Volume 8, No. 2, Feb 2012

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 29 FEBRUARY 2012

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

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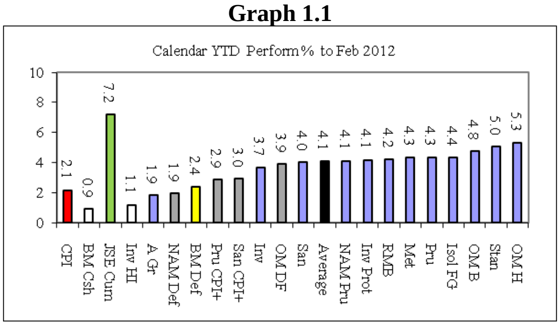
1. Review of Portfolio Performance

In **February** our **average prudential balanced portfolio** returned 1.12% (January 2.92%). Top performer is Stanlib (1.68%), while Allan Gray (0.55%) takes bottom spot.

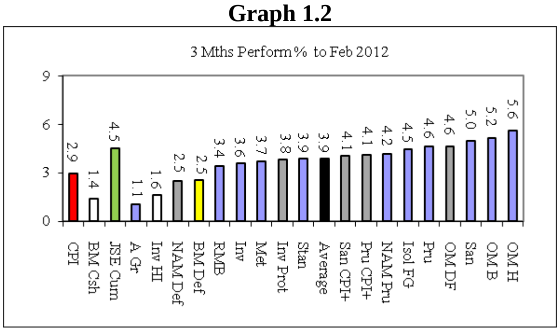
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no color bars), the average of prudential balanced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

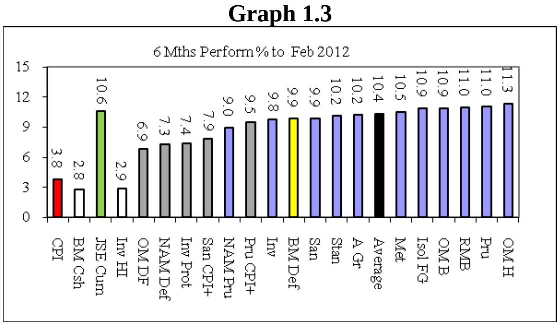
Graph 1.1



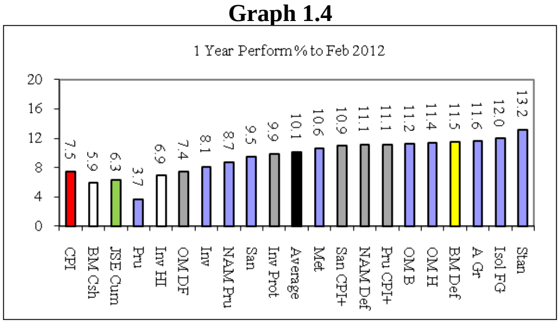
Graph 1.2



Graph 1.3



Graph 1.4



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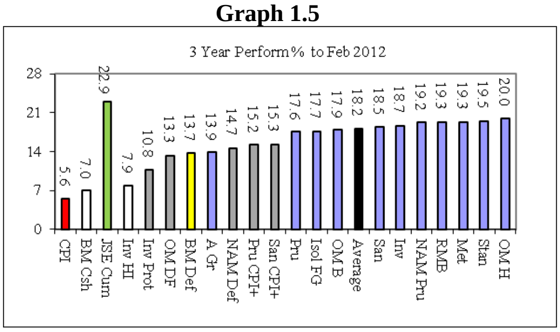
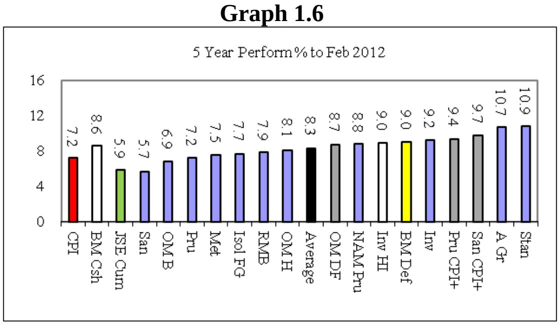
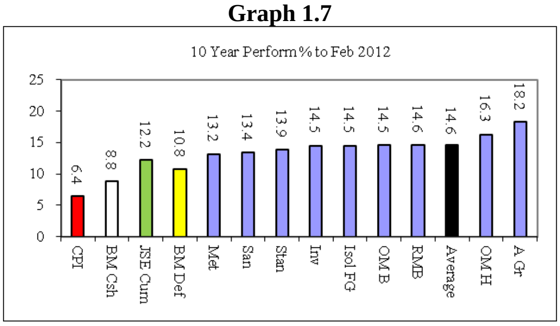
Graph 1.5



