Volume 10, No. 07,
July 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JULY 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

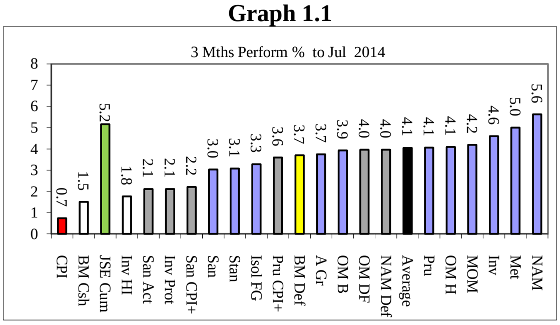
In **July** the **average prudential balanced portfolio** returned 0.69% (June: 1.81%). Top performer for the second consecutive month is Metropolitan (1.13%); Stanlib (0.29%) takes the bottom spot. For the 3 month period Namibia Asset Management is top performer outperforming the 'average' by roughly 1.5%. On the other end of the scale Sanlam underperformed the 'average' by 1.1%.

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 Balanced Fund.

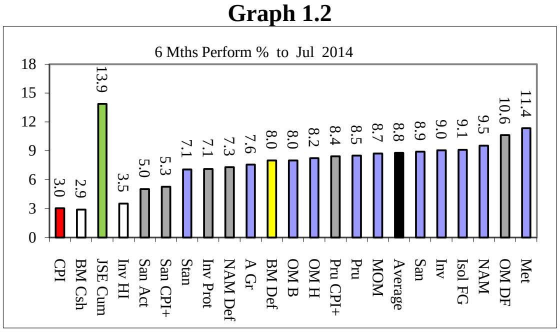
Below is the legend to the abbreviations reflected on the graphs:

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 Linked	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 Pinnacle Profile Growth	OM H (blue)
Momentum Managed	MOM (blue)
Sanlam Balanced	San (blue)
Stanlib Managed	Stan (blue)

