Volume 9, No. 9,
September 2013

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 SEPTEMBER 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

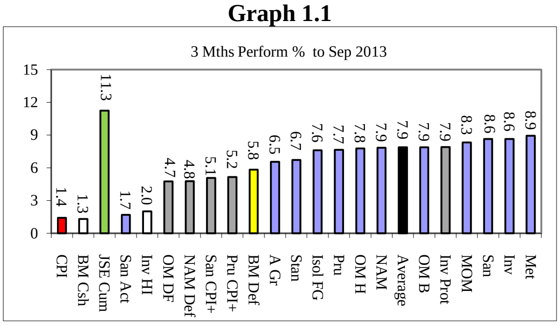
In **September** the **average prudential balanced portfolio** returned 3.42% (August: 1.58%). Top performer is Metropolitan (4.32%), Allan Gray (2.40%) takes the bottom spot.

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.

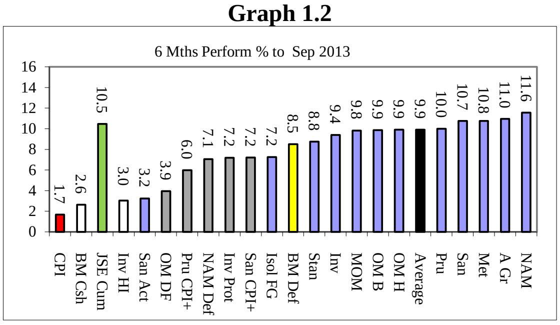
Below is the legend to the abbreviations reflected on the graphs:

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 Active	San Act (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)

