Benchmark Retirement Fund

Volume 11, No. 06,
June 2015

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 JUNE 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

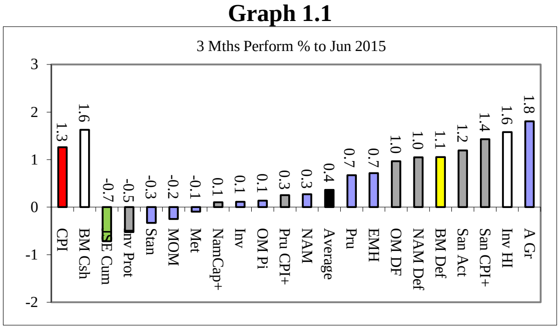
In **June** the **average prudential balanced portfolio** returned -0.95% (May: -1.01%). Top performer is Momentum (-0.44%); while Namibia Asset Management (-1.52%) takes the bottom spot. For the 3 month period Allan Gray takes top spot, outperforming the 'average' by roughly 1.4%. On the other end of the scale Stanlib underperformed the 'average' by 0.7%.

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.

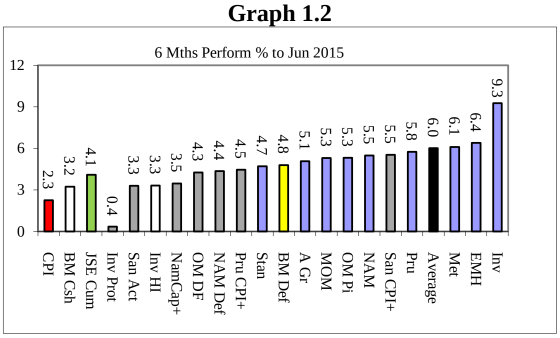
Below is the legend to the abbreviations reflected on the graphs:

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)

