Benchmark Retirement Fund

Volume 11, No. 02,
February 2015

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 28 FEBRUARY 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

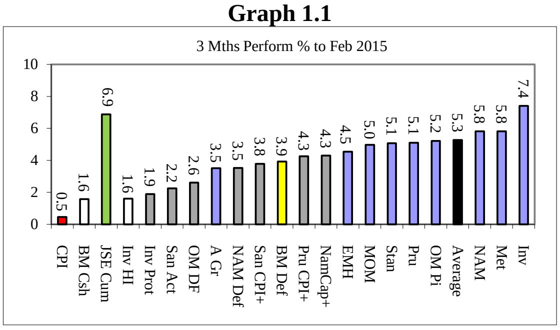
In **February** the **average prudential balanced portfolio** returned 2.56% (Jan: 1.69%). Top performer is Stanlib (3.59%); while EMH Prescient (1.22%) takes the bottom spot. For the 3 month period Investec takes top spot, for the fourth consecutive month, outperforming the 'average' by roughly 2.1%. On the other end of the scale Allan Gray underperformed the 'average', for the fourth consecutive month, by 1.8%.

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.

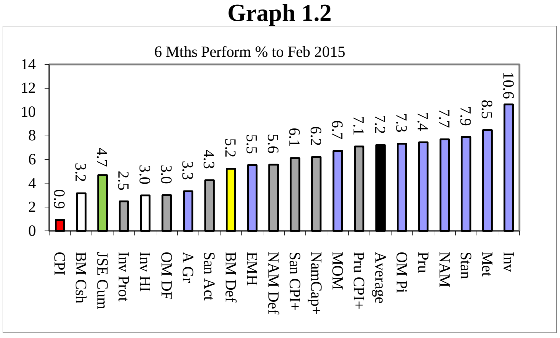
Below is the legend to the abbreviations reflected on the graphs:

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)

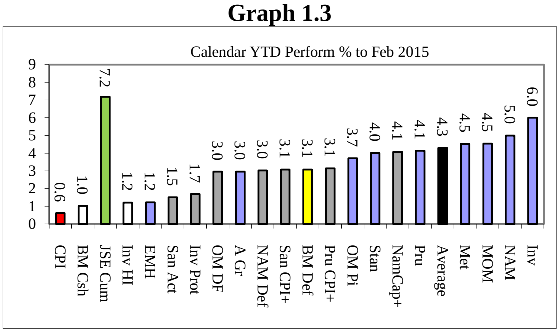
Graph 1.1



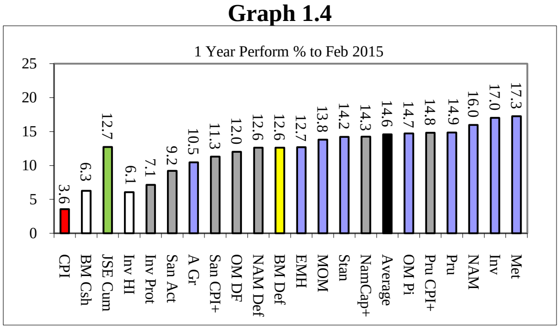
Graph 1.2



Graph 1.3



Graph 1.4



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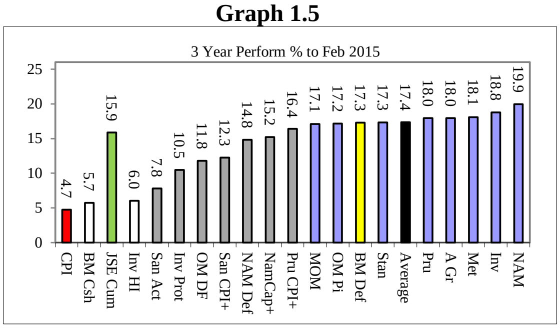
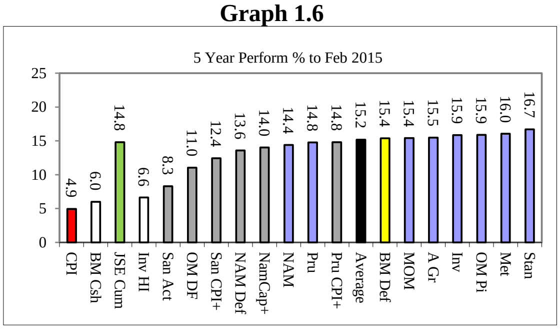
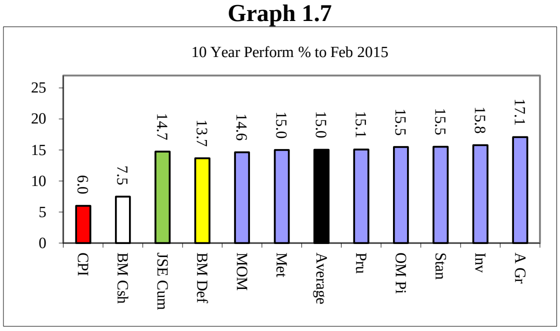
Graph 1.5