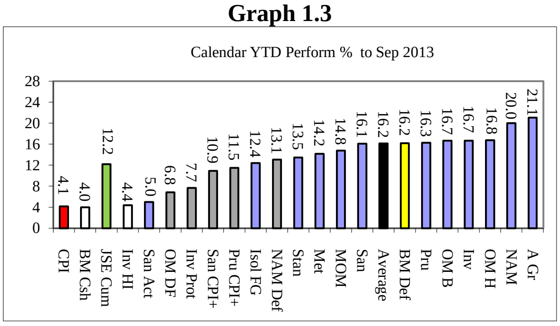
Graph 1.1



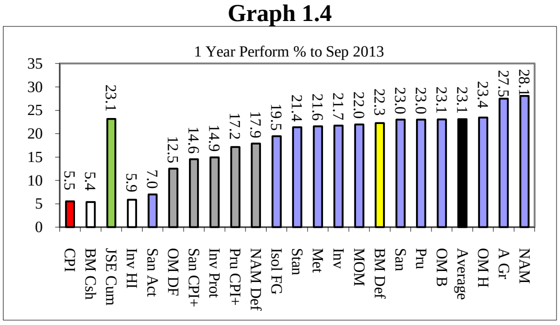
Graph 1.2



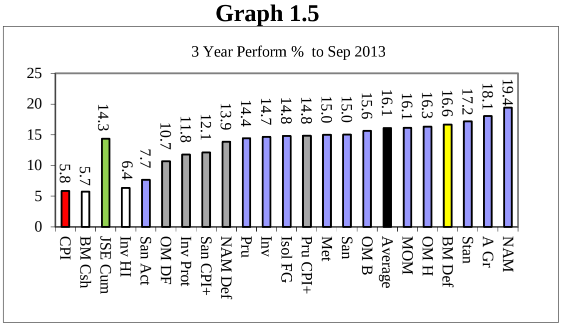
Graph 1.3



Graph 1.4



Graph 1.5



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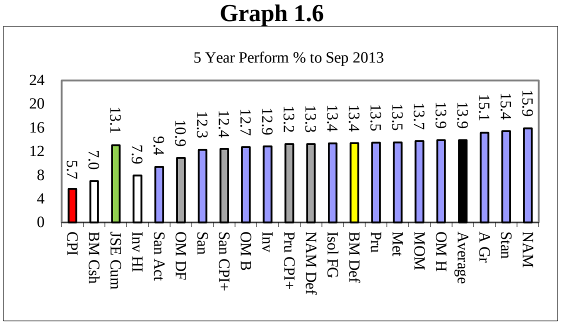
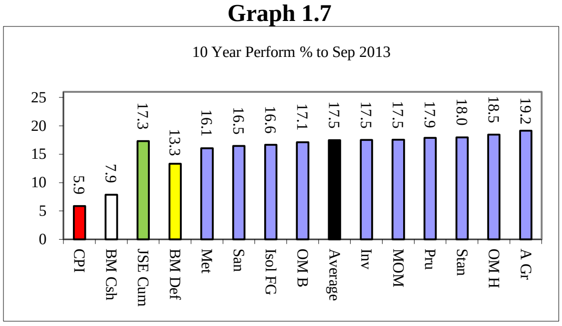
Graph 1.6

