Benchmark Retirement Fund

Volume 11, No. 01,
January 2015

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JANUARY 2015

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

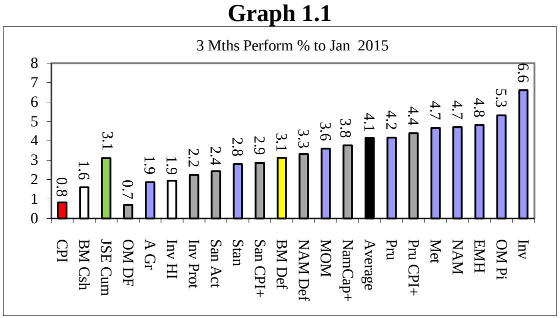
In **January** the **average prudential balanced portfolio** returned 1.69% (Dec: 0.94%). Top performer is Investec (2.75%); while Stanlib (0.41%) takes the bottom spot. For the 3 month period Investec takes top spot, outperforming the 'average' by roughly 2.5%. On the other end of the scale Allan Gray underperformed the 'average', for the third consecutive month, by 4.7%.

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.

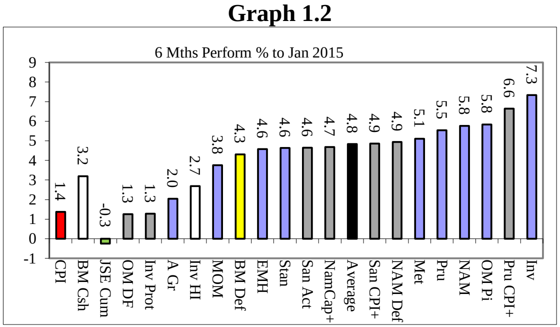
Below is the legend to the abbreviations reflected on the graphs:

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)

