Volume 10, No. 05,
May 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MAY 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

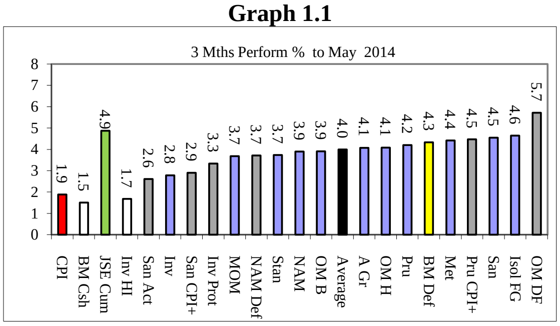
In **May** the **average prudential balanced portfolio** returned 1.52% (April: 1.36%). Top performer is Namibia Asset Managers (2.74%); Investment Solutions (0.75%) takes the bottom spot. For the 3 month period Investment Solutions is top performer outperforming the 'average' by roughly 0.6%. On the other end of the scale Investec underperformed the 'average' by 1.2%.

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.

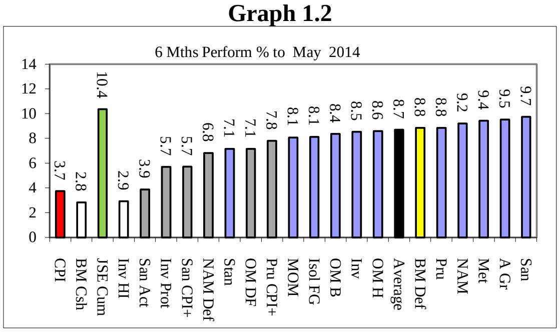
Below is the legend to the abbreviations reflected on the graphs:

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)

