Volume 10, No. 01,
January 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JANUARY 2014

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

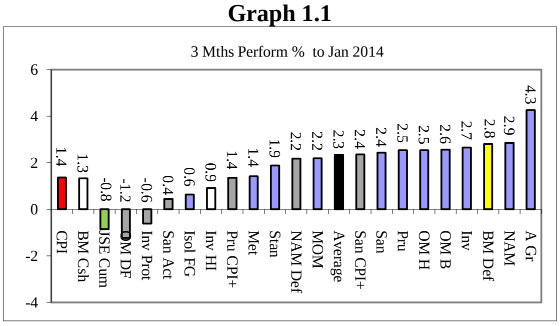
In **January** the **average prudential balanced portfolio** returned -0.34% (December: 2.77%). Top performer is Allan Gray (1.17%), Metropolitan (-1.23%) takes the bottom spot. Allan Gray, top performer for the quarter outperformed the 'average' by roughly 1.9%, primarily through their maximum exposure to offshore investments paired with the significant decrease of the Rand against the USD. On the other end of the scale Investment Solutions' underperformance of the 'average' by 1.7% was caused primarily by sector and asset allocation.

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.

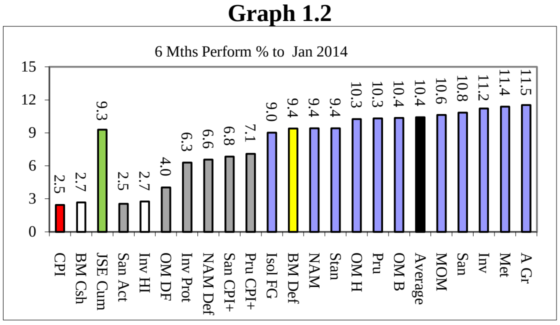
Below is the legend to the abbreviations reflected on the graphs:

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)

