Volume 10, No. 10,
October 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 OCTOBER 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

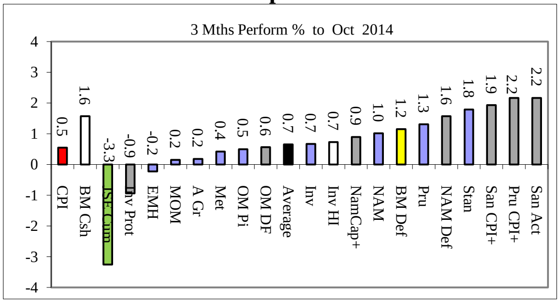
In **October** the **average prudential balanced portfolio** returned 0.12% (Sep: 0.25%). Top performer is Prudential (0.91%); while Allan Gray (-1.50%) takes the bottom spot. For the 3 month period Stanlib takes top spot, outperforming the ‘average’ by roughly 1.1%. On the other end of the scale EMH Prescient underperformed the ‘average’ by 0.9%.

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.

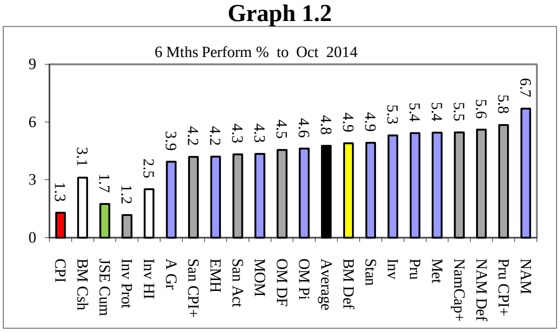
Below is the legend to the abbreviations reflected on the graphs:

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 Capital Plus	NamCap+ (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)
Prudential Managed	Pru (blue)
Metropolitan Managed	Met (blue)
NAM Prudential Balanced	NAM (blue)
Old Mutual Pinnacle Profile Growth	OM Pi (blue)
Momentum Managed	MOM (blue)
Stanlib Managed	Stan (blue)