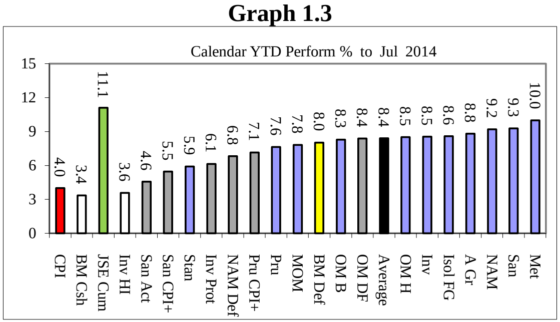
Graph 1.1



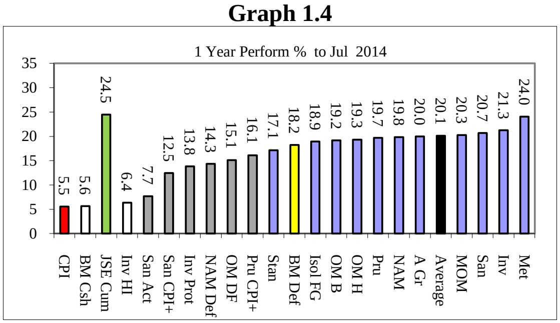
Graph 1.2



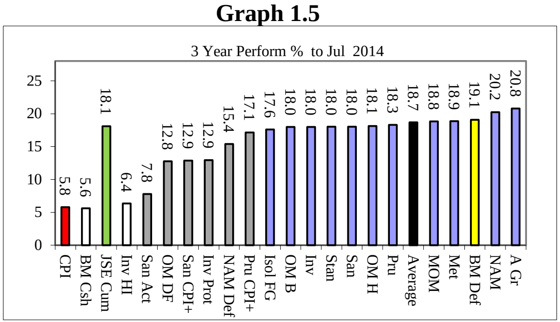
Graph 1.3



Graph 1.4



Graph 1.5



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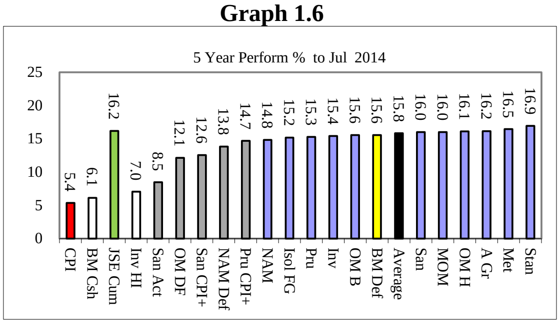
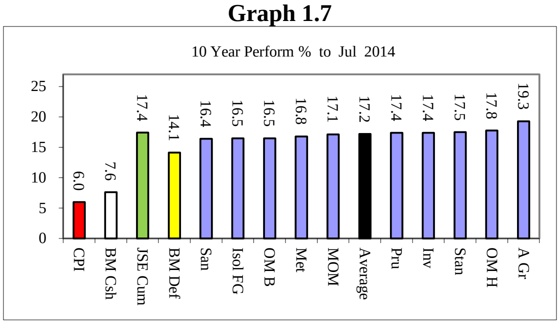
Graph 1.6

