Volume 9, No. 10,
October 2013

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 OCTOBER 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

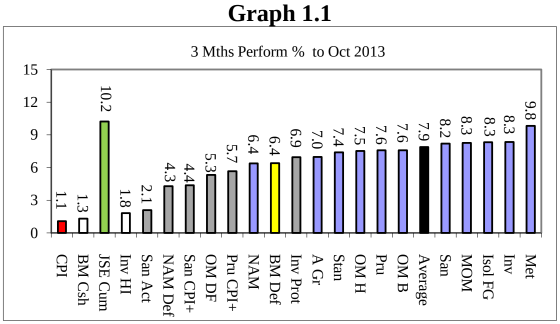
In **October** the **average prudential balanced portfolio** returned 2.70% (September: 3.42%). Top performer is Metropolitan (3.42%), Allan Gray (2.10%) takes the bottom spot.

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.

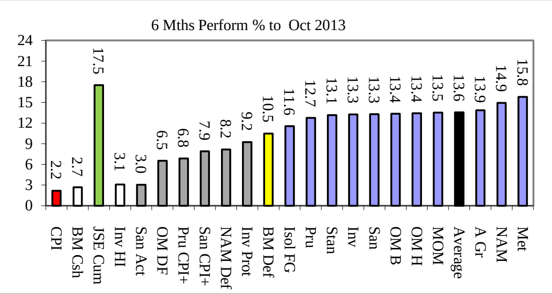
Below is the legend to the abbreviations reflected on the graphs:

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)

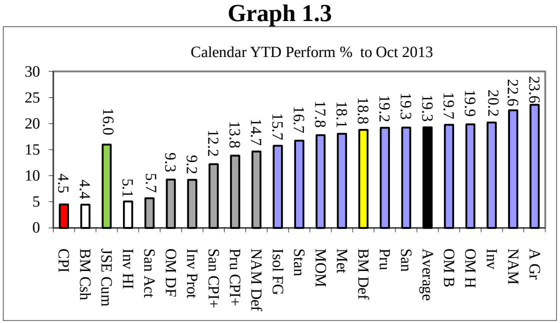
Graph 1.1



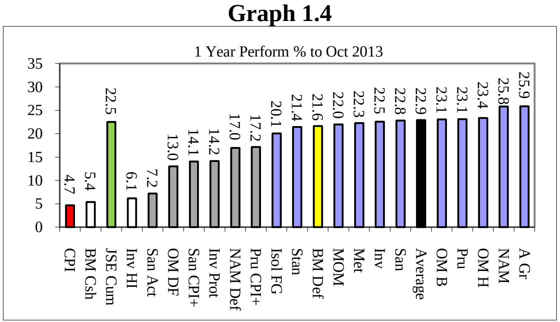
Graph 1.2



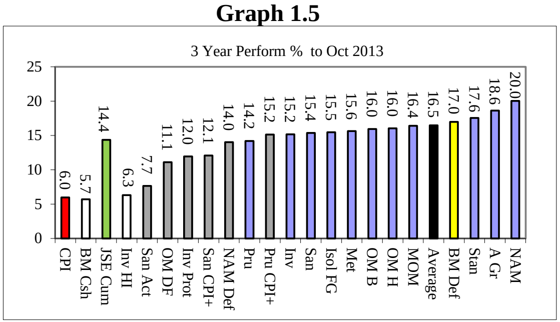
Graph 1.3



Graph 1.4



Graph 1.5



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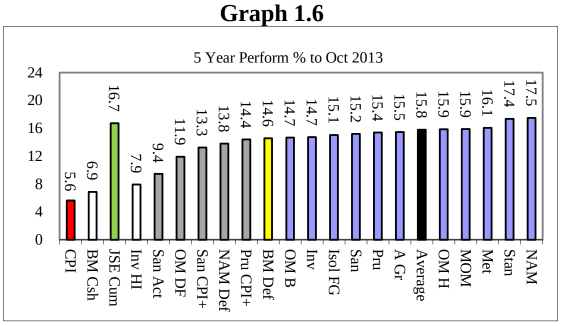
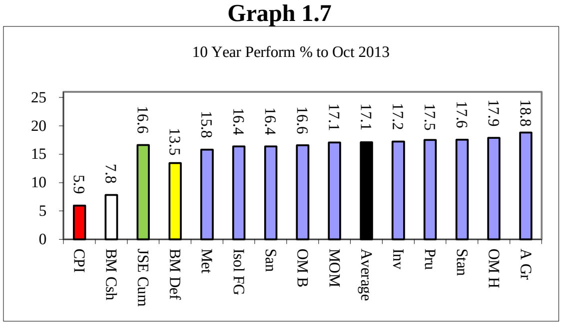
Graph 1.6

