Volume 7, No. 2, February 2011

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 28 FEBRUARY 2011

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.

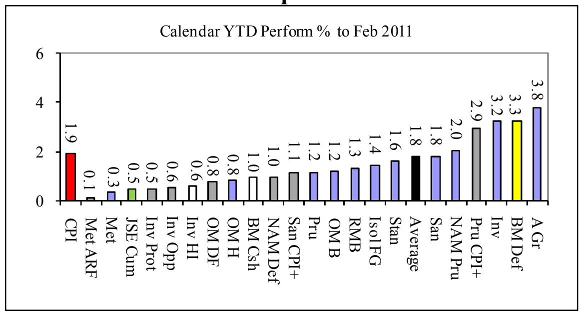
1. Review of Portfolio Performance

In **February** our **average prudential balanced portfolio** returned 1.21% (January 0.57%). Top performer is Investec (2.21%), while Old Mutual (0.4%) takes bottom spot. In very broad terms, Investec relative to the average prudential balanced portfolio had 5% lower exposure to onshore equities and a 4% lower exposure to onshore bonds and cash, with a compensating 9% higher exposure to offshore assets. Old Mutual's asset allocation was pretty much that of the average. In both cases the performance should have closely resembled that of the average. Investec's outperformance and Old Mutual's underperformance is thus a function of stock picking.

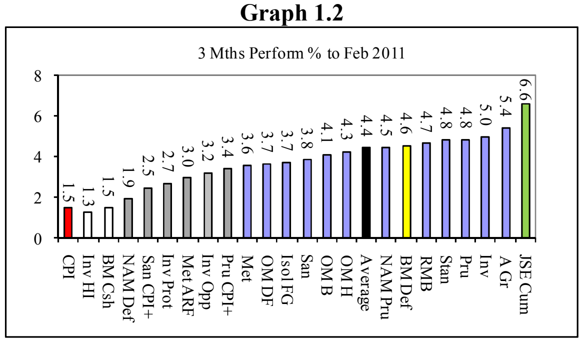
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential balanced 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 now represents a combination of Prudential Namibia Inflation Plus and Allan Gray. 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)

