Volume 9, No. 3, Mar 2013

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MARCH 2013

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

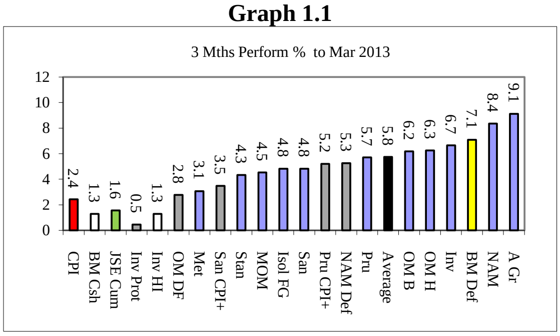
In **March** our **average prudential balanced portfolio** returned 2.15% (February minus 0.44%). Top performer is Allan Gray (3.78%), Sanlam (1.53%) takes bottom spot.

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.

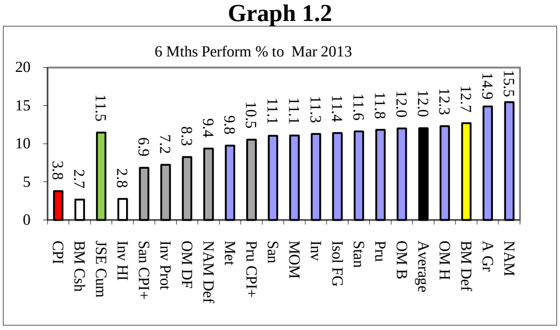
Below is the legend to the abbreviations reflected on the graphs:

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)
Momentum Managed	MOM (blue)
Sanlam Managed	San (blue)
Stanlib Managed	Stan (blue)

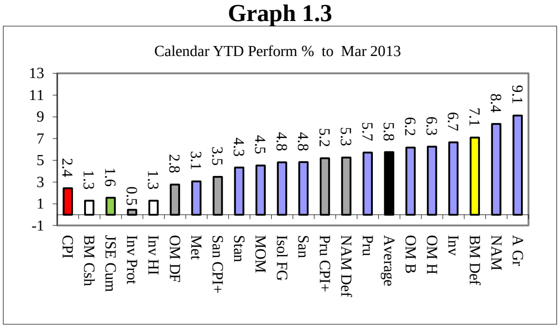
Graph 1.1



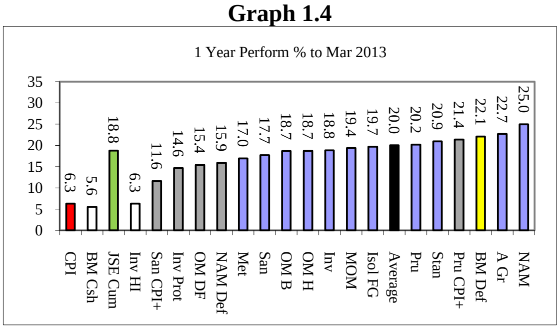
Graph 1.2



Graph 1.3



Graph 1.4



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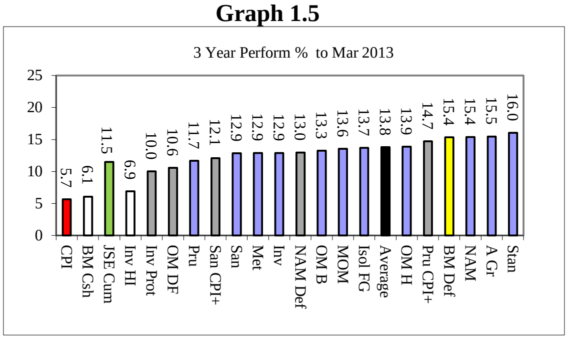
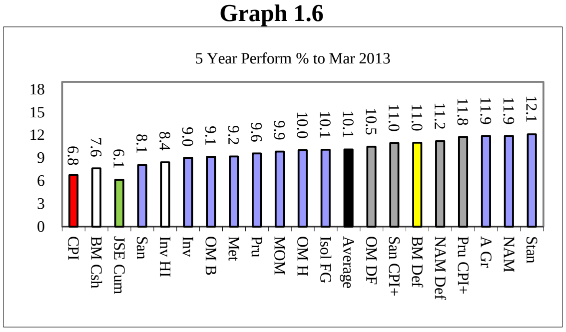
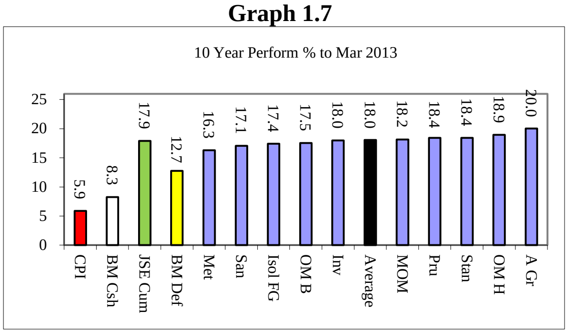
Graph 1.5