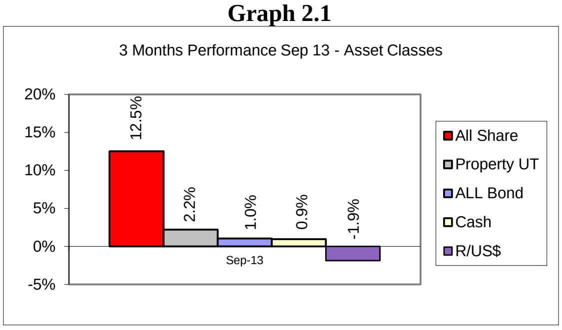


Graph 1.7

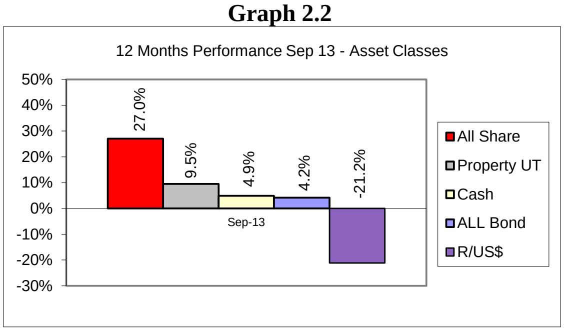


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

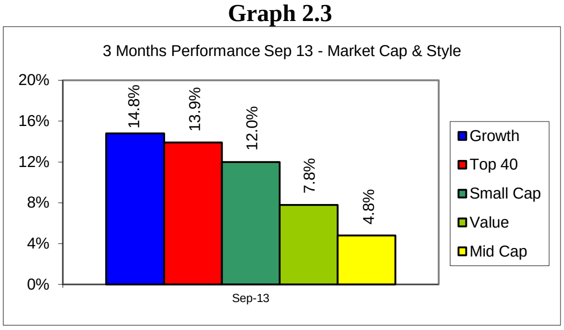
Graph 2.1



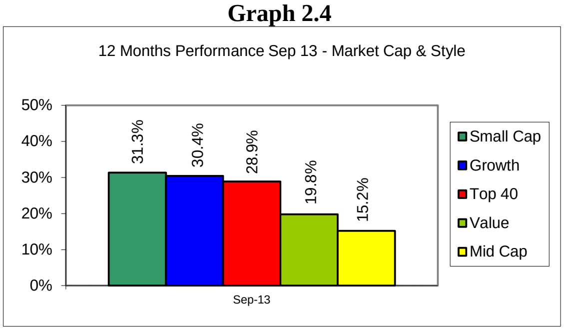
Graph 2.2



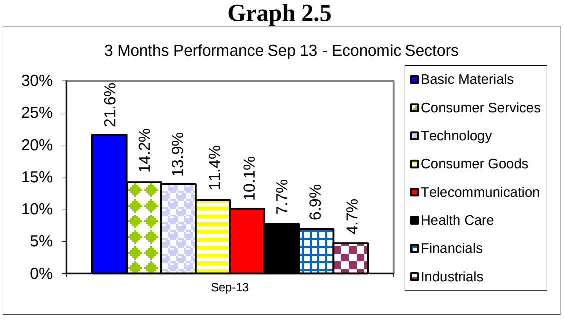
Graph 2.3



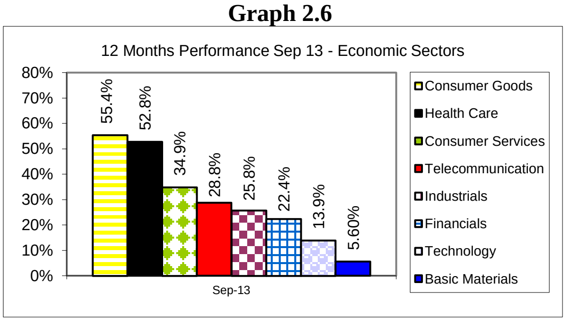
Graph 2.4



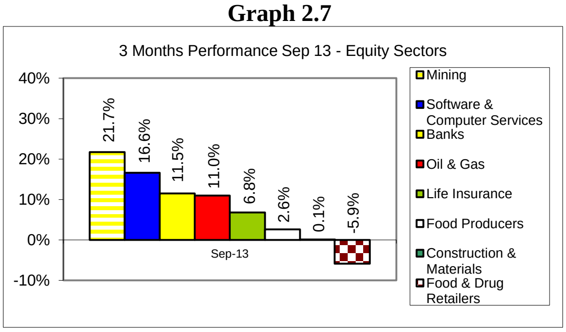
Graph 2.5



Graph 2.6



Graph 2.7



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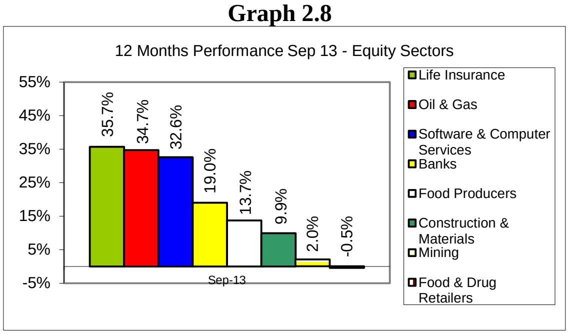
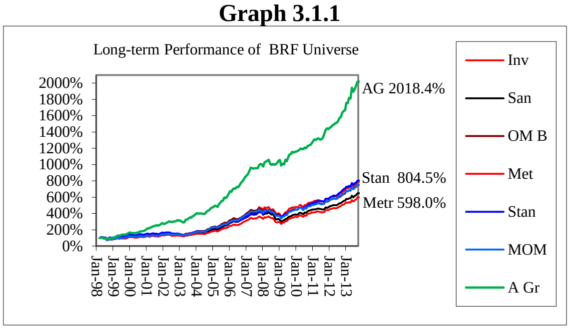
Graph 2.8



3. Portfolio Performance Analysis

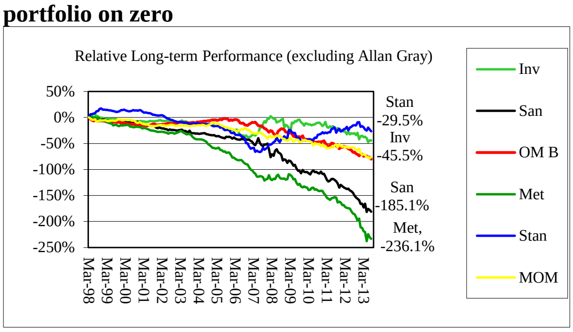
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