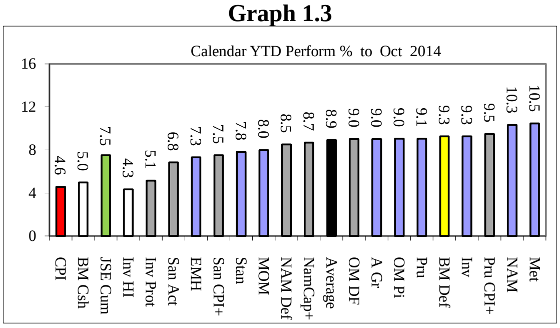
Graph 1.1



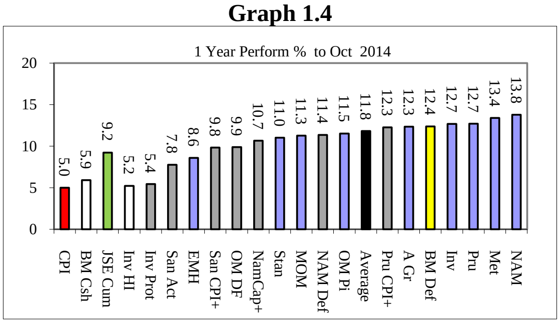
Graph 1.2



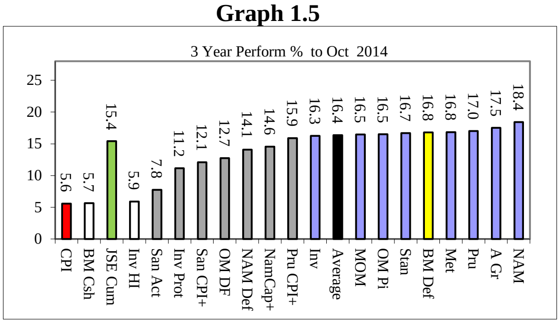
Graph 1.3



Graph 1.4



Graph 1.5



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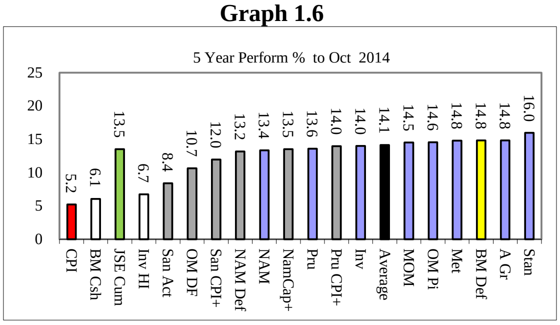
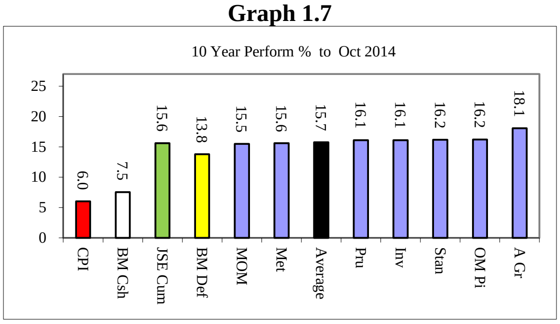
Graph 1.6

