Volume 6, No. 5, May 2010

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MAY 2010

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.

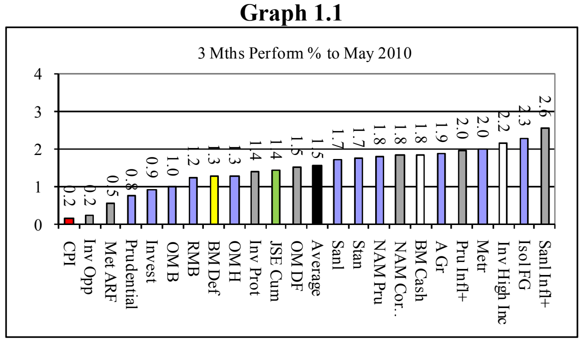
1. Review of Portfolio Performance

In **May** the **average prudential balanced portfolio** returned a minus 3.1% (April 0.67%). Best and worst performance **for the month** was delivered by Allan Gray (minus 0.72%) and Prudential (minus 4.35%), respectively. We haven't seen Allan Gray on top spot for a while. It seems the weakening Rand and the poor performance of resources has again benefited Allan Gray's relative performance in May as Allan Gray has a relative overweight to offshore assets and a relative underweight to basic materials. Prudential's underperformance on the other hand appears to be due to an overweight to basic materials.

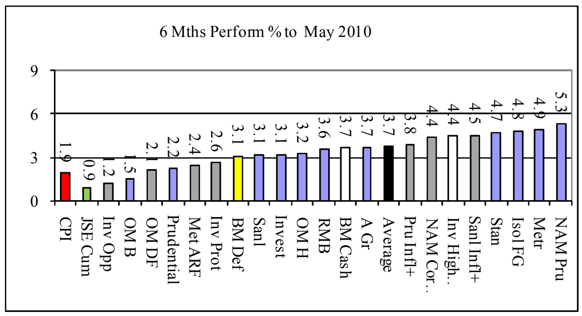
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential balanced 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 and Metropolitan Namibia Absolute Return. Below is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Consumer Price Index	CPI Cum (red)
JSE Allshare Index	JSE Cum (green)
Benchmark Default Portfolio	BM Def (yellow)
Average Portfolio (prudential, balanced)	Aver (black)
Special Mandate Portfolios	
Money market	BM Cash (no colour)
Investec High Income (interest bearing assets)	Inv High (no colour)
Investec Protector	Inv Prot (grey)
Investec Opportunity Fund	Inv Opp (grey)
Metropolitan Absolute Return	Metr ARF (grey)
Prudential Inflation Plus	Pru Infl+ (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Sanlam Inflation Plus	Sanl Infl+ (grey)
NAM Coronation Balanced Def	NAM Cor Def (grey)
Market related portfolios	
Allan Gray Balanced	A Gr (blue)
Investec Managed	Invest (blue)
Investment Solutions Bal Growth, prev. Focused Growth (multimanager)	Isol FG (blue)
Prudential Managed	Prudential (blue)
Metropolitan Managed	Metr (blue)
NAM Prudential Balanced	NAM Pru (blue)
Old Mutual Profile Balanced	OM B (blue)
Old Mutual Profile Growth	OM H (blue)
RMB Managed	RMB (blue)
Sanlam Managed	Sanl (blue)
Stanlib Managed	Stan (blue)