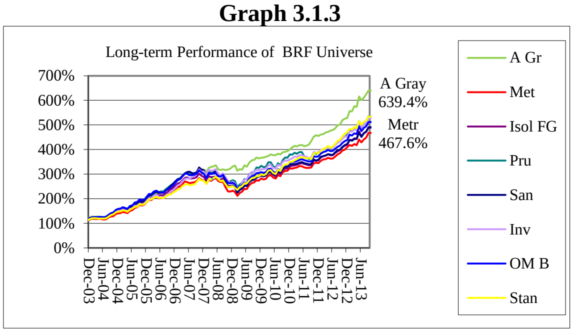


Graph 3.1.2

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

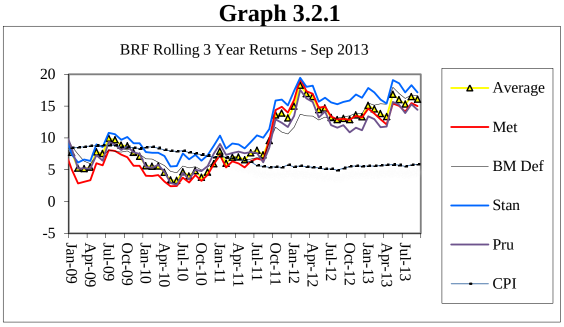


Graph 3.1.3

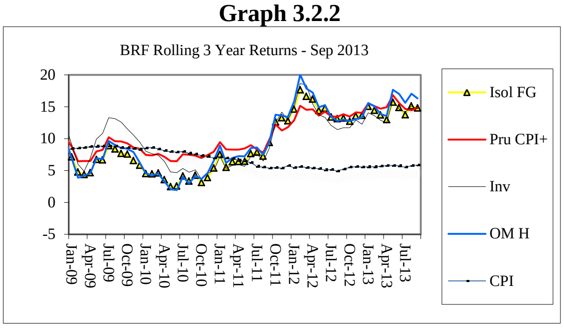


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

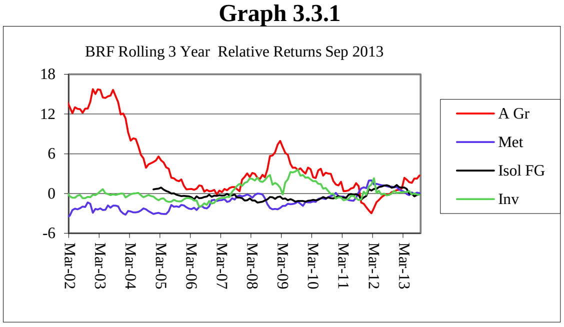


Graph 3.2.2

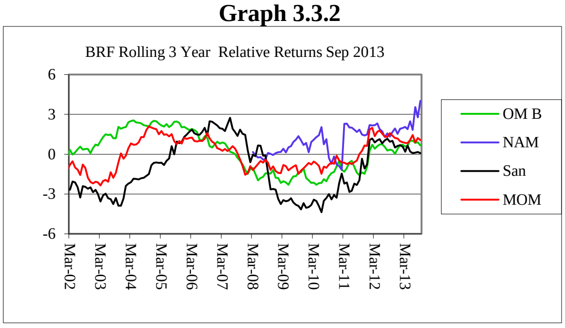


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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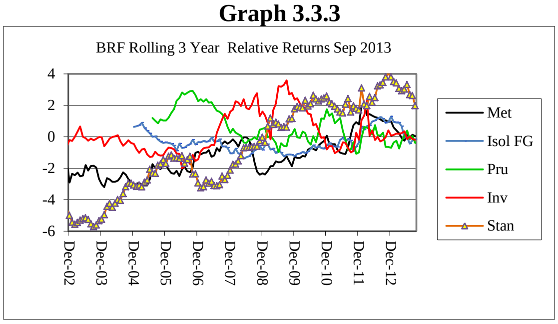
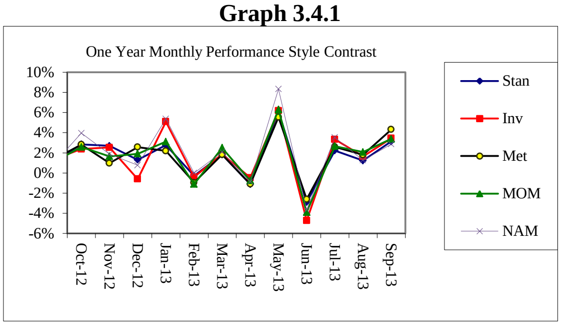
Graph 3.3.3

