Volume 6, No. 9, September 2010

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 SEPTEMBER 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.

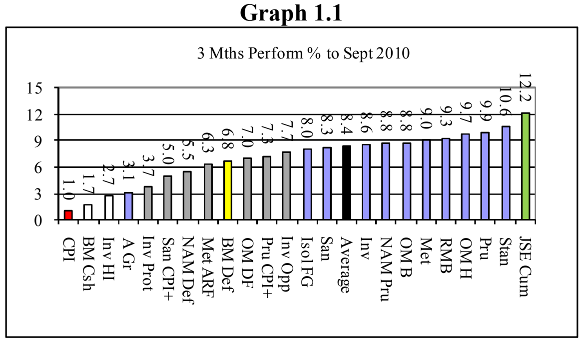
1. Review of Portfolio Performance

In **September** the **average prudential balanced portfolio** returned 4.89% (August minus 1.6%). The see-saw in terms of performance ranking continues. This month, last month's worst performer, Prudential, takes top spot (6.25%), worst performance once again delivered by Allan Gray (2.14%), last month's top performer.

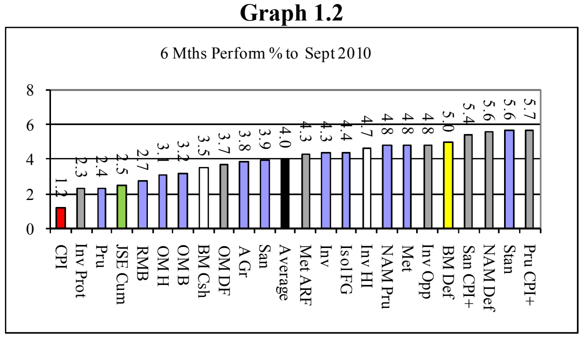
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential balanced 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 Csh (no colour)
Investec High Income (interest bearing assets)	Inv HI (no colour)
Investec Protector	Inv Prot (grey)
Investec Opportunity Fund	Inv Opp (grey)
Metropolitan Absolute Return	Met ARF (grey)
Prudential Inflation Plus	Pru CPI+ (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Sanlam Inflation Plus	San CPI+ (grey)
NAM Coronation Balanced Def	NAM Def (grey)
Market related portfolios	
Allan Gray Balanced	A Gr (blue)
Investec Managed	Inv (blue)
Investment Solutions Bal Growth, prev. Focused Growth (multimanager)	Isol FG (blue)
Prudential Managed	Prud (blue)
Metropolitan Managed	Met (blue)
NAM Prudential Balanced	NAM (blue)
Old Mutual Profile Balanced	OM B (blue)
Old Mutual Profile Growth	OM H (blue)
RMB Managed	RMB (blue)
Sanlam Managed	San (blue)
Stanlib Managed	Stan (blue)

