Volume 8, No. 12, Dec 2012

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 2012

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.

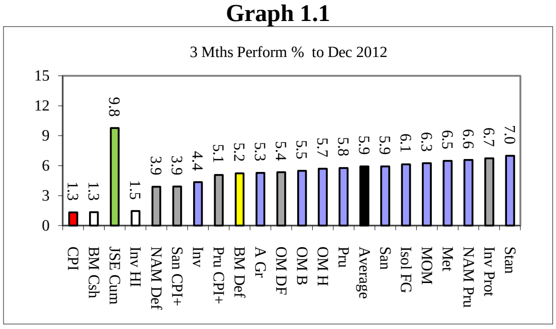
1. Review of Portfolio Performance

In **December** our **average prudential balanced portfolio** returned 1.24% (November 1.8%). Top performer is Metropolitan (2.57%), Investec (- 0.6%) takes bottom spot.

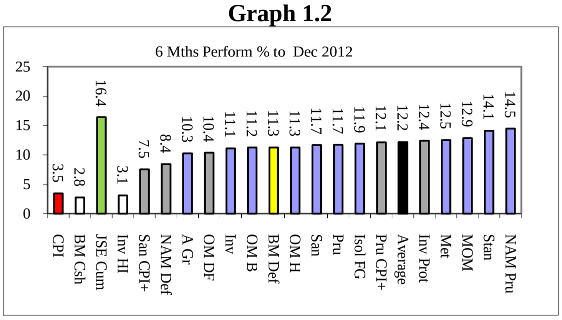
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no color bars), the average of prudential balanced 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 Pru (blue)
Old Mutual Profile Balanced	OM B (blue)
Old Mutual Profile Growth	OM H (blue)
Momentum Managed	MOM (blue)
Sanlam Managed	San (blue)
Stanlib Managed	Stan (blue)

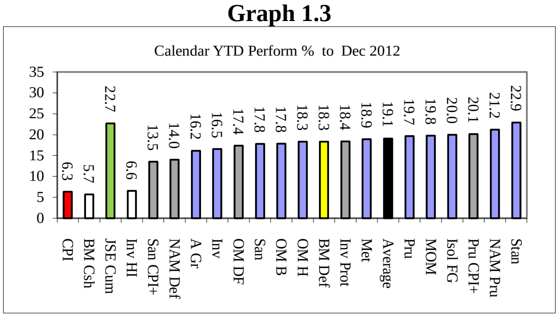
Graph 1.1



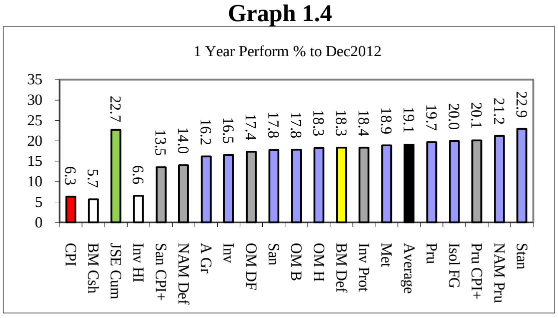
Graph 1.2



Graph 1.3



Graph 1.4



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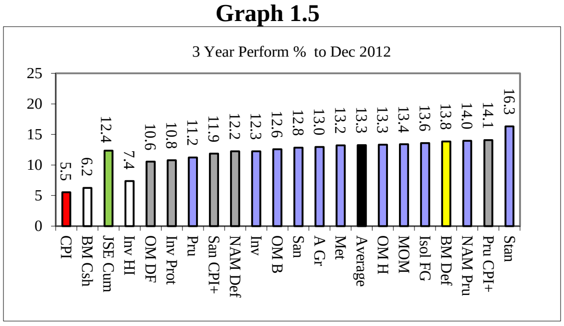
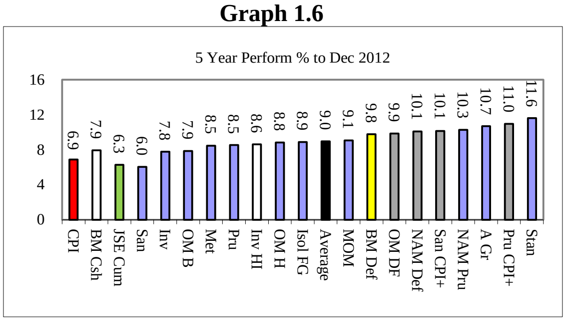
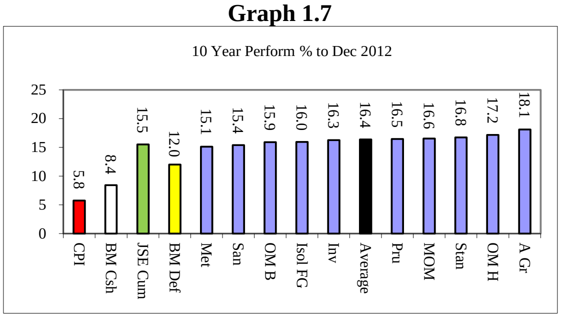
Graph 1.5