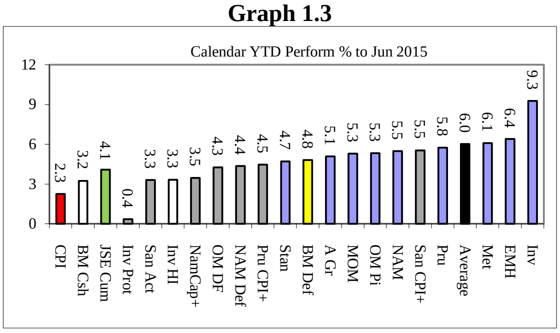
Graph 1.1



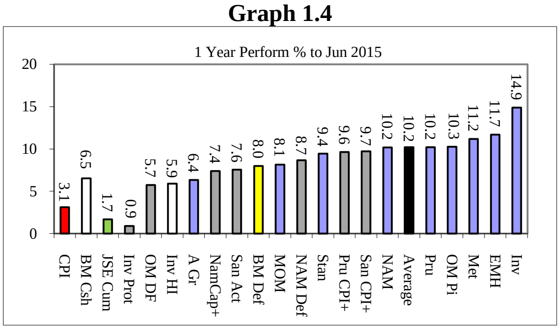
Graph 1.2



Graph 1.3



Graph 1.4



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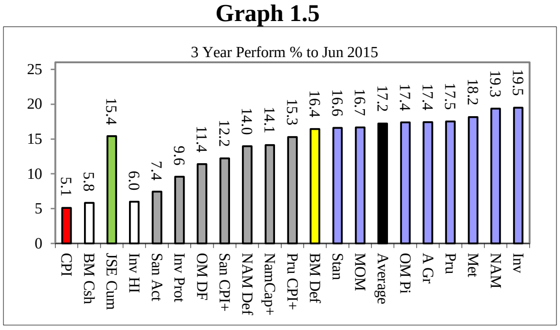
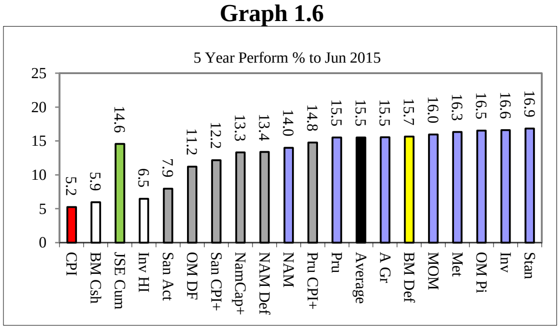
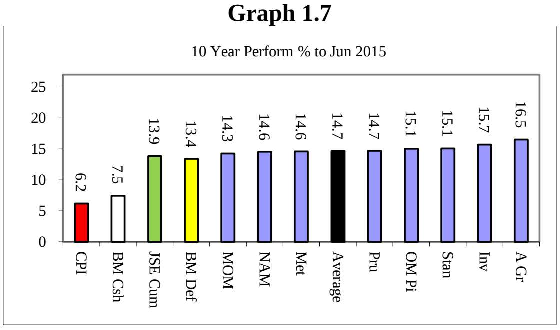
Graph 1.5