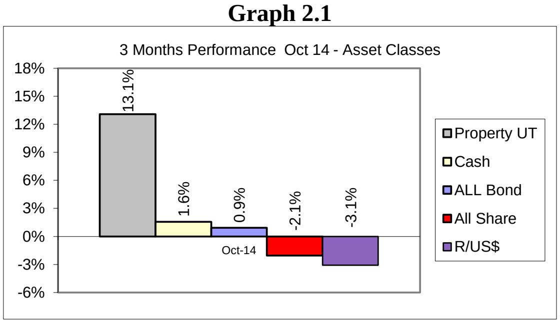


Graph 1.7

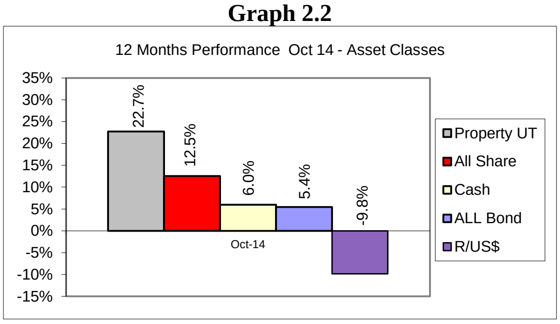


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

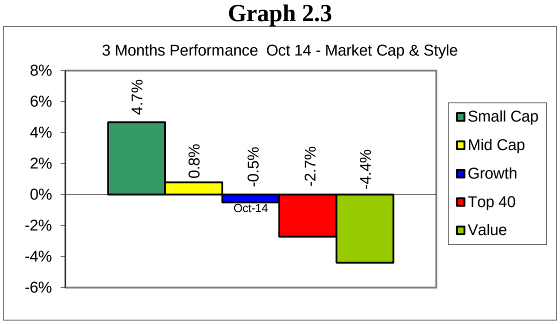
Graph 2.1



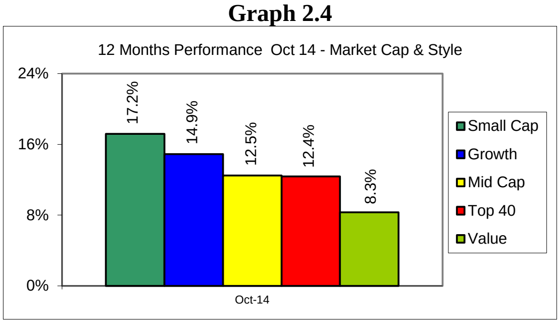
Graph 2.2



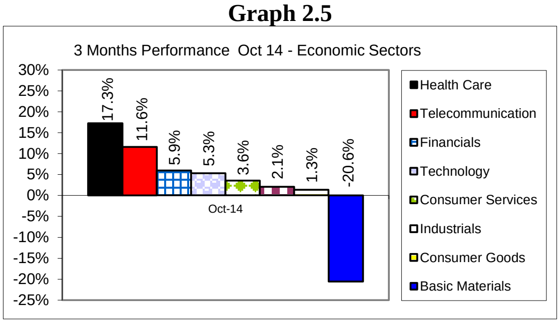
Graph 2.3



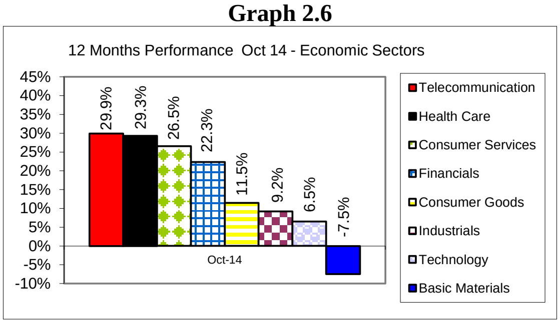
Graph 2.4



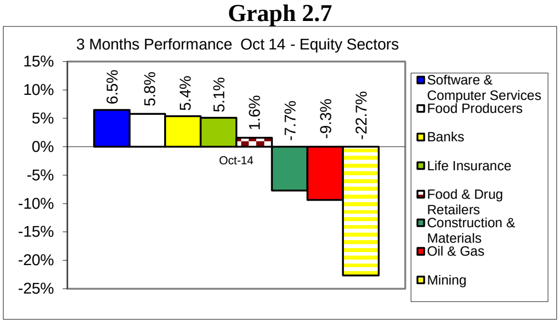
Graph 2.5



Graph 2.6



Graph 2.7



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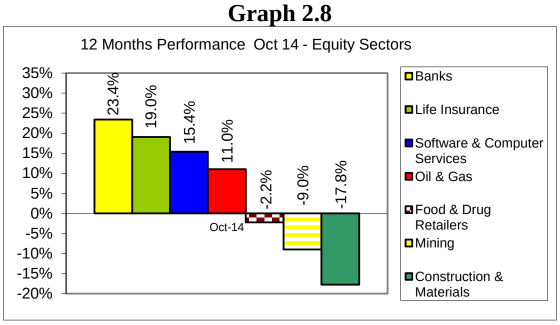
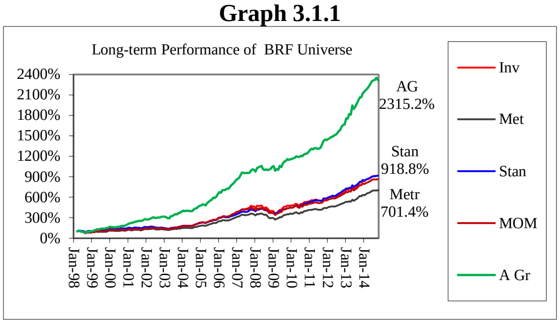
Graph 2.8



3. Portfolio Performance Analysis

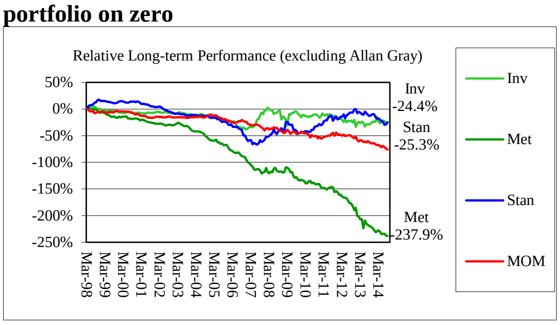
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

