Volume 9, No. 6, June 2013

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 JUNE 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

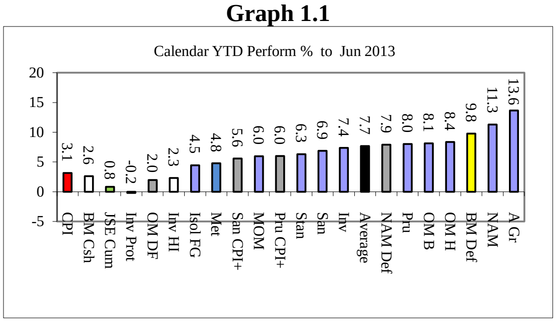
In **June** the **average prudential balanced portfolio** returned minus 3.42% (May 6.25%). Top performer is Allan Gray (-2.58%), Investec (-4.72%) takes bottom spot.

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.

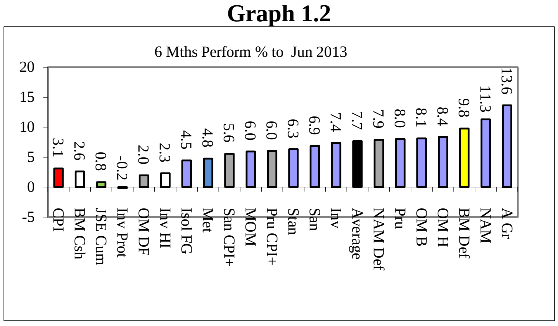
Below is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Consumer Price Index	CPI (red)
JSE Allshare Index	JSE Cum (green)
Benchmark Default Portfolio	BM Def (yellow)
Average Portfolio (prudential, balanced)	Average (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)
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	Pru (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)

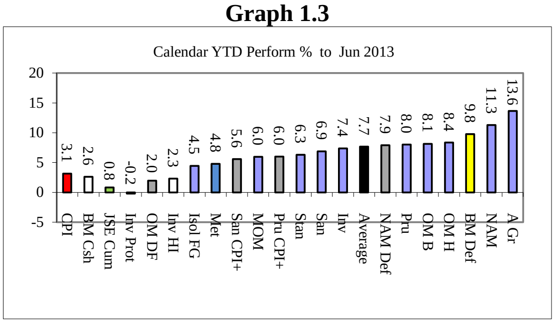
Graph 1.1



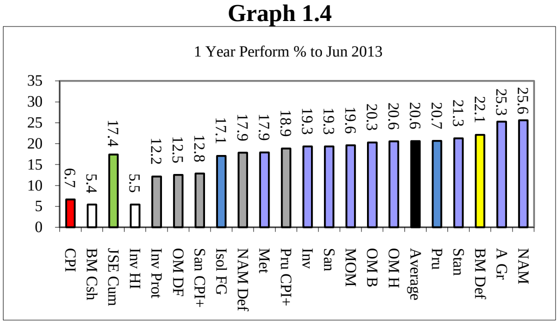
Graph 1.2



Graph 1.3



Graph 1.4



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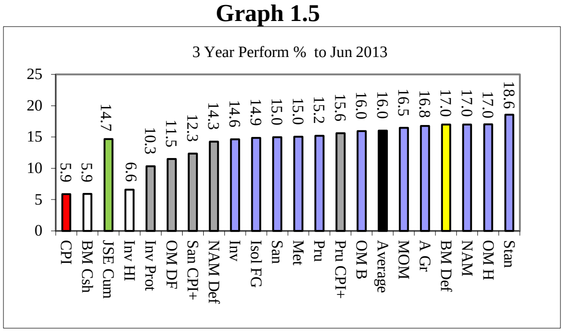
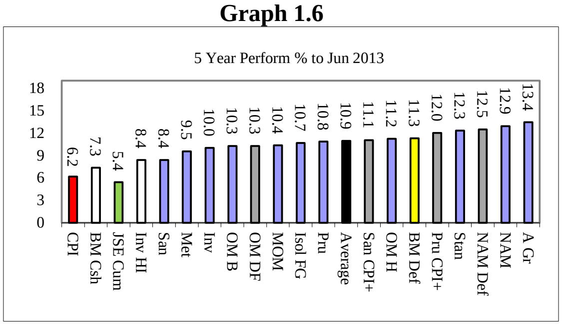
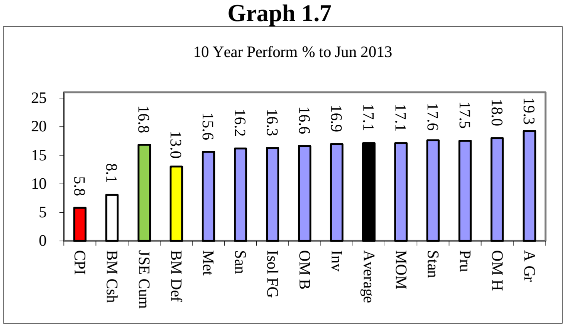
Graph 1.5



