Volume 7, No. 7, Jul 2011

# Benchmark Retirement Fund

## MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JULY 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.

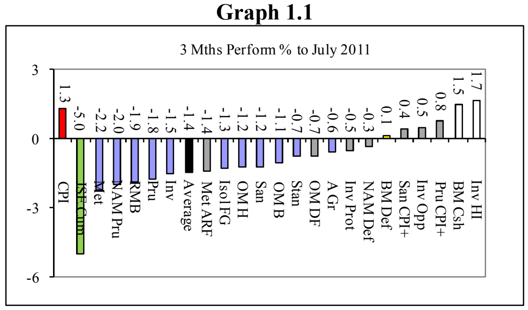
### 1. Review of Portfolio Performance

In **July** our **average prudential balanced portfolio** returned minus 0.64% (June minus 1.15%). Top performer is Allan Gray (0.34%), while Namibia Asset Managers (minus 1.24%) takes bottom spot.

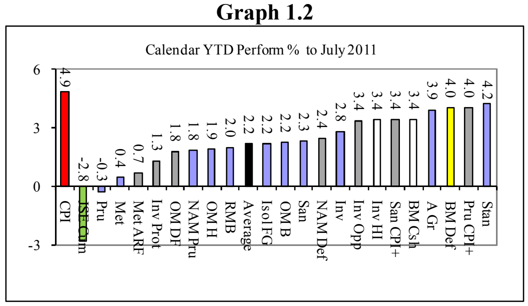
**Graphs 1.1 to 1.7** reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential 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, (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) |

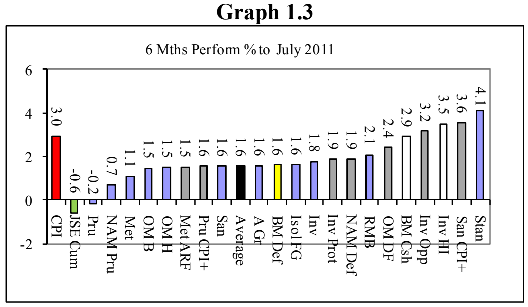
**Graph 1.1**



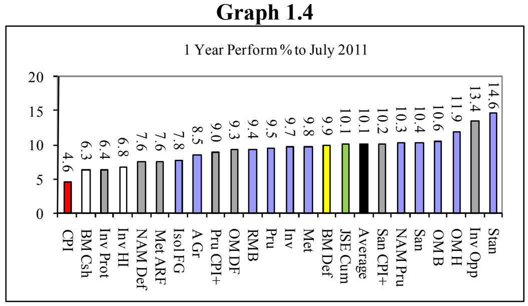

**Graph 1.2**




**Graph 1.3**




**Graph 1.4**



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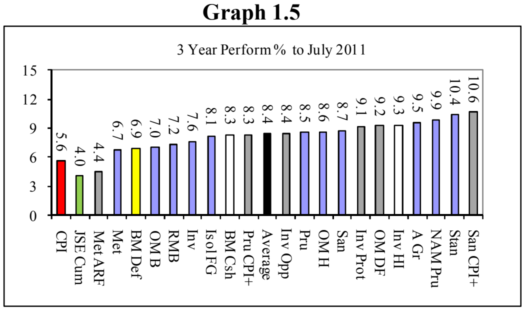
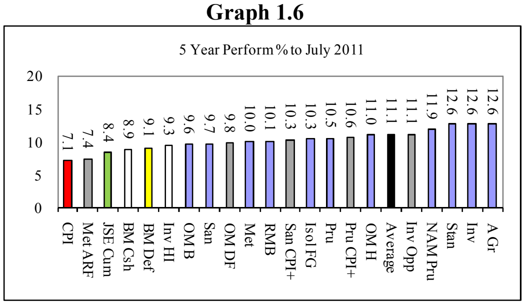
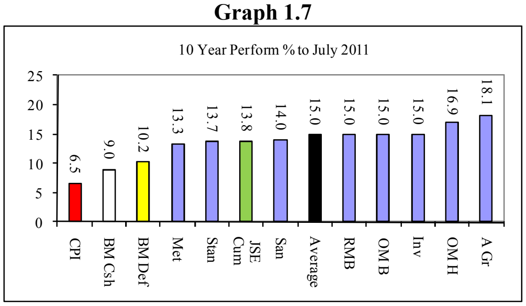
### Graph 1.5