Graph 1.6

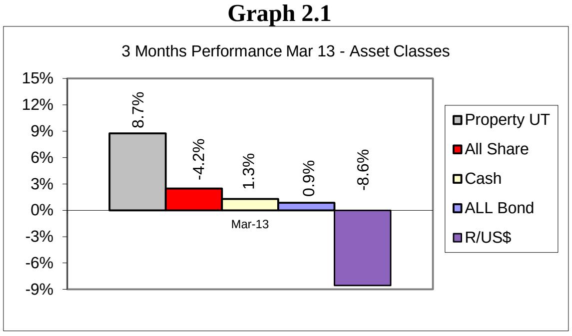


Graph 1.7

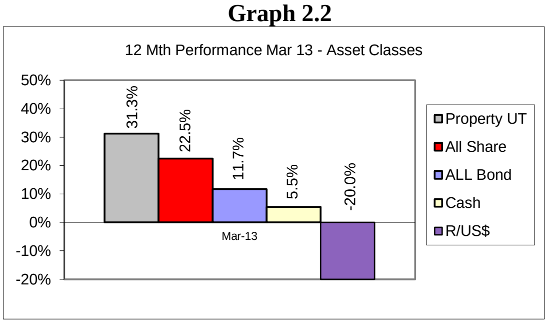


2. **Performance of Key Indices** (index performance by courtesy of IJG/Deutsche Securities)