Graph 1.6

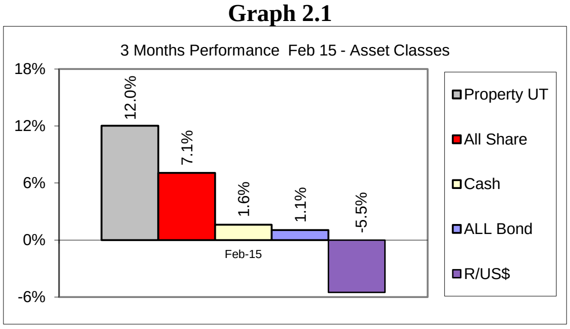


Graph 1.7

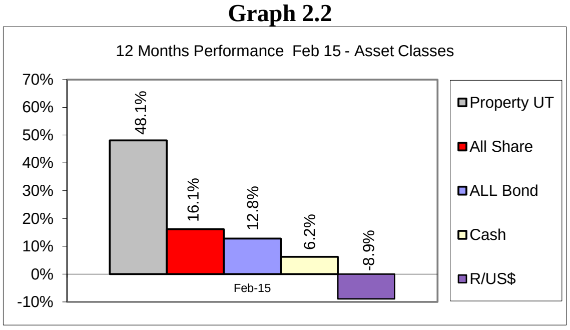


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

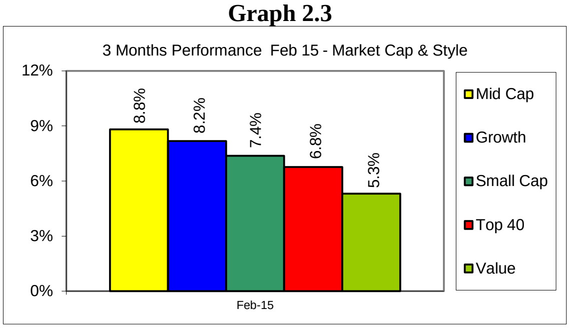
Graph 2.1



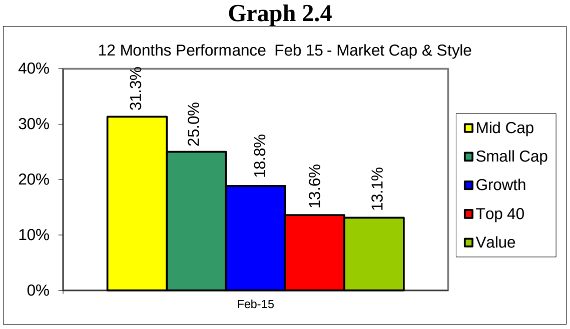
Graph 2.2



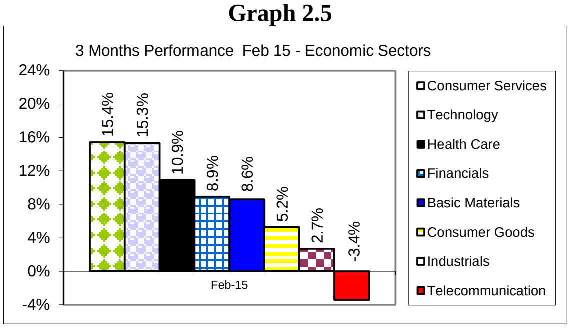
Graph 2.3



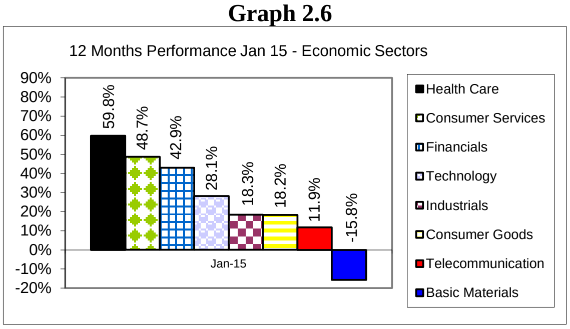