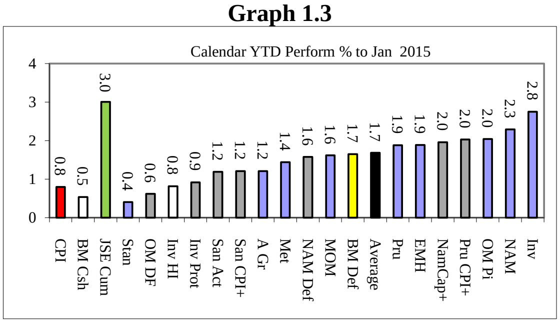
Graph 1.1



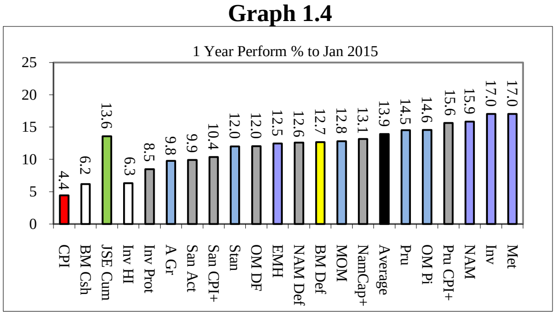
Graph 1.2



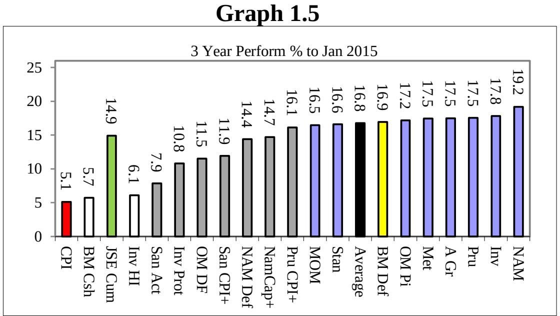
Graph 1.3



Graph 1.4



Graph 1.5



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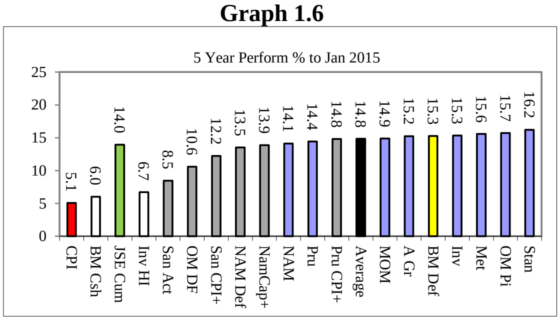
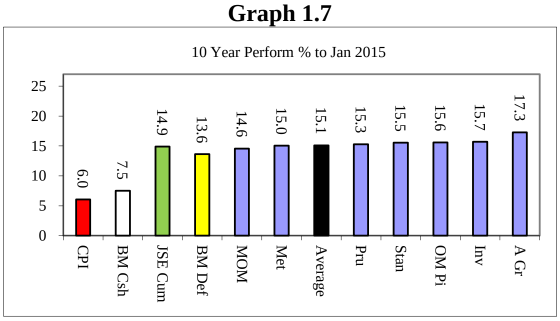
Graph 1.6

