Volume 17 No. 05
May 2021

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MAY 2021

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

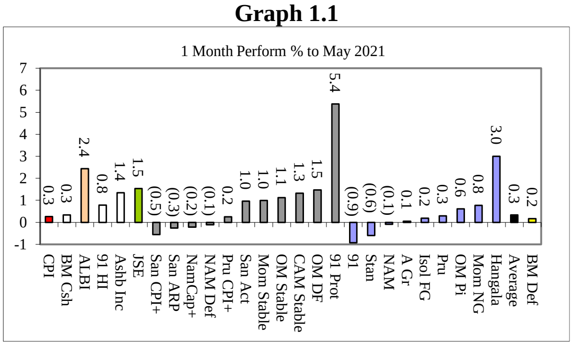
In May 2021 the average prudential balanced portfolio returned 0.3% (April 2021: 1.5%). Top performer is Hangala Prescient Absolute Balanced Fund with 3.0%, while Ninety One Managed Fund with -0.9% takes the bottom spot. For the 3-month period, Hangala Prescient Absolute Balanced Fund takes the top spot, outperforming the 'average' by roughly 3.8%. On the other end of the scale Stanlib Managed Fund underperformed the 'average' by 1.5%. 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. **Take note that we have added a new graph 3.5.3 which reflects the returns of the low risk special mandate funds**.

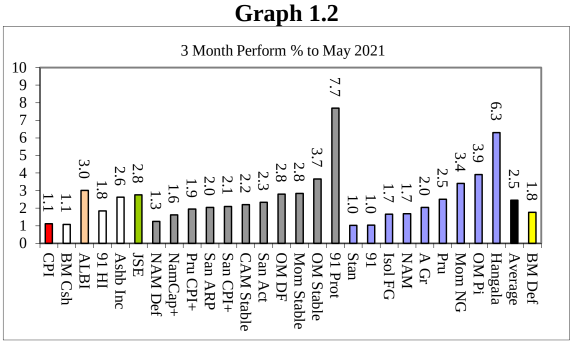
Below is the legend to the abbreviations reflected on the graphs:

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)
NinetyOne High Income (interest bearing assets)	91 HI (no color)
Ashburton Namibia Income Fund	Ashb Inc (no color)
Capricorn Stable	CAM Stable (grey)
Momentum Nam Stable Growth	Mom Stable (grey)
NAM Capital Plus	NamCap+ (grey)
NAM Coronation Balanced Def	NAM Def (grey)
NinetyOne Protector Balanced Fund	91 Prot (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)
Sanlam Absolute Return Plus	San ARP (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)

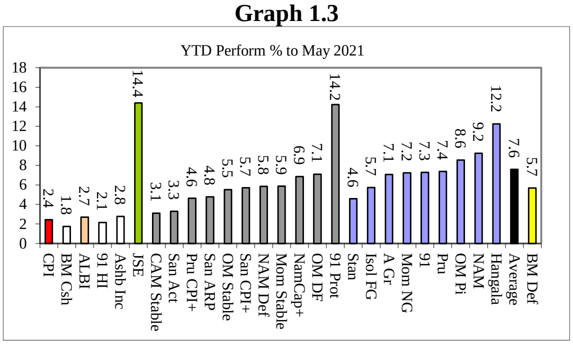
Graph 1.1



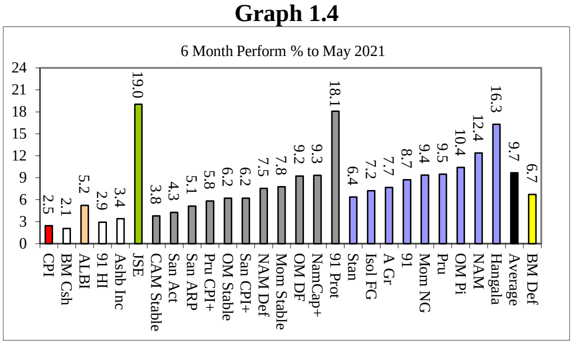
Graph 1.2



Graph 1.3



Graph 1.4



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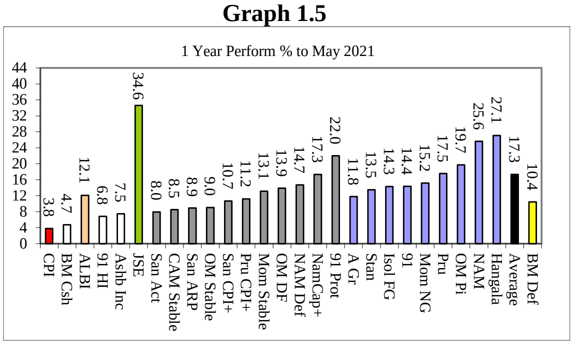
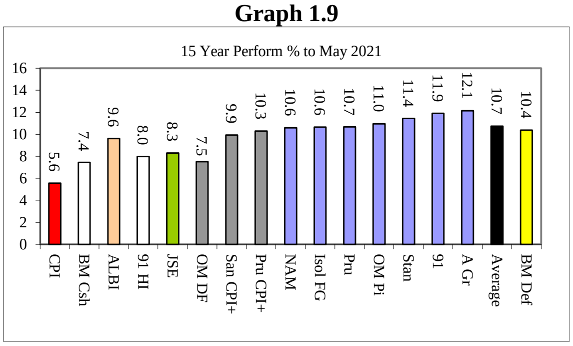
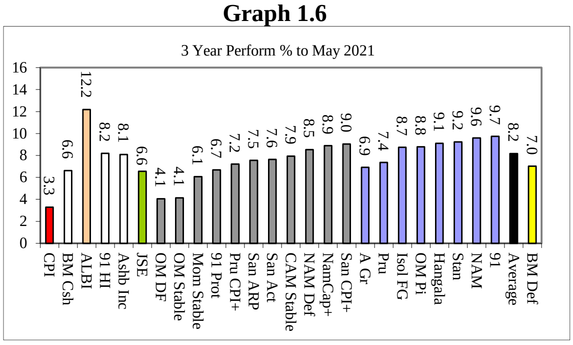
Graph 1.5



