Volume 11, No. 03,
March 2015

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MARCH 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

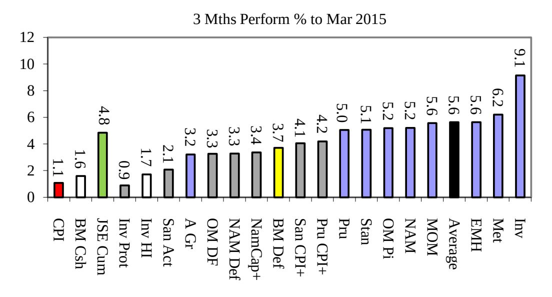
In **March** the **average prudential balanced portfolio** returned 1.28% (Feb: 2.56%). Top performer is Investec (2.96%); while Namibia Asset Management (0.19%) takes the bottom spot. For the 3 month period Investec takes top spot, for the fifth consecutive month, outperforming the 'average' by roughly 3.5%. On the other end of the scale Allan Gray underperformed the 'average', for the fourth consecutive month, by 2.4%.

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.

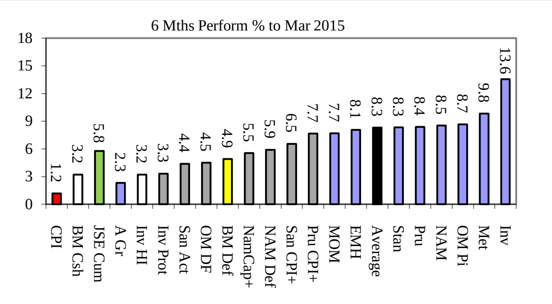
Below is the legend to the abbreviations reflected on the graphs:

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)

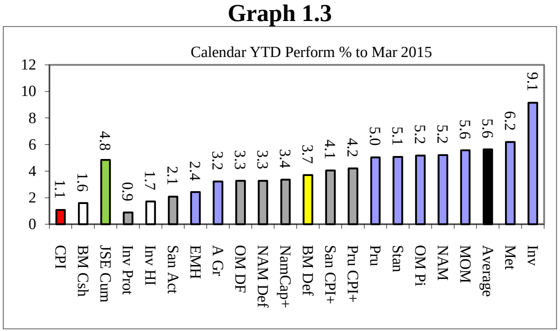
Graph 1.1



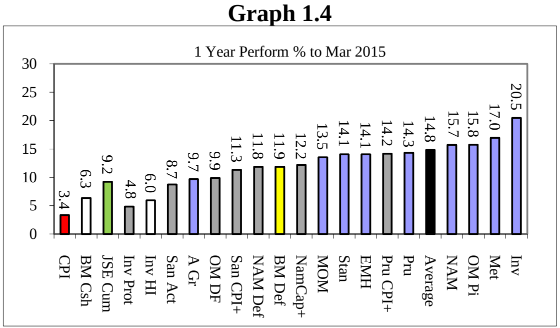
Graph 1.2



Graph 1.3



Graph 1.4



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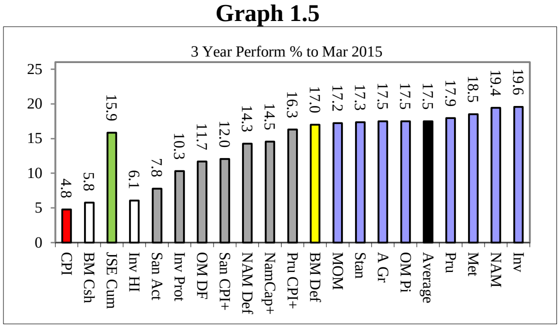
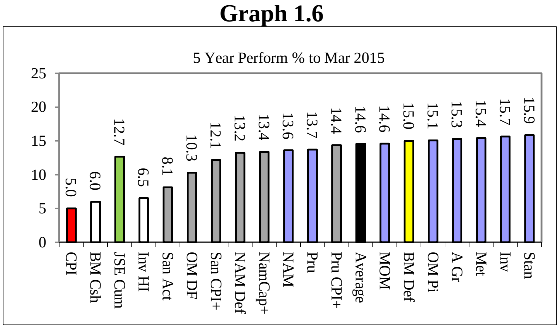
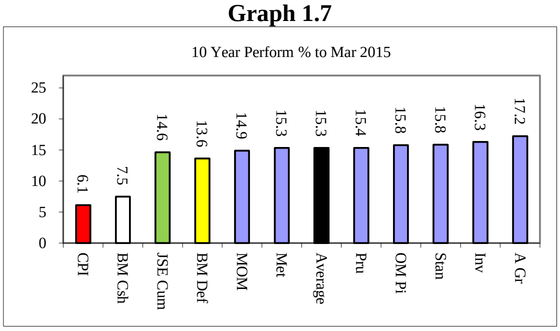
Graph 1.5



