BENCHTEST

Volume 4, No. 3, Mar 2008

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 March 2008

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 now also available on our website at www.rfsol.com.na.

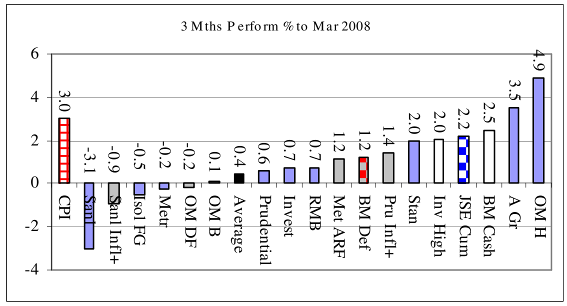
1. Review of Portfolio Performance

In March the average prudential balanced portfolio returned minus 1.34% (February 6.89%). Best and worst performance **for the month** was delivered by Allan Gray (1.01%) and RMB (minus 1.85%), respectively.

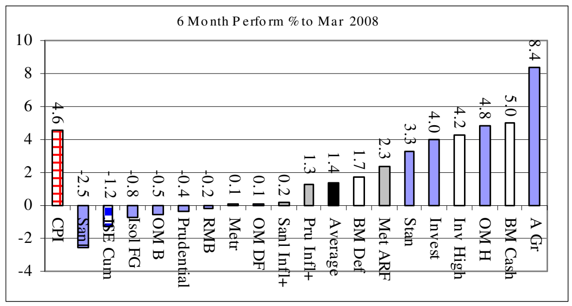
Graphs 1 to 7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential balanced portfolios (black bar) and the CPI (red checked bar). Amongst the prudential balanced portfolios, Allan Gray, Prudential and Sanlam have a value bias, the other more style neutral portfolios. Benchmark investors should take note of the performance of the default portfolio (red and grey checkered bar), which represents a combination of Prudential Inflation Plus and Metropolitan Absolute Return. Here is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Cons Price Index	CPI Cum
JSE Allshare Index	JSE Cum
Benchmark Default Portfolio	BM Def
Average Portfolio (prudential, balanced)	Aver
Special Mandate Portfolios	
Sanlam Cash	BM Cash (no colour)
Investec High Income (IBA)	Inv High (no colour)
Metropolitan Absolute Return	Metr ARF (grey)
Prudential Inflation Plus	Pru Infl+ (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Sanlam Inflation Plus	Sanl Infl+ (grey)
Market related portfolios	
Allan Gray Balanced	A Gr (blue)
Investec Managed	Invest (blue)
Investment Solutions Focused Growth (multi manager)	Isol FG (blue)
Prudential Managed	Prudential (blue)
Metropolitan Managed	Metr (blue)
Old Mutual Profile Balanced	OM B (blue)
Old Mutual Profile Growth	OM H (blue)
RMB Managed	RMB (blue)
Sanlam Managed	Sanl (blue)
Stanlib Managed	Stan (blue)