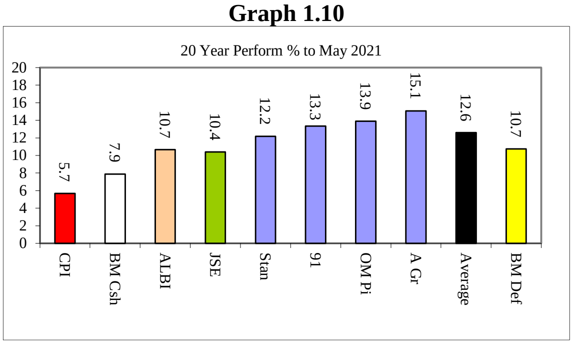
Graph 1.9



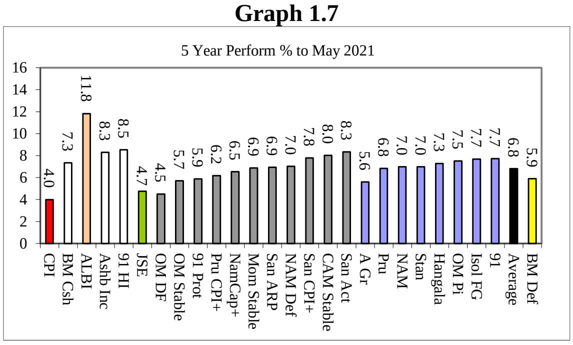
Graph 1.6



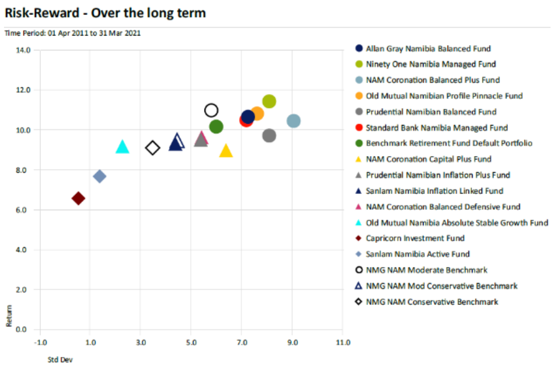
Graph 1.10

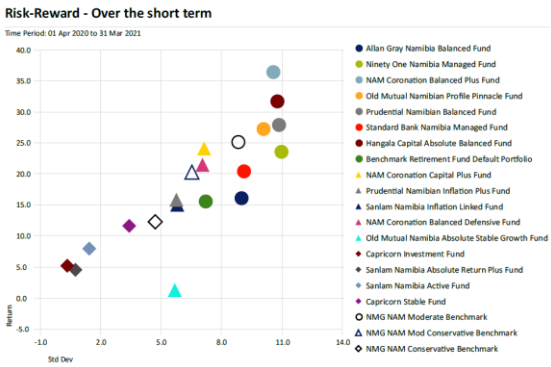


Graph 1.7

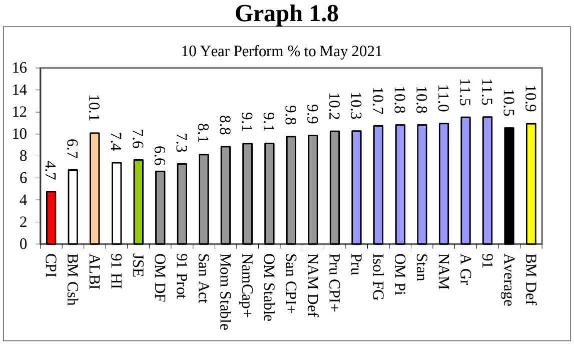


Risk/ Return





Graph 1.8



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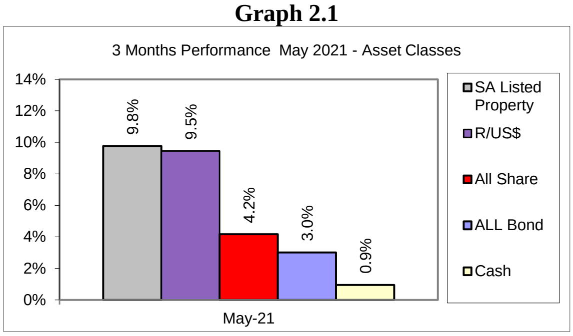
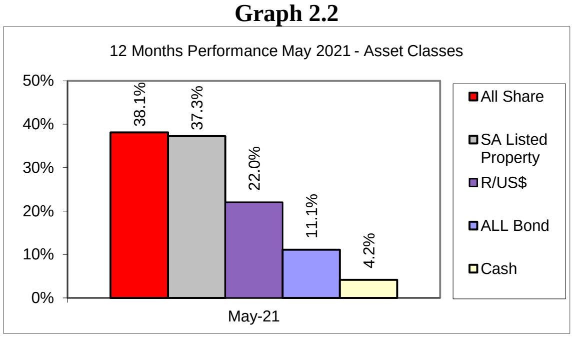
2. **Performance of Key Indices** (index performance by courtesy of IJG/Deutsche Securities)