Graph 1.6

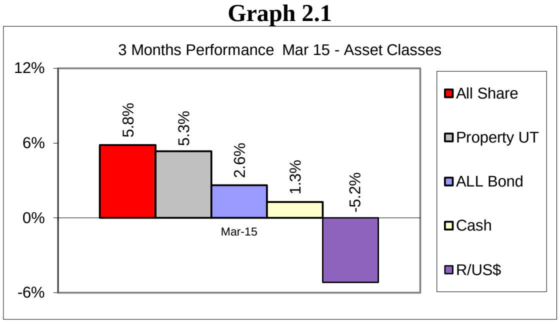


Graph 1.7

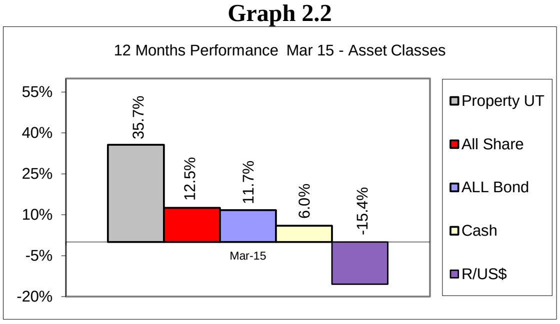


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

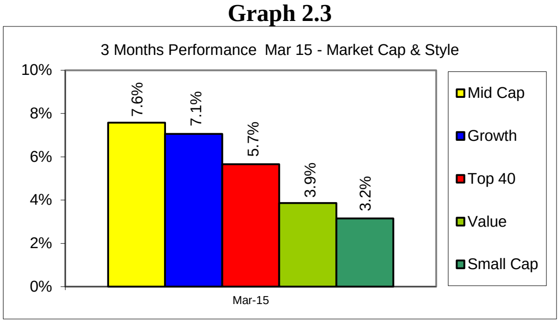
Graph 2.1



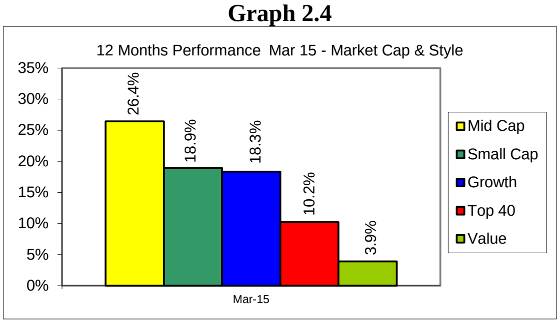
Graph 2.2



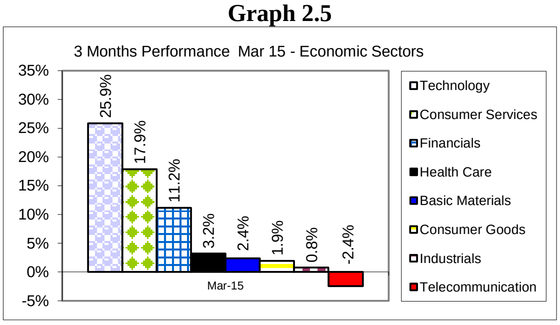
Graph 2.3



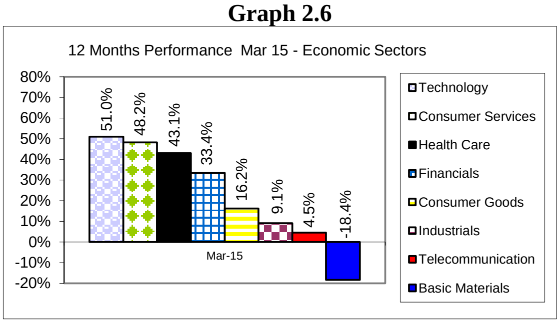