Graph 1.6

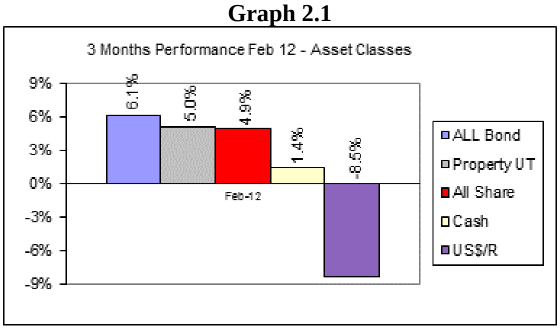


Graph 1.7

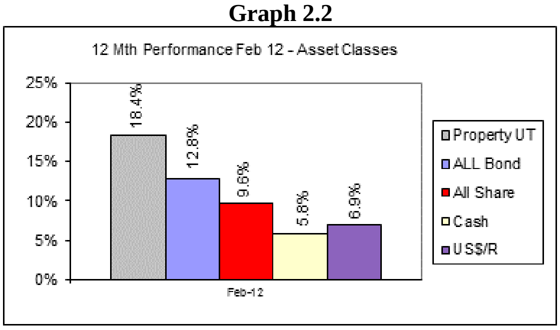


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

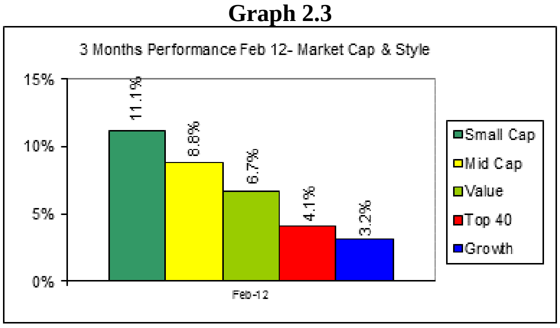
Graph 2.1



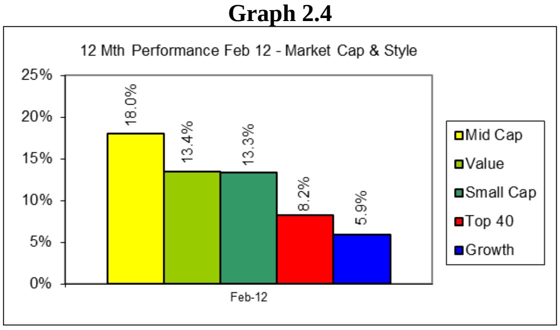
Graph 2.2



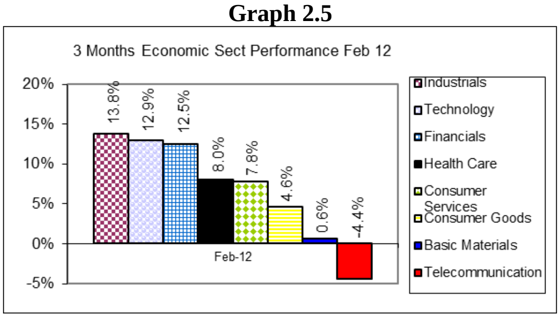
Graph 2.3



Graph 2.4



Graph 2.5