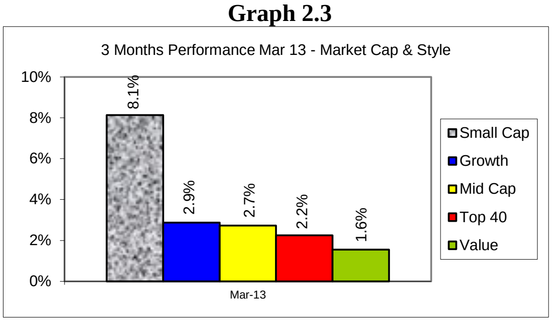
Graph 2.1



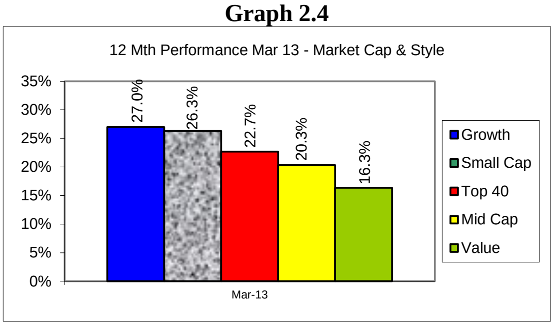
Graph 2.2



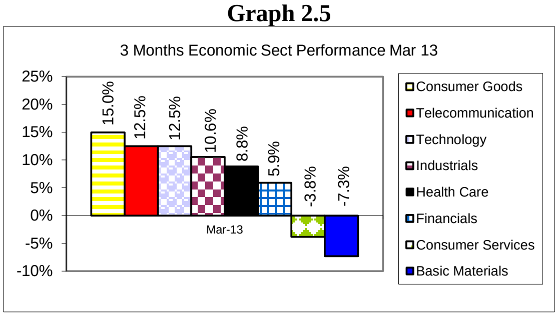
Graph 2.3



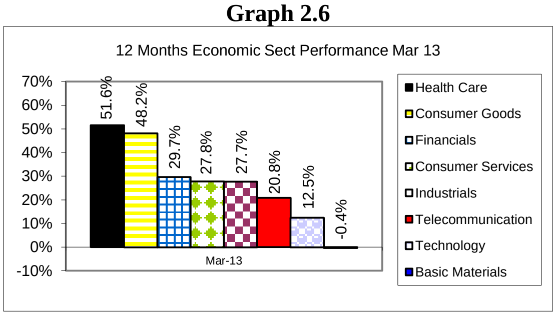
Graph 2.4



Graph 2.5



Graph 2.6



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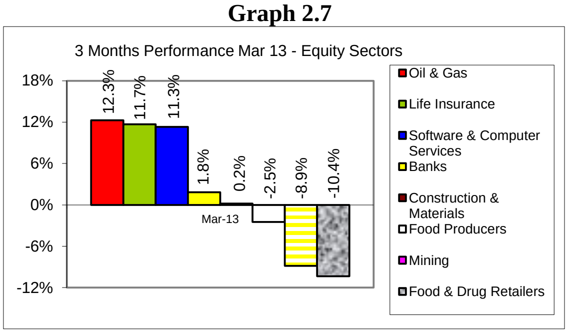
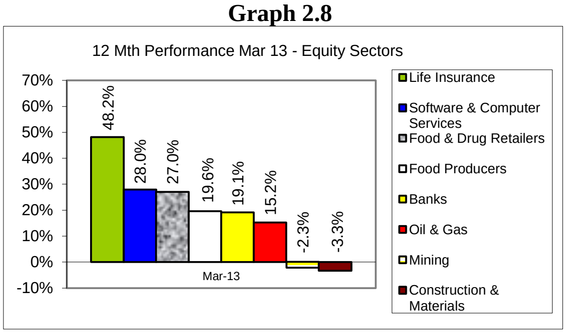
Graph 2.7



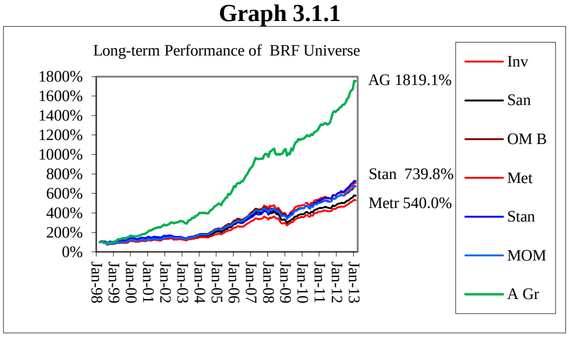
Graph 2.8



3. Portfolio Performance Analysis

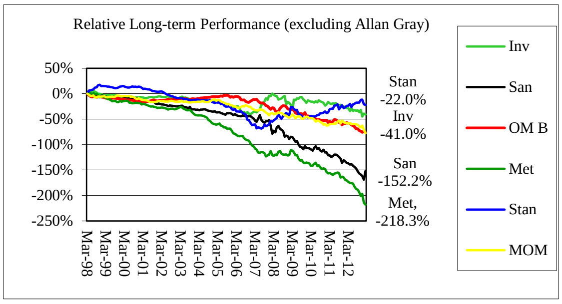
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