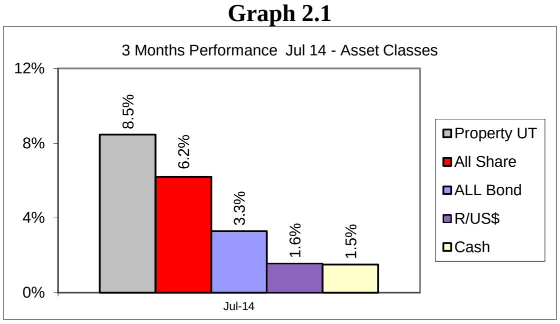


Graph 1.7

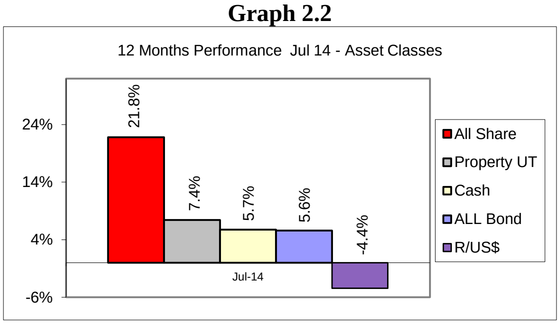


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

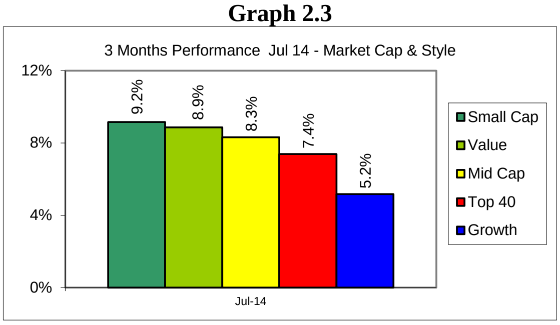
Graph 2.1



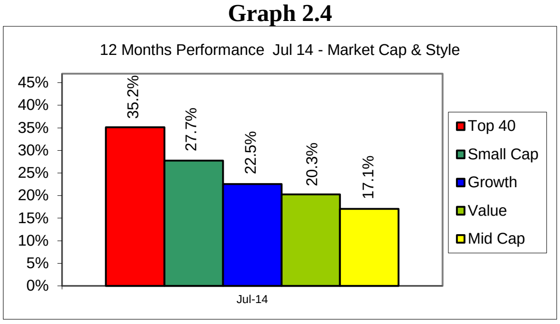
Graph 2.2



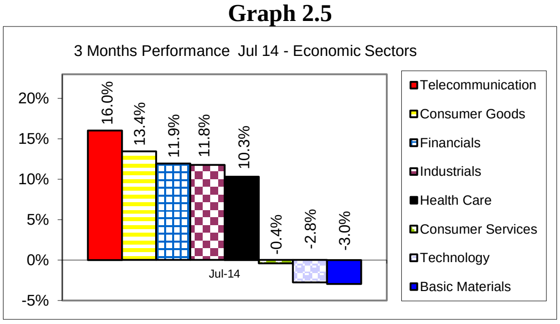
Graph 2.3



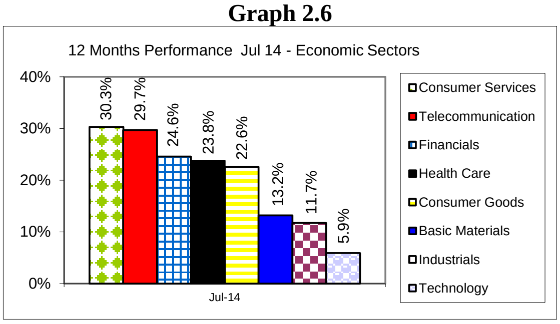
Graph 2.4



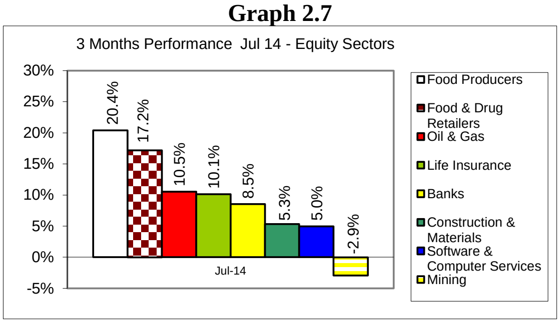
Graph 2.5



Graph 2.6



Graph 2.7



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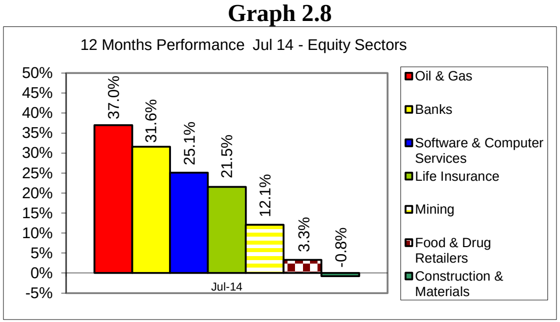
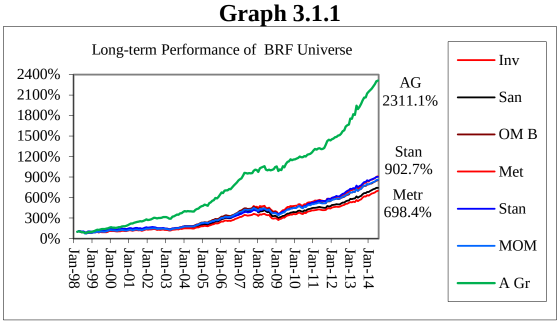
Graph 2.8



3. Portfolio Performance Analysis

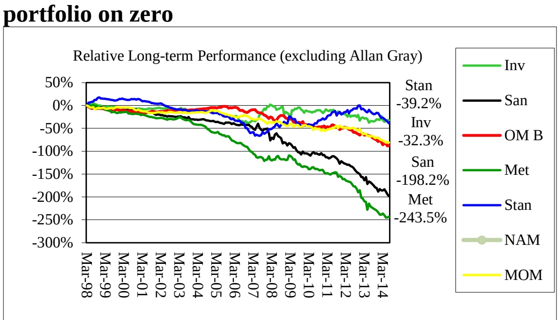
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