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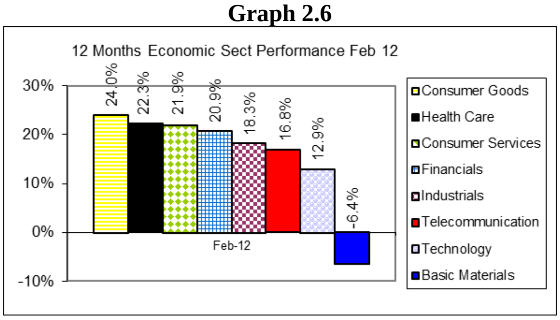
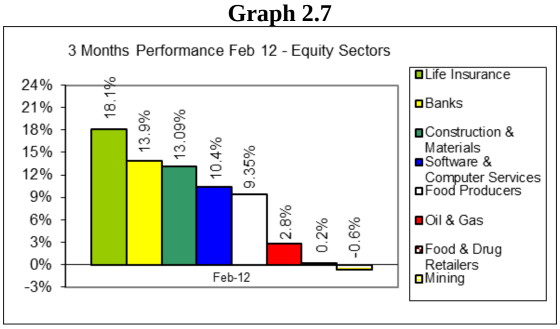
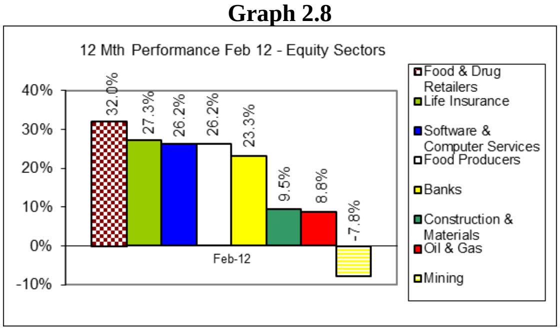
Graph 2.6



Graph 2.7



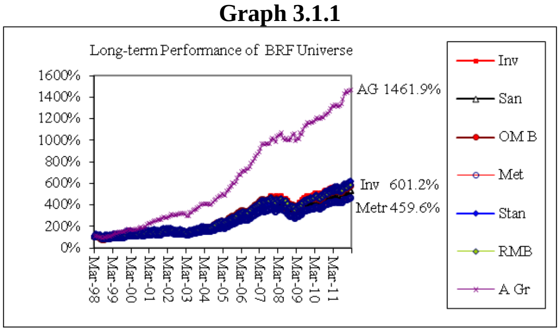
Graph 2.8



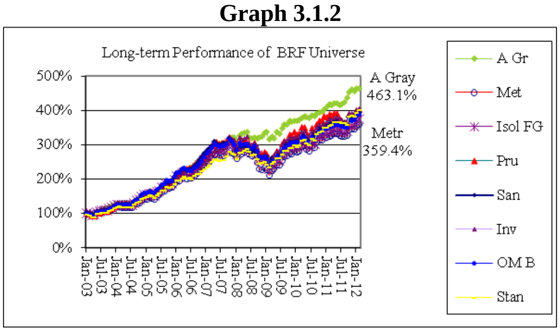
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