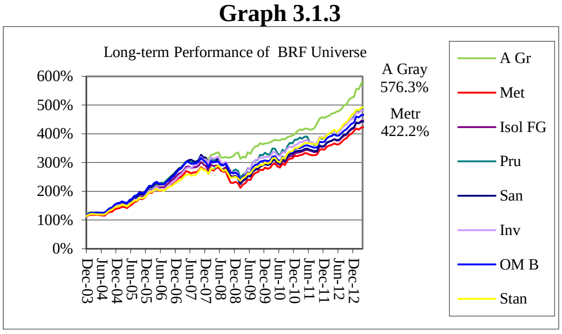


Graph 3.1.2

Cumulative performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

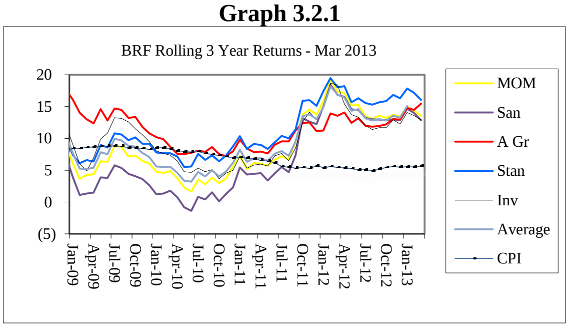


Graph 3.1.3

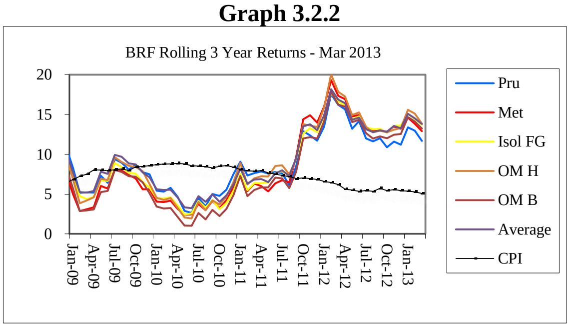


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

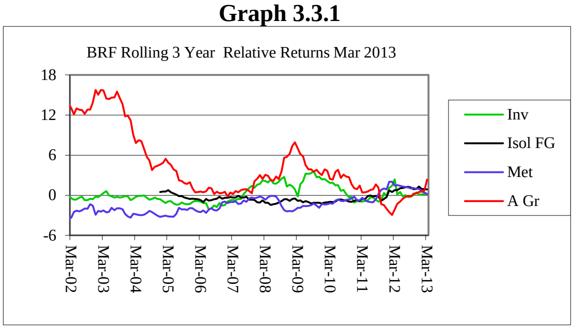


Graph 3.2.2



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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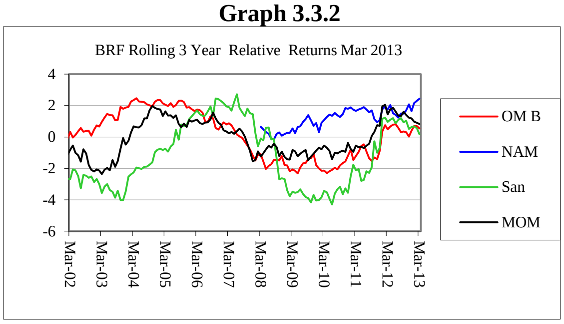
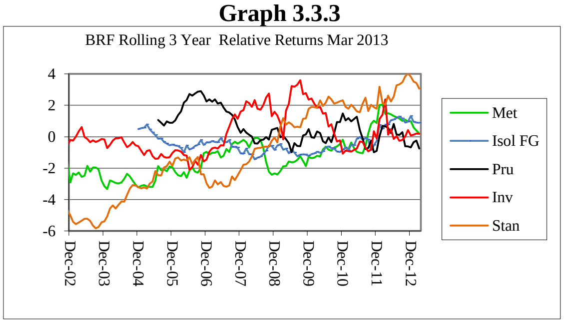
Graph 3.3.2