### Graph 1.6

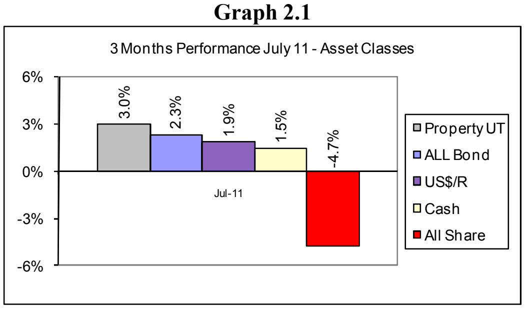



### Graph 1.7

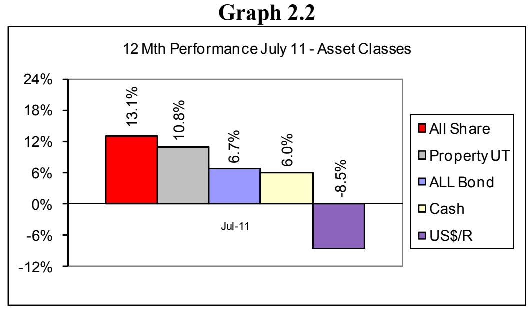



## 2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

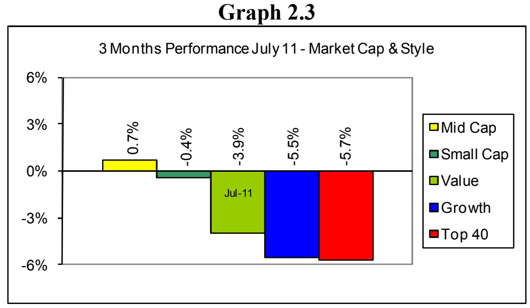
### Graph 2.1



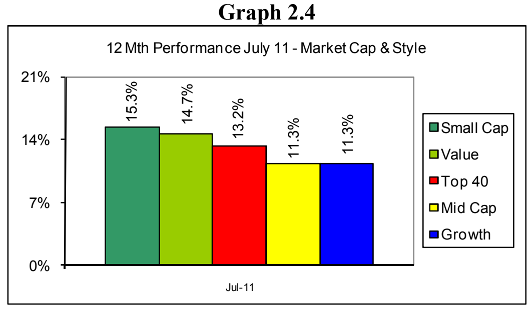

### Graph 2.2



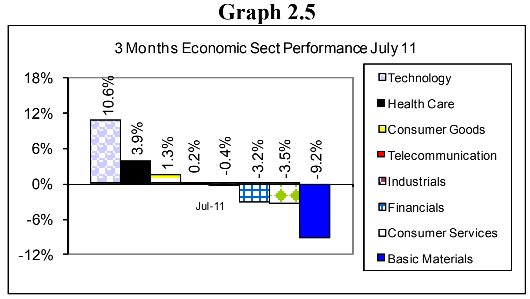

### Graph 2.3




### Graph 2.4




### Graph 2.5



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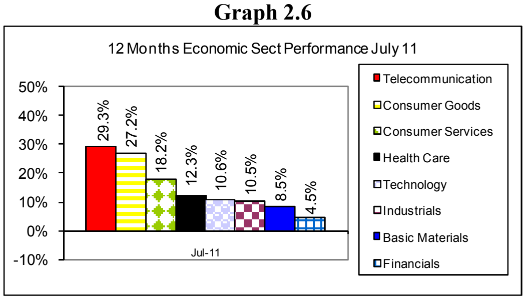
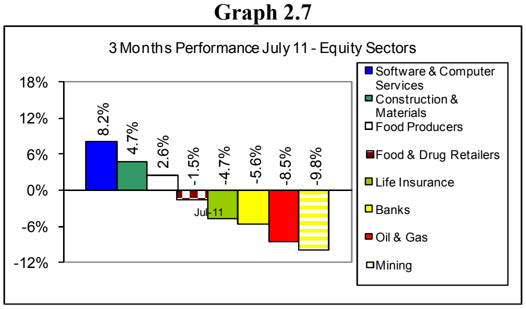
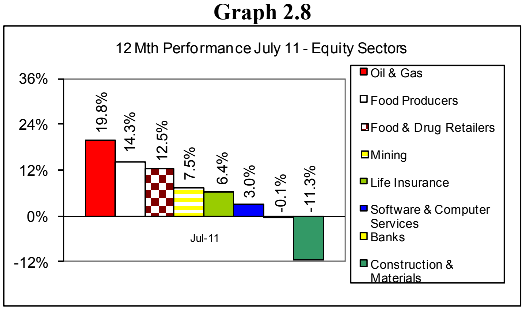