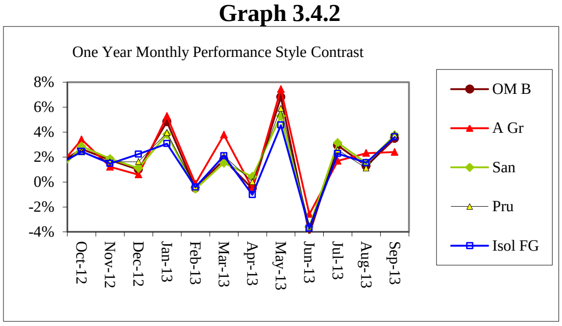


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

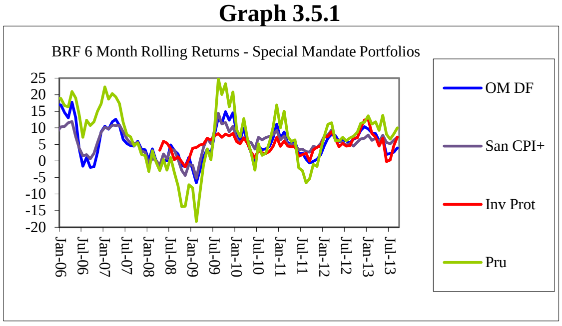


Graph 3.4.2

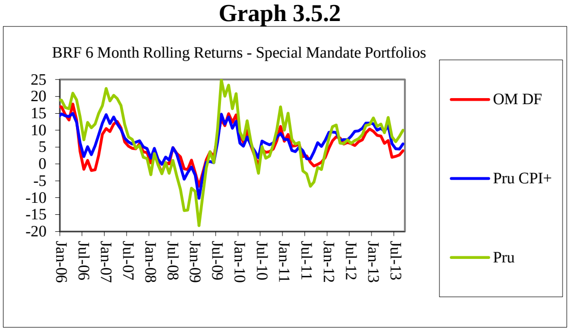


3.5. 6-month rolling returns of ‘special mandate’ portfolios

Graph 3.5.1

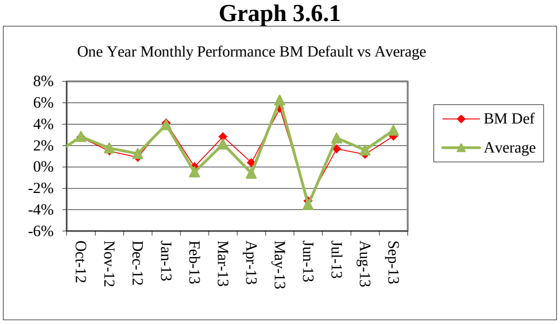


Graph 3.5.2

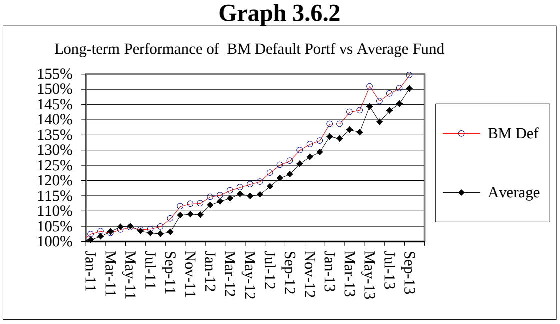


3.6 Monthly and cumulative performance of ‘Benchmark Default’ portfolio relative to average prudential balanced portfolio