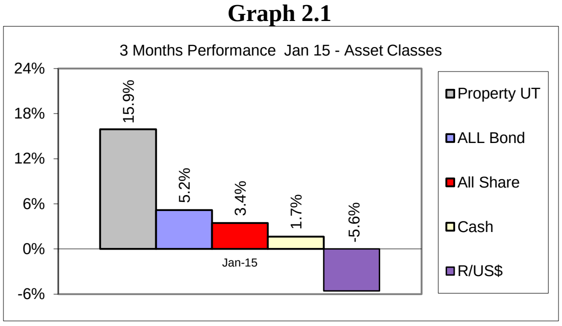


Graph 1.7

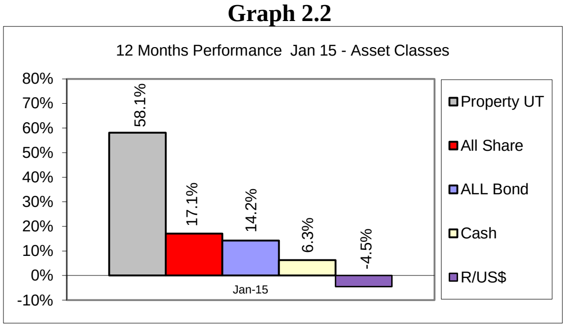


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

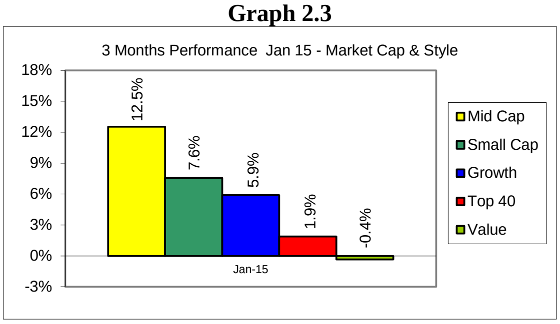
Graph 2.1



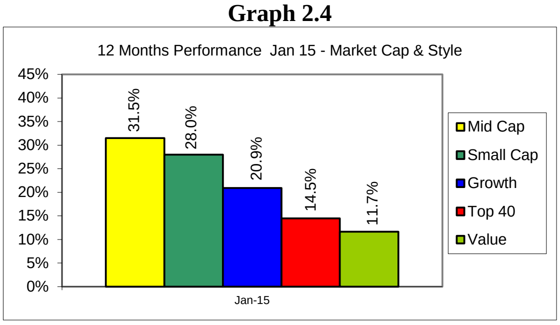
Graph 2.2



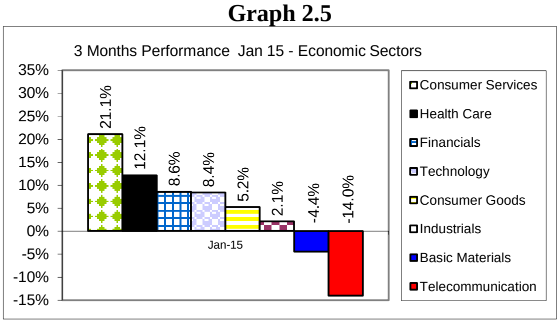
Graph 2.3



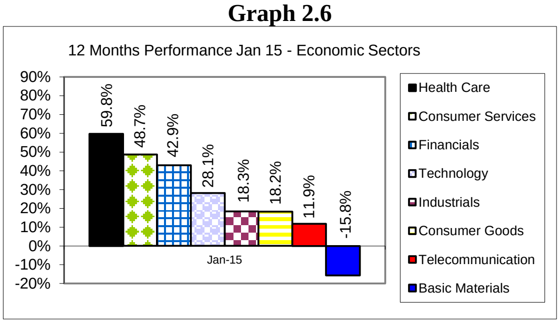
Graph 2.4



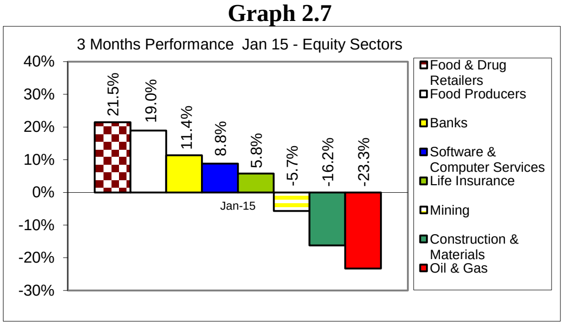
Graph 2.5



Graph 2.6



Graph 2.7



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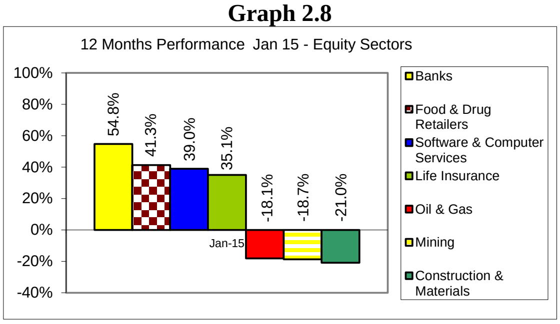
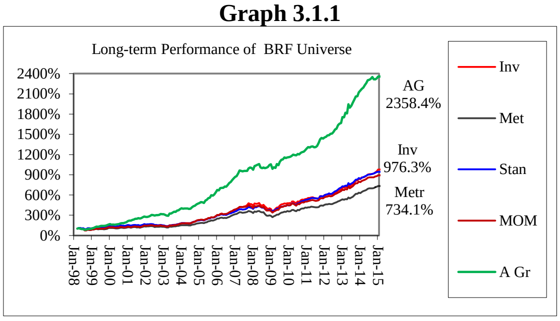
Graph 2.8



3. Portfolio Performance Analysis

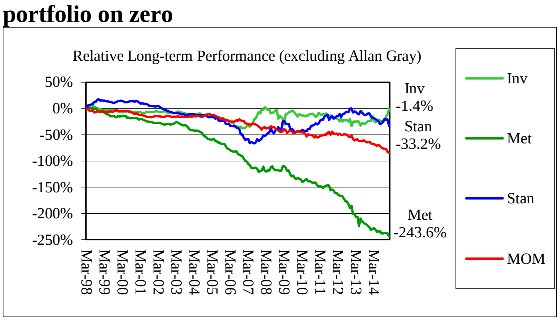
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