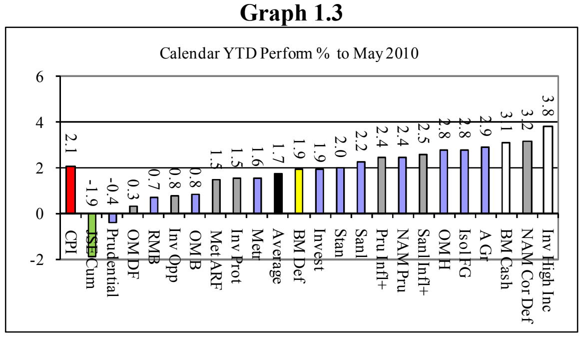
Graph 1.1



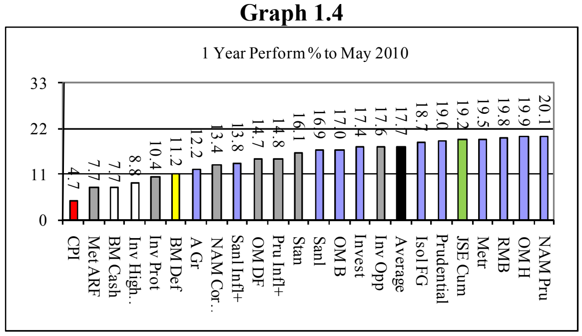
Graph 1.2



Graph 1.3



Graph 1.4



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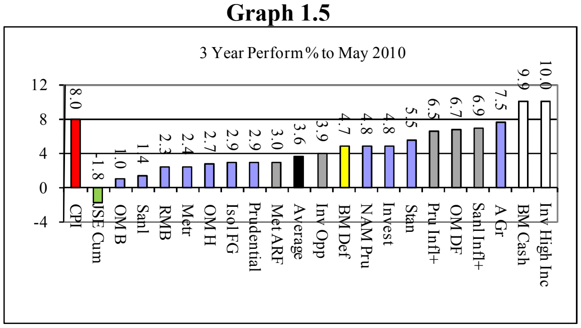
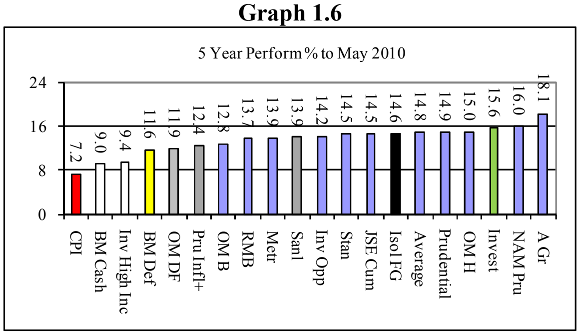
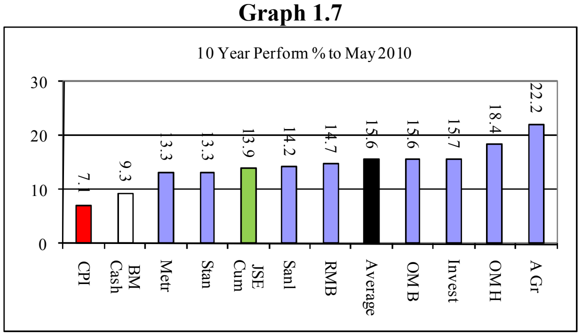
Graph 1.5