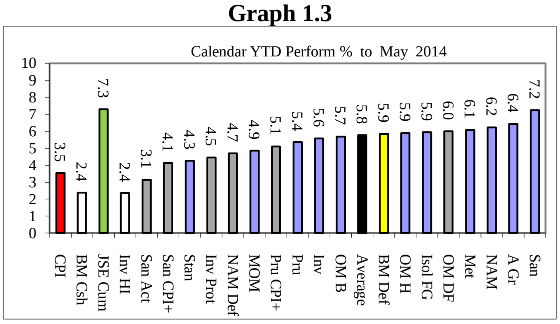
Graph 1.1



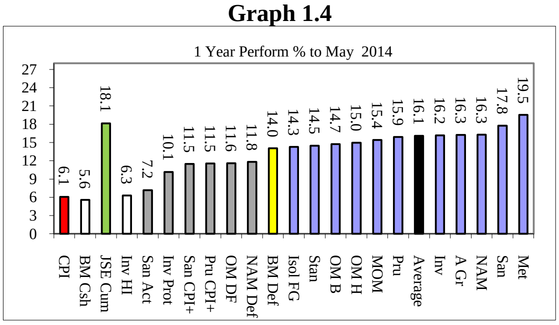
Graph 1.2



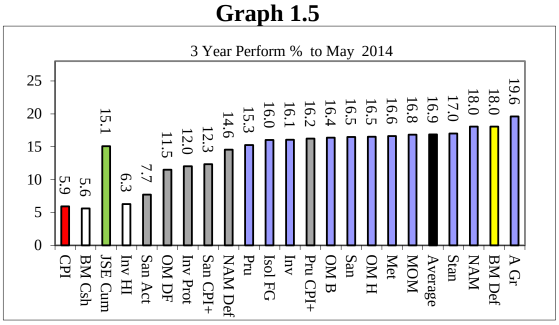
Graph 1.3



Graph 1.4



Graph 1.5



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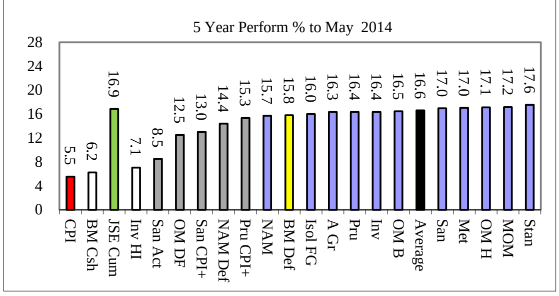
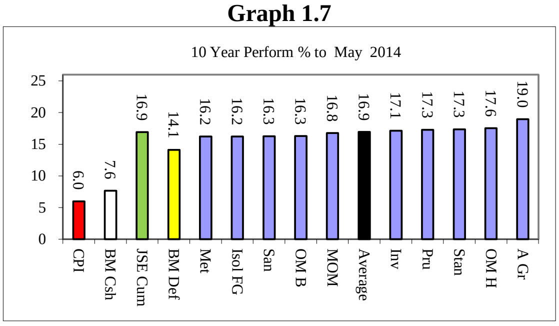
Graph 1.6