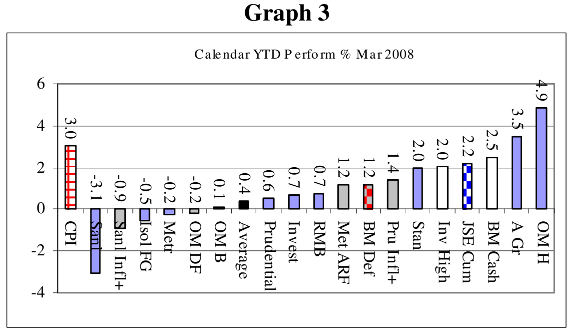
Graph 1



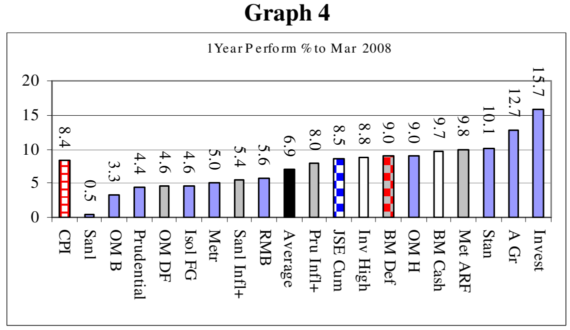
Graph 2



Graph 3



Graph 4



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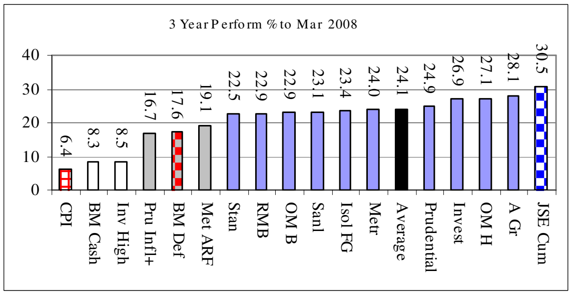
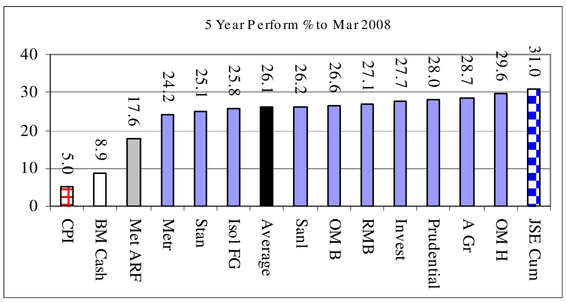
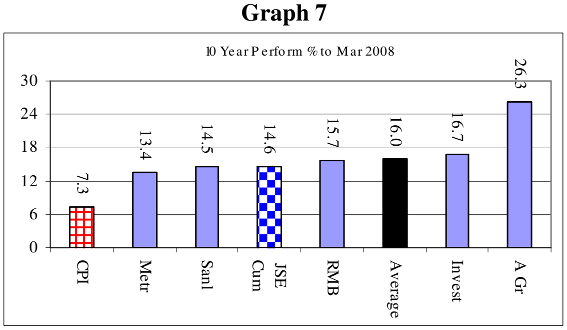
Graph 5



Graph 6



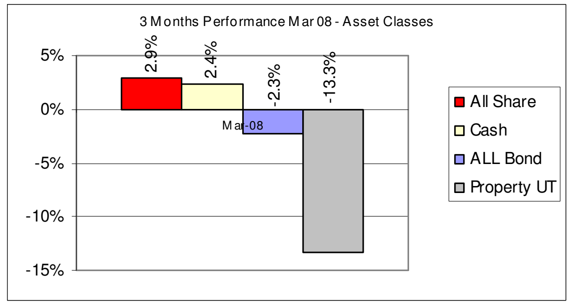
Graph 7



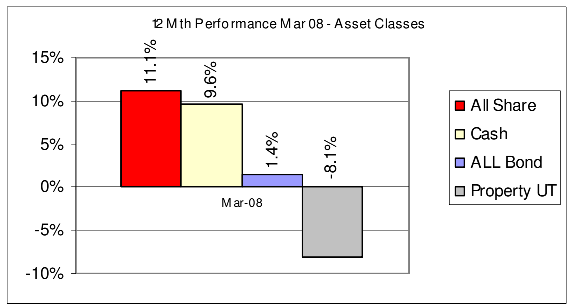
2. Review of Performance of Key Indices (index performance by courtesy from pointBreak/Deutsche Securities)

Graph 8 and **graph 9** show the same order of asset classes in terms of performance, including dividends, over the quarter and the 12 months. The poor performance of bonds and property can be ascribed to recent increases of the Repo rate by the SARB.

Graph 8

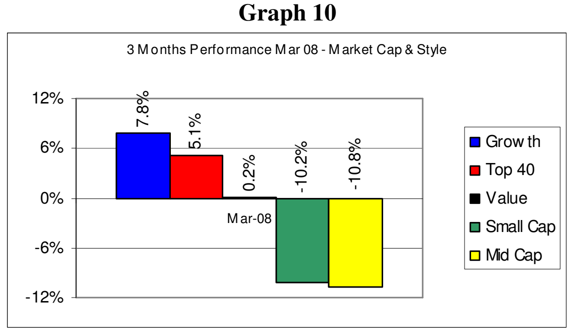


Graph 9



As for the above graphs, **graph 10** and **graph 11** reflect the same order, over 3 and 12 months, of type of company and market capitalization. In times of uncertainty and volatility, one would expect large cap companies to do better than the smaller companies, and one would expect the top performers and the bottom performers to switch position from one quarter to the next.