Graph 1.6

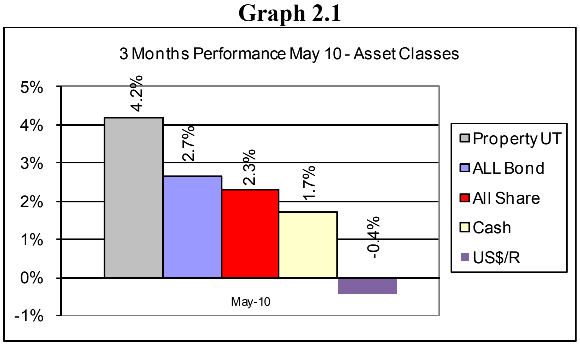


Graph 1.7

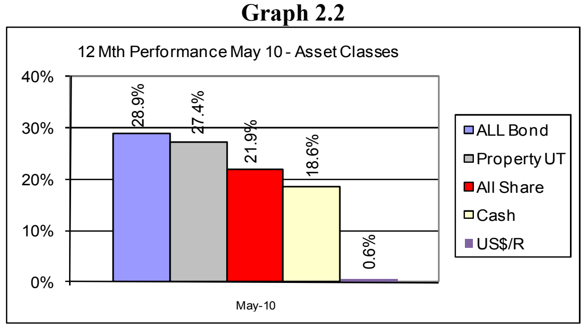


2. Performance of Key Indices (index performance by courtesy from pointBreak/Deutsche Securities)

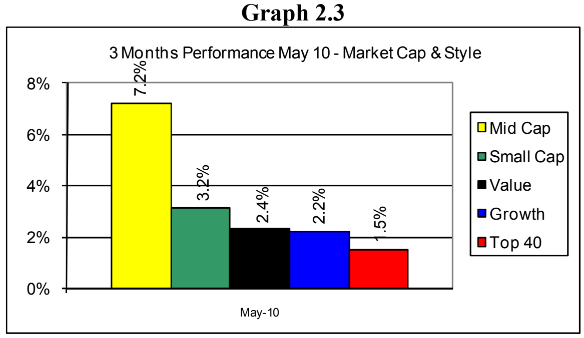
Graph 2.1



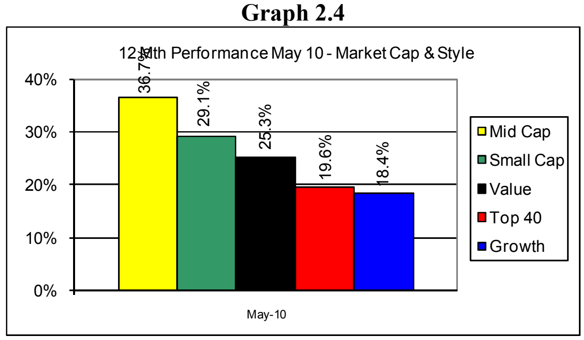
Graph 2.2



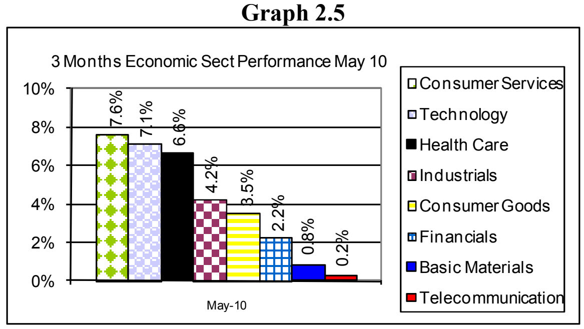
Graph 2.3



Graph 2.4



Graph 2.5



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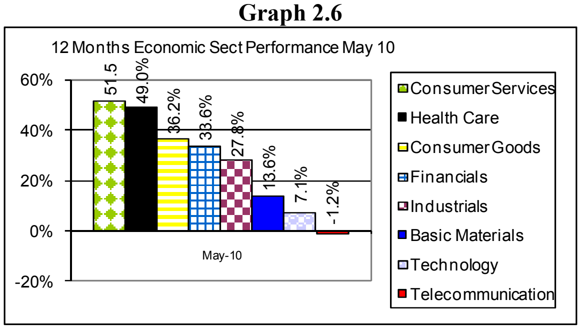
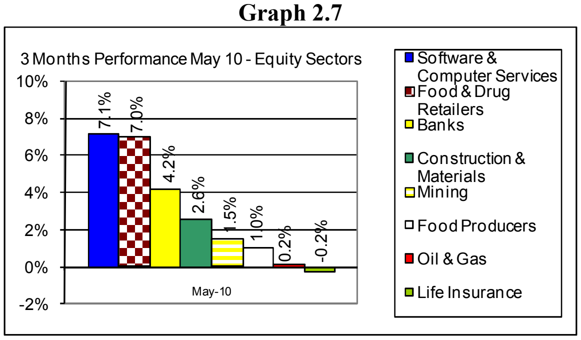
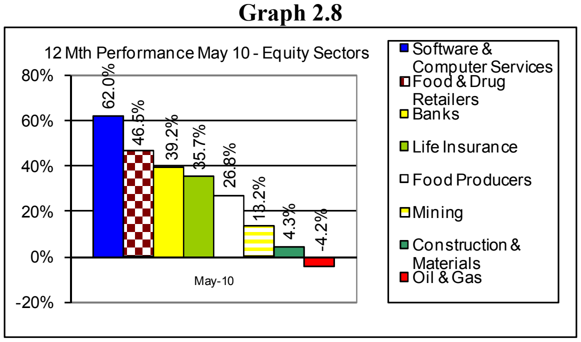
Graph 2.6