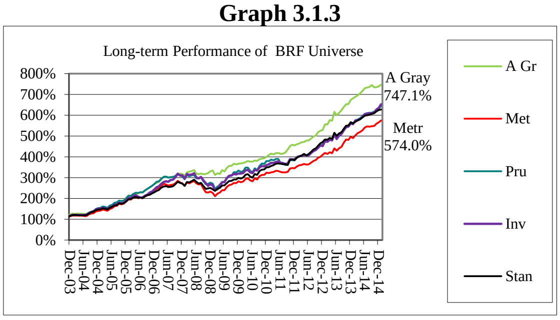


Graph 3.1.2

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

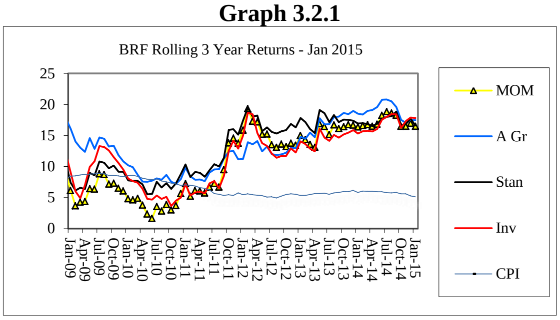


Graph 3.1.3

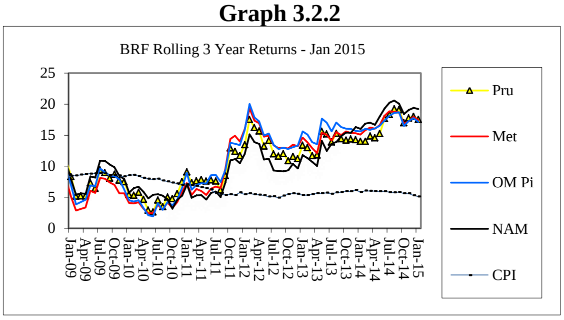


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

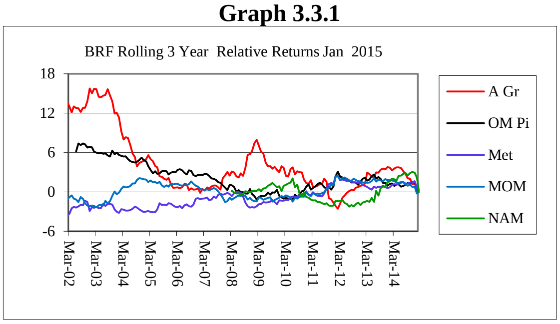


Graph 3.2.2

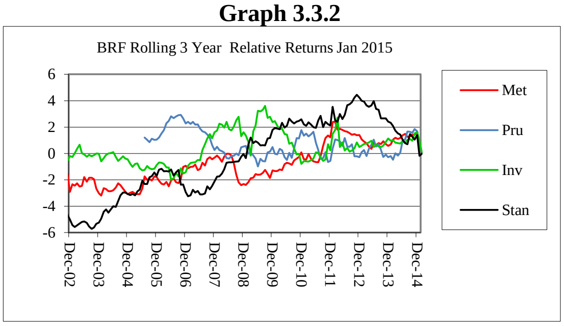


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1



Graph 3.3.2



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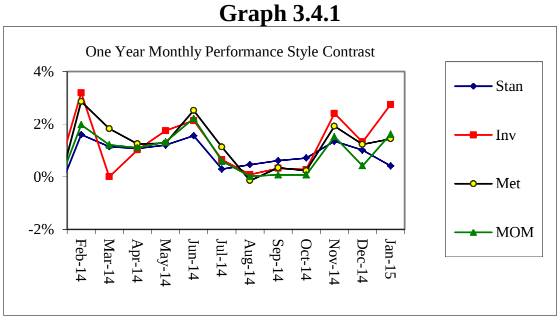
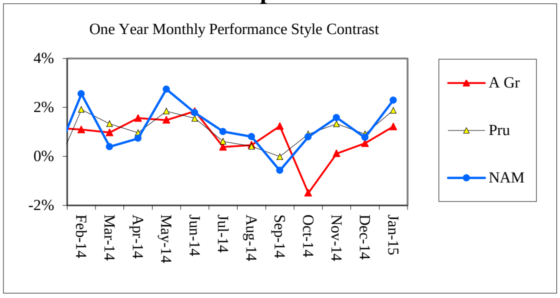
3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