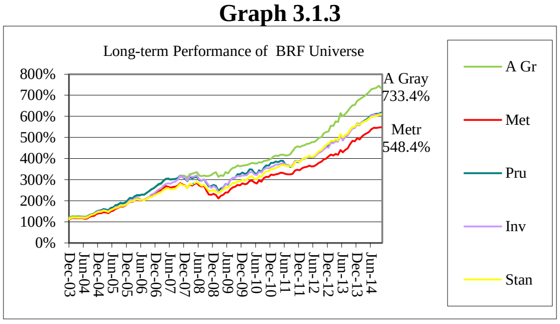


Graph 3.1.2

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

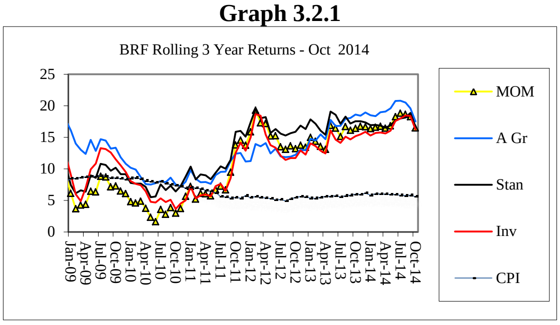


Graph 3.1.3

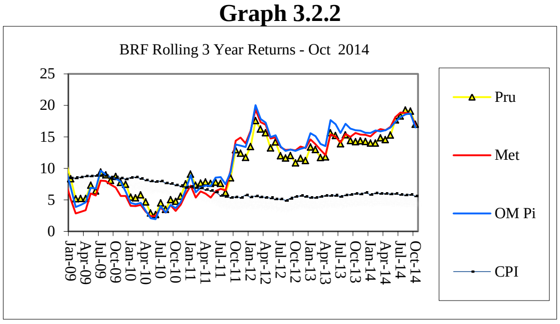


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

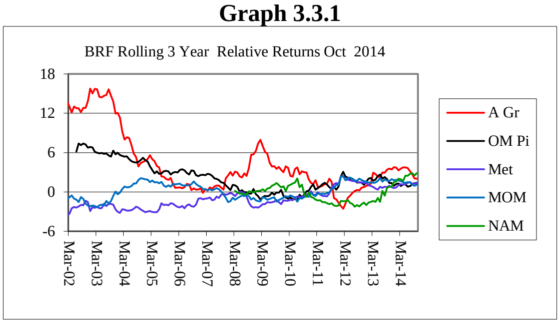


Graph 3.2.2

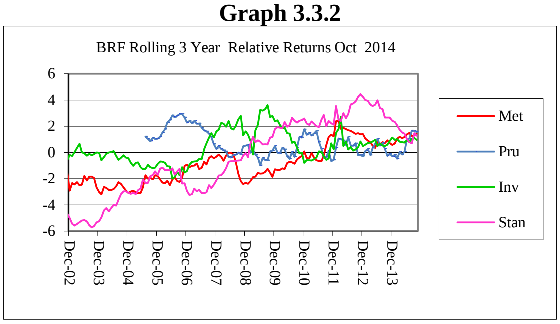


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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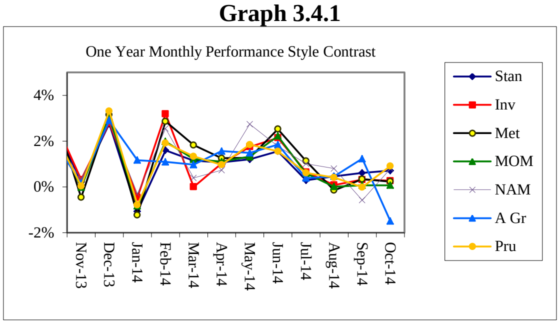
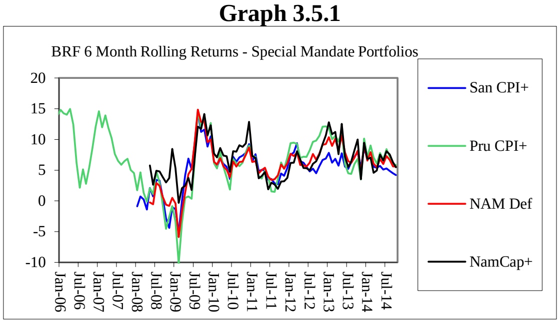
3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