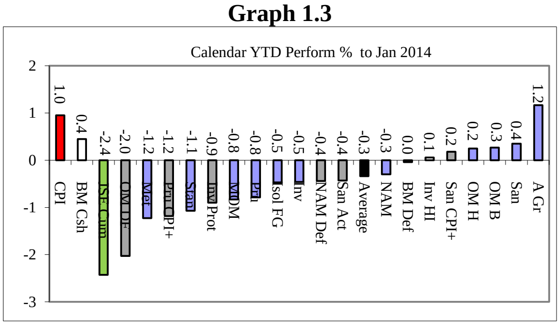
Graph 1.1



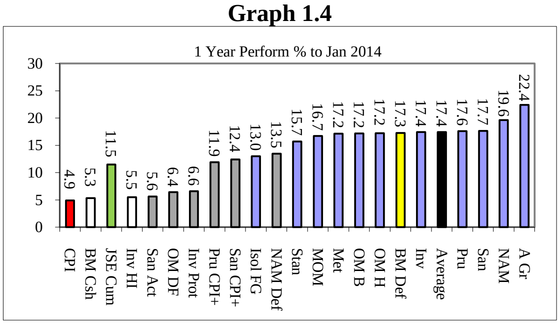
Graph 1.2



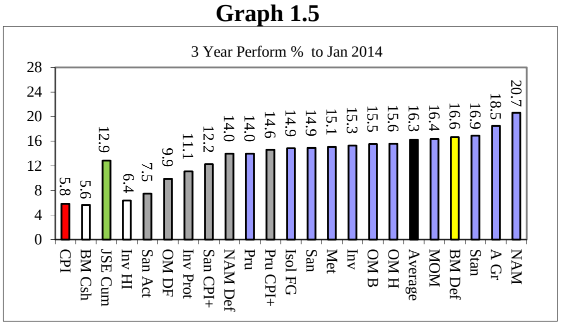
Graph 1.3



Graph 1.4



Graph 1.5



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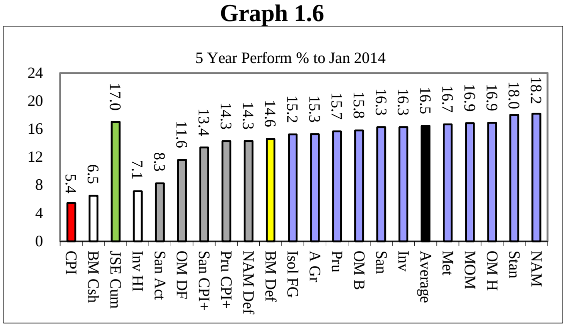
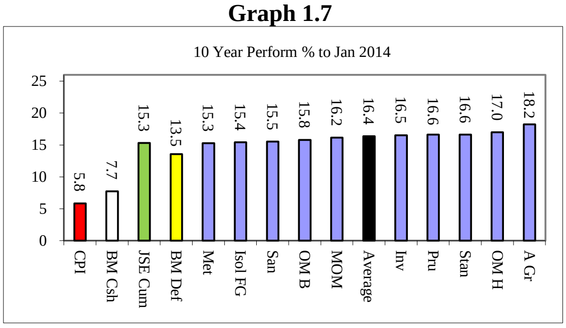
Graph 1.6