Graph 2.4



Graph 2.5



Graph 2.6



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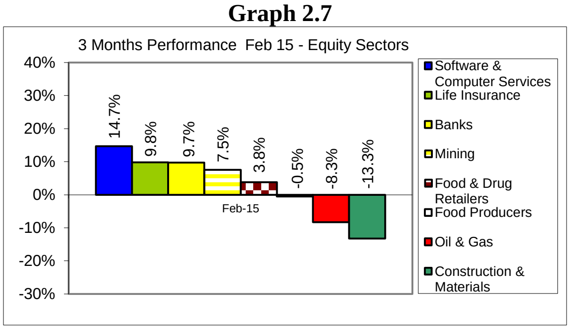
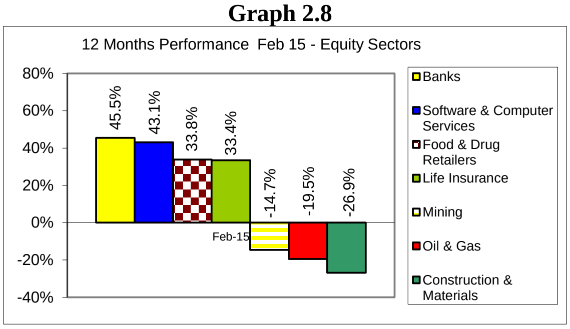


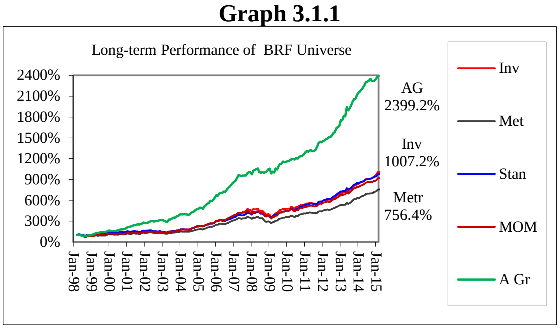
Graph 2.8



3. Portfolio Performance Analysis

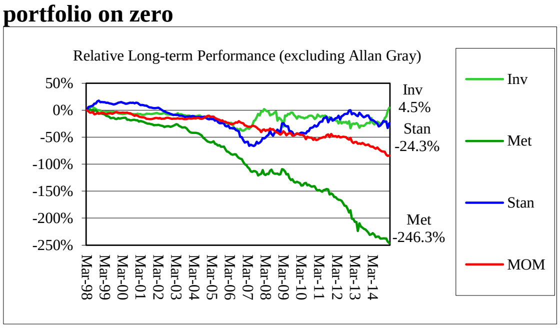
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