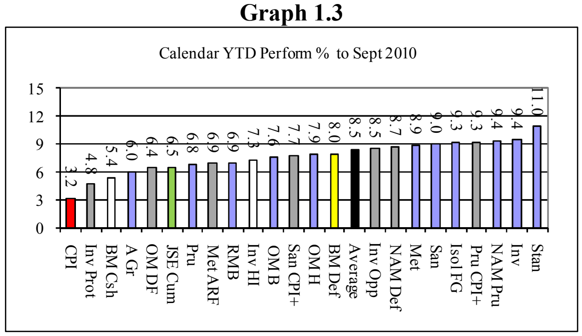
Graph 1.1



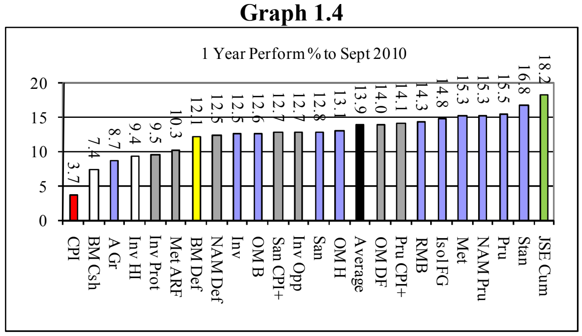
Graph 1.2



Graph 1.3



Graph 1.4



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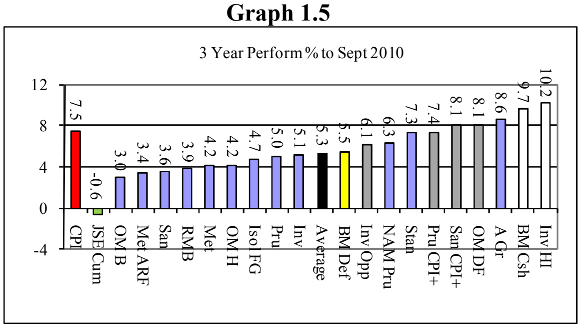
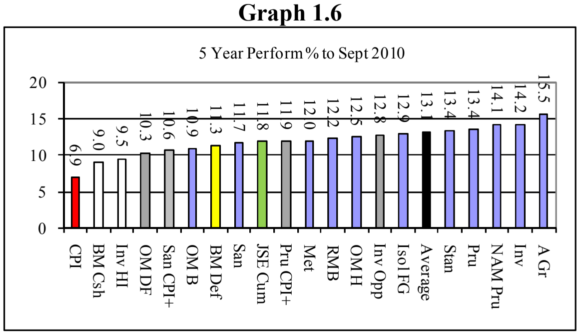
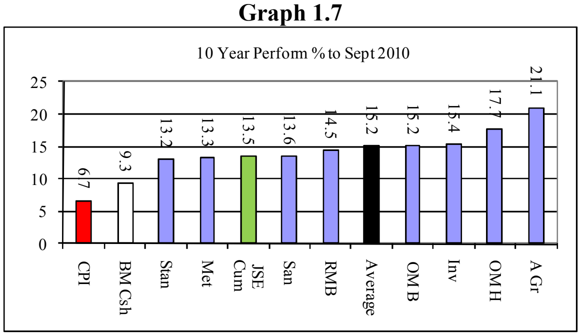
Graph 1.5