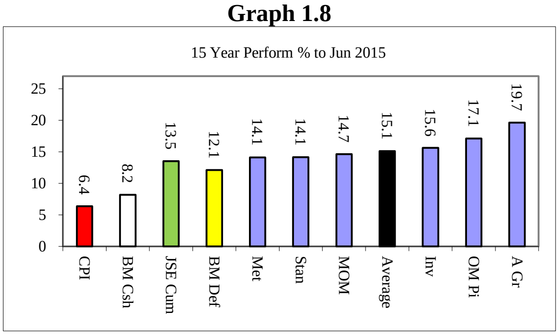
Graph 1.6



Graph 1.7

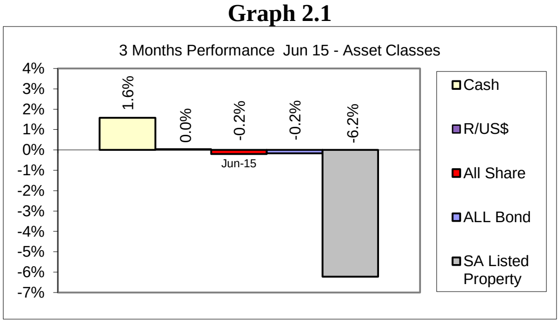


Graph 1.8

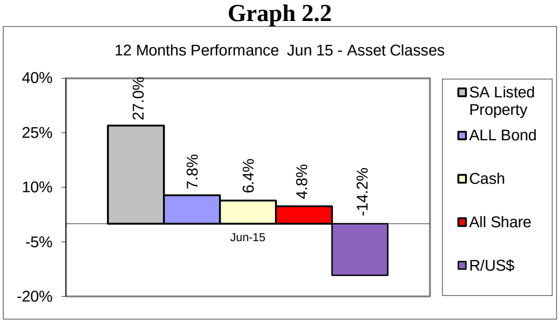


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

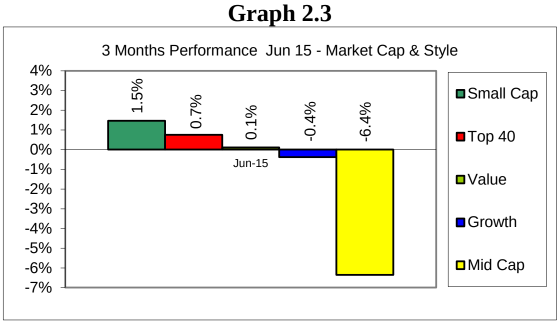
Graph 2.1



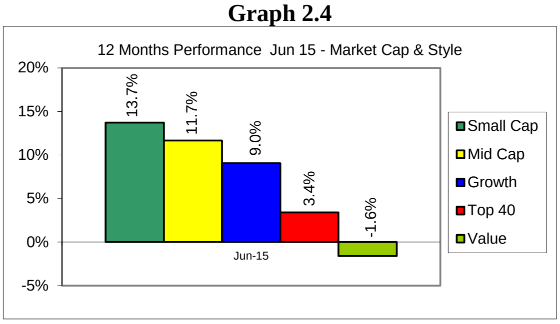
Graph 2.2



Graph 2.3



Graph 2.4



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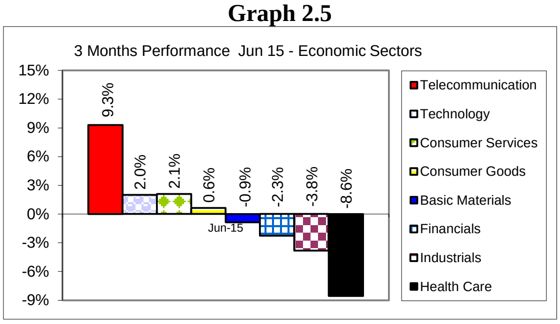

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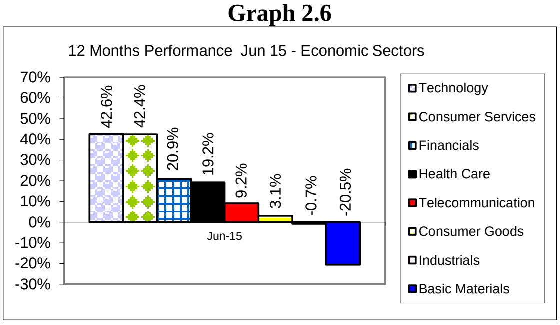
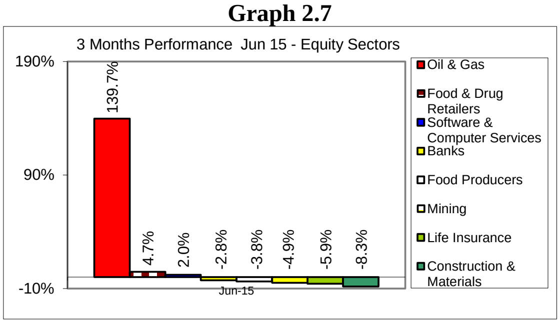
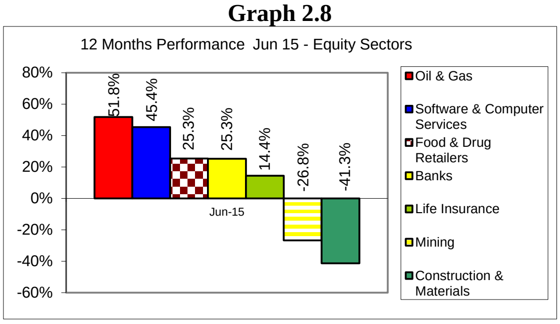


Graph 2.7



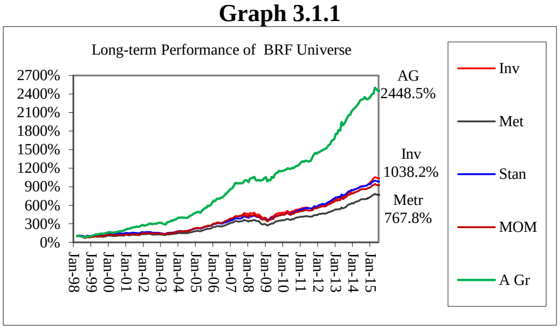
Graph 2.8



3. Portfolio Performance Analysis

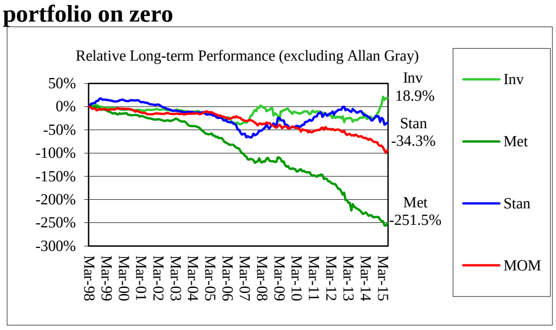
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

