Volume 9, No. 8, August 2013

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 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

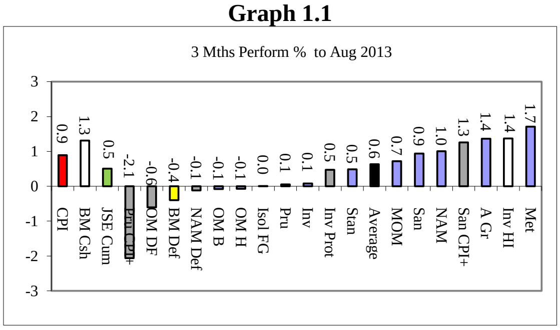
In **August** the **average prudential balanced portfolio** returned 1.58% (July: 2.70%). Top performer is Allan Gray (2.31%), Prudential Namibia Managed (1.11%) takes the bottom spot.

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 Namibia.

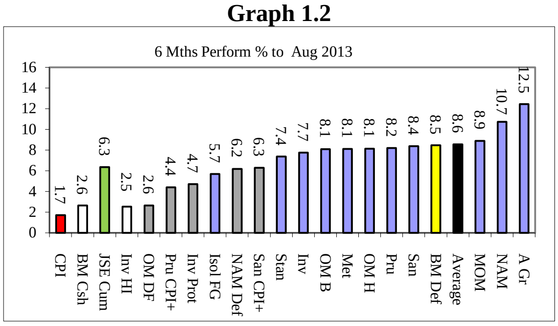
Below is the legend to the abbreviations reflected on the graphs:

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)

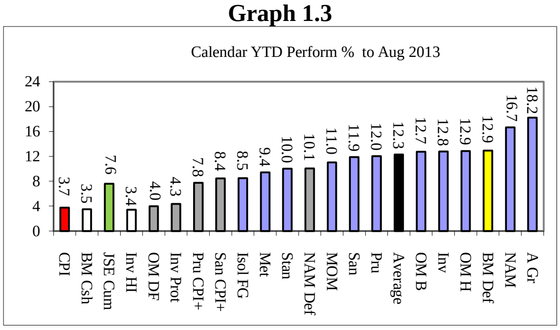
Graph 1.1



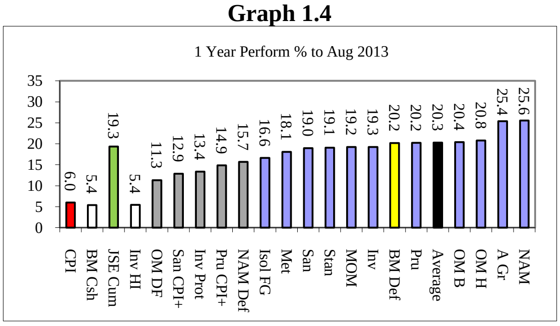
Graph 1.2



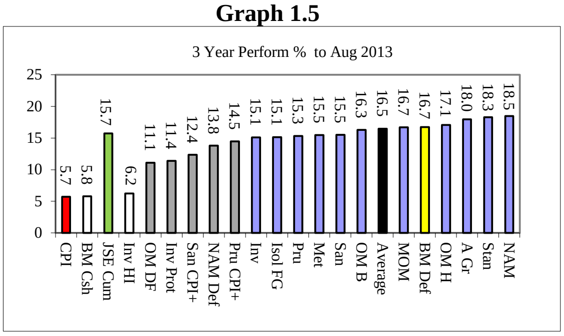
Graph 1.3



Graph 1.4



Graph 1.5



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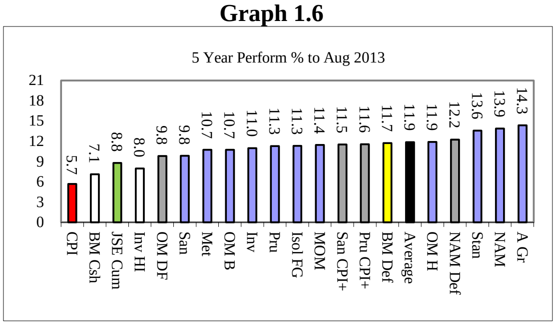
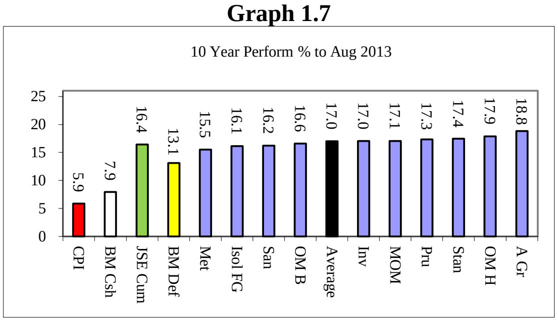
Graph 1.6