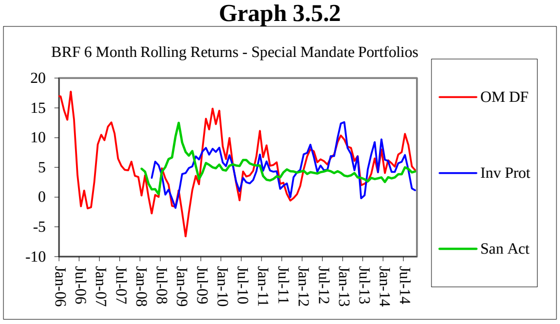


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

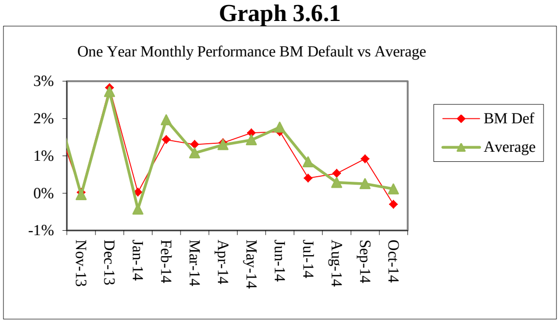


Graph 3.5.2

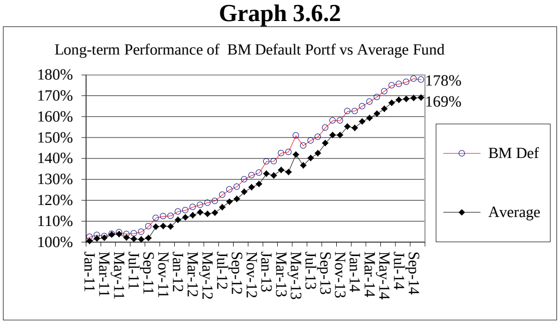


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

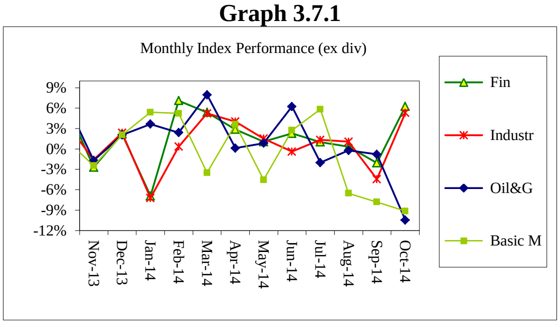


Graph 3.6.2

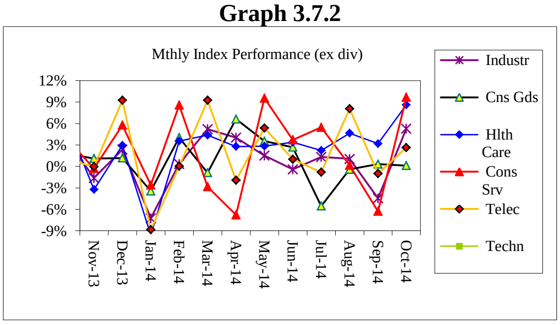


3.7 One year monthly performance of key indices (excluding dividends)

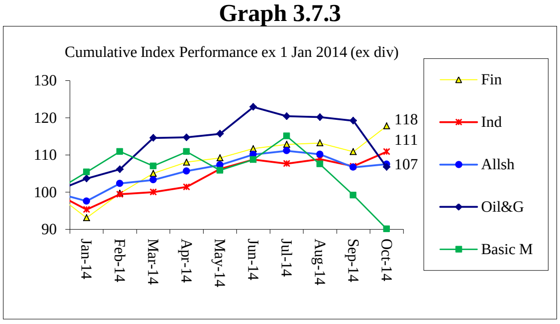
Graph 3.7.1



Graph 3.7.2



Graph 3.7.3



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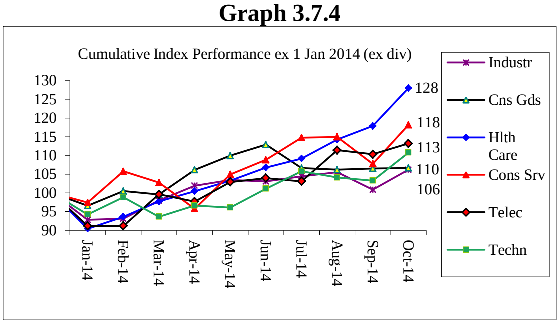
Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 14.1% p.a. in nominal terms, or 8.9% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 14.8% p.a. in nominal terms, or 9.6% 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 (45.4% vs. 71.7% of the average prudential balanced portfolio, as at the end of September 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 77.7% compared to 69.1% for the average prudential balanced portfolio over this 46 month period.