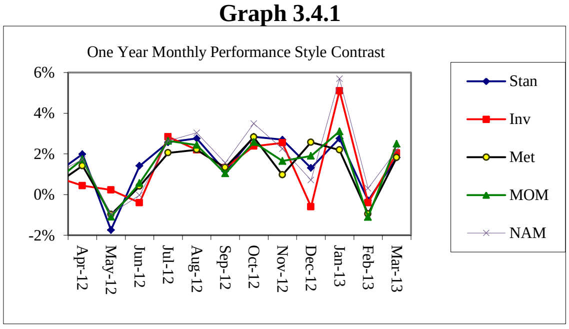


Graph 3.3.3

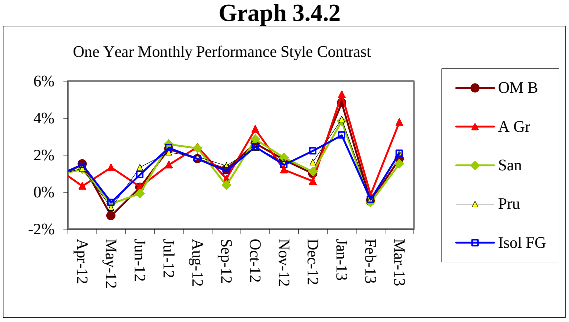


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

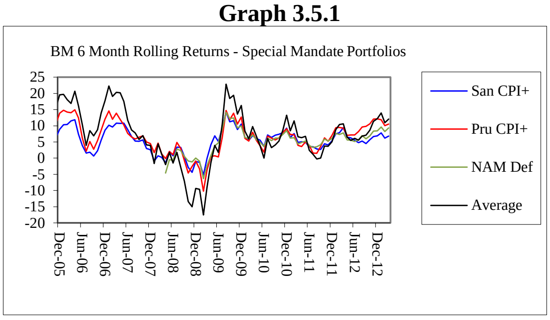


Graph 3.4.2

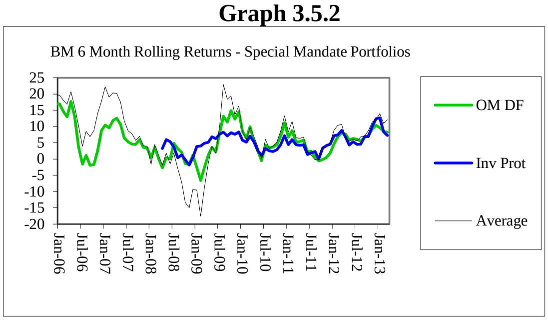


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

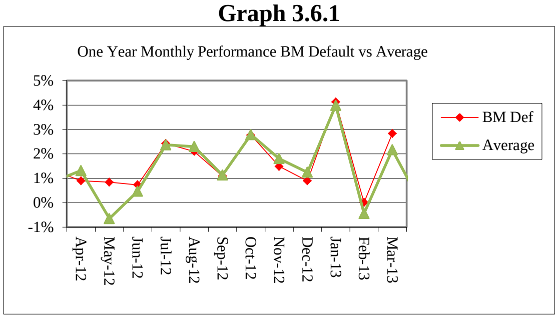


Graph 3.5.2

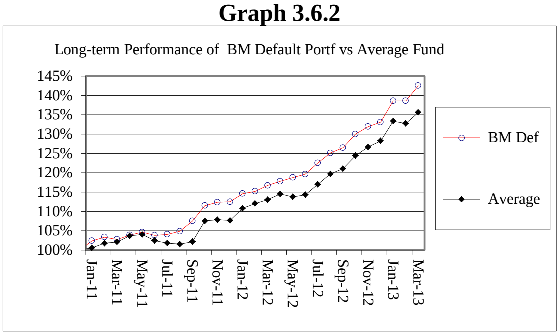


3.6 Monthly and cumulative performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1



Graph 3.6.2



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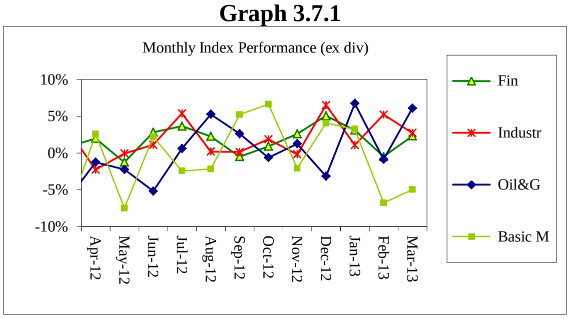
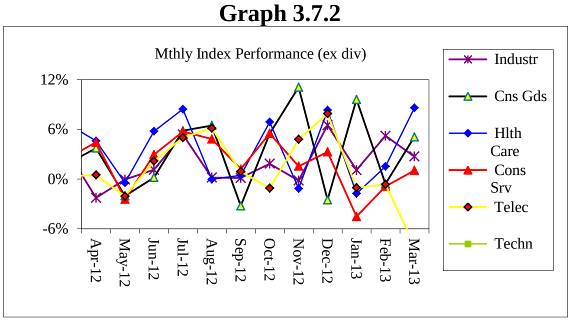
3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