**Graph 2.7**



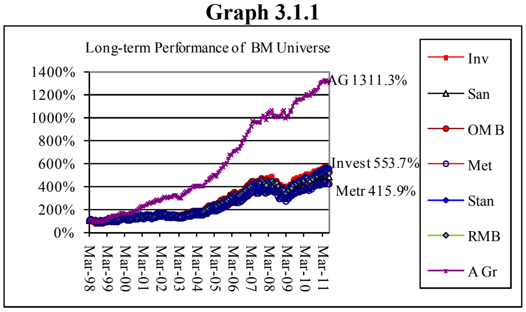

**Graph 2.8**



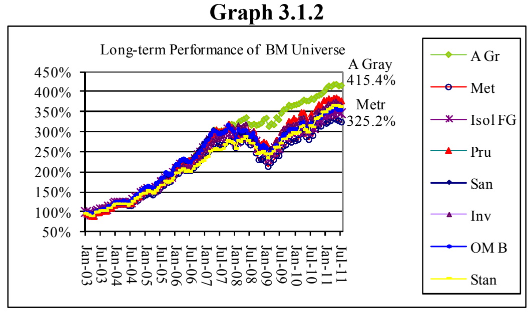

## 3. Portfolio Performance Analysis

### 3.1. Cumulative performance of prudential balanced portfolios

**Graph 3.1.1**

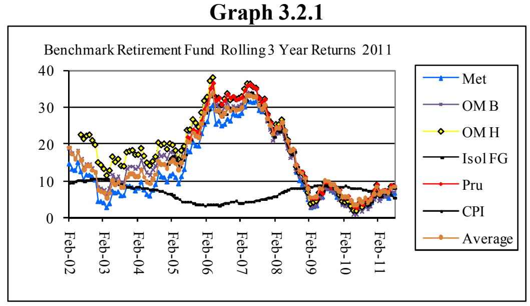



**Graph 3.1.2**

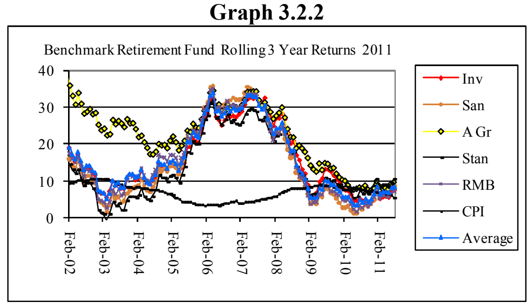



### 3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

**Graph 3.2.1**

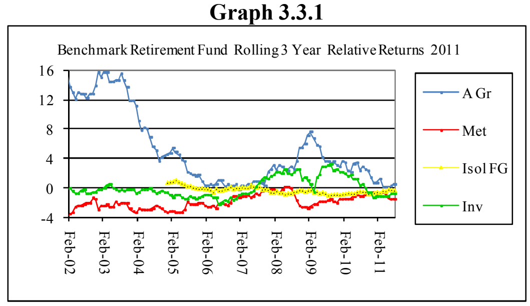



**Graph 3.2.2**




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

**Graph 3.3.1**




**Graph 3.3.2**

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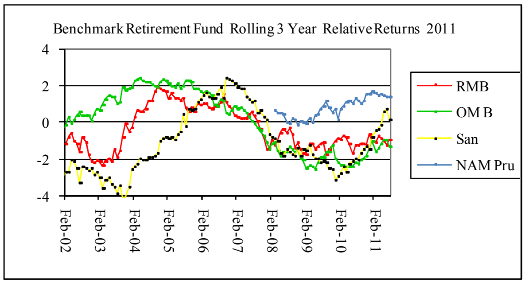
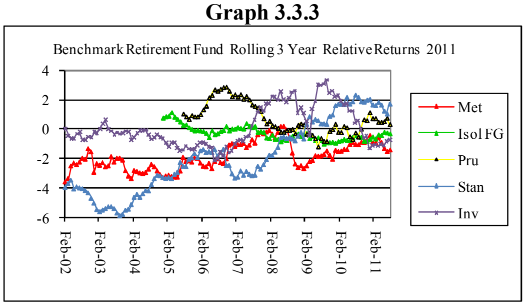
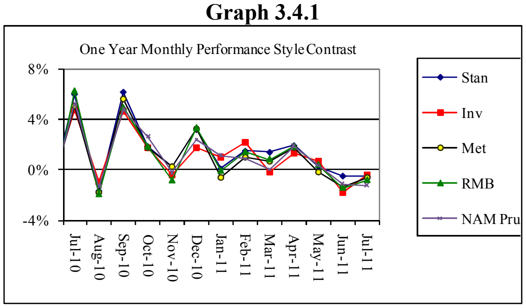