Graph 2.7



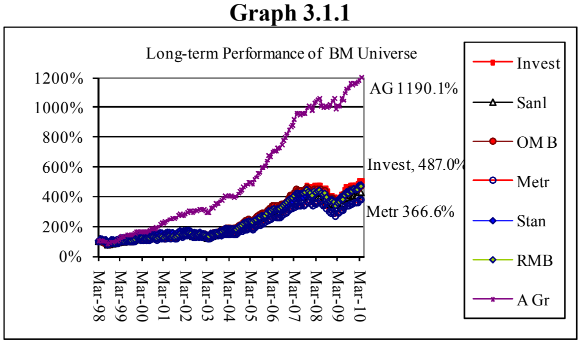
Graph 2.8



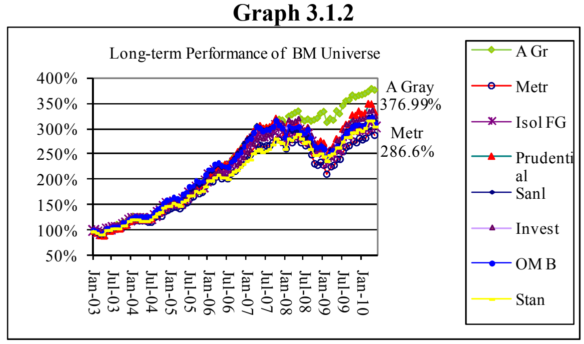
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

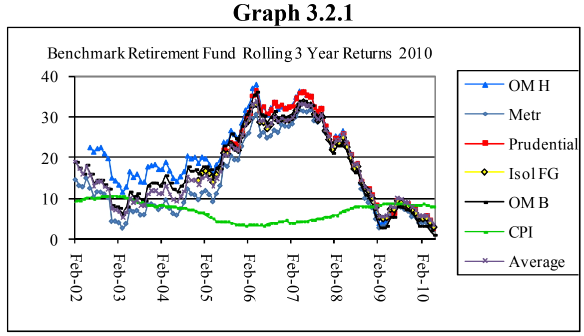


Graph 3.1.2

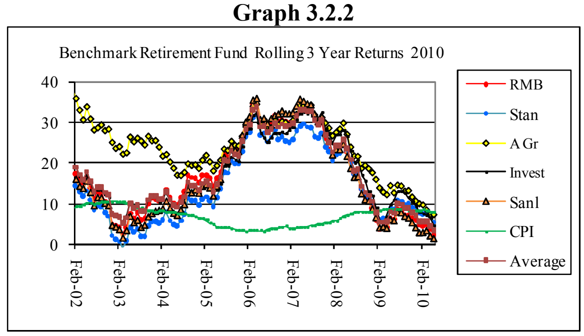


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

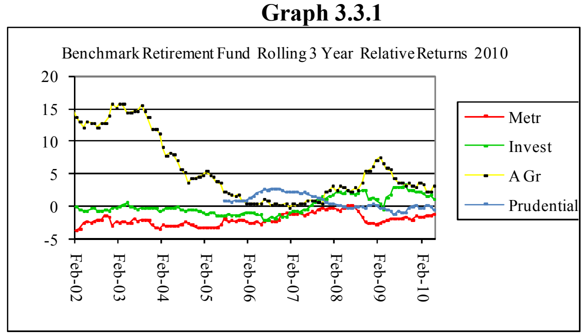


Graph 3.2.2



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

Graph 3.3.1



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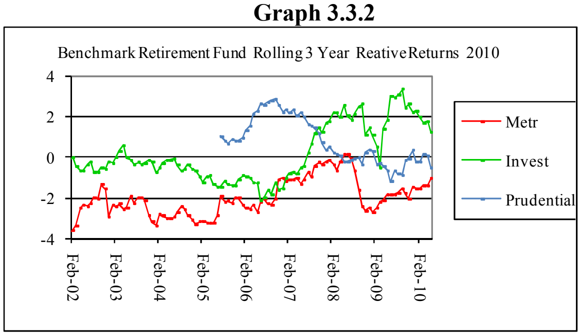
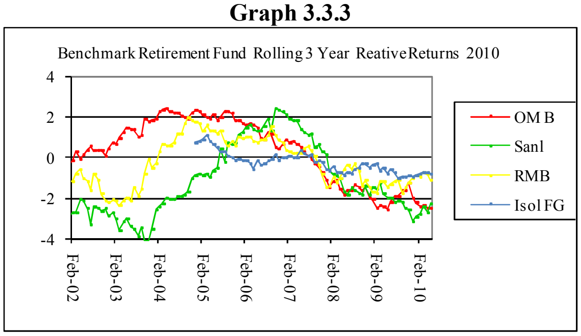
Graph 3.3.2