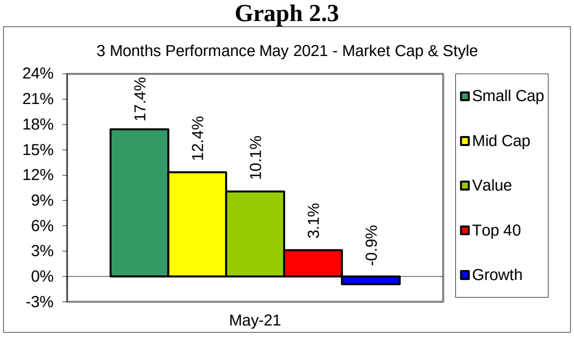
Graph 2.1



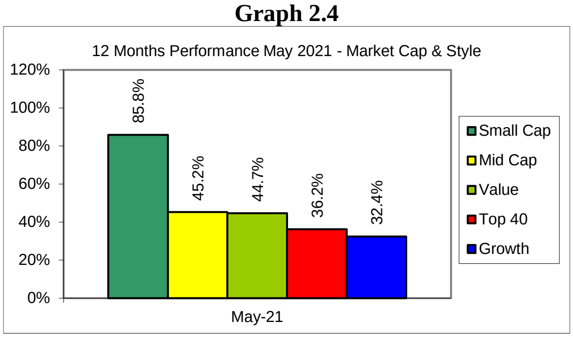
Graph 2.2



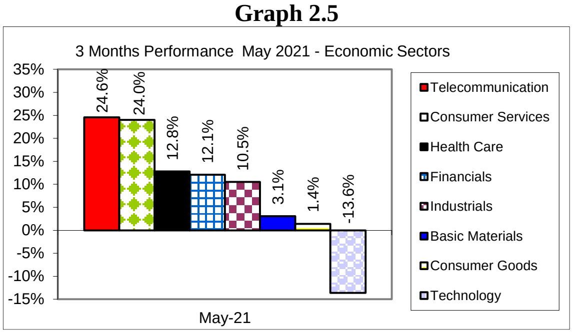
Graph 2.3



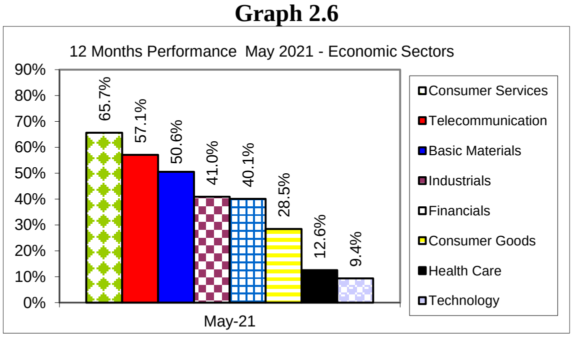
Graph 2.4



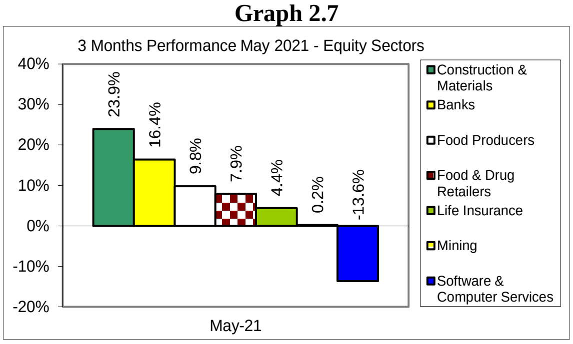
Graph 2.5



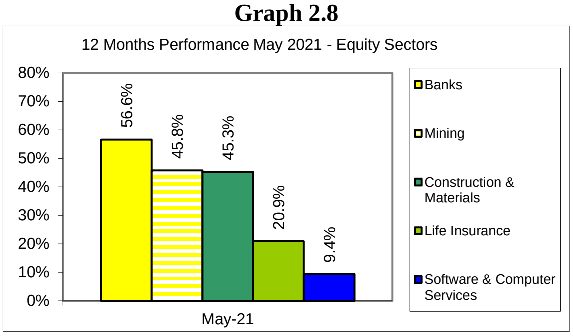
Graph 2.6



Graph 2.7



Graph 2.8



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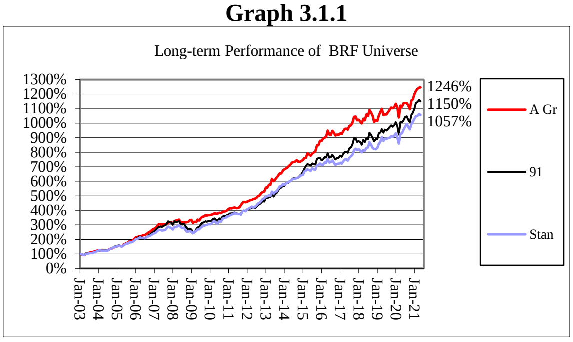
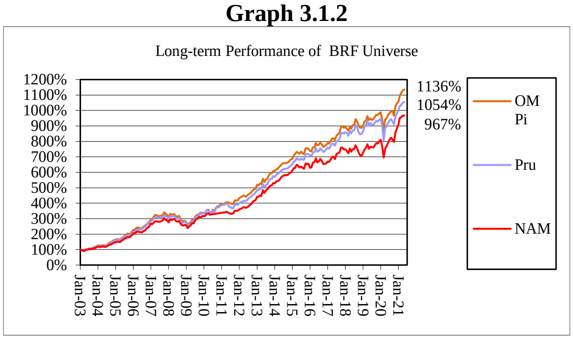
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

