Volume 7, No. 11, Nov 2011

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 NOVEMBER 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.

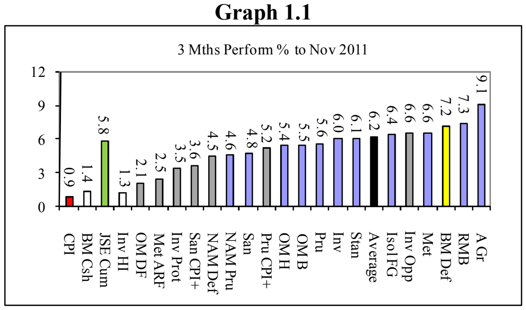
1. Review of Portfolio Performance

In **November** our **average prudential balanced portfolio** returned 0.28% (October 5.31%). Top performer is Investment Solutions multi manager (1.48%), while Sanlam (minus 1.32%) takes bottom spot.

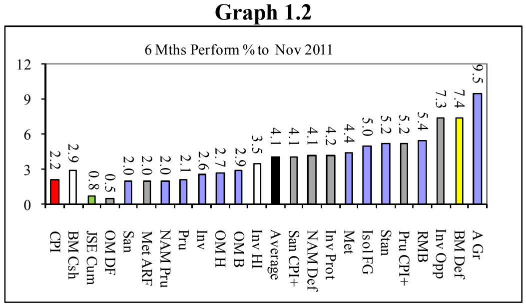
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no color bars), the average of prudential balanced 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 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 color)
Investec High Income (interest bearing assets)	Inv HI (no color)
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)

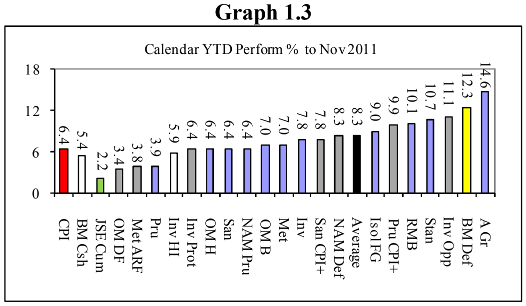
Graph 1.1



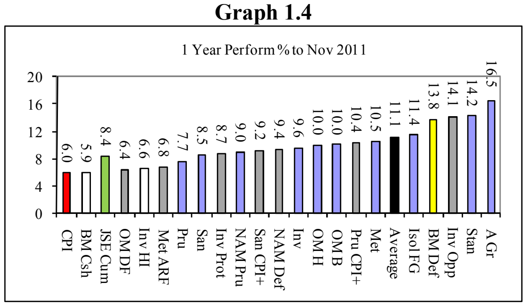
Graph 1.2



Graph 1.3



Graph 1.4



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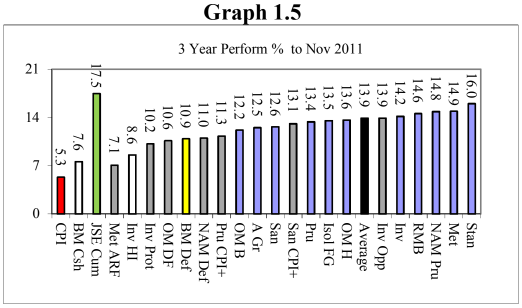
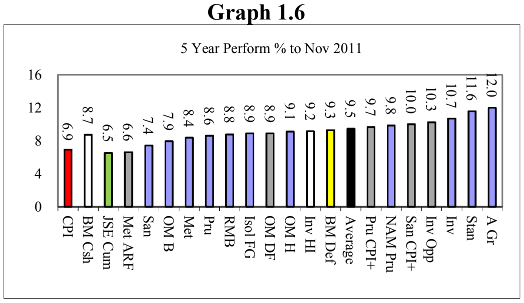
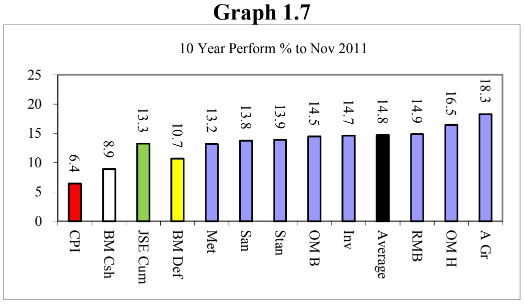
Graph 1.5