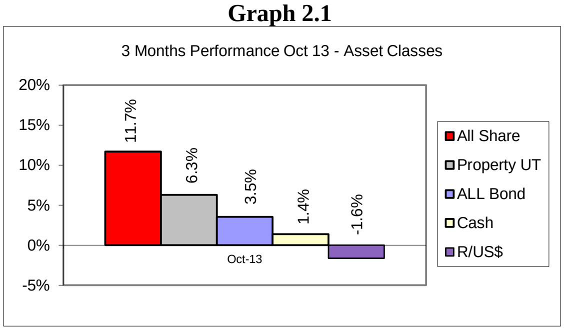


Graph 1.7

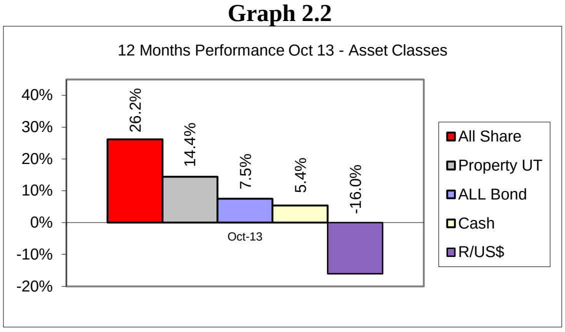


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

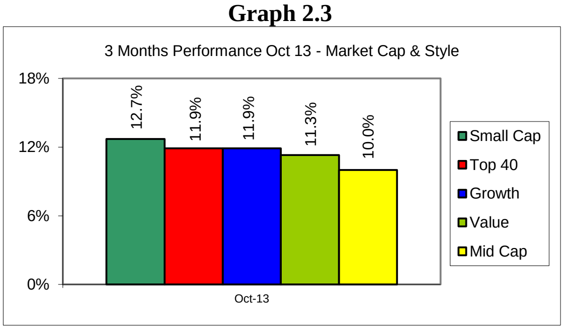
Graph 2.1



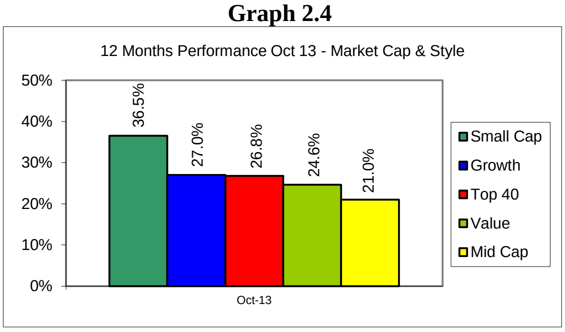
Graph 2.2



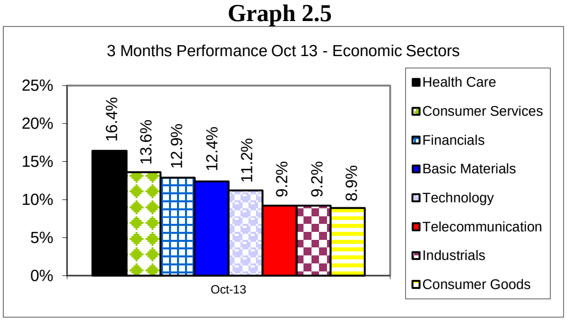
Graph 2.3



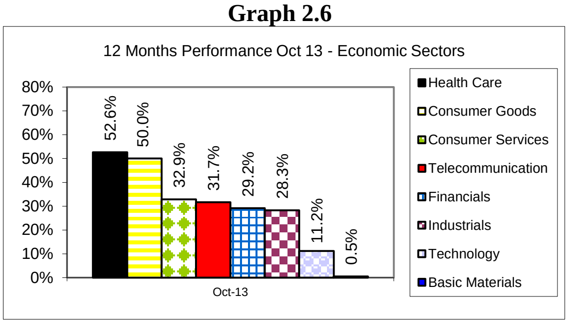
Graph 2.4