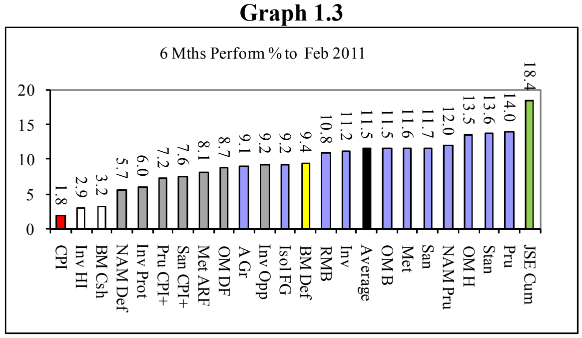
Graph 1.1



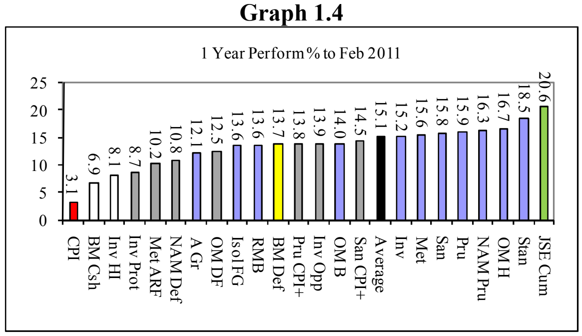
Graph 1.2



Graph 1.3



Graph 1.4



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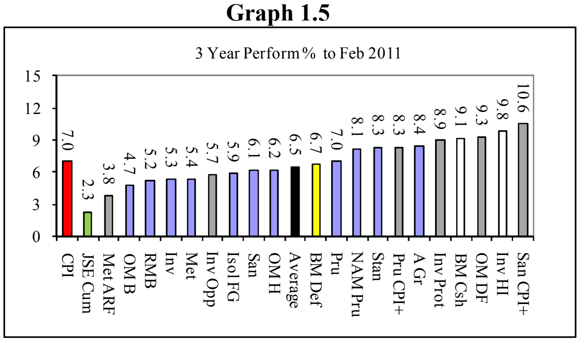
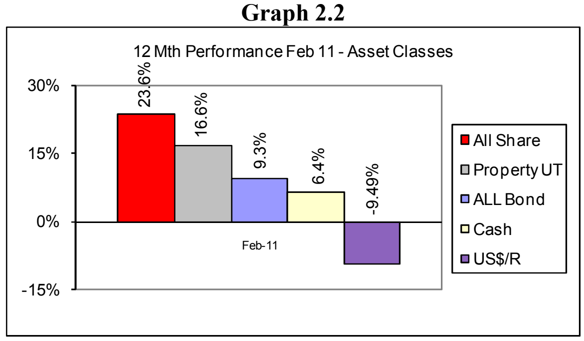
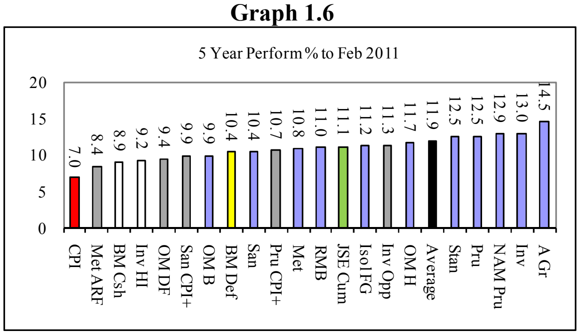
Graph 1.5



