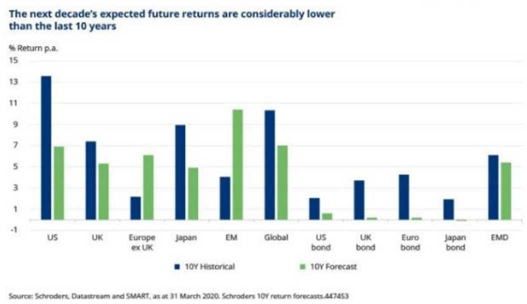
6. When can we expect to see double digit returns again?

by Tilman Friedrich

In our latest Benchtest newsletter 07.2020, we present two articles that effectively address the same subject. Firstly 'Governments must beware of the lure of free money' that appeared in the Economist of 23 July wherein it is pointed out that we are currently dealing with a profound shift in economics as the result of policy decisions taken by governments across the developed world in response to the COVID pandemic. It talks of 4 defining features of the 'new epoch' induced by COVID. Firstly, the extent of government borrowing, secondly, the extent of money printing by central banks, thirdly the governments' increasing roles as capital allocators in their economies and fourthly, a persistently low inflation rate. These 'epochal features' lay the foundation for how economies and consequently the financial markets will evolve for many years to come.

The second article 'Portfolios need to be more active and flexible to ensure returns', international asset manager Schroders believes that both, equity and bond returns, are likely to be lower in the future than during the past 10 years. Equities are facing economic headwinds and record valuations, while interest rates are at record lows and likely to remain low for years, affecting both the income and price appreciation potential for bonds as depicted in graph 6.1 below.

Graph 6.1



In this article Schroders argues that "…investors should take a more active approach and consider a globally diversified portfolio of equities, fixed income and alternative assets. Its research has found that a balanced portfolio, traditionally investing 60% in equities and 40% in bonds, may not perform as well over the next 10 to 15 years as it did during the last decade. These static 60/40 portfolios have delivered a strong performance in recent years as both equities and bonds have benefitted from favourable policy tailwinds. It has been an unusual period in history as correlations between these key asset classes have been negative. Bonds benefitted from falling interest rates to generate strong returns while, at the same time, equities have enjoyed the longest bull run in history…"

These views of Schroders of course assume 'everything else being equal'. At the prevailing low to negative interest rates, governments will only attract funding if the investor has no better investment alternatives. So-called safe haven investments still seem to be fine as developed countries are still able to attract the funding they require. Even in Namibia the government bond issuance of middle August was over-subscribed on average by 4.2 times. As time progresses and the financial woes resulting from COVID policy decisions of developing countries manifest ever more, countries such as Namibia, should find ever more difficult to attract foreign funding in particular.

The assumption of 'everything else being equal' appears very bold considering the political tensions between China and Russia on the one side and US and some of its staunchest allies on the other. Given that the US is unlikely to give up its 'sole rights claim' to being the global hegemon and China's apparent challenge to this claim, both militarily and economically, it is not an unwarranted scenario that the conflict will be escalating to a final show-down. The only alternative would be if

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

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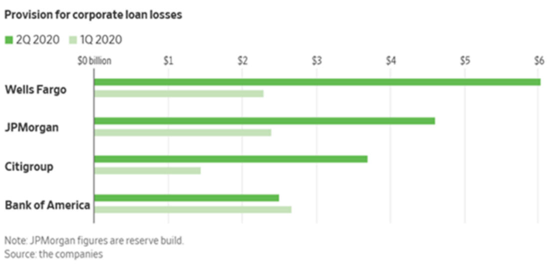
China were to let go of its ambitions to emancipate itself from US hegemony. There are no such signs in any of China's responses so far to US demands and challenges.