Graph 1.6

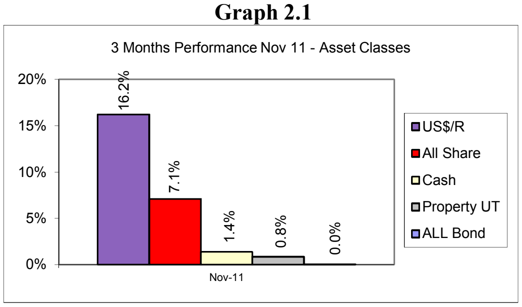


Graph 1.7

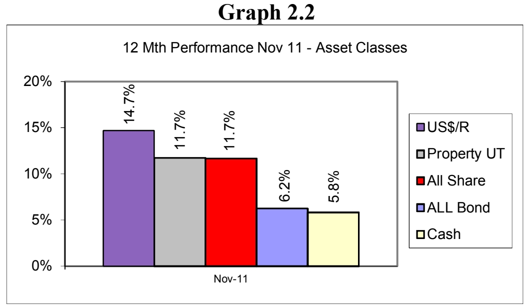


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

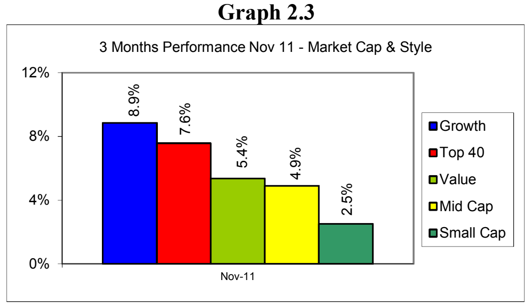
Graph 2.1



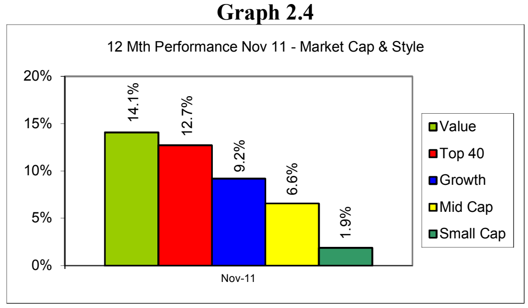
Graph 2.2



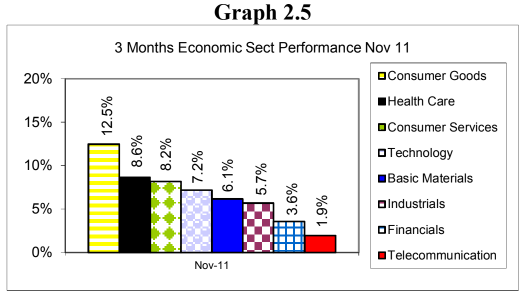
Graph 2.3



Graph 2.4



Graph 2.5



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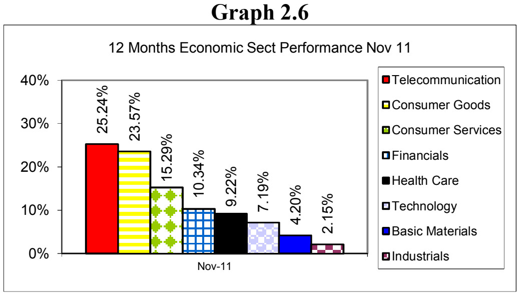
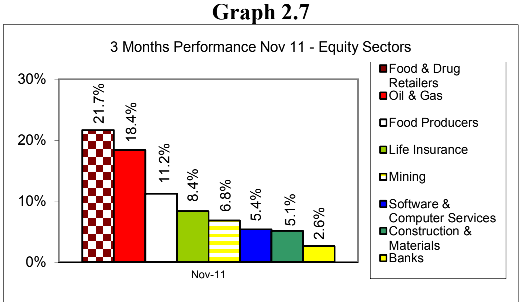
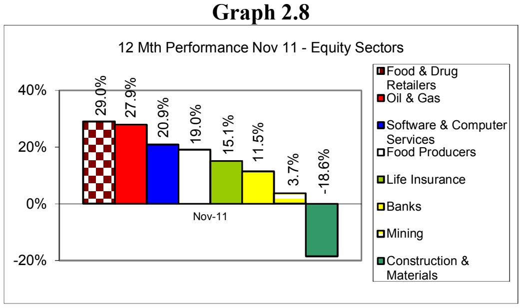