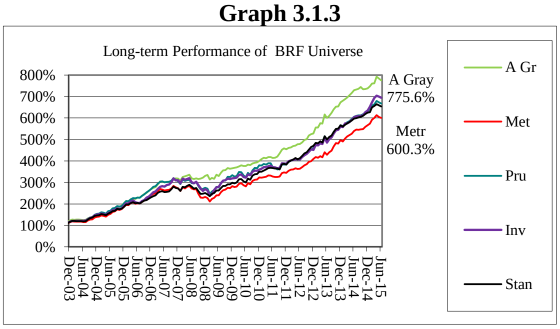


Graph 3.1.2

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

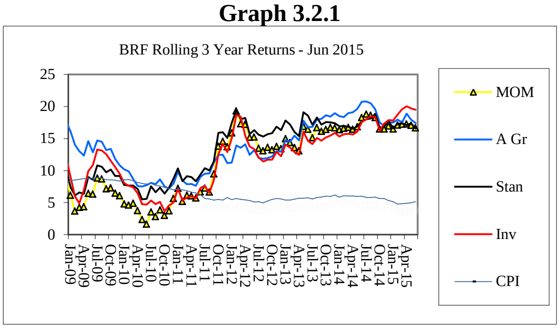


Graph 3.1.3



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

Graph 3.2.1



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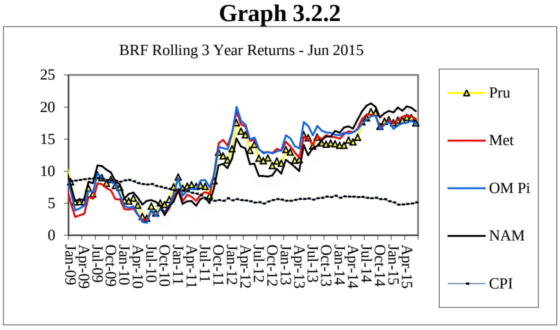
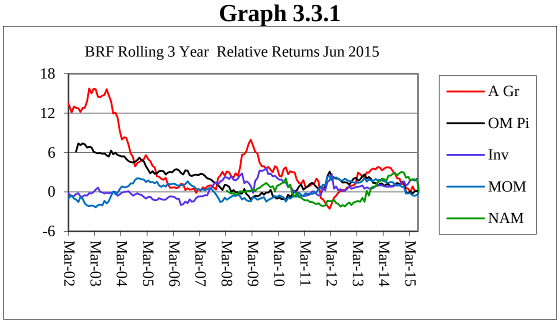
Graph 3.2.2