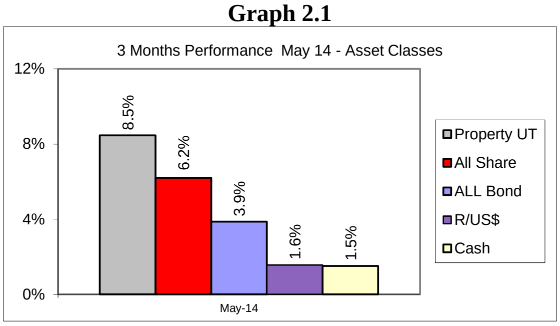


Graph 1.7

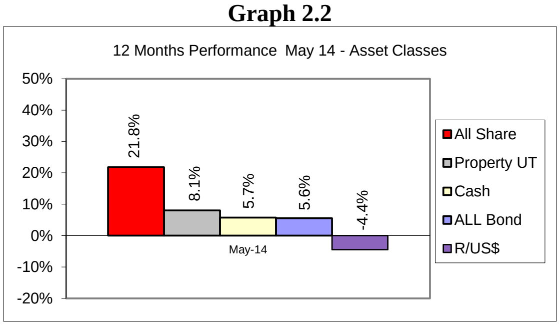


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

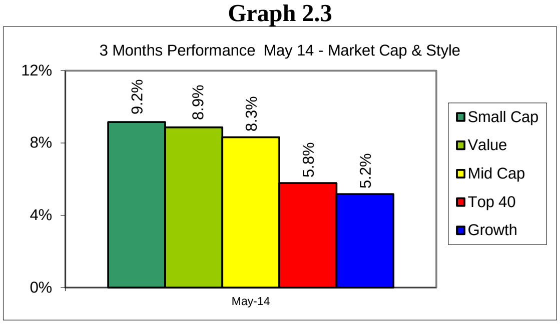
Graph 2.1



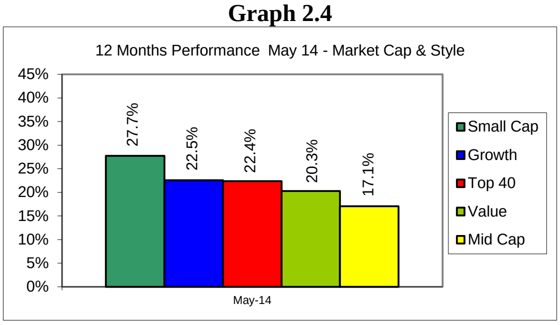
Graph 2.2



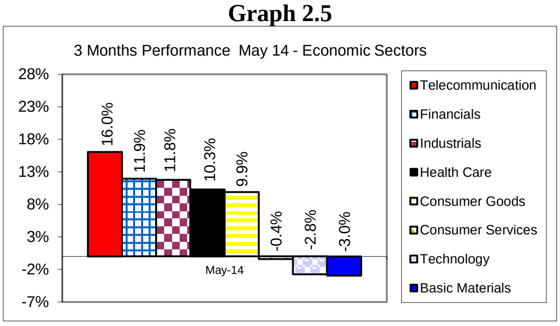
Graph 2.3



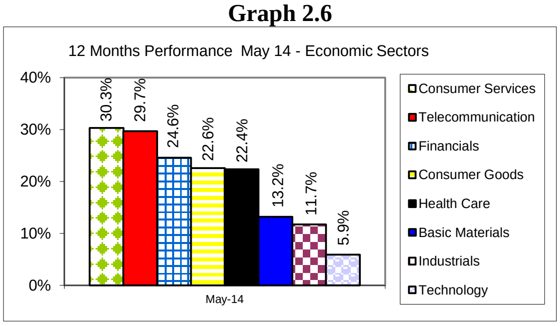
Graph 2.4



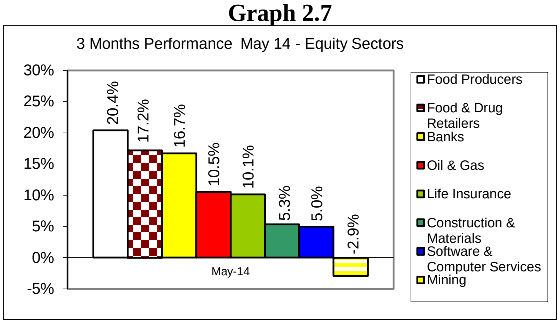
Graph 2.5



Graph 2.6



Graph 2.7



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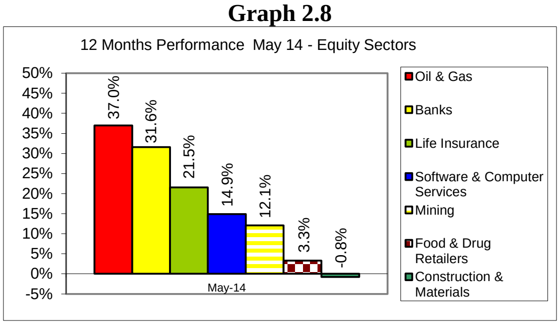
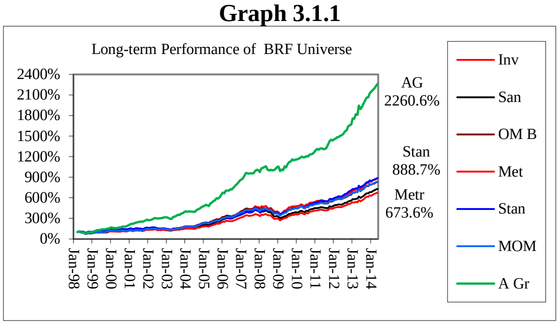
Graph 2.8



3. Portfolio Performance Analysis

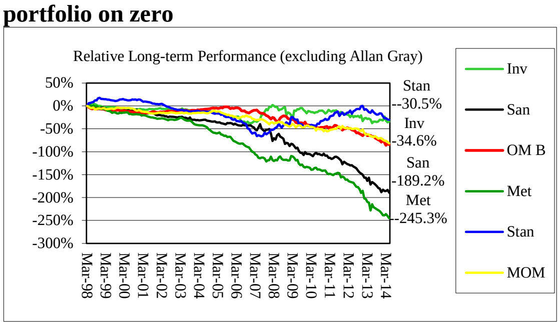
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