Graph 2.4



Graph 2.5



Graph 2.6



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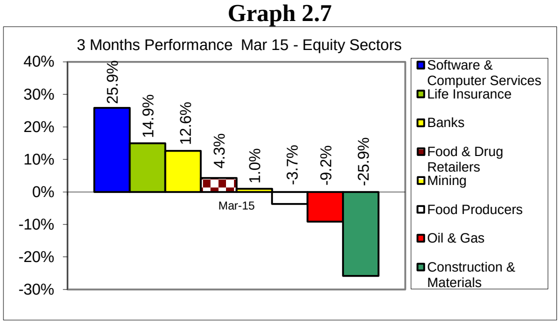
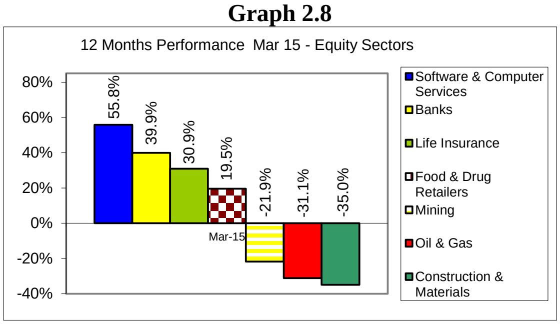
Graph 2.7



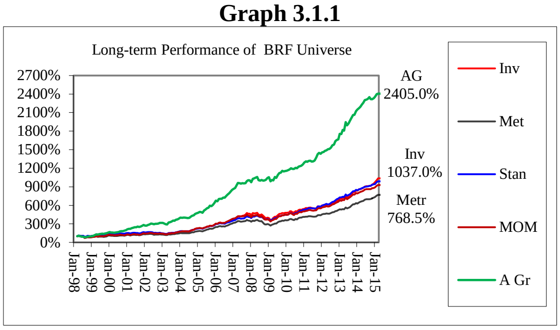
Graph 2.8



3. Portfolio Performance Analysis

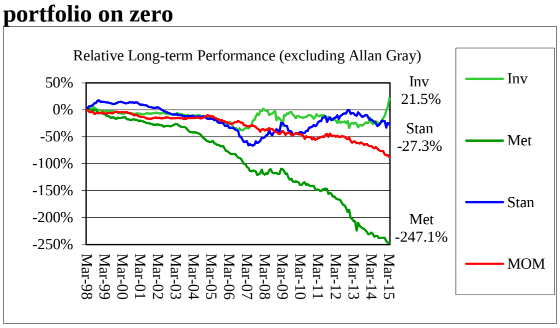
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