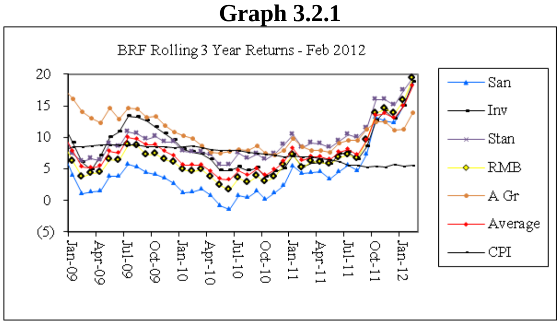


Graph 3.1.2

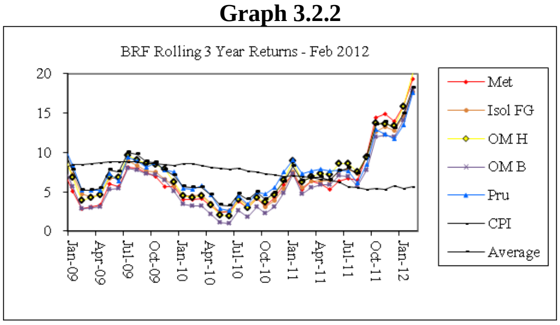


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

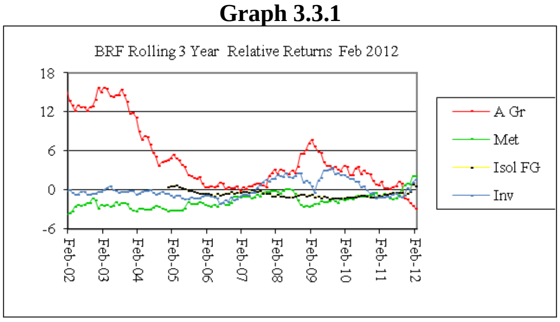


Graph 3.2.2



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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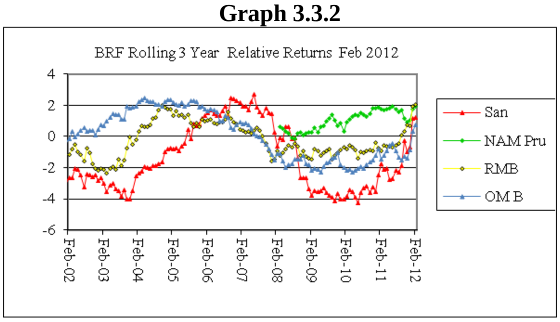
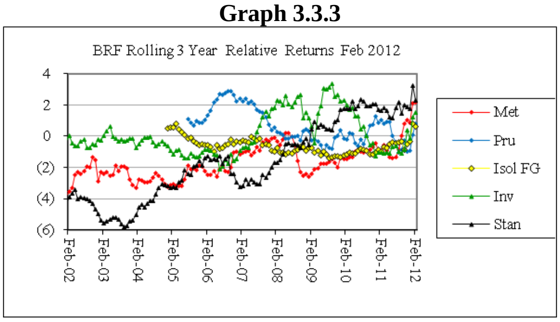
Graph 3.3.2