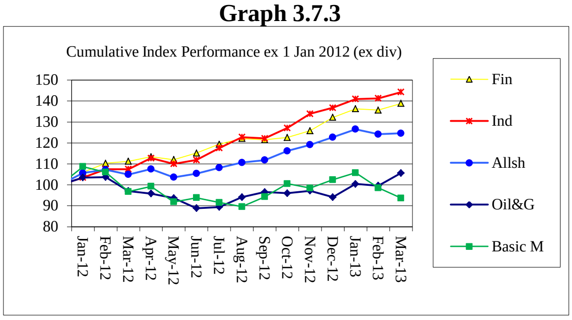
Graph 3.7.1



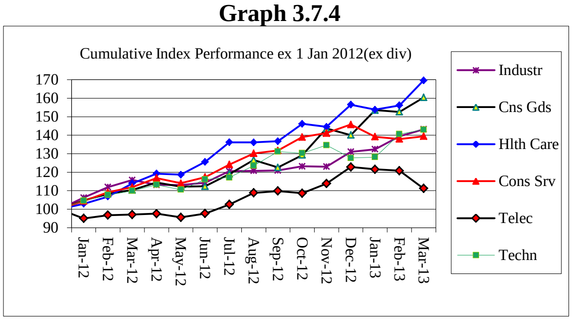
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 10.1 % p.a. in nominal terms, or 3.3% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 11.0% p.a. in nominal terms, or 4.2% 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 (47.9% vs 61.3% as at the end of December 2012).

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 Prudential Inflation Plus Fund, we would expect the Default portfolio to sacrifice around 1% return for the benefit of lower volatility compared to the average prudential balanced portfolio, 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 35.9% compared to 30.9% for the average prudential balanced portfolio over this 27 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 April 2010 to March 2013:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.6%	9.2%	6.7%
Best annual performance	7.9%	22.1 %	27.6%
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	6.4%	13.9%	14.0 %

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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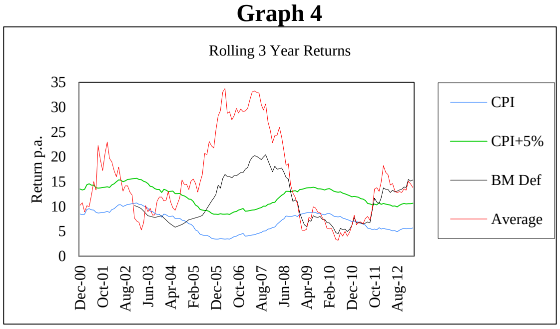
Graph 4



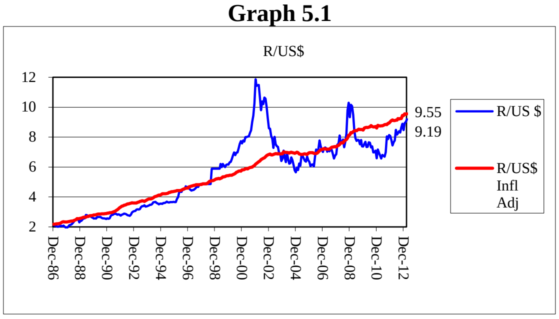
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 2008, both the Benchmark Default portfolio as well as the average prudential balanced portfolio were lagging inflation plus 5% and have surpassed inflation plus 5% since October 2011, Benchmark default portfolio currently on 15.4%, the average on 13.8% vs CPI plus 5% currently on 10.7%.

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 9.55 to the US Dollar while it actually stood at 9.19 at the end of March. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

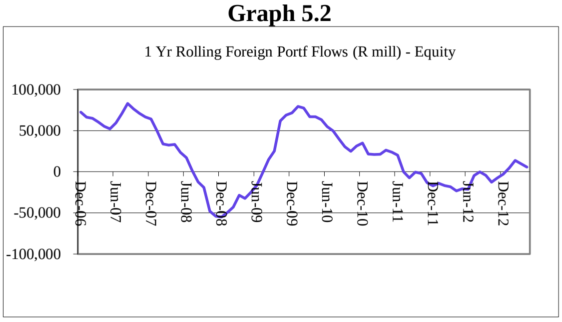


Support of the Rand from foreign capital flows continues, mainly through bond purchases

Graph 5.2 reflects a now declining yet still positive flow of capital into South African equities on a rolling one year basis, with a net inflow just below R 5.7 bn on a year-on-year basis at the end of March (inflow of R 13.7 bn to end February). Since the beginning of 2006, foreign net investment in equities amounts to N$ 173 billion (end February R 178 billion). This represents roughly 2% of the market capitalization of the JSE.

