Volume 10, No. 08,
August 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 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

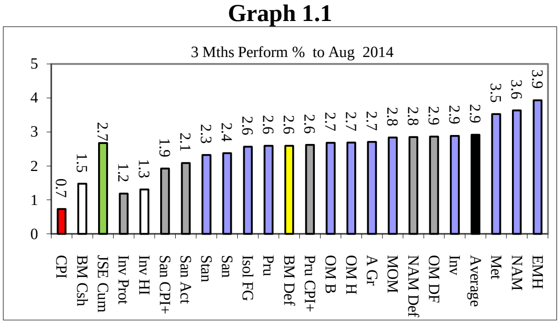
In **August** the **average prudential balanced portfolio** returned 0.29% (July: 0.84%). Top performer is Namibia Asset Management (0.80%); while Metropolitan (-0.15%) takes the bottom spot. For the 3 month period EMH Prescient is top performer outperforming the 'average' by roughly 1.0%. On the other end of the scale Stanlib underperformed the 'average' by 0.60%.

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.

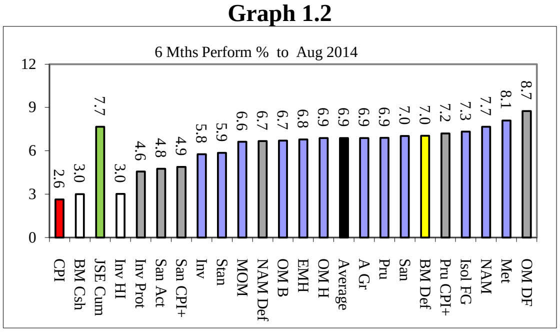
Below is the legend to the abbreviations reflected on the graphs:

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)
EMH Prescient Balanced Absolute	EMH (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)