Graph 3.6.1

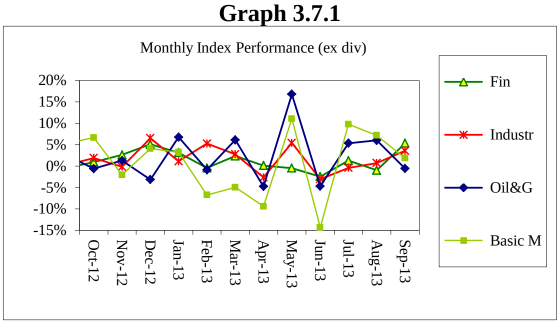


Graph 3.6.2



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

Graph 3.7.1



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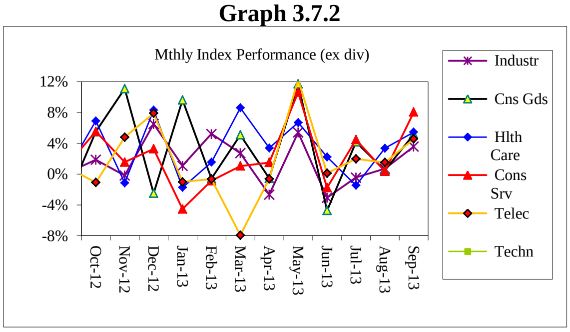
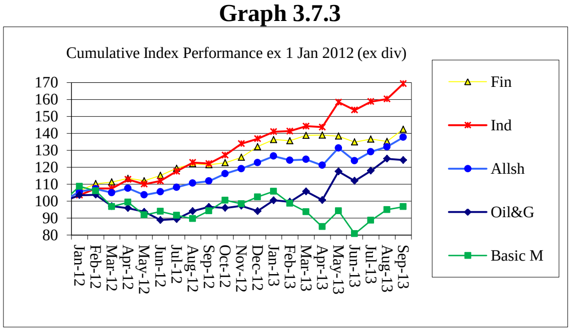
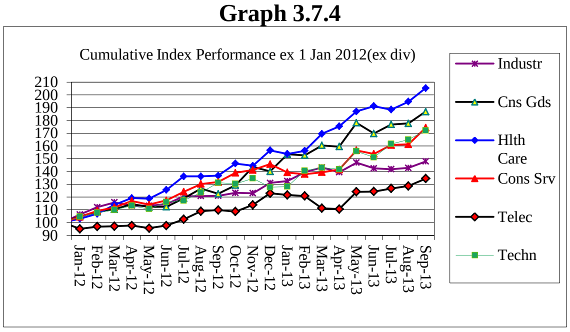
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 13.9% p.a. in nominal terms, or 8.2% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 13.4% p.a. in nominal terms, or 7.7% p.a. in real terms. The fact that the performance of the Benchmark Default portfolio is almost 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 June 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 exceeding 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 54.6% compared to 50.2% for the average prudential balanced portfolio over this 33 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 October 2010 to September 2013:

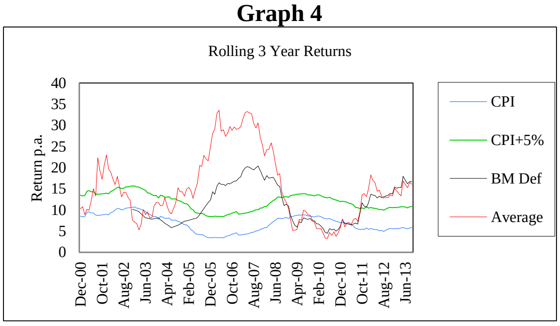
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.4%	9.9%	7.4%
Best annual performance	7.3%	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	6.0%	15.7%	14.9%