Graph 2.7



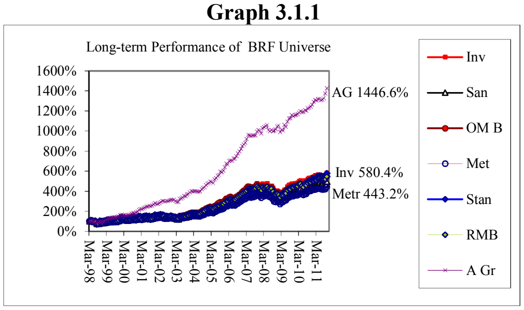
Graph 2.8



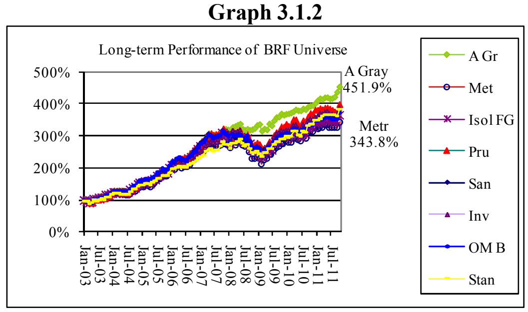
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

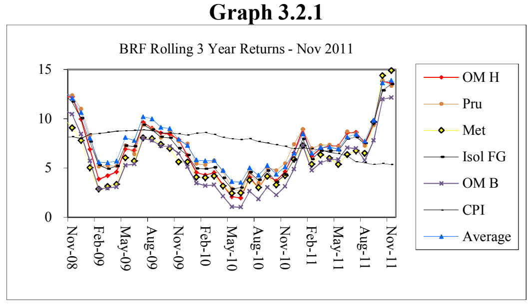


Graph 3.1.2

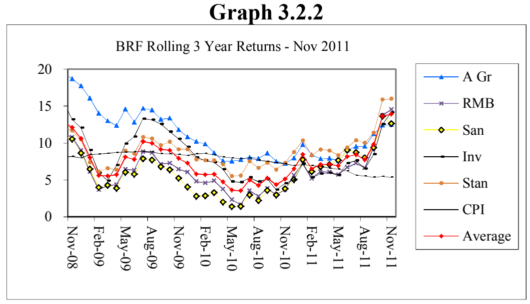


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

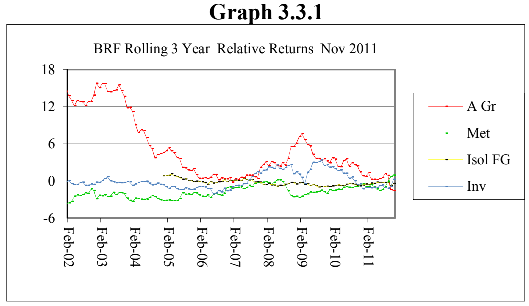


Graph 3.2.2



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

Graph 3.3.1



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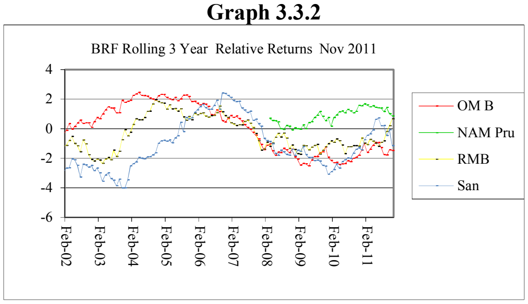
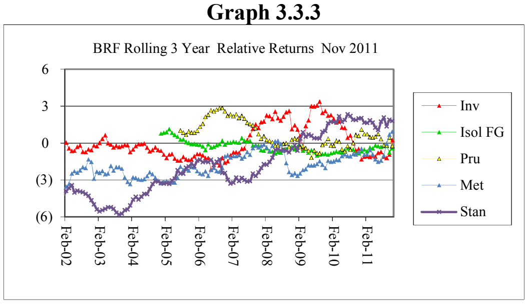
Graph 3.3.2