Graph 1.6

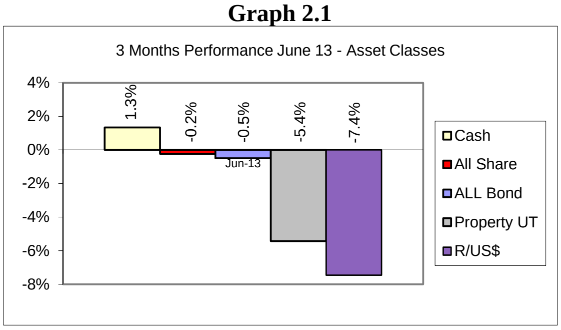


Graph 1.7

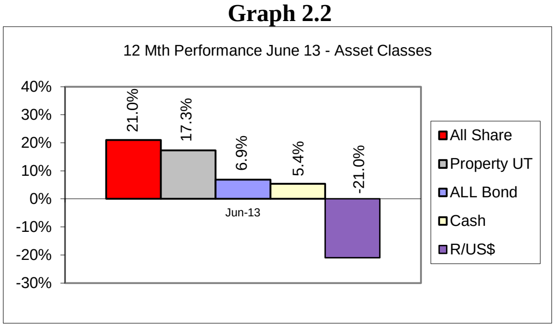


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

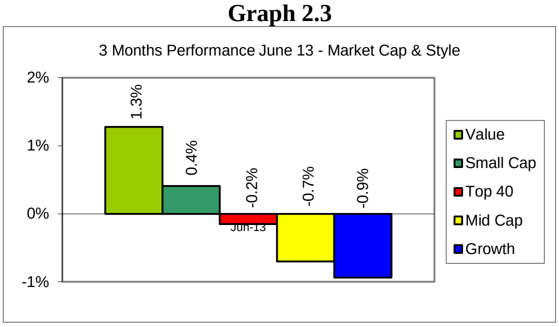
Graph 2.1



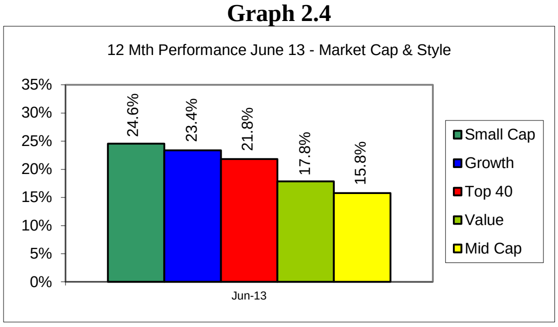
Graph 2.2



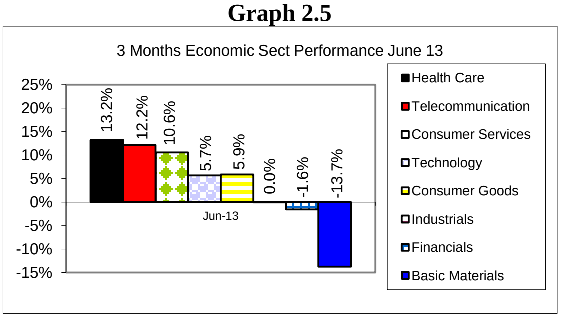
Graph 2.3



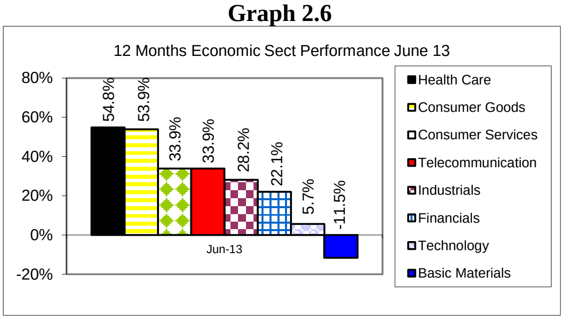