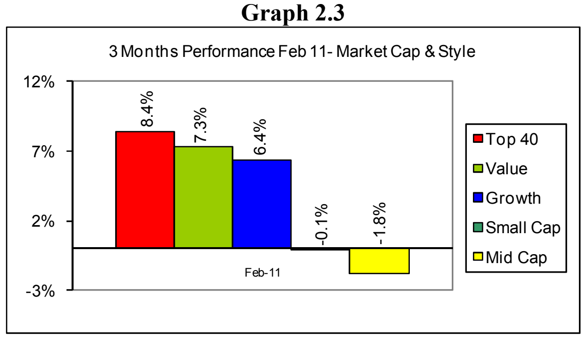
Graph 2.2



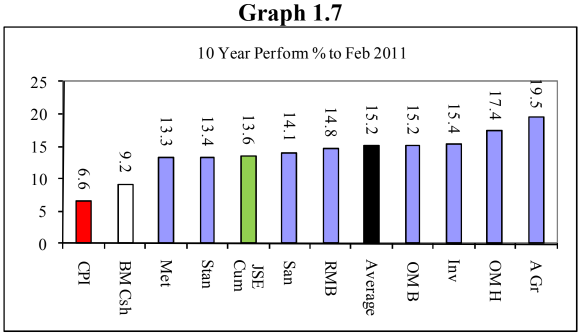
Graph 1.6



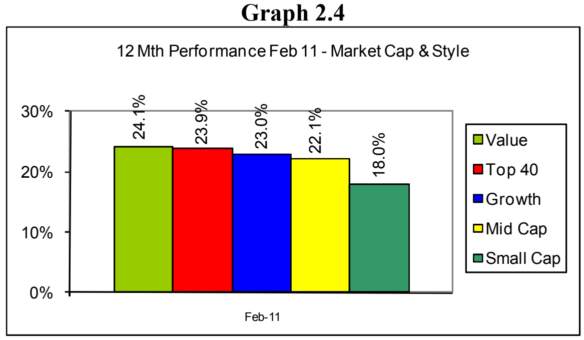
Graph 2.3



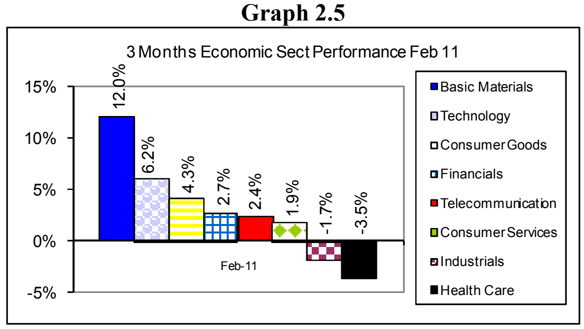
Graph 1.7



Graph 2.4

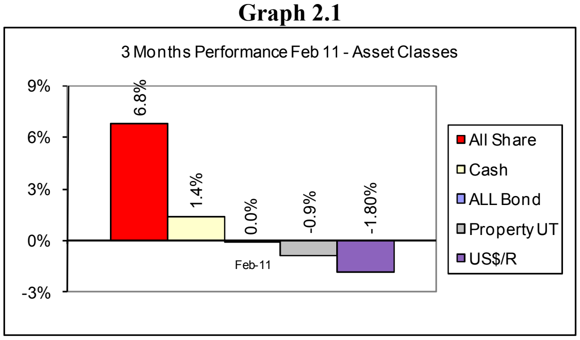


Graph 2.5



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

Graph 2.1



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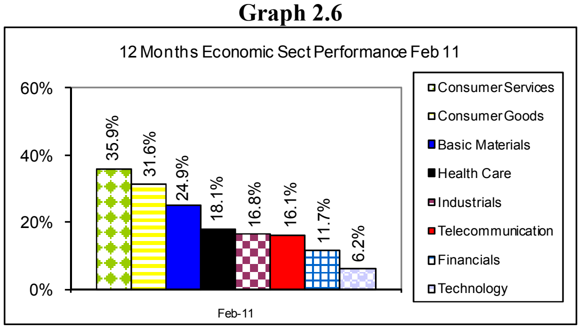
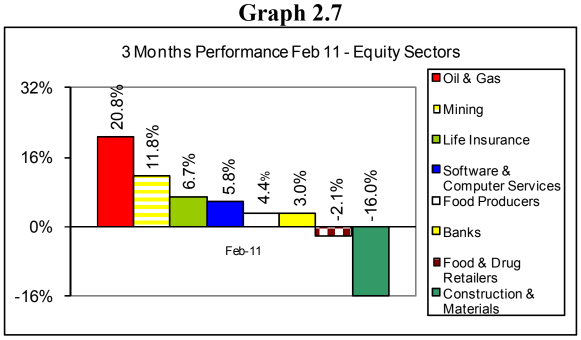
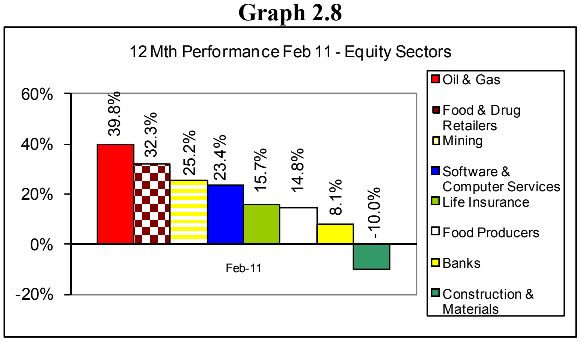
Graph 2.6



Graph 2.7



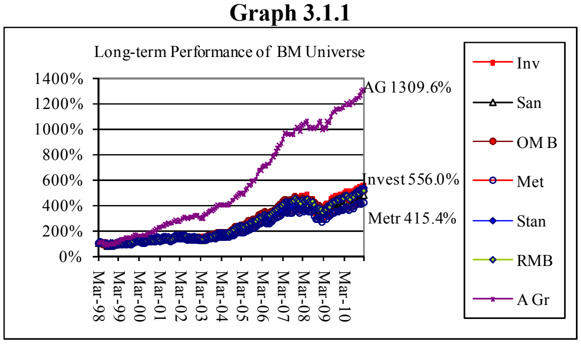
Graph 2.8



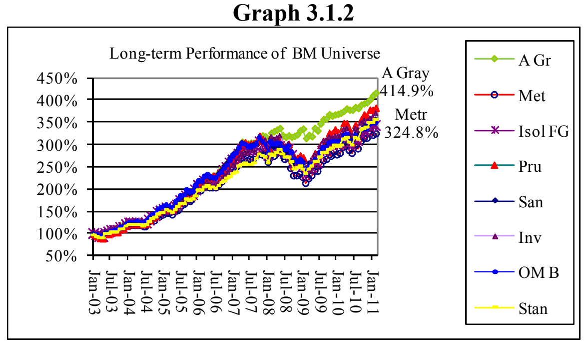
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