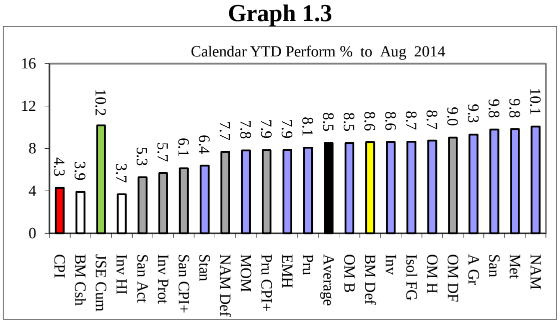
Graph 1.1



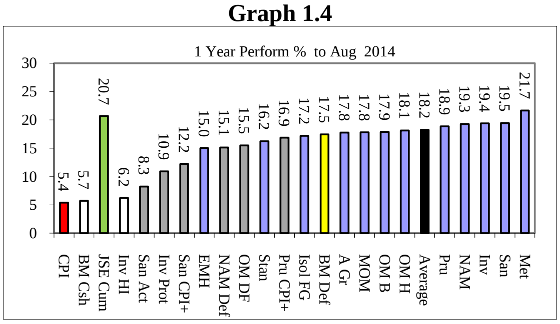
Graph 1.2



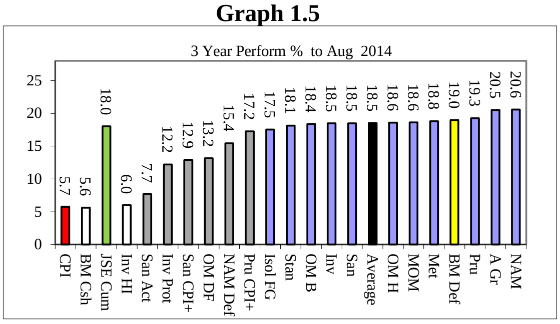
Graph 1.3



Graph 1.4



Graph 1.5



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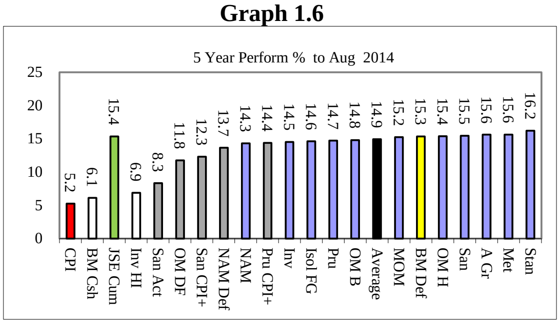
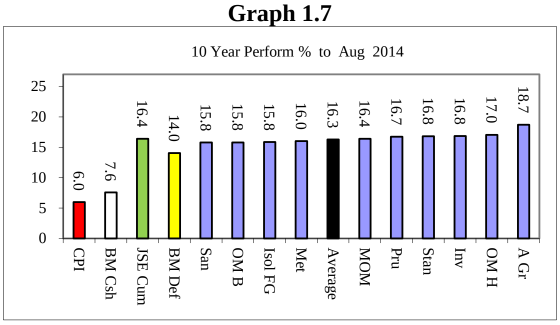
Graph 1.6