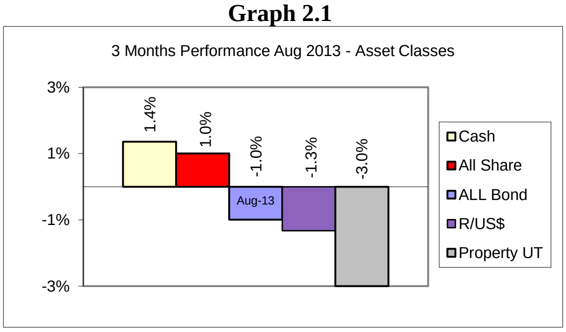


Graph 1.7

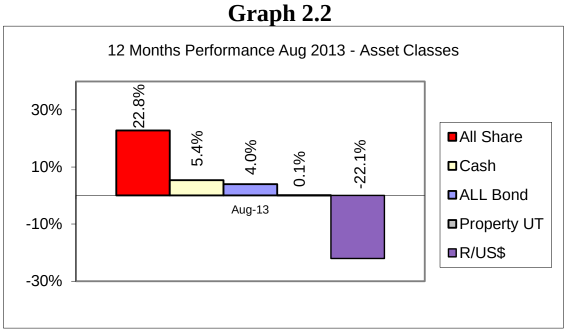


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

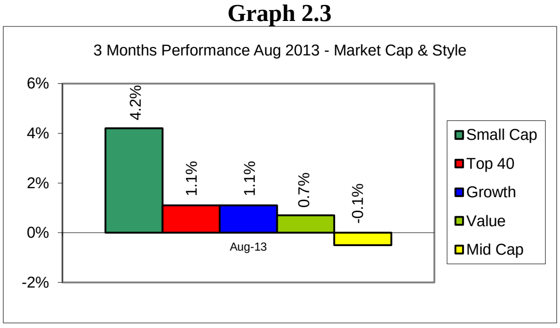
Graph 2.1



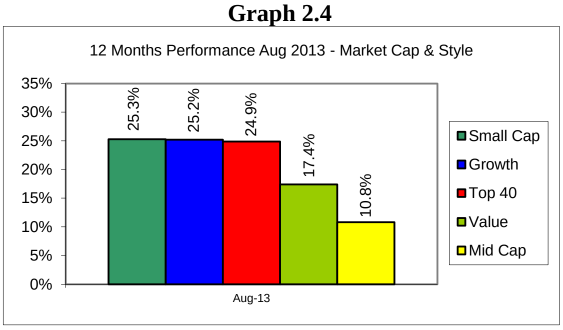
Graph 2.2



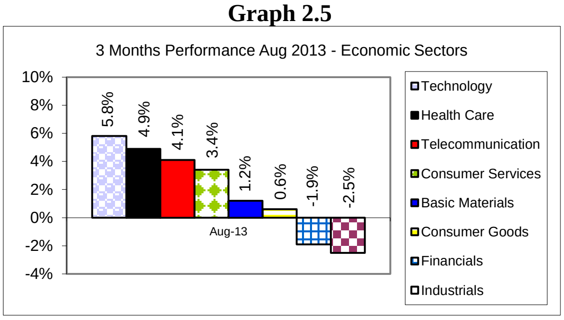
Graph 2.3



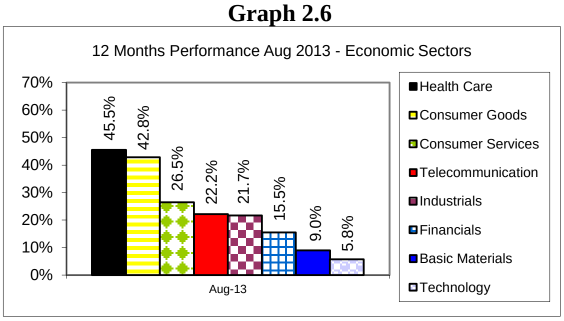
Graph 2.4