Graph 2.4



Graph 2.5



Graph 2.6



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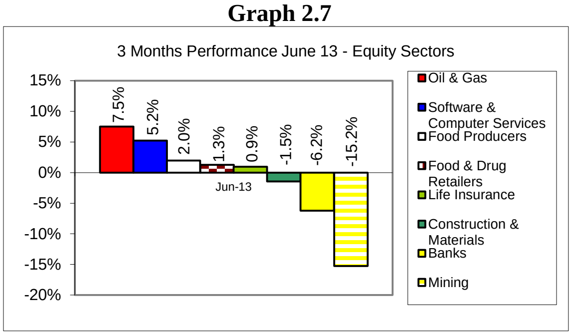
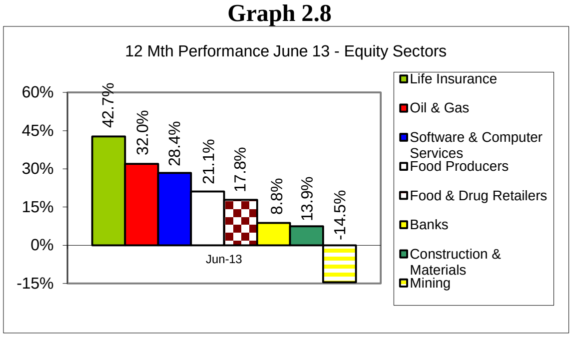
Graph 2.7



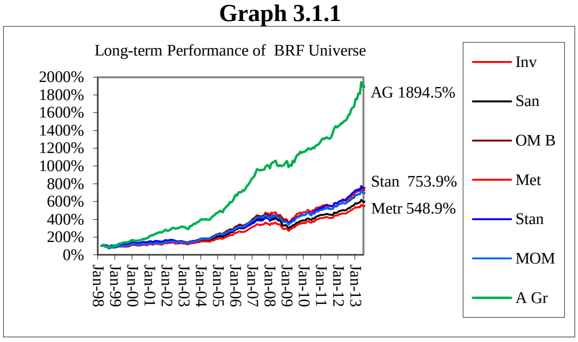
Graph 2.8



3. Portfolio Performance Analysis

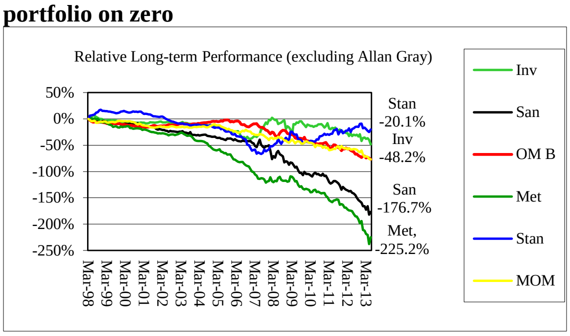
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