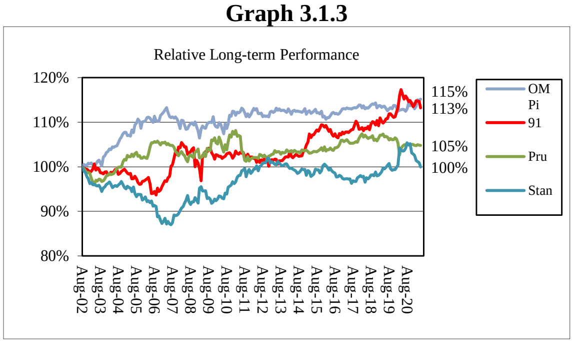
Graph 3.1.1



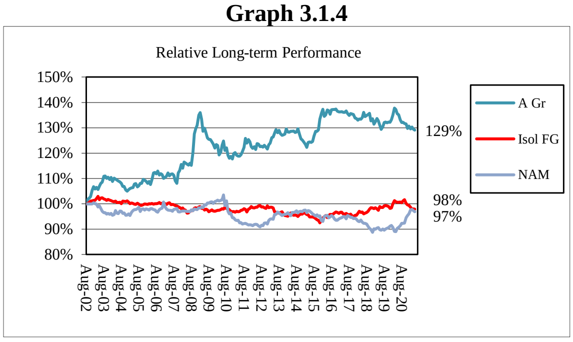
Graph 3.1.2



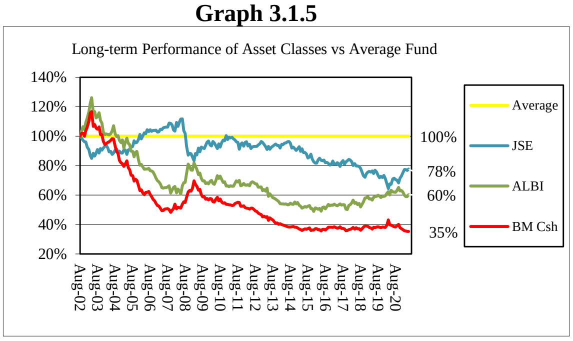
Graph 3.1.3



Graph 3.1.4

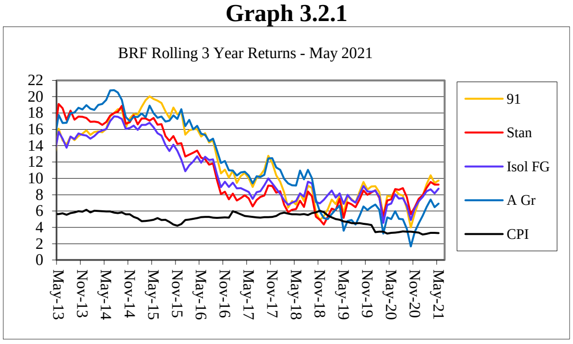


Graph 3.1.5

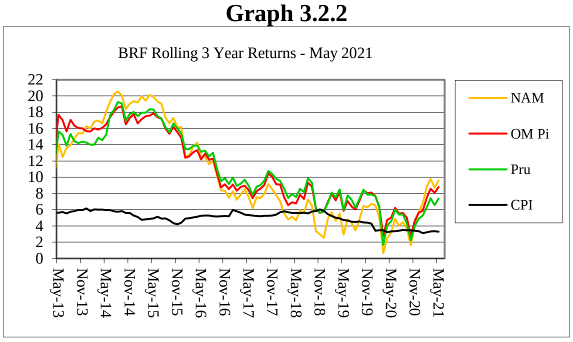


3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

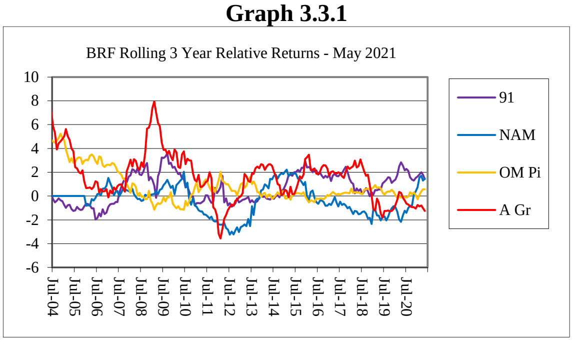


Graph 3.2.2



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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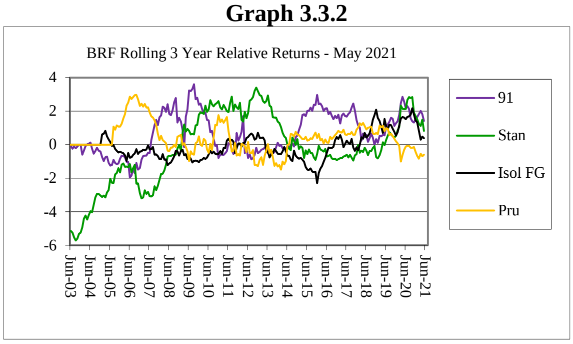
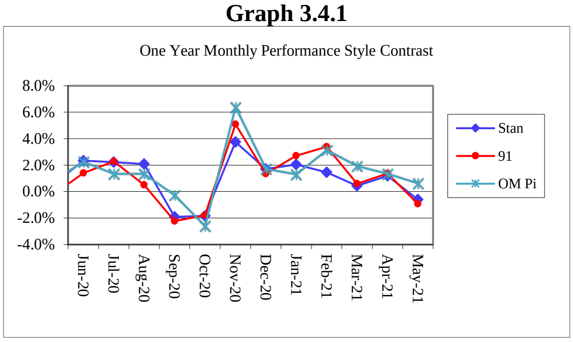
Graph 3.3.2