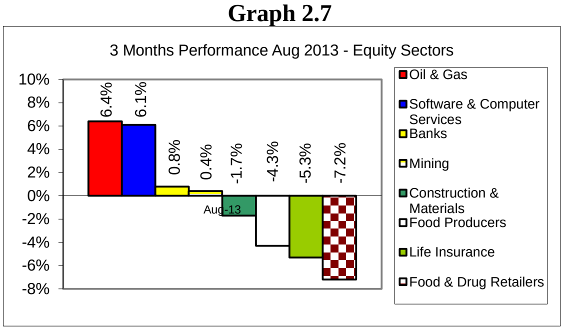
Graph 2.5



Graph 2.6



Graph 2.7



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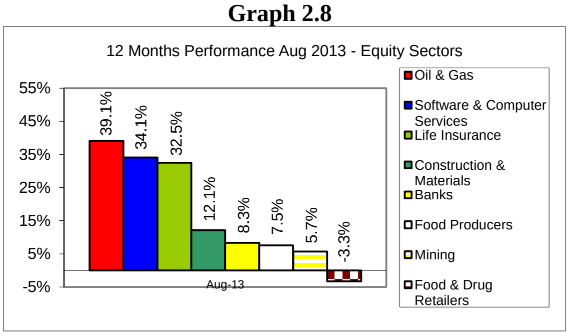
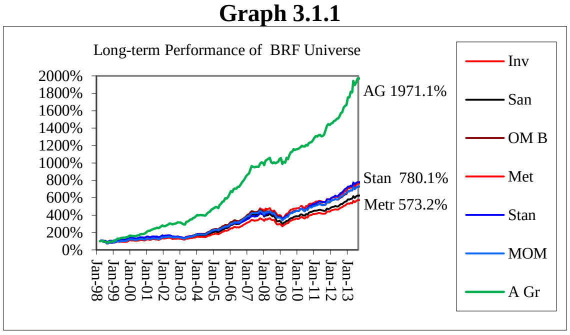
Graph 2.8



3. Portfolio Performance Analysis

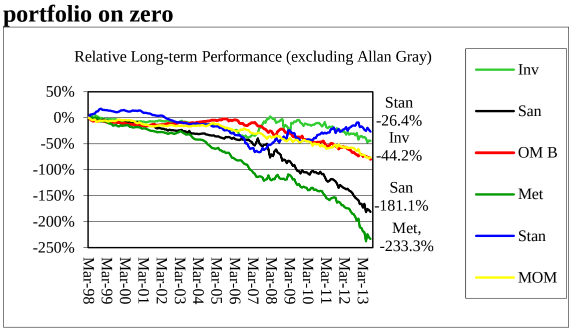
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