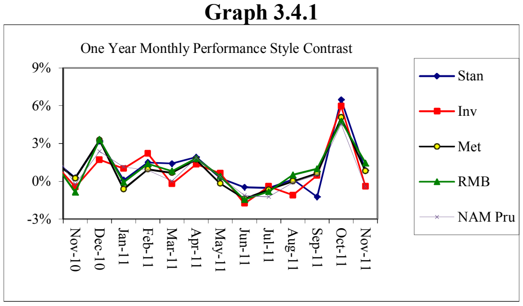


Graph 3.3.3

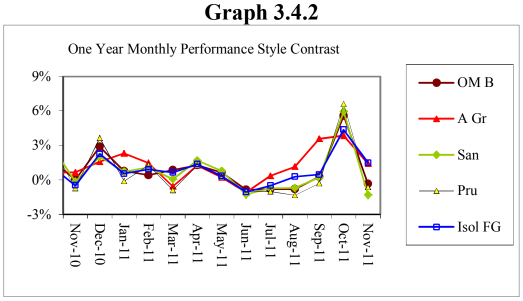


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

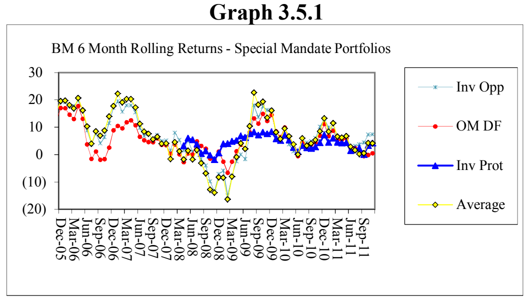


Graph 3.4.2

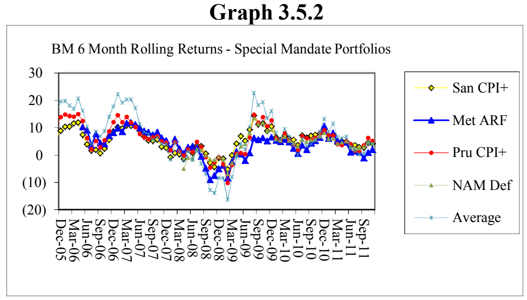


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

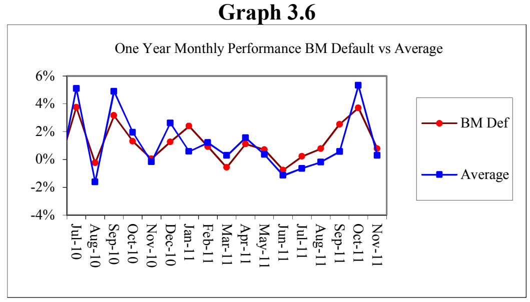


Graph 3.5.2



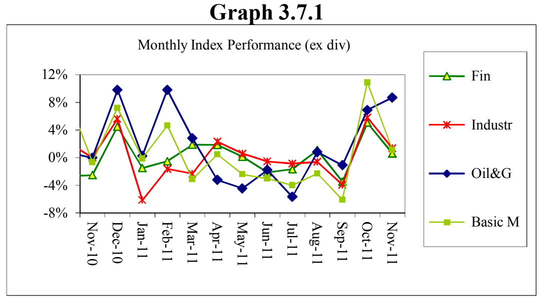
3.6 Monthly performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6



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

Graph 3.7.1



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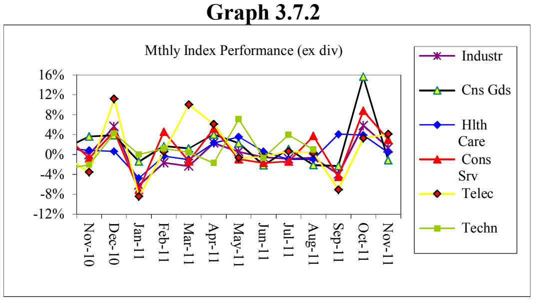
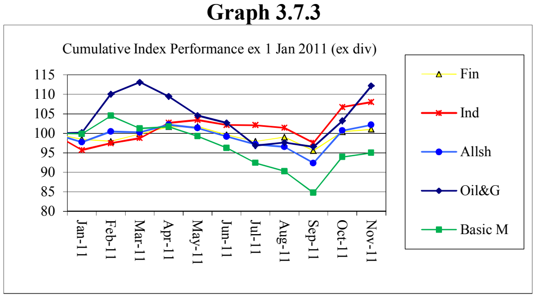
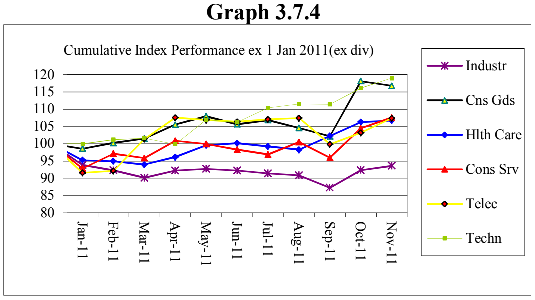
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 9.5% p.a. in nominal terms, or 2.6% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 9.3% p.a. in nominal terms, or 2.4% 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 12.3% compared to 8.3% for the average 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 December 2008 to November 2011:

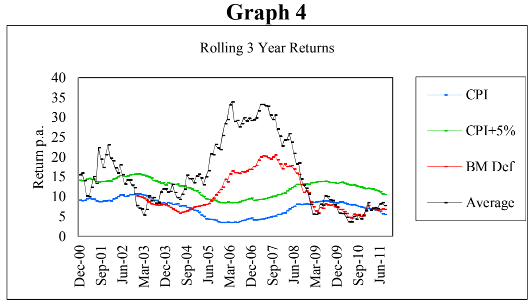
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.0%	- 8.0%	- 19.1%
Best annual performance	12.1%	16.2%	29.7%
No of negative 1 year periods	n/a	7	7
Average of negative 1 year periods	n/a	- 4.0%	- 11.6%
Average of positive 1 year periods	8.5 %	10.8%	14.4 %

The Benchmark Default portfolio is a more conservative investment aimed at reducing 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 just ahead of inflation over the latest 3 year period.

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5. What We Expect Of The Next 12 Months

The global back drop

Financial markets particularly in Europe are still in turmoil. Hopes that were placed in the proposal for Eurobonds sofar were misguided. Latest measures agreed upon by EU countries have evidently not convinced markets. Greater fiscal integration in Europe, with stricter budgetary discipline and debt caps, now appears to be the agreed way forward although the UK resolved already that it will no go along, while other countries have also voiced skepticism. So markets are unlikely to recover soon and this will also impact negatively on global economies. In the US things continue to look up though. Due to the precarious position of European banks as the result of the sovereign debt problems, US banks are moving money back home and and investors are likely to follow. As the result we expect the US Dollar to trend stronger versus the Euro, while we also expect the Rand to emulate the Euro and trend weaker against the Dollar.

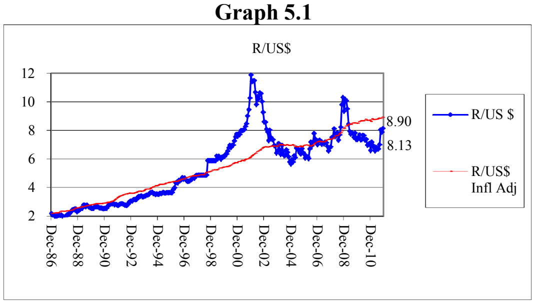
Global inflation is currently fairly stable, that of the US for November year-on-year standing at 3.6% (October 3.4%), Euroland at 3% (October vs 3% in September), China at 4.2% (October 5.5%). We do believe though, that this is a short-term lull and that inflation will pick up again as consumption starts gaining steam.

Local inflation, however, is already taking the opposite direction. SA's now stands at 6.1% (October 6.06%) and Namibia's at 6% (October 6.2%). The expected weakening of the Rand will no doubt reinforce this trend for the next year or two.

How is the Rand doing?

Graph 5.1 indicates that the Rand is fairly valued at 8.90 to the US Dollar while it actually stood at 8.13 at the end of November. This is based on adjusting the two currencies by the respective domestic inflation rates. Admittedly, this is only one measure and there are other measures such as the 'big Mac index', and of course the point at which one starts measuring is also critical to the outcome. The 'big Max' index for example considers the Rand under valued. Our conclusion from this graph, however, is that the likelihood of the Rand depreciating is significantly greater than the opposite.

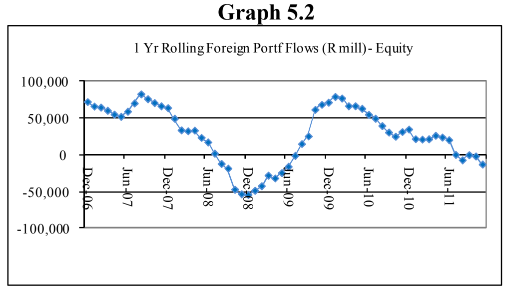
Graph 5.1



Support of the Rand from foreign capital flows as expected, continues to fade

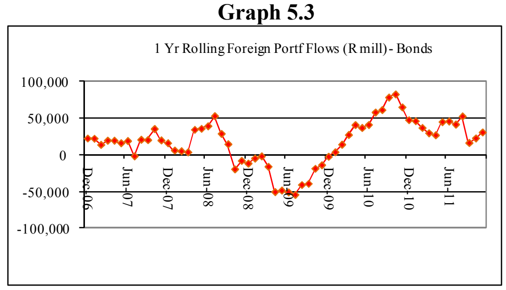
Graph 5.2 reflects a significant decline in the flow of capital into South African equities to around zero on a year-on-year basis at the end of November, the trend having been downward since peaking in January 2010 with a one year inflow of R 79.5 billion.