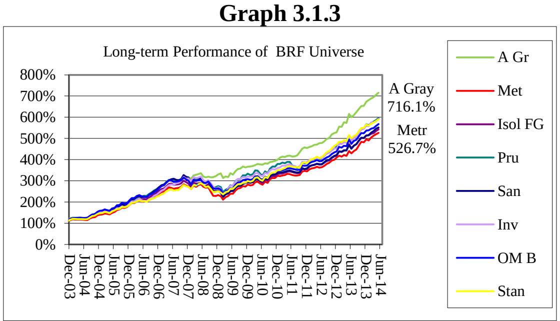


Graph 3.1.2

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

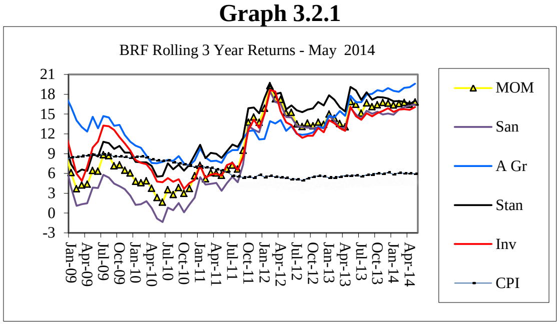


Graph 3.1.3

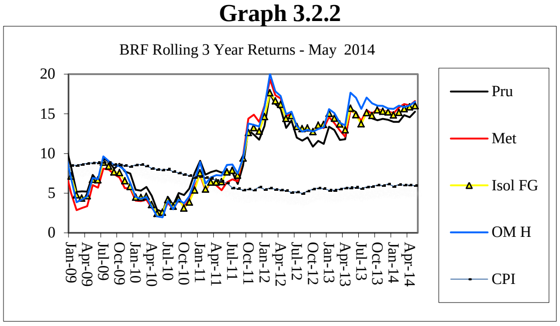


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

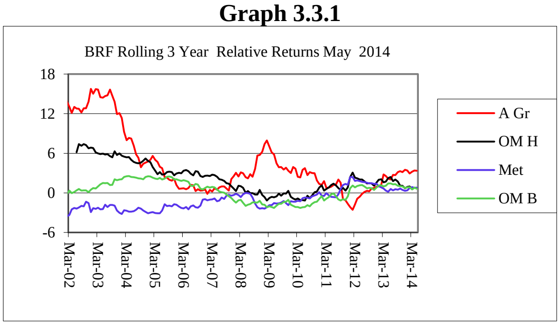


Graph 3.2.2

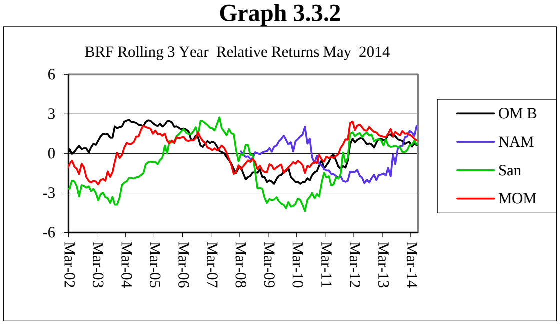


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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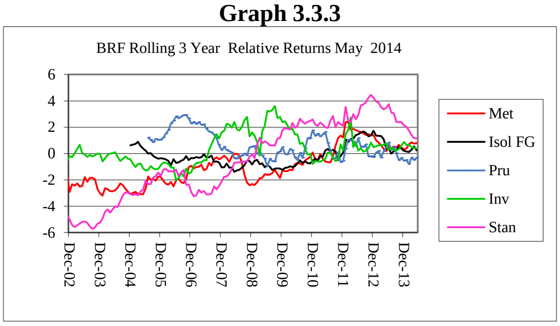
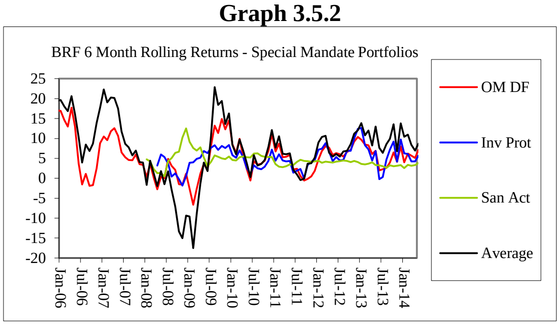
Graph 3.3.3