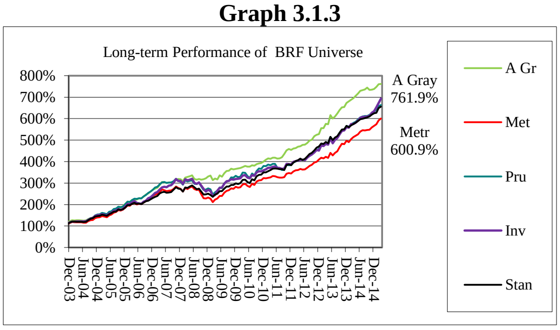


Graph 3.1.2

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

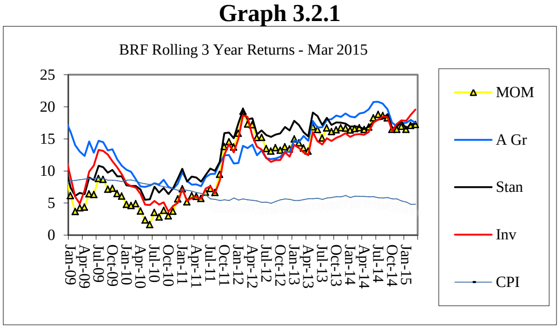


Graph 3.1.3

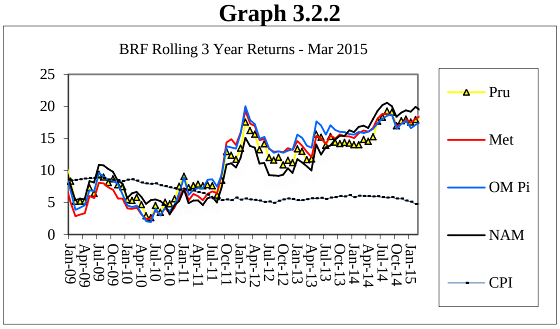


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

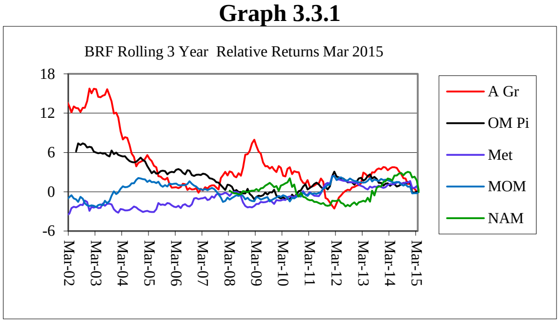


Graph 3.2.2



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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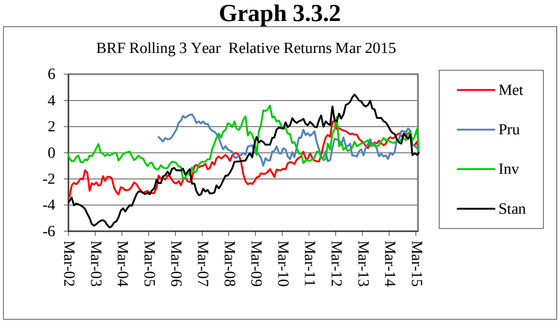
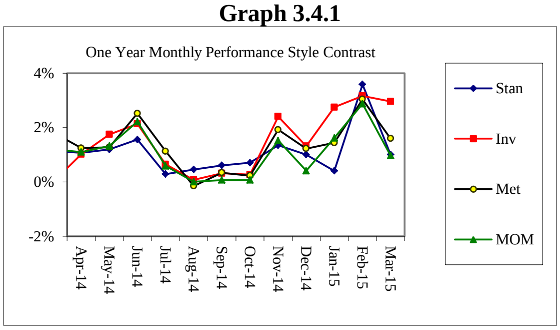
Graph 3.3.2

