Volume 10, No. 11,
November 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 NOVEMBER 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

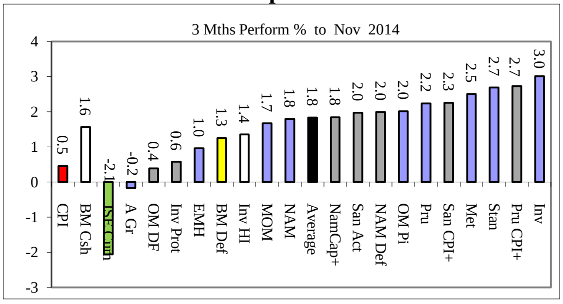
In **November** the **average prudential balanced portfolio** returned 1.46% (Oct: 0.12%). Top performer is Investec (2.41%); while Allan Gray (0.11%) takes the bottom spot. For the 3 month period Investec takes top spot, outperforming the 'average' by roughly 1.2%. On the other end of the scale Allan Gray underperformed the 'average' by 2.0%.

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.

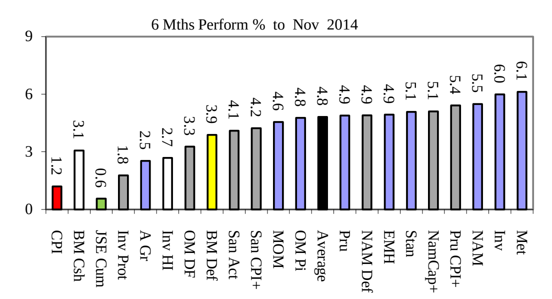
Below is the legend to the abbreviations reflected on the graphs:

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)

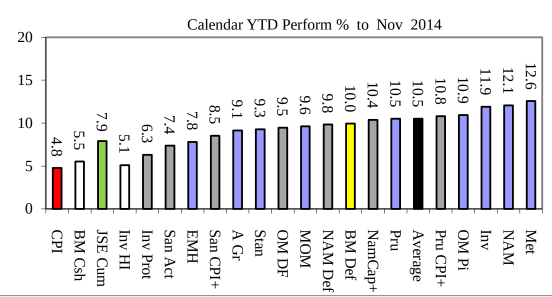
Graph 1.1



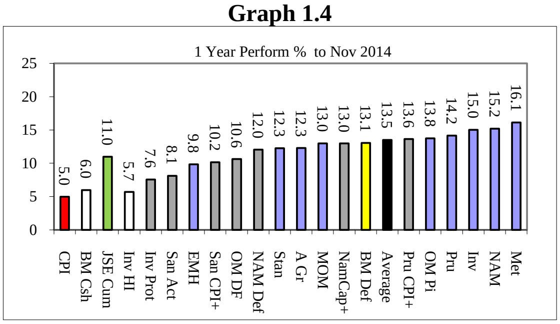
Graph 1.2



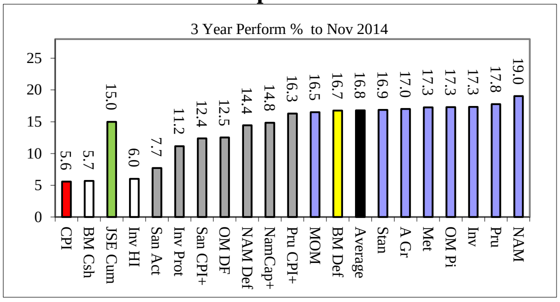
Graph 1.3



Graph 1.4



Graph 1.5



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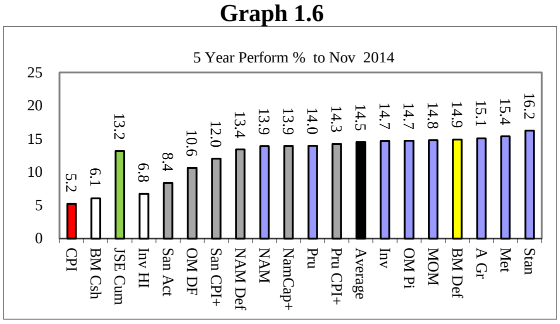
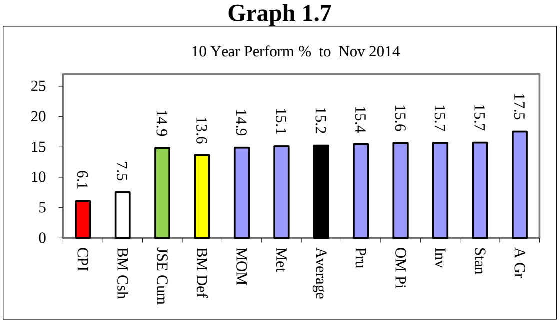
Graph 1.6