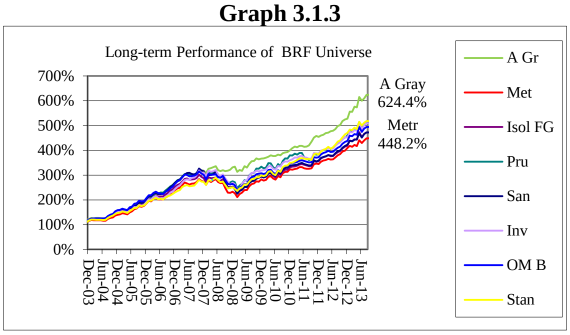


Graph 3.1.2

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

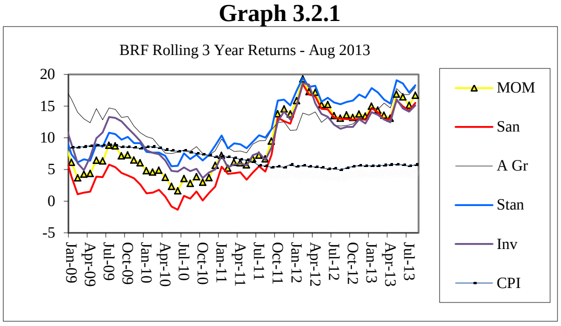


Graph 3.1.3

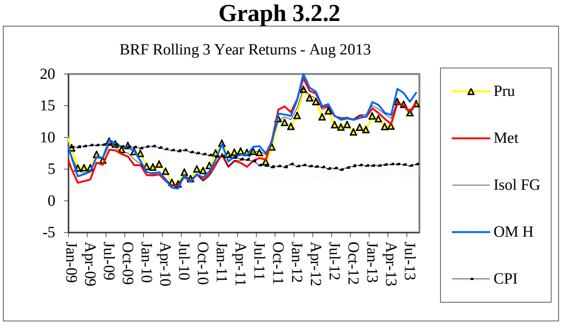


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

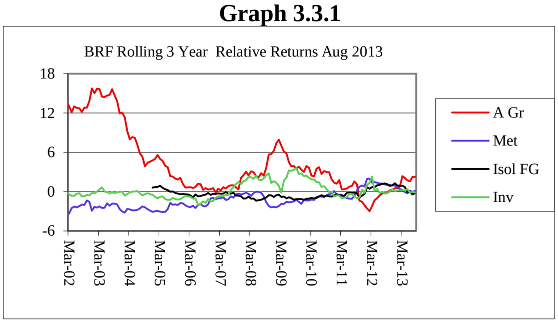


Graph 3.2.2

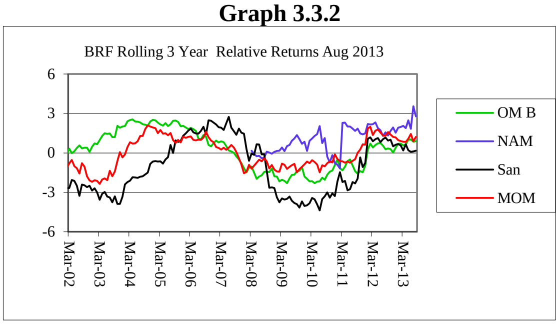


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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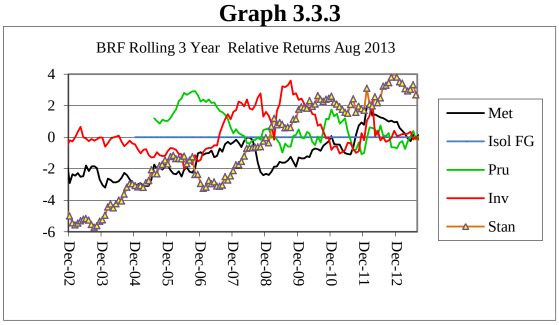
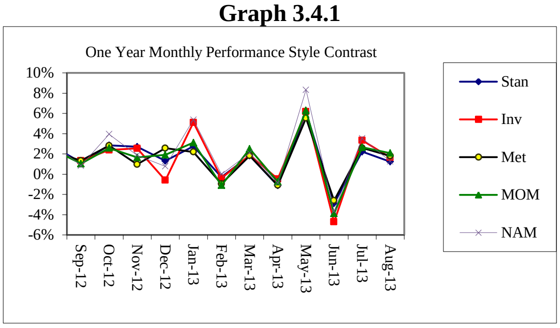
Graph 3.3.3