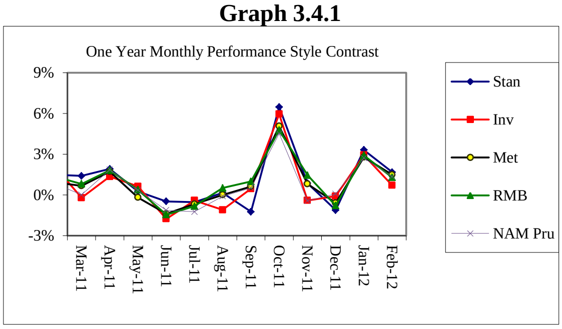


Graph 3.3.3

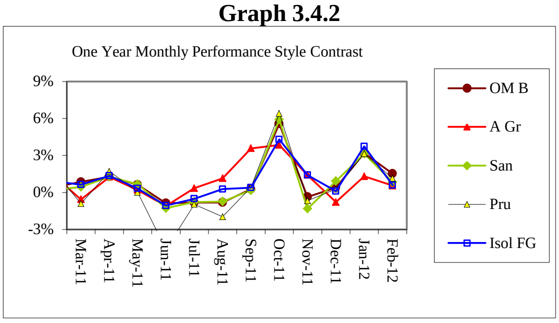


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

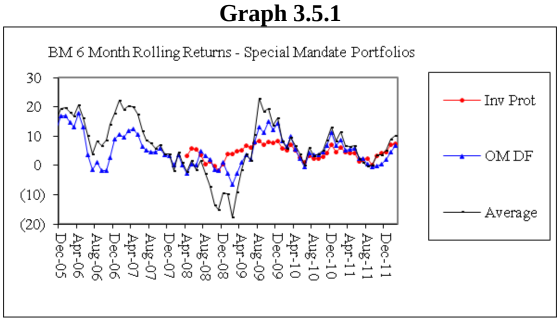


Graph 3.4.2

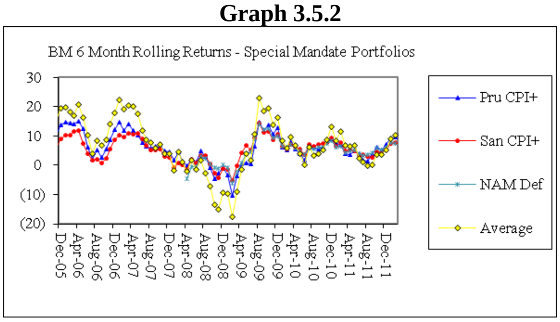


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

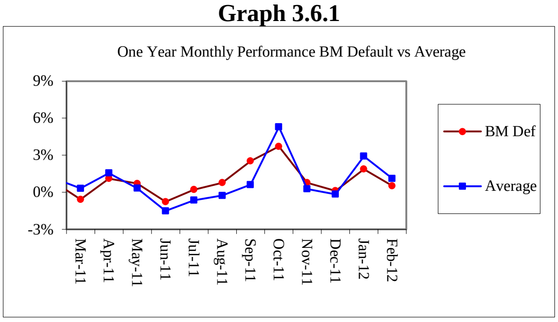


Graph 3.5.2

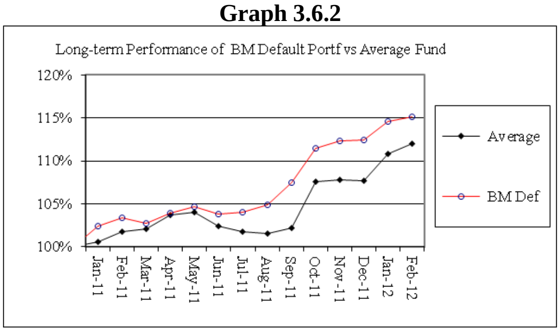


3.6 Monthly and cumulative performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1



Graph 3.6.2



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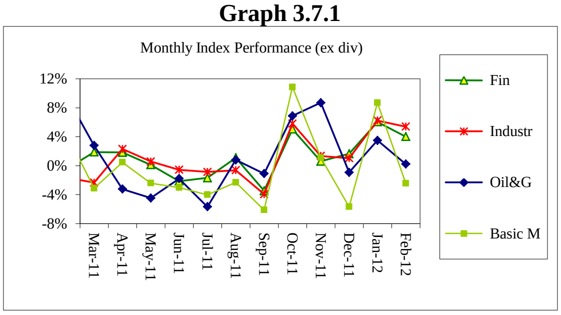
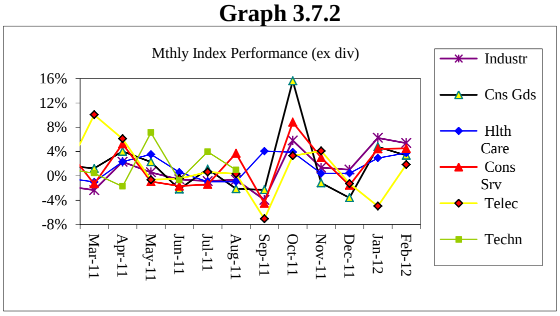
3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