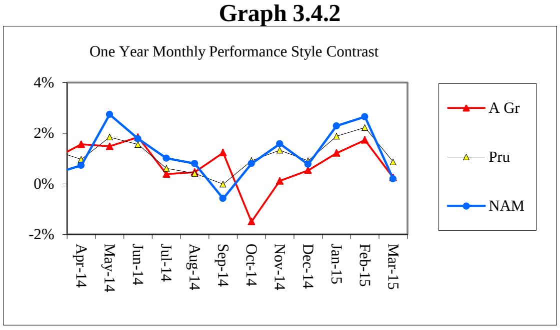


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

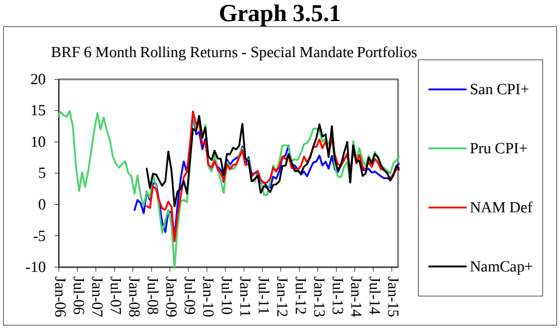


Graph 3.4.2

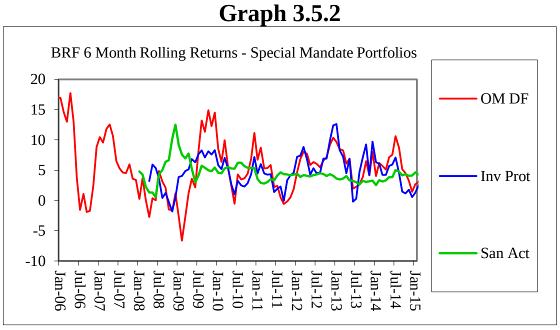


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

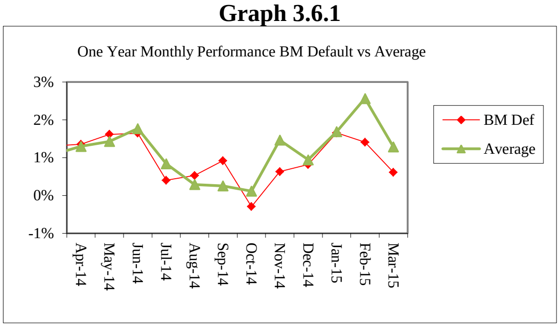


Graph 3.5.2

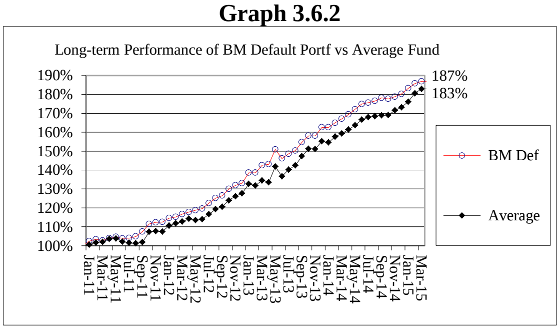


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

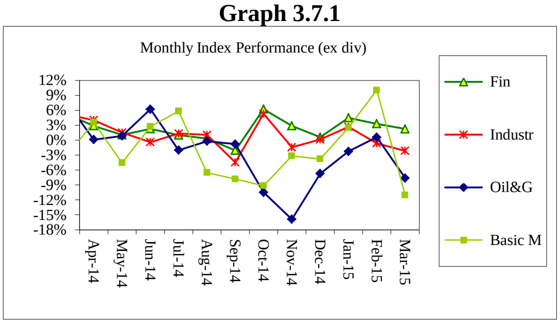


Graph 3.6.2



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

Graph 3.7.1



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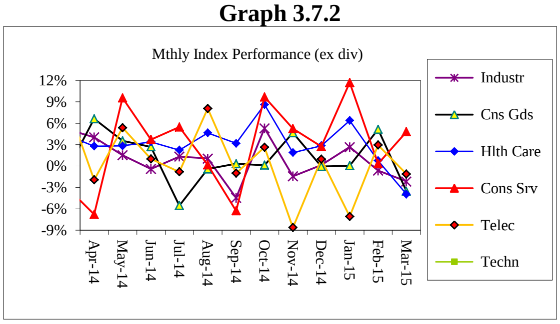
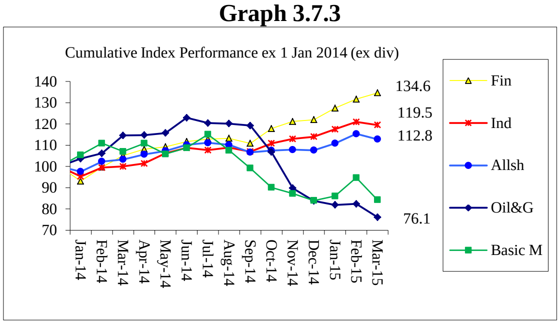
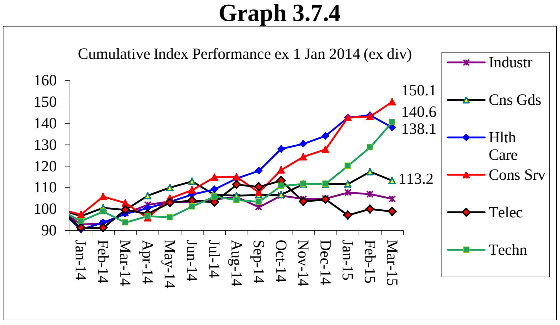
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 14.6% p.a. in nominal terms, or 9.6% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 15.0% p.a. in nominal terms, or 10.0% 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.