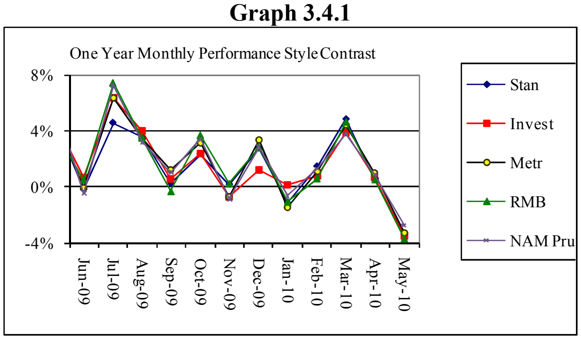


Graph 3.3.3

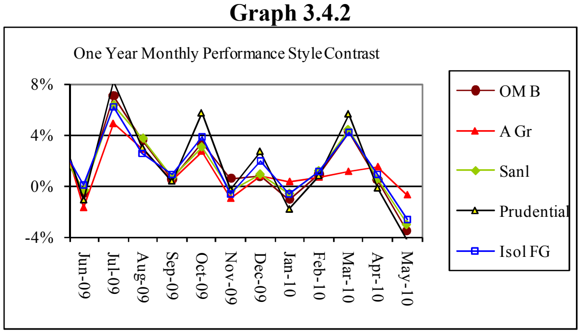


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

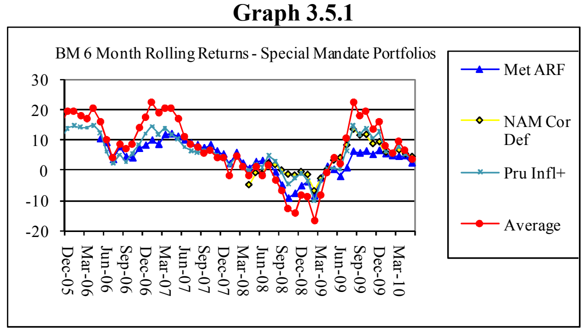


Graph 3.4.2

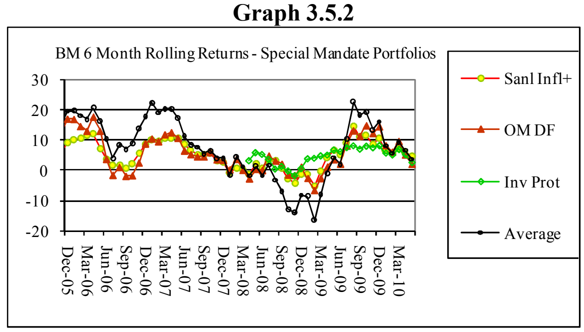


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

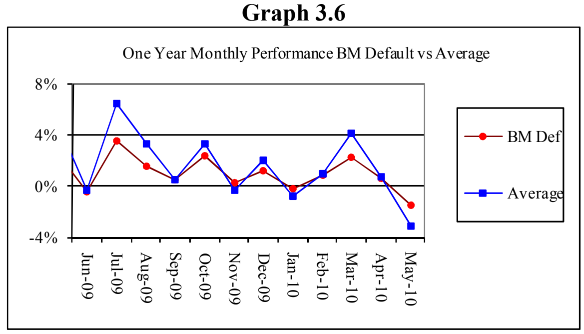


Graph 3.5.2



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

Graph 3.6



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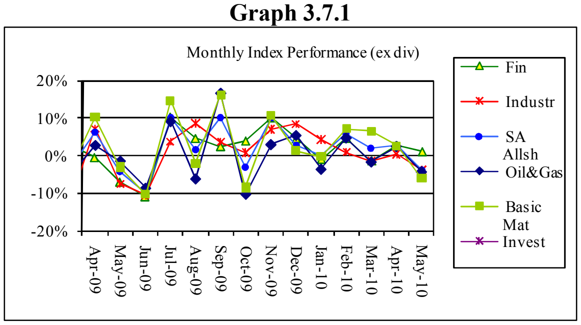
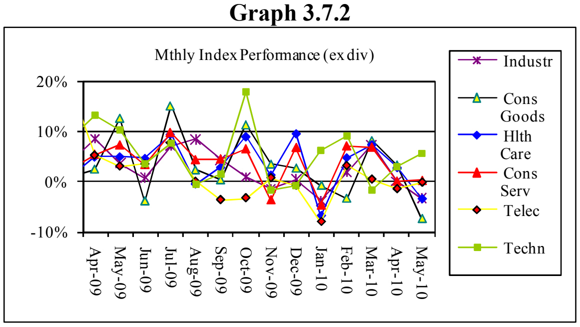
3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