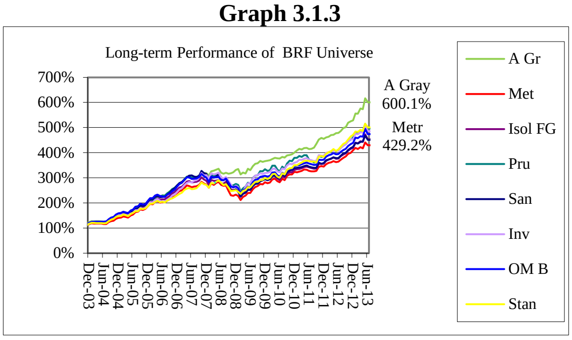


Graph 3.1.2

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

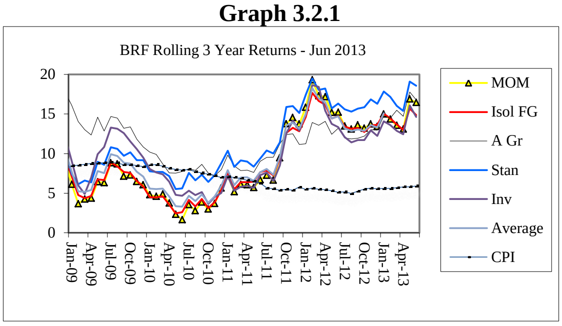


Graph 3.1.3

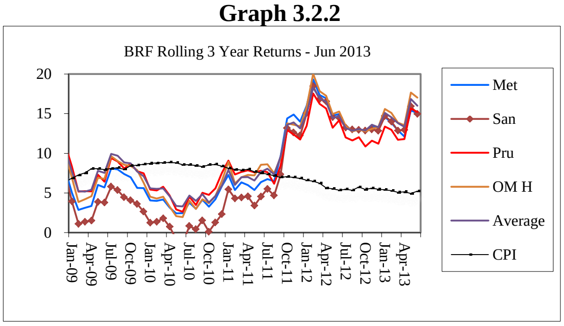


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

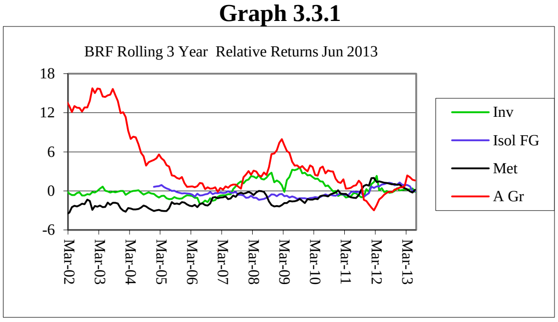


Graph 3.2.2



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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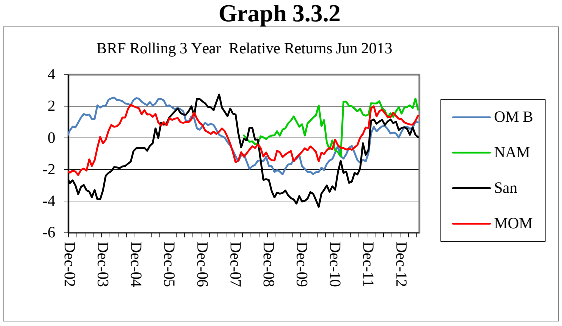
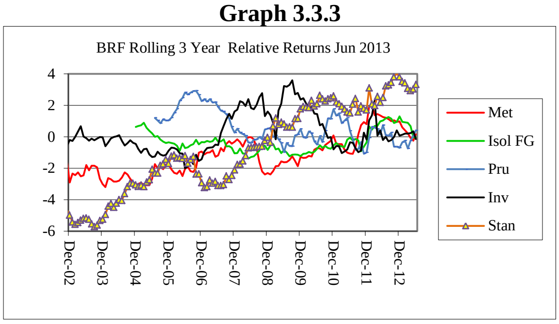
Graph 3.3.2