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 86.9% compared to 82.9% for the average prudential balanced portfolio over this 51 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 April 2012 to March 2015:

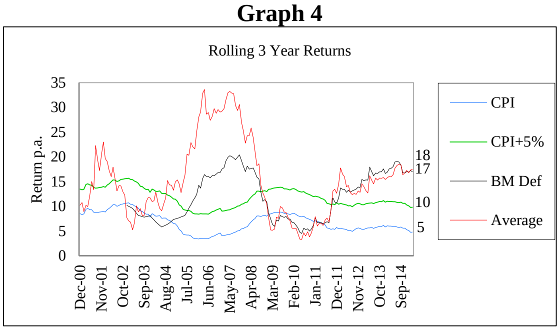
Table 4.1

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%	17.3%

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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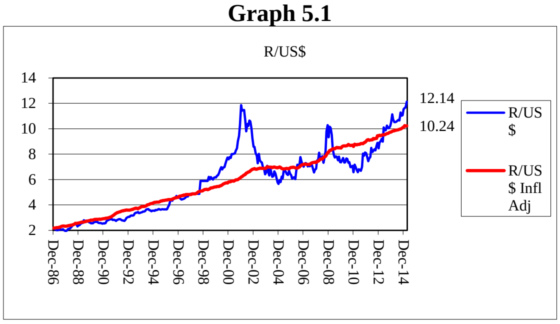
portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end March was 17.0%, the average was 17.5% 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 10.24 to the US Dollar while it actually stood at 12.14 at the end of March. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

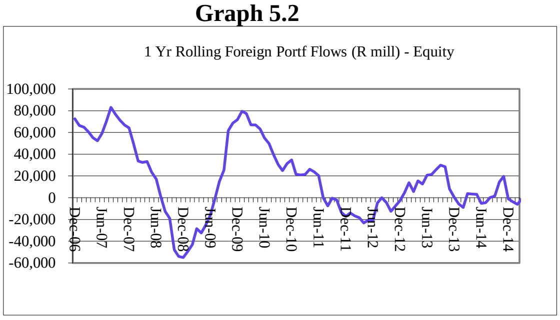
Graph 5.1



Rand continues to weaken with foreign capital outflows

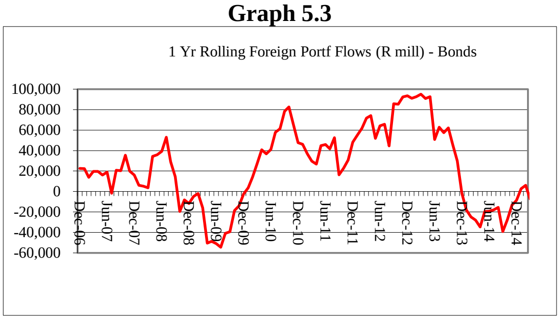
Graph 5.2 reflects a flow of capital out of South African equities on a rolling one year basis, with a net outflow of 1 bn on a year-on-year basis at the end of March (outflow of R 6.1 bn year-on-year to end February). The month of March experienced a net inflow of R 12.8 bn. Since the beginning of 2006, foreign net investment in equities amounts to R 175 bn (end February R 163 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 7.2 bn over the past 12 months to end of March (inflow of R 6.0 bn over the 12 months to end of February). Since the beginning of 2006, foreign net investment in bonds amounts to R 199 bn (to February just over R 204 bn). The month of March experienced a net outflow of R 5 bn.