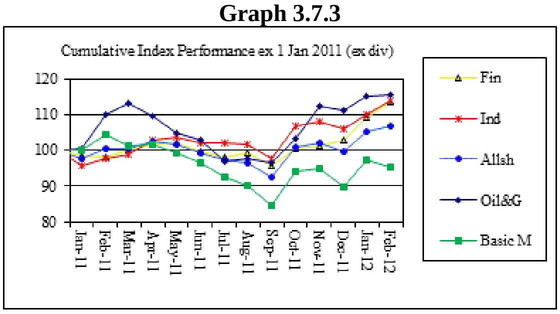
Graph 3.7.1



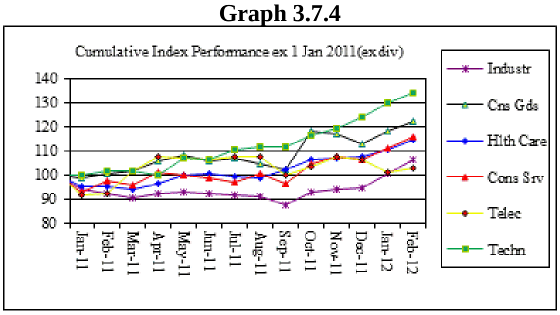
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 8.3% p.a. in nominal terms, or 1.1% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 9% p.a. in nominal terms, or 1.8% 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 a cumulative 15.2% compared to 12% for the average prudential balanced portfolio over this 14 month period.

Relative to the default portfolio, the performance of the prudential balanced portfolios should be more volatile due to a significantly higher equity exposure and its performance should be much closer correlated to that of the overall equity market. The default portfolio should produce a significantly more volatile performance than the money market portfolio. The table below presents one year performance statistics over the 3 years March 2009 to February 2012:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.9%	- 5.7%	- 15.4%
Best annual performance	12.1%	16.2%	30.2%
No of negative 1 year periods	n/a	5	5
Average of negative 1 year periods	n/a	- 3.9%	- 9.9%
Average of positive 1 year periods	8%	11.3%	14.3 %

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.

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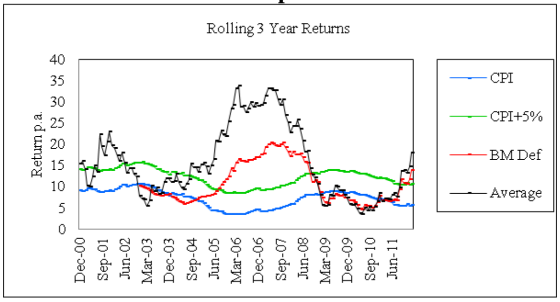
Graph 4



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 were lagging inflation plus 5% and at times even inflation but have surpassed inflation plus 5% since October 2011.

5. What We Expect Of The Next 12 Months

The global back drop

Reaching a level of 34,296 at the end of February, the Allshare Index this year for the first time since the financial crisis moved to above its month end peak of just below 32,000 at the end of May 2008. Including dividends an investment in the Allshare Index returned 9.6% on a one year basis, up from 2.6% at the end of December. Best performing asset class was Property (18.4%), followed by bonds (12.8%) and cash (5.8%). With an average performance of 10.1% achieved by of our prudential balanced portfolios, Namibian pension funds produced a return slightly ahead of the Allshare Index, including dividends for the 12 month period, adding a real return of 2.6% above inflation of 7.5%.

For Namibian funds, the weakening of the Rand vs the US$ by 6.9% over this 12 month period was more than offset by the poor performance of the MSCI World Free Index that produced -1.1% including dividends, in US$. Comparing the 12 month performance of managers with a high off-shore exposure, such as Investec (31.5%), Allan Gray (30.4%) and Prudential (29.7%), with that of managers with a low offshore/high local equity exposure such as Stanlib (18.4%/50.6%), IS Balanced Growth (19.7%/46.8%) and OM Balanced Growth (23.5%/49.8%), the latter group should have and have outperformed the former group with the exception of Allan Gray that in fact produced the 3rd best performance of these 6 managers, trailing IS Balanced Growth and Stanlib just slightly.

In terms of price: earnings ratios which is an indicator of the state of the economy and investor sentiment, the 1 year trailing and 1 year forward p:e as at the end of January 2012, of the SA Allshare stood at 12.8 respectively 11.4, compared to 14, respectively 13.1 of the US S&P 500. However, considering the relative position of these two economies, the US having just passed the bottom of the cycle, while the SA economy is lingering on the opposite side of the cycle, we would expect the US market to outperform the South African market over the medium term.