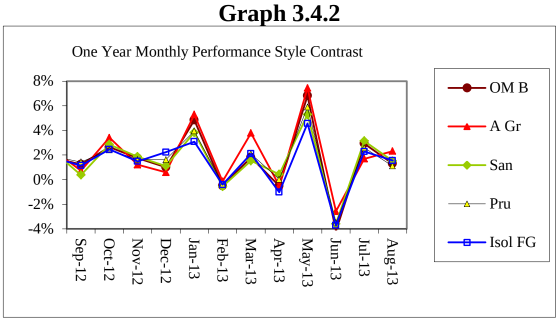


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

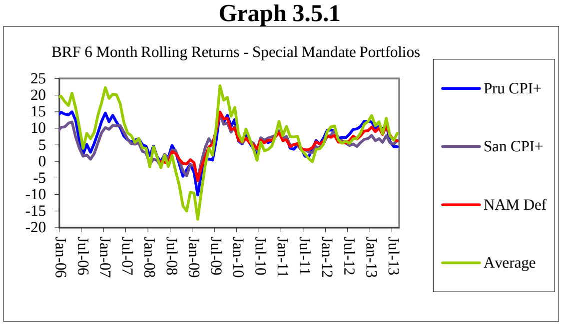


Graph 3.4.2

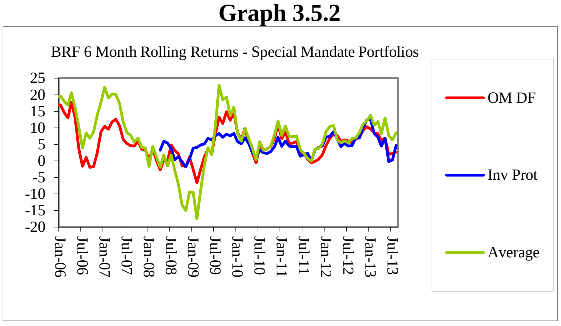


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

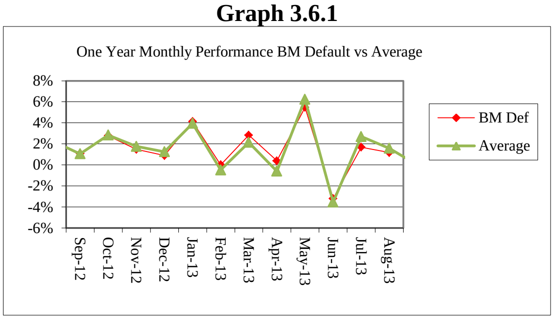


Graph 3.5.2

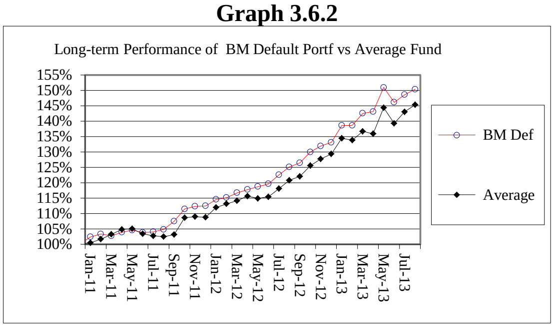


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

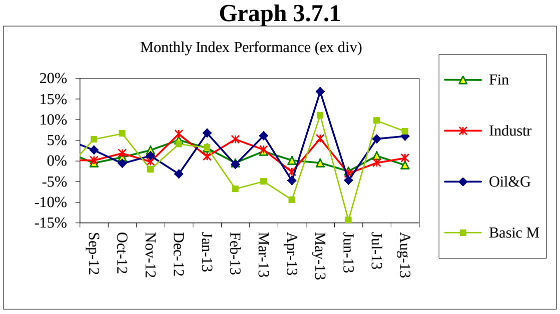


Graph 3.6.2



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

Graph 3.7.1



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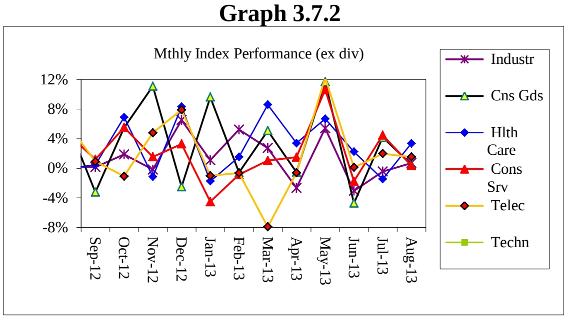
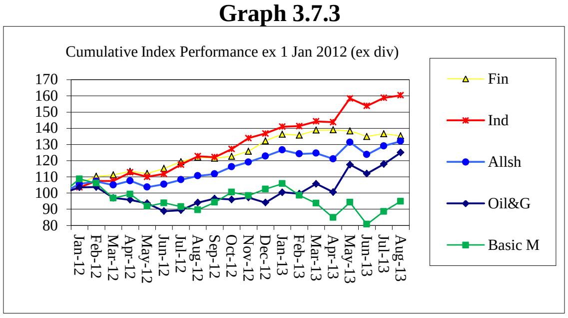
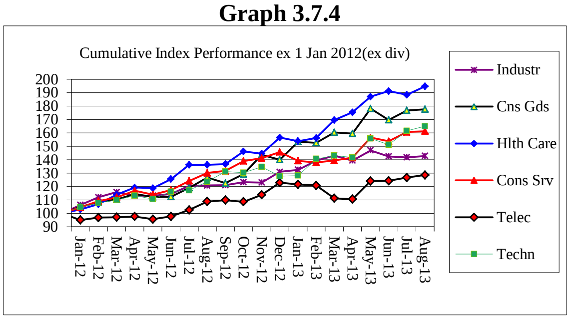
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 11.9% p.a. in nominal terms, or 6.2% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 11.7% p.a. in nominal terms, or 6.0% p.a. in real terms. The fact that the performance of the Benchmark Default portfolio is on par with the average manager is quite remarkable considering its significantly lower equity exposure (47.7% vs 61.0% as at the end of August 2013) and the lower risk it consequently entails for the investor.

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 on par with the expected long-term goal over the past 5 years, respectively.