**Graph 3.3.3**

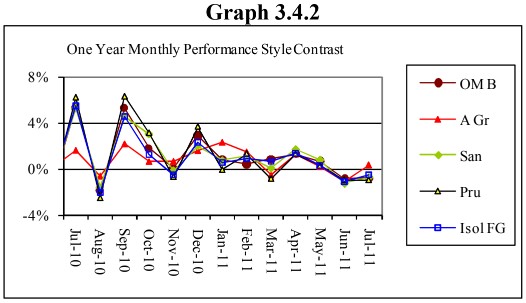



### 3.4. Monthly performance of prudential balanced portfolios

**Graph 3.4.1**

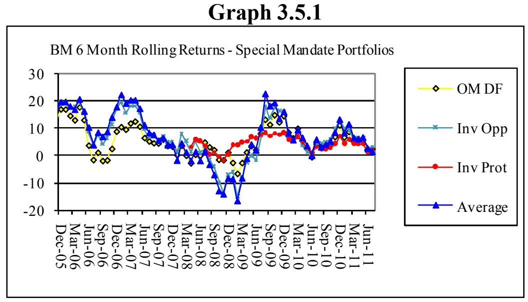



**Graph 3.4.2**

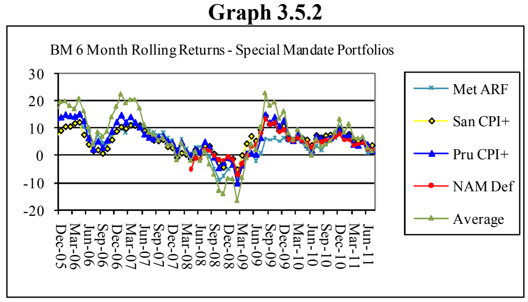



### 3.5. 6-month rolling returns of 'special mandate' portfolios

**Graph 3.5.1**

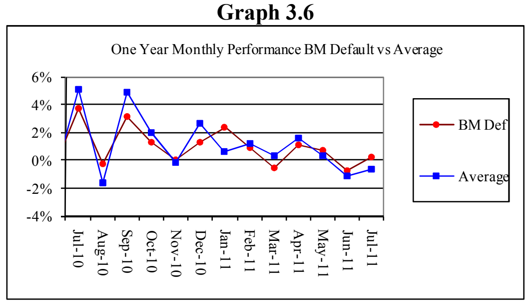



**Graph 3.5.2**



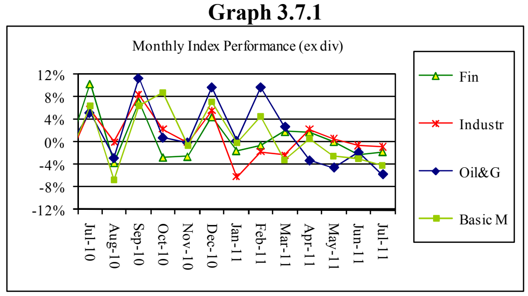

### 3.6 Monthly performance of 'Default' portfolio relative to average prudential balanced portfolio

**Graph 3.6**




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

**Graph 3.7.1**



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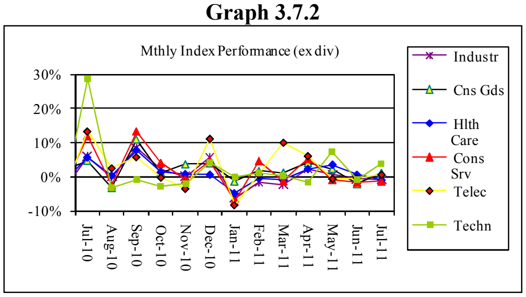
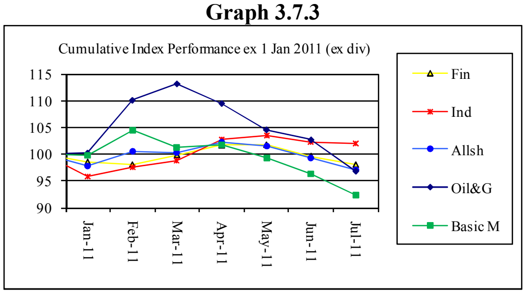
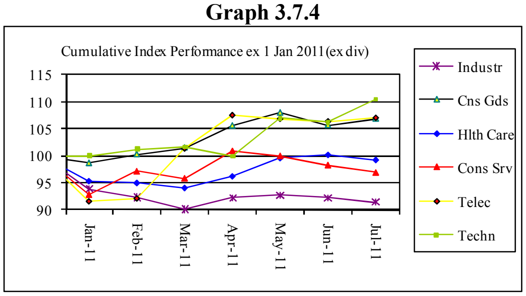
**Graph 3.7.2**




**Graph 3.7.3**




**Graph 3.7.4**




### 4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 11.1% p.a. in nominal terms, or 3.9% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 9.1% p.a. in nominal terms, or 1.9% p.a. in real terms. Considering that the average prudential balanced portfolio should deliver a real return before management fees (typically 0.75%), of roughly 6% per year, these portfolios are currently trailing the expected long-term goal significantly over the past 5 years.