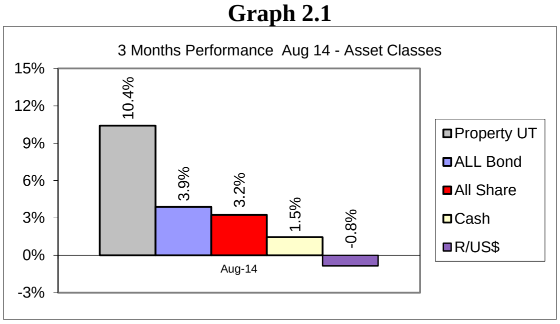


Graph 1.7

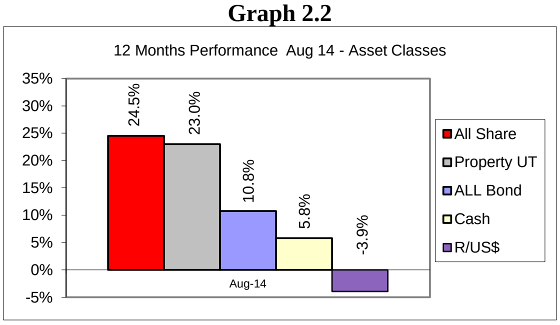


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

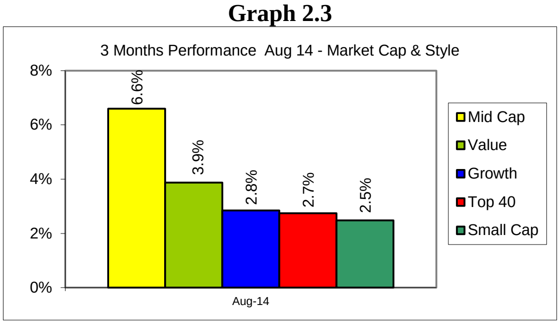
Graph 2.1



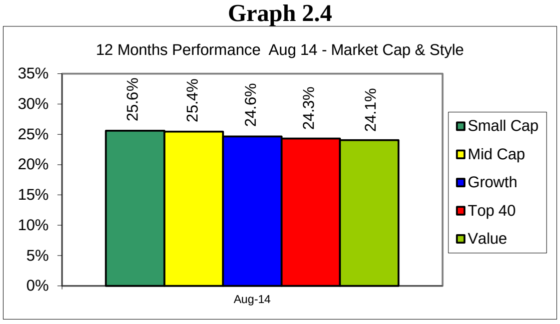
Graph 2.2



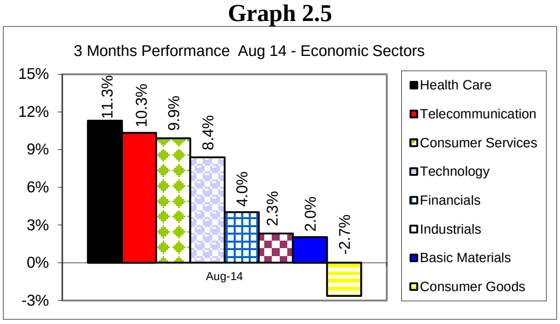
Graph 2.3



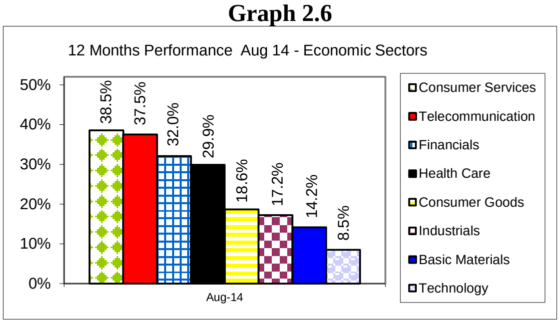
Graph 2.4



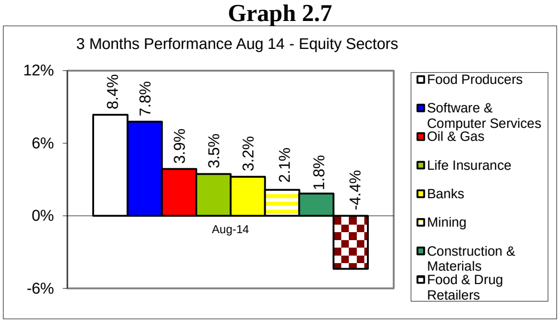
Graph 2.5



Graph 2.6



Graph 2.7



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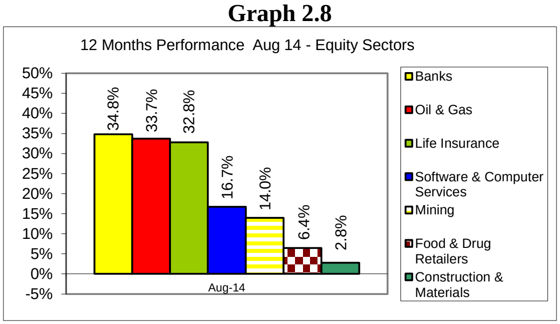
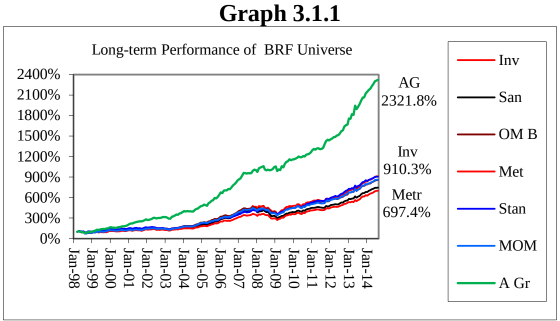
Graph 2.8



3. Portfolio Performance Analysis

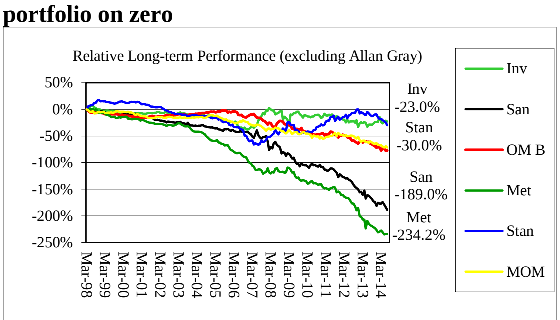
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