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 50.3% compared to 45.3% for the average prudential balanced portfolio over this 32 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 September 2010 to August 2013:

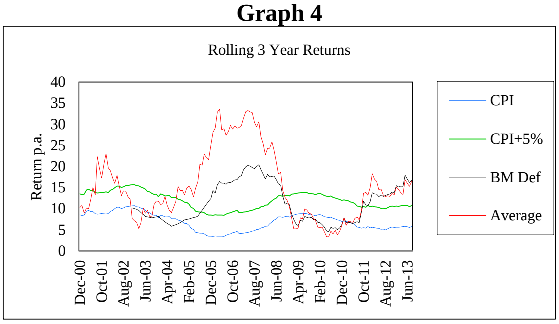
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.4%	9.9%	7.4%
Best annual performance	7.4%	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	6.1%	15.4%	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

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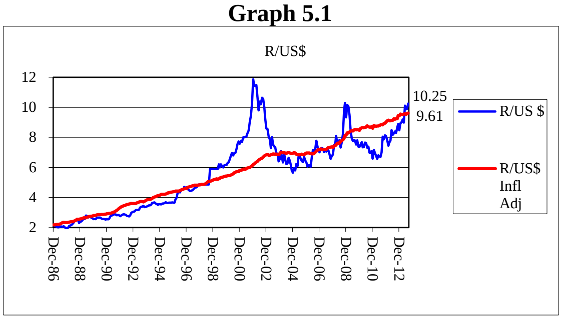
Default portfolio as well as the average prudential balanced portfolio were lagging inflation plus 5% and have surpassed inflation plus 5% since October 2011, Benchmark default portfolio currently on 16.8%, the average on 16.5% vs CPI plus 5% currently on 10.7%.

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 9.61 to the US Dollar while it actually stood at 10.25 at the end of August. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

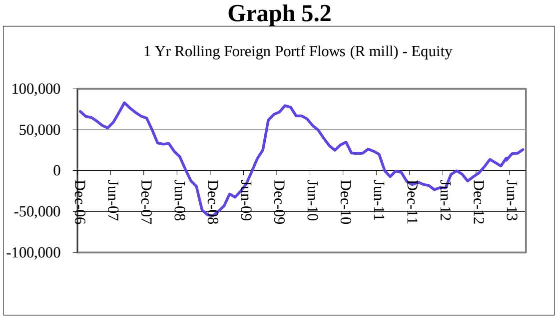
Graph 5.1



Rand under pressure due to foreign capital flows

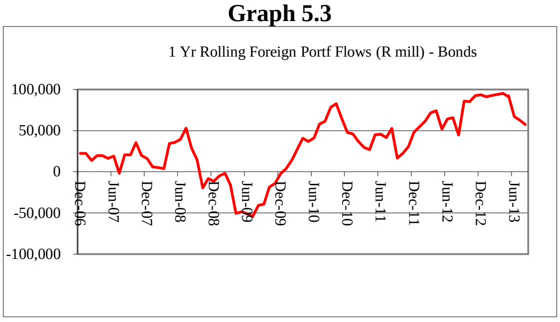
Graph 5.2 reflects a steady positive flow of capital into South African equities on a rolling one year basis, with a net inflow of R 25.6 bn on a year-on-year basis at the end of August (inflow of R 21.3 bn to end July). Since the beginning of 2006, foreign net investment in equities amounts to R 196 billion (end July R 191 billion). This represents roughly 9.15% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects a sharp decrease of foreign portfolio flow into bonds of R 57.4 bn over the past 12 months to end of August (R 62.8 billion over the 12 months to end of July). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 241 bn (to July just over R 243 bn).

Graph 5.3

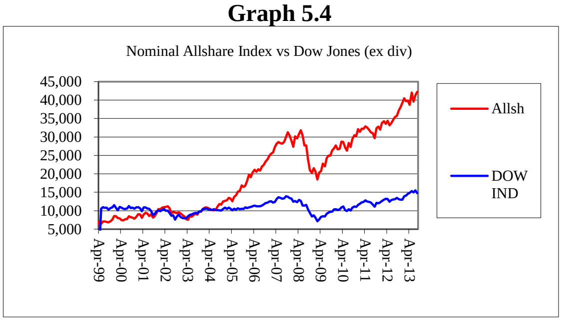


The net inflow of foreign capital into equity and fixed interest assets was down to R 83.0 bn for the 12 months to end August 2013 (inflow of R 84.1 bn to end July 2013), compared to R 45 bn for the 12 months to end August 2012 (R 61 bn to end July 2012). Since the beginning of 2006, total net foreign portfolio flows amounted to R 436 billion (July R 435bn).