Graph 10



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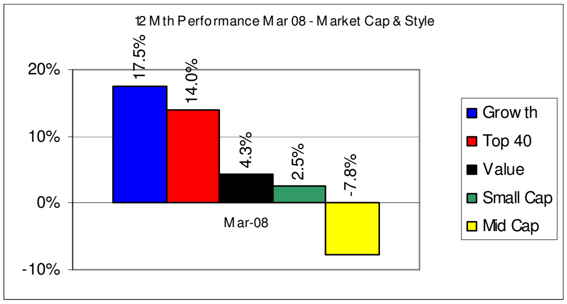
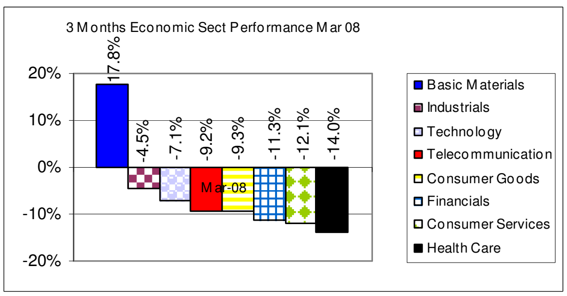
Graph 11

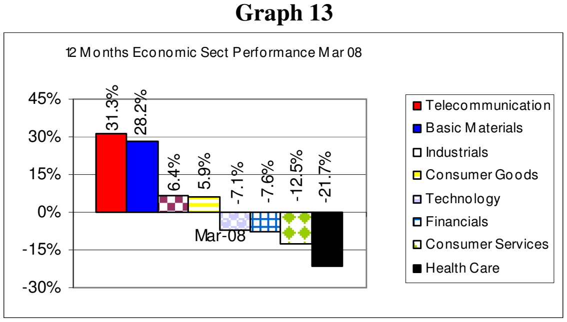


Graph 12 and **graph 13** depict the performance of the main equity sectors. Of the sectors with the highest weights, only basic materials managed to out perform cash over 3 and 12 months, the others being industrials, consumer goods, financials and consumer services.

Graph 12

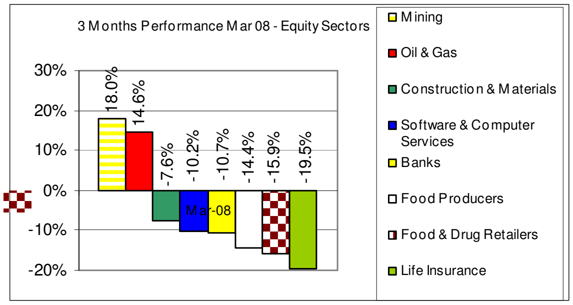


Graph 13

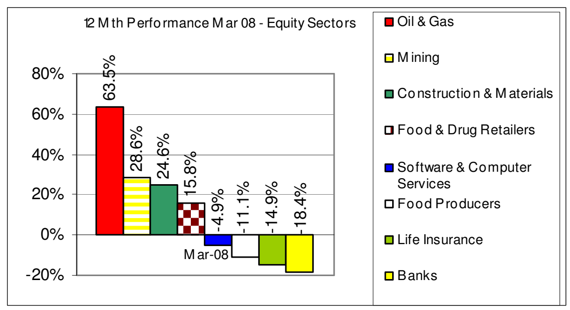


Drilling down one level into the main equity sectors, **graph 14** and **graph 15** shows that resources are still experiencing a bull run. Has the construction sector now run out of steam with a negative performance over the latest quarter and a much flatter performance over the 12 months?