Graph 1.6

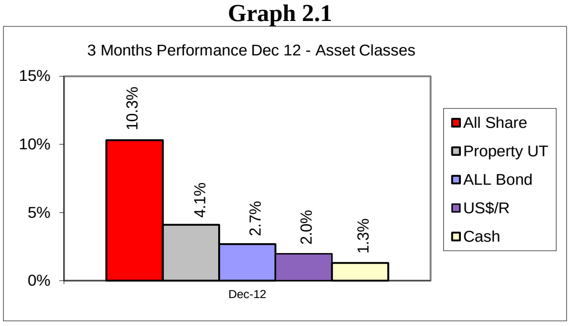


Graph 1.7

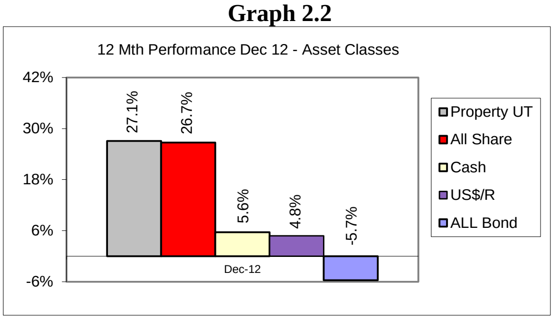


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

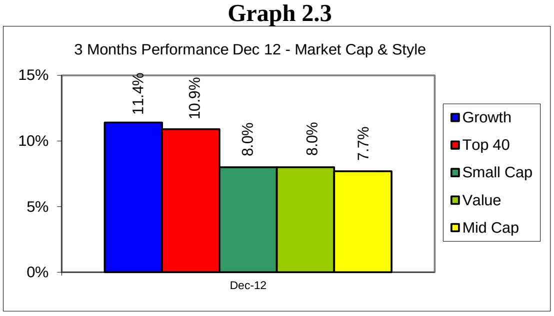
Graph 2.1



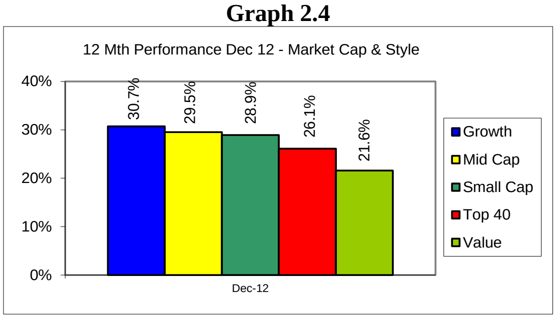
Graph 2.2



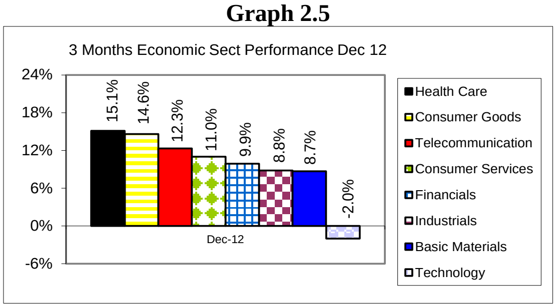
Graph 2.3



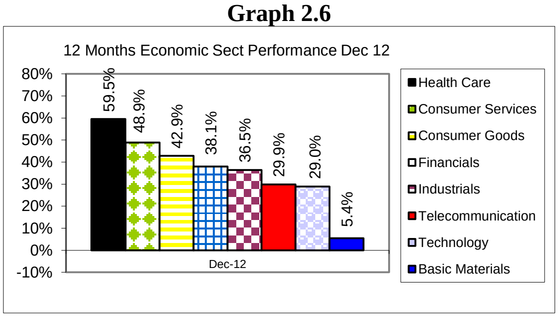