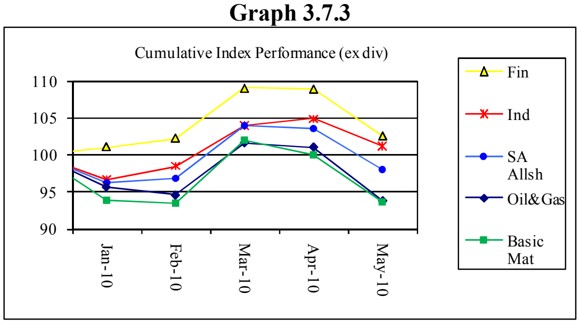
Graph 3.7.1



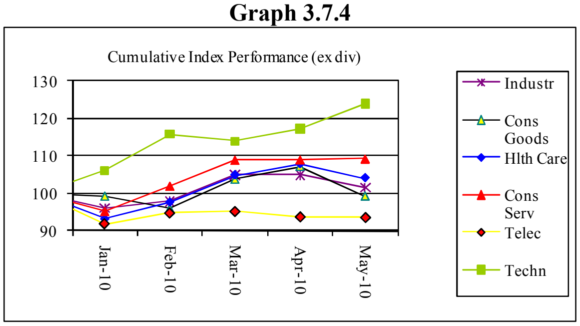
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 14.6% p.a. in nominal terms, or 7.4% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 11.6% p.a. in nominal terms, or 4.4% p.a. in real terms. The past 5 years reflect returns very close to expected long-term returns. The long-term performance differential of 3% p.a., between the Default portfolio and the average prudential balanced portfolio, may be expected to be representative of a realistic long-term expectation. We would expect the average prudential balanced portfolio to deliver a real return of roughly 6% per year and the Default portfolio to sacrifice around 2% for the benefit of lower volatility, thus an expected real return of around 4% per year.

The Money Market portfolio returned 7.7% and the Default portfolio returned 11.2%, gross for the one year to end May. The more 'risky' average prudential balanced portfolio returned 17.7% gross over this period. A fee of roughly 0.75% p.a. still has to be deducted from all but the Money Market Portfolio. The performance of the prudential balanced portfolios is significantly more volatile than that of the Default portfolio, which produces significantly more volatile performance than the Money Market portfolio. The table below presents one year statistics over the 3 years June 2007 to May 2010:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	7.7%	- 8.0%	- 19.1%
Best annual performance	12.1%	20.8%	32.6%
No of negative 1 year periods	n/a	10	11
Average of negative 1 year periods	n/a	- 3.7%	- 10.3%
Average of positive 1 year periods	10.1%	11.6%	16.6%

This table represents the different characteristics of the three types of portfolio quite well. The Default portfolio is a more conservative investment aimed at minimising negative returns and with a long-term return objective of inflation plus 4%.

It is very important, though, that employers invested in the Default portfolio are comfortable with these investment characteristics and that they should be able to create comfort amongst their employees as well!

5. A Contrarian Preview Of The Next 12 Months

Global equity markets have experienced a dramatic recovery to the end of the first quarter but moved into a more volatile territory of late with two poor months April and May in a row.

We believe that the global economy is now at the cross roads. It can either turn flat to negative, or it can pick up steam again to mirror a situation we have experienced up until the financial crisis of late 2007. As laymen we are

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concerned about the consequences of the huge debts that countries took up in order to stimulate their economies. It is difficult to envisage how countries will reduce their debt levels without raising taxes, thereby retarding economic growth. Another plausible way out could be the creation of inflation in an effort to inflate asset values while at the same time keeping interest rates well below inflation so that debt declines in real terms. Corroborating reports in certain media claim that printing press manufacturers are currently facing a glut of new orders. Our expectation is that equity markets are unlikely to produce any further meaningful positive returns in 2010 assuming our more likely of the two scenarios referred to below.