Graph 1.6

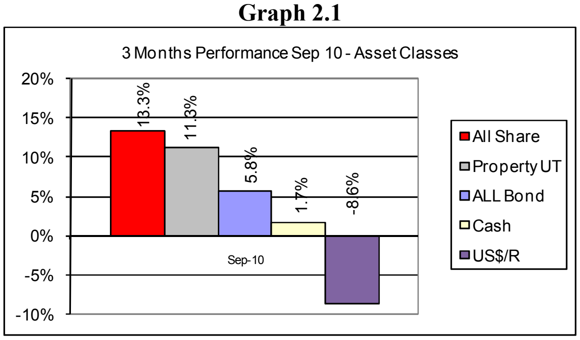


Graph 1.7

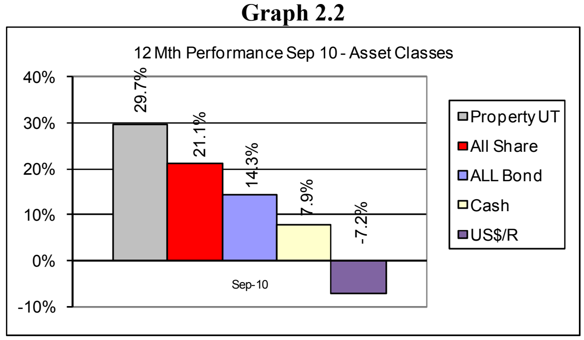


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

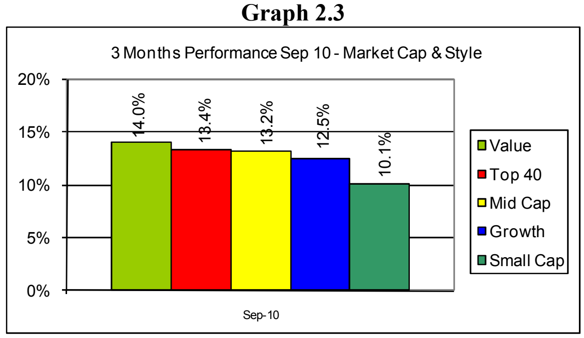
Graph 2.1



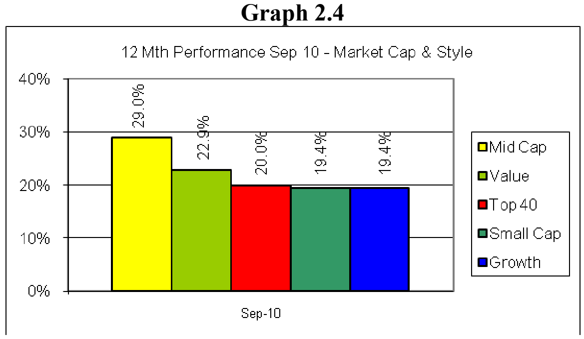
Graph 2.2



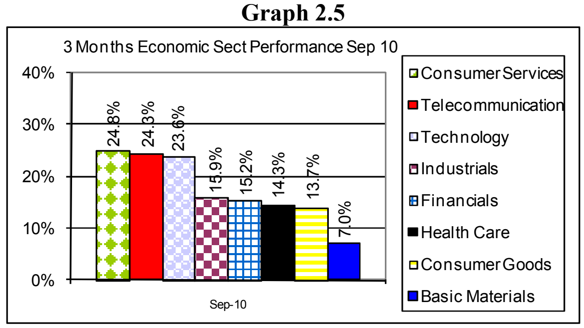
Graph 2.3



Graph 2.4



Graph 2.5



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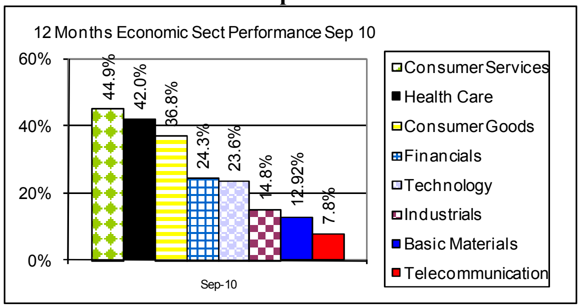
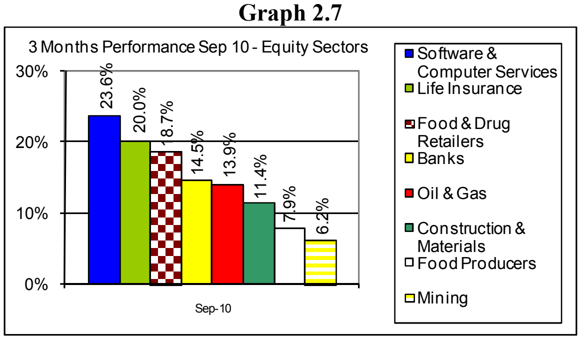
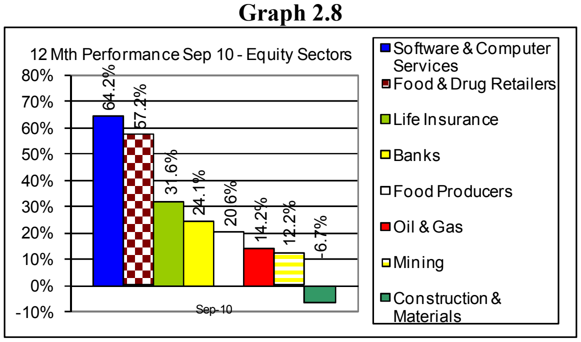
Graph 2.6