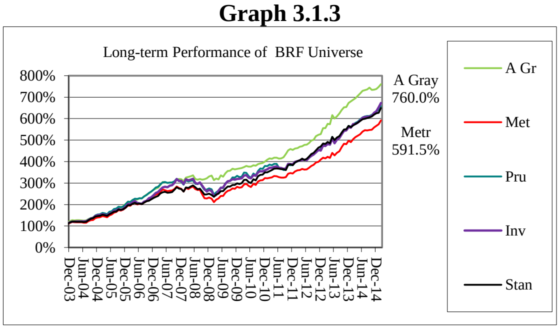


Graph 3.1.2

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

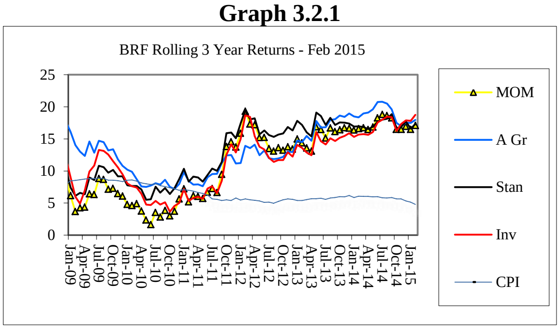


Graph 3.1.3

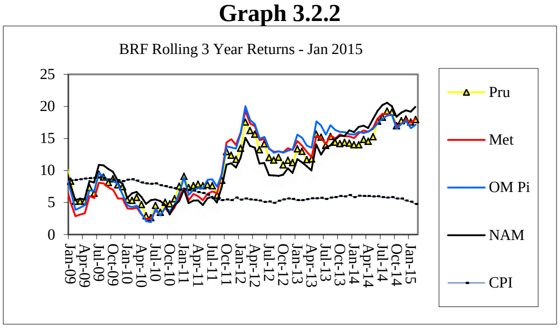


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

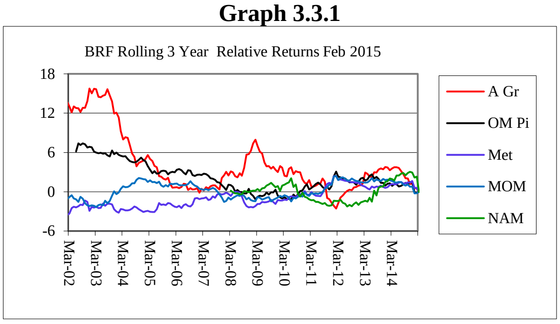


Graph 3.2.2



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

Graph 3.3.1



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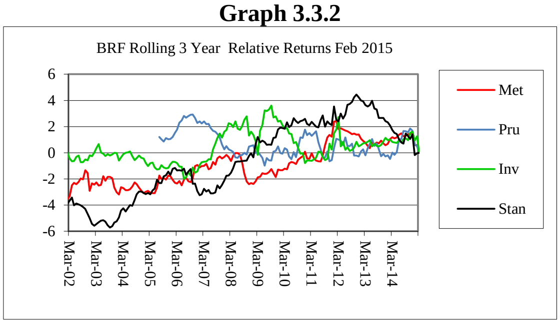
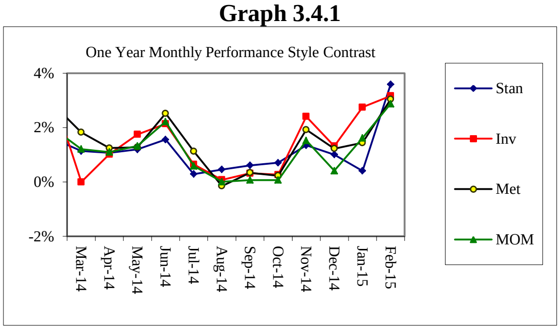
Graph 3.3.2