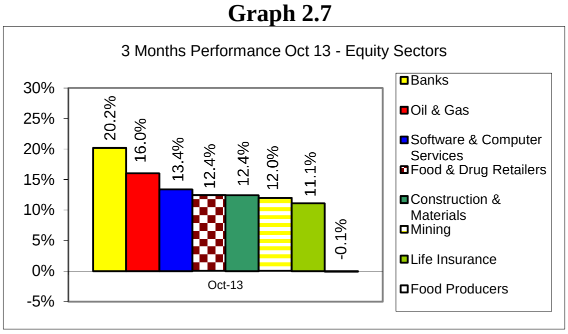
Graph 2.5



Graph 2.6



Graph 2.7



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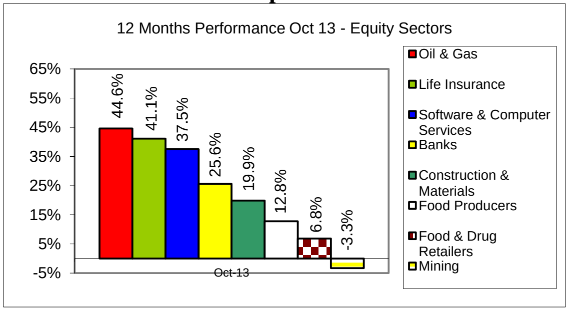
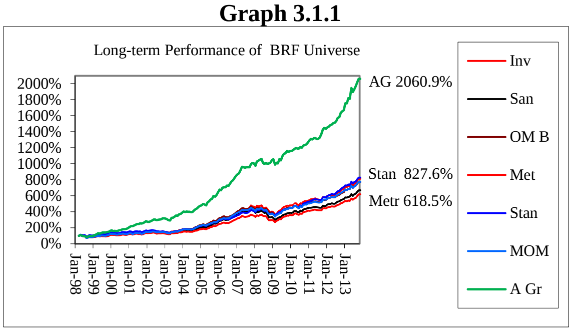
Graph 2.8



3. Portfolio Performance Analysis

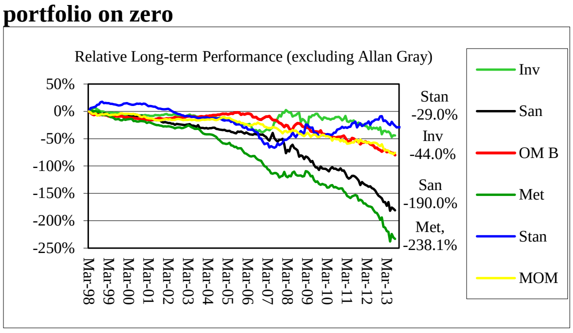
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