Graph 14



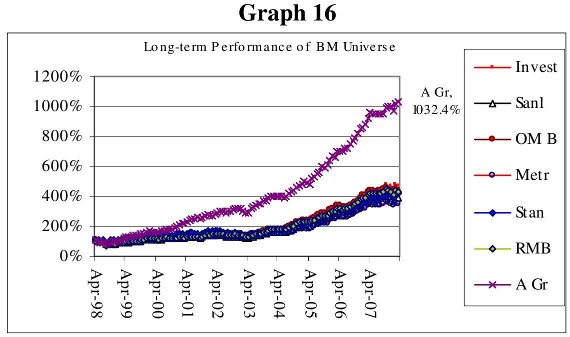
Graph 15



3. Portfolio Performance Analysis

Namibian prudential balanced portfolios essentially only acquired their own identity in 1998 when changes were brought about regulation 28. **Graph 16** and **graph 17** reflect cumulative performance of these portfolios since April 1998 and since January 2003, respectively. The conclusions should be self evident.

Graph 16



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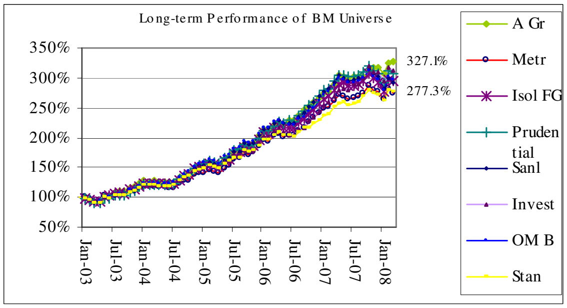
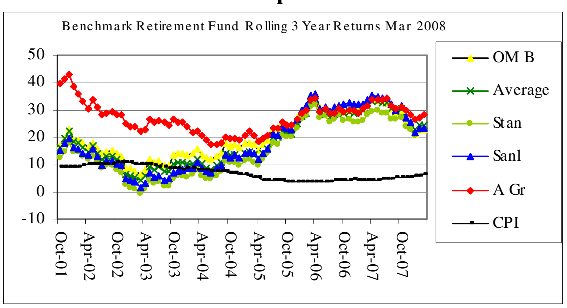
Graph 17

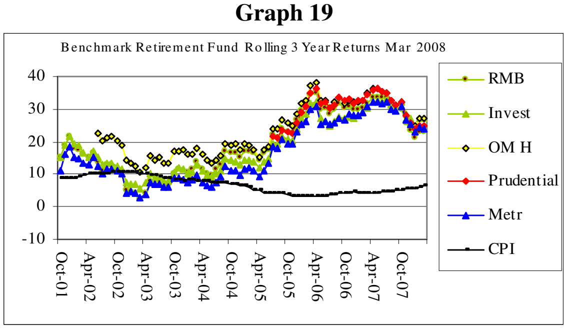


Graphs 18 and graph 19 reflect rolling 3 year returns since October 1998. For long-term projection and planning purposes the general assumption is that prudential balanced portfolios should outperform the CPI by between 3% and 5%, which has over this period only been achieved throughout by Allan Gay.

Graph 18

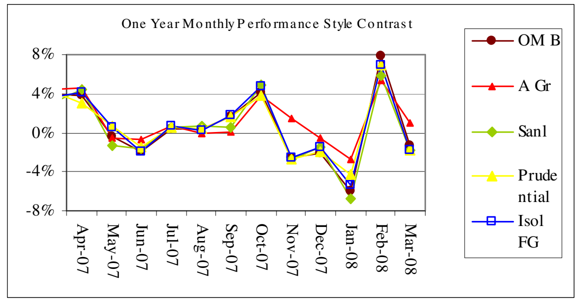


Graph 19

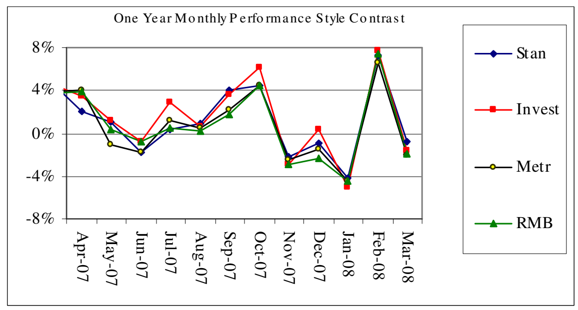


Graph 20 and **graph 21** depict the monthly performance of the prudential balanced portfolios in this survey. What it shows is that managers do generally perform very similarly but it also affords the opportunity to identify odd trends for further investigation and for drawing conclusions about expected future performance and historic skills of the managers.