Graph 5.2



Graph 5.3 also reflects a declining trend of foreign portfolio flows into bonds to R 30.7 billion year-on-year at the end of November, from a peak of R 82.6 billion in October 2010.

Graph 5.3



The net inflow of foreign capital into equity and fixed interest assets was R 17.4 bn for the 12 months to end November (inflow of R 20.6 bn to end October), compared to R 96.4 bn for the 12 months to end November 2010 (R 107.5 bn to end October 2010).

Graph 5.4 reflects the movement of the JSE and the DOW Jones since December 1997, the financial crisis being clearly visible. In nominal terms the JSE passed its month end peak of before the financial crisis, while the DOW Jones is still substantially below its previous peak. **Graph 5.5** reflects the same statistics but adjusted for US and SA inflation respectively. The JSE has accordingly grown by 5.2% per year above inflation over this period of 14 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW Jones declined by 1.2% per year above inflation over a slightly shorter period of 12.5 years, also excluding dividends.

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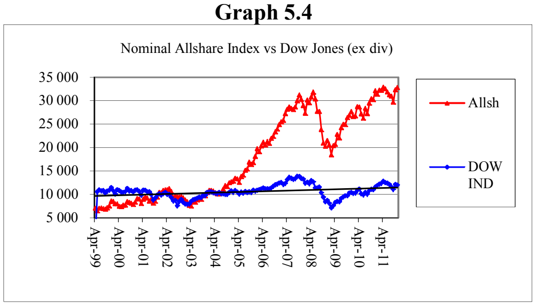
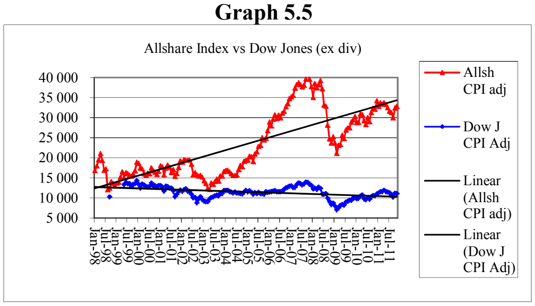
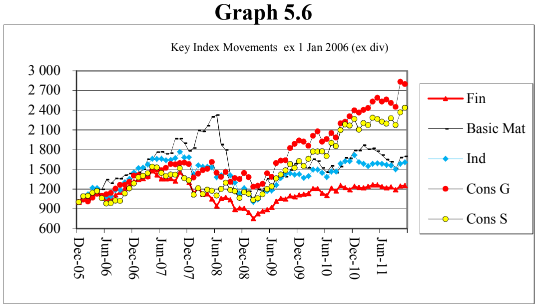


Graph 5.5



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

We now see a reversal in the fortunes of the Rand and expect this trend to continue, raising the risk of retaining one's investment capital in local markets and suggesting greater offshore diversification.

We foresee declining long-term interest rates, declining inflation and sluggish bourses and economies, particularly in the developing world for the medium term. We expect to see more productive investment, particularly in infrastructure and productive capacity in the US. This should benefit industrial and financial counters, particularly in the industrialized world.

Graph 5.6 indicates that local consumer goods and consumer services had an excellent run over this period of nearly 6 years. Consumer Goods rose by 16% and Consumer Services by 18.7% per year, before dividends, over this period. Basic Materials, Industrials and Financials, in contrast, produced relatively pedestrian returns of 9.2%, 8.2% and 3.8% per year, before dividends, over this period. We do not expect too much more joy out of Consumer Goods and Consumer Services 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 that have not seen the growth of the consumer sectors. Industrials should, of course, also benefit from a weaker Rand. Basic Materials should also benefit from a weaker Rand and now offer some buying opportunities. An expected further depreciation of the Rand in the medium term would favor exposure to Rand hedge shares locally and an increase in foreign holdings.

With a medium- to long-term investment horizon, equities should ensure that the value of the investment will at least keep pace with higher trending inflation in the medium to longer-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 and bonds. Property on the other hand should benefit from low long-term interest rates. 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 still prefer a conservative balanced portfolio with a fair spread across equities, bonds and property, but moving towards a more assertive position over the next year. A high foreign equity exposure, particularly to industrialized western countries is our call for the next few years.

7. Important notice and disclaimer