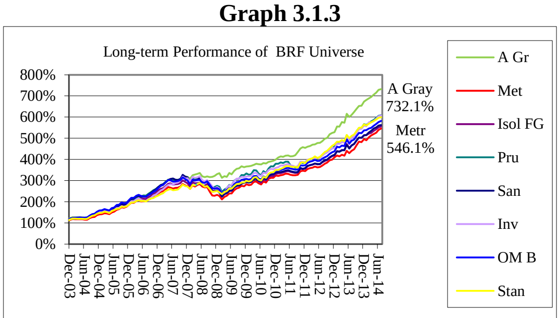


Graph 3.1.2

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

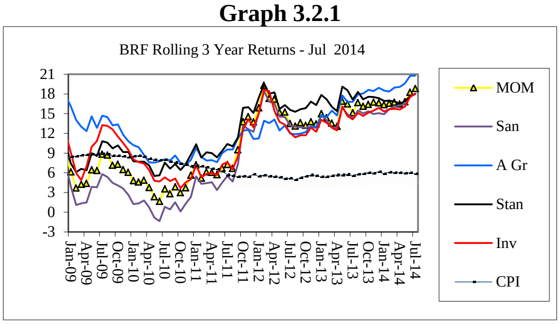


Graph 3.1.3

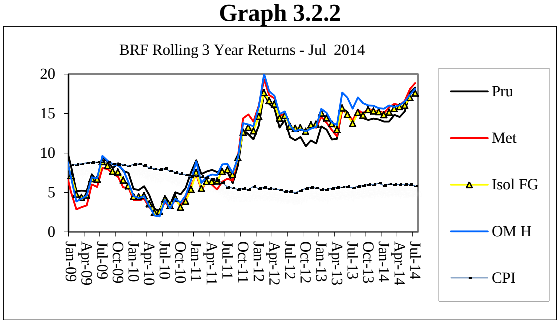


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

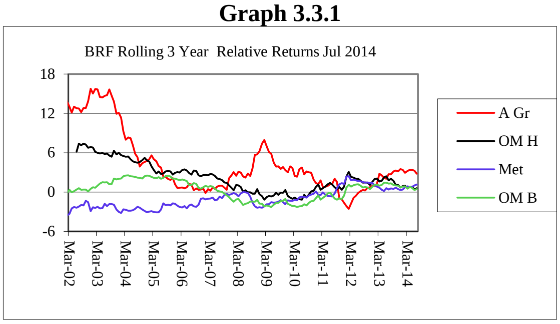


Graph 3.2.2

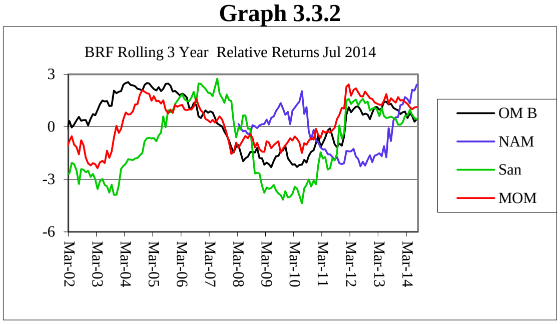


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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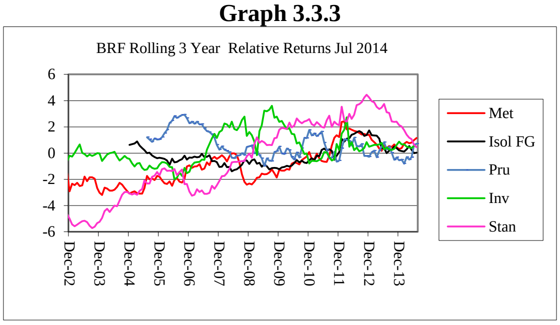
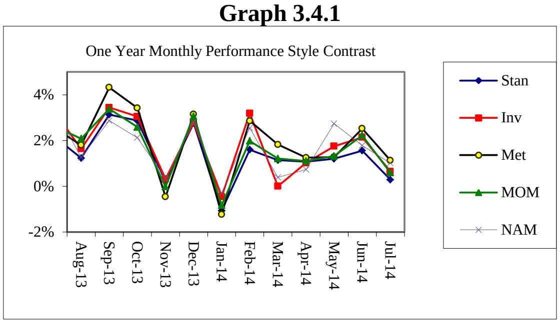
Graph 3.3.3