Participating employers who are invested in the Benchmark default portfolio will be aware that we have raised the risk profile of the default portfolio since the beginning of 2011 by replacing Metropolitan ARF with Allan Gray. With this combination, its risk profile is still considerably lower than that of the average prudential balanced portfolio. We would therefore 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. Since this change was effected, the default portfolio returned 4% compared to 2.2% for the prudential balanced portfolio.

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 August 2008 to July 2011:

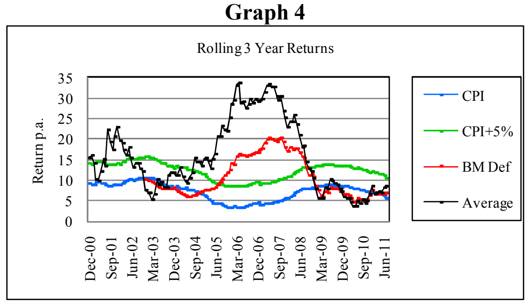
**Table 4.1**

| Measure | Money Market | Default Portf | Average Prud Bal |
|---|---|---|---|
| Worst annual performance | 6.3% | - 8.0% | - 19.1% |
| Best annual performance | 12.1% | 16.2% | 29.7% |
| No of negative 1 year periods | n/a | 10 | 10 |
| Average of negative 1 year periods | n/a | - 3.7% | - 11.4% |
| Average of positive 1 year periods | 9.1 % | 10.5% | 14.6% |

The Benchmark 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.