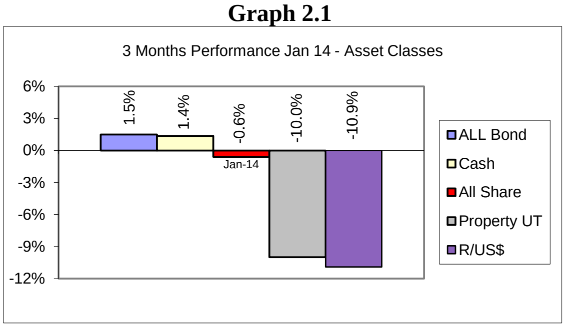


Graph 1.7

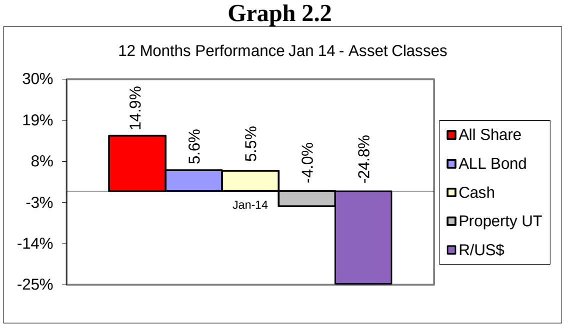


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

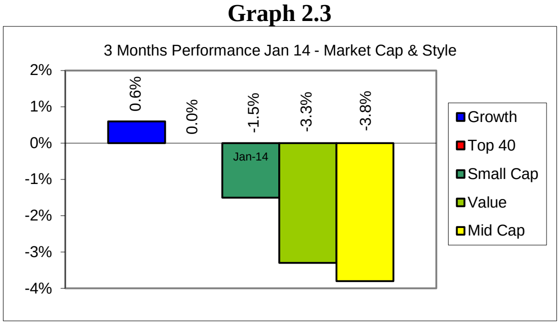
Graph 2.1



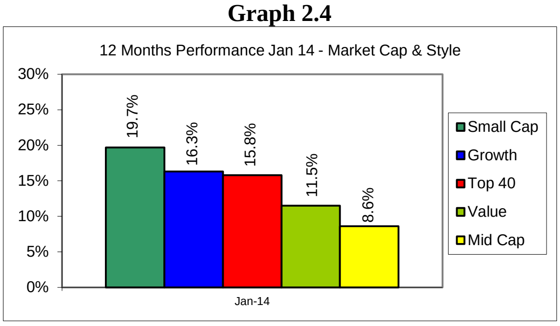
Graph 2.2



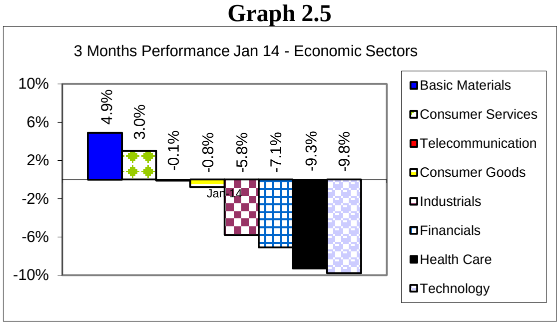
Graph 2.3



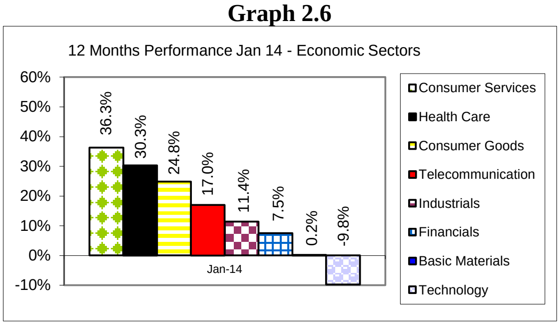
Graph 2.4



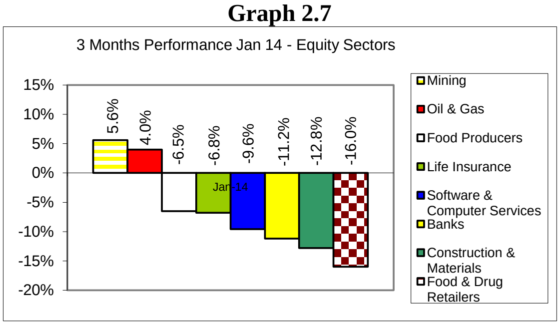
Graph 2.5



Graph 2.6



Graph 2.7



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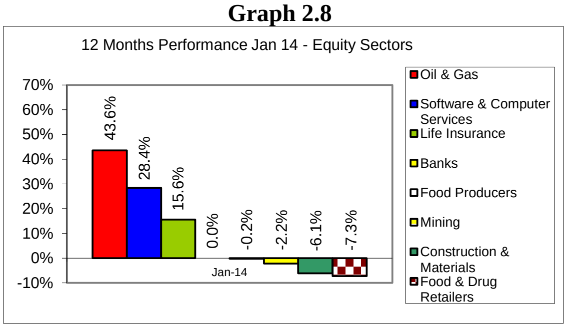
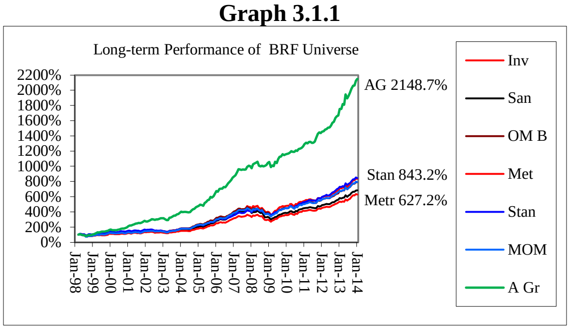
Graph 2.8



3. Portfolio Performance Analysis

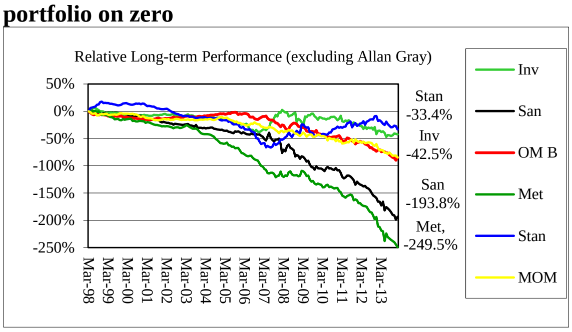
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