Graph 2.7



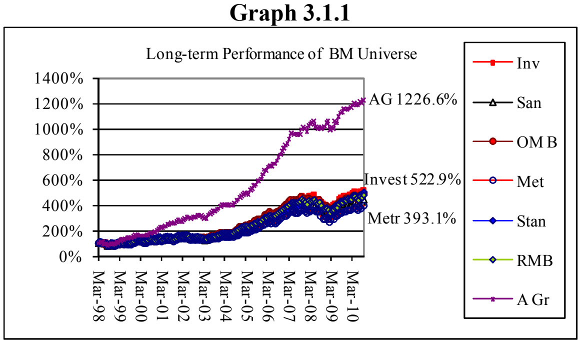
Graph 2.8



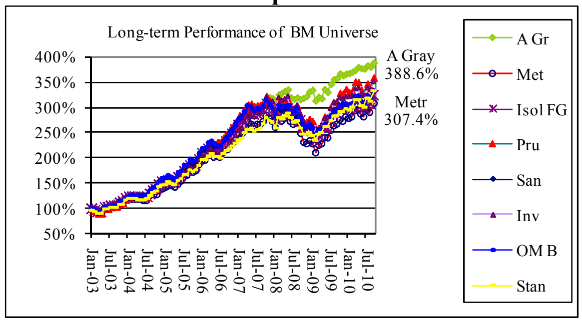
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

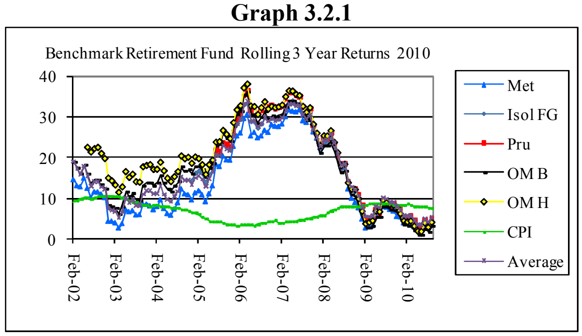


Graph 3.1.2

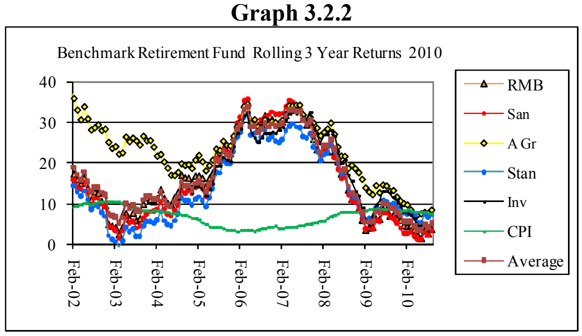


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1



Graph 3.2.2



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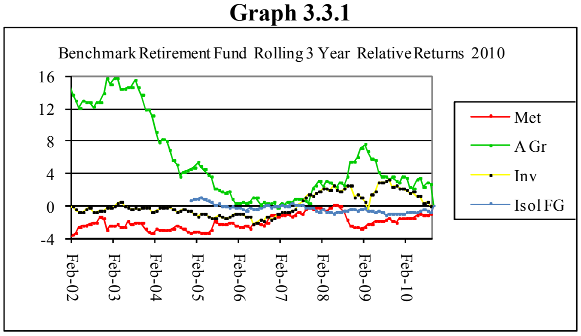
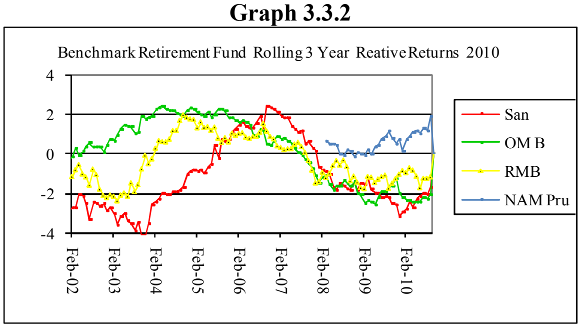
3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