More likely scenario:

- Governments will take measures to curb speculative trading of commodities and equities (Germany has unilaterally taken the first step).
- Crude price will revert to cost based levels, in our expectation somewhere around 60 US$ (currently around US$ 70) cost being in the region of US$ 45.
- Global fiscal stimulus will be removed as economies start recovering.
- Inflation will set in.
- Unwinding of the global sovereign debt bubble will be a long drawn out process.
- Global interest rates will start rising.
- Global taxes will start rising.
- Consumer sentiment will be dampened.
- Portfolio flows will be diverted from equities to interest bearing assets (see graph 29).
- Equity markets will move sideways with a risk of a downward correction (as we have seen since the end of April).
- The Rand will weaken as global interest rates rise and portfolio flows are diverted from commodities and equities to other asset classes and as higher risk premiums are placed on smaller economies (as experienced in May).

Less likely scenario:

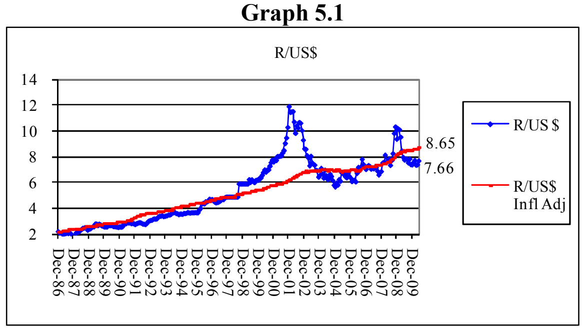
- Speculative trading in commodities and equities will remain unchecked.
- The oil price continues to be driven by speculation to levels above 100 US$.
- Another bubble develops in commodity and asset prices.
- Although consumers are likely to be weary of venturing into another spending spree for a while, risk appetite is likely to increase again a year or so down the track.
- Global interest rates will remain low as consumers are reducing debt levels.
- The Rand will remain strong as the result of the demand for commodity based stocks and interest rate arbitrage.

We believe that it will take globally coordinated policy measures to correct the existing economic imbalances. These have not quite manifested yet and until such time as they do we are likely to see volatility in financial markets. This will not be a good time to be invested in volatile assets. Defensive shares should steal the day from cyclical. Once the policy measures are in place and start to get traction, we would expect inflation to set in. Volatility should start to decline and this is the time when one should start to get exposure to inflation hedged assets and get out of interest bearing assets.

Graph 5.1 indicates that the Rand is fairly valued at 8.65 to the US Dollar. Our more likely scenario expects a weakening of the Rand over the next 12 months as the result of the inflation differential, an increasing risk premium likely to be attached to weaker currencies and a redirection of foreign portfolio flows. Should the Rand weaken from its current level of around 7.60, to 8.7 over the course of the next 12 months, this would represent a potential return on a US$ investment of around 14% all else being equal.

Graph 5.2 indicates that foreign equity purchases in SA remain subdued and given our outlook based on the more likely scenario, this should persist for an extended period of time putting pressure on the Rand and on local equity markets. For the year to end of May, the FTSE/JSE still experienced a massive net inflow of R 66 billion (R 67 billion, 12 months to end April), compared to a net outflow of R 25 billion for the year to end May (R 32 billion, year to end May 2009).

Graph 5.1



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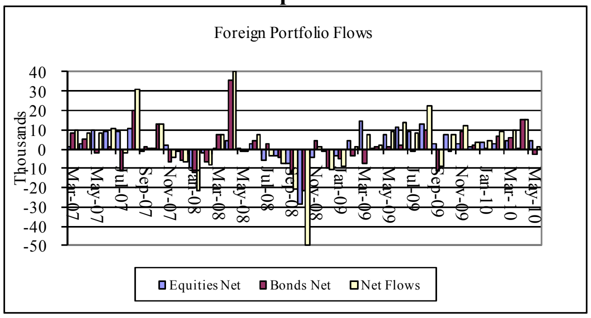
Graph 5.2