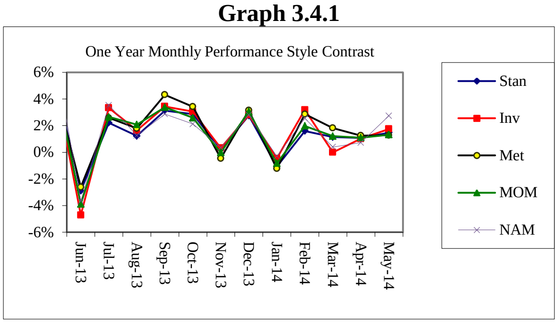


Graph 3.5.2

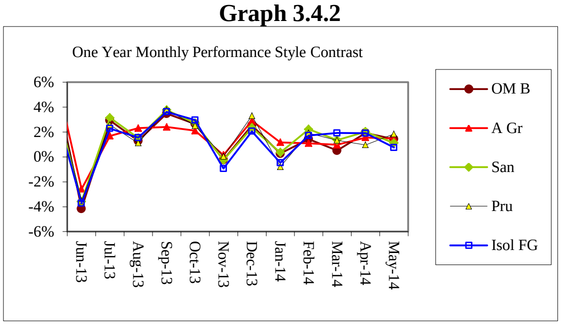


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

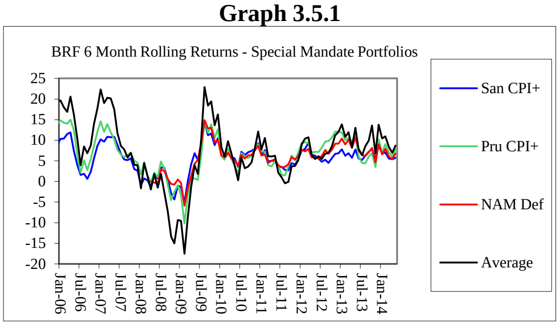


Graph 3.4.2



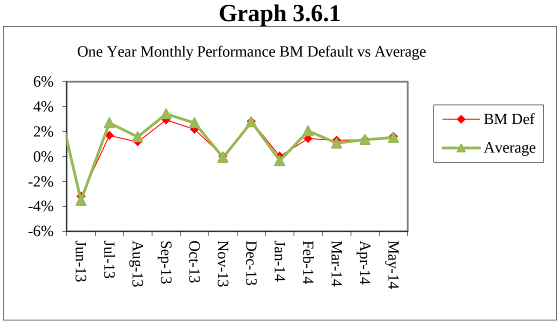
3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