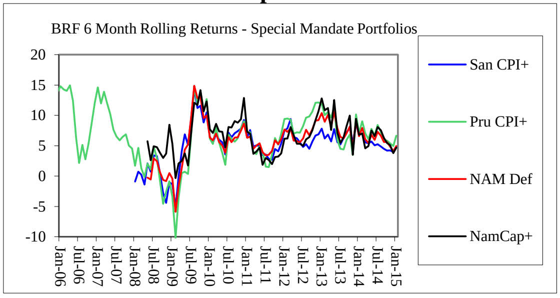


Graph 3.4.2

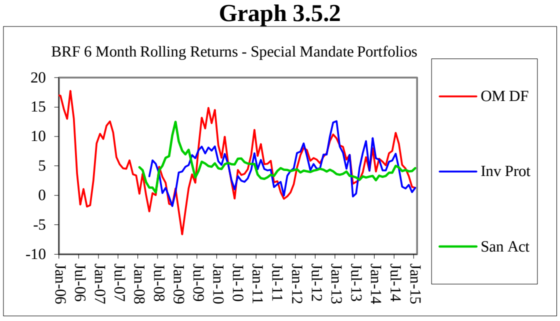


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

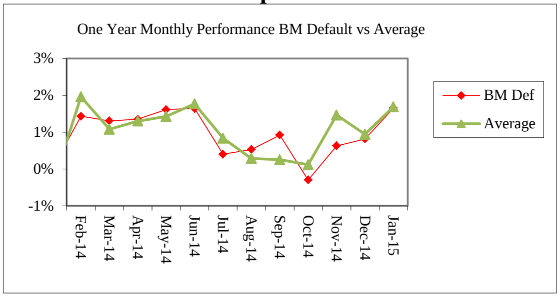


Graph 3.5.2

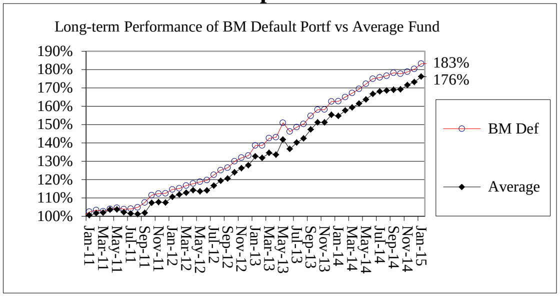


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

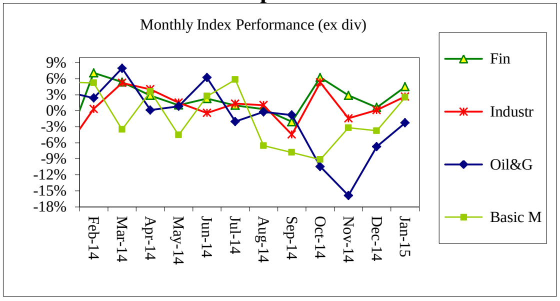


Graph 3.6.2

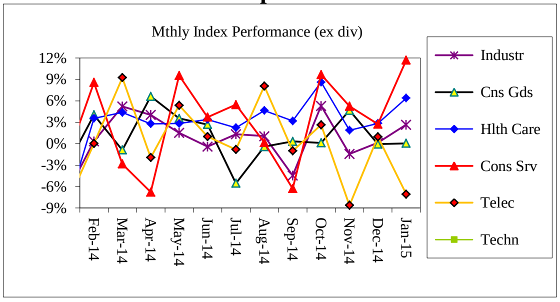


3.7 One year monthly performance of key indices (excluding dividends)

Graph 3.7.1



Graph 3.7.2



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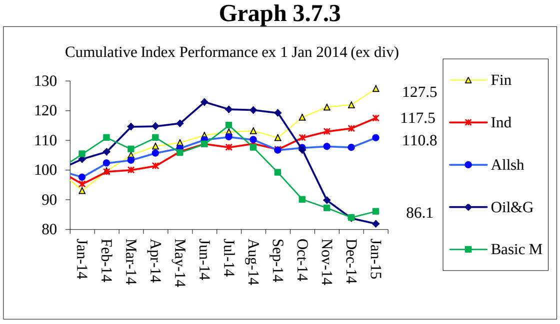
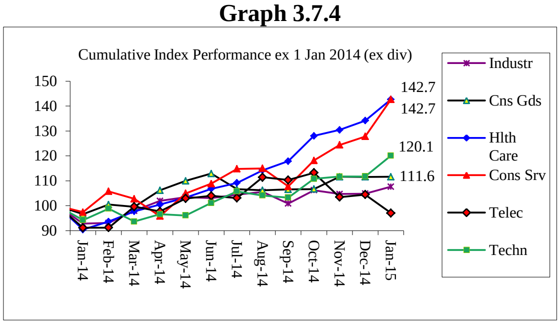
Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 14.8% 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 10.2% p.a. in real terms. The Benchmark Default portfolio is designed to produce a less volatile performance but also lower returns than the average prudential balanced portfolios with its significantly lower equity exposure (49.5% vs. 62.3% of the average prudential balanced portfolio, as at the end of December 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 83.2% compared to 76.1% for the average prudential balanced portfolio over this 49 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 February 2012 to January 2015:

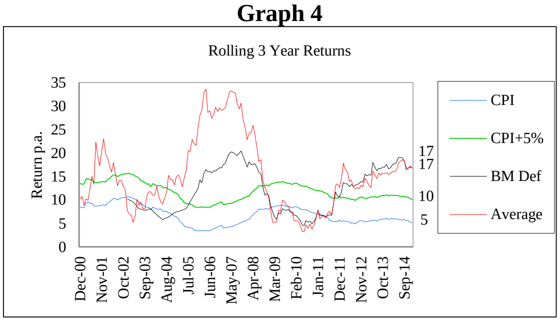
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	10.8%	7.4%
Best annual performance	6.2%	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%	17.1%

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



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 16.9%, the average on 16.8% vs CPI plus 5% currently on 10.1%.

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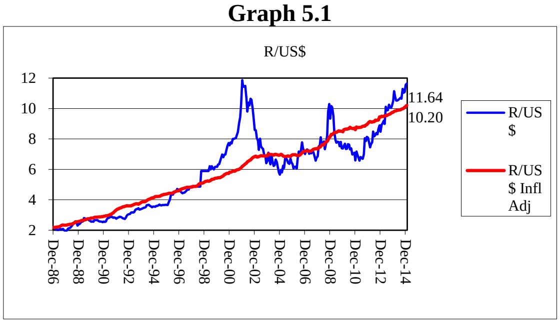
5. Review of Foreign Portfolio Flows and the Rand

How is the Rand doing?

Graph 5.1 indicates that the Rand by our measure is fairly valued at 10.20 to the US Dollar while it actually stood at 11.64 at the end of January. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

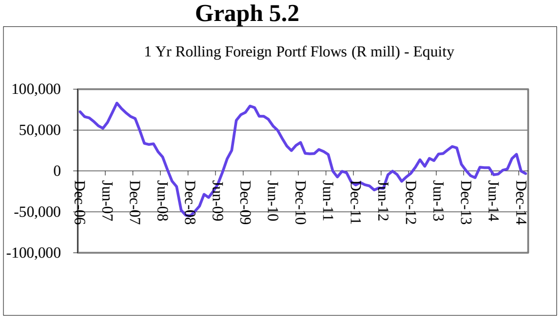
Graph 5.1



Rand weakens despite foreign capital inflows

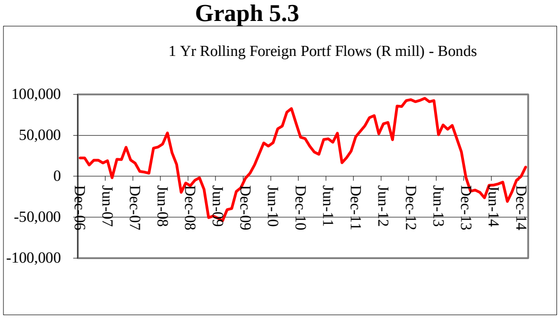
Graph 5.2 reflects a flow of capital out of South African equities on a rolling one year basis, with a net outflow of 3.1 bn on a year-on-year basis at the end of January (outflow of R 0.3 bn to end December). Since the beginning of 2006, foreign net investment in equities amounts to R 161 bn (end December R 169 bn). This represents roughly 1.4% 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 11.3 bn over the past 12 months to end of January (outflow of R 0.07 bn over the 12 months to end of December). Since the beginning of 2006, foreign net investment in bonds amounts to R 210 bn (to December just over R 212 bn).

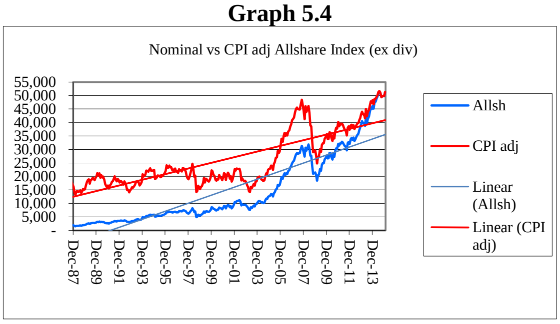
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was R 8.2 bn for the 12 months to end January 2015 (outflow of R 0.35 bn to end December 2014), compared to an outflow of R 23.9 bn for the 12 months to end January 2014 (outflow of R 1.0 bn to end of December 2013). Since the beginning of 2006, total net foreign portfolio flows amounted to R 371 bn (December R 381 bn).