Graph 2.4



Graph 2.5



Graph 2.6



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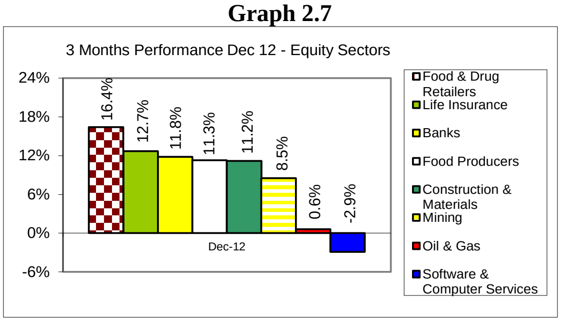
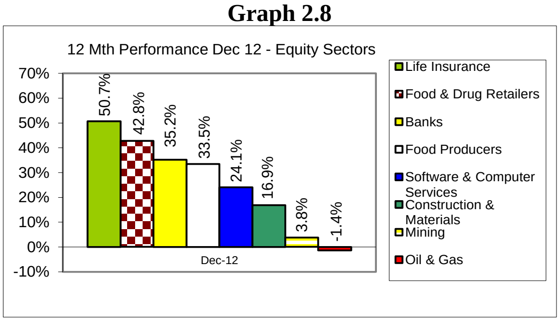
Graph 2.7



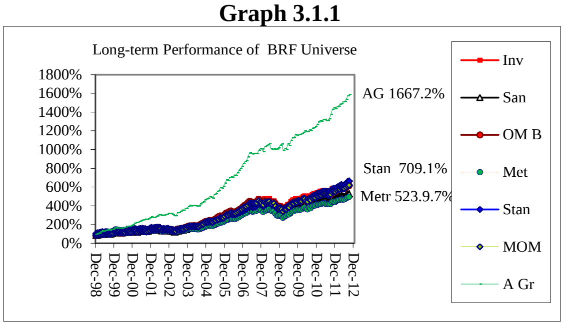
Graph 2.8



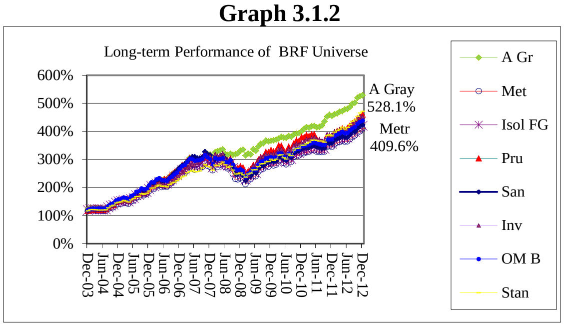
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