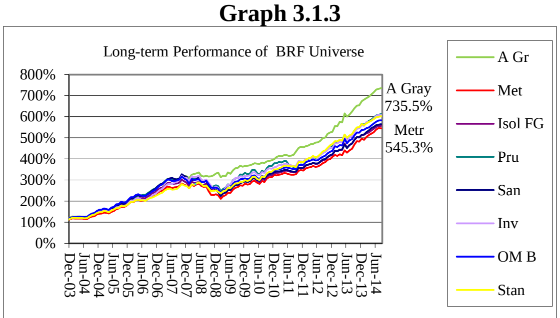


Graph 3.1.2

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

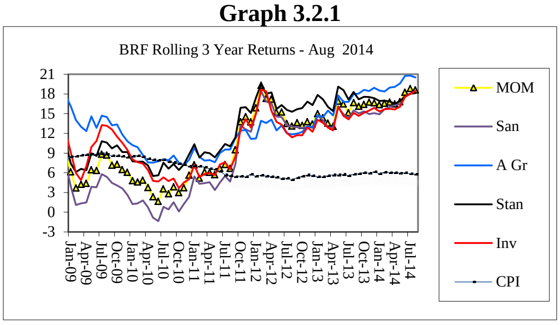


Graph 3.1.3

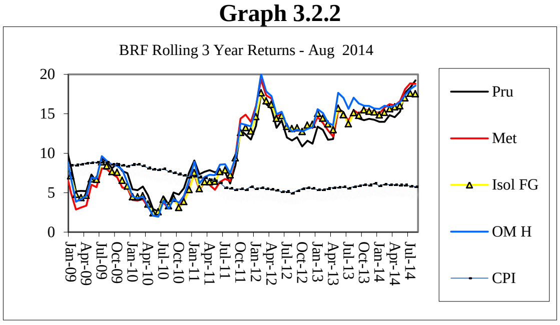


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

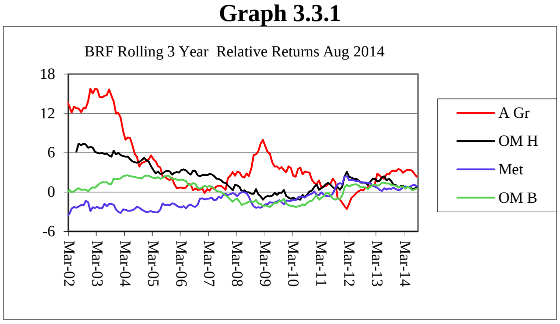


Graph 3.2.2

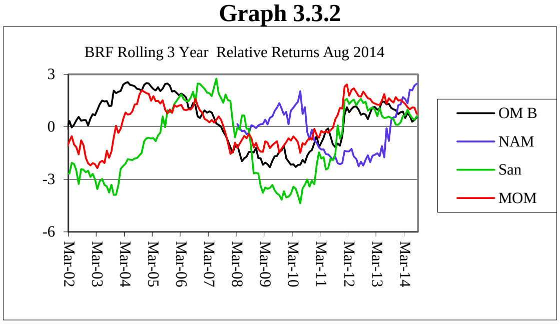


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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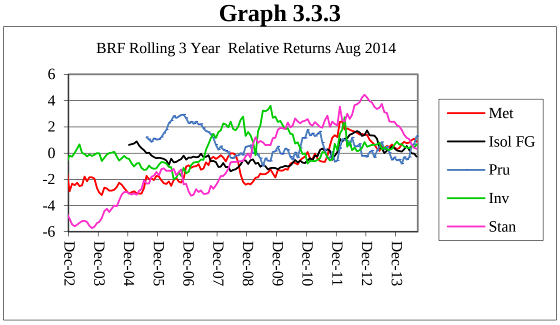
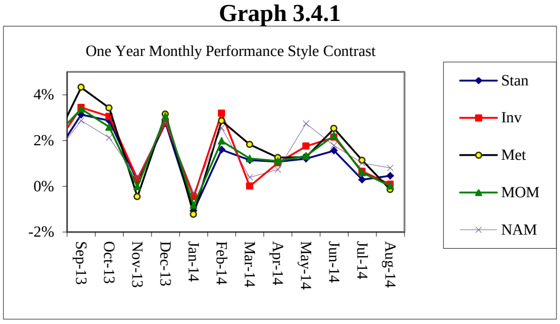
Graph 3.3.3