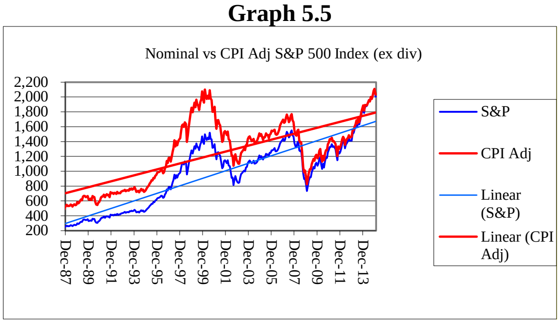
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 12.3% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period was 8.5% per year. This is 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 7.3% 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 4.6% 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 DAX and the JSE Allshare as the top performing share indices.

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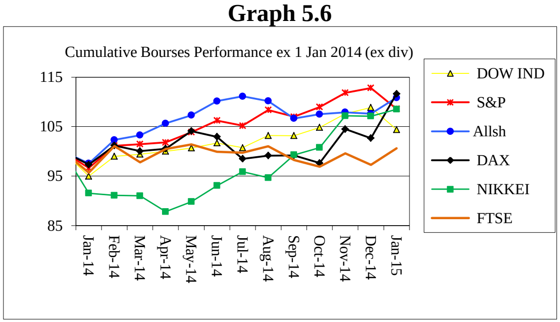
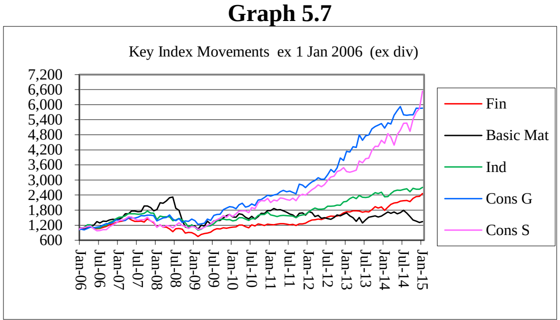
Graph 5.6



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: 21.5%; Consumer Services: 23.0%; Industrials: 11.6%; Financials: 10.4% and Basic Materials: 3.3%.

Graph 5.7



6. Investment decisions in the context of a unipolar financial system

In our previous newsletter we expressed our opinion that the dramatic decline in the oil prices from its peak of close to US$ 140 in June 2008, to currently around US$ 60, is unlikely to have been the result of a decline in demand and a simultaneous increase in production primarily through fracking in the US. We further pointed out that from a starting point of US$ 16 at the beginning of 1987, inflation adjusted the oil price should now be in the region of US$ 35. At its current level, the oil price is realistic in the context of production cost and, probably 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.

We have concluded that the rapid swings we have seen are the result of speculative trading on a massive scale. In this context it is interesting that the value of derivative financial instruments represent approximately the 10 fold of global GDP at over US$ 700 trillion at the end of 2013, certainly large enough to make an impact on the price of any commodity or exchange rate. In contrast the total value of these financial instruments only amounted to US$ 95 trillion at the end of 2000.

The question is what could be the purpose of such large scale market intervention? James Rickards an American lawyer, regular commentator on finance, and the author of The New York Times bestseller Currency Wars first acquainted the editor of this newsletter to the concept of financial war games, defined by James as a branch of 'asymmetric or unrestricted warfare'. Are these seemingly inexplicable developments perhaps part of this 'asymmetric warfare' rather than random market events?

Is there indeed a close linkage between politics and economic interests that one must be cognisant of when trying to interpret and understand economic events? Well, considering that the purpose of any economic activity in a capitalist world is the promotion of the profit motive, it is plausible that behind these activities may very well be business interests. These business interests are nowadays spanning the globe and are promoted under the banner of global economic integration. But is global integration really aimed at benefiting all, as professed? This is not the nature of capitalist behaviour, so it's probably rather a pretext for eliminating competition and gaining control.