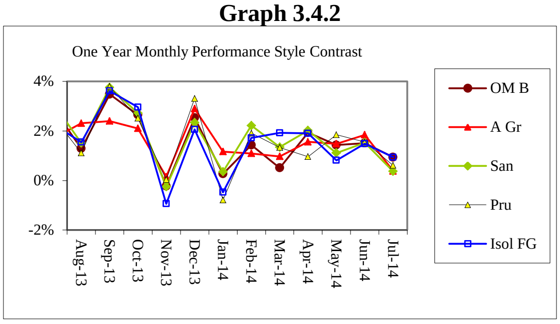


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

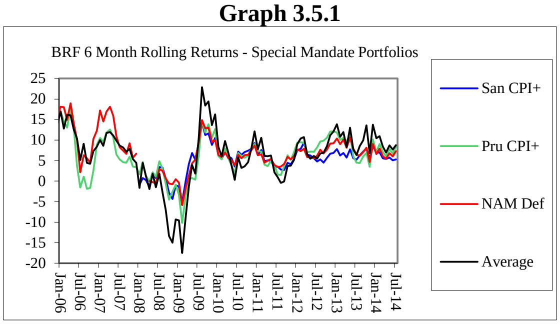


Graph 3.4.2

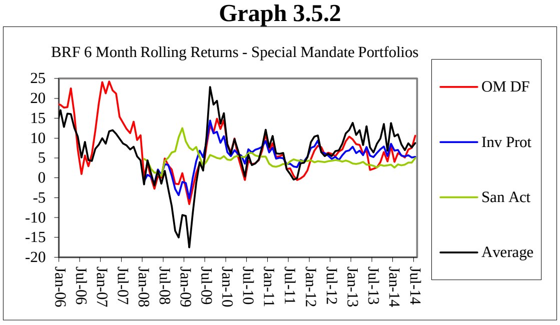


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

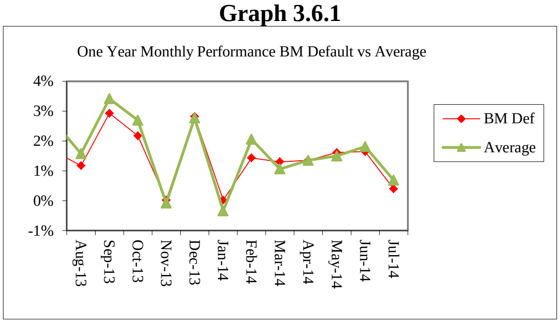


Graph 3.5.2

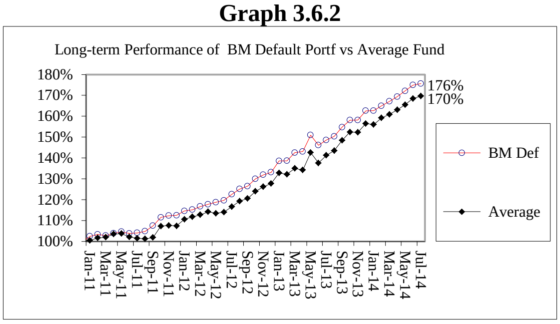


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

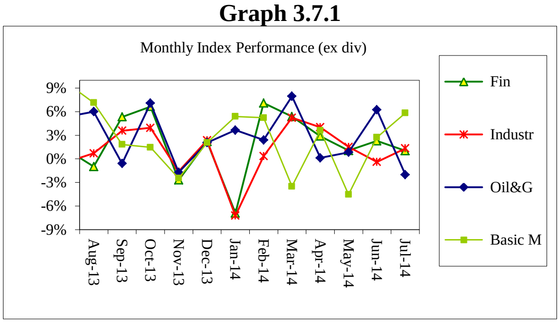


Graph 3.6.2



3.7 One year monthly performance of key indices (excluding dividends)

Graph 3.7.1



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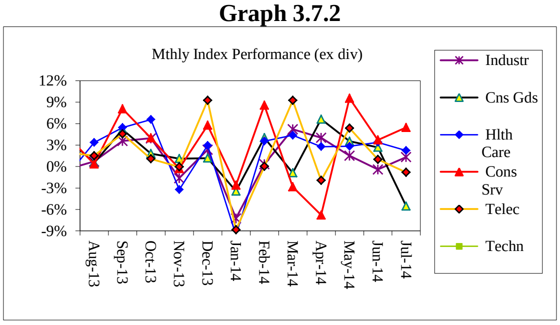
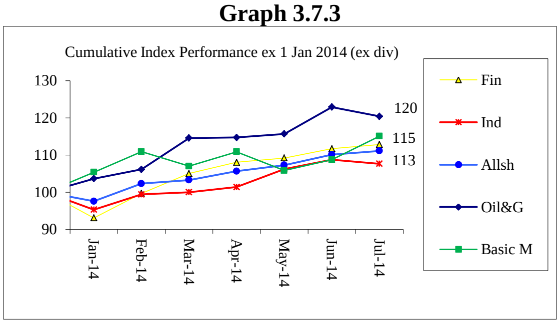
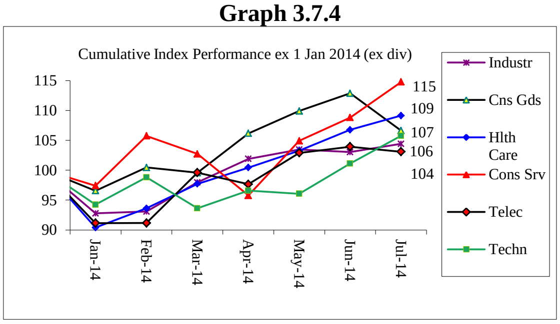
Graph 3.7.2



