Volume 10, No. 12,
December 2014

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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

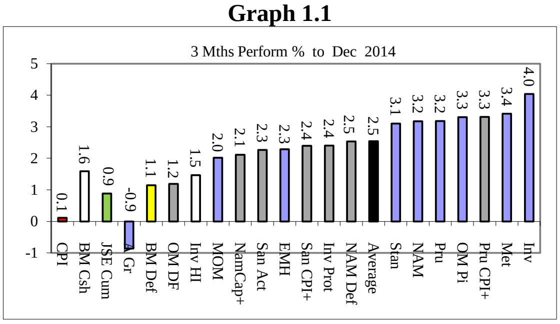
In **December** the **average prudential balanced portfolio** returned 0.94% (Nov: 1.46%). Top performer is EMH Prescient (1.36%); while Momentum (0.41%) takes the bottom spot. For the 3 month period Investec takes top spot, outperforming the 'average' by roughly 1.5%. On the other end of the scale Allan Gray underperformed the 'average' by 3.4%.

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.

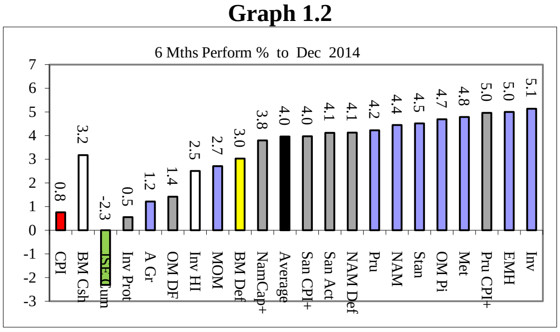
Below is the legend to the abbreviations reflected on the graphs:

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)

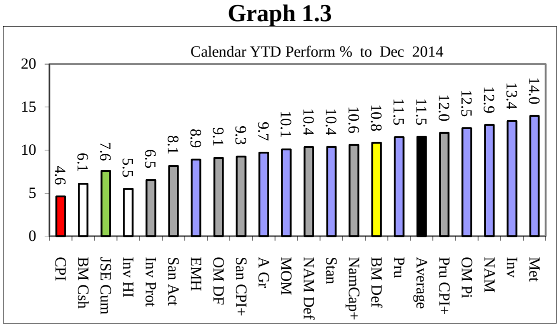
Graph 1.1



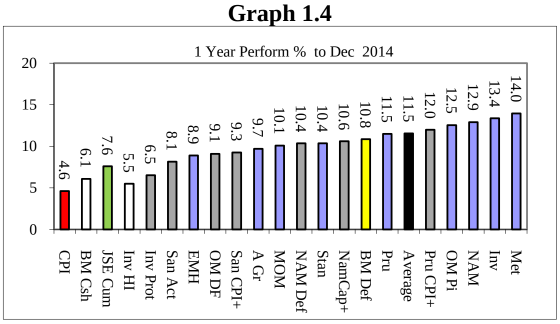
Graph 1.2



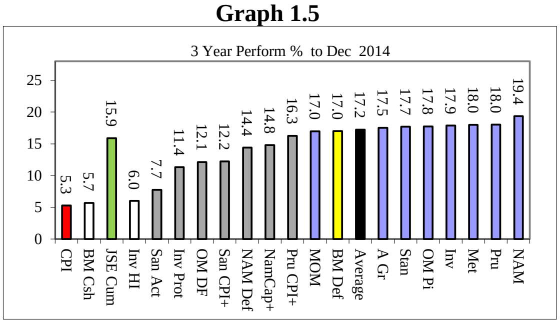
Graph 1.3



Graph 1.4



Graph 1.5



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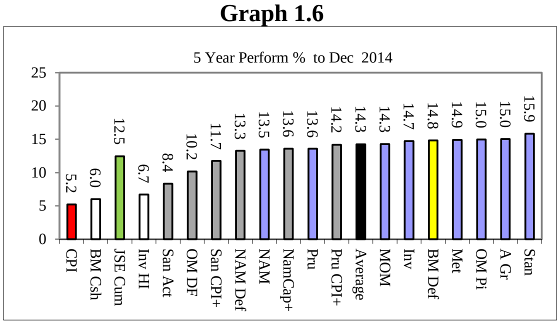
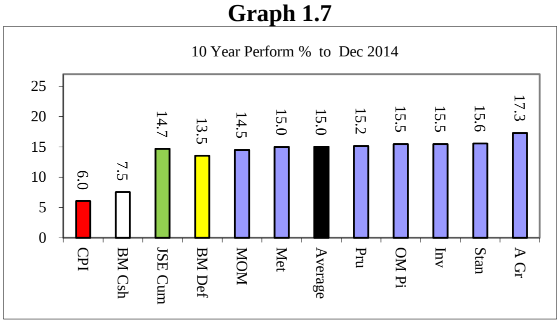
Graph 1.6