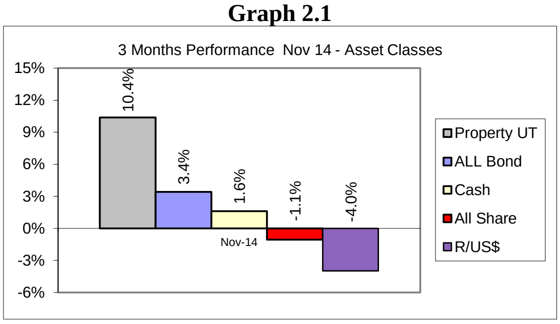


Graph 1.7

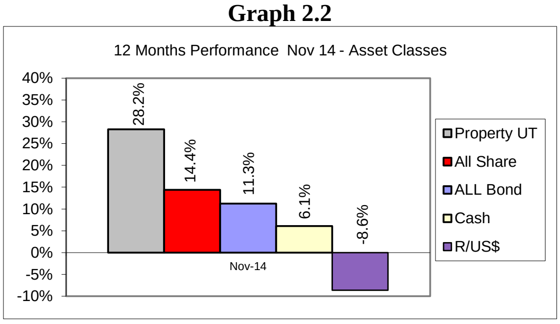


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

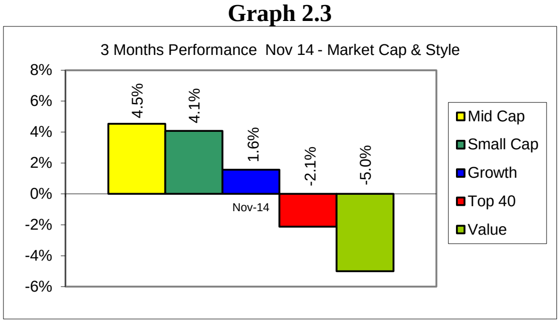
Graph 2.1



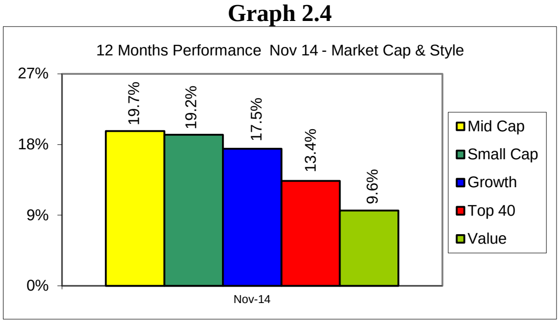
Graph 2.2



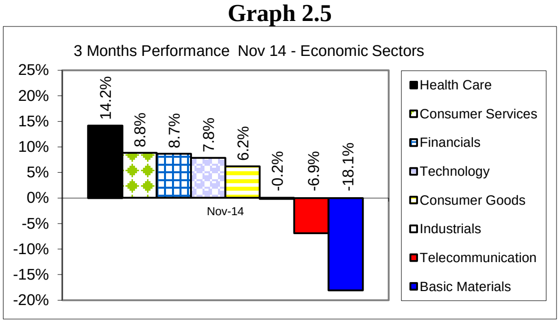
Graph 2.3



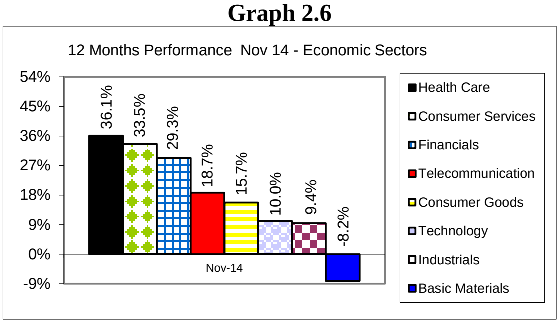
Graph 2.4