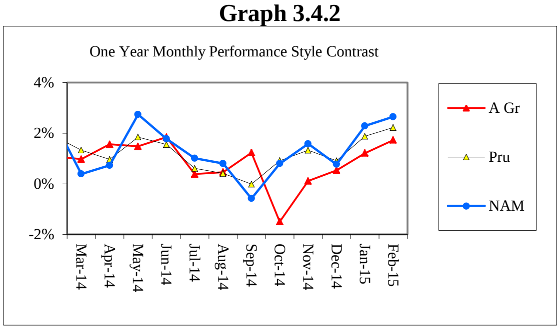


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

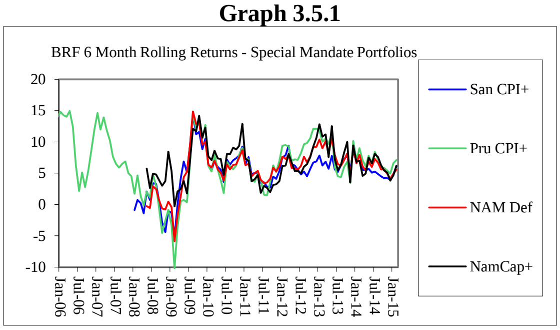


Graph 3.4.2

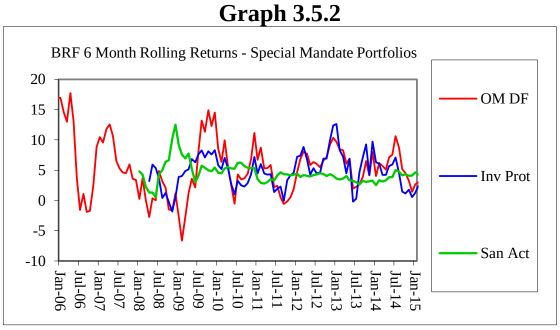


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

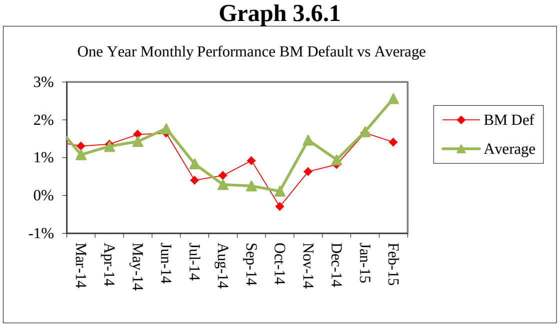


Graph 3.5.2

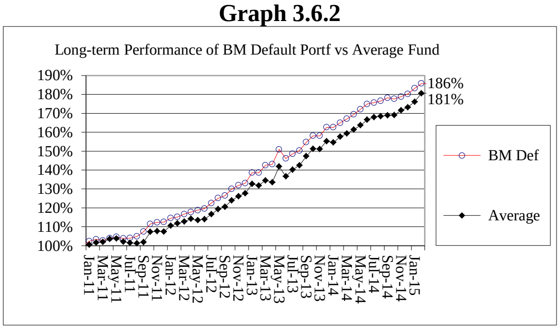


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

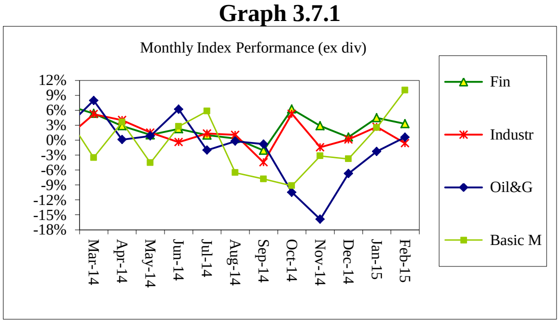


Graph 3.6.2



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

Graph 3.7.1



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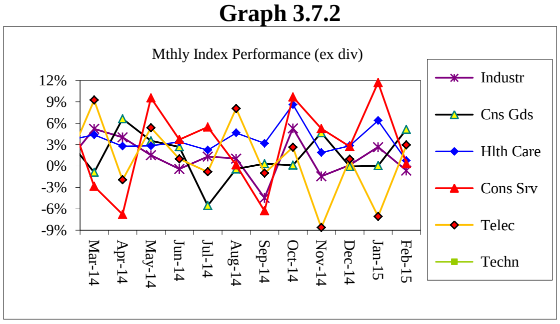
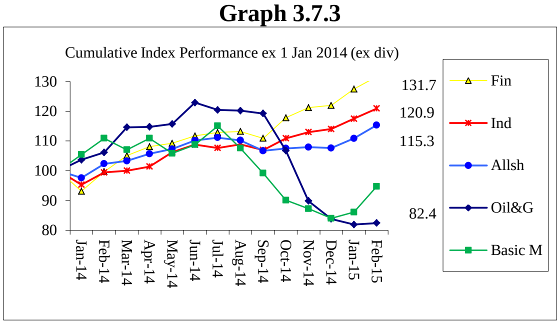
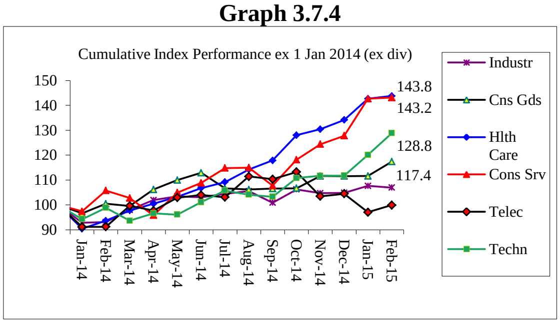
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 15.2% p.a. in nominal terms, or 10.3% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 15.4% p.a. in nominal terms, or 10.5% 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 85.8% compared to 80.6% for the average prudential balanced portfolio over this 50 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 March 2012 to February 2015:

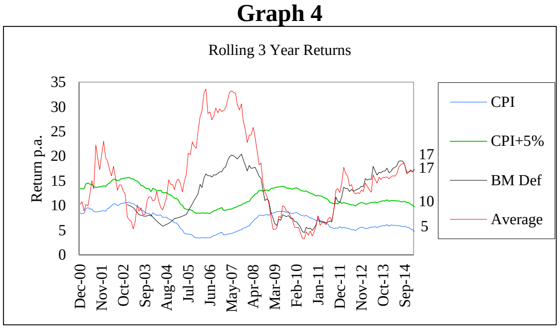
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	10.8%	9.4%
Best annual performance	6.3%	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	5.7%	17.8%	17.2%

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

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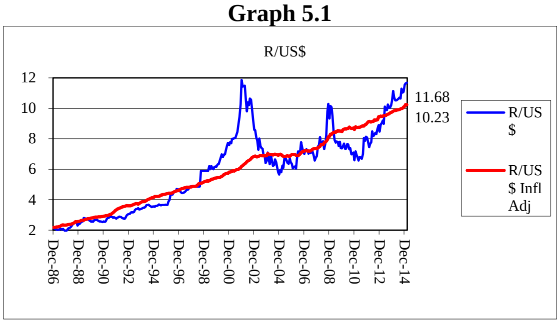
portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. It shows that since September 2008, both the Benchmark Default portfolio as 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 17.3%, the average on 17.4% vs CPI plus 5% currently on 9.8%.

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 10.23 to the US Dollar while it actually stood at 11.68 at the end of February. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

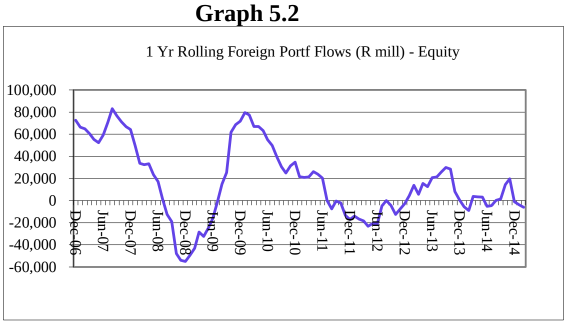
Graph 5.1



Rand continues to weaken despite foreign capital inflows

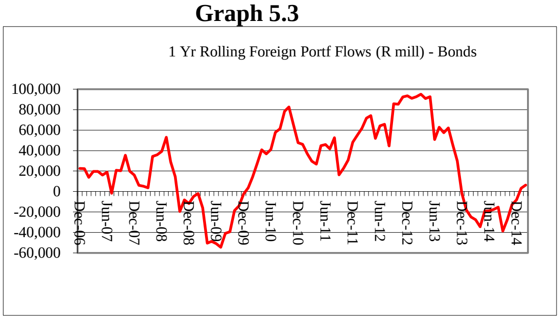
Graph 5.2 reflects a flow of capital out of South African equities on a rolling one year basis, with a net outflow of 6.1 bn on a year-on-year basis at the end of February (outflow of R 3.8 bn year-on-year to end January). Since the beginning of 2006, foreign net investment in equities amounts to R 163 bn (end January R 161 bn). This represents roughly 1.3% 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 6.4 bn over the past 12 months to end of February (inflow of R 3.2 bn over the 12 months to end of January). Since the beginning of 2006, foreign net investment in bonds amounts to R 204 bn (to January just over R 202 bn).

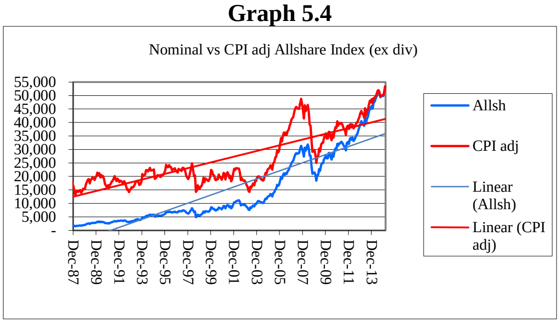
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was R 0.02 bn for the 12 months to end February 2015 (outflow of R 0.06 bn to end January 2015), compared to an outflow of R 33.9 bn for the 12 months to end February 2014 (outflow of R 23.9 bn to end of January 2014). Since the beginning of 2006, total net foreign portfolio flows amounted to R 367 bn (January R 362 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 12.4% 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 3.9% 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.