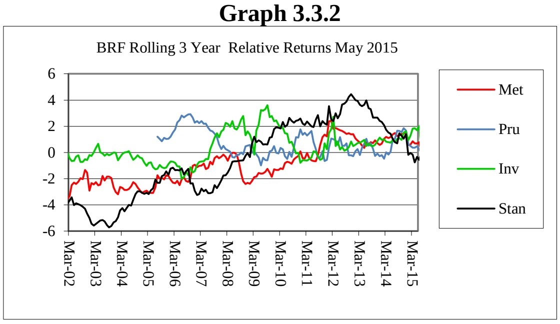


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

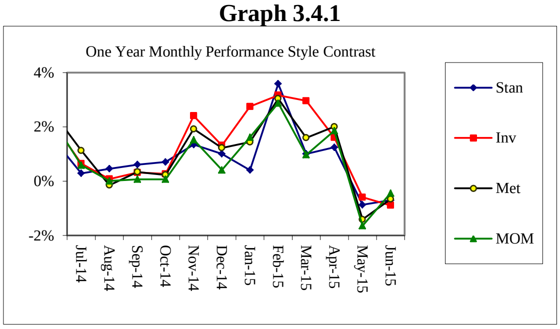


Graph 3.3.2

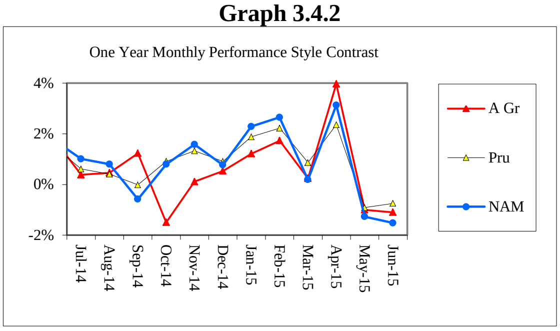


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

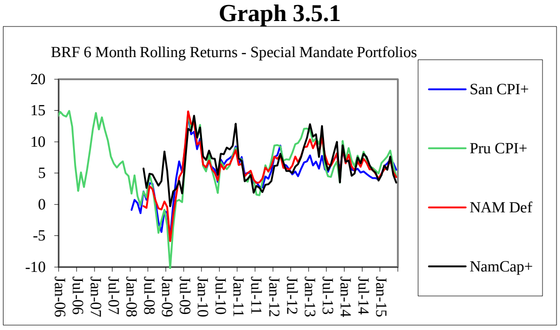


Graph 3.4.2

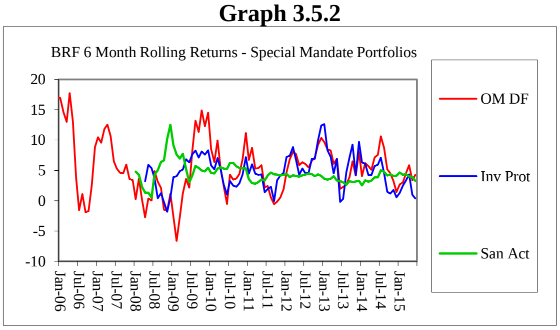


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

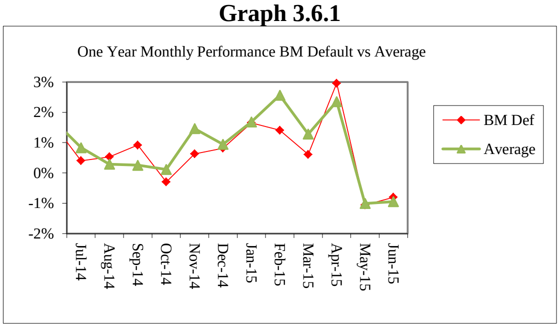


Graph 3.5.2



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

Graph 3.6.1



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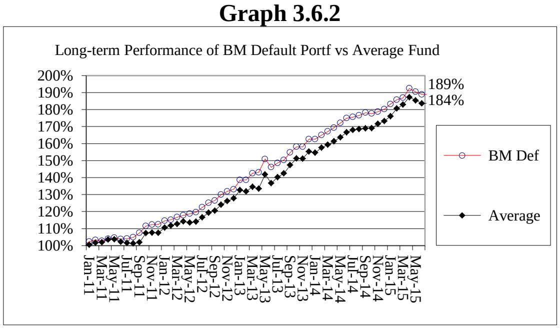
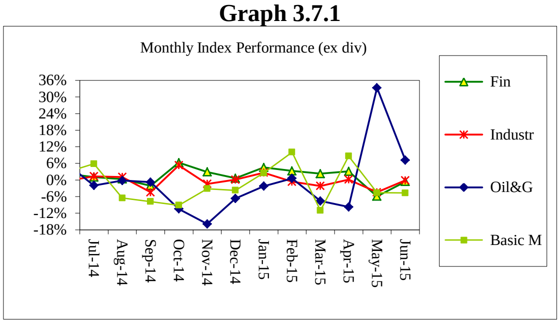
Graph 3.6.2