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 10.4% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 15.6% p.a. in nominal terms, or 10.2% 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 (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 75.6% compared to 69.6% for the average prudential balanced portfolio over this 43 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 August 2011 to July 2014:

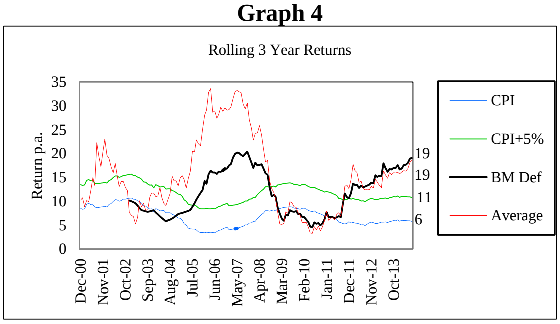
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	10.3%	6.1%
Best annual performance	6.2%	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%	17.6%	16.6%

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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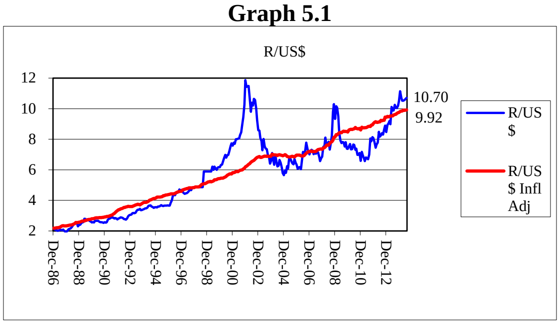
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 19.1%, the average on 18.7% 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 9.92 to the US Dollar while it actually stood at 10.70 at the end of July. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

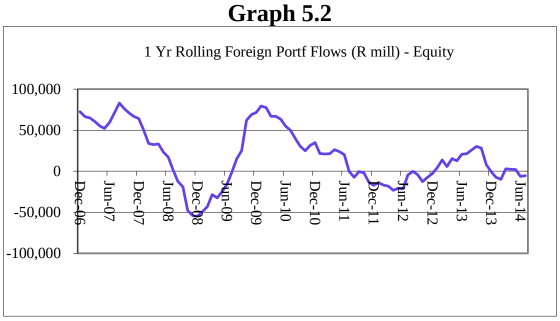
Graph 5.1



Rand strengthens despite foreign capital outflows

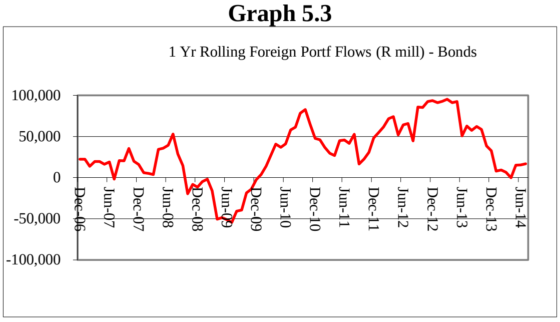
Graph 5.2 reflects a flow of capital out of South African equities on a rolling one year basis, with a net outflow of R 5.5 bn on a year-on-year basis at the end of July (outflow of R 6.2 bn to end June). Since the beginning of 2006, foreign net investment in equities amounts to R 186 bn (end June R 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 foreign portfolio inflows in respect of SA bonds of R 16.8 bn over the past 12 months to end of July (inflow of R 15.3 bn over the 12 months to end of June). Since the beginning of 2006, foreign net investment in bonds amounts to just over R 260 bn (to June just over R 216bn).