The Eurozone is faced with another recession as evidenced by declining economies of a number of the peripheral countries and the most recent decline in manufacturing output even in the more resilient economies such as Germany. We do not believe that fiscal easing through printing of money will solve the problem. This will only redistribute wealth from the wealthier countries to the poorer countries. Interestingly, the Bundesbank recently announced it financial results that reflect a decline in net profits from more than 2 bn to 600 million Euro for the latest financial year, linking this to the ECB policies. Both, in the US and in Europe the Central Banks currently lend money at rates well below the inflation rates, mainly to assist their financial institutions that are ‘too big to fail’ to repair their balance sheets – at the cost of the tax payer, who will be called to carry the burden over the next couple of years. China too is showing signs of economic stagnation. This has been one of the major consumers of based metals and commodities in general and therefore an anchor for resource based economies such as the South African and the Namibian economy.

For us these trends will mean lower demand for our exports, less tourism, eventually higher inflation and interest rates as Namibia takes course in the same direction as our trading partners in the developed world. While our economy will be impacted negatively and the tax base is likely to shrink, we will have to face higher interest rates and higher debt repayment obligations. This is not exactly a good cocktail for a rosy economic outlook or for a strong Rand for the next few years.

How is the Rand doing?

Graph 5.1 indicates that the Rand by our measure is fairly valued at 9.13 to the US Dollar while it actually stood at 7.44 at the end of February. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

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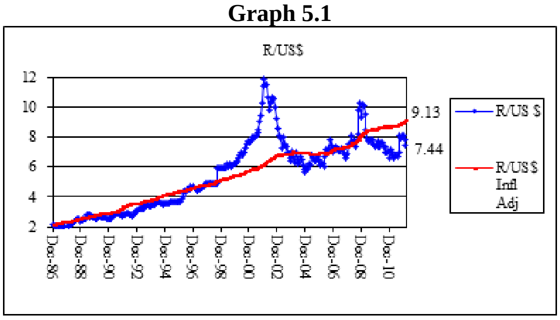
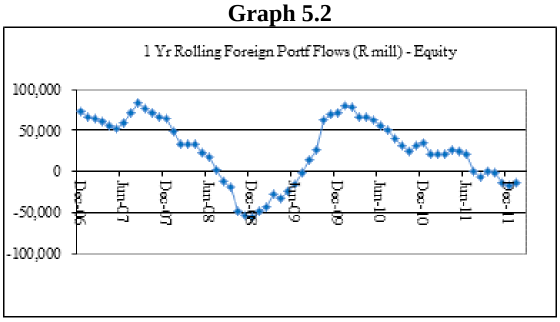
Graph 5.1



Support of the Rand from foreign capital flows continues

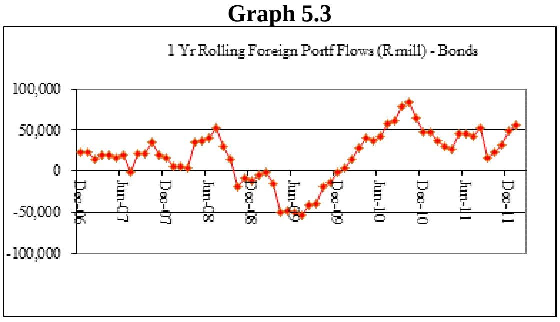
Graph 5.2 reflects a further decline in the flow of capital into South African equities to a net outflow of R 17 bn on a year-on-year basis at the end of February (outflow of 14 bn to end January), the trend having been downward since peaking in January 2010 with a one year inflow of R 79.5 billion. As pointed out above the fiscal easing measures of the Eurozone is likely to once again reverse the declining trend.

Graph 5.2



Graph 5.3 also reflects a much more volatile but rising trend of foreign portfolio flows into bonds of R 62 bn over the past 12 months (R 55 billion over the 12 months to end of January), still down from a peak of R 82.6 billion in October 2010 though.