Taking investment decisions in the prevailing environment of low and even negative interest rates, low forecast future equity returns and the rising tensions between China and the US, is extremely difficult. There is no such thing as the free market mechanisms anymore, which is actually essential for price finding between a willing buyer and a willing seller. Undoubtedly this also explains the run on physical gold and the consequent increase in the price of gold to around US$ 2,000 per fine ounce. People find it difficult to identify good investment prospects and in the light of the prevailing environment rather resort to buying an asset that offers no real economic value or to safe haven investments offering negative returns.

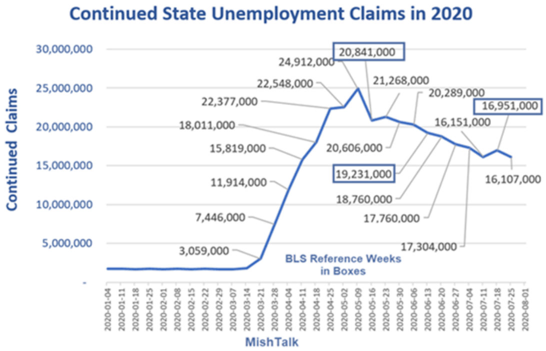
Just about every economy around the world has been hard hit by measures taken to fight the COVID pandemic. Global debt of the 6 largest global economies had increased by 300% from US$ 6 trn to US$ 21 trn following the global financial crisis and will be bloated further as the result of stimulus measures taken to counter the impact of COVID. In essence, governments around the world now borrow money to give people the money they would have earned in their jobs, had they not lost their jobs through these measures. As the saying goes, if the US economy, as largest economy in the world sneezes, the economies of the rest of the world will catch a cold. And the US economy is sneezing heartily. John Mauldin reported in one of his recent 'Thoughts from the Frontline' newsletters a huge increase in corporate loan loss reserves of the big lenders in the US as set out in graph 6.2. Local banks have not been spared of this and some of our banks have reported large declines in earnings.

Graph 6.2



What's more frightening, is the US unemployment situation, as measured by continued state unemployment claims and presented in graph 6.3 in same newsletter:

Graph 6.3



Clearly, the US economy is in a bad shape and will take a number of years to recover.

Conclusion

Equity markets and other asset classes are evidently once again in a bubble as the result of the global flooding of markets by reserve banks. In contrast global economies have been hard hit and will struggle to recover the ground lost, initially after the global financial crisis and now as the result of COVID. Companies therefor cannot rely on a solid economic underpin for growth for some time to come.

Based on the experience of the aftermath of the global financial crisis and the measures taken by central banks in response, it is likely that the re-inflated bubble of late is unlikely to burst, everything else remaining equal, but will rather be allowed to slowly deflate. In the mean-time returns on conventional asset classes will be subdued for the next 10 years as argued and as depicted clearly in graph 6.1 above.

In abnormal times and high market volatility as we are currently experiencing, prices are driven by sentiment rather than fundamentals. Some stocks are driven to dizzy heights while others that are out of favour are up for a song, offering exceptionally high dividend yields. The speculator would try to find stocks in an upswing driven by sentiment and try to sell when he believes they are at the top. This is a high risk, potentially high reward approach. For pension capital, it is not advisable to speculate. Here one should rather focus on the real economic value of the investment, essentially how well the underlying business is doing and what its dividend payment capacity is. Stock picking skills should be applied to choosing where to invest.

If one had sold out already and one had not re-entered the market, one will have lost out on the close to 30% recovery of the SA Allshare index since the March month-end low. In the face of prevailing volatility and the uncertainty of how the COVID-19 crisis will pan out, one

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should now best stay out of the market at least until the end of the year to use any opportunity a market correction will offer. Economic performance is not supporting any meaningful growth in equity markets for a while.

Investing offshore is a great risk diversifier and must be part of one's investment strategy. This is what international asset manager Schroders also suggest. Timing plays an important role when one considers expatriating investment capital. However, due to the severe under-valuation of the Rand it is not a good time to expatriate investments at this stage and the suggestion to hold on to the end of the year may also bring with it a further strengthening of the Rand, presenting an opportunity to re-enter offshore equities.