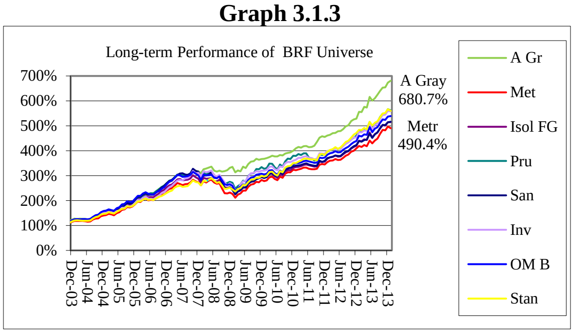


Graph 3.1.2

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

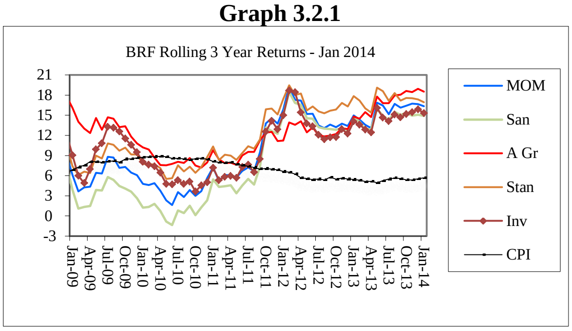


Graph 3.1.3

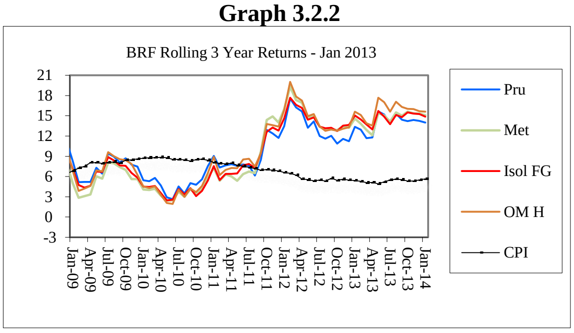


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

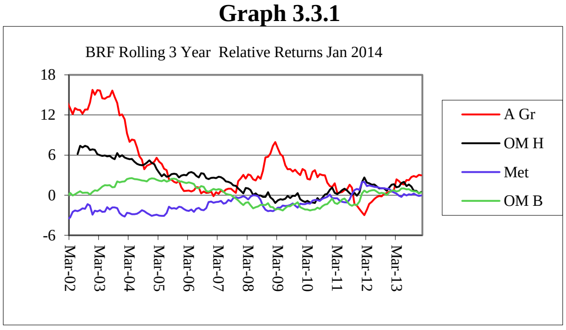


Graph 3.2.2

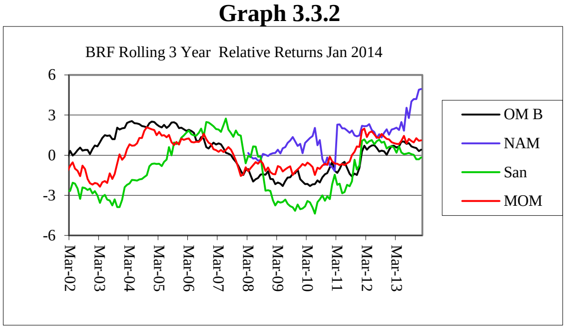


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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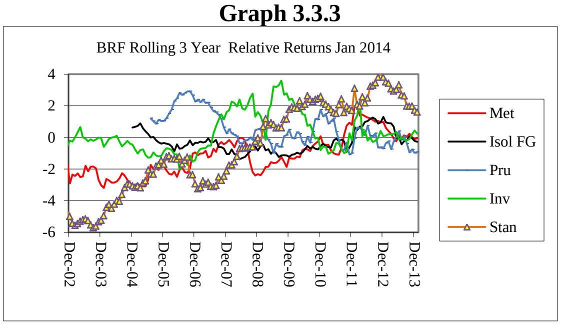
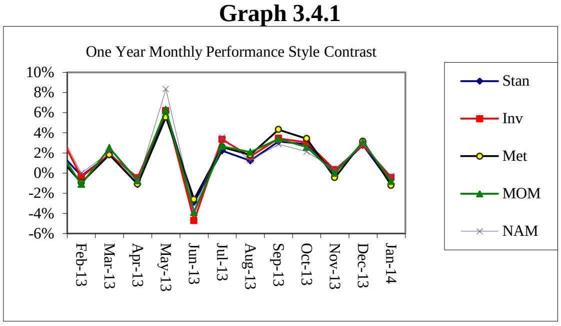
Graph 3.3.3