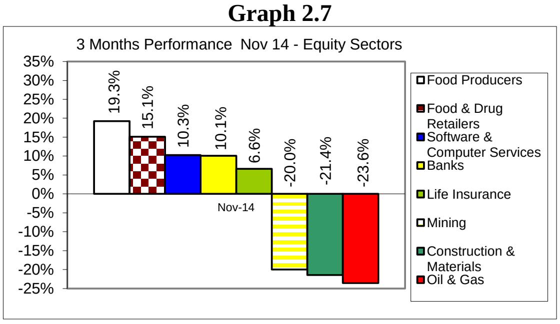
Graph 2.5



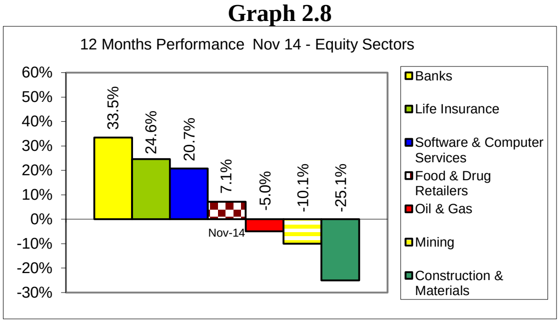
Graph 2.6



Graph 2.7



Graph 2.8



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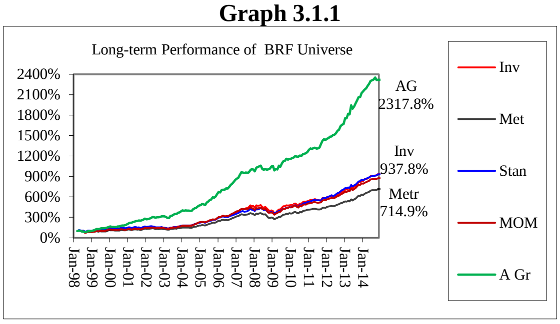
3. Portfolio Performance Analysis

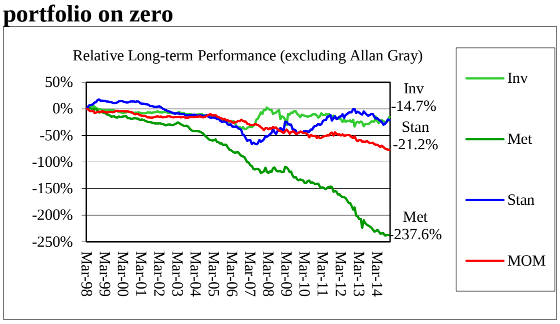
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