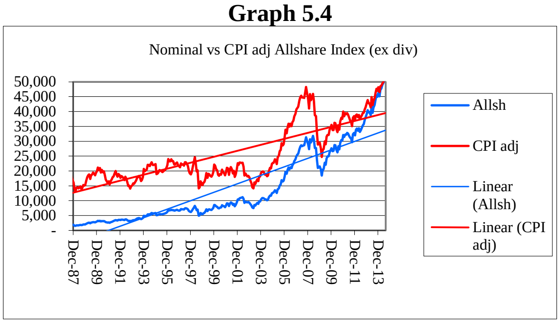
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was R 11.2 bn for the 12 months to end July 2014 (inflow of R 9.0 bn to end June 2014), compared to R 84.1 bn for the 12 months to end July 2013 (R 71.6 bn to end of June 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 446 bn (June R 402 bn).

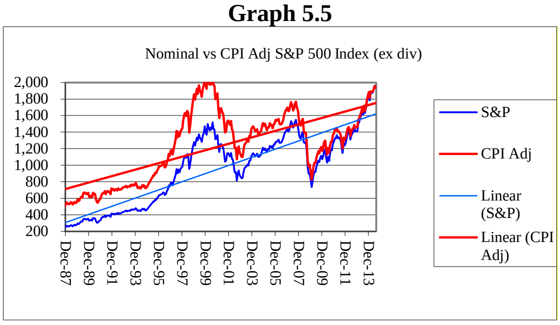
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal terms, adjusted for indigenous inflation, with trend lines for these. In nominal terms, the JSE grew by 12.5% per year since January 1987, and this excludes dividends of somewhere in the region of 2% to 4%. Namibian inflation over this period was 8.6% per year. This is equivalent to a growth in real terms of 3.6% p.a. over this period.

Graph 5.4



Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal terms, adjusted for indigenous inflation, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.4% per, over this period of 27 years. US inflation over this period was 2.8%. This is equivalent to a growth in real terms of 4.5% p.a. over this period.

Graph 5.5



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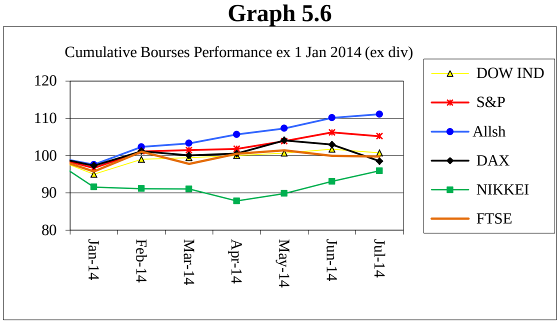
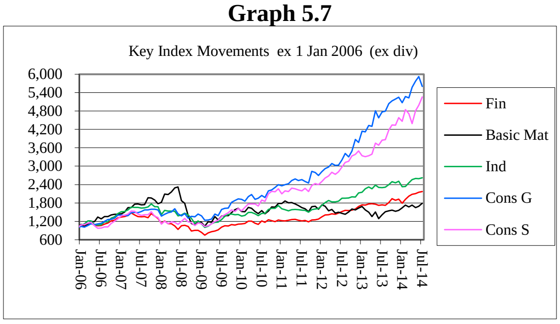
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Allshare and the S&P 500 as the top performing share indices.

Graph 5.6



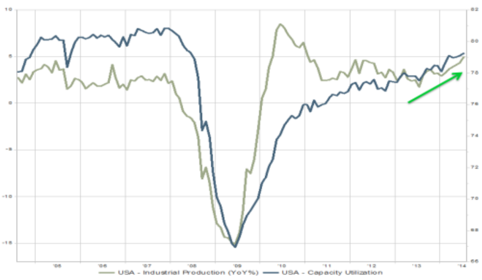
Graph 5.7 provides an overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced. From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals. Annualised returns for these indices since the beginning of 2006 were: Consumer Goods: 22.0%; Consumer Services: 21.1%; Industrials: 11.8%; Financials: 9.4% and Basic Materials: 7.0%.