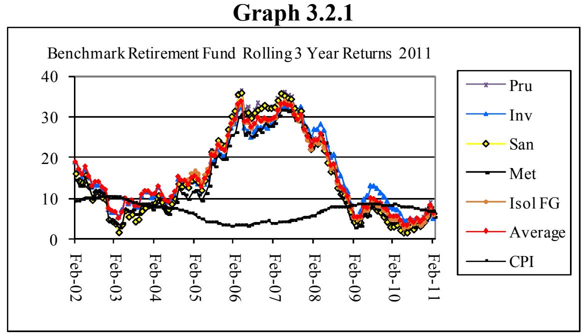


Graph 3.1.2

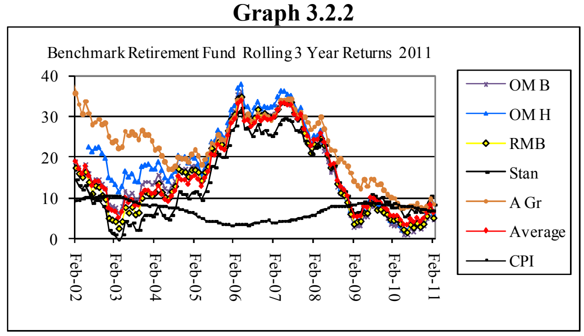


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1



Graph 3.2.2



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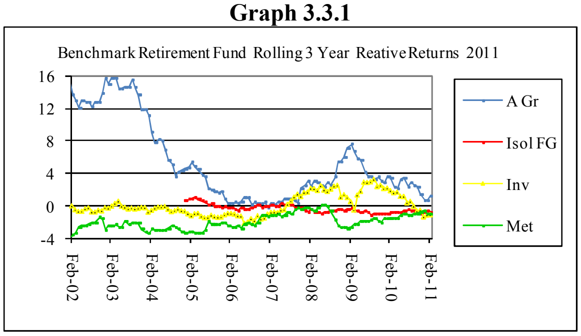
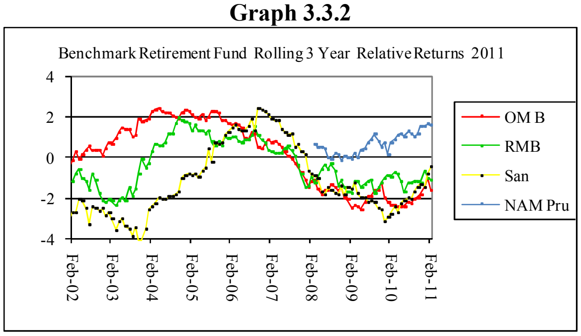
3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