Relative to the default portfolio, the performance of the prudential balanced portfolios should be more volatile due to a significantly higher equity exposure and its performance should be much closer correlated to that of the overall equity market. The default portfolio should produce a significantly more volatile performance than the money market portfolio. The table below presents one year performance statistics over the 3 years November 2011 to October 2014:

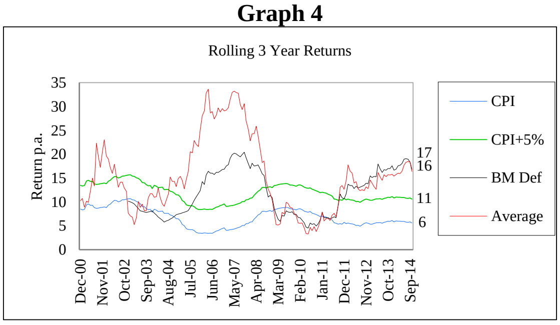
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	11.5%	7.4%
Best annual performance	6.0%	27.1 %	25.0 %
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%	17.9%	16.8%

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



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 16.8%, the average on 16.4% vs CPI plus 5% currently on 10.6%.

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 9.96 to the US Dollar while it actually stood at 11.03 at the end of October. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

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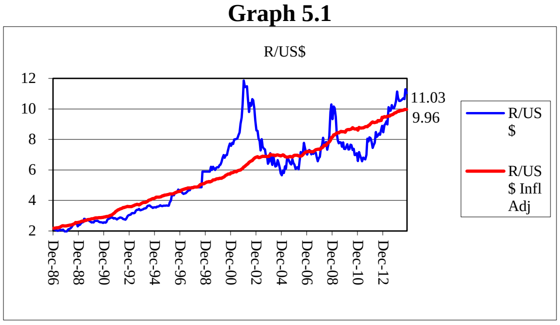
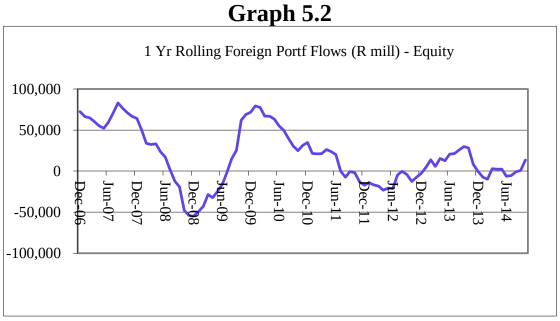
Graph 5.1



Rand strengthens with foreign capital inflows

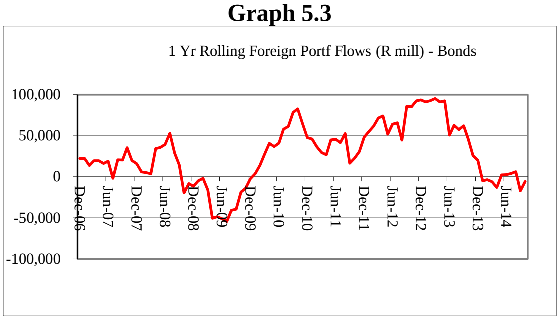
Graph 5.2 reflects a flow of capital into South African equities on a rolling one year basis, with a net inflow of R 13.4 bn on a year-on-year basis at the end of October (inflow of R 0.6 bn to end September). Since the beginning of 2006, foreign net investment in equities amounts to R 201 bn (end September R 196 bn). This represents roughly 1.7% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis reflects foreign portfolio outflows in respect of SA bonds of R 5.7bn over the past 12 months to end of October (outflow of R 17 bn over the 12 months to end of September). Since the beginning of 2006, foreign net investment in bonds amounts to R 244 bn (to September just over R 251.5 bn).