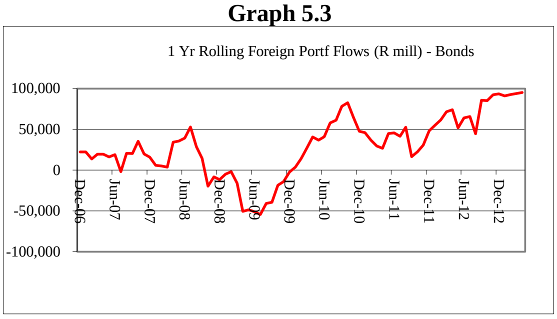
The fiscal easing measures of the Eurozone, the US and with more vigour now by the Bank of Japan, are likely to provide an artificial underpin to the Rand through continued foreign 'hot money' inflows into local financial markets, more specifically into the bond market though.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects a strong foreign portfolio flow into bonds of R 95.2 bn over the past 12 months to end of March (R 92.7 billion over the 12 months to end of February). Since the beginning of 2006, foreign net investment in bonds amounts to just below R 235 bn (to February N$ 223 bn).

Graph 5.3



The net inflow of foreign capital into equity and fixed interest assets was R 101 bn for the 12 months to end March (inflow of R 107 bn to end February), compared to R 53 bn for the 12 months to end March 2012 (R 45 bn to end February 2012). Since the beginning of 2006, total net foreign portfolio flows amounted to N$ 407 billion (February R 401 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 at the end of January for the first time matched its previous peak of 13,896 (Sep 2007). In nominal terms, the JSE grew by 14% per year, while the DOW Jones only grew by 2.4% 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 2.5%.

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% per year above inflation, over this period of close to 14 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW only managed to match inflation over this period, also excluding dividends.

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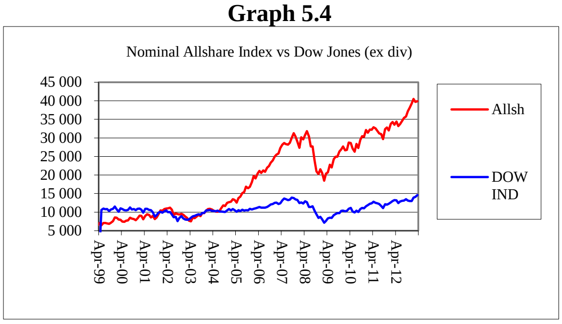
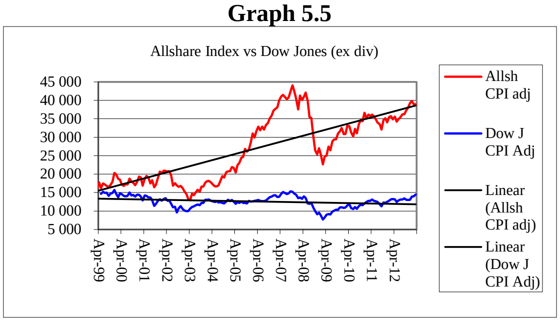
Graph 5.4

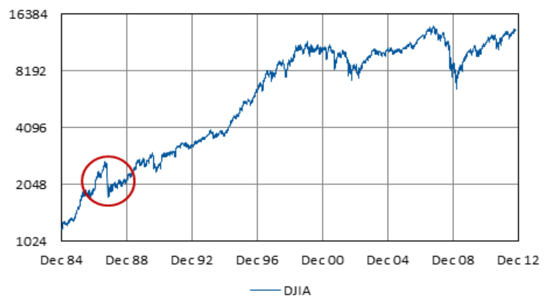


Graph 5.5



Graph 5.6

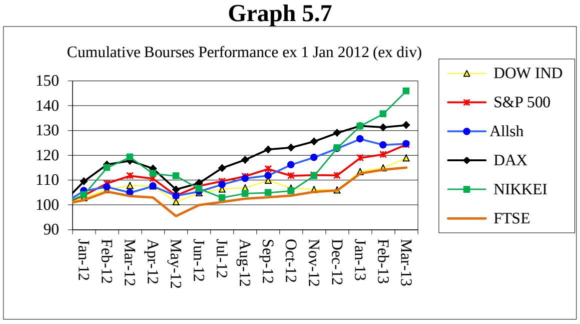
The Dow Jones Industrial Index, over the longer term:



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.