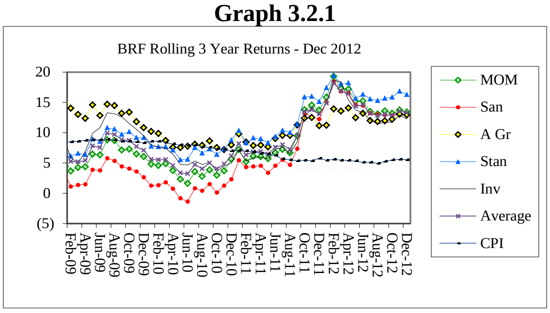


Graph 3.1.2

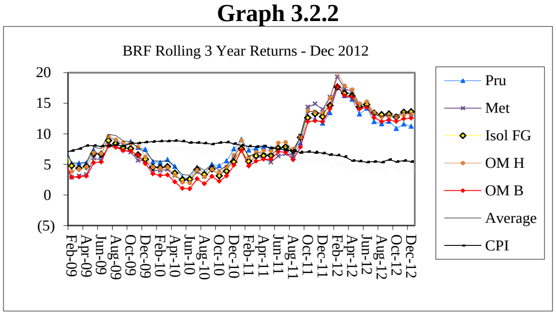


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

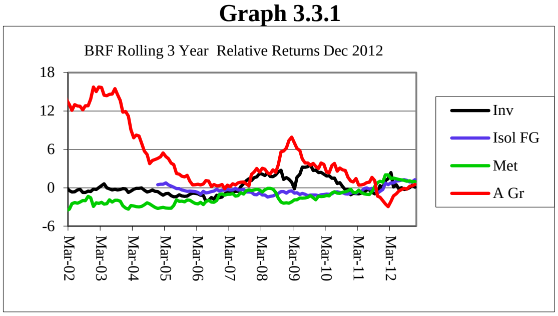


Graph 3.2.2

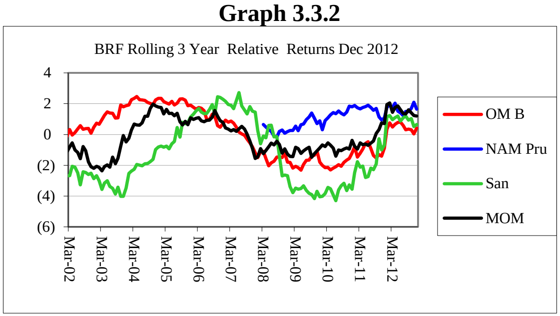


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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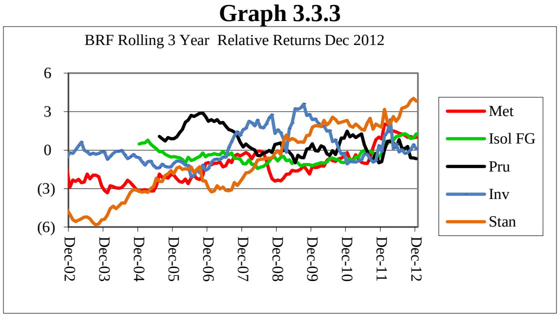
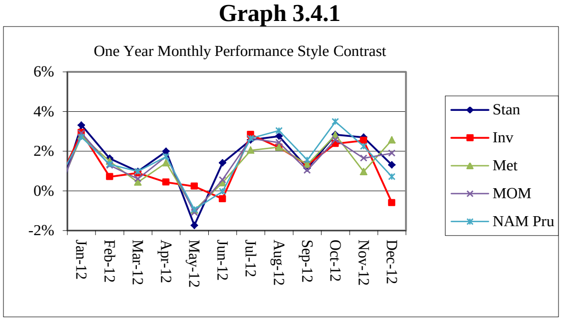
Graph 3.3.3