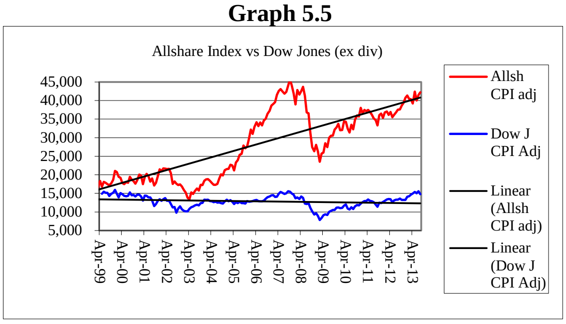
Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms, the JSE grew by 14.0% per year, while the DOW Jones only grew by 2.4% per year, over a period of just over 14 years, dividends excluded. Namibian inflation over this period was 6.9% per year in contrast with 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 7.1% 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 (both at 2.4%), also excluding dividends.

Graph 5.4



Graph 5.5



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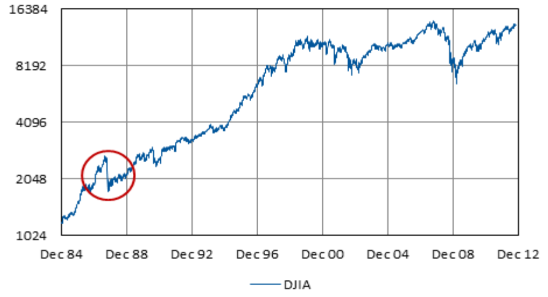
Graph 5.6

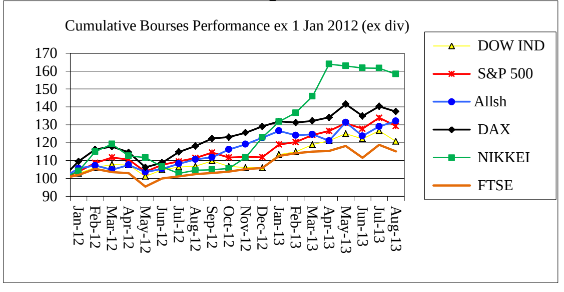
The Dow Jones Industrial Index, over the longer term:



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.

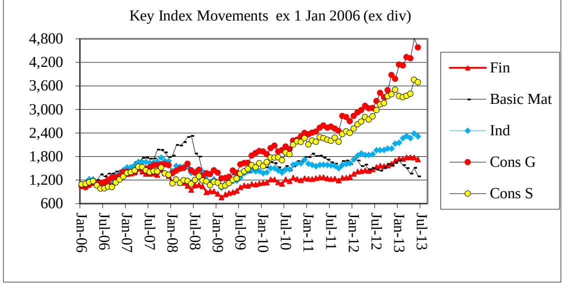
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the DAX as the top performing share indices.

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

Ardent followers of our newsletter, and more specifically our comments on the world of investments will be forgiven for their conclusion that the 'fiscal easing measures' of the US Fed must be my pet topic. It's not really though, however, it probably is *the* one intervention by a global regulator that currently has the biggest impact on global financial markets. How does this now gel with the principle of the free market mechanism? Are we acknowledging that the free market philosophy is a relic of the past?

Fact of the matter is that players in global financial markets, and investors, are in the hands of the Fed and if you have any inside information about the next moves of the Fed you can become very rich in a very short time, obviously at the expense of someone else, those that do not have inside information.

We have seen the violent negative reaction of markets when Ben Bernanke indicated that the Fed was contemplating to taper its massive bond buying programme and we have seen the exuberance following the latest meeting of the Fed where Ben Bernanke announced that the Fed will continue with its asset purchase programme for a while.

So for the next couple of months it could still be a matter of making hay while the sun shines for the aggressive equity investors. As James Downie once observed, "in a hurricane even turkeys can fly", and this is likely to be the case even with the turkeys amongst equities while this hurricane lasts.

For pension fund investments this is unfortunately not a conducive environment because they have to be focused on the long-term and in the long-term, everything that goes up will come down and every bubble will burst some time or other.

To protect pension fund assets against the negative impact of the bursting of a bubble, the investor needs to know what assets represents a bubble. A more speculative investor (or growth/momentum investor) would still attempt to ride the bubble and to get off just in time while a conservative investor (or value investor) would rather try to avoid investing in a bubble. We certainly are proponents of the latter and this should be borne in mind by our readers when considering when, how and where to invest.