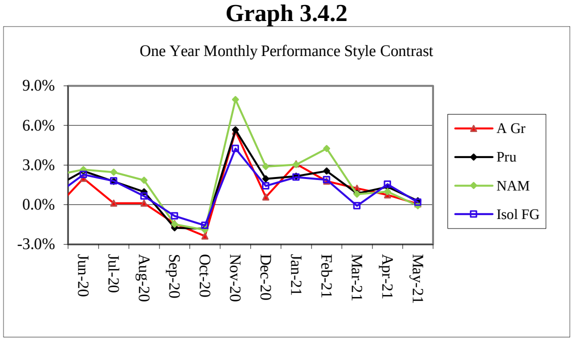


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

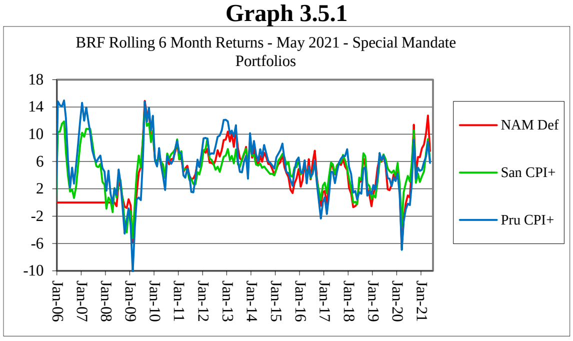


Graph 3.4.2

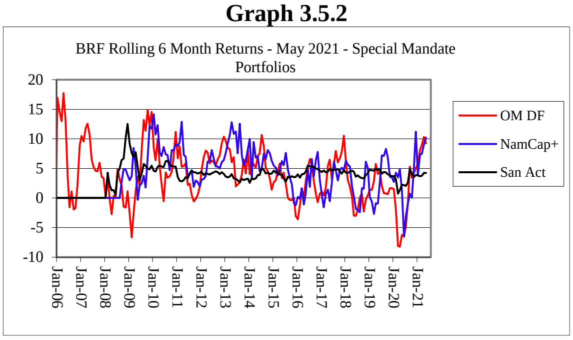


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

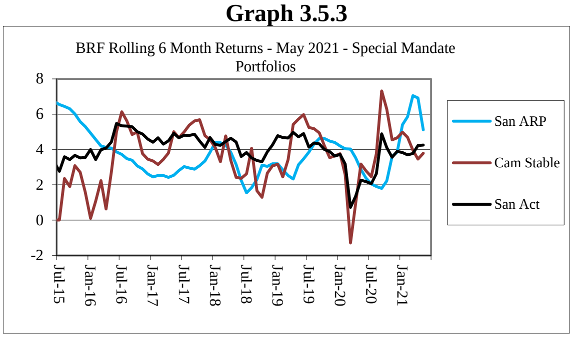
Graph 3.5.1



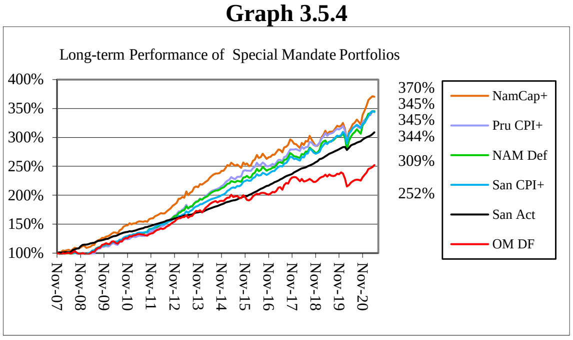
Graph 3.5.2



Graph 3.5.3

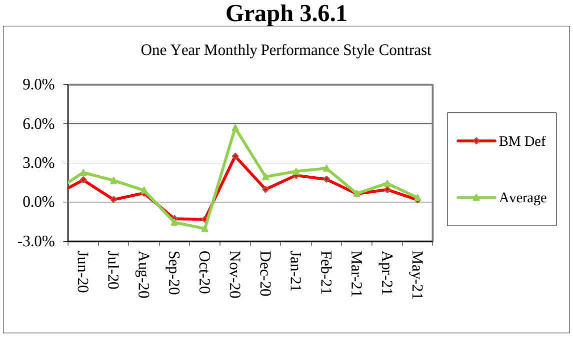


Graph 3.5.4



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

Graph 3.6.1



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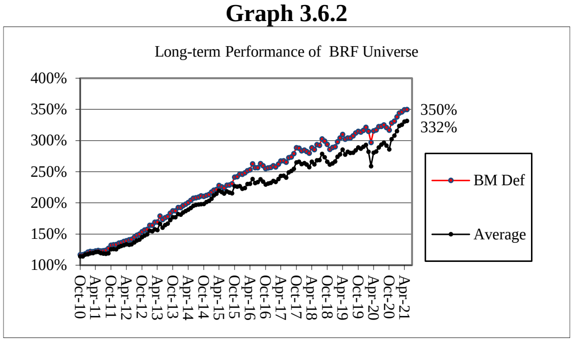
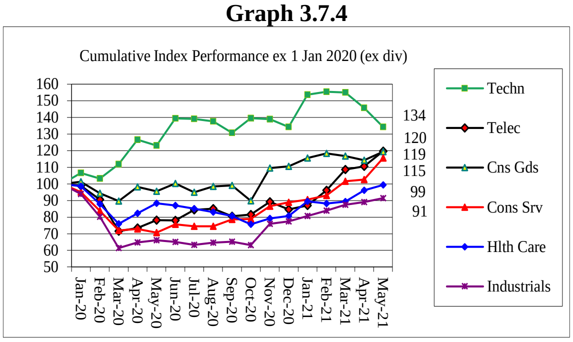
Graph 3.6.2