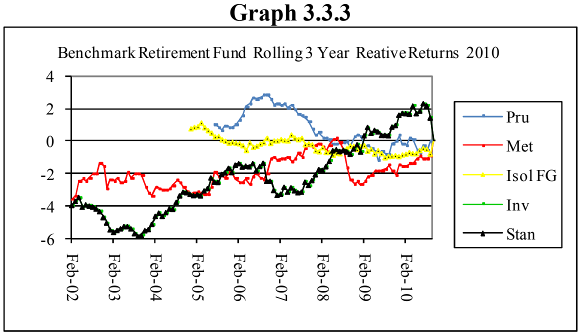
Graph 3.3.1



Graph 3.3.2

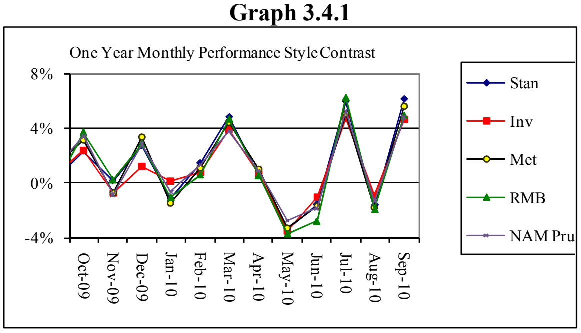


Graph 3.3.3

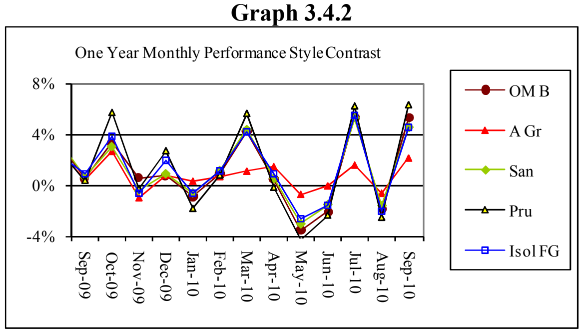


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

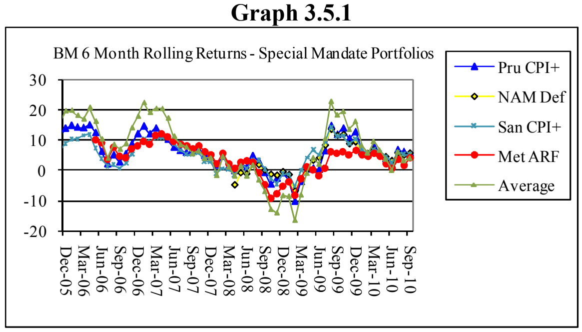


Graph 3.4.2

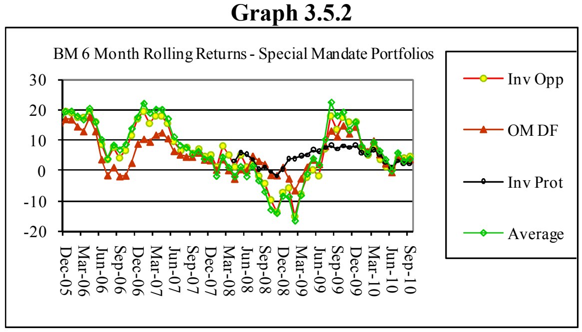


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

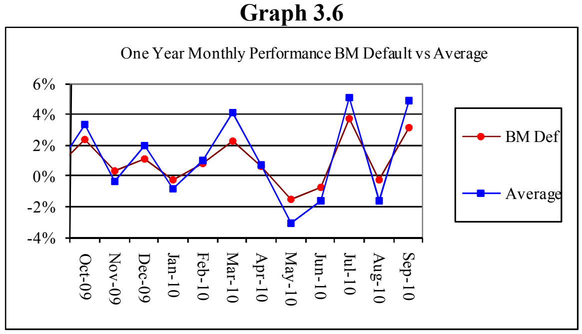


Graph 3.5.2



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

Graph 3.6



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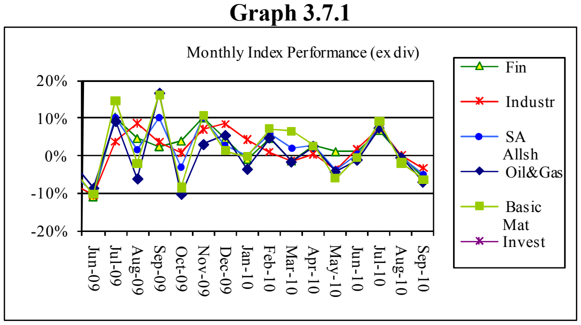
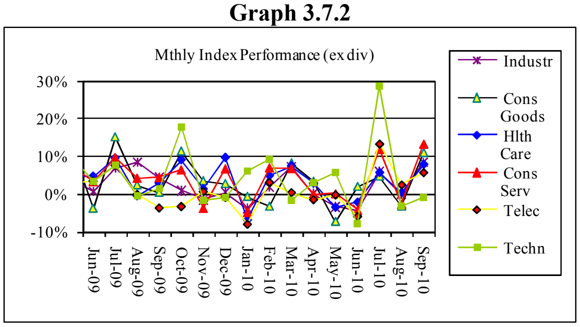
3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

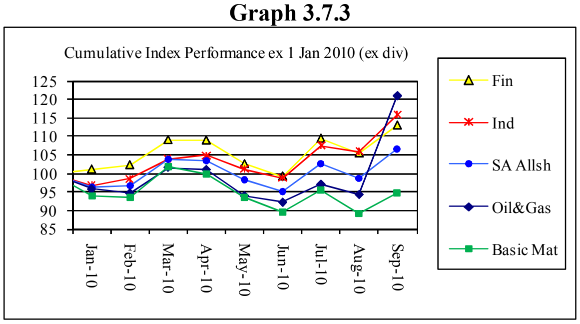
Graph 3.7.1



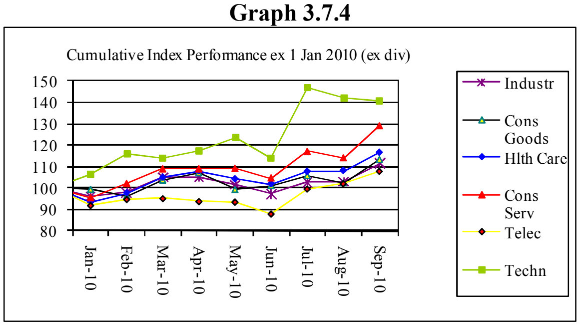
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 13.1% p.a. in nominal terms, or 6.2% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 11.3% 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 1.8% p.a., between the Default portfolio and the average prudential balanced portfolio, is probably representative of a realistic long-term expectation. We would expect the average prudential balanced portfolio to deliver a real return before management fees (typically 0.75%), of roughly 6% per year and the Default portfolio to sacrifice around 2% to 3% for the benefit of lower volatility, thus an expected real return before management fees (typically 0.75%), of around 4% per year.

The Money Market portfolio returned 7.4% and the Default portfolio returned 12.1%, gross for the one year to end September. The more 'risky' average prudential balanced portfolio returned 13.9% 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 performance statistics over the 3 years October 2007 to September 2010:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	7.4%	- 8.0%	- 19.1%
Best annual performance	12.1%	20.8%	29.7%