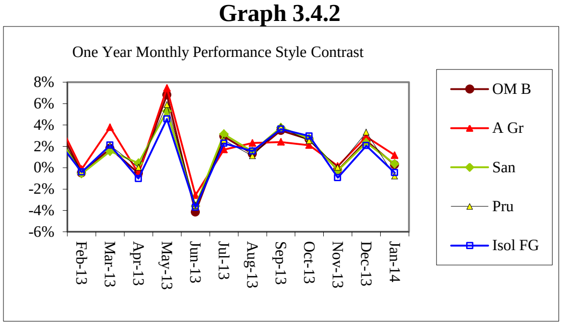


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

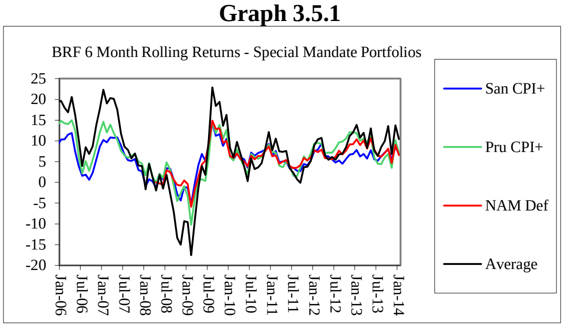


Graph 3.4.2

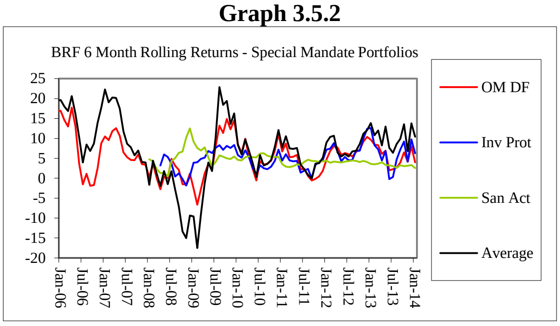


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

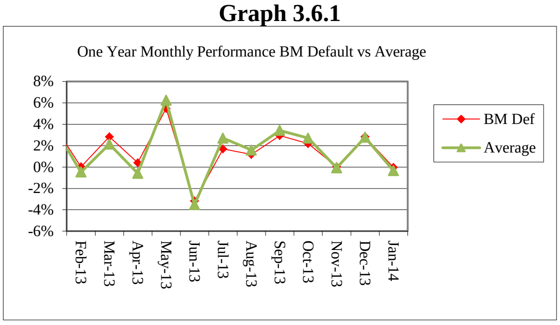


Graph 3.5.2

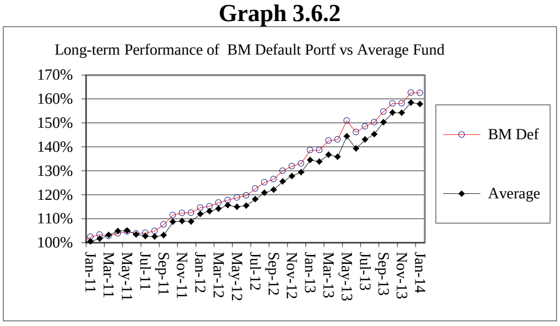


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

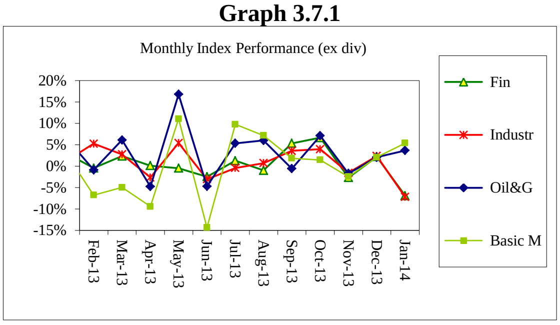


Graph 3.6.2



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

Graph 3.7.1



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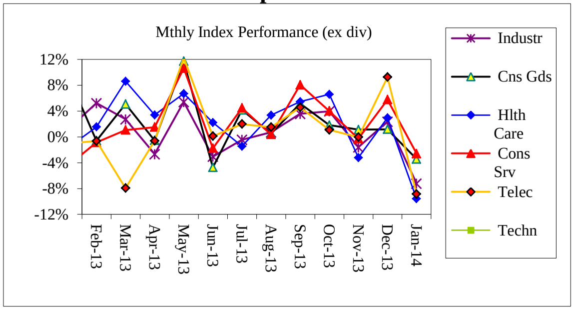
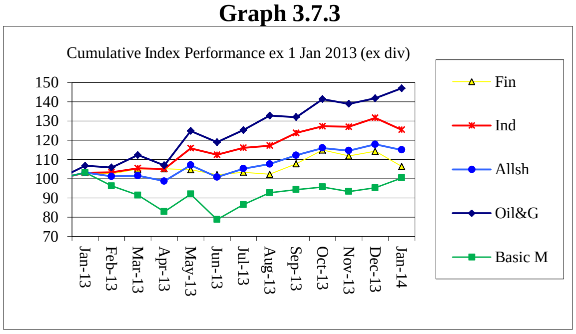
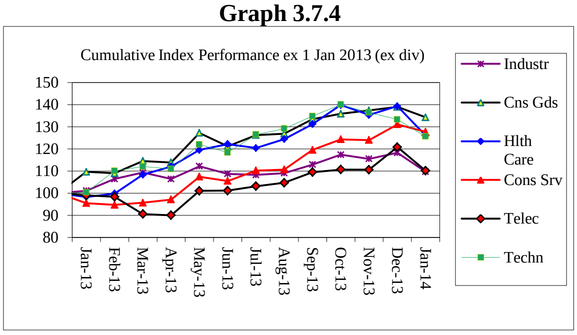
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 16.5% p.a. in nominal terms, or 11.1% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 14.6% p.a. in nominal terms, or 9.2% p.a. in real terms. The Benchmark Default portfolio is designed to produce a less volatile performance but also lower returns than the average prudential balanced portfolios with its significantly lower equity exposure (47.7% vs. 62.1% of the average prudential balanced portfolio, as at the end of December 2013) and