Graph 20

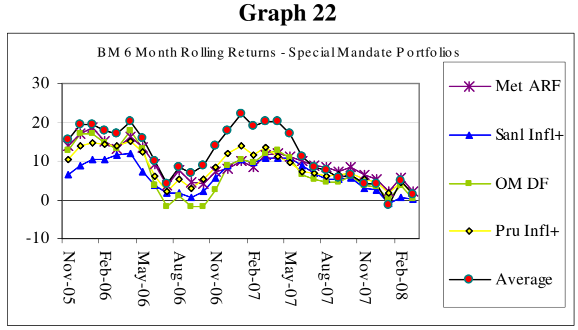


Graph 21



Graph 22 puts some focus on the 'special mandate portfolios' in relation to the average prudential balanced portfolio, in terms of 6 month rolling returns. **Graph 23** depicts the monthly performance of the Benchmark default portfolio in relation to the average prudential balanced portfolio. These graphs should give the investor a pretty good feel for what he can expect in terms of performance volatility and relative performance over the long term.

Graph 22



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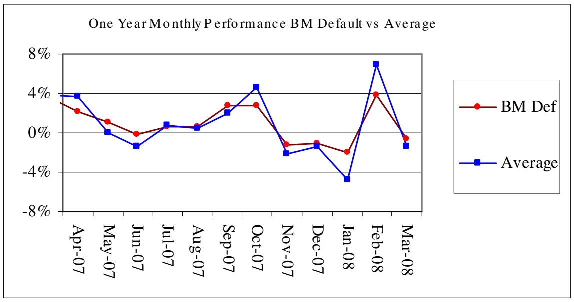
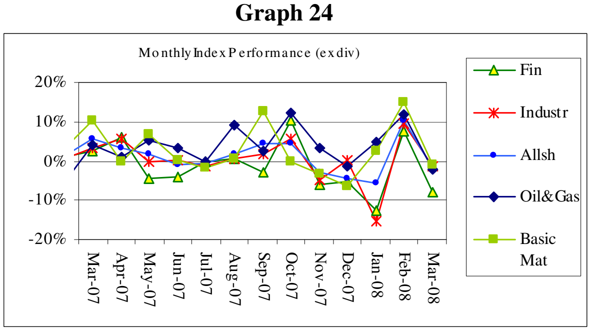
Graph 23

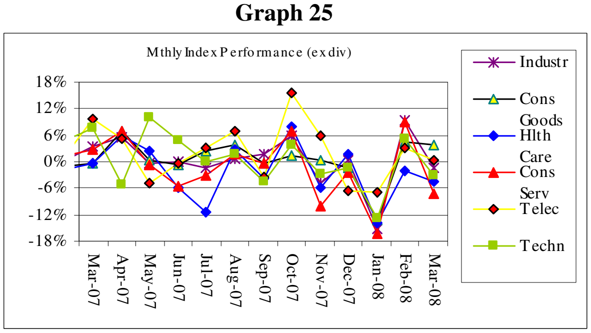


Graph 24 and **graph 25** afford the investor the opportunity to compare managers' monthly performance (as depicted in graph 20 and graph 21) against various equity sectors and to draw his conclusions regarding a manager's investment style and philosophy. **Graph 25** and **graph 26** serve a similar purpose, but with regard to cumulative performance since January 2007.