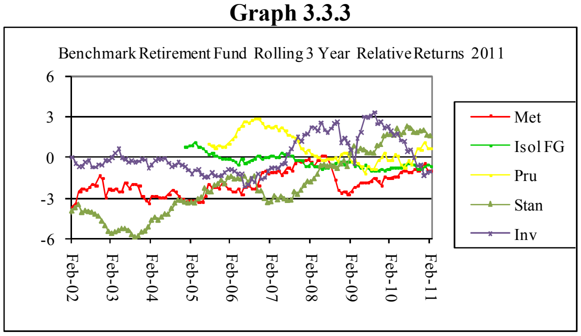
Graph 3.3.1



Graph 3.3.2

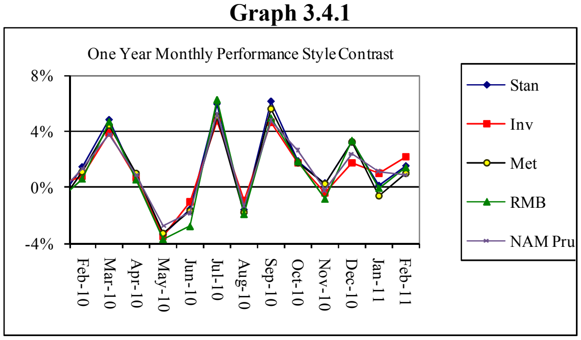


Graph 3.3.3

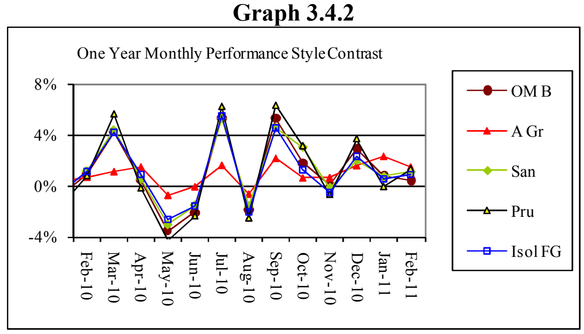


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

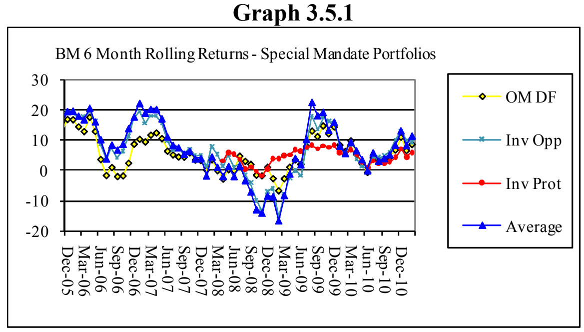


Graph 3.4.2

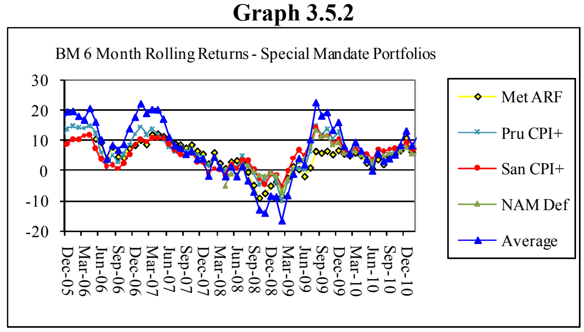


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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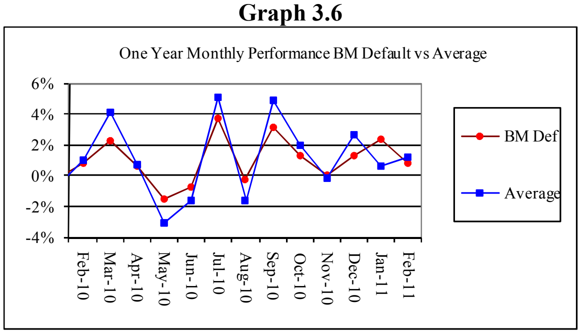
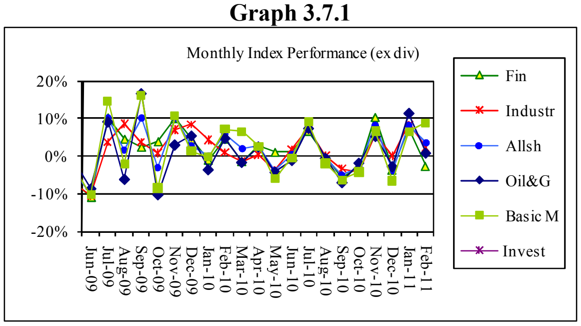
3.6 Monthly performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6