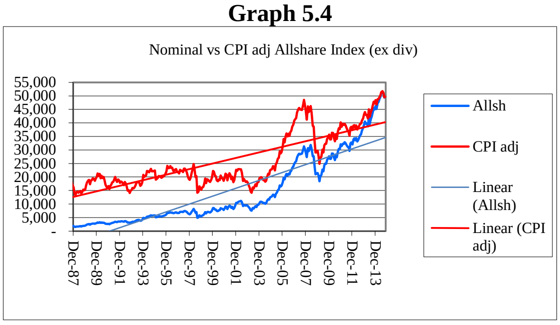
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was R 7.7 bn for the 12 months to end October 2014 (outflow of R 16.6 bn to end September 2014), compared to R 74 bn for the 12 months to end October 2013 (R 92 bn to end of September 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 444 bn (September R 448 bn).

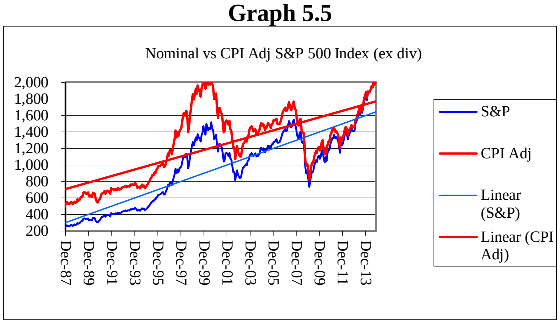
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal terms, adjusted for local inflation, with trend lines for these. In nominal terms, the JSE grew by 12.2% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period was 8.6% per year. This is equivalent to a growth in real terms of 3.6% p.a. over this period, excluding dividends, of around 7% including dividends.

Graph 5.4



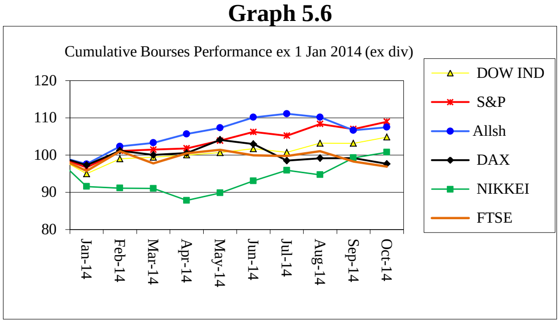
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal terms, adjusted for indigenous inflation, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.4% per, over this period of 27 years. US inflation over this period was 2.8%. This is equivalent to a growth in real terms of 4.6% p.a. over this period, excluding dividends.

Graph 5.5



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

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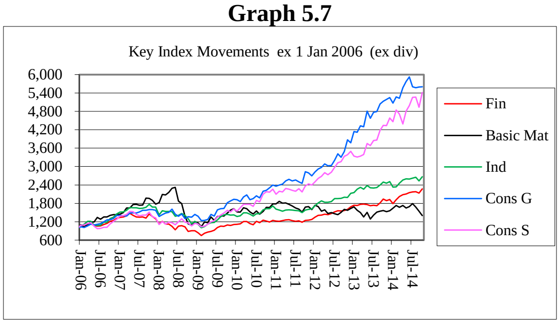
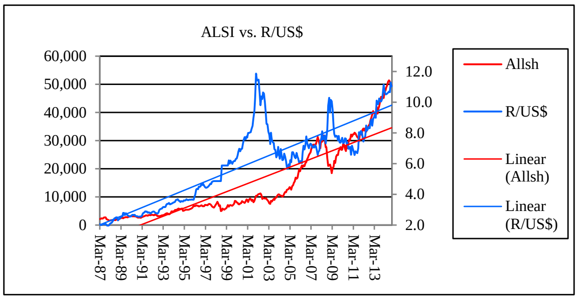
From this the investor should be able to deduce which sectors offer greater value and which one's offer less value on the basis of fundamentals. Annualised returns for these indices since the beginning of 2006 were: Consumer Goods: 21.5%; Consumer Services: 21.1%; Industrials: 11.7%; Financials: 9.7% and Basic Materials: 3.9%.