If one follows the pointers of James Rickards, politics and economics cannot be separated in the global context but these are fully intertwined and strive towards the same goals. Politics are just one of the means to achieve the economic goals of business and politics will use all means at its disposal to advance the interest of business, including all types of warfare. So if we hear and read today about bad boy Russia having annexed the Crimean peninsula, Russia is protecting its global economic interest. The 'West' and the US have economic interests that are in conflict with Russia's, hence the Ukraining crisis.

Today we evidently live in a unipolar world where military and financial supremacy vests in the US only. Financial supremacy is maintained by virtue of the US Dollar based international financial system that has given the US the most effective tool to promote US business interests globally. Trying to understand global developments one needs to try and understand what US global economic interests are and what might threaten the free unfolding of their business interests. Morals and values are only the disguise for business interest.

Undoubtedly, the biggest threat to US business interests today is China and the Achilles heel of China is Russia. The rest of the world will have to get out of the way of these competing interests and rather try to get into their slip stream, which is probably not always that easy. At this stage it is probably wiser to be in the US's slip stream.

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JANUARY 2015
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.

Looking at global events it is quite evident which countries failed to get out of the way while the rest have generally chosen the US slip stream, with some hedging on Chinese economic interests.

What are the issues the US is facing today and what is the implication of these for the Namibian investor? Undoubtedly one of the major issues is the huge debt burden the US has loaded upon itself. This needs to be unwound without hurting its own economic interests. Ideally this should be transferred to someone else such as the global consumer or investor. The tools the US has are the US$ based global financial system and its military. In the weapons arsenal of the financial system are interest rates and exchange rates. Using the exchange rate would require targeting of a commodity that can yield results, first and foremost oil and gold. Of course one can only speculate as the US strategists will not divulge their strategies. If the investor gets it right to get into the US' slip stream, he should be able to earn good returns.

It would seem that an increase in interest rates by the US Fed will be a simple way to make safe haven investors pay for the US debt. Foreign investors lent money to the US financial system at a very low interest rate for its safe haven status, but also in consequence of the high oil price paid in US Dollars. An increase in the interest rate would thus mean that the value of the investment declines. In this way money lent at 1% would depreciate by 2/3rds if interest rates were raised by 2% to 3%. It's great to be a debtor if you can set the interest rates and own the only global reserve and trade currency!

If one is the master of the global trade and reserve currency like the Fed is, one can thus monetize and demonetize debt at will without any implication for your own financial system, always at the expense of those you are transacting with either by way of trade or in the form of investment. The US will therefore at all costs defend its supremacy of the global financial system through the US Dollar and will have to maintain its military supremacy and the global financial system to do so.

A high oil price results in high foreign US Dollar holdings and must be paired with low US interest rates to effectively counter the cash flow impact for the US economy. Low interest rates stimulate the domestic economy and this is what we are seeing in the US. Now that we are out of this phase, a low oil price decreases foreign US Dollar holdings and offers the opportunity to raise interest rates once again to counter the cash flow impact for the US economy.

We believe that the Fed will soon start raising interest rates. The decline in the oil price that is currently benefiting economies at the rate of 4% of GDP relative to the time the price was at its peak. An increase in interest rates will thus not impact the consumer as badly. As the US starts raising the interest rate SA and Namibia will have to follow and here too the impact of this will be cushioned by the decline in the price of fuel that will benefit consumers' pockets. Unfortunately the Namibian and SA governments are unlikely to pass on the full benefit of the lower oil price to the consumer but will pounce on the opportunity to fund some of their past excesses.

The Rand is likely to remain weak as the result of the decline in global commodity prices. An improvement of global consumer sentiment should manifest over the next one to two years on the back of lower fuel prices although higher interest rates are likely to temper sentiment.

Our investment view remains unchanged

In this phase of economic adjustment the local investor should invest in equity and property in preference to fixed interest assets, talking only about conventional asset classes.

With the expected upswing in consumer sentiment over the next year or two, one should see the demand for consumer goods and hence commodities increasing again. A weakening Rand and a depressed local economy suggest that the investor should continue to diversify offshore. 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 over the past few years, such as consumer goods and consumer services should now be switched for those shunned by them, primarily basic materials, financials and industrials. From a macro economic perspective the weakening Rand should advantage Rand hedge shares, exporters and manufacturers locally.

7. Important notice and disclaimer