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

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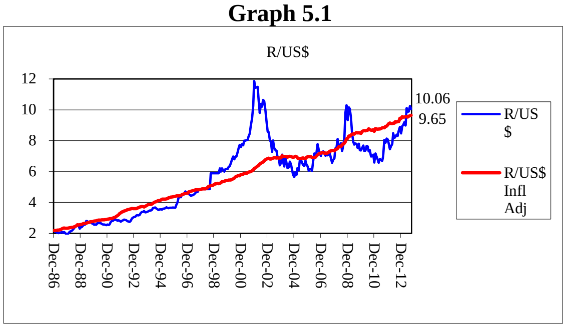
basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 2008, both the Benchmark Default portfolio as well as the average prudential balanced portfolio were lagging inflation plus 5% and have surpassed inflation plus 5% since October 2011, Benchmark default portfolio currently on 16.6%, 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 9.65 to the US Dollar while it actually stood at 10.06 at the end of September. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

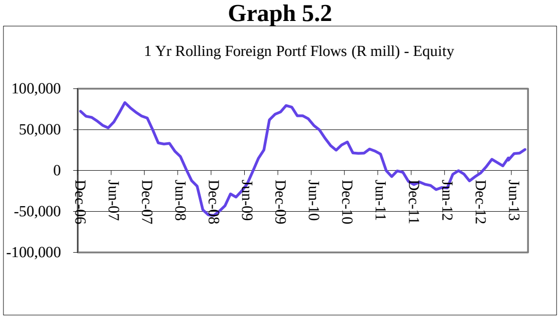
Graph 5.1



Rand supported by foreign capital flows

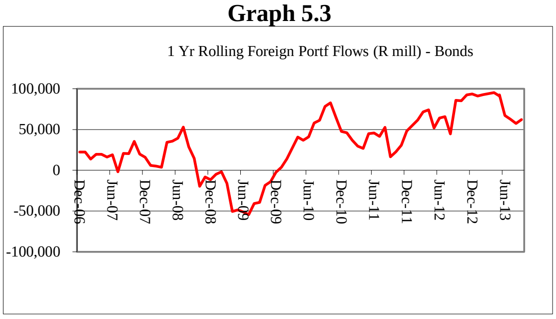
Graph 5.2 reflects a steady positive flow of capital into South African equities on a rolling one year basis, with a net inflow of R 30.0 bn on a year-on-year basis at the end of September (inflow of R 25.6 bn to end August). Since the beginning of 2006, foreign net investment in equities amounts to R 197 billion (end August R 196 billion). This represents roughly 2.05% 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 62.1 bn over the past 12 months to end of September (R 57.4 billion over the 12 months to end of August). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 256 bn (to August just under R 241bn).

Graph 5.3

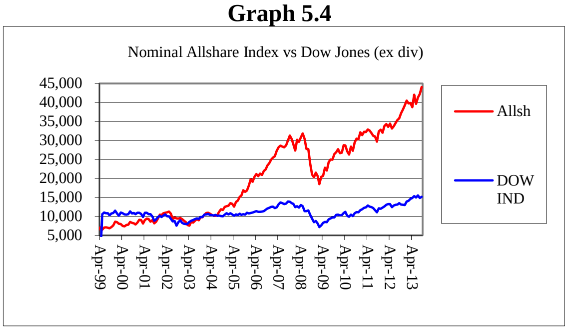


The net inflow of foreign capital into equity and fixed interest assets was up to R 92.1 bn for the 12 months to end September 2013 (inflow of R 83.0 bn to end August 2013), compared to R 81.5 bn for the 12 months to end September 2012 (R 45bn to end of August 2012). Since the beginning of 2006, total net foreign portfolio flows amounted to R 453 billion (August R 436 bn).