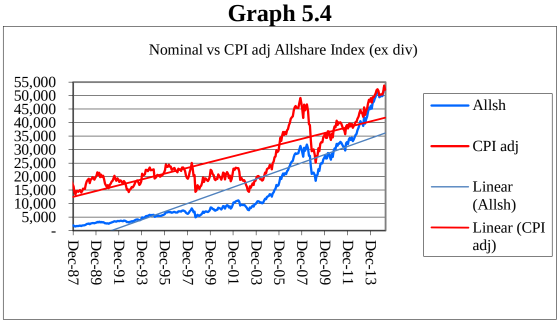
Graph 5.3



The net inflows of foreign capital from equity and fixed interest assets was R 8.2 bn for the 12 months to end March 2015 (outflow of R 0.2 bn to end February 2015), compared to an outflow of R 24.2 bn for the 12 months to end February 2014 (outflow of R 33.9 bn to end of February 2014). The month of March experienced a net inflow of R 7.2 bn. Since the beginning of 2006, total net foreign portfolio inflows amounted to R 375 bn (February R 367 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 of just over 28 years 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 7.4% per annum, over this period of just over 28 years. US inflation over this period was 2.7%. This is equivalent to a growth in real terms of 4.7% p.a. over this period, excluding dividends.

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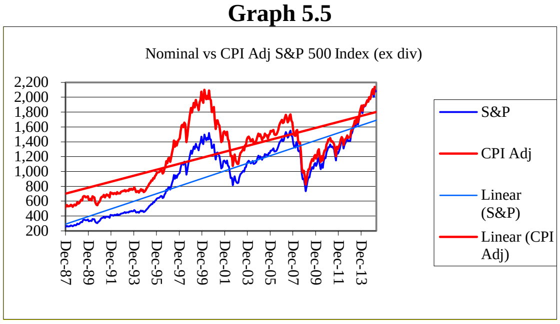
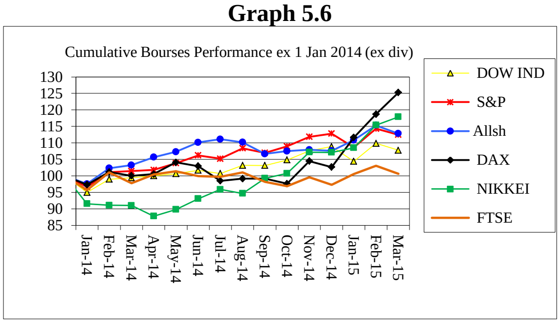
Graph 5.5



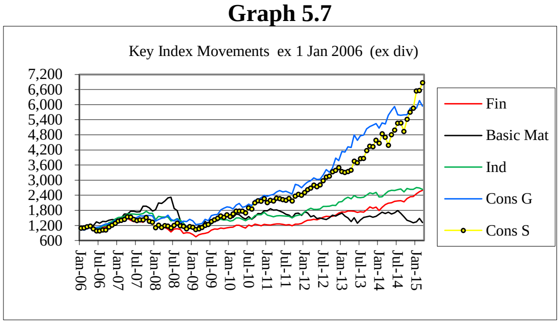
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the DAX, and the NIKKEI as the top performing share indices.

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: 23.2%; Consumer Goods: 21.3%; Industrials: 11.0%; Financials: 10.9% and Basic Materials: 3.0%.

Graph 5.7

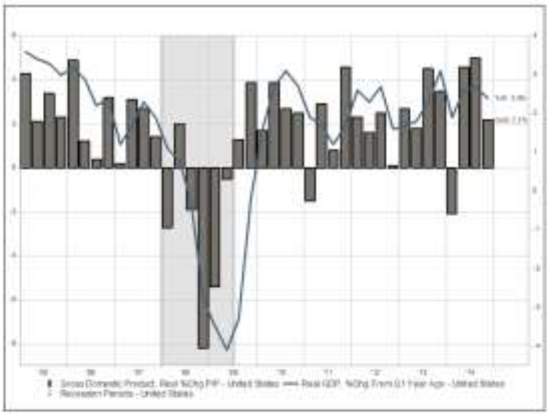


6. Global market sailing in calmer waters

Global investment markets have not changed significantly since last month's newsletter as the result of the economic environment having remained stable. The WTI oil price declined only marginally from US$ 49.80 to US$ 48.9. In Rand terms it increased slightly from R 581 to R 593.The Rand weakened slightly from US$ 11.68 to US$ 12.14, while global interest rates remained unchanged. Is this the calm before the storm and is there any need for the investor to adjust his investment strategy?