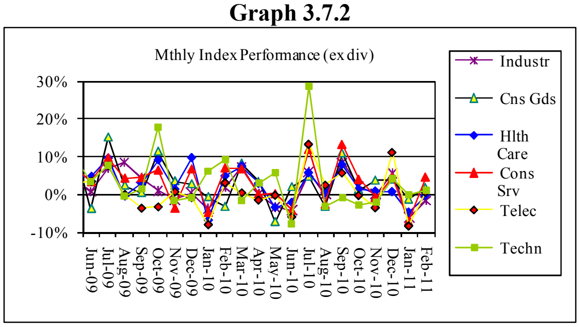


3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

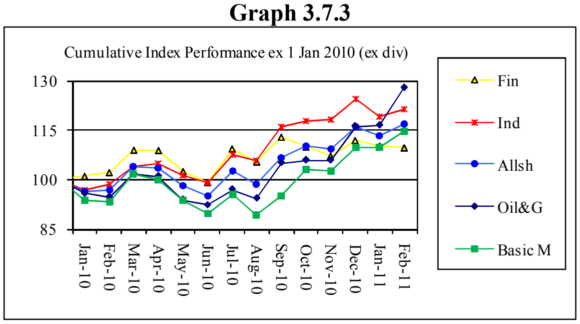
Graph 3.7.1



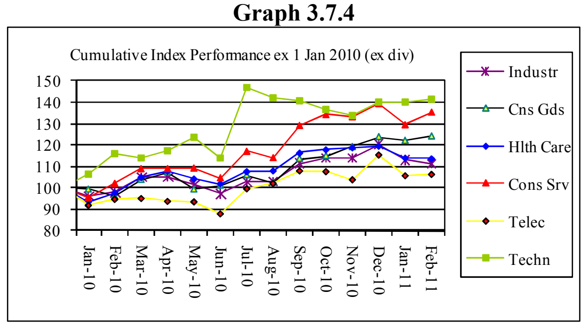
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 11.9% p.a. in nominal terms, or 4.9% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 10.4% p.a. in nominal terms, or 3.4% p.a. in real terms. We would expect the average prudential balanced portfolio to deliver a real return before management fees (typically 0.75%), of roughly 6% per year. Having raised the risk profile of the Default portfolio since the beginning of 2011 by replacing Metropolitan ARF with Allan Gray we would expect the Default portfolio to sacrifice around 1% for the benefit of lower volatility, thus an expected real return before management fees (typically 0.75%), of around 5% per year.

The performance of the prudential balanced portfolios should be 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 March 2008 to February 2011:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.9%	- 8.0%	- 19.1%
Best annual performance	12.1%	16.2%	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	9.7 %	9.7%	13.3%

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 5% before fees and roughly 4.3% 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 13% 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!

5. What We Expect Of The Next 12 Months

Global markets have recovered very nicely since the advent of the financial crisis, particularly those of commodity driven economies that have at times surpassed pre-crisis highs. Looking at the position of consumers globally, this 'hype' cannot have derived from consumers investing in equities. Rather than investing any surplus cash in the markets, consumers have done their utmost to reduce household debt as quickly as possible. We suspect that a significant driving force behind equity markets has come from the quantitative easing measures implemented by many governments globally, and of course the US in particular. This huge money supply probably mostly ended up in financial institutions rather than encouraging consumption and thereby getting the real economies going again. As the result of the historically low interest rates, these institutions had to hunt for positive returns, mostly believed to be found in commodities and also resorted to interest arbitrage. In other words, borrowing cheaply at home and investing at higher rates elsewhere. Commodity based economies had to endure the thrust of money from both sources which lead to the strengthening of their currencies and markets.

In the mean time consumer sentiment is now starting to improve slowly in the developed economies and the end of quantitative easing measure becomes ever more likely. Governments will then have to start looking at ways and means to improve their fiscal position. Growing consumption means growing revenue from taxes and should contribute towards an improvement. However an important policy instrument is likely to be inflation that raises the value of the asset side of balance sheets, as we all know. Once inflation starts manifesting, interest rates will rise as well, generally lagging inflation on the upturn and vice-versa on the down turn of inflation.