So with this background, we know that interest rates will remain low and equity will continue to be carried in the storm, but we do not know for how much longer this will continue. It is unlikely though that the Fed will consciously do serious harm to global financial markets, so it is likely to taper in initially small, later increasing steps, depending on how markets respond.

To add to the uncertainty that currently prevails, we quote below a few opinions that appeared in global financial media recently.

- The Fed's decision to maintain the pace of stimulus prompted Barclays Plc to boost its estimate for the S&P 500 to 1,800, the highest 2013 projection among Wall Street equity strategists. "'Lower for longer monetary policy is more probable than we believed a week ago," Barry C. Knapp, the firm's head of U.S. equity strategy, wrote in a note today. The new forecast implies a 5.3 percent gain from today's close and tops the average strategist

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MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 2013

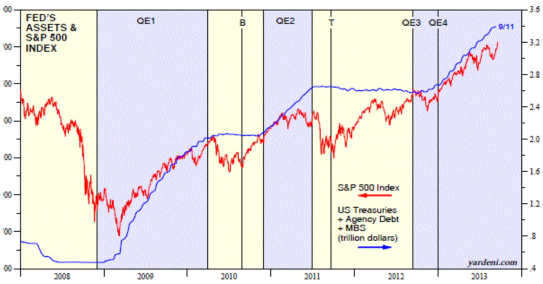
By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

projection of 1,706, according to data compiled by Bloomberg. Knapp had previously said the S&P 500 would finish 2013 at 1,600.

- "The market, where we are, could be more volatile around key economic data points," Sam Turner, a fund manager with Richmond, Virginia-based Riverfront Investment Group LLC, said in a phone interview. "Even though volatility could increase, we suspect the trend will still be higher. What the Fed has communicated is that they won't pull the IV from the patient until the patient can walk on its own."
- Gina Martin Adams is sticking to her guns. The Wells Fargo strategist has been bearish on stocks all year, even as she watched the S&P 500 add 21 percent. And on Thursday's " Futures Now ," Adams reiterated her call that the index would close out the year at 1,440. "Our target is based on fundamentals," Adams insisted. "We're basing our target on typical valuation measures, given the level of interest rates and also on earnings forecasts. And that's why our target is relatively low."

The graph below reflects a very close correlation of the S&P 500 Index and the growth in the Fed's assets and should allow our reader to reach his or her own conclusion on what is most likely to happen when the growth in the Feds assets ends or starts declining. Low interest rates have driven investors into the equity market, increasing rates are most likely to have the opposite effect.



B = Ben Bernanke set the stage for QE2 and QE3 during his Jackson Hole speeches on August 27, 2010 and August 31, 2012.
T = Operation Twist was started on September 21, 2011 and terminated on December 31, 2012.
Source: Standard & Poor's Corporation.

1741 AM Fair Value indices are always an interesting read. For end August, they still indicate great buying opportunities in foreign equity markets, primarily EMU markets (Austria -51%, Italy –56%, Portugal -28%, Spain -40%) but also Japan on -34%. The US is considered overvalued by 31%. A weak Rand, and by our measure undervalued at its current value around 10 to the US versus fair value at around 9.6, suggests that one should now hold back on investing offshore though.

Commodities are one of the main asset classes. We know that the Basic Materials index of the FTSE/JSE has done poorly since 2005. This could indicate a buying opportunity, assuming global commodity prices are at attractive levels. The Thomson Reuters/Jefferies CRB Index (TR/J CRB) reflected in the graph below, is a commodity futures price index. Evidently the index is still at fairly high levels. In the mean time miners have and still are hit by strikes for higher wages raising the cost pressures and boding badly for prospective profitability at elevated commodity prices.

Based on the above deliberation, we expect global commodity and equity markets including local markets, to move sideways over the medium term. The investor should really only expect returns equal to the dividend yield with very little or no capital appreciation. Ignoring the scenario of deflation, interest rates will rise slowly and buying opportunities will arise provided one invests to maturity.

A globally well diversified portfolio, comprising of value companies in the industrial, financial and technology sectors with strong cash flows and high dividend yields. Listed property is likely to track the performance of equities in the short-term, implying short-term opportunities but are likely to feel the impact of an increase in interest rates more severely than equities. In terms of the weighting of the equity exposure we believe that foreign equity should be overweight relative to local equity, considering that local investors will hold the major portion of their assets locally.

7. Important notice and disclaimer