the lower risk it consequently entails for the investor. It should be expected to underperform the average prudential balanced portfolio at times when shares outperform other asset classes and vice versa.

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 significantly over the past 5 years.

Having raised the risk profile of the Default portfolio effective the start of 2011, by replacing Metropolitan ARF with 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 exceeded noticeably. Since this change was effected, the default portfolio returned a cumulative 49.3% compared to 46.6% for the average prudential balanced portfolio over this 37 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 February 2011 to January 2014:

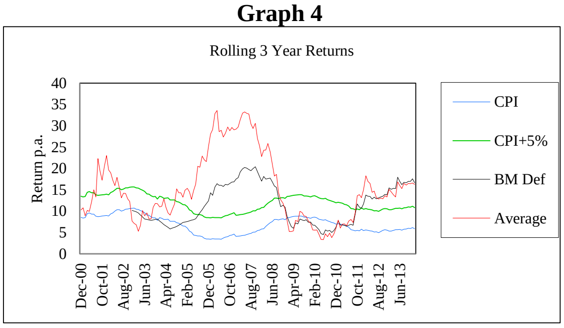
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	9.9%	7.4%
Best annual performance	6.9%	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	5.8%	16.6%	15.8%

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



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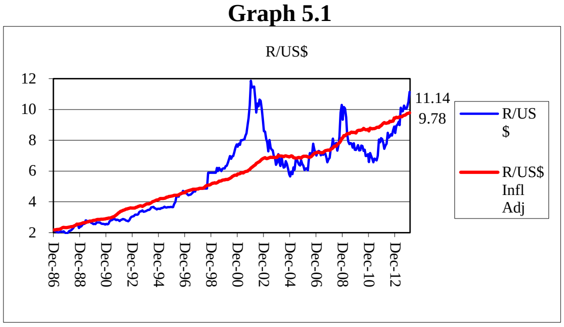
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 16.7%, the average on 16.3% vs CPI plus 5% currently on 10.8%.