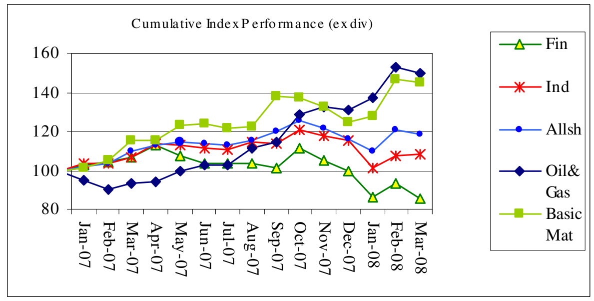
Graph 24



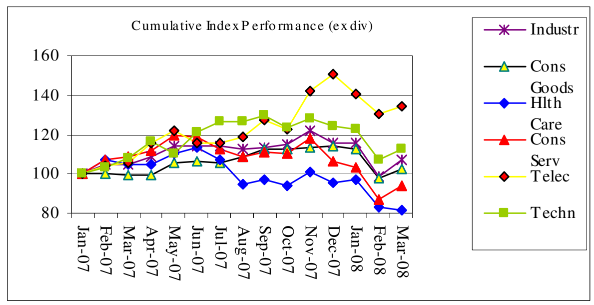
Graph 25



Graph 26



Graph 27



4. A Preview Of The Next 12 Months

The theme of the day has recently been, and will be, the sub-prime crisis, for some time to come, still to be followed by its knock-on effects. Banks and other financial institutions had to write off billion and billions, and to save their balance sheets many had to find foreign investors who are prepared to invest in their institution and to save them from bankruptcy. Central banks have created liquidity to assist while the US Federal Reserve reduced its lending rate to 2.25% also to lend support to the system. Considering the fact that US inflation is currently running at 4.4%, the questions beg to be asked – is this sustainable and who pays for the difference, probably not far off US$ 200 billion per annum or around 0.4% of US GDP, just to return zero percent real?

Another pet theme of ours, and in our view **the only** theme of real global significance at this stage, is the extremely high oil price that currently produces windfall surpluses for oil producing countries of around US$ 3 trillion per annum, or roughly 1.8% of total world financial markets, or 5% of global GDP, or 21% of US GDP, frightening isn't it? This means that there is an avalanche of money flowing from the rest of the world to oil producing countries and disproportionately so from the poorer countries, in terms of personal disposable incomes. With distortions in global markets of such magnitude, we admit, the possible consequences are beyond our grasp. What seems obvious is that wherever these money flows are directed, major

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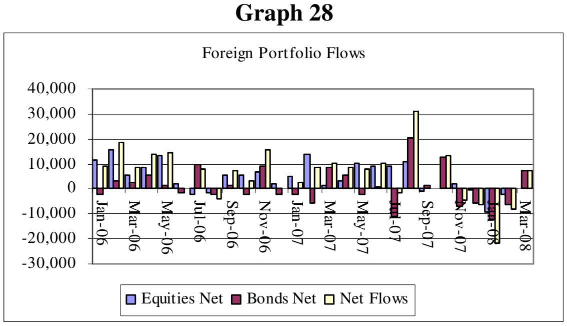
repercussions will manifest. Was the sub-prime crisis possibly a consequence of such redirected money flows? Is the weak Dollar and the strong Euro a result of oil producing countries exchanging Dollars for Euros? Going back to the recent run in SA resources, there is a strong correlation to the run in the oil price, which implies severe potential repercussions for our local equity markets if the oil bubble should itself burst.

We have not seen any rational explanation for the excessive price of oil. Supply and demand, according to all available statistics, seem to be pretty much in balance and this is borne out by comments coming from oil producing countries being pressurized to raise production. The reason they offer is speculation. So someone borrows money (from oil producers?) to buy oil today to on sell at a higher price tomorrow. The same happens tomorrow and the day after and of course the balance sheet looks better by the day as the result of all these paper profits. One visualizes a water fountain that keeps rising for as long as the pressure can be raised systematically, the final collapse being inevitable, only the timing being uncertain. Besides such dramatic corrections or bubbles to burst, a more gradual dissipation of money will occur and has commenced already by way of increasing global food (or commodity) prices. Currencies will play their part in finding equilibrium in global markets. Social turmoil is probably unavoidable with distortions of such proportion as we have also started to evidence.

For South Africa and Namibia the inevitable correction of prevailing imbalance in global financial market should have the effect of higher inflation, higher interest rates, eventually higher taxes and a weaker currency, which in turn feeds inflation. We had all these factors working for us over the past couple of years, but it seems the party is over, or will soon be.

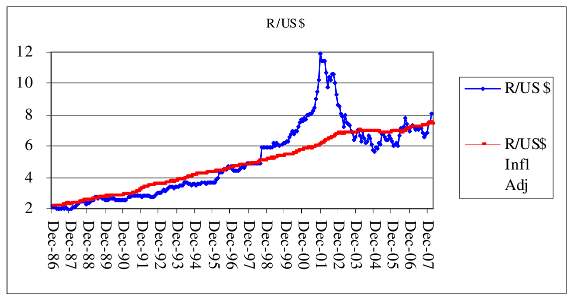
In South Africa we have seen equity markets, and other asset classes for that matter having been boosted by massive inflow of foreign capital. **Graph 28** shows a reversal in these flows, having turned negative since October last year with some inflow into bonds in March.