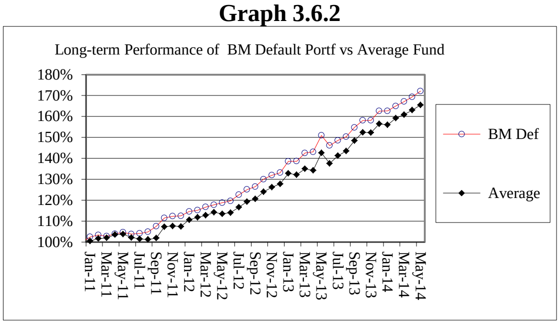


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

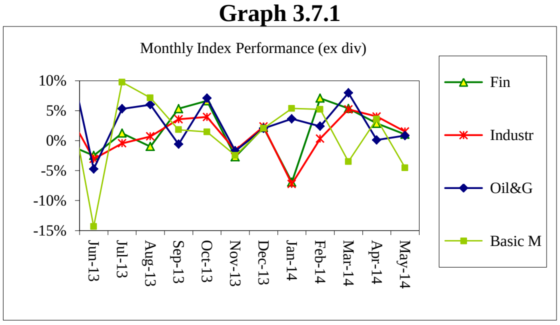


Graph 3.6.2



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

Graph 3.7.1



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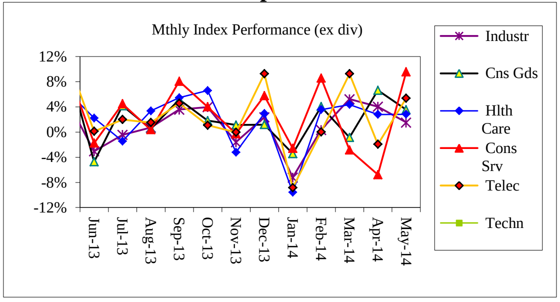
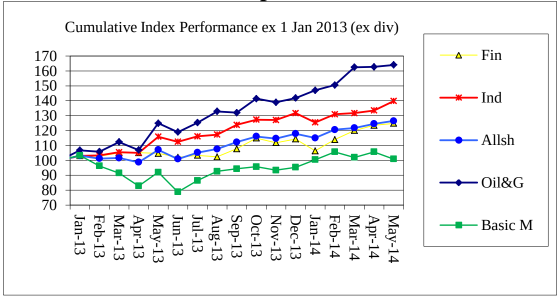
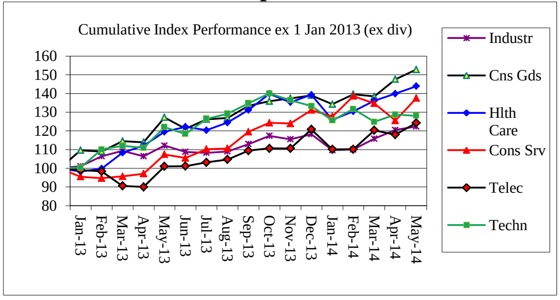
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 16.6% p.a. in nominal terms, or 11.1% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 15.8% p.a. in nominal terms, or 10.3% 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 (48.9% vs. 60.5% of the average prudential balanced portfolio, as at the end of March 2014) 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 Namibia Unit Trust, we would in the long-term 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 55.1% compared to 51.3% for the average prudential balanced portfolio over this 41 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 June 2011 to May 2014:

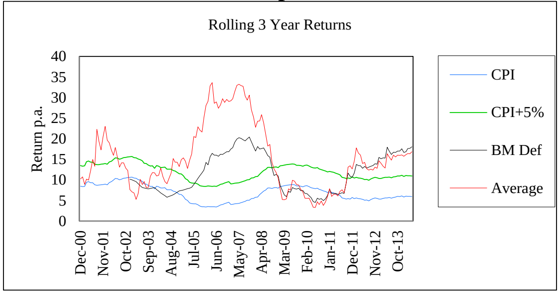
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	9.9%	6.1%
Best annual performance	6.4%	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	5.7%	17.2%	16.1%

The Benchmark Default portfolio is a more conservative investment portfolio 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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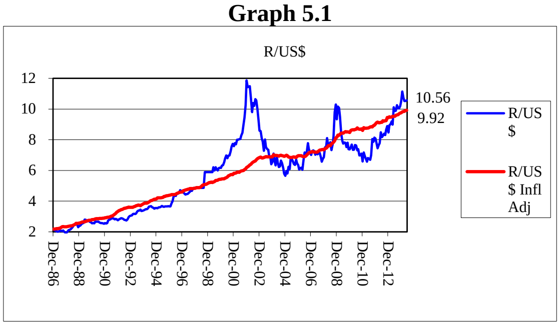
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 18.0%, the average on 16.9% 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 9.92 to the US Dollar while it actually stood at 10.56 at the end of May. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

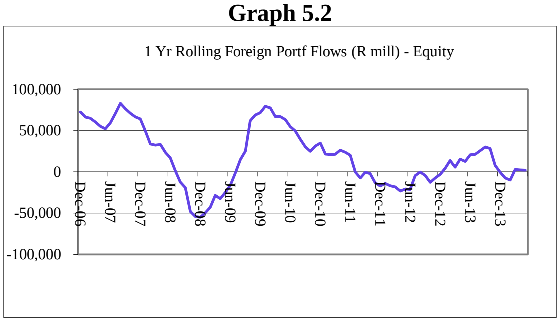
Graph 5.1



Rand strengthens through foreign capital inflows

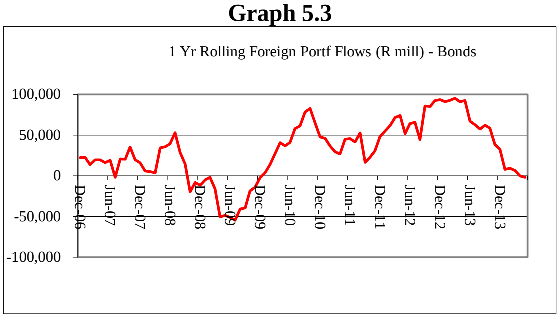
Graph 5.2 reflects a positive flow of capital into South African equities on a rolling one year basis, with a net inflow of R 2.2 bn on a year-on-year basis at the end of May (inflow of R 2.3 bn to end April). Since the beginning of 2006, foreign net investment in equities amounts to R 186 bn (end April R 185 bn). This represents roughly 1.6% 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 flows into SA bonds of R 1.9 bn over the past 12 months to end of May (outflow of R 0.2 bn over the 12 months to end of April). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 238 bn (to April just over R 245 bn).