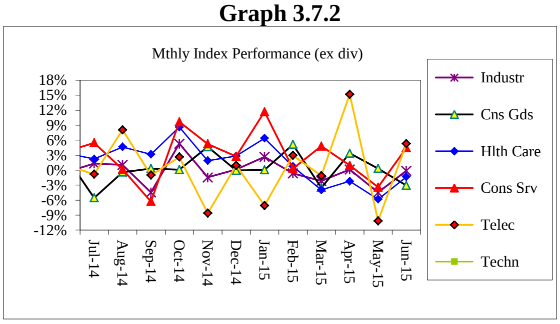


3.7 One year monthly performance of key indices (excluding dividends)

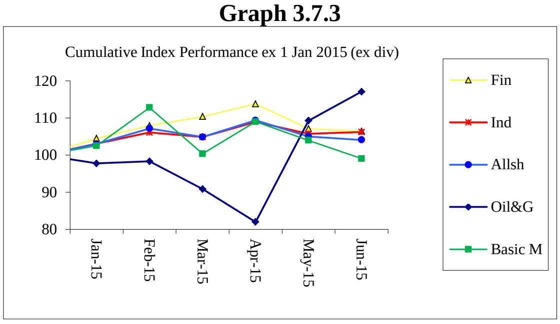
Graph 3.7.1



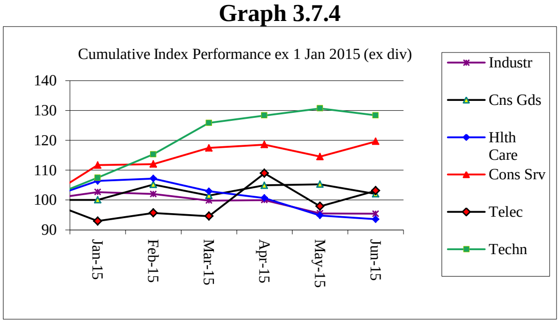
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 15.5% p.a. in nominal terms, or 10.3% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 15.7% 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 (49.8% vs. 61.8% of the average prudential balanced portfolio, as at the end of March 2015) 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. The default portfolio returned a cumulative 88.9% compared to 83.6% for the average prudential balanced portfolio over this 54 month period from January 2011 .

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 July 2012 to June 2015:

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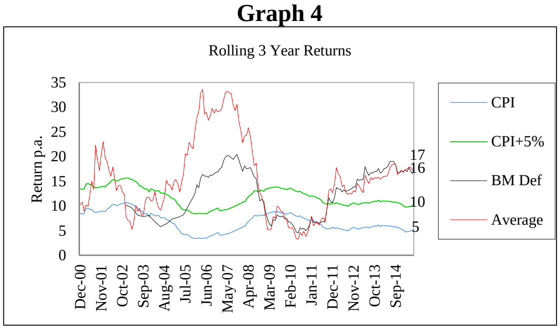
Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	8.0%	10.2%
Best annual performance	6.5%	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%	17.5%	17.6%

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



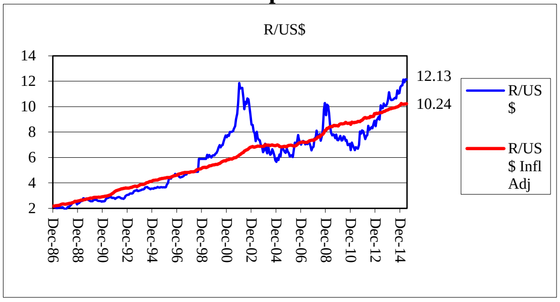
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end June was 16.4%, the average was 17.2% vs CPI plus 5% currently on 10.1%.

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 12.13 at the end of June. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