Graph 28



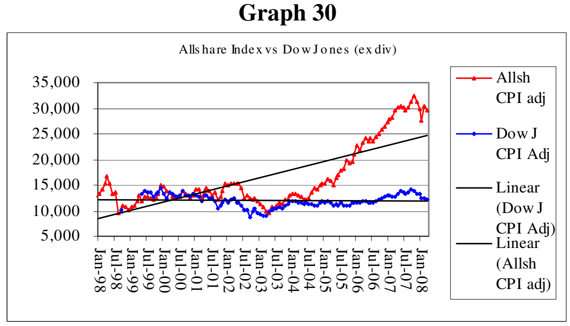
Graph 29 indicates that on the basis of fundamentals, the Rand was overvalued in US$ terms since 2003, probably driven by high commodity prices and high foreign portfolio flows. Currently the Rand stands at around 7.75 after weakening even further recently, mainly as the result of a slight weakening of the US$, fair value per **graph 29** shown as 7.46. At the current inflation differential between the US and SA, i.e. 4% vs 8%, the Rand should stand at its current level by the end of the year.

Graph 29



Graph 30 shows clearly to what extent the South African share market has departed from the US market, despite the recent correction, far off its US peer.

Graph 30



5. Conclusion

Given the above scenario, there is no harm for the pension fund member to keep his investment in cash at this stage. It is important though, firstly, to understand what returns you expect over the long-term? Secondly, since forecasting the future is crystal ball gazing, one will need to take a view on global market developments and how these are expected to impact on investible asset classes and currencies.

Cash will currently produce a return of inflation plus 1.7% with little risk, risk being mainly any significant change in the inflation rate. In view of the inflation currently being expected to trend upwards and the SARB policy of curtailing inflation through proactive interest rate management, we do not see any risk of negative real returns on cash in the near term. Such developments will be negative for bonds and property though. We expect these developments to 'put a lid' on equity performance while they are likely to result in the depreciation of the Rand. Weighing up foreign markets against local markets, we expect our markets to bear more negative potential than foreign markets. Developing countries should experience the increase in energy and food prices more negatively than developed countries where in the latter case, a smaller portion of disposable income is applied to consumption. A logical consequence of these expectations is that one should be fully invested offshore. Locally, these expectations would favour cash first, then equities.

The Benchmark targeted return portfolios (Prudential Inflation Plus and Metropolitan Absolute Return), strive to produce a return of between 4% and 5% above inflation, over the medium term with a low effective equity exposure. This should be about 2% less than what one can expect from balanced portfolios in the long term. At the moment with the high market volatility, they are out performing the average balanced portfolio and we do not expect the balanced portfolios to out perform these portfolios for the next 6 months or so. Both types of portfolio should find it difficult to out perform cash for the next 6 months or so, but the balanced portfolios even less so, in our view. Too much negative sentiment currently prevails on the part of the consumer and more potential of that exists. There are optimists around though who think equities will experience a re-rating in the next 6 to 12 months, so be forewarned.

Pension portfolios simply do not lend themselves to timing the market and one must take a long-term view and stick to one's strategy. We currently do not see any potential for a major swing in the markets either positive or negative. Spreading one's entry into the market over time, whilst not critical based on our expectations, remains the most rational approach to take at this stage, if one aspires to out perform targeted return portfolios. If one is comfortable with the return targets of the targeted return portfolios one can comfortably ignore any timing issues as these portfolios already provide substantial protection against a major down turn in the market.

6. Important notice and disclaimer

Whilst we have taken all reasonable measures to ensure that the results reflected herein are correct, Benchmark Retirement Fund and Retirement Fund Solutions Namibia (Pty) Ltd do not accept any liability for the accuracy of the information and no decision should be taken on the basis of the information contained herein before having confirmed the detail with the relevant portfolio manager.