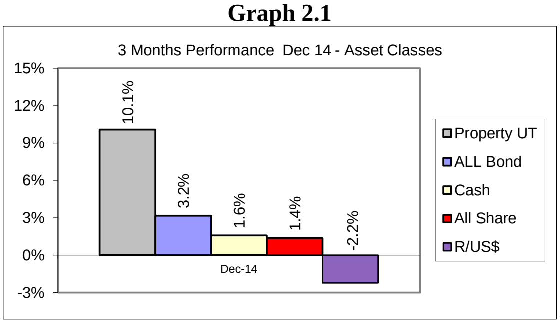


Graph 1.7

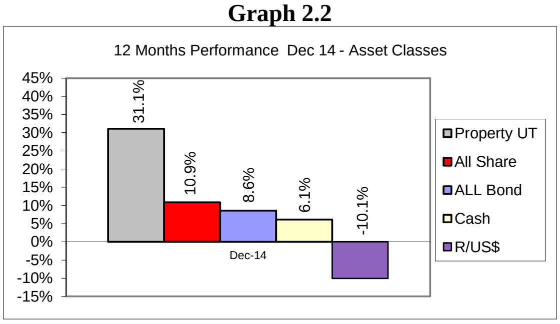


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

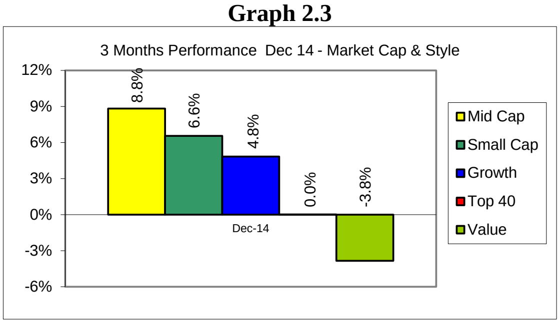
Graph 2.1



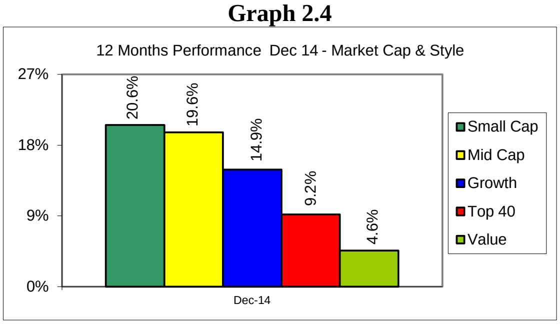
Graph 2.2



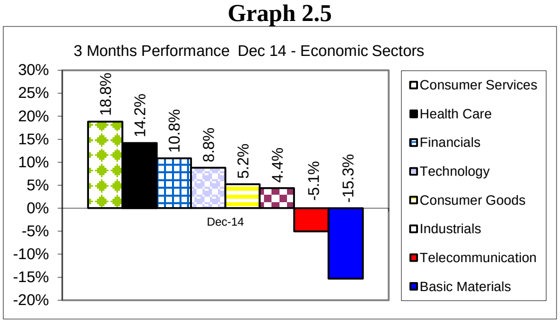
Graph 2.3



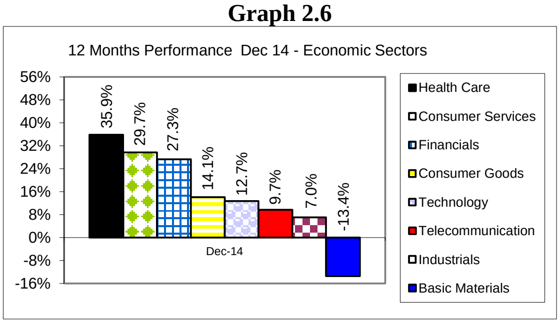
Graph 2.4



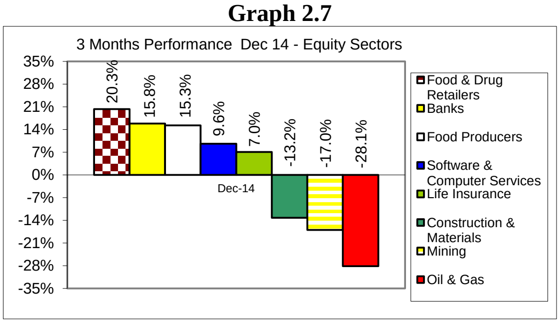
Graph 2.5



Graph 2.6



Graph 2.7



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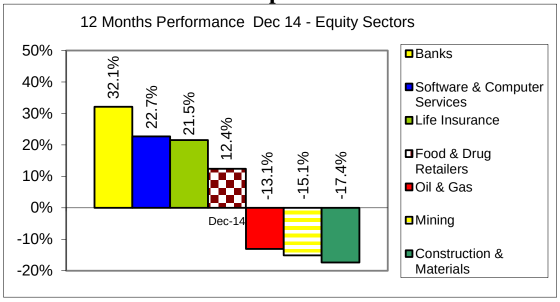
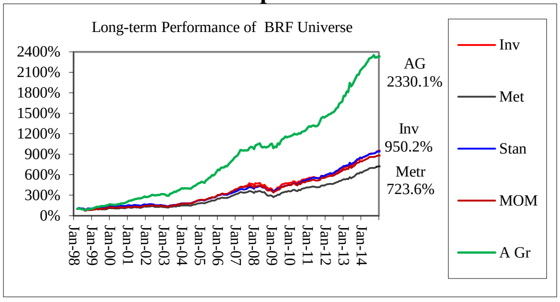
Graph 2.8



3. Portfolio Performance Analysis

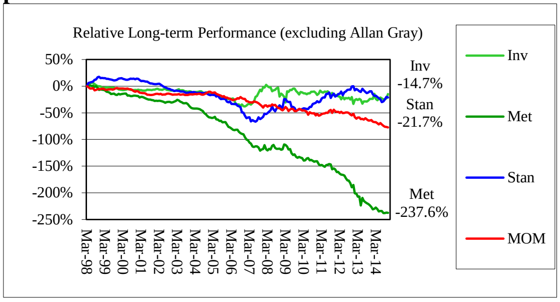
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