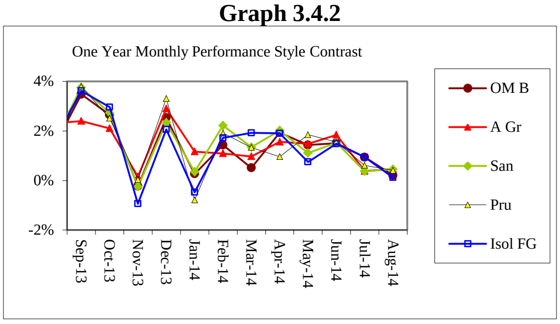


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

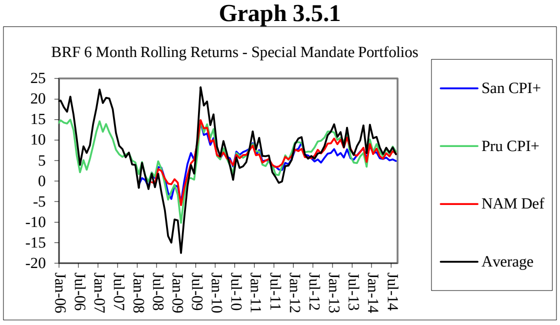


Graph 3.4.2

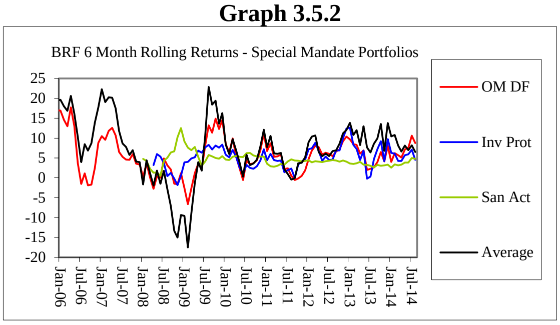


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

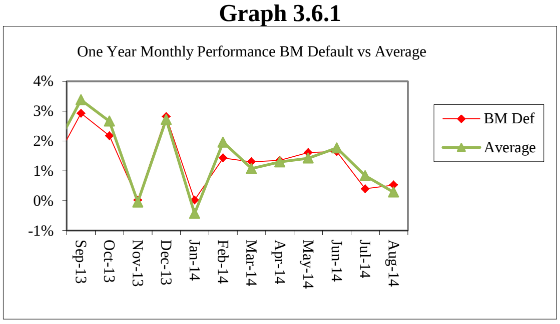


Graph 3.5.2

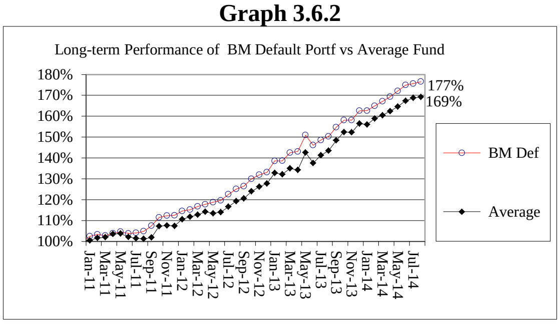


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

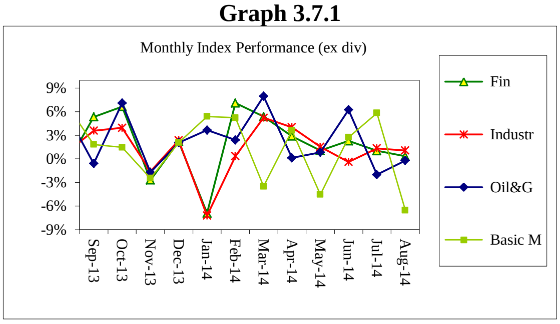


Graph 3.6.2



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

Graph 3.7.1



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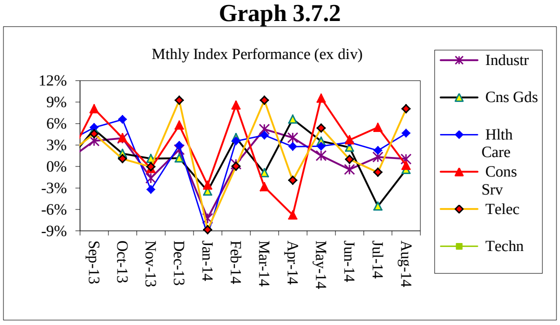
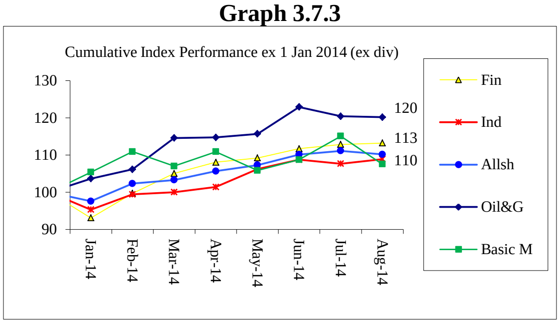
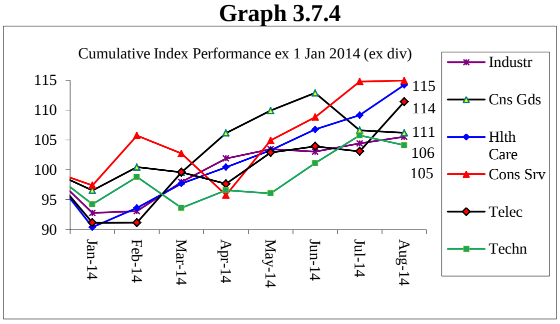
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 14.9% p.a. in nominal terms, or 9.7% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 15.3% p.a. in nominal terms, or 10.1% 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 (47.8% vs. 59.6% of the average prudential balanced portfolio, as at the end of June 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 76.6% compared to 68.5% for the average prudential balanced portfolio over this 44 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 September 2011 to August 2014:

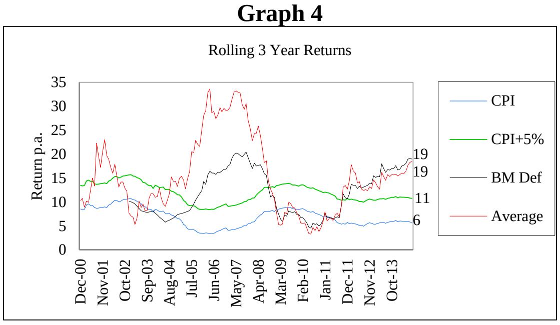
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	10.3%	6.1%
Best annual performance	6.1%	27.1 %	24.4 %
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	5.6%	17.7%	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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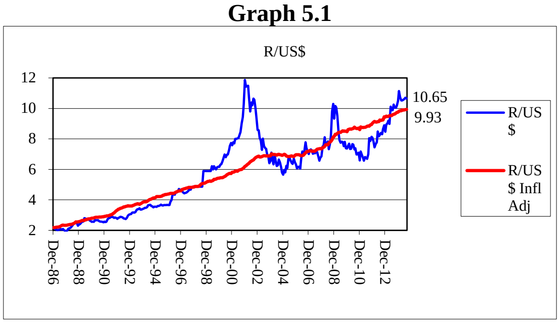
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 19.0%, the average on 18.5% vs CPI plus 5% currently on 10.7%.

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 9.93 to the US Dollar while it actually stood at 10.65 at the end of August. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

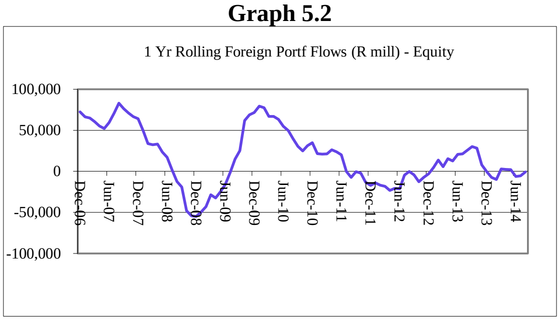
Graph 5.1



Rand strengthens with foreign capital inflows

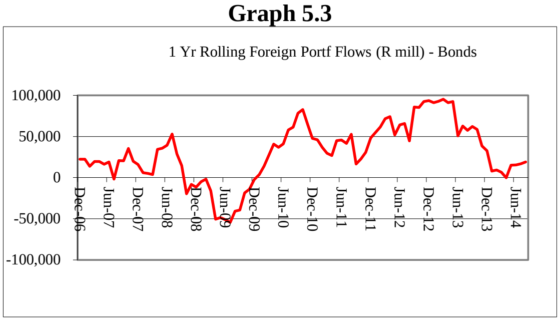
Graph 5.2 reflects a flow of capital out of South African equities on a rolling one year basis, with a net outflow of R 0.8 bn on a year-on-year basis at the end of August (outflow of R 5.5 bn to end July). Since the beginning of 2006, foreign net investment in equities amounts to R 195 bn (end July R 186 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 19.0bn over the past 12 months to end of August(inflow of R 16.8 bn over the 12 months to end of July). Since the beginning of 2006, foreign net investment in bonds amounts to R 259.7 bn (to July just over R 260 bn).