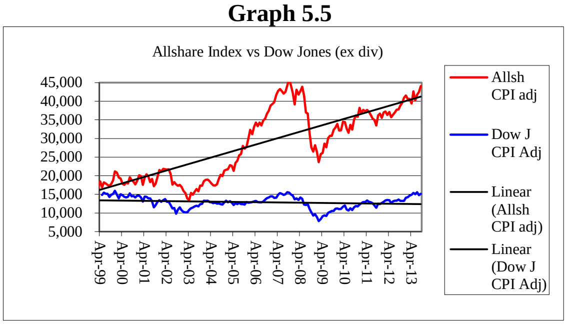
Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms, the JSE grew by 14.2% per year, while the DOW Jones only grew by 2.5% per year, over a period of over 14 years, dividends excluded. Namibian inflation over this period was 6.8% per year in contrast with US 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 6.9% 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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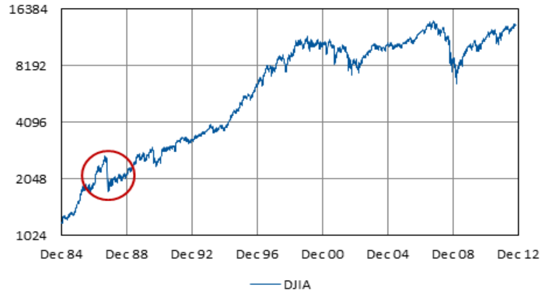
Graph 5.6

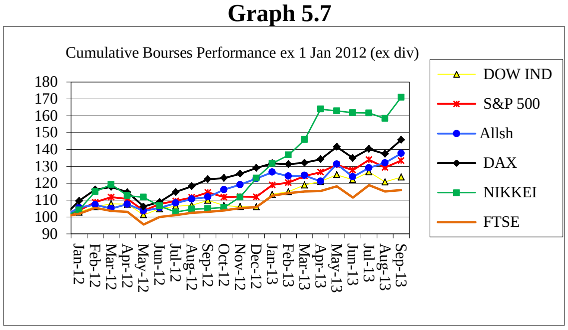
The Dow Jones Industrial Index, over the longer term:



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.

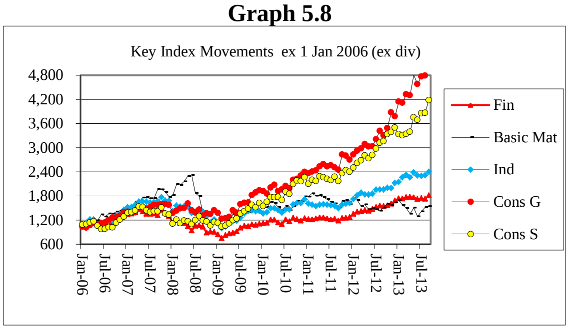
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the DAX as the top performing share indices.

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

As we reported in our previous newsletter, we expect global commodity and equity markets including local markets, to move sideways over the medium term. Global commodity prices are at fairly elevated levels and we do not expect much support for the Rand and local miners from that source.

While foreign investors can still borrow extremely cheaply overseas and can still earn attractive returns on low risk investments in SA and other developing countries, we will continue to see foreign investment flows into local markets supporting local equities and a low interest rate environment.

The investor should however not expect returns much higher than the dividend yield, with very little or no capital appreciation in the medium term although in the short-term the more speculative investor may still be able to make hay while the sun shines. Ignoring the scenario of deflation, interest rates will in the medium term rise slowly and buying opportunities will arise provided one invests to maturity. As interest rates drift upwards, presenting buying opportunities in fixed interest instruments equities will lose some of their shine.

1741 AM Fair Value indices are always an interesting read. For end September, they still indicate great buying opportunities in foreign equity markets, primarily EMU markets (Austria -48%, Italy –53%, Portugal -22%, Spain -31%) but also Japan on -29%. The US is considered overvalued by 35%. A weak Rand, and by our measure currently just slightly undervalued at its current value around 9.78 to the US versus fair value at around 9.65, suggests that one can invest offshore again.

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