Graph 5.7



6. **Conclusion**

The US economy appears to be out of the doldrums having had only two quarters of negative GDP growth since the beginning of 2011, year-on-year GPD recording 2.4% at the end of quarter 2 of 2014. The following graph in Efficient Select newsletter of 18 August, provides this interesting review of the change in US GDP since 2005:



The Fed's large scale asset purchase program has been reduced steadily from its high of US$ 90 bn per month, and will probably fade out by the end the end of the year or early 2015. The Chinese economy has decelerated from growing at the rate of 9.2% in the first quarter of 2012 to growing at only 7.5% at the end of the second quarter of 2014. Interestingly, not too long ago when the growth rate was still double digit, a growth rate of below 9% was labelled a 'hard landing'. China's leadership is in the process of restructuring the economy from an export driven economy to one driven by internal consumption. The Eurozone has just been showing some signs of timid recovery but this will not doubt be short-lived as the result of the sanctions that were imposed on Russia, an important growth market for Europe. Just to mention Germany as one country affected by the santions, it is exporting around € 35 billion p.a. to Russia which is equivalent to 1.4% of Germany's GDP. Over the first 5 months of the year, which probably still only reflects pro-active steps taken by German exporters in anticipation of sanctions due to be imposed, Germany's exports to Russia have declined by 15%. Extrapolating this over a full 12 month period, Germany's GDP could easily shrink by around 1% as the result of sanctions. The Japanese economy has hardly been showing any growth for a long time. Although it has returned a few encouraging economic indicators for the first few months of the year, economic growth and inflation having recently reached 4% the latest developments are turning negatively once again, so not much can be expected from Japan either for the next 12 months.

Developing economies such as South Africa are still disappointing. These countries depend on the export of commodities to a significant extent and China has been one of, if not the biggest export market for their commodities. The restructuring of the Chinese economy will no doubt impact negatively on China's demand for commodities and therefore on the South African and Namibian economies. Our economies are thus likely to grow sluggishly over the next year or two. South Africa is expected to grow at only 3% or less over the next 5 years, while the Namibian economy is expected to average around 4.5%. Inflation is expected to average around 6% both in SA and Namibia. Both SA and Namibia are expected to run a deficit on their trade balances for the next 3 years. Interest rates have recently been lifted marginally but the trend is evident, essentially forced by the weakness of the currency and the trend in interest rates overseas, particularly in the US.

There is now much talk in global financial media that the Fed is on a mission to move towards a more normalised interest rate environment meaning that there is a great likelihood of the Fed rate being raised as soon as towards the end of this year. We have already seen foreign investment capital flow into SA having dried up since the end of last year. The last key economic parameter, the Rand: US$ exchange rate has weakened steadily since the early part of 2011. In the light of a sluggish local economy, lower demand for local commodities from China and a resulting negative trade balance, an absence of foreign portfolio flows and the upward trend in interest rates, the Rand will remain under pressure for the next couple of years and so will be the highly leveraged local consumer.

In this economic environment, we will see negative short-term interest rates, low to negative returns on longer dated stocks and muted growth in equities that are dependent on a growing economy and low interest rates. We would therefore not expect returns on equities to exceed 4% in real terms over the next 3 years. On the positive side, our local economies are either near the bottom of the economic cycle or have already passed the bottom and are turning up gradually with a low downward risk and more upward potential.

Under these circumstances, we consider equities the preferred asset class and would maximise exposure to equities for the foreseeable future but on a very selective basis in terms of the countries, and in terms of the type of company to invest in. Since the local equity market on average is expensive, international diversification into markets with superior growth prospects should be maximised. These are countries that were worst hit by the financial crisis and have not recovered yet as well as emerging economies. Stock picking skills are critical to investment in equities. A 'safe play' of investing in companies with superior free cash flows, high dividend yields and low p:e's in industries that focus on basic consumer needs and perhaps in new technologies is what we would be looking for.

7. Important notice and disclaimer

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