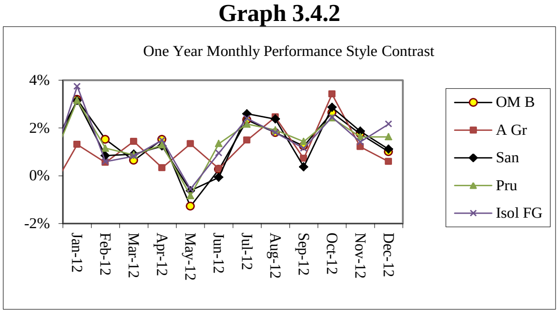


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

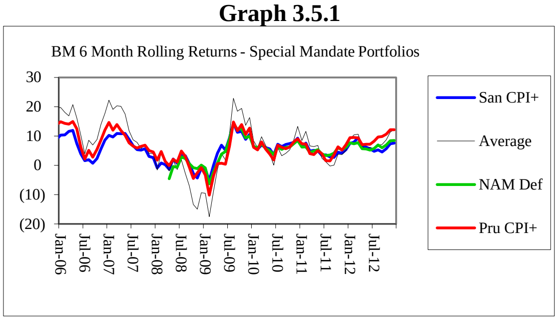


Graph 3.4.2

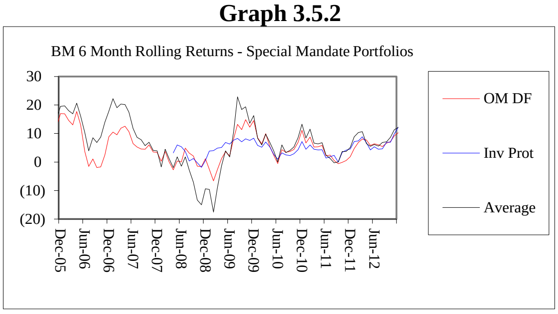


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

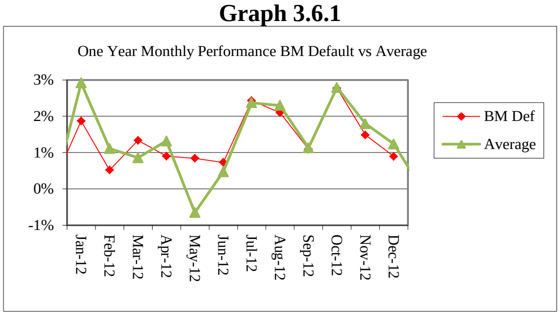


Graph 3.5.2

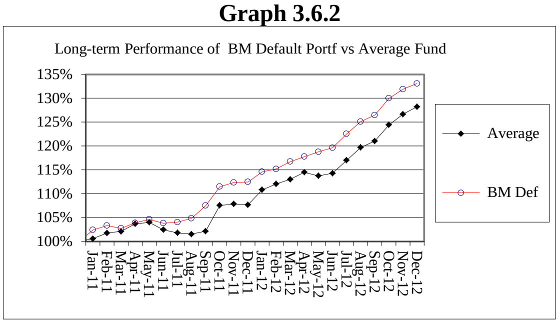


3.6 Monthly and cumulative performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

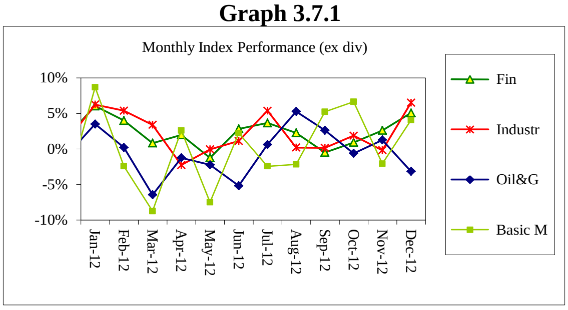


Graph 3.6.2



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

Graph 3.7.1



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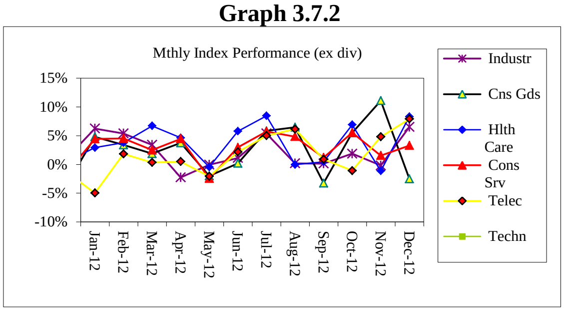
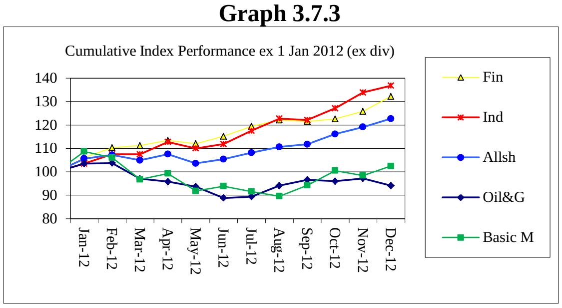
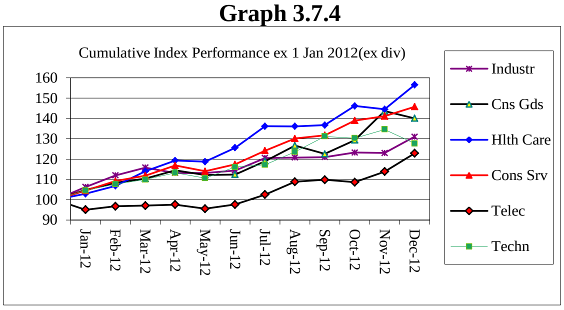
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 9.0 % p.a. in nominal terms, or 2.1 % p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 9.8% p.a. in nominal terms, or 2.9% p.a. in real terms. This outperformance of the average manager by the Benchmark Default portfolio is quite remarkable considering its substantially lower equity exposure (44.9% vs 59.5% as at the end of September).