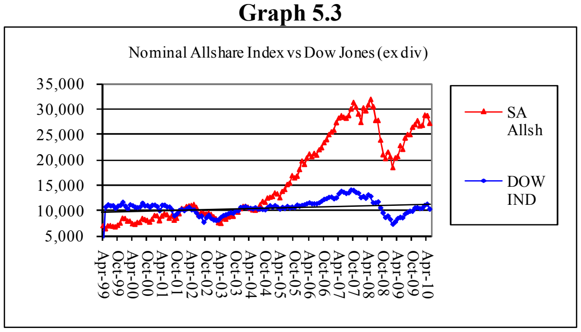


Graph 5.3 shows to what extent equity markets have recovered in nominal terms since their low at the end of February 2009. The DOW Jones Industrial Index is now back at 80% of its September 2007 peak, while the SA Allshare already reached 85% of the May 2008 peak.

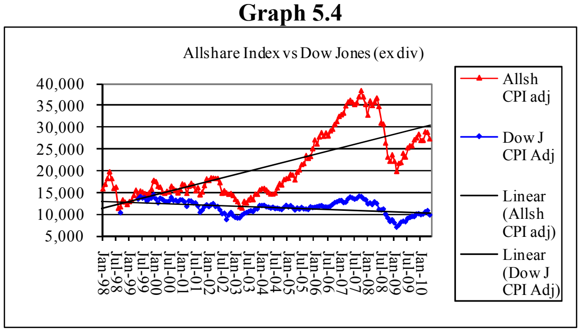
Graph 5.4 reflects the same statistics but adjusted for US and SA inflation respectively. Inflation adjusted, the Allshare has grown by 4.9% per annum over more than 12 years, since December 1997.

Over the past 12 months, the 1 year trailing SA Allshare P:E more than doubled, gaining 8.4 points to 16.6 from its bottom of 8.2 at the end of February 2009.

Graph 5.3

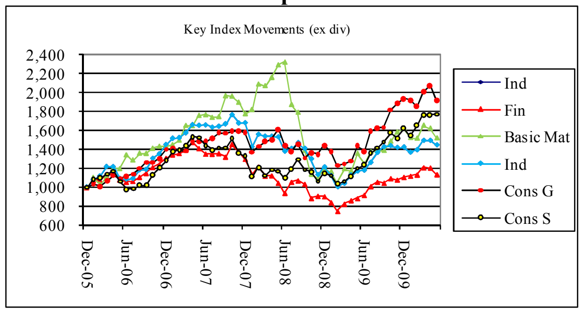


Graph 5.4



Graph 5.5 provides an interesting 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.

Graph 5.5



6. Conclusion

In our view, global equity markets are still in risky territory and are likely to produce pedestrian growth for the next 6 to 12 months, with considerable volatility. Global interest rates will remain stable for another 3 months or so, to start picking up from thereon, and consumer demand will be subdued for the next 12 to 24 months, while the Rand should weaken further once global interest rates start rising.

In terms of local equity sectors, **graph 5.5** indicates that consumer goods and consumer services had a good run. We do not expect too much joy out of these sectors anymore and these should hence be underweight. On the basis of fundamentals, one should be overweight financials and industrials, while commodities should be neutral to underweight. We believe that the performance of most conventional asset classes will be muted. We expect equities in general to perform sluggishly but stock picking can add value. As far as precious metals are concerned, we expect prices do decline in US$ terms. Due to our expectation of the Rand depreciating, this will offset the decline in prices to produce a muted return for the year.

A lack of sparkling local investment opportunities and a prospective declining Rand suggests that one should be overweight offshore assets. Taking our view on the Rand, an investment in the US$ could produce a return of between 5% and 15% over the next 12 months. Locally, interest rates may first decline before turning. This should enhance the performance of bonds and property in the short term, to be potentially on par with equities.

For pension funds, a conservative balanced portfolio with a fair spread across equities, bonds and property and a high foreign exposure is our call for now.

7. Important notice and disclaimer

Whilst we have taken all reasonable measures to ensure that the results reflected herein are correct, Benchmark Retirement Fund and Retirement Fund Solutions Namibia (Pty) Ltd do not accept any liability for the accuracy of the information and no decision should be taken on the basis of the information contained herein before having confirmed the detail with the relevant portfolio manager. The views expressed herein are those of the author and not necessarily those of Benchmark Retirement Fund or Retirement Fund Solutions.