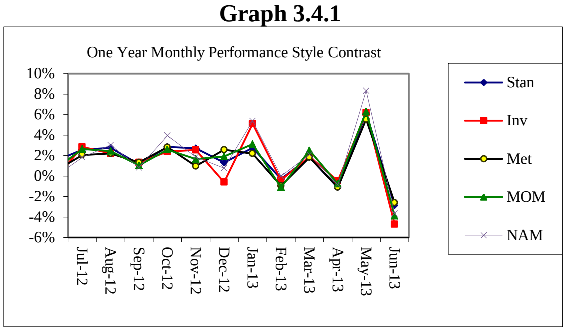


Graph 3.3.3

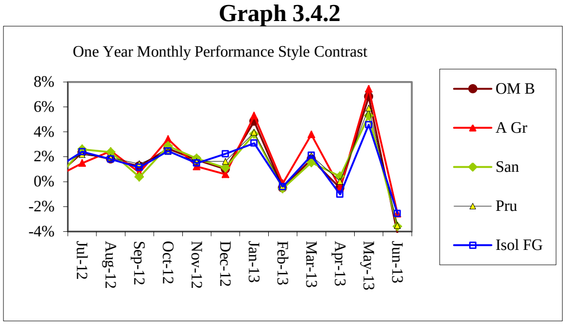


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

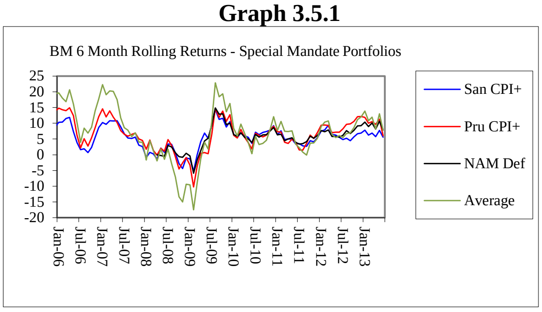


Graph 3.4.2

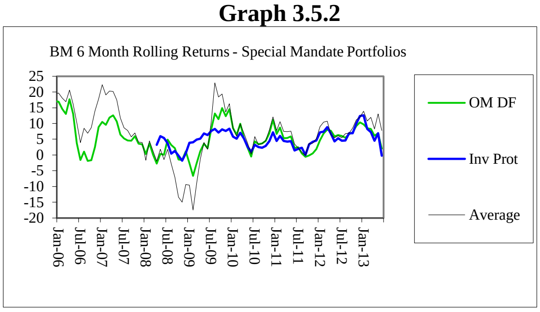


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

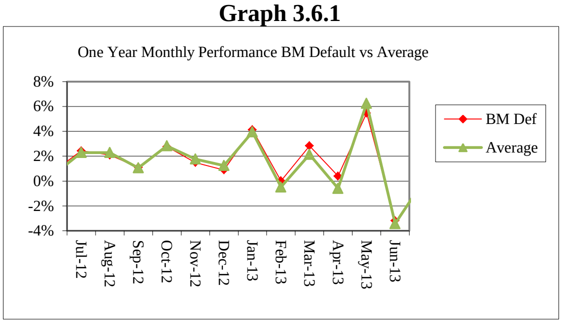


Graph 3.5.2

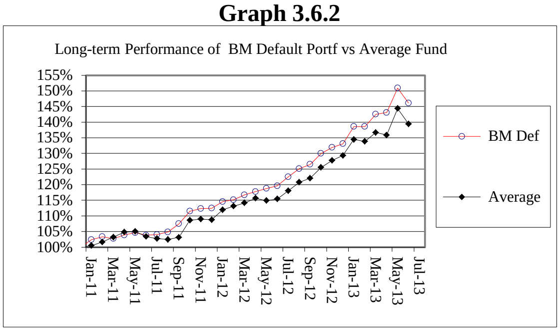


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1



Graph 3.6.2



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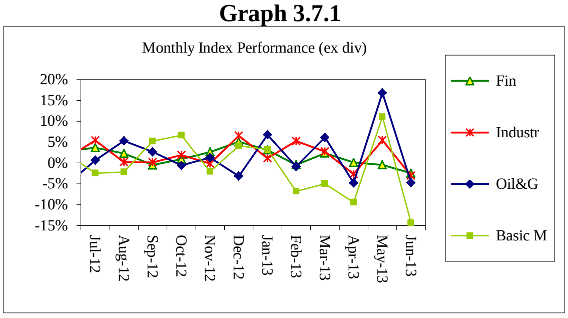
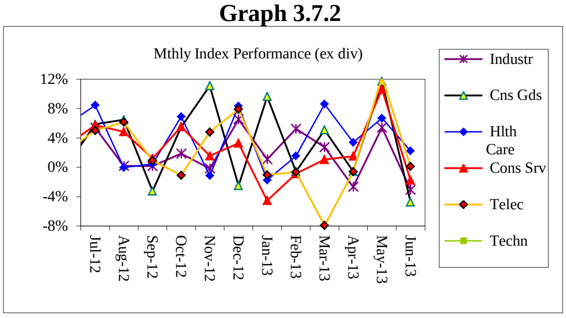
3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