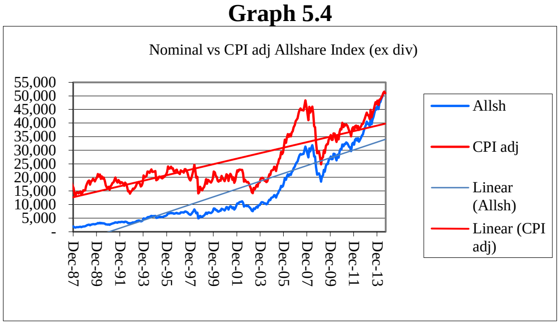
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was R 18.3 bn for the 12 months to end August 2014 (inflow of R 11.2 bn to end July 2014), compared to R 83.1 bn for the 12 months to end August 2013 (R 84.1 bn to end of July 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 455 bn (July R 446 bn).

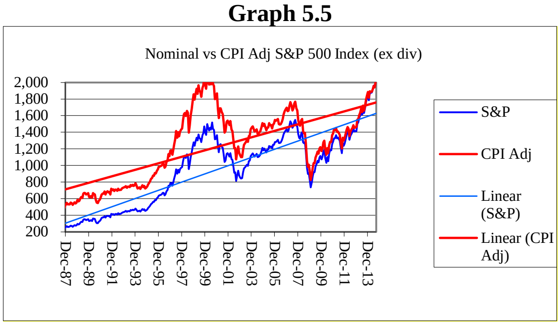
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal terms, adjusted for indigenous inflation, with trend lines for these. In nominal terms, the JSE grew by 12.4% per year since January 1987, and this excludes dividends of somewhere in the region of 2% to 4%. Namibian inflation over this period was 8.6% per year. This is equivalent to a growth in real terms of 3.8% 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 4.6% p.a. over this period.

Graph 5.5



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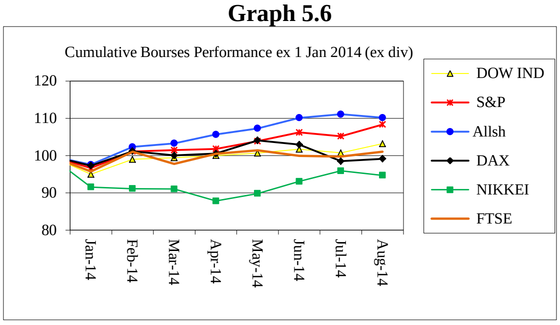
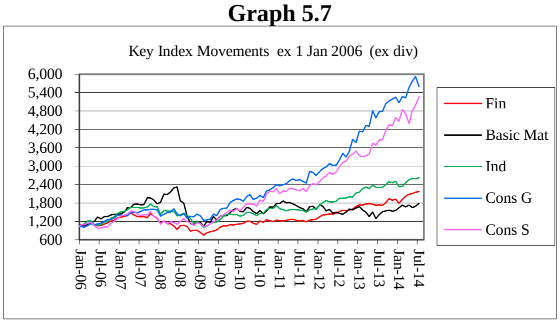
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Allshare and the S&P 500 as the top performing share indices.

Graph 5.6



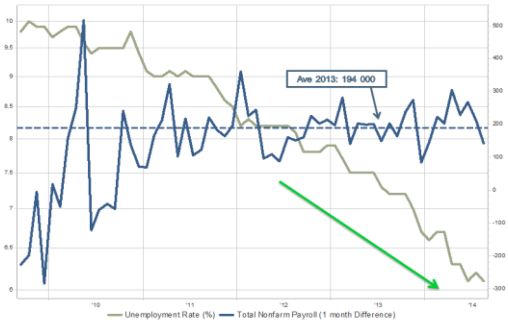
Graph 5.7 provides an overview of relative movement of the key equity sectors on the FTSE/JSE since December 2005 when these indices were first introduced. From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals. Annualised returns for these indices since the beginning of 2006 were: Consumer Goods: 21.7%; Consumer Services: 20.9%; Industrials: 11.8%; Financials: 9.3% and Basic Materials: 6.1%.