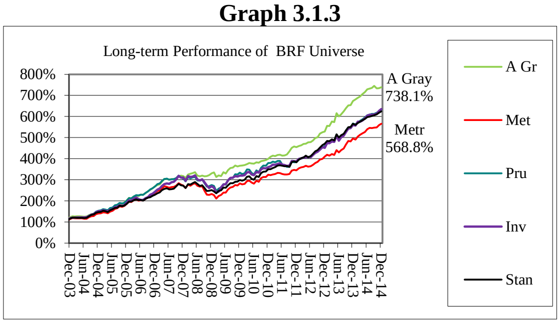


Graph 3.1.2

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

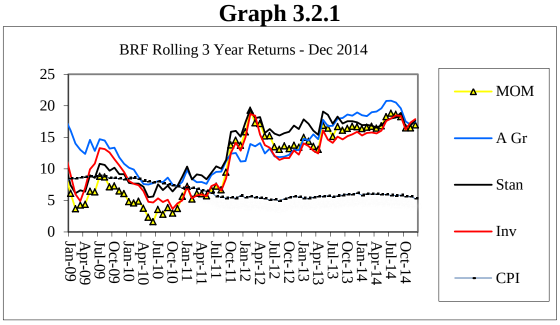


Graph 3.1.3

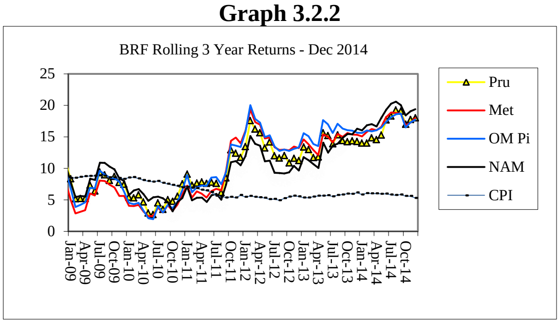


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

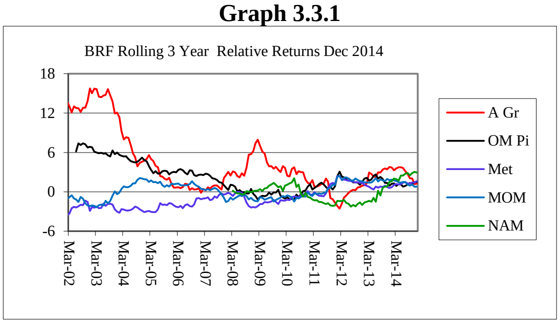


Graph 3.2.2

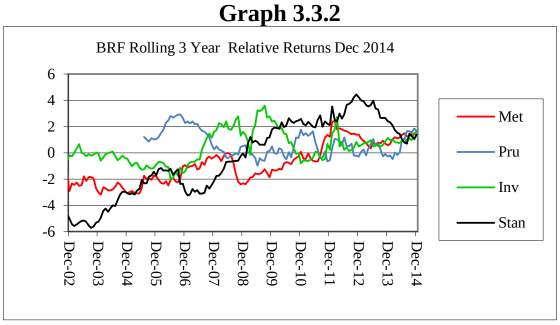


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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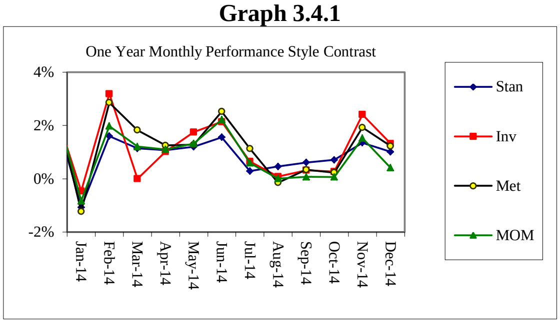
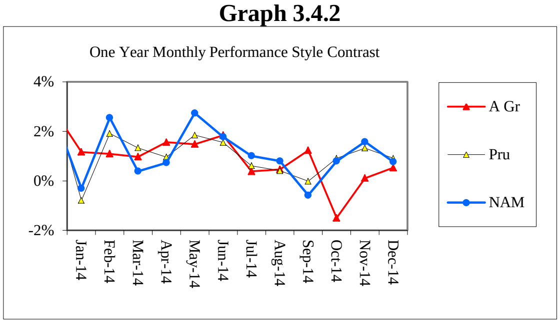
3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