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. 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.

**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. It shows that since September 2008, both the Benchmark Default portfolio as well as the average prudential balanced portfolio are lagging inflation plus 5% and at times even inflation and are currently on par with inflation over the latest 3 year period.

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### 5. What We Expect Of The Next 12 Months

**The global back drop**

After a few recent shocks to financial markets, such as the down grading of debt ratings of the US and Italy, consumer sentiment appears to be once again turning negative in the developed world. Inflation continues to trend upwards, that of the US for July year-on-year standing at 4.0% (June 4%), Euroland at 2.5% (June 2.7%), China at 6.5% (June 6.4%), SA June at 4.9% (May 4.6%) and Namibia at 4.8% (June 5.3%). At this stage the Federal Reserve will not renew its quantitative easing measures which ended at the end of June although there is renewed talk suggesting a possible reconsideration.

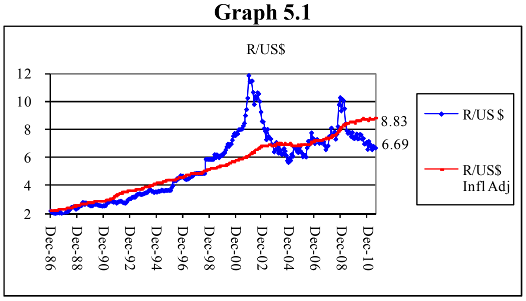
Although the price of crude has receded somewhat on the back of declining consumer sentiment, at a price of probably double its cost of production, it continues to funnel capital flows into a few assets, such as US government bonds, commodities, precious metals and property. We have seen the gold price reaching new peaks daily as investors try to find safe havens and in the absence of any real returns on US government debt. This undermines any broad based return of investors to the financial markets and is probably fuelling speculative bubbles in these areas, rather than supporting sustainable growth. High oil prices are fueling inflation across the globe as is evident in global food prices.

With massive government intervention in developed countries it appears that the free market mechanism has been dislodged and it is impossible to comprehend the medium to long-term implications of these and how markets will correct.

**How is the Rand doing?**

**Graph 5.1** indicates that the Rand is fairly valued at 8.83 to the US Dollar while it actually stood at 6.69. 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 than the opposite. More recently it appears to have suffered a slight rerating now hovering around 7.15.

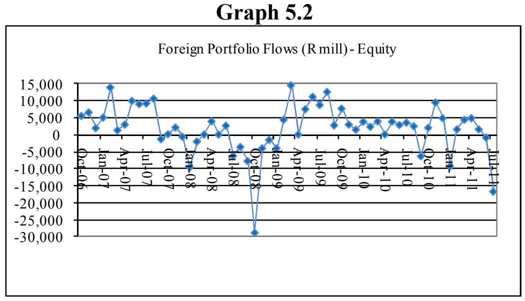
**Graph 5.1**




**At this stage there is strong support from foreign capital flows**

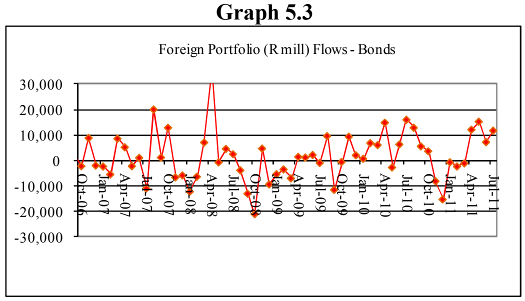
**Graph 5.2** reflects a declining trend in the flow of capital into South African equities. For the 12 months to end of July, the FTSE/JSE experienced a net outflow of R 80 million (R 20.2 billion net inflow, 12 months to end June 2011), compared to a net inflow of R 4.1 billion for the 12 months to end July 2010 (net inflow of R 54.9 billion, 12 months to end June 2010).