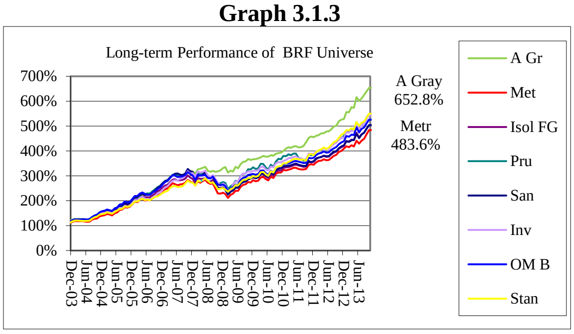


Graph 3.1.2

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

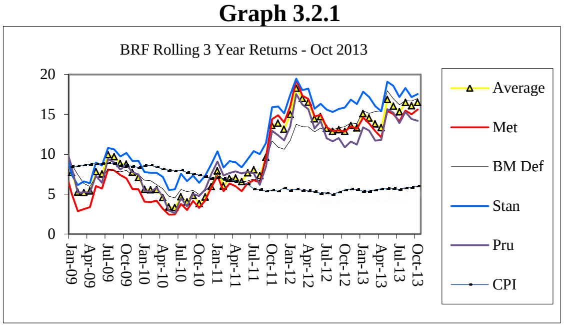


Graph 3.1.3

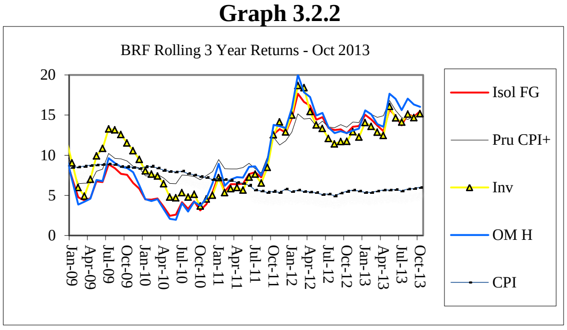


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

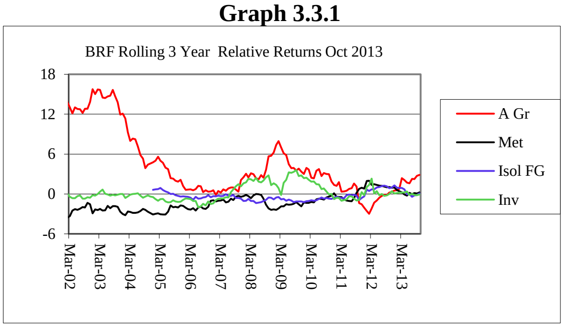


Graph 3.2.2

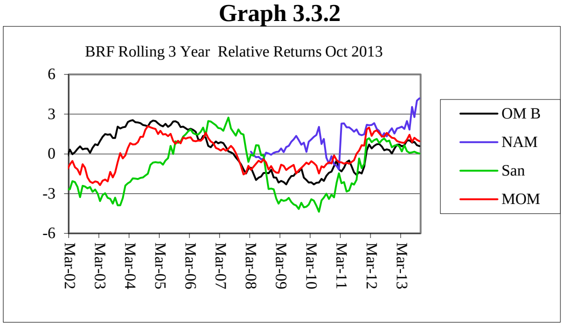


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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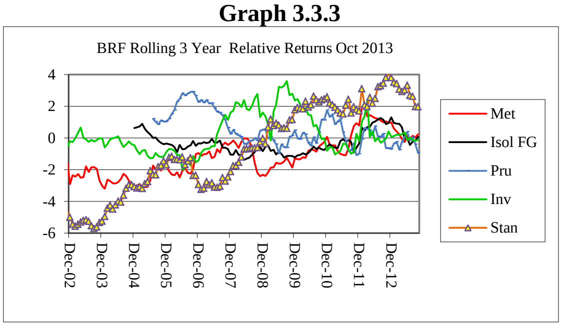
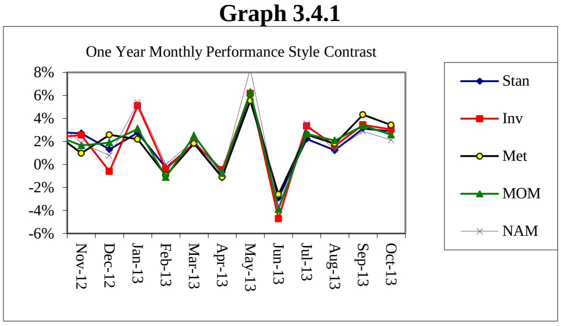
Graph 3.3.3