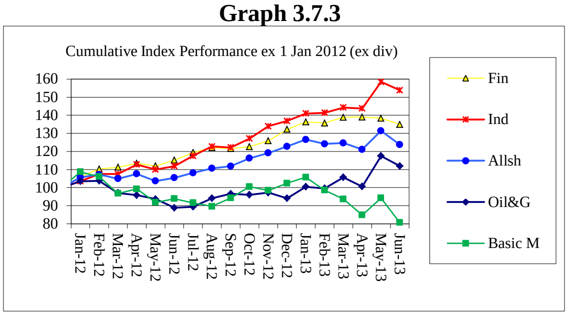
Graph 3.7.1



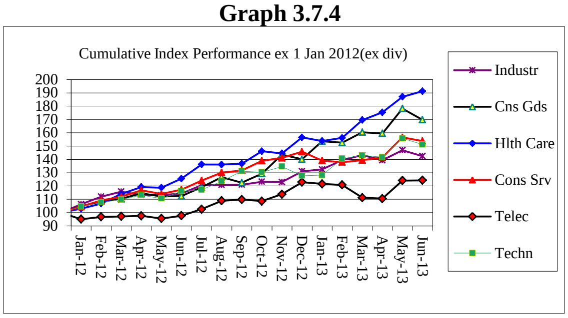
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 11.0 % p.a. in nominal terms, or 4.8% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 11.3% p.a. in nominal terms, or 5.1% 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 (49.0% vs 62.8% as at the end of May 2013).

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 over the past 5 years.

Having raised the risk profile of the Default portfolio effective the start of 2011, by replacing Metropolitan ARF with the Allan Gray Investment Trust, 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. Over the past 5 years this performance objective was achieved. Since this change was effected, the default portfolio returned a cumulative 46.1% compared to 39.3% for the average prudential balanced portfolio over this 30 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 July 2010 to June 2013:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.4%	9.2%	7.4%
Best annual performance	7.5%	27.1 %	25.6%
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	6.2%	14.8%	14.1%

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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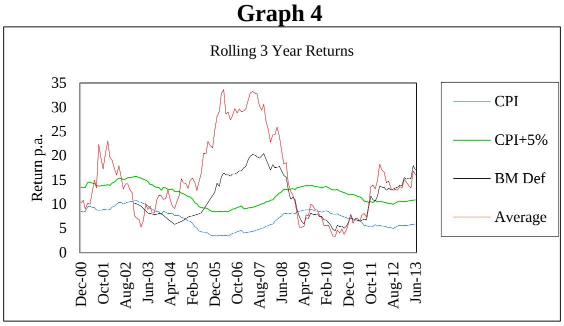
Graph 4



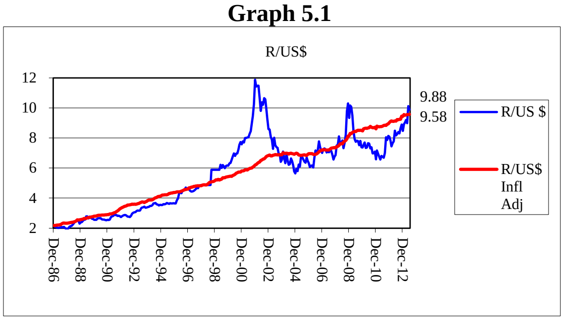
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 17.0%, the average on 16.1% vs CPI plus 5% currently on 10.9%.

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 9.58 to the US Dollar while it actually stood at 9.88 at the end of June. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

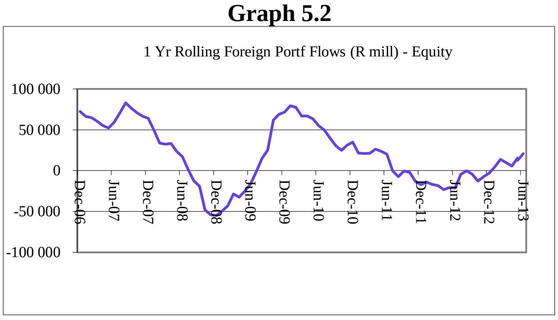


Rand under pressure due to foreign capital flows

Graph 5.2 reflects a steady positive flow of capital into South African equities on a rolling one year basis, with a net inflow of R 20.8 bn on a year-on-year basis at the end of June (inflow of R 12.6 bn to end May). Since the beginning of 2006, foreign net investment in equities amounts to N$ 191 billion (end May R 184 billion). This represents roughly 2.2% of the market capitalization of the JSE.