Graph 5.7



6. Conclusion

Our graph of the day below depicts the R: US$ exchange rate as the blue line, the scale shown on the right hand of the graph, overlaid by the SA Allshare index as red line, its scale shown on the left side of the graph. This graph shows a few interesting trends. Firstly it shows a close correlation between a weakening Rand and a growing Allshare index.

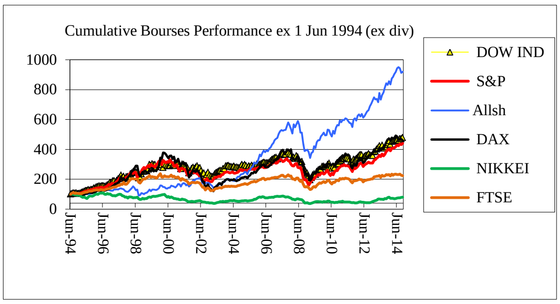


The trend lines overlaid on the two lines run virtually parallel. This means in broad terms the Rand has been weakening virtually at the same rate as the rate of growth of the SA Allshare index, over the period of over 27 years. A foreign investor on the trendline would thus have had no return on his investment in the SA Allshare index other than dividends (somewhere between 2% and 4%). Bringing inflation into this picture, from a foreign investor perspective, his return over this 27 year period would have been very close to zero. Not exactly a convincing investment case. Of course, right now a foreigner who invested in March 1987 would have had the index return him 6% per annum in US$, had he sold his investment in October 2014, and this excludes dividends. Based on the trendlines, the Rand is significantly undervalued while the Allshare index is significantly over valued right now, however the investor would currently receive more US$ for his investment in the SA Allshare index then he would if both indices were to return to their trendline. For both foreign and local investors this indicates that it should be a good time to exchange an investment in the Allshare index with an offshore investment.

Another interesting trend is that a rapid panic driven change in the value of the Rand against the US$ seems to be mirrored by a rapid contraction in the Allshare index. For the foreign investor this is a double whammy, losing on both sides of the equation. It is likely that these rapid swings are largely the result of foreign investor panic. It is intersting though that this has such a significant impact on the Allshare index. Quite clearly this is evidence that the investor should not act when markets are driven by panic. Markets will corrrect, and they will typically correct as rapidly in the opposite direction.

Market indicators have not changed since last month's newsletter. Easy money is still supporting and driving equities across the world and has pushed equity indices way past their trendlines or reasonable levels. At the same time the weakness of the Rand appears to be overdone and it may be expect to correct over the near to medium term.

The below graphs gives an indication of the position of the SA Allshare index relative to that of other major foreign bourses, rebasing the bourses on 100 points as at June 1994. The SA Allshare index has clearly outperformed these foreign bourses by leaps and bounds. The question is, can the SA Allshare index maintain this position? This is very questionable but certainly there is a significant risk of a correction.



Having expressed some caution on the downside risk of the SA Allshare index on the basis of its relative outperformance of some of the major international bourses, its inflation adjusted trendline would represent a growth in the index of 2.5% over a period of 27+ years since January 1987, while its actual inflation adjusted growth has been 3.4% excluding dividends, or just under 7% including dividends. Going by much longer term performance history, the performance over the past 27+ years is actually on the lower side and by itself should not make an investor overly nervous. As pointed out above, any rapid decline of the index should be followed by a rapid recovery, but this requires the investor not to panic and to exercise a little bit of patience.

Based on this background we are still of the view that local investors should diversify their investments by lowering their local equity exposure in favour of offshore equity exposure taking this to the maximum legal limit.

Locally we expect the consumer to suffer as interest rates will continue to drift upwards. From a macro economic perspective the weakening Rand should advantage Rand hedge shares, exporters and manufacturers locally. An investment in depressed foreign economies and bourses should be biased towards the consumer while any investment in stocks on bourses already at high levels should focus on finding value rather than on any particular sector. These expectations would shape our local and foreign asset and sector allocation views.

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.