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.

Having raised the risk profile of the Default portfolio effective the start 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. Since this change was effected, the default portfolio returned a cumulative 33.1% compared to 28.2% for the average prudential balanced portfolio over this 24 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 January 2010 to December 2012:

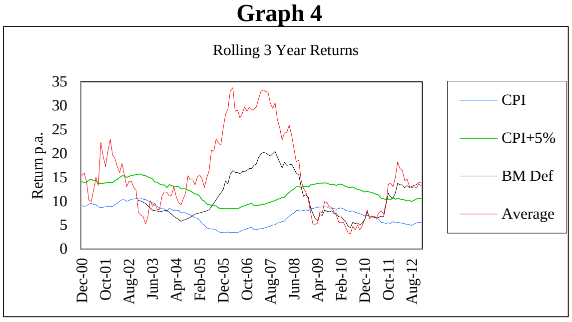
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.7%	9.2%	7.7%
Best annual performance	8.7%	19.3 %	30.2%
No of negative 1 year periods	n/a	0	0
Average of negative 1 year periods	n/a	n/a	n/a
Average of positive 1 year periods	6.6%	13.3%	14.6 %

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 were lagging inflation plus 5% and have surpassed inflation plus 5% since October 2011, Benchmark default portfolio currently on 13.8%, the

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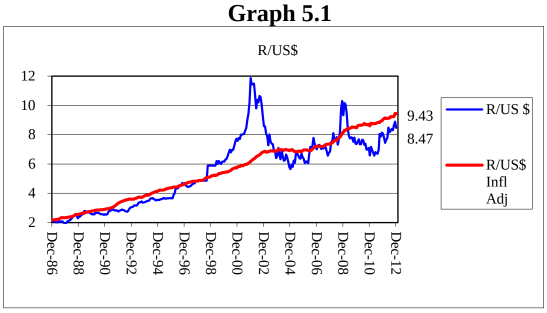
average on 13.3% vs CPI plus 5% currently on 10.5%.

5. Review of Foreign Portfolio Flows and the Rand

How is the Rand doing?

Graph 5.1 indicates that the Rand by our measure is fairly valued at 9.43 to the US Dollar while it actually stood at 8.47 at the end of December. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

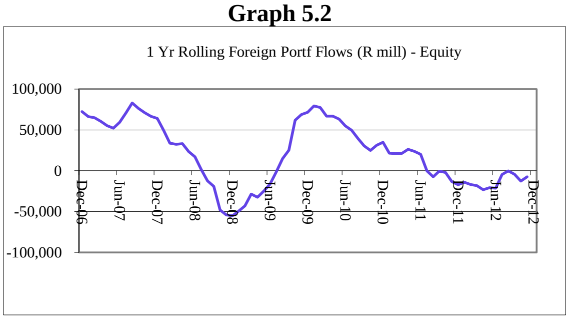


Support of the Rand from foreign capital flows continues, mainly through bond purchases

Graph 5.2 reflects a more steady but still slightly negative flow of capital out of South African equities on a rolling one year basis, with a net outflow of R 2.9 bn on a year-on-year basis at the end of December (outflow of R 7.4 bn to end November). Since the beginning of 2006, foreign net investment in equities amounts to N$ 168 billion (end November R 162 billion). This represents roughly 2% of the market capitalization of the JSE.