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	10.0 %	10.3%	14.0%

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% before fees and roughly 3.3% after fees.

It is also important to realize that at this rate of return, the net contribution towards retirement by both, member and employer should be roughly 16% of remuneration, in order to achieve a reasonable income replacement ratio of 2% per year of service. In contrast, the expected long term net rate of return of 5.3% that the average prudential balanced portfolio should achieve, should produce an income replacement ratio of roughly 3% per year of service.

It is very important 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!

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5. A Contrarian Preview Of The Next 12 Months

Global equity markets remain in volatile territory, four of the last six months producing poor to very poor returns, July, and September having produced excellent returns though.

For the sake of our readers appreciating the magnitude of sovereign indebtedness of developed countries specifically, we repeat some interesting observations from the previous newsletter. We pointed out that the budget deficit in Germany is currently around 4% of GDP, with public debt at 80% of GDP. In the US the comparatives are 8% and 90% of GDP, respectively. In contrast, in SA the current budget deficit is in the region of 7% of GDP while public debt stands at 40% of GDP. Namibia also budgets for a deficit of 7% of GDP while its public debt is only 20% of GDP. To put the US debt statistics into more plausible terms, for a person earning say N$ 20,000 per month or N$ 240,000 per annum, it would mean that his total debt is around N$ 650,000 and that he continues to borrow at the rate of N$ 55,000 per year. To repay this debt at a real interest rate of 3% over 10 years would mean that this person would have to apply 35% of his income, increasing at a rate of 2.5% of his income per year.