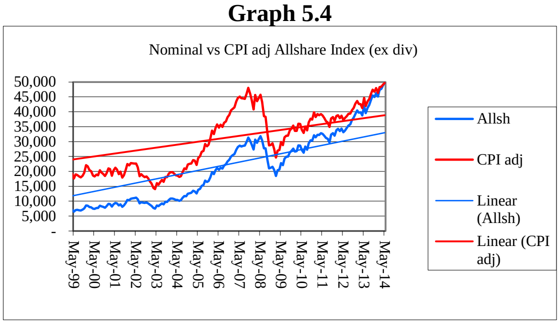
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was a mere R 4.1 bn for the 12 months to end May 2014 (inflow of R 2.1 bn to end April 2014), compared to R 105.2 bn for the 12 months to end May 2013 (R 106.5 bn to end of April 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 424 bn (April R 430 bn).

Graphs 5.4 reflects the movement of the JSE since May 1999 in nominal terms, adjusted for indigenous inflation, with trend lines for these. In nominal terms, the JSE grew by 14.4% per year since May 1999, and this excludes dividends of somewhere in the region of 2% to 4%. Namibian inflation over this period was 6.8% per year. This is equivalent to a growth in real terms of 6.7% p.a. over this period.

Graph 5.4



Graph 5.5 reflects the movement of the S&P500 Index since May 1999 in nominal terms, adjusted for indigenous inflation, with trend lines for these. Since May 1999 the S&P500 Index has grown by 3.1% per, over this period of 15 years. US inflation over this period was 2.4%. This is equivalent to a growth in real terms of 0.7% p.a. over this period.

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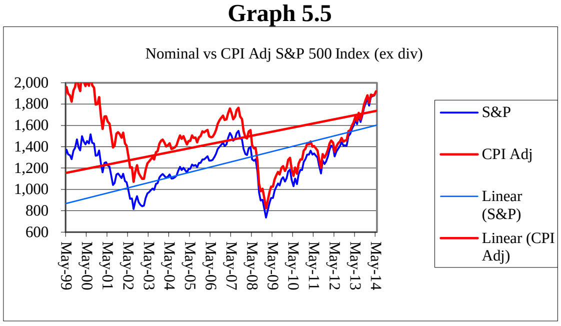
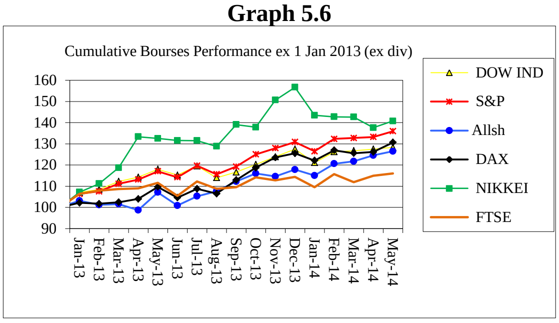
Graph 5.5



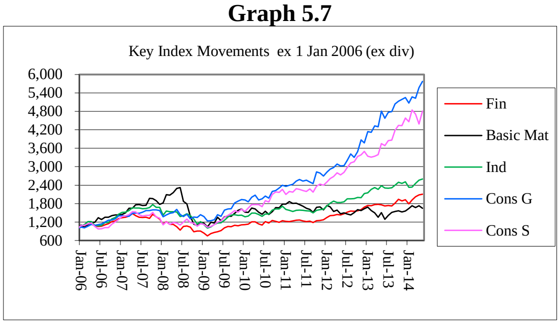
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the S&P 500 as the top performing share indices.

Graph 5.6



Graph 5.7 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. Annualised returns for these indices since the beginning of 2006 were: Consumer Goods – 23.2%; Consumer Services – 20.5%; Industrials – 12%; Financials – 9.2% and Basic Materials – 6.1%.