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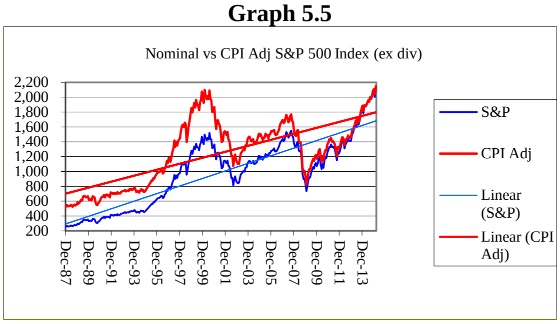
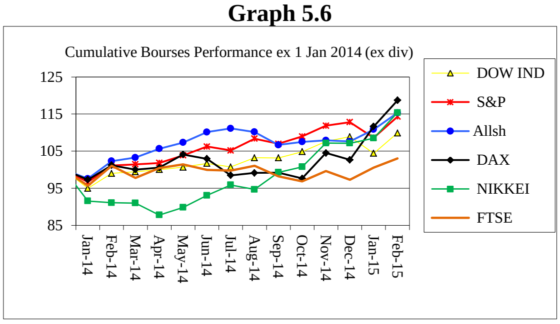


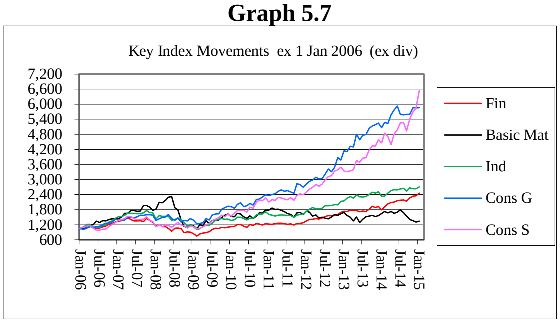
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the DAX, NIKKEI and the JSE Allshare as the top performing share indices.

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 Services: 22.8%; Consumer Goods: 21.9%; Industrials: 11.4%; Financials: 10.7% and Basic Materials: 4.3%.

Graph 5.7



6. Investment decisions need to consider both global strategic considerations and domestic economic necessities

I have started to read the book 'Currency Wars' by James Rickards. I did not get very far yet but the message is clear and frightening for me as an investor. It makes one realize how vulnerable the investor is, not to the market forces but really to the goings on behind the scenes – or is this just being naïve to believe that there is anything else but economic interests and power play using the political system to advance these interests. Hasn't this been with human beings ever since they have been around on this globe? Currency wars are part of economic warfare, which in turn is part of asymmetric warfare where all warfare is aimed at control of resources.

The relevance to me as an investor is that I should understand what the strategies of the warring parties are to know how this will impact on investment markets and on my investment decisions, besides also taking cognisance of the impact of domestic, and more particularly the US domestic, economic necessities on these markets.

Of course us mortals will never be in the position of understanding and knowing. We can speculate and hope that we are right and have consequently taken the right decisions regarding the investment of our hard earned savings.

Strategically the most important resources are currency, oil, water and agricultural land. Looking at the global political map today, the main adversaries for the control of global resources are the US and China and then there are all the other countries. As George W Bush put it – if you are not for us you are against us.

There were a lot of countries particularly in the Middle East and some in the Americas that were trying to chart their own waters on the back of the oil riches. This evidently did not serve them well. Where conventional warfare did not achieve the desired result of changing the political system and then choosing the right side, economic warfare has taken over. Russia is another country that is trying to chart its own waters. Problem is that it is the back-door to the house of China besides the fact that it is also trying to play a global game in protecting and promoting its economic interests.

Where does the US stand with regard to the key resources? It controls the global currency and it will do all - 'all options will be on the table' to use President Obama's pet phrase - to defend this status. The US is large enough to be self-sufficient as far as water, resources and agricultural land is concerned, unlike China. Although it does not have to be too worried about these strategic resources, it will no doubt try to deny China access as far as possible. Oil then is the next strategic resource. With the advent of fracking technology the US has become virtually self sufficient but for how long is a question to which I have not seen an answer yet. At this stage one would believe that the US is still strategically very much focused on securing global control of this resource which at the same time would deny control by China and would maintain China's sub-ordination.