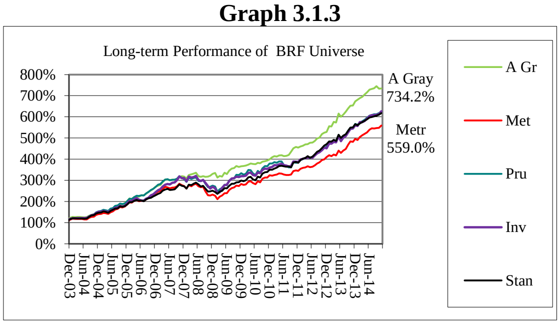


Graph 3.1.2

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

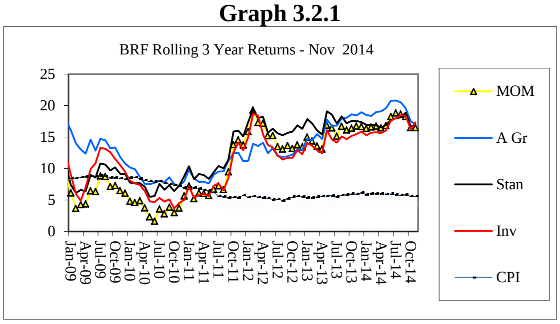


Graph 3.1.3

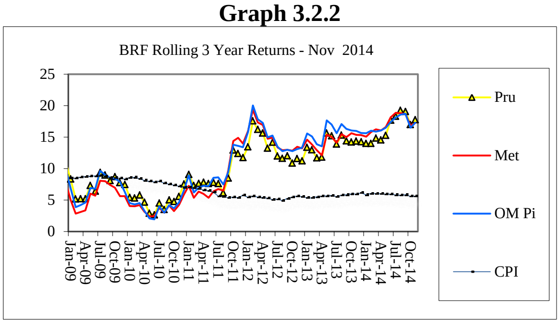


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

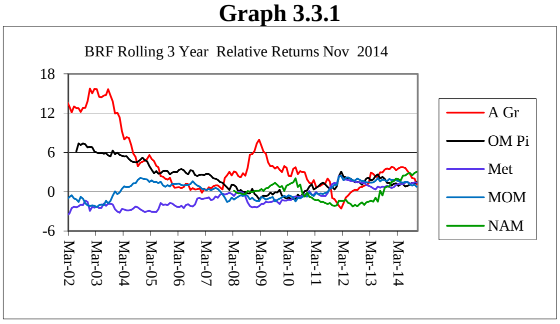


Graph 3.2.2

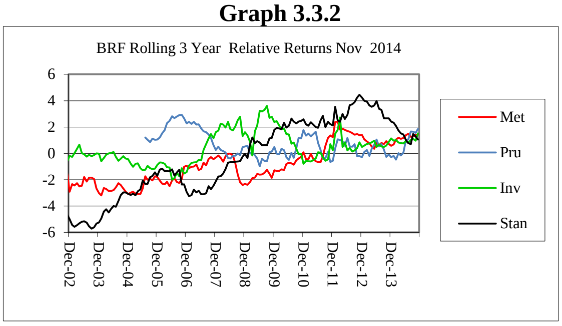


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

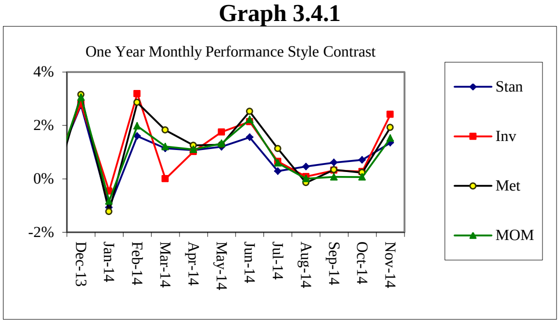


Graph 3.3.2



3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1



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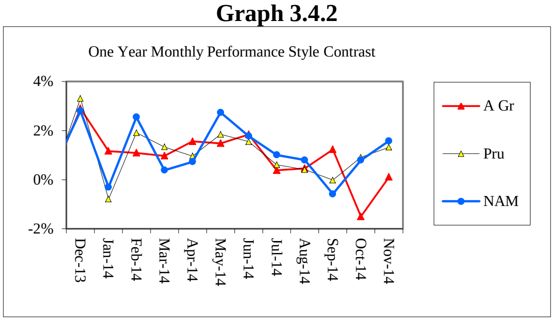
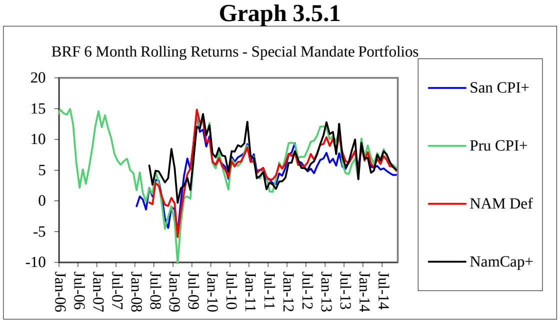
Graph 3.4.2