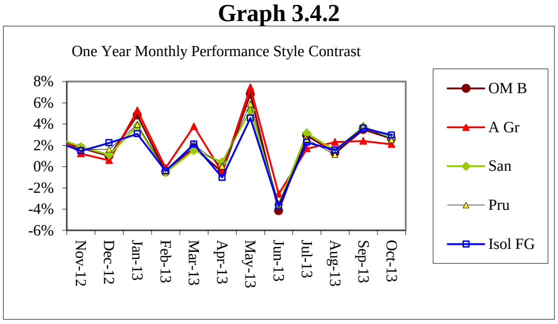


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

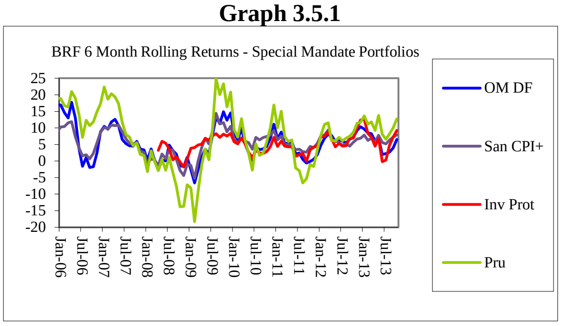


Graph 3.4.2

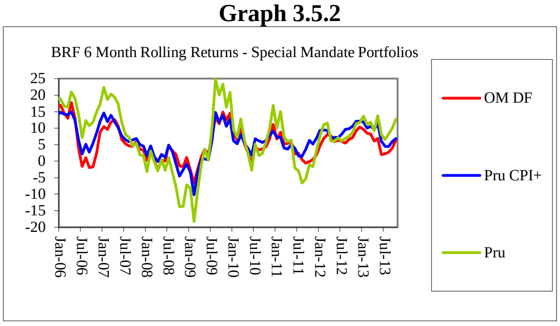


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

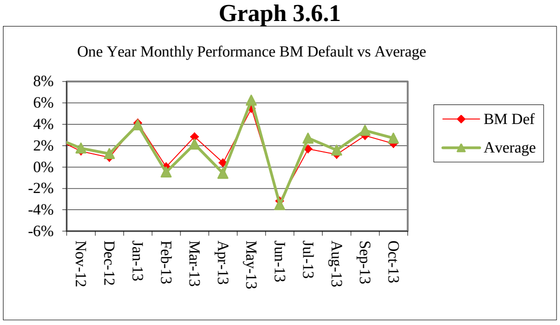


Graph 3.5.2

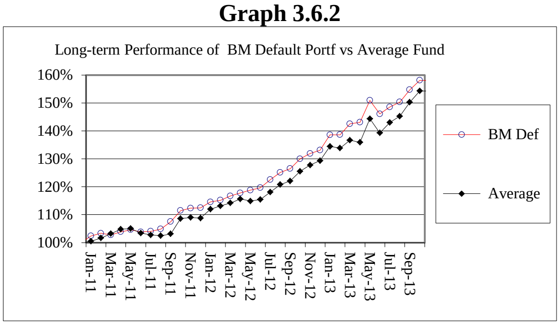


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

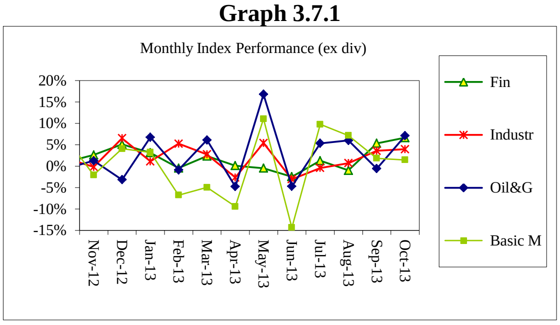


Graph 3.6.2



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

Graph 3.7.1



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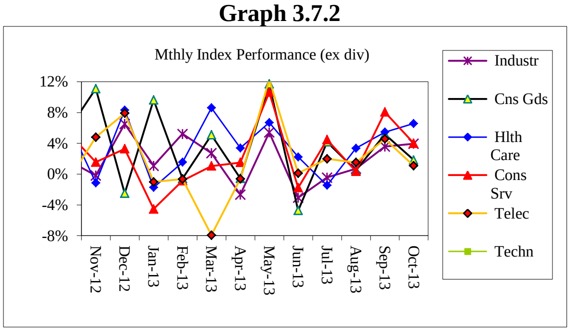
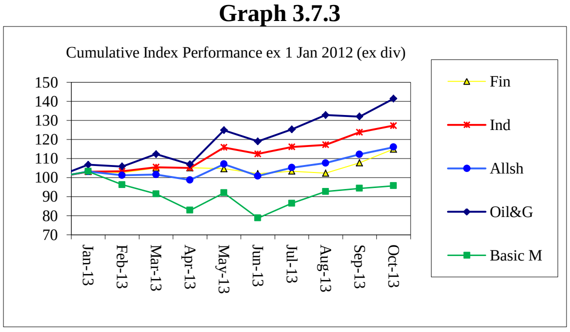
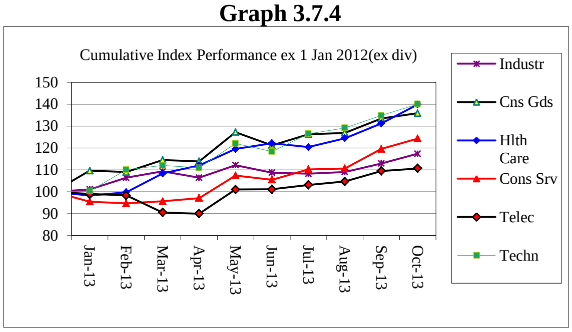
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 15.8% p.a. in nominal terms, or 10.2% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 14.6% p.a. in nominal terms, or 9.0% 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 (43.6% vs 62.3% as at the end of September 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 46.5% compared to 44.2% for the average prudential balanced portfolio over this 34 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 November 2010 to October 2013:

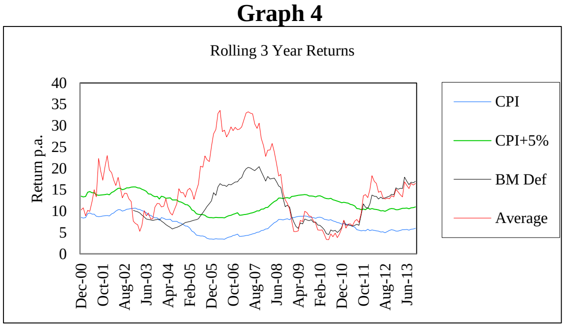
Table 4.1

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%	16.0%	15.2%

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

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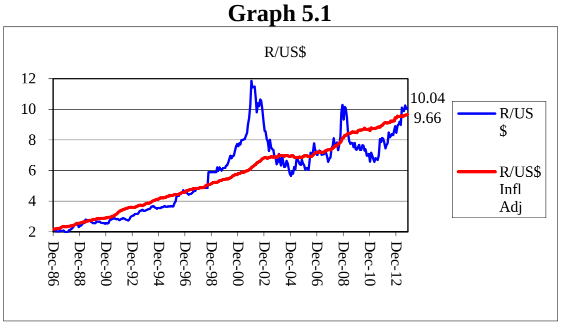
return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 2008, both the Benchmark Default portfolio as well as the average prudential balanced portfolio were lagging inflation plus 5% and have surpassed inflation plus 5% since October 2011, Benchmark default portfolio currently on 17.0%, the average on 16.5% vs CPI plus 5% currently on 11.0%.

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 9.66 to the US Dollar while it actually stood at 10.04 at the end of October. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

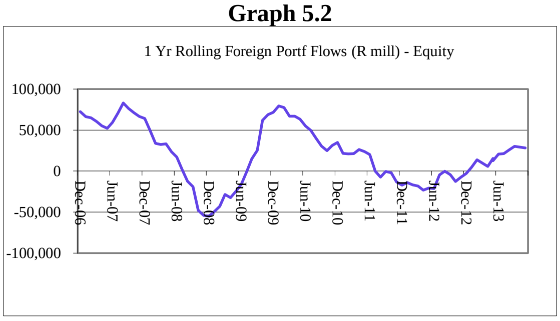
Graph 5.1



Rand supported by foreign capital flows

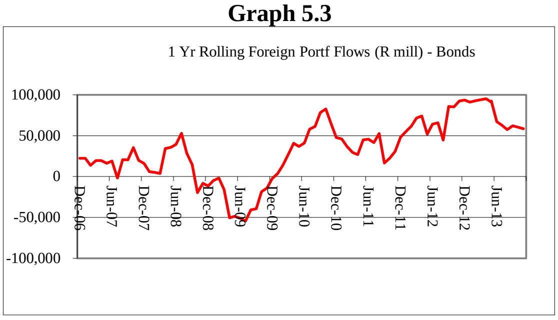
Graph 5.2 reflects a steady positive flow of capital into South African equities on a rolling one year basis, with a net inflow of R 28.2 bn on a year-on-year basis at the end of October (inflow of R 30.0 bn to end September). Since the beginning of 2006, foreign net investment in equities amounts to R 187 billion (end September R 197 billion). This represents roughly 1.91% 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 58.6 bn over the past 12 months to end of October (R 62.1 billion over the 12 months to end of September). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 262 bn (to September just over R 256 bn).

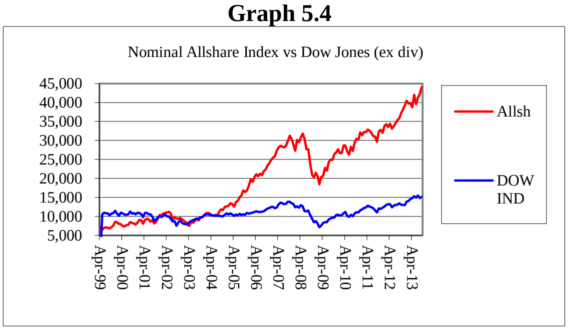
Graph 5.3



The net inflow of foreign capital into equity and fixed interest assets was up to R 86.9 bn for the 12 months to end October 2013 (inflow of R 92.1 bn to end September 2013), compared to R 72.7 bn for the 12 months to end October 2012 (R 81.5 bn to end of September 2012). Since the beginning of 2006, total net foreign portfolio flows amounted to R 449 billion (September R 453 bn).

Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms, the JSE grew by 14.4% per year, while the DOW Jones only grew by 2.7% 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 5.4



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 over more than 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 3.3%), also excluding dividends.

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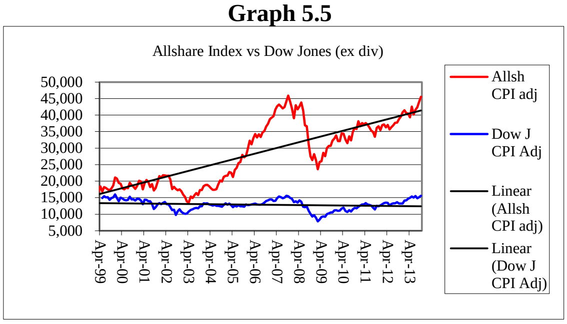
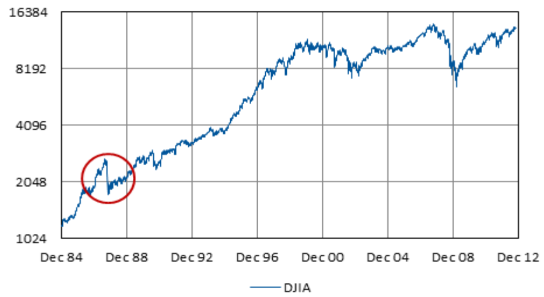
Graph 5.5



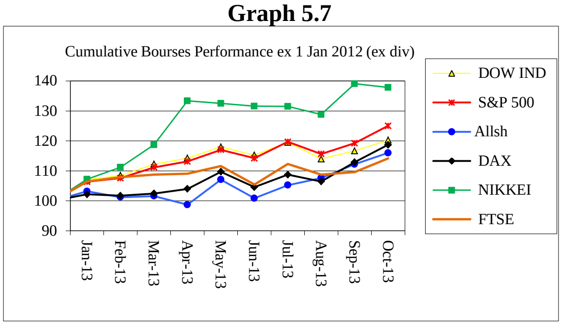
Graph 5.6 places the data as per graph 5.4 into a better perspective, showing that graph 5.4 actually starts measuring the DOW Jones just after it had reached a peak around 1998.

Graph 5.6



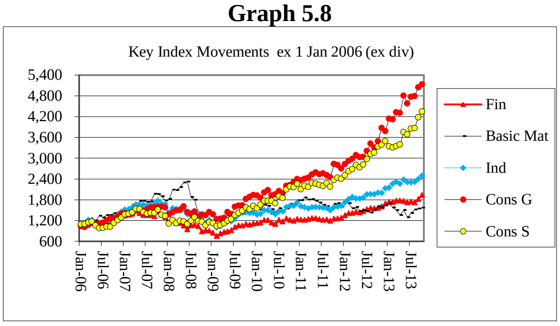
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the S&P 500 as the top performing share indices.

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

We have previously been reporting and have placed a lot of emphasis on the impact that global quantitative easing, or asset purchase programmes undertaken by reserve banks, had on emerging economies and more specifically on commodity based economies. These measures have and are still producing a strong flow of capital into emerging economies. This flow presents an artificial support of the currencies of emerging countries, artificial support of their equity markets and an artificially low interest rate environment. This artificial support will fall away as soon as these programmes are reduced and eventually withdrawn.

At this stage it seems that the Fed will put the brakes on its asset purchase programme in the next year but that it will continue with its zero interest rate policy. If this will be the case, one may expect the further bloating of global equity markets to recede although a low interest rate environment will still result in an investor equity bias. The investor needs to now look beyond the tapering by the Fed. For South Africa and Namibia, being commodity based economies, our economies and markets are highly sensitive to movements in global commodity markets.

Against this backdrop, it is interesting to study global commodity markets and how this impacted on our currencies and markets. This can also provide a queue to how our local equity markets are likely to develop over the next few years.

Graph 6.1 depicts the Economist Continuous Commodity Index for the period 1956 to 2012 (apologies for the poort quality). It first reached a base level of 200 in the middle of 1972. For the 28 years until the end of 2000, the index recorded no growth. Since the beginning of 2001, however, it had an incredible run from the base of 200 (R: US$ at 7.58) to around 400 at the end of 2005. Since January 2006 it rose to 600 (R: US$ at 7.05) by the middle of 2007 (+16% p.a.). It then fell back to around 350 (R: US$ at 9.34) by the end of 2008, moving back up to just over 500 (R: US$ at 8.30) by September of 2012.