As the result of the strengthening of the US$ against most global currencies, the expansion of the US economy has lost some steam, expanding at only 2.2% over the third quarter of 2014, as opposed to 5% over the 3rd quarter. The following graph depicts this trend:

Graph 6.1

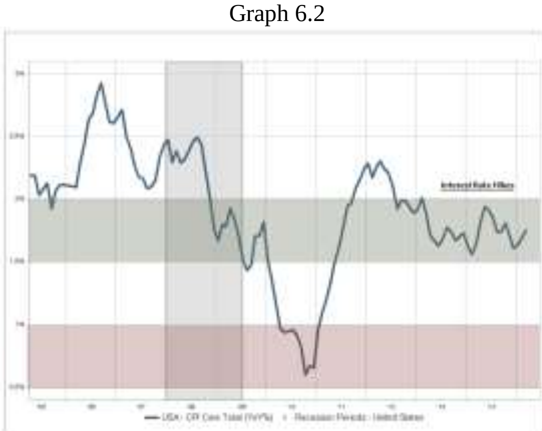


Source: Factsheet

Conversely, the weakening of the Euro has aided the European economy, growing at 0.9% in 2014, compared to 0.5% in 2013, despite the negative impact of sanctions imposed on Russia in the earlier part of 2014.

US inflation, another key economic indicator for the determination of the US repo rate, besides the state of the economy, shows no clear trend despite an upturn since the beginning of the year as depicted by the following graph.

Graph 6.2



Source: Factsheet

Based on these parameters, it seems that the US economy is not 'ripe' yet for an increase in the repo rate, there being neither a clear indication of a sustainable expansion of the economy nor of clear upward trend of inflation. Following the weekly utterance of the various

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US reserve bank governors, their views consistently alternate between an increase in the repo rate and maintaining the status quo. Foreign investors seem to believe in an increase in the repo rate in the not too distant future, having withdrawn R6 billion from the SA equity market and R 7 billion from the SA fixed interest market over the 12 months to end of March 2015.

The fact that any government would want its economy to expand is evident, as it should lead to an improvement in the employment rate and an improvement in the tax base that funds government. Inflation, typically not perceived as positive by the consumer, does present the benefit to the government of improving the net wealth through the appreciation of asset values while debt remains unchanged, and it raises the income levels of consumers and hence the tax revenue for the government. The US government does have a debt problem following the quantitative easing program that was aimed at getting the US economy back onto the growth path after the financial crisis in 2008.

An effective means of growing the economy is a weak exchange rate. As pointed out above, however, the US Dollar has actually strengthened gradually against most currencies of its main trading partners, which no doubt has put a damper on the economy as depicted in graph 6.1. Whereas the repo rate is typically employed by monetary authorities to manipulate the currency, as low as the US repo rate currently is, it cannot serve this purpose anymore

So where to from here for the US under these circumstances? It would seem that the only alternative is to weather the period of quantitative easing currently being employed in the Eurozone and Japan. This means that we will see no major changes in monetary policy probably until early to middle of 2016. To ease over – indebted developed countries out of their debt problem, any evolving economic growth is likely to be retarded by a simultaneous increase in interest rates.

This scenario would mean that we will move into a cycle of increasing interest rates and slow economic growth and gradually increasing inflation. As a result equity markets are likely to experience only pedestrian performance for years to come.

On this basis we do not expect any major swings in investment market for the next 2 years plus, given no political upheavals impacting investment markets.

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. Stock picking should prove to make the difference in returns and will be a prerequisite for out-performance of a portfolio.
Investors should forget about double digit annual return and focus on investing to out-perform inflation. With an inflation rate in the region of 4%, the investor should be comfortable with a return of between 45 and 10% p.a. over the next few years.

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.

On the basis of fundamentals, 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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