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By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd
The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

The assertion that the dramatic collapse of the oil price has nothing to do with market forces was floated in a previous newsletter, as was the case with the dramatic incline in the price a few years earlier. So if its not market forces it must be the result of economic war games – but what could be the purpose of this? If it had anything to do with the US it has certainly hurt its own economy badly but have the other consequences been more important for the US in the greater scheme of things? It has certainly badly effected the Russian economy particularly in tandem with the sanctions imposed on Russia by the West. It will have also badly effected other oil producing countries first and foremost Saudi Arabia. Saudi Arabia seemingly being fully aligned with the US it would be odd if the US played this game. However, Saudi Arabia has a 'war chest' of something like US$ 700 billion. Considering that oil is a finite resource could it be a matter of what is not pumped this year can be pumped next year? In the short-term the only goal that the oil price strategy could then rationally have is to achieve regime change through economic hardship in countries that are not aligned with the US and that do not have the war chest of a Saudi Arabia - countries like Russia, Venezuela, Syria, Iran.

Assuming these speculations are sound, as far as the oil price is concerned, it will have achieved its goal when the desired regime change has happened. On that basis we would not expect the oil price to remain at its current levels for too long, still it could be a few years. Thereafter it should move back to a price that will make fracking viable once again which will be broadly between US$ 70 and US$ 100. This will of course help the global consumer and governments of oil importing countries across the globe. South Africa is saving on an annualised basis on the basis of the decline in the oil price in Rand terms from the beginning of 2014 to its current level, an amount of R 23 billion or approximately 0.5% of GDP (based on oil consumption of 25 million liters a day). Namibia's saving as a ratio of GDP should be very similar where Namibia's GDP is 4.4% of SA's.
Although the lower import costs of oil will help SA's trade balance, SA is currently running a large trade deficit (R 90 billion for 2014) far exceeding the benefit of lower oil import costs. The Rand will thus not experience any support but will remain under pressure as the result of foreign investors withdrawing investment capital from SA.

Besides the global strategies that impact on investment markets the investor also needs to consider how domestic economic developments may impact financial markets. Of particular importance is obviously the US economy that represents one quarter of the global economy. It is common cause that the Fed's strategy to avoid a recession following the financial crisis was to issue debt and print money on a large scale with the result that a totally artificial interest rate environment was created with negative real interest rates prevailing in many economies across the globe. It is now moving towards normalizing the interest rate environment in such was that it will not risk that the economy turns back into a recession.

The outcome of this process of normalizing the interest rate environment will in most likelihood be an increase in the local Repo rate soon. This in turn will impact negatively on fixed interest investments but should render support to equities.

As we know, the ECB has now also started its large scale asset purchase programme of € 60 billion per month in March. This is not far behind the US's equivalent that ran out in October last year. Although we do not believe that Europeans are as inclined to invest in developing countries as US investors were, but are likely to focus on developed economies, there is likely to be some 'overflow' into our bourses with an overall positive outcome for equities locally.

While the general expectation was that the money printing by the US Fed would result in an increase in US and eventually global inflation this has seemingly not happened. It is also unlikely that the ECB's printing commitment will produce a different result in the medium term. However what one should not lose sight of is the fact that these money avalanches have dramatically deflated interest rates and inflated prices of equities across the globe. No doubt, however part of the increase in equities also the inflationary impact of the money glut. The question at this stage being how much this is reflecting inflation already and how much was occasioned by artificially low interest rates? As global interest rates will start returning to normal, there will be correction of the disparity between equities and fixed interest investments to the point of a risk adjusted equilibrium between these two asset classes. For the time being equities is really the only conventional asset class one should be invested in while one should avoid fixed interest investments. Despite equities being at extremely high levels in nominal terms, the SA equity market returned only 3.5% (excluding dividends) in real terms since the beginning of 1986 while the S&P 500 returned 4.5% (excluding dividends) over this period. We do not consider this return as excessive and are therefore of the opinion that equities should be able to continue delivering fair returns over the medium to long-term.

For the next 2 years we should expect no major swings in investment markets, given no political upheavals impacting investment markets. Over this period the interest rate environment will be normalized in step with an improvement in the domestic economies. At that time we would expect inflation to start gathering pace and with that we will see interest rates being increased in step with inflation. Only at that point will fixed interest investments become an attractive asset class again. Since the US introduced its money printing programme fixed interest investors, in essence, have been, and will continue to foot the bill of these programmes for quite a number of years still.

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

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