We believe that 2011 will see the start of a turn in the cycles based on the improving consumer sentiment in the developed economies. Money flows are likely to reverse from foreign markets back into the domestic markets in the developed economies. This will put a cap on further meaningful growth of equity markets in the developing world and should lead to the depreciation of their currencies, the opposite likely to happen in the developed world.

As far as the global demand for commodities is concerned, which has benefited our domestic markets and economies over the past 10 years or so, we believe that this is likely to subside some time, without venturing any guess as to a time line though. The argument about the thriving Chinese economy continuing to push demand appears to be flawed in our view. We argue that the global demand for commodities should not exceed global growth significantly over any extended period of time, which it has though, by leaps and bounds, for the past number of years. This in our opinion was probably due to a global realignment having occurred over these years where China took up an ever greater share of production at the expense of other countries that are now likely to experience over capacities to the extent that China's growth outpaced global growth. While domestic consumption in China is likely to grow faster than that in other countries, there is a limit to the pace at which a country can develop due to domestic capacity constraints.

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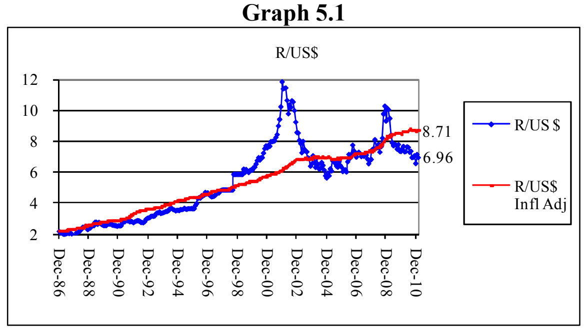
Graph 5.1 indicates that the Rand is fairly valued at 8.71 to the US Dollar. This is based on adjusting the two currencies by the respective domestic inflation rates. Our conclusion from this graph is that the likelihood of the Rand depreciating is significantly greater that the opposite.

Graph 5.1



Graphs 5.2 and **5.3** continue to reflect an ebbing of the flow of capital into South Africa, particularly into fixed interest area as the result of the declining opportunity for interest arbitrage. This trend is likely to continue and to accelerate and should result in the Rand depreciating while interest rates are likely to rise.

For the 12 months to end of February, the FTSE/JSE still experienced a net inflow of only R 21 billion (R 21 billion, 12 months to end January 2011), compared to a net inflow of R 77 billion for the 12 months to end February 2010 (net inflow of R 79 billion, 12 months to end January 2010).

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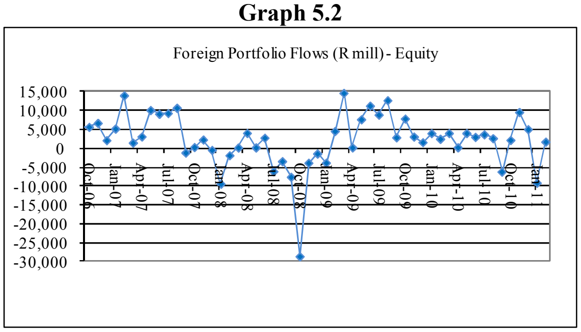
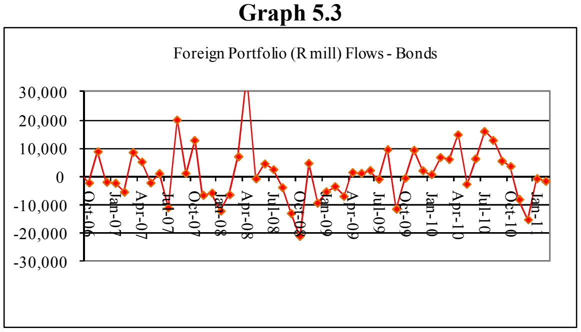
Graph 5.2



Graph 5.3 also reflects strong but declining net flows into fixed interest instruments, which amounted to R 38 billion for the 12 months to end February (R 46 billion for the 12 months to end January), compared to an inflow of R 14 billion for the 12 months to end February 2010 (R 4 billion for the 12 months to end January 2010).