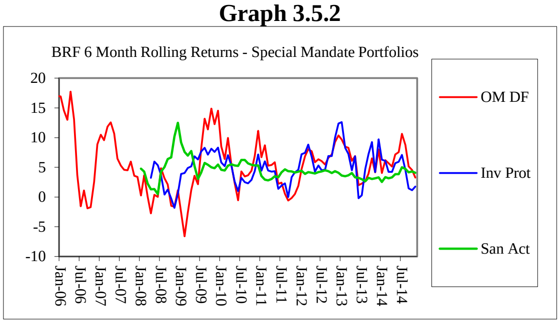


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

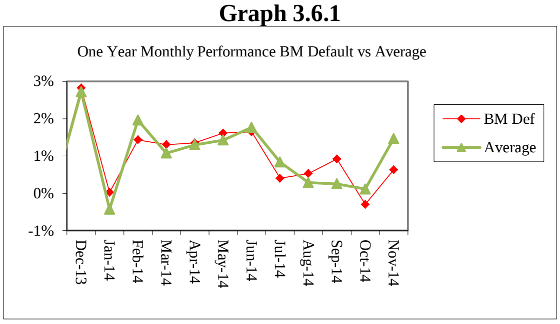


Graph 3.5.2

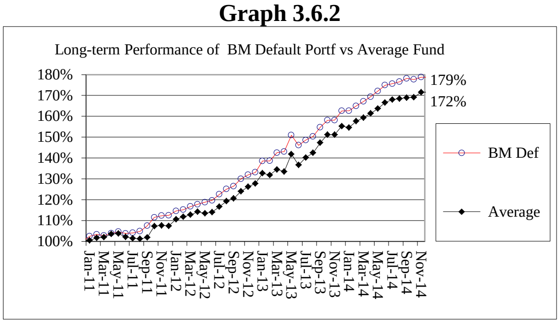


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

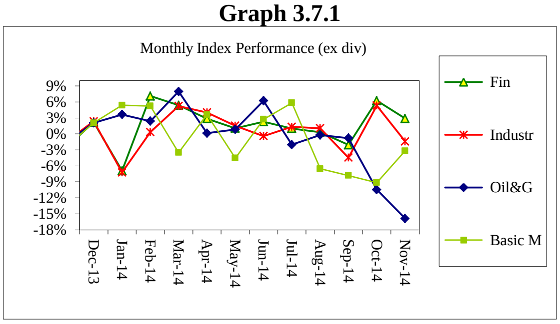


Graph 3.6.2

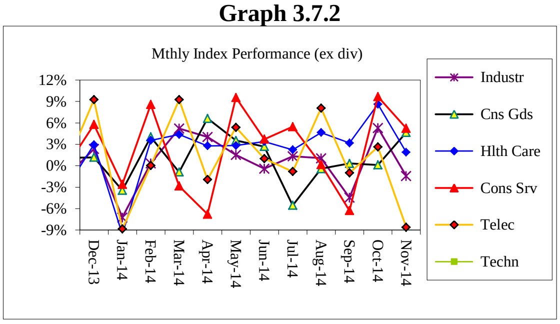


3.7 One year monthly performance of key indices (excluding dividends)

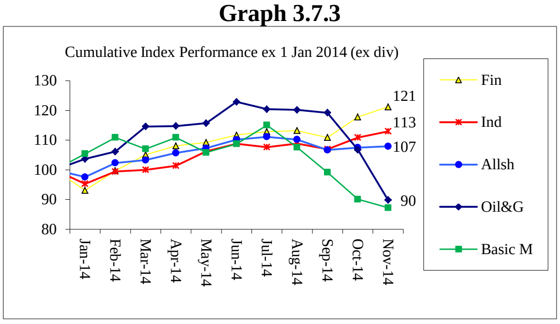
Graph 3.7.1



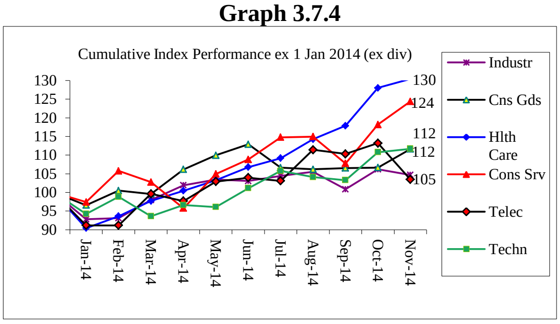
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



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4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 14.5% p.a. in nominal terms, or 9.3% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 14.9% p.a. in nominal terms, or 9.7% 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. 60.1% 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 78.8% compared to 71.6% for the average prudential balanced portfolio over this 47 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 December 2011 to November 2014:

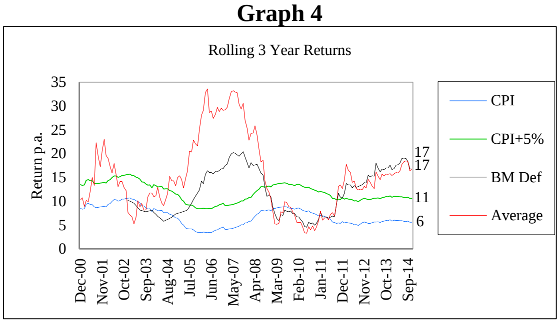
Table 4.1

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%	17.8%	16.9%

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



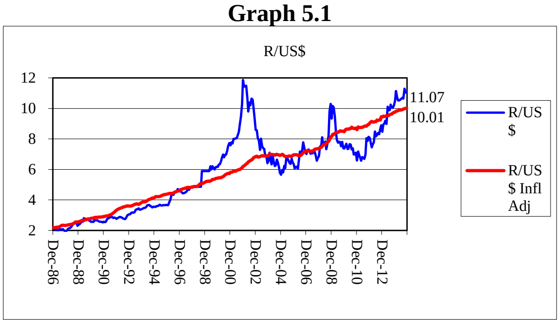
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 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 16.8% 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 10.01 to the US Dollar while it actually stood at 11.07 at the end of November. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1



Rand supported byforeign 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 18.9 bn on a year-on-year basis at the end of November

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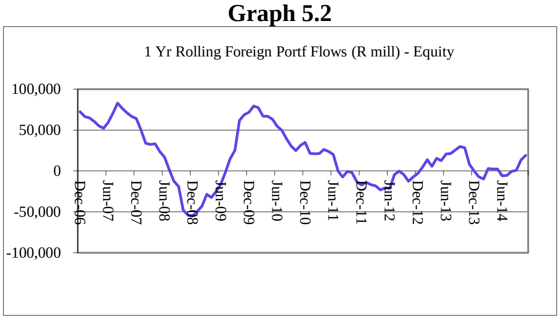
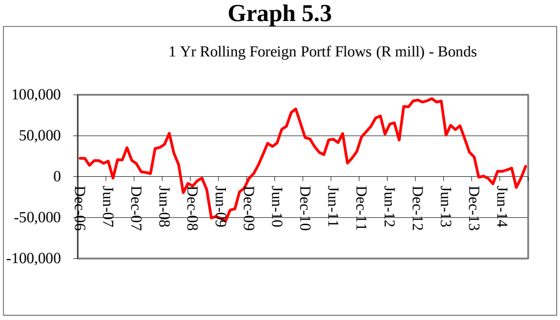
(inflow of R 13.6 bn to end October). Since the beginning of 2006, foreign net investment in equities amounts to R 189 bn (end October R 201 bn). This represents roughly 1.6% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one year basis reflects foreign portfolio inflows in respect of SA bonds of R 12.7bn over the past 12 months to end of November (outflow of R 1.6 bn over the 12 months to end of October). Since the beginning of 2006, foreign net investment in bonds amounts to R 253 bn (to October just over R 248 bn).

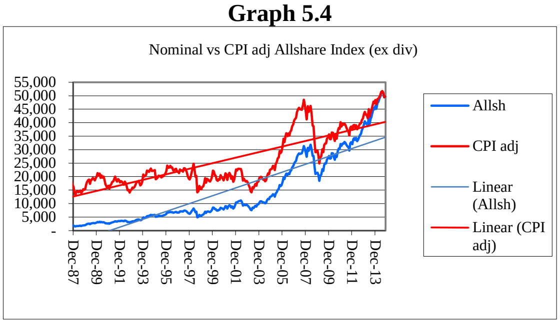
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was R 31.7 bn for the 12 months to end November 2014 (inflow of R 11.9 bn to end October 2014), compared to R 38 bn for the 12 months to end November 2013 (R 74 bn to end of October 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 443 bn (October R 448 bn).

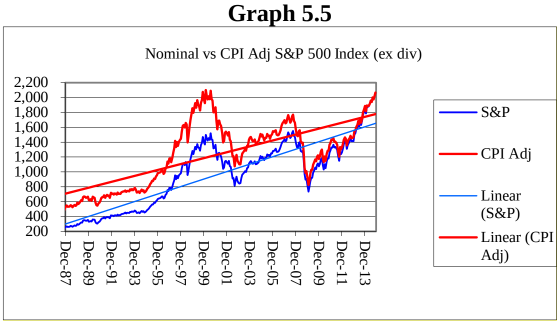
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 12.3% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period was 8.5% per year. This is equivalent to a growth in real terms of 3.8% p.a. over this period, excluding dividends, or around 7% including dividends.