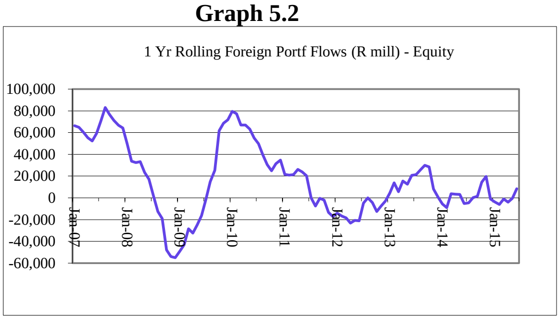
Graph 5.1



Rand supported by foreign capital inflows

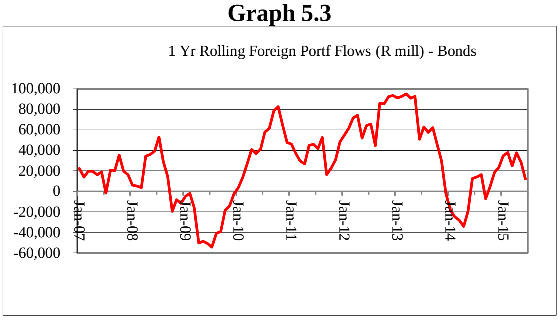
Graph 5.2 reflects a flow of capital into South African equities on a rolling one year basis, with a net inflow of 8.5 bn on a year-on-year basis at the end of June (outflow of R 0.4 bn year-on-year to end May). The month of June experienced a net inflow of R 7.3 bn. Since the beginning of 2006, foreign net investment in equities amounts to R 194 bn (end May R 186 bn). This represents roughly 1.6% 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 12.1 bn over the past 12 months to end of June (inflow of R 28.3 bn over the 12 months to end of May). Since the beginning of 2006, foreign net investment in bonds amounts to R 242 bn (to May just over R 248 bn). The month of June experienced a net outflow of R 6.1 bn.

Graph 5.3



The net inflows of foreign capital into equity and fixed interest securities was R 20.6 bn for the rolling 12 months to end June 2015 (inflow of R 27.9 bn to end May 2015), compared to an inflow of R 7.3 bn for the 12

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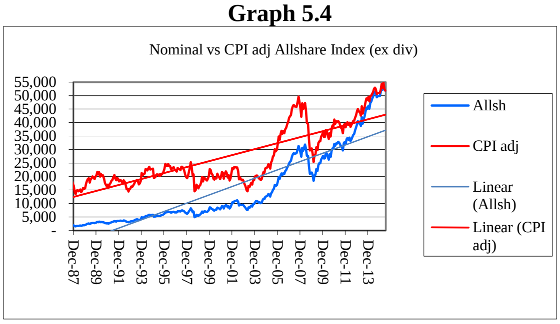
months to end June 2014 (outflow of R 16.4 bn to end of May 2014). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 437 bn (May R 435 bn).

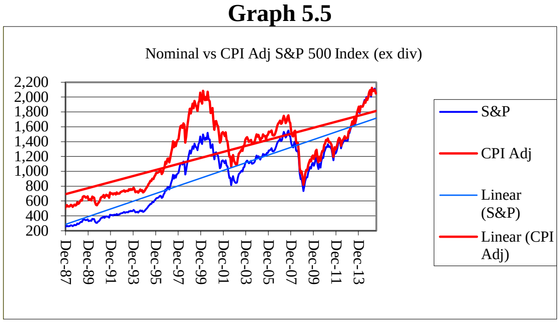
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 12.1% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of just over 28 years was 8.4% per year. This is equivalent to a growth in real terms of 3.7% p.a. over this period, excluding dividends, or around 7% including dividends.

Graph 5.4



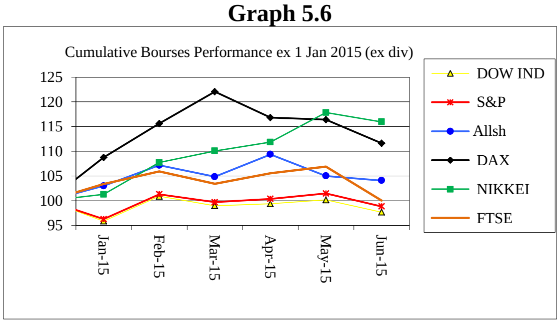
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.3% per annum, over this period of just over 28 years. US inflation over this period was 2.7%. This is equivalent to a growth in real terms of 4.6% p.a. over this period, excluding dividends.

Graph 5.5



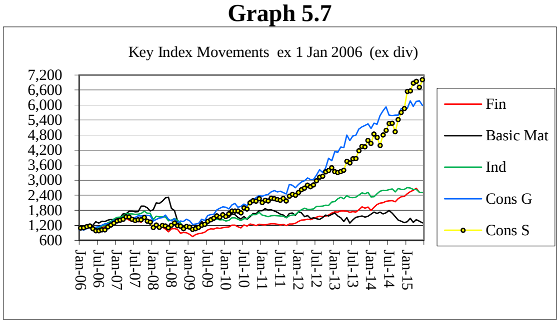
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the NIKKEI and the DAX as the top performing share indices.