Considering these facts and the possibility of further quantitative easing measures to be taken in the US and other countries, one may be forgiven for wondering whether there is any limit to the levels of debt a country can take on.

It appears that the principles of a free market economy have been abandoned in the light of the massive global government intervention that one has seen since the start of the financial crisis. Under these circumstances it is extremely difficult to express any views on the development of global economies and hence our own economy and of financial markets over the next 12 months.

Where we have expected equity markets to move sideways in 2010, they have in fact shown exceptional growth (the Allshare index increased by 37% from end December 2009 to end September 2010), spurred on by massive money supply. One would have expected inflation to rise on the back of the massive money supply. This has not happened as the fiscal interventions have failed to stimulate consumer demand.

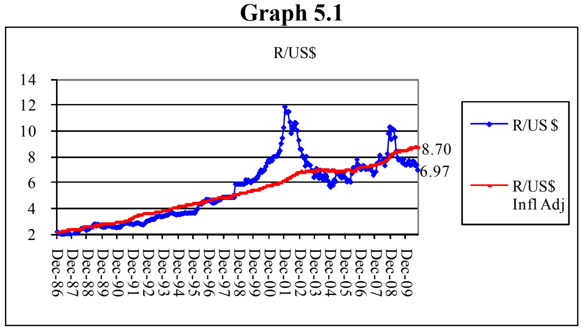
The housing bubble in the US is far from resolved and there remains a massive debt problem and oversupply of housing that will have to first dissolve slowly over an extended period of time. Consumers' balance sheets have to be rebuilt either through debt repayment (or deleveraging) and/or through inflation bloating their asset values, before we would expect consumer sentiment to improve and demand to pick up.

The heating up in equity markets is therefore not due to healthy diversified demand but rather due to an oversupply of money at an institutional level and is probably another bubble that will either burst or deflate slowly over an extended period of time. While the oversupply of money remains in the institutional domain, it is likely that we will continue to see lots of volatility and capital flows swinging in various directions across the globe, based on government interventions at different times in different parts of the world.

What we expected to happen this year was probably only delayed through globally coordinated government intervention. In other words, we still expect an extended period of sideways movement in equity markets and increased inflation levels, likely to be higher in developing economies and therefore likely to cause a depreciation of their currencies.

Graph 5.1 indicates that the Rand is fairly valued at 8.80 to the US Dollar. This is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1



Graphs 5.2 and **5.3** still reflect a steady flow of capital into South Africa. Low demand in SA's and Namibia's main export markets and the strong Rand should put a damper on our export performance, while cheaper imports should result in our local industries being less competitive. They will be forced to increase productivity and reduce costs and employment, which will in turn put a damper on local consumer sentiment.

We expect these trends to only start reversing within the next 12 to 24 months. In the mean time, equity markets are likely to move sideways while interest rates will remain stable with some scope for downward adjustment in SA and Namibia still.

For the year to end of September, the FTSE/JSE still experienced a strong net inflow of R 30 billion (R 40 billion, 12 months to end August), compared to a net inflow of R 25 billion for the year to end September 2009 (net inflow of R 15 billion, year to end August 2009).

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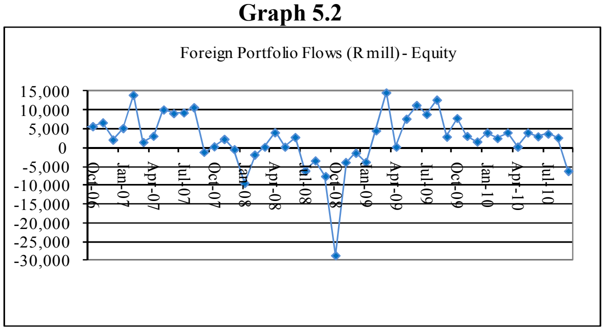
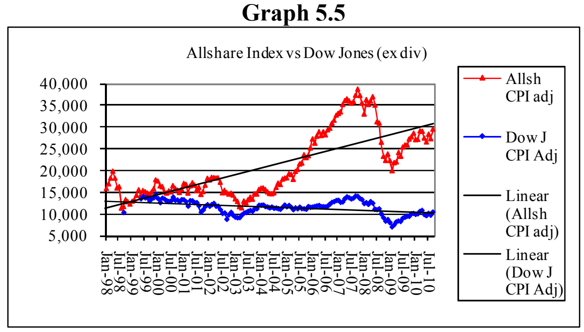
Graph 5.2