Graph 5.4



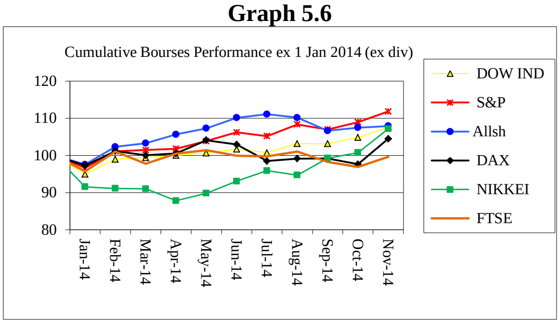
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms,with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.5% per, over this period of 27 years. US inflation over this period was 2.8%. This is equivalent to a growth in real terms of 4.7% 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. 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: 21.9%; Consumer Services: 21.6%; Industrials: 11.5%; Financials: 10.0% and Basic Materials: 3.5%.

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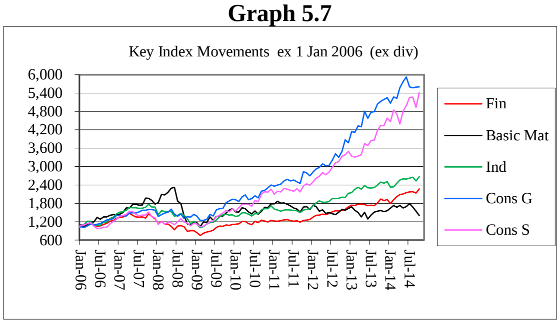
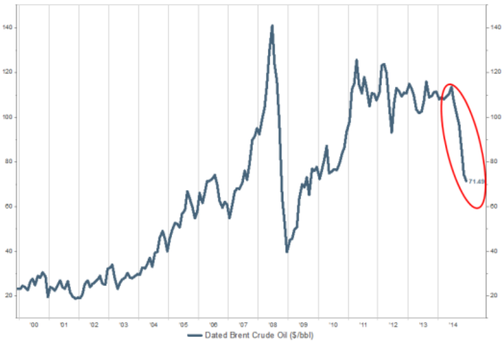
Graph 5.7



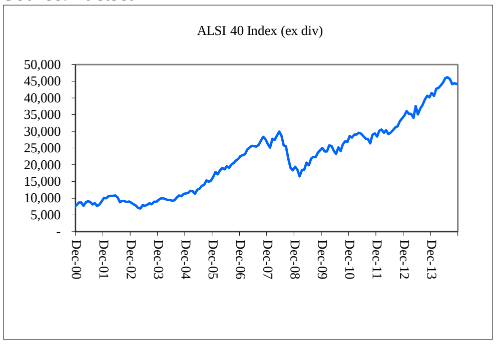
6. The Geopolitics of the oil price

The topic of the day for the investor must be the sudden and sharp decline in the oil price. The following graph was published in Efficient Select news brief of 4 December. This was the time when the oil price was still at US$ 71.49 per barrel. At the time of writing this piece, it has dropped to below US$ 60 per barrel. As difficult as we found it to comprehend the sharp increase since the beginning of this century to a peak of US$ 140 a barrel, it is to comprehend the steep decline in the oil price since the first quarter of this year.

We have seen the increase in the oil price pulling along commodities and the broader market as depicted in the lower graph reflecting the FTSE/JSE Alsi 40. The broader market has maybe not been as volatile and has not had as sharp a peak and a trough before and after the financial crisis, as the oil price, the close correlation is very evident. On its way down, the broader market is also likely not to bottom out as low as the oil price, but where will the oil price bottom out?



Source: Factset



As little as we were convinced then of the peak oil theory suggesting that declining resources and increasing consumption caused the increase, we are convinced that the sharp increase in US production through fracking is the reason for the sudden decline in the oil price. US production is still minute relative to global production and it is produced at a cost making it already in many cases uneconomical at today's oil price.

Fracking, by the way is not such a revolutionary new method of extracting oil where it was never thought possible, that it could have caught all by surprise. A couple of years ago we already came across an article suggesting that Vietnam has become virtually self-sufficient, producing oil by means of Russian fracking technology.

Oil is a weapon used in the economic warfare of global hegemonies. What we see today, we believe, is the reversal of what happened with the oil price on its way up, as we opined upon in our newsletter of March 2008. It is worth reading it again and follows here under.