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: 22.7%; Consumer Goods 20.7%; Industrials 10.2%; Financials 10.1%; and Basic Materials 2.8%.

Graph 5.7



6. Be The Beauty of Prudential Balanced Portfolios

by Tilman Friedrich

Pension funds typically invest their moneys in prudential balanced portfolios. These are multi-asset portfolios where either the fund or its investment manager/s determine from time to time how much will be invested in which global market and how much will be invested in equity, property, bonds and or cash, to mention only the main asset classes employed by pension funds. The difficulty here is that one is dealing with the future and the future entails uncertainty. In giving preference to one of these asset classes and the various global markets above the other, the decision makers consider the relative risk-return profile of the various asset classes and of specific securities as at a point in time. Various models are used to arrive at the risk-return profile of prospective securities, such as top-down analyses, where the economic environment and its expected impact on the different asset classes is considered or bottom-up analyses where specific companies and other securities are analysed to determine their economic prospects, or a combination of top-down and bottom-up analyses. The reason for profiling risk versus return is that managers want to optimize the ratio between these variants within their investment portfolio. If two shares for example are expected to produce the same return over a given period but the risk of share A is rated higher than the risk of share B, the decision maker would rather purchase share B than share A as this should increase the probability of the portfolio achieving the expected return. A higher risk would reduce the probability of achieving the expected return.

The table below shows the asset allocation of the average prudential balanced portfolio as at 31 March 2015, and the return of each asset class to June 2015 (note – 'other' assets are do not have a return benchmark):

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Quarter to June 2015

Asset Class	Allocation %	Return %
Equity	60.4	- 0.8
Bonds	13.4	0.3
Property	16.2	- 3.5
Cash	3.6	1.5
Other	6.4	n/a
Total	100	

The actual return for the average prudential balanced portfolio for this quarter was 0.4% (best 1.8%; worst – 0.3%). The average manager and the worst performing manager have both thus outperformed all asset classes except cash for the latest quarter.

Year to June 2015

Asset Class	Allocation %	Return %
Equity	61.5	8.5
Bonds	14.4	8.9
Property	15.7	31.7
Cash	3.2	6.3
Other	5.2	n/a
Total	100	

The actual return for the average prudential balanced portfolio for the 12 months was 10.2% (best 14.9%; worst 6.4%), outperforming all asset classes except property for the 12 month period.

This shows two things. Firstly, last period's winning asset class is unlikely to also be this period's winning asset class. Secondly it shows that spreading one's investment between the different asset classes is outperforming most asset classes. This is of course a very simplistic comparison as it does not take into account what happened in offshore markets and the foreign exchange rate movements. Looking at foreign exchange rate movements, the Rand depreciated by 12% against the US Dollar and by 5% against the Pound Sterling while appreciating by 7% against the Euro. Still, for the individual local investor, who cannot freely invest offshore or move assets between asset classes, these conclusions are quite relevant.

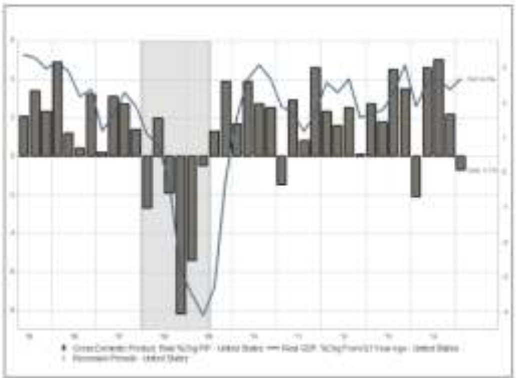
Looking at the performance of prudential balanced portfolios from another perspective, namely their performance relative to that of the local equity market (JSE Allshare Index), where equities are typically the preferred asset class with the highest expected returns over the long-term, the following table also reveals interesting results for periods to 30 June