**Graph 5.2**




**Graph 5.3** also appears to reflect a declining trend in net flows into fixed interest instruments, which amounted to R 41.6 billion for the 12 months to end July (R 45.8 billion for the 12 months to end June), compared to an inflow of R 58.0 billion for the 12 months to end July 2010 (R 41.0 billion for the 12 months to end June 2010). Whilst these figures reflect a declining trend, it still provides considerable support to the Rand.

**Graph 5.3**

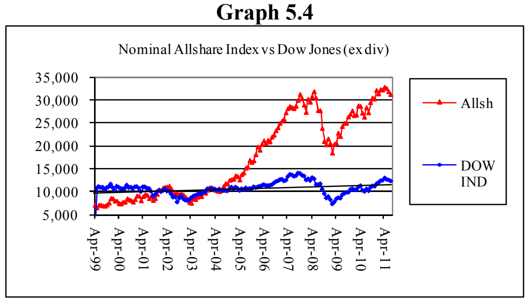



The net flow of foreign capital into equity and fixed interest assets was R 41.5 bn for the 12 months to end July (R 66 bn to end June), compared to R 62.1 bn for the 12 months to end July 2010 (R 95.9 bn to end June 2010).

**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**



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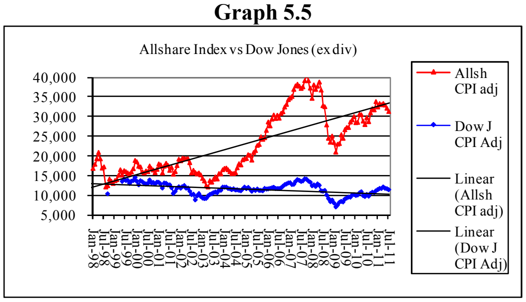
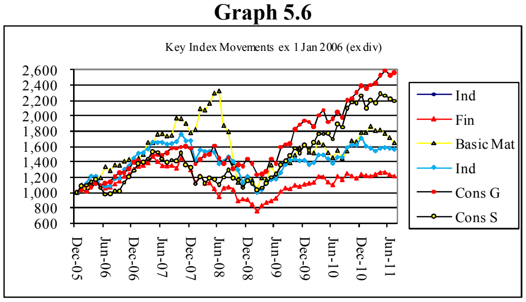



**Graph 5.6** provides an interesting overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced. From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals.

**Graph 5.6**




## 6. Conclusion

In our view, the Rand has been experiencing tail winds in all regards for quite some time, resulting in its prolonged strength in historical context. This will not continue for too much longer but while it persists, investors in local assets are doing well while the more cautious investor spreading his investments globally, is having a tough time. An overweight in local assets in our view, is taking a very speculative position and requires good timing to avoid the impact of a likely reversal of the fate of the Rand.

On balance we believe that we are now entering a prolonged period of slow economic growth, rising interest rates, rising inflation and sluggish bourses. It will be difficult to find any investments delivering high yields and investors are therefore likely to continue investing in precious metals.

**Graph 5.6** indicates that local consumer goods and consumer services had an excellent run over this period of more than 5 years. We do not expect too much more joy out of these sectors anymore and these should hence be underweight.

On the basis of fundamentals, one should now move to an overweight position in local industrials and financials, a underweight position in local basic materials and an underweight position in local consumer goods and consumer services. An expected depreciation of the Rand in the medium term would favour exposure to Rand hedge shares locally.

Investing in equities should ensure that the value of the investment will at least keep pace with higher trending inflation in the medium to long-term, and should also produce a real return in excess of inflation in the medium to long-term. Equities in general should outperform the other conventional asset classes such as cash, bonds and property. Companies with a low gearing, high dividend yield and those offering a hedge against a depreciating Rand would be our preferred targets.

In view of prevailing uncertainties, we now prefer a conservative balanced portfolio with a fair spread across equities, bonds and property. 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.