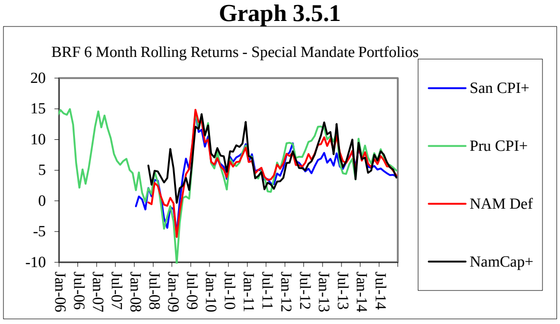


Graph 3.4.2

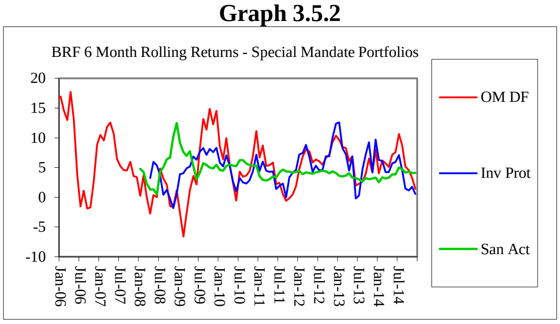


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

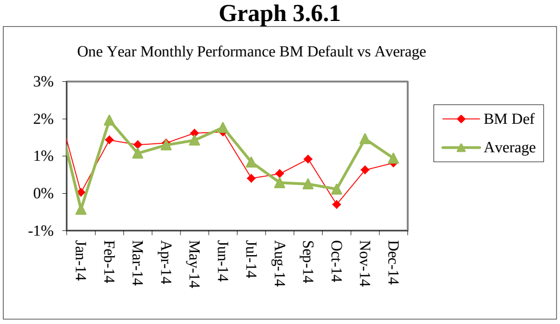


Graph 3.5.2

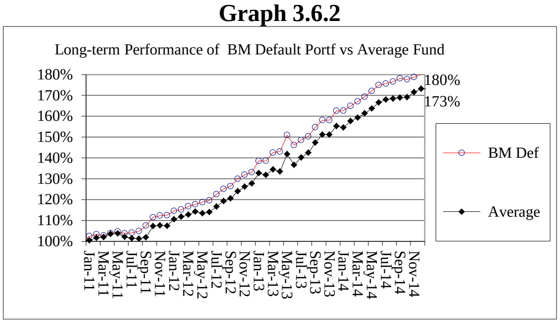


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

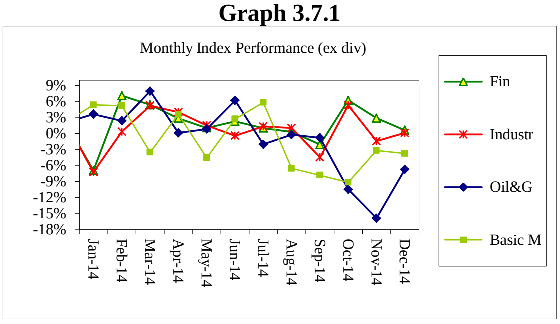


Graph 3.6.2

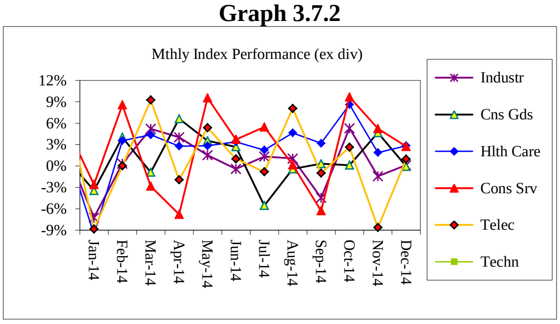


3.7 One year monthly performance of key indices (excluding dividends)

Graph 3.7.1



Graph 3.7.2



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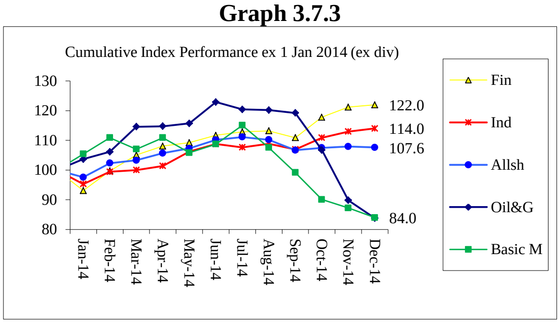
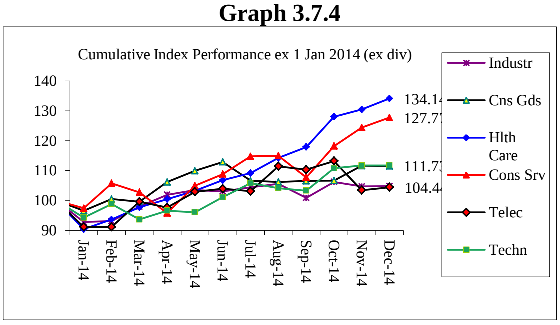
Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 14.3% p.a. in nominal terms, or 9.1% 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. 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 80.2% compared to 73.2% for the average prudential balanced portfolio over this 48 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 January 2012 to December 2014:

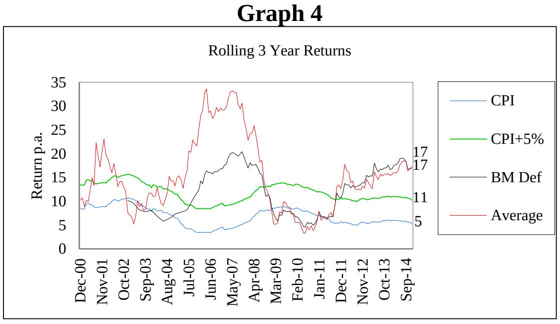
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	10.8%	7.3%
Best annual performance	6.1%	27.1%	26.8%
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%	16.8%

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 17.0%, the average on 17.3% vs CPI plus 5% currently on 10.3%.

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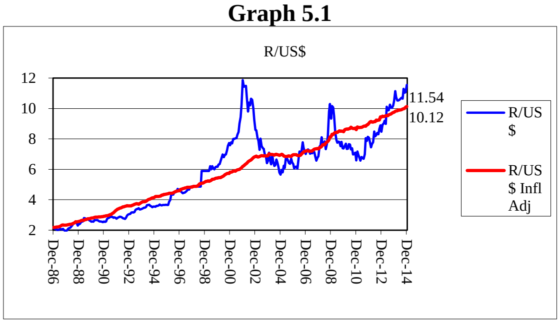
5. Review of Foreign Portfolio Flows and the Rand

How is the Rand doing?