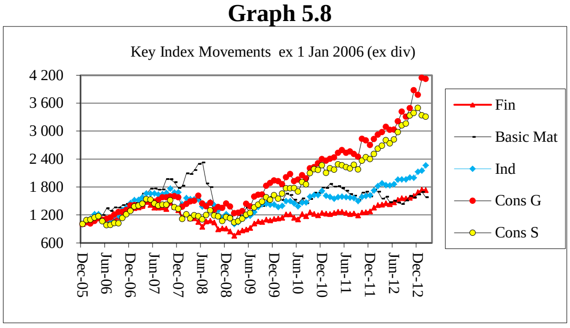
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the DAX as the top performing share indices.

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

Politicians, particularly those of the western world would want to make us believe we live in an open global economy. However, where international trade is concluded in a single currency, where fiscal and monetary authorities intervene massively in financial markets, more will have to be done by the politicians to make the public believe.

The law of economics, of demand and supply, has no bearing on the behaviour of markets today. Savers are paying off the debt of borrowers through artificially low interest rates that are set by monetary authorities. So-called 'safe haven' investments are earning negative real interest rates and the investor is now conditioned to accepting that he will have to work until he drops dead, instead of realising his dream of retiring at an age where one might still be able to enjoy life for a while. Retirement ages are extended while pension entitlements are at best being questioned already, and even reduced in some countries.

With negative real interest rates seemingly having become the 'new norm', asset valuation models are now being questioned. Why should this be of concern to a pension fund member? Well the point is that pension fund contribution structures were established over the course of the past century or more based on the assumption of cash returning around 2% above inflation, bonds around 4% above inflation, property around 5% above inflation and equity around 8% above inflation. A typical balanced portfolio comprising of a mix of these assets based on conventional investment theory was expected to return roughly 5% above inflation, net of fees. Pension theory then arrived at a net retirement funding contribution rate of 11%+, to produce an income replacement ratio of 2% per year of membership.

Indications based on the 'new norm' are that one is now only looking at a net return of between 2% and 3% p.a. If this were to be true, the retirement funding contribution rate would have to be raised from 11% to at least 16%. Add to this a typical cost element of 6% for risk benefits and management costs, the 'new norm' for a total retirement fund contribution rate is now at least 22% instead of the 17% before the advent of the 'new norm'. Alternatively the retiree would now have to settle on an income replacement ratio of only around 40% after 30 years of service, instead of his expected 60%! No wonder the mortals are being conditioned by politicians to be prepared to work until they drop dead.

We are certainly living in a different world today to what is was 30 years ago. What we expected of the future will be materially different and we will have to find ways and means to deal with the impact these changes have on our lives and on our retirement planning. One can only find some comfort in the fact that we are all 'in the same boat', the answers have not been found and a lot of energy and time will be spent all across the globe to find answers how to still have time in retirement to enjoy.

For local pension fund investors, one probably needs to take a different view of the risks of investing offshore. In the past, developing countries and Africa in particular was loaded with a political risk premium. The Cyprus experience has shown that the political risk in developed countries has manifested. Add to this huge demographic risks for a more callous view on investment in developed countries. In contrast the demographic risks Africa is facing appear to be receding going by general population growth rates.

Given this environment, where can a pension fund still invest? Fixed interest assets are evidently too risky being too exposed to monetary and fiscal manipulation. Even if we here at the southern tip of Africa are living in a much more sheltered environment, our financial markets are shackled by global developments. This essentially leaves real business as the asset class to invest in. We all have to live, eat, drink, dress, get to work, nurture our health, go on holiday, learn, find shelter and so on. The 'real economy' will continue and is best represented by commerce and industry, in short, investment in equity appears to be really the most appropriate asset class for the normal investor who shies away from the more exotic asset classes such as gold, works of art etc.

As we usually say, based on fundamentals, equities is our preferred asset class, more specifically value companies offering a high dividend yield. Despite all we have said about the risks presented by offshore markets, sound risk diversification principles still dictate that investments should be spread across the globe, and again with an equity bias. If one can find value in property, it should also be an appropriate asset class, being closely tied into the 'real economy'. In terms of local equity sectors, fundamentals indicate that consumer goods and consumer services are due to fall out of favour for the benefit of industrials, resources, and financials.

Dear reader, please take note that due to the absence from office of the author of this column, our next newsletter will spare you of his commentary!

7. Important notice and disclaimer

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