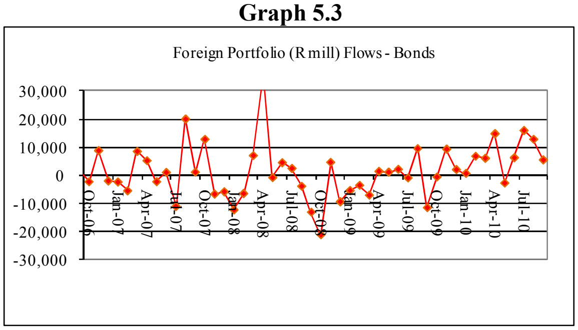


Graph 5.5



Graph 5.3 reflects the net flows into fixed interest instruments, which amounted to R 78 billion for the 12 months to end September (R 61 billion for the 12 months to end August), compared to an outflow of R 39 billion for the 12 months to end September 2009 ($ 41 billion outflow for the 12 months to end August 2009).

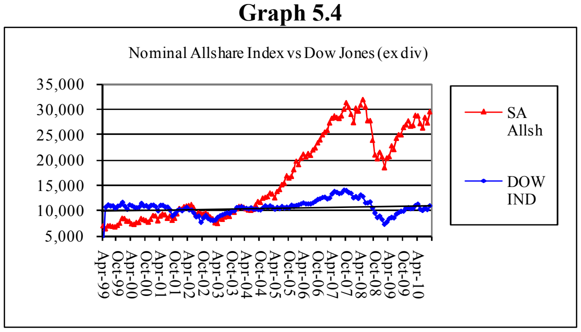
Graph 5.3



Graph 5.4 shows to what extent equity markets have recovered in nominal terms since their low at the end of February 2009.

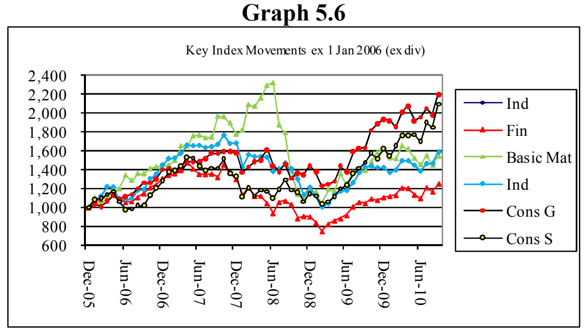
Graph 5.5 reflects the same statistics but adjusted for US and SA inflation respectively.

Graph 5.4



Graph 5.6 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 on the basis of fundamentals.

Graph 5.6



6. Conclusion

Our view remains that global equity markets are still fairly valued, but are likely to produce pedestrian growth for the next 12 months and longer, with considerable volatility. While some global interest rates have already been raised they will remain at low levels for a while, to start picking up once consumer demand picks up meaningfully. This we expect to only happen within the next 12 to 24 months. We still expect the Rand to remain pretty strong, but volatile for a while and weakness to only surface once global economies start picking up steam.

Our local equity markets also remain fairly valued. In terms of local equity sectors, **graph 5.6** 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 locally, 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. Property is a high yielding asset class and should deliver superior returns in the current environment. Shorter dated local bonds may also still produce fair returns

A lack of sparkling local investment opportunities and the current Rand strength suggests that one should be overweight offshore assets, more specifically in growing economies such as the BRIC countries.

For pension funds, a conservative balanced portfolio with a fair spread across equities, bonds and property and a high foreign exposure remains 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.