Graph 5.1 indicates that the Rand by our measure is fairly valued at 10.12 to the US Dollar while it actually stood at 11.54 at the end of December. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

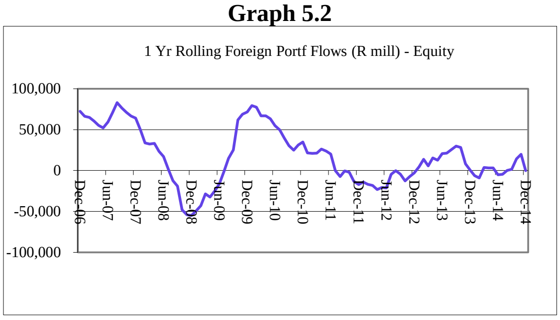
Graph 5.1



Rand continues to weaken with foreign capital outflows

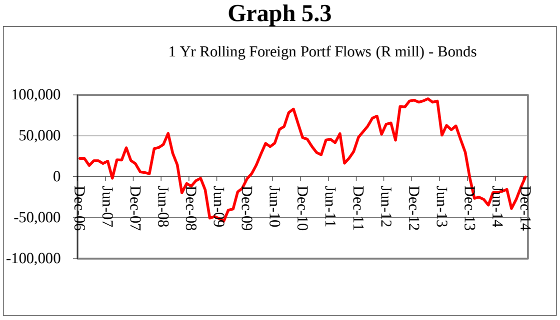
Graph 5.2 reflects a flow of capital into South African equities on a rolling one year basis, with a net outflow of 0.3 bn on a year-on-year basis at the end of December (inflow of R 19.8 bn to end November). Since the beginning of 2006, foreign net investment in equities amounts to R 169 bn (end November R 189 bn). This represents roughly 1.5% 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 0.07bn over the past 12 months to end of December (outflow of R 13.0 bn over the 12 months to end of November). Since the beginning of 2006, foreign net investment in bonds amounts to R 212 bn (to November just over R 227 bn).

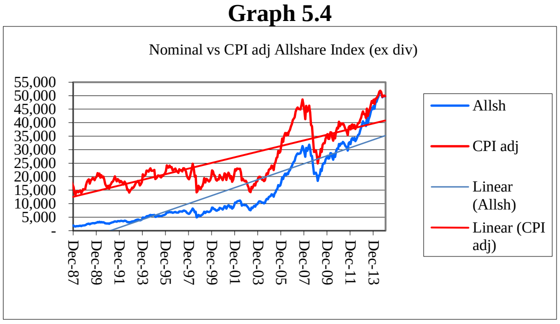
Graph 5.3



The net outflows of foreign capital from equity and fixed interest assets was R 0.35 bn for the 12 months to end December 2014 (inflow of R 6.7 bn to end November 2014), compared to -R 1.0 bn for the 12 months to end December 2013 (R 38 bn to end of November 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 381 bn (November R 418 bn).

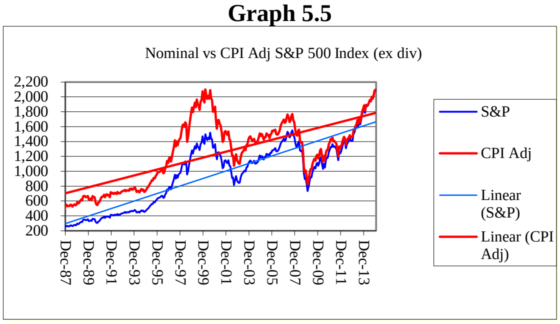
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 12.2% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period was 8.5% per year. This is equivalent to a growth in real terms of 3.7% 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 28 years. US inflation over this period was 2.7%. This is equivalent to a growth in real terms of 4.8% p.a. over this period, excluding dividends.

Graph 5.5



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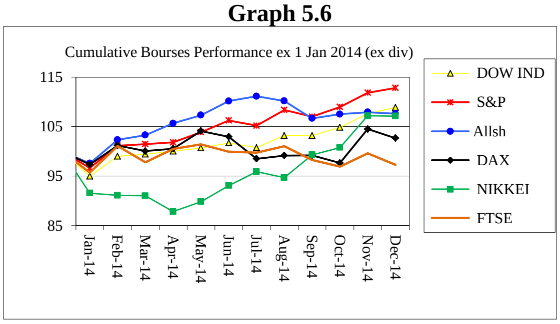
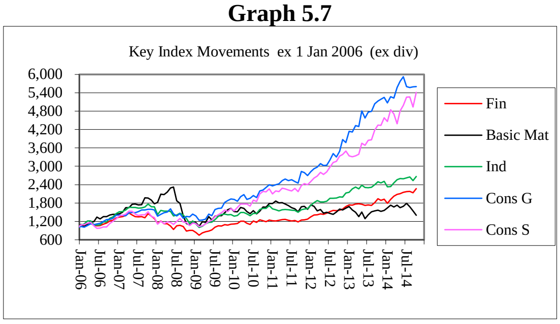
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P 500 and the Dow Jones as the top performing share indices.