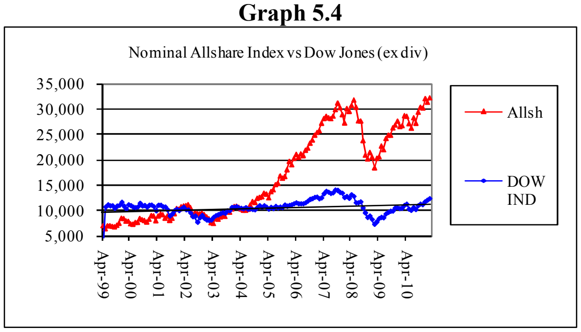
Graph 5.3



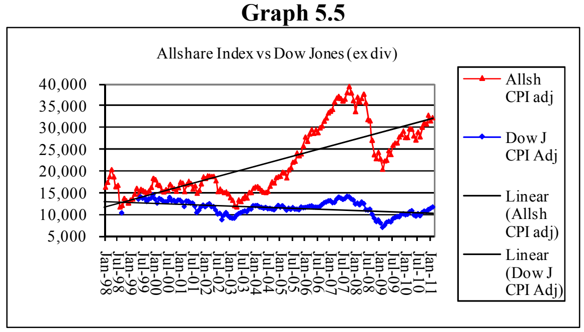
Graph 5.4 shows to what extent equity markets have recovered in nominal terms since their low at the end of February 2009.

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

Graph 5.4

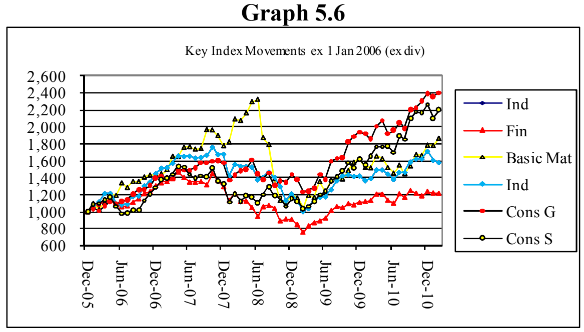


Graph 5.5



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

While the demand for our domestic commodities may still remain stable in the short to medium term, we believe that it is likely to start subsiding in the medium to longer term but should still provide some support to the Rand in the short term. A reversal in money flows from our financial markets should however lead to a weakening of the Rand. At the same time more expensive imports should result in our local industries becoming more competitive. This should in turn underpin local consumer sentiment over the course of the next 2 years.

All things being equal, we would have expected these trends to manifest over the next 12 to 24 months. The impact of the recent natural disaster that has hit Japan and its impact on the global economy may yet derail these expectations and produce unexpected spikes over the short term, as may the latest social upheaval in various Middle East countries and the steep increase in crude prices. In general however, equity markets are likely to move

sideways while local interest rates are likely to start moving up towards the end of 2011.
Global equity markets are still fairly valued, but are likely to produce pedestrian growth for the next 12 months and longer. 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 may though be retarded by political events in the Middle East, while high oil prices will accelerate inflation if the crisis persists for longer.

Our local equity markets also remain fairly valued although not at very competitive levels compared to other global bourses, with a significant risk posed by a possible depreciation of our local currencies and a subsiding demand for commodities. 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 more joy out of these sectors anymore and these should hence be underweight. This view is however very much dependent on political stability returning to the Middle East

On the basis of fundamentals, one should be overweight basic materials and industrials in the short-term but shifting weight from basic materials to financials and Rand hedge shares locally. We expect equities in general to outperform most other asset classes in general, but stock picking is really the key to successful investment. We do not expect too much joy from property in the short to medium term. Bonds as asset class appears risky under current conditions where there is a fair chance of an increase in rates but stock picking can still produce returns in excess of cash.

The current Rand strength suggests that one should be overweight offshore assets and moving the focus to equities in Europe and the US, in particular.

For pension funds, an assertive balanced portfolio with a fair spread across equities, bonds and property and a high foreign equity 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.