Graph 5.3

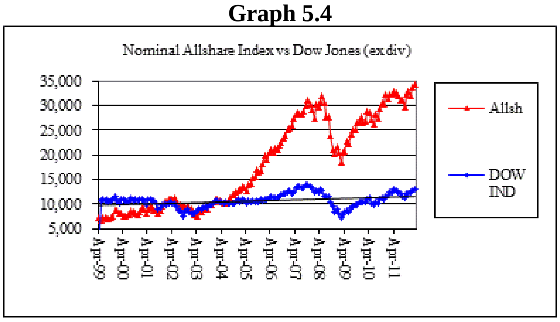


The net inflow of foreign capital into equity and fixed interest assets was R 45 bn for the 12 months to end February (inflow of R 41 bn to end January), compared to R 58 bn for the 12 months to end February 2011 (R 68 bn to end January 2011).

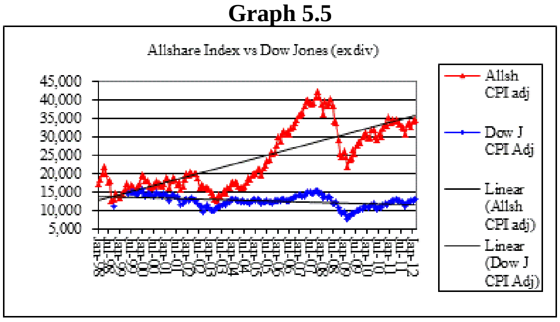
Graph 5.4 reflects the movement of the JSE and the DOW Jones since December 1997, the financial crisis being clearly visible. In nominal terms the JSE passed its month end peak of before the financial crisis, while the DOW Jones is still substantially below its previous peak.

Graph 5.5 reflects the same statistics but adjusted for US and SA inflation respectively. The JSE has accordingly grown by 5.6% per year above inflation over this period of just over 14 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW Jones declined by 1.1% per year above inflation over a slightly shorter period of 12 years and 9 months, also excluding dividends.

Graph 5.4

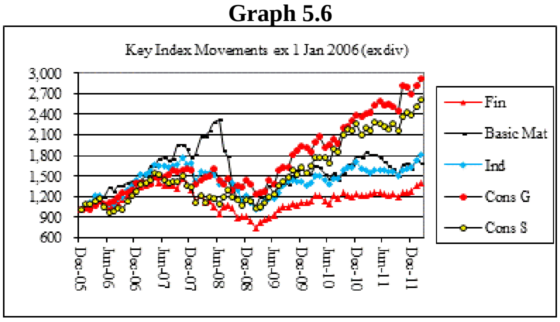


Graph 5.5



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

In summary, we do not see much excitement coming from our local financial markets over the next year or two, although an expected continuation of foreign portfolio flows, as the result of the fiscal easing in the Eurozone, is likely to ensure that this asset class should outperform other asset classes. Diversifying offshore, more specifically to the US would appear worth a consideration for the investor with a time horizon of 3 years and longer. European markets also offer great opportunities if you are brave and if you can be patient. In the short term, local equity markets may well still outperform offshore markets over the next 3 years.

For the next year or two, interest rates and inflation in the developed world are likely to remain at current levels. Bourses and economies will be sluggish, particularly in the Eurozone while there is a fair chance of US interest rates and inflation to start rising over the course of the next year. As US consumer sentiment improves, inflation may be the tool to reduce monetary aggregates in the US. Another tool is an increase in taxes although this alternative appears to be the less likely, considering the continuous haggling on taxes between Democrats and Republicans.

Investments offering high yields are likely to be the winners while we would expect gold to lose more of its glamour as the developed world starts getting to grips with its financial crisis.

Locally we would now expect the Rand to hold its own for the next two to three years but it is likely to depreciate later on, while interest rates and inflation may well pick up over the course of the next two to three years.

Graph 5.6 indicates that local consumer goods and consumer services had an excellent run over this period of over 6 years relative to the other sectors and are in our view in dangerous territory. 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 be 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 Rand at its current depreciated level. Basic Materials should also benefit from a weaker Rand and should offer 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.

We believe an assertive balanced portfolio with an overweight in equities and property and underweight bonds and cash should be appropriate under current circumstances. A high foreign equity exposure to the US, Japan and particularly Eurozone countries where market experienced a dramatic decline as the result of negative investor sentiment, is our call for the next year.

7. Important notice and disclaimer