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: 21.7%; Industrials: 11.4%; Financials: 10.0% and Basic Materials: 3.0%.

Graph 5.7

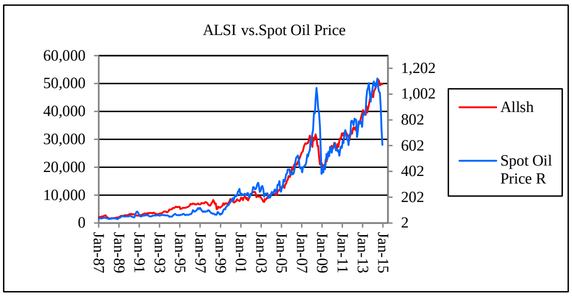


6. Oil and its impact on the local economy and the local investor

In our previous newsletter we deliberated on the possible reasons and the implications of the oil price on global financial markets. We noted a close correlation between longer term trends in the oil price and the FTSE/JSE Allshare index, given that the SA Allshare Index is heavily resources weighted. Of course, oil being a major import component of SA's trade balance, its price changes will also impact on the Rand everything else being equal.

Oil will have a major impact on local equities and the Rand

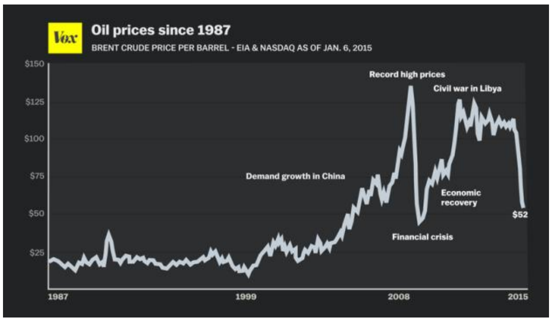
The below graph shows a surprisingly high correlation between the Allshare index and the spot oil price in Rand barring the times when there was a rapid change in the oil price, such as over the last few months, where the Allshare index responds more cautiously.



One may thus rationally conclude that what is happening to the oil price will have a major impact on local equities and the Rand if it becomes a longer term trend. The question is – will it become a longer term trend? An indicator for this becoming a longer term trend is the demand/ supply situation. It would not become a longer term trend if the previous price levels were driven by the demand/ supply situation rather than speculative trading.

What can one expect the oil price to be?

The below graph reflecting oil prices shows a long term increasing trend in the oil price and a few steep and rather rapid changes where we believe these were the result of speculative trading rather than any fundamentals. Without speculative trading the peaks would be reflective realistic price levels, else one would expect a more slowly increasing line that will be somewhere between the peaks and the troughs.



The below graph now provides an interesting picture of the demand/supply balance of oil. At first sight one might conclude the gap between demand and supply is rapidly opening up. However looking more closely at the demand line one notices that an annual peak demand occurs in the 4th quarter where after the demand drops off significantly for 2 quarters only to move up again in a pretty consistent fashion. If one were to extend a straight line from the latest 3 demand peaks, one will conclude that demand should be pretty close to supply again by the end of 2015 assuming no drastic increase in supply, which cannot be foreseen, certainly not at today's price. In other words it appears unlikely that supply will significantly outpace demand even in the short term and that the current price level is unsustainable over a longer period.