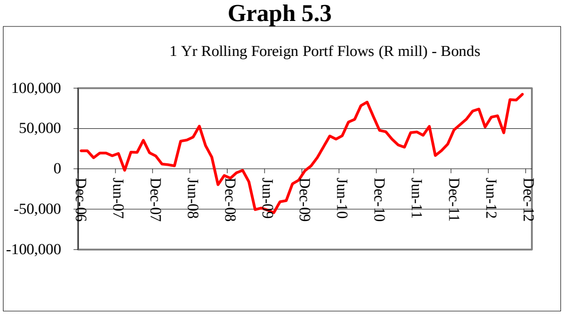
The fiscal easing measures of the Eurozone and again by the US are likely to provide an artificial underpin to the Rand through continued foreign inflows into local financial markets, more specifically into the bond market though.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects a much more volatile foreign portfolio flow into bonds of R 93.6 bn over the past 12 months to end of December (R 92.5 billion over the 12 months to end of November). Since the beginning of 2006, foreign net investment in bonds amounts to R 214 bn (November N$ 211 bn).

Graph 5.3

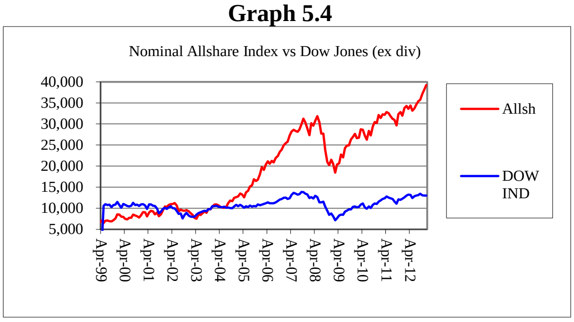


The net inflow of foreign capital into equity and fixed interest assets was R 91 bn for the 12 months to end December (inflow of R 85 bn to end November), compared to R 31 bn for the 12 months to end December 2011 (R 17 bn to end November 2011). Since the beginning of 2006, total net foreign portfolio flows amounted to N$ 382 billion since the beginning of 2006 (November R 373 bn).

Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms the JSE passed its month end peak of before the financial crisis of 31,841 (May 2008), while the DOW Jones is still substantially below its previous peak of 13,896 (Sep 2007). In nominal terms, the JSE grew by 14.2% per year, while the DOW Jones only grew by 1.5% per year, over this period of just over 13 years, dividends excluded. Namibian inflation over this period was 7% per year in contrast with US inflation of 2.4%.

Graph 5.5 reflects the same statistics but adjusted for US and SA inflation respectively. Since May 1999 the JSE Allshare Index has grown by 7.2% per year above inflation, over this period of just over 13 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW Jones declined by 0.9% per year above inflation over this period, also excluding dividends.

Graph 5.4



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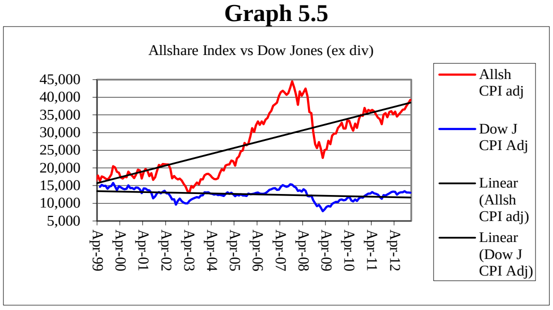
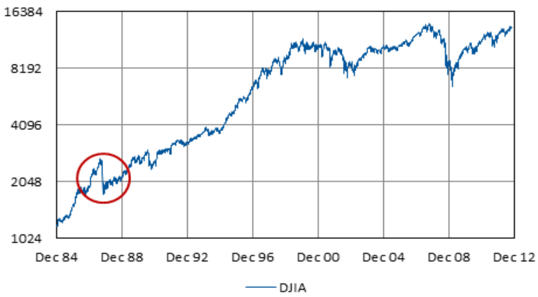
Graph 5.5