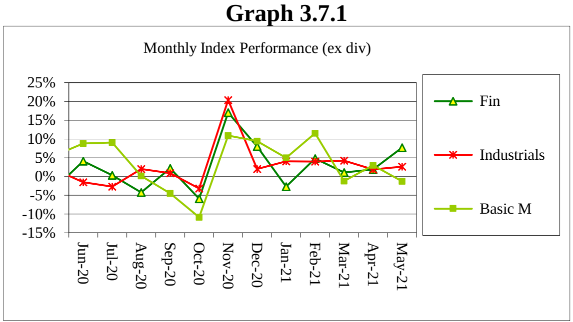


Graph 3.7.4

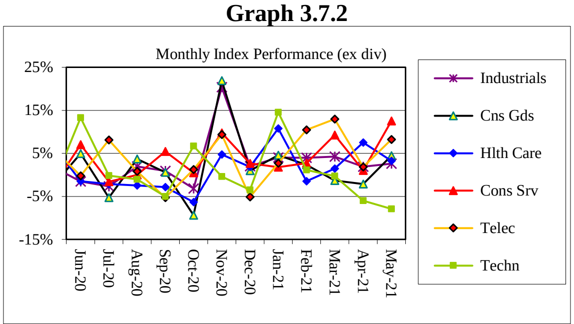


3.7 One-year monthly performance of key indices (excluding dividends)

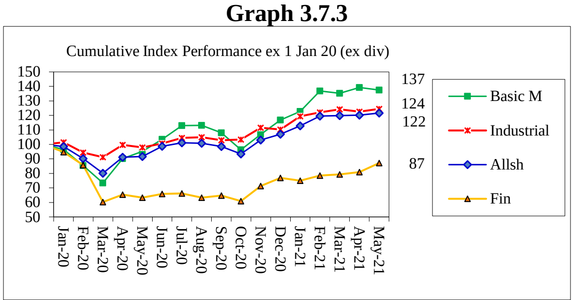
Graph 3.7.1



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.	5.9	6.8
5-year real return - % p.a.	1.9	2.8
Equity exposure - % of portfolio (qtr end March 2021)	47.5	63.6
Cumulative return ex Jan 2011	195.3	182.7
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 of late under-performed the average prudential balanced portfolio, although still ahead since January 2011, when it was restructured to its present structure. This is the result of its significantly more conservative structure with an equity exposure of only 48% compared to the average prudential balanced portfolio's exposure of 64%. When equities significantly out-perform the other main asset classes, the default portfolio will under-perform the average prudential balanced portfolio. Over the past 12 months and as the result of the further significant increase in central banks' bond buying activities, equities have indeed significantly outperformed the other asset classes except property. This intervention of course distorts financial markets and causes significant volatility and artificially increased valuations of equities, in particular.

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.

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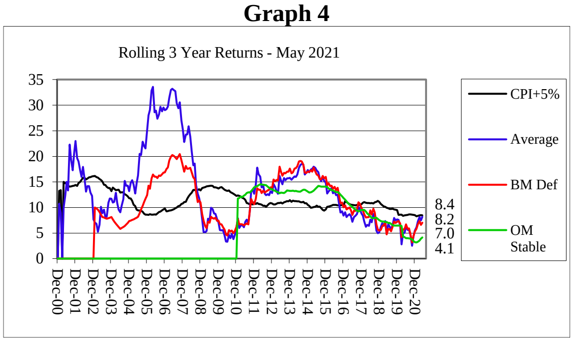
Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.6%	3.2%	2.5%
Best annual performance	8.2%	9.8%	8.8%
No of negative 1-year periods	n/a	0	0
Average of negative 1-year periods	n/a	n/a	n/a
Average of positive 1-year periods	7.8%	6.4%	6.3%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years June 2018 to May 2021. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4

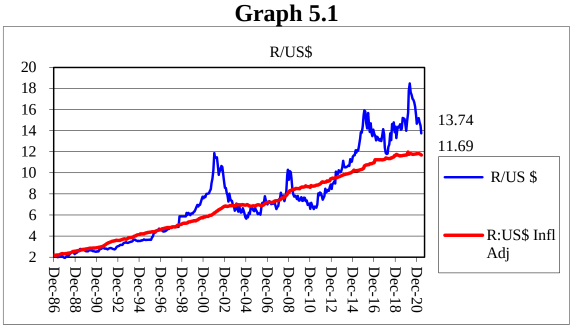


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3-year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end May was 7.0%, the average was 8.2% vs CPI plus 5% currently on 8.4%.

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 11.69 to the US Dollar while it actually stood at 13.74 at the end of May. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

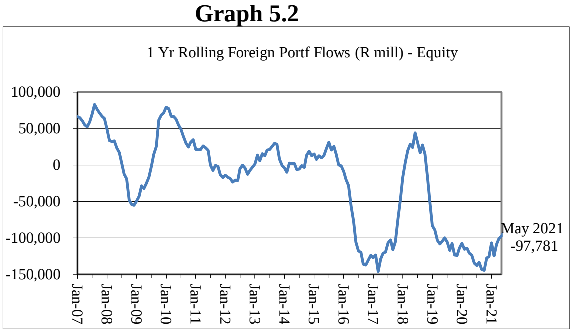


The Rand strengthened by 5.0% in May with net foreign investment outflows from bonds and equities of R3.9 bn. Over the past 12 months the Rand strengthened by 22.0%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 108.3 bn (outflow of R 121.5 bn to end of April 2021).

Since the beginning of 2006, total net foreign portfolio outflows amounted to R 134.1 bn (April R 130.2 bn outflows).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 97.8 bn at the end of May (outflow of R 101.0 bn year-on-year to end April). The month of May experienced a net outflow of R 9.4 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 301.0 bn (end April net investment outflow of R 291.6 bn). This represents roughly 1.6% 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 10.5 bn over the past 12 months to end of May (outflow of R 20.5 bn over the 12 months to end of April). The month of May experienced a net inflow of R 5.5 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 167.0 bn (to April R 161.5 bn).

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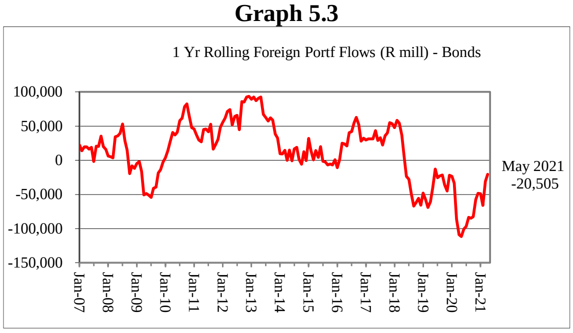
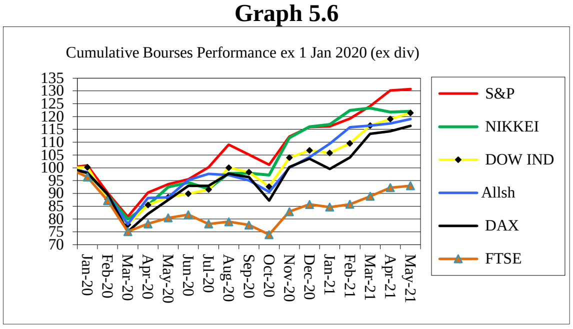
Graph 5.3