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By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

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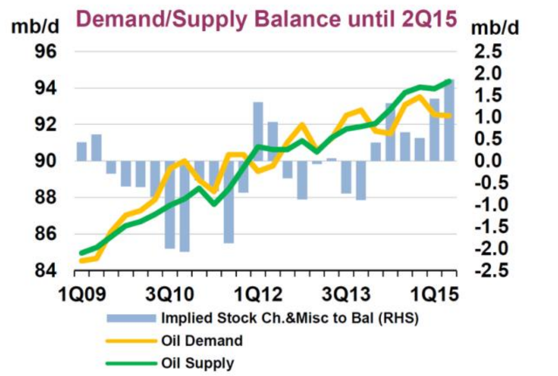
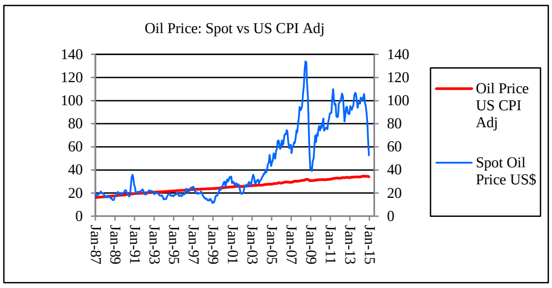


Source: vox.com

The question then is, what is a realistic price of oil? Rationally one would argue that if supply and demand is about in balance the price should be cost based. The following graph now reflects the spot price in US$ as the blue line and the price if it were to have increased by the change in the US CPI starting in January 1987 at 16US$ per barrel and telling us that the price should now be around US$ 35 per barrel.



From these graphs one can conclude that the current level of the oil price is realistic in the context of production cost and, in fact, provides for some premium for the steady increase in demand and production costs over this period. We therefore believe that without a renewed speculative bubble being blown up we should see current oil prices representing the new normal.

How will the oil price impact our economy and the investor?

On the other side of the coin, a drop in the price per barrel from around US$ 135 in June 2014 to under US$ 50 at the time of writing aggregates to a drop of roughly US$ 3 trillion per annum, which is equivalent to roughly 4% of global GDP. Oil producers previously raked in these money flows produced by the global consumer and concentrating them in the hands of a few oil producers and market intermediaries. Most of this money avalanche traded hands in US$ and much of it was invested in emerging markets. The graph below shows the extent to which foreign investment flows into SA equities has subsided since the beginning of 2007.

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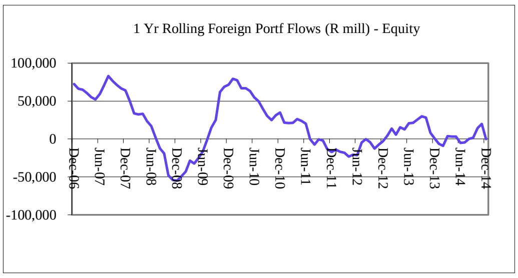

Commodity exporting countries like SA and Namibia have been hard hit by the decline in commodity prices, mainly as the result of the decline in demand by the Chinese. The decline in the cost of fuel should be a welcome 'windfall' to these countries. To put this 'windfall' into a Namibian perspective, we assume that Namibia's oil consumption should be approximately the same as SA's, and the world's for that matter, relative to the respective GDP (SA consuming 25 million liters per day). On this basis Namibia would consume just over 6 million barrels per annum and is now saving on its fuel bill something in the region of N$ 17 million per day or roughly N$ 6 billion per annum which represents nearly 4% of our GDP. Imagine what this could to the Namibian Government's finances. Magnus Heystek, investment strategist of SA Brenthurst Wealth recently suggested in the article 'SA just got very, very lucky – let's not squander it', in Moneyweb of 9 January 2015, that the SA Government should use this opportunity to raise the fuel levy by R 1 per liter. Of course whatever Government passes on to the man in the street will make a noticeable impact on his spending power. This in turn should be positive for the economy and company profits.

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 funneled 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$ 8 billion per day at 4% of global GDP. Ownership of this relief will now be widely dispersed across the globe and this will no doubt lead to increased consumption and a general improvement in the global economy but reduced investment flows. We believe that the effect of this swing of the pendulum should manifest a year on from now. In the meantime as financial markets start to adjust to the new normal, there will be lots of volatility.

What will the impact of the developments be on the SA Rand? We have seen the Rand weakening despite the steep decline in the oil price. For one this can be ascribed to the fact that the demand and price for many of SA's commodities has declined and foreign investment flows have all but dried up. None of these factors are likely to change dramatically over the next 12 months, although increasing consumer demand should filter through to an increase in the price of commodities thereafter. This means that the SA current account is unlikely to improve significantly and that the Rand will remain under pressure. Since the Fed is hinting to an increase in interest rates and in view of the pressure on the Rand, the welcome windfall of lower fuel prices for the consumer may just offer an opportunity to the SARB to raise its interest rate to protect the Rand and to hedge against inflation deriving from increased consumer demand, which is also likely to manifest 12 months from now.

Our investment view remains unchanged

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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