Graph 5.6

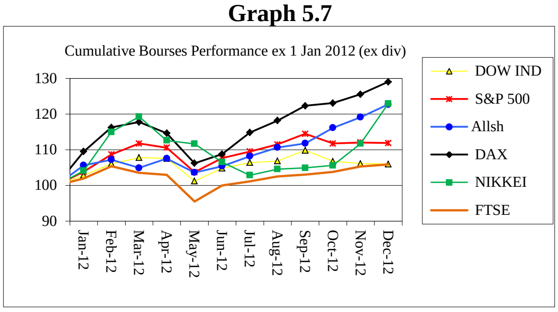
The Dow Jones Industrial Index, over the longer term:



Graph 5.6 places the data as per graph 5.5 into a better perspective, showing that graph 5.5 actually starts measuring the DOW Jones just after it had reached a peak around 1998.

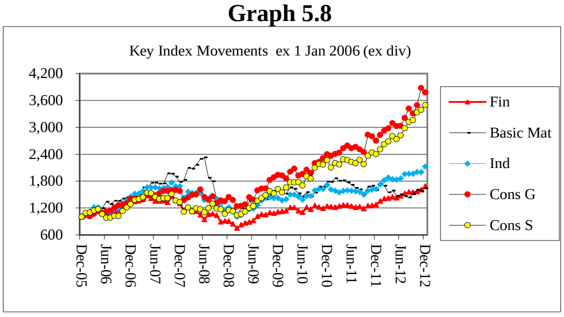
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the DAX as the top performing share index.

Graph 5.7



Graph 5.8 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 5.8



6. Conclusion

After the down grading of South Africa's debt rating by international rating agencies, the Rand weakness continued, it briefly breaching the R 9 to the US$ hurdle. This should dampen the enthusiasm of short-term foreign investors as will the continuing negative inflation differential between SA and it major trading partners and the fact that SA Reserve Bank kept the Repo rate unchanged. Foreign investment flows, particularly the more speculative flows, are likely to subside which should impact negatively on our local equity and bond markets.

A weaker Rand obviously benefits local exporters and local manufacturers and will make them more competitive against imports. Imports, including fuel, will become more expensive and this should filter through to raised inflation levels and to higher interest rates eventually.

We expect these trends to manifest ever more over the course of 2013. Although we do not expect any significant adjustments, we do expect more subdued local equity markets, low, probably negative real returns on fixed interest investments, a negative real return on cash, reasonable returns on property and an increasing inflation rate.

On the basis of fundamentals and the prevailing economic environment, we expect foreign equities to outperform foreign bonds and property. A number of foreign bourses still offer high discounts on fair value occasioned by sentiment that is likely to fade out slowly. According to data produced by 1741 Asset Managment, the MSCI Italy offers a discount of 59% on fair value, Germany and Austria around 50% and, believe it or not, Portugal 'only' 41%. The MSCI EMU offers a discount of 33% and MSCI Japan a discount of 42%, compared to MSCI USA with a premium of 16%. In the face of a depreciating Rand, such investments would of course experience that benefit as well. Such discounts must be compelling investment opportunities that should be capitalised on now. It is like being offered a house for N$ 1.5 million that was in the market for N$ 3 million before the financial crisis.

In terms of local equity sectors, we remain concerned about the significant growth SA Consumer Goods and Consumer Services have seen, returning 20.9% and 19.6 % per year, respectively, since December 2005, excluding dividends. Add dividends to this return and the investor would have earned a return close to 25% per year over the past 7 years! Similar returns were generated by the Health Care and Technology sub-sectors.

We do not believe this is sustainable and that the tide may be about to turn. Financials and Industrials have returned much more modest growth rates of 7.7% and 11.4%. Over the same period, the Namibian CPI grew by 6.8% per annum. Basic Materials that have grown by a similarly modest rate of 7.3 % per year since the beginning of 2006, should also offer some buying opportunities although as a sector we do not foresee it showing any significant recovery in the medium term.

We believe an assertive balanced portfolio with an overweight in equities, neutral property and underweight bonds and cash should be appropriate under current circumstances. Inflation linked bonds might offer an exception though. A high foreign equity exposure to particularly Eurozone countries where markets experienced a dramatic decline as the result of negative investor sentiment, remains our call for 2013.

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.