Graph 5.7



6. Conclusion

Over 3 months to end of May, compared to the 3 months to end of April, the performance of asset classes relative to each other has not changed significantly while the Rand appreciated over both periods. Property remained the top performing asset class followed by equity, bonds and cash. Over the 12 months to end May, compared to the 12 months to end of April, local equity was the top performing asset class but property moved from the worst performing asset class at the end of April to the 2nd best performing asset class at the end of May.

The Rand depreciated over both 12 month periods, much more pronounced though over the 12 months to end of April (-17.2%) compared to the 12 months to end of May (-4.4%). Considering the main economic sectors in equities the most pronounced change over the 3 and 12 month periods to end April and end May was an improvement in the fortunes of Basic Materials from -3% to 7% over the two 3 month periods and from 13.2% to 31.7% over the two 12 month periods.

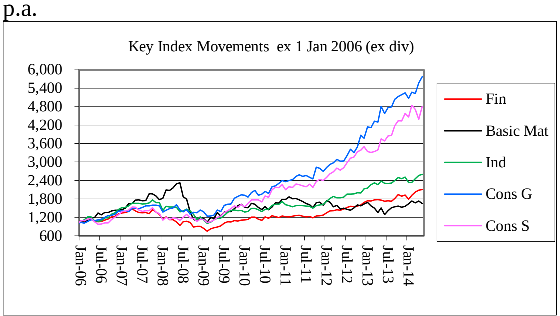
The punishment investment managers with a high offshore exposure endured at the hands of an appreciating Rand (Allan Gray, Investec, Old Mutual and Prudential) should thus be less pronounced when comparing 3 month performances at the end of May to those at the end of April. Asset managers typically holding a fairly low exposure to property and the turnaround in the fortunes of property over these two 3 month periods should be less noticeable.

Equity both locally and offshore, remained the top performing asset class for both 12 months periods to end April and end May, which should have benefited the more aggressive investment managers with a high equity exposure (Old Mutual Pinnacle at 67%, all others only at around 60%). Over the two 12 month periods the more pronounced depreciation of the Rand to end of April should have benefited investment managers with a high offshore exposure more to end of April than to end of May. The fortunes of investment managers with a high exposure to Basic Materials should have improved quite a bit over both the 3 and 12 month periods

At this stage local and offshore equity may be expected to remain the best performing asset class for the next 12 months as the result of monetary stimulus measures being maintained globally, despite the fact that markets are already expensive. There is a chance of interest rates being raised in the US later this year although the US government will not really be able to shoulder anything but a minute increase in interest rates due to its high indebtedness, unless this was accompanied by increasing inflation. Local interest rates may well be increased again soon by the SA Reserve Bank particularly in view of the down grading of SA's credit rating by Standard & Poors to BBB-, one level above junk, while Fitch lowered the outlook on its BBB grading from stable to negative. This will impact negatively on returns on interest bearing investments and on property but will lend support to the Rand. It is therefore likely that the Rand will maintain its current position and may be expected to move sideways for the next 12 months.

With a stable Rand and equities continuing to be driven through monetary stimulus, equity is really the only conventional asset class that should outperform the other asset classes. Interest bearing investments present the risk of capital losses in the event of an increase in interest rates. Given that equities do present a substantial risk, being overvalued in many cases, the investor needs to be selective as to what equities to invest in that will not be affected as much by a correction in valuations that is likely to occur. The 'value' style of investing, where valuation and dividend yield plays an important role in selecting specific shares is our preferred investment style in the current environment although one may sacrifice returns in the face of a tidal wave carrying equity to ever higher levels. Diversifying to offshore markets also remains a sensible strategy in our assessment.

As the below graph depicts, some indices had an unbelievable run since the beginning of 2006, producing annualised returns 23.2% (Consumer Goods), 20.5% (Consumer Services), 12% (Industrials), 9.2% (Financials) and 6.1% (Basic Materials). These returns must be seen against the backdrop of inflation of 6.7% p.a.



In the light of this background, as far as local equity sectors are concerned we prefer the financials -, industrials – and basic materials sectors to consumer goods and consumer services although value can be found in all sectors.

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.