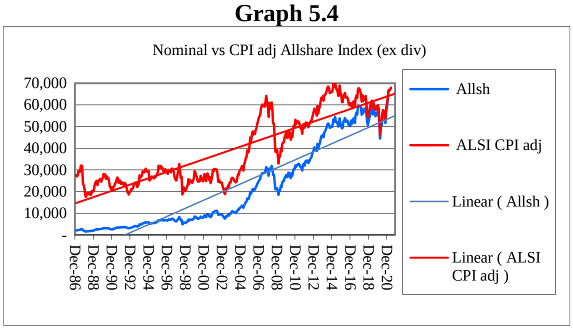


Graph 5.6



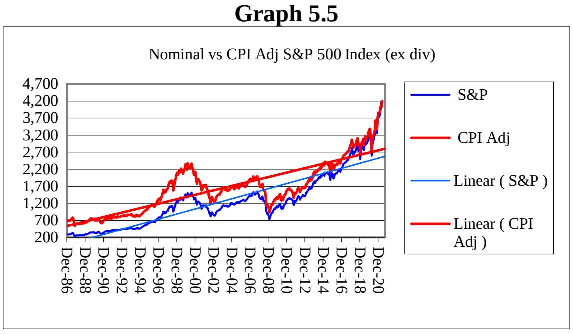
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.8% per year since January 1987, and this excludes dividends of 3.1%. Namibian inflation over this period of 34 years was 7.7% per year. This is equivalent to a growth in real terms of 3.1% p.a. over this period, excluding dividends, or around 6.2% 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 8.3% per annum, over this period of 34 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 5.7% p.a. over this period, excluding dividends or around 7.9% including dividends.

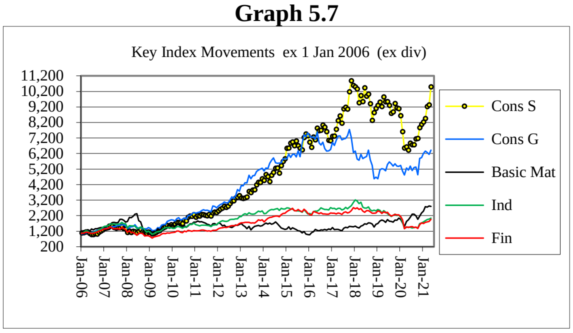
Graph 5.5



Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P500 as the top performing index since the start of 2020.

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 ones offer less value on the basis of fundamentals. Annualised returns for these indices since the beginning of 2006 were: Consumer Services: 16.5%; Consumer Goods: 12.8%; Basic Materials: 6.9%; Industrials: 4.7% and Financials: 4.5%.

Graph 5.7



6. Understanding Benchmark Retirement Fund investments – Part 2

By Tilman Friedrich

In the next few issues of our monthly Performance Review, I will be providing background and guidance on investments to assist Benchmark Retirement Fund members to take charge of their fund investments. This will address the following topics:

1. Parties to fund and their roles and responsibilities
2. Investment choice and return objectives
3. Investment range and portfolio composition
4. Performance characteristics of asset classes and portfolios
5. The default portfolio
6. The default portfolio vs the smooth growth portfolio
7. Income replacement ratio and contribution rates
8. Selection of investment managers
9. Combining investment portfolios and when to switch
10. Investment manager risks and manager diversification
11. Performance measurement

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MAY 2021

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

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In Part 1 in last month's newsletter, I covered the first 3 topics. In this newsletter I will cover the topic 'performance characteristics of asset classes and portfolios.

4. Performance characteristics of asset classes and portfolios

To understand why different portfolios perform differently, let us look at the type of assets typical prudential balanced retirement fund portfolios invest in and where they typically invest.

Table 6.1 – average regional asset class allocation

Weighted Average	31 March 2021	31 March 2020
Namibian Equities	13.1%	12.6%
Namibian Bonds	13.2%	14.7%
Namibian Cash	19.8%	17.1%
Namibian Property	0.7%	1.2%
Namibian Other	1.0%	0.0%
South African Equities	25.0%	22.1%
South African Bonds	4.0%	4.9%
South African Cash	-6.3%	-6.0%
South African Property	0.8%	0.3%
International Equity	25.6%	28.8%
International Bonds	1.2%	0.6%
International Cash	0.9%	2.0%
International Property	0.0%	0.0%
International Other	1.0%	1.7%
Total	**100.0%**	**100.0%**

Table 6.2 – average asset allocation

Average asset allocation	31 March 2021	31 March 2020
Equity [1], [7], [8]	63.7%	63.5%
Bonds [2]	18.4%	20.2%
Cash [3]	14.6%	13.1%
Property [4], [7], [8]	1.5%	1.5%
Debentures [5], [8]		
Other [6], [8]	1.8%	1.7%
Total	**100.0%**	**100.0%**

Note: The maximum allocation to each asset class is subject to the following statutory limits (regulation 13):

1 – Equity max: 75%;
2 – bonds max: 50% (gov bonds is 95%);
3 – cash max: 95% (20% per bank);
4 – property max: 25%;
5 – debentures max: 25%;
6 – other max: 2.5%;
7 – property & equity max: 90%;
8 – property, equity, debentures, other max: 95%

Table 6.3 – average total regional allocation

Average	31 March 2021	31 March 2020
Namibia	46.8%	41.1%
South Africa	20.6%	25.1%
International	31.1%	31.8%
Africa	1.5%	2.0%
Total	**100.0%**	**100.0%**

Note: The minimum and maximum allocation to the different geographical areas is subject to the following statutory limits (regulation 13):

1 – Namibia min: 45%
3 – South Africa: -
4 – International max: 35%
5 – Africa excl SA, Namibia: 5%

Equity, of course, represents the highest-risk asset class, with the highest expected long-term return, the highest volatility, and the highest risk of negative returns; cash the lowest-risk and lowest expected long-term return; bonds and property somewhere between these two asset classes. Portfolio managers of the prudential balanced portfolios, spread investments widely across each of these asset classes. In addition, they are, by regulation, limited to how much they can invest in a single company, issuer, bank, or property. A portfolio manager may not invest more than 20% of the portfolio in a single bank, regional authority, local authority, or statutory body; not more than 40% in a government; not more than 5% in a single property, and not more than 10% in a single company. In practice, the portfolio managers spread their investments between all of the above institutions. Although the number of holdings varies widely between the different portfolio managers, and from time to time, they cover easily 50 or more different companies, banks, bonds, properties, etc.