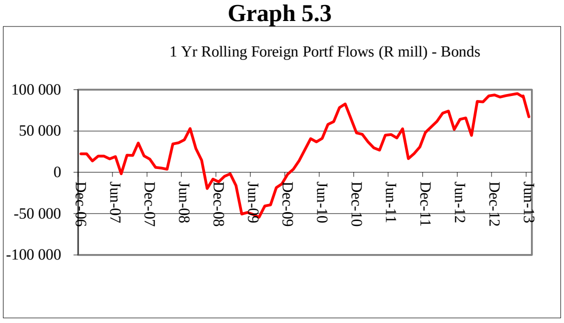
Revaluations of emerging economies combined with a possible let up of fiscal easing measures in the US has led to significant capital outflows out of South Africa. Local bond yields are on the rise and many foreign investors are seeking value elsewhere. This sell off of emerging markets (mostly bond market) has put pressure on the exchange rate. The declining trend in foreign portfolio flows and the pressure on the Rand is likely to persist and to increase as the prospect of the tapering off of intervention by the Fed becomes ever more likely.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects a sharp decrease of foreign portfolio flow into bonds of R 67.1 bn over the past 12 months to end of June (R 92.5 billion over the 12 months to end of May). Since the beginning of 2006, foreign net investment in bonds amounts to just above R 234 bn (to May just above N$ 240 bn).

Graph 5.3



The net inflow of foreign capital into equity and fixed interest assets was down to R 87.8 bn for the 12 months to end June 2013 (inflow of R 105 bn to end May 2013), compared to R 43 bn for the 12 months to end June 2012 (R 31 bn to end May 2012). Since the beginning of 2006, total net foreign portfolio flows amounted to N$ 425 billion (May R 424 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 13.5% per year, while the DOW Jones only grew by 2.4% per year, over a period of just over 14 years, dividends excluded. Namibian inflation over this period was 6.9% 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 6.6% per year above

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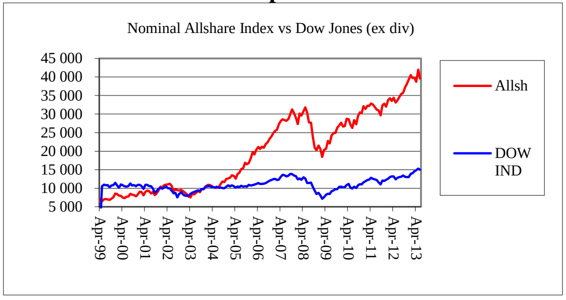
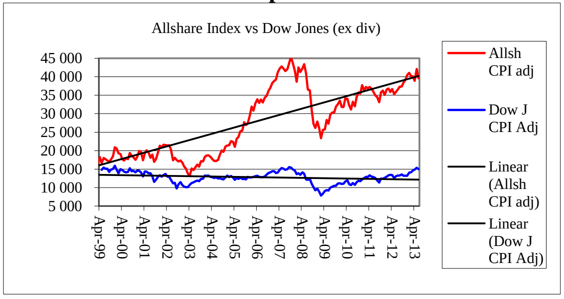
inflation, over this period of close to 14 years, and this excludes dividends of somewhere in the region of 2% to 4%. In contrast, the DOW only managed to match inflation over this period, also excluding dividends.