"**The Geopolitics of US$ 130 per barrel**

Those interested in economics would have learnt about cost push and demand pull inflation. Rising prices should accordingly be caused by one, or the other, or both these factors. To us it seems pretty obvious that the high oil price is at the core of rising global commodity prices. Convince yourself of its huge, huge proportions when you consider current supply levels of 90 million barrels per day, an oil price of say US$ 130 per barrel and an average cost of around US$ 20 per barrel. Try to read the result on your calculator!

The question then is whether this is caused by a cost push or a demand pull effect? Well if the average cost per barrel is in the region of only US$ 20, it surely cannot be a question of a cost push factor, leaving the demand pull factor as the only possible cause. The next question then is, why is there such a high demand? From all publicly available information, crude supply and demand is about in balance, so this is not really the current problem, and this is what OPEC is claiming too.
We all know of course that oil is a limited and declining resource and therefore it is highly sensitive to speculation. But why should people be concerned about projected short supplies in 5 to 10 years' time today? Many analysts believe that speculation is at the root of this problem of global proportions. Isn't speculation just another way of hoarding, call it paper hoarding? So through speculation the demand for oil is artificially raised and this becomes a spiral which may be without end if its is not brought under control rapidly. It is another form of printing of money that is normally controlled through government regulation, such as reserve requirements for banks.

Normally governments intervene when its population starts hoarding commodities to prevent happening what

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 NOVEMBER 2014
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The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

we currently experience in global price levels and in the increasing levels of social unrest. Isn't it time for governments to start intervening here to prevent social upheaval as we have seen around the globe already? Since hoarding does not add any value and amounts to printing money, it will simply have to lead to general price level adjustments as we are also seeing across the globe. So at the end of the day no-one is benefiting but the adjustments will be very painful for many people around the globe until price equilibrium has been re-established.

Why haven't governments started to intervene yet? Well in the US the Commodity Futures Trading Commission is looking at closing a regulatory loophole that has allowed extremely large commodity index funds to get around position limits and it is under extreme pressure from Congress to change the rules. Perhaps this will do the trick? Is this why the oil price has come down these last few days? We certainly hope that this madness will be stopped soon before it causes further upheaval and we sincerely hope that it is not part of an amoury of global strategic interests for achieving their global strategic goals!"

What will the consequences of the great unwinding of super profits in the production and distributions chain of oil be for the investor and how far will this unwinding go? Whereas we had moneys of the man in the street being funnelled into the hands of a few oil producing countries and large internationals, the man in the street will now benefit greatly from lower fuel prices, assuming of course governments will not use the opportunity to raise taxes on fuel at the pace fuel prices should decline. The relief for the man in the street will be around US$ 4 billion per day! That is equivalent of more than 2% of global GDP! Ownership of this relief will be widely dispersed across the globe and this will no doubt lead to increased consumption and a general improvement in the global economy. How far this unwinding can go is difficult to foresee but it is likely to result in an oil price that is once again cost based. A wide guess would be somewhere between US$ 30 and US$ 50 a barrel meaning that there is still room to the downside. If this scenario materialises we are now heading for a period of economic adjustment with high volatility until a new equilibrium has been found and matters settle down again.

Since oil is trading in US$, we should see a weakening of the US$ and increased pressure on interest rates in the US which will of course spread around the globe and lower foreign investment flows, particularly into emerging economies. Their currencies should consequently also weaken.

As a local investor in this scenario, we have already seen equities decline in this process of adjustment and we are likely to experience more of this volatility. This is not the time to panic and worsen one's woes by selling out of the market or by switching from local to offshore assets, but one should rather hold one's investment position as any adjustment to it may just be at the wrong time.

With the expected upswing in consumer sentiment and the global economy, one should see the demand for consumer goods and hence commodities increasing again. 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.

Local sectors and shares driven by foreign investors, such as consumer goods and consumer services should now be switched for those shunned by them, primarily basic materials. Although we expect the local consumer to be impacted negatively as interest rates will drift upwards, lower fuel prices are likely to largely dampen the impact. From a macro economic perspective the weakening Rand should advantage Rand hedge shares, exporters and manufacturers locally. With the prospect of interest rates increasing, we believe that fixed interest investments as an asset class should generally be avoided.

7. Important notice and disclaimer

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