We pointed out that the statistics reflected in the graphs above are those of the average prudential balanced portfolio. In practice, this is currently the portfolio that comprises the highest risk among pension fund portfolios. A wide range of portfolios is available with lower-risk profiles. This means that in these lower-risk portfolios, the total allocation to equities varies substantially and is much lower than the 64% reflected in table 6.2 above. The exposure to bonds and cash will be much higher than that reflected in table 6.2 above. Some do not hold equity at all, but only cash, or only cash and bonds. As the result, these lower-risk portfolios will produce lower return volatility, less negative returns, but also less positive

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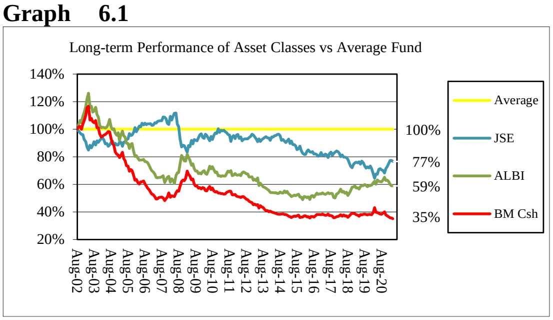
returns. They must be expected to produce lower long-term returns than portfolios with high equity exposure.

Graph 6.1

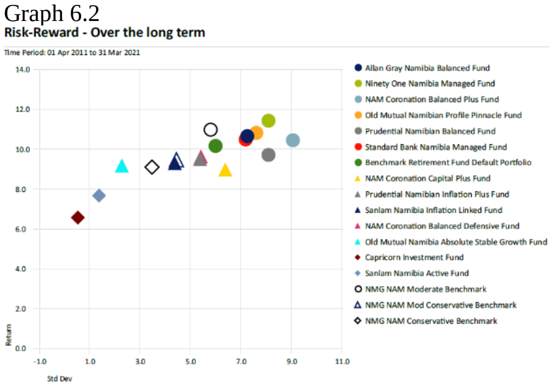


Graph 6.1 above confirms that higher risk results in higher returns. It reflects the relative, cumulative performance of the average prudential balanced portfolio, as the yellow line on 100%. In other words, this line returned N$ 100 on investment over the 20 years reflected in Graph 6.1. The actual annual performance of this notional portfolio was 13%, over this period from August 2002 to April 2021. The annual inflation over this period was 5.3%. The notional portfolio, thus out-performed inflation by 7.7% per year! Now, let's look at the blue line, representing the JSE Allshare index. An investment in this index would have only produced better returns than the notional portfolio, from February 2006 to August 2008. Before and after that short period of out-performance, the JSE Allshare index never produced a better return than the notional portfolio. By the end of January 2021, its return was 22% lower than the return of the notional portfolio. In other words, the return on this investment would have only been N$ 77 over this period. The same applies to all of the other asset classes. In order of cumulative underperformance, the graph shows that the 'Allbond Index' underperformed the notional portfolio by 41%, and right at the bottom, the money-market portfolio underperformed by 65%, cumulatively to the end of April 2021.

Whenever one assesses the performance of any investment portfolio, one should know whether it is a low-risk portfolio, a medium-risk portfolio, or a high-risk portfolio. The key factors that determine performance are prevailing interest rates and the state of equity markets. Equity markets are driven by the economy and by investor sentiment. One, therefore, has to determine if the equity markets have grown or declined throughout, and if interest rates have increased or decreased over this period. There are periods when shares, bonds, and cash produce better returns than the average prudential balanced portfolio, but those periods are typically short-term. In the long run, the returns of all these asset classes are substantially lower than the returns of the average prudential balanced portfolio. One should not expect a cash portfolio to behave like an equity-only portfolio, or a bond-only portfolio, or a prudential balanced portfolio, and the converse. A simplistic analogy – do not expect a passenger vehicle to behave like an SUV and vise-versa. Be clear on whether you need a passenger vehicle or an SUV!

Another way of substantiating the saying of high risk, high return, low risk, low return is graph 6.2.

Graph 6.2



On Graph 6.2, the horizontal axis reflects the risk as measured by volatility, while the vertical axis reflects the return. The theory then says that the further a portfolio moves toward the right the higher up its return should move. This graph reflects a relatively short period of 10 years. It covers the period of artificially low interest rates that were set by national banks after the 2008/ 2009 global financial crisis, and their large-scale money printing. Despite those distortions, the theory remains intact: high risk, high return, low risk, low return. The diamond in the graph with no fill represents a model, or a benchmark portfolio, with no equity exposure. The pyramid with no fill represents a model portfolio with a low-equity exposure. Finally, the circle with no fill represents a model portfolio similar to the typical prudential balanced portfolio. Note, that these 3 geometric figures without fill are more or less in a straight, inclining, line, that is consistent with their risk profile. The position of each portfolio is then also reflected, and all filled diamonds, all filled pyramids, and all filled circles are portfolios that fit into the relevant risk category, as represented by the geometric figure without fill. It will be noted that by and large, the theory applies, although there are some outliers, possibly the result of the abnormal circumstances that prevailed over this period.

This article will be continued in the next Benchtest Performance Review.

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