Graph 5.4



Graph 5.5



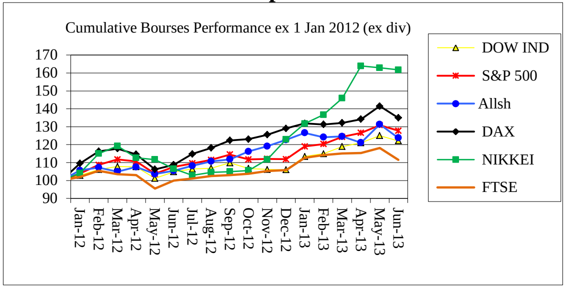
Graph 5.6

The Dow Jones Industrial Index, over the longer term:

Graph 5.6 places the data as per graph 5.4 into a better perspective, showing that graph 5.4 actually starts measuring the DOW Jones just after it had reached a peak around 1998.

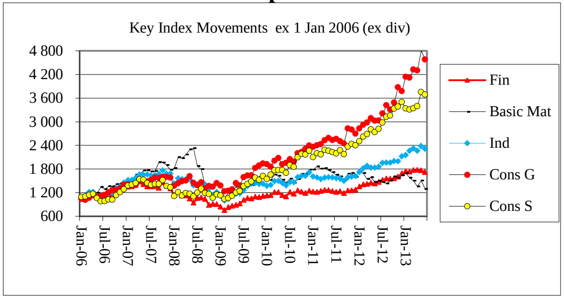
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the DAX as the top performing share indices.

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

Those that kept an eye on global financial markets, would have taken note of the severe impact a 'casual remark' by the governor of the Federal Reserve Bank had on these markets in June, when shares took a knock of around 6%, while interest rates responded with an immediate increase, albeit a fairly modest increase. Was this vicious response not foreseen by the governor to have tried to put his comment in a more rosy perspective shortly afterwards?

In any event, this 'oral refurbishment' again impacted strongly on global equity markets in July, this time with a strong upward movement. So where does this leave the investor, more particularly trustees who are charged with the responsibility of overseeing the investments of their funds?

It seems that the US Fed is in quite a predicament as shown by the recent violent swings in global financial markets. Equity investors and borrowers are praying that the Fed, in particular may not withdraw its bond buying programme while fixed interest investors are hoping that it will, so that they once again may earn positive real interest rates.

Most probably global investors are more and more coming to expect that the Fed will taper off its bond buying programme in the foreseeable future and are starting to adjust their investment strategy on the basis of this expectation.

It is also likely that the Fed will not splash their intentions across the media in future after the recent scare effect. Listening to statements made since, there are now more 'ifs' and 'buts' that seem to be designed to be less dogmatic about what steps to take when. These can be interpreted to be 'cautionary announcements' for investors not to place too much reliance on the Fed keeping up its programme unchanged.

What appears to happen as far as local financial markets are concerned is that foreign portfolio flows are declining. As the result interest rates are on the increase, consistent with a more cautious stance of global investors and the general expectation that the Fed's bond buying programme will start tapering off in the foreseeable future.

As far as the Rand is concerned, we believe that its fair value is 9.58 (see graph 5.1) to the US Dollar and that it is undervalued at its current levels. When transferring investments offshore timing does play an important role and the exchange rate prevailing should be monitored closely.

In the longer term, conventional investment wisdom would expect the exchange rate movement between two currencies to reflect the inflation differential between the two countries concerned, meaning that it has no impact on the real value of the investment. The longer term is not equally relevant to different investors depending on the investors investment time horizon relative to the current position in the economic cycle. Political developments of course are another key, yet largely imponderable factor that may impact.

Ignoring any short-term exchange rate consideration, the decision whether or not to invest offshore is currently really a question of relative value. It goes without saying that assets should be spread widely so as not to have all eggs in one basket. Since the bulk of one's assets are normally located in the country of residence, prudence would suggest that the larger portion of discretionary investments should be placed outside the country of residence.

Going by 1741 Asset Management's fair value analysis for May 2013 (formerly Wegelin Bank of Switzerland), many Euro countries and Japan represent buying opportunities whereas the US, UK, Australia and New Zealand do not present buying opportunities.

Following our above argumentation, a globally well diversified portfolio, comprising of value companies in the consumer and technology sectors with strong cash flows and high dividend yields, some high yielding property exposure with low gearing are really the asset classes we believe can deliver satisfactory returns over the next one to two years. In terms of the weighting of the equity exposure we believe that foreign equity should be overweight relative to local equity.

7. Important notice and disclaimer