Graph 6.1

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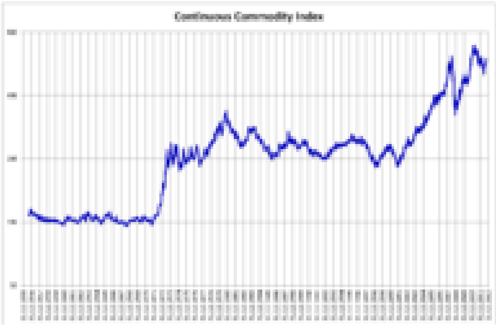
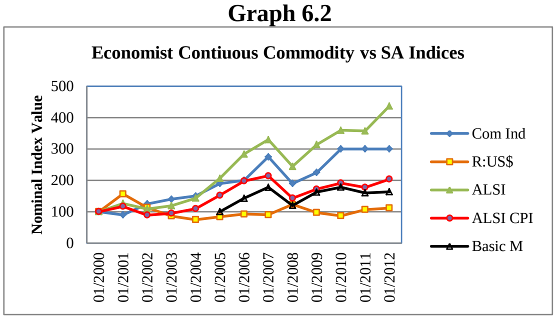


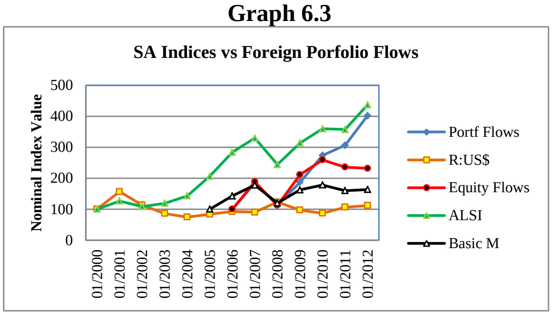
Graph 6.2 show a strong correlation between the SA ALSI 40 and the Basic Materials indices to global commodity index while the R: US$ exchange rate appears to be fairly uncorrelated to these indices. Since the beginning of 2001 for example, the global commodity index grew by 200% and the ALSI 40 by 340% (CPI adjusted though by only 100%), while the Rand depreciated against the US$ by 12%. The significant outperformance by the ALSI 40 of the commodity index can probably be ascribed to the avalanche of foreign capital flows into our market as the result of excessively loose monetary policies in developed countries.

Graph 6.2



Graph 6.3 presents an equally interesting picture. There is a close correlation between foreign portfolio flows into equities and the Basic Materials index. As portfolio flows increased, the Basic Materials index increased to then move sideways as foreign portfolio flows flattened. The ALSI index however, continued move upwards as foreign portfolio flows into fixed interest instruments continued to pour in.

Graph 6.3



Given the close correlation between the global commodity index and the SA ALSI 40 and Basic Materials indices, the expectation concerning the future development of the global commodity index will be a good pointer for these key equity indices on the FTSE/JSE. Global commodity prices are at fairly elevated levels, as graph 6.1 reveals, and global commodities are likely to move sideways over the medium term, particularly also in view of the fact that no major global economy shows any sign of rapid recovery.

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. This flow of capital into our local markets, however, is likely to start drying up over the next few years. The support of local equities from that source will thus reduce while the indicators are that global commodity prices are also unlikely to come to the rescue of our local equity markets.

The investor should thus not expect returns on equities in the medium term to be anywhere close to what we have seen over the past 10 years and more, although in the short-term the more speculative investor may still be able to make hay while the sun shines. With the expected tapering of the asset purchase programme of the Fed, interest rates will in the medium term rise slowly while the Rand is likely to depreciate in the face of these negative developments.

A weak Rand, and by our measure currently undervalued at its current value around 10 to the US versus fair value at around 9.66, suggests that one can invest offshore, the risk of a significant correction of the exchange rate being considered low.

A globally well diversified portfolio, comprising of value companies in the industrial, financial and technology sectors with strong cash flows and high dividend yields is our call. Listed property is likely to track the performance of equities in the short-term, implying short-term opportunities but is 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

Whilst we have taken all reasonable measures to ensure that the results reflected herein are correct, Benchmark Retirement Fund and Retirement Fund Solutions Namibia (Pty) Ltd do not accept any liability for the accuracy of the information and no decision should be taken on the basis of the information contained herein before having confirmed the detail with the relevant portfolio manager. The views expressed herein are those of the author and not necessarily those of Benchmark Retirement Fund or Retirement Fund Solutions.