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 9.78 to the US Dollar while it actually stood at 11.14 at the end of January. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

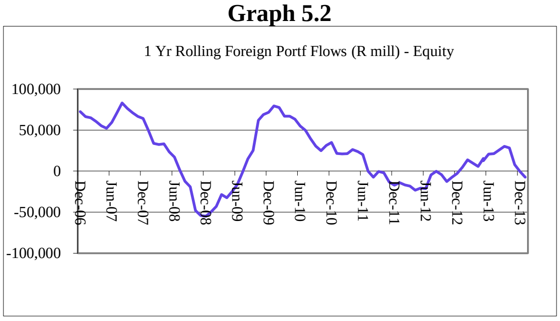
Graph 5.1



Rand still supported by foreign capital flows

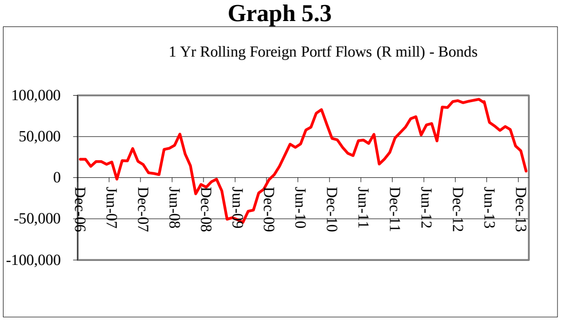
Graph 5.2 reflects a negative flow of capital out of South African equities on a rolling one year basis, with a net outflow of R 7.4 bn on a year-on-year basis at the end of January (outflow of R 0.4 bn to end December). Since the beginning of 2006, foreign net investment in equities amounts to R 162 bn (end December R 168 bn). This represents roughly 1.54% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis, reflects a decrease of foreign portfolio flow into bonds of R 7.9 bn over the past 12 months to end of January (R 32.8 bn over the 12 months to end of December). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 225 bn (to December just over R 247 bn).

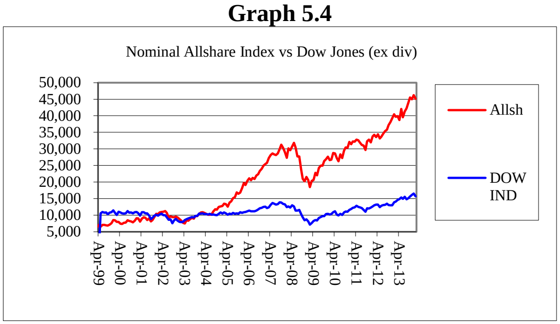
Graph 5.3



The net inflow of foreign capital into equity and fixed interest assets was down to R 0.6 bn for the 12 months to end January 2014 (inflow of R 32.4 bn to end December 2013), compared to R 95.5 bn for the 12 months to end January 2013 (R 90.7 bn to end of December 2012). Since the beginning of 2006, total net foreign portfolio flows amounted to R 387 bn (December R 414 bn).

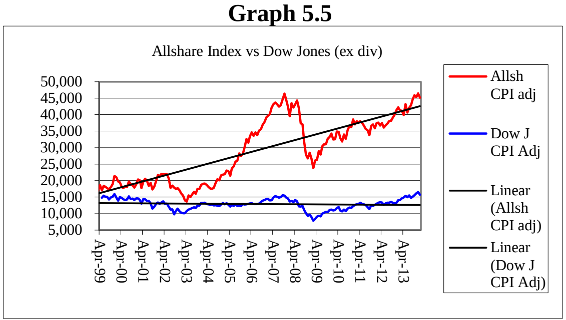
Graph 5.4 reflects the movement of the JSE and the DOW Jones since May 1999. In nominal terms, the JSE grew by 14.1% per year, while the DOW Jones only grew by 2.8% per year, over a period of over 14 years, dividends excluded. Namibian inflation over this period was 6.8% per year in contrast with US inflation of 2.3%.

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 6.8% 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 keep pace with inflation over this period, also excluding dividends.