Graph 5.7



6. **Conclusion**

In last month's newsletter we provided a graph depicting the recovery of the US industrial production to levels last seen 4 years before the financial crisis struck. Year-on-year growth now stands at around 5%, up from its trough of minus 15% in the middle of 2009. Capacity utilization improvement correlates very closely with industrial production, having improved to 79%, up from 67% in the middle of 2009. The graph below and in this link is further evidence of the improvement of the US economy. It shows that unemployment has decline from around 10% at its peak at the end of 2009 to 6% while non-farm payroll improved from losing 300,000 jobs in a single month to currently adding around 200,000 jobs monthly.



Financial media no longer talk about monetary stimulus but rather speculate about when the Fed will start raising interest rates, after warnings having been uttered by the Fed. 10 Year US bond yields have turned up recently in anticipation of such an increase. Is this the reason why bond purchases by foreigners on the FTSE/JSE have declined from net purchases of R 21.8 billion in July to net sales of R 237 million in August? Most likely so.

If this trend continues, our local currencies will remain under pressure while local interest rates will also be under upward pressure. The 0.25% increase in SARB's repo rate in the middle of July that followed the first rise for a long time of 0.5% at the end of January has not done much to support our currencies. Further local interest rate increases are inevitable once the Fed announces its first increase.

The SA current account deficit running at 6.2% for the second quarter of 2014, and having been in deficit for the past 10 years as well as a steep decline in the Chinese GDP from a peak of over 9% in 2007 to 7.5% currently, add to the woes of our local economies.

Both consumers and our governments (SA and Namibia) have indulged in debt over the years since the financial crisis - witness all the government sponsored construction happening across Namibia. SA bolstered its total external debt from 30.5% of GDP in 2010 to 48.2% of GDP in 2014, an increase of 60%. Namibia has been a lot more modest in terms of foreign borrowing, increasing its external debt from 21.7% of GDP in 2014 to only 24.1% of GDP in 2014. However total Namibian government debt has increased from N$ 25 billion in the 2012 fiscal year to around N$ 38 billion in fiscal year 2015, an increase of 50%. At this point with government debt and government revenue running on par, every 1% increase in the interest rate will consume 1% of government revenue and will add 0.3% of GDP to a current budget deficit 6.3% of GDP.

Both in SA and Namibia, government will soon have to start raising taxes in an effort to reduce its fiscal deficit and the rate of growth in its debt. This together with the prospect of further interest rate increases does not bode well for the local consumer.

Benchmark Retirement Fund

Volume 10, No. 08,
August 2014

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 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.

The turning of tides undoubtedly will impact on local and global investment markets. Investors need to be wary as it will not be business as usual as we move into the future! We are now facing headwinds which we will have to weather on our own devices!

The tailwinds have turned into headwinds for our local economies. For the investor this means, in the first instance, to increase global diversification to benefit from the upturn that is starting to manifest in some economies such as the US economy. In these markets, consumer goods and consumer services should benefit most from an improvement in the economy. Locally it means that consumer driven returns are likely to lag and such equities should be underweight, i.e. consumer goods, consumer services. Commodities are likely to linger for longer and commodity driven equities should be held at neutral weighting to under-weight. Rand hedge and exporters should be up-weighted to overweight. Property should be retained at neutral weighting while fixed interest investments should be underweight.

Having said this, however, the investor must be cognisant of the fact that equity values globally have been inflated by the low interest rate environment where money is borrowed cheaply and then invested in any asset that has any prospect of out-performing the cost of borrowing, primarily in equities. Equities are generally expensive. This means that one would have to be very selective about what equities to invest in, to avoid paying too much for the value offered.

An interesting article in Sanlam Personal Portfolios Funds on Friday "the difficulty of investing in an environment where almost everything looks expensive". It also looks at other 'less conventional' assets. Renee Prinsloo suggests the following three strategies for "…earning decent returns from this point forward":

- Searching for relative value;
- Attempt to uncover unique opportunities;
- Diversify your exposure, and
- Be more cautiously positioned than one would typically be, on average, over the long-term."

You can access this article via Benchtest 08.2014 on our website.

7. Important notice and disclaimer

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