Graph 5.5



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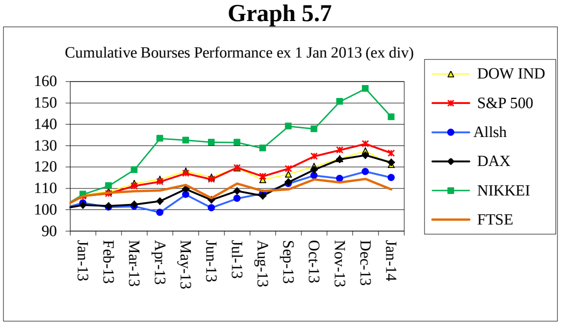
Graph 5.6 places the data as per graph 5.4 into a better perspective, showing that graph 5.4 actually starts measuring the DOW Jones just after it had reached a peak around 1998.

Graph 5.6

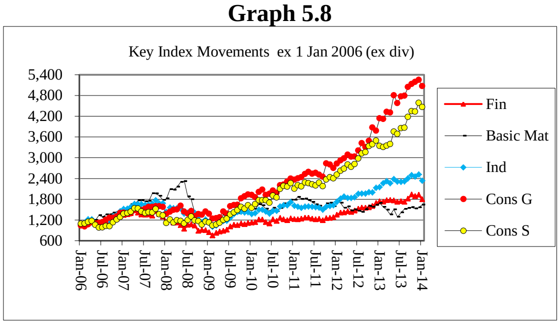
Graph 5.7 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the S&P 500 as the top performing share indices.

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

Global investment markets have not changed since our previous newsletter. Positive economic trends are still being registered in the US, a number of European countries, Japan and China. In accordance with the 1741 Asset Management global equity valuations as of December 2013, global equity markets currently present 'fair value', with fairly wide disparities between overvalued markets such as the US market (+45%) and undervalued markets such as Japan (-25%). To achieve superior equity returns, investors would have to find pockets of value outside the traditional developed markets, which would usually be associated with higher investment risks. Emerging markets have fallen out of favour with investors in developed countries who now prefer to put their money on their own markets, in particular the US market. Despite this trend having led to a correction and even to overly optimistic views of equity markets in the developed world, we believe that this trend will persist for a while.

As we have seen, this trend has led to a significant decline of foreign investment capital into the financial markets of developing countries, and a significant depreciation of their currencies. A number of the worst effected countries, including SA, have started to lift their interest rates in an effort to shield their currencies.

The external environment we are facing in SA and Namibia is thus one of continued weakness in our currency, continued upward pressure on interest rates and on inflation as the result of a weak currency paired with sluggish performance of our exports due to a slow recovery in global economies. This should hurt the local consumer in the first instance. However, the latest national budget released on 19 February, is once again an expansionary budget that should provide a positive impetus to the Namibian economy, deferring the 'evil day' by another year. It remains to be seen whether SA will go the same route or whether it will be more cautious.

As pointed out above the global economy is expected to grow by around 2.5% in 2014, including generally higher growth of emerging economies, offset by lower growth of developed economies, where the demand for our goods and services is primarily derived.

Offshore equity markets can therefore not be expected to produce any fireworks but should show some growth, in the US supported by the Fed's monetary policies up to the point where US economic growth and the support of its equity market becomes self-sustaining. Our expectation is that these markets should produce real returns of between 5% and 10% in 2014.

In summary, 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 few years since the financial crisis and before the financial crisis.

Due to the over-extended weakness of our currency, we believe it is currently not the opportune time to invest offshore but to hold onto any offshore investments.

On the basis of the global economic environment and our expectations of global financial markets we retain our investment call on a globally well diversified portfolio, comprising of value companies in the industrial, financial and technology sectors with strong cash flows and high dividend yields.

Resource stocks, having been in the doldrums since their peak in May 2008, should also offer buying opportunities despite our expectation of muted global commodity prices. 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.

Pension fund members and the typical local investor would generally hold the major portion of his or her assets locally. In terms of the weighting of the equity exposure we therefore believe that the local investor should, as a matter of principle, maintain an 'overweight' to foreign investments in general, and to foreign equity more specifically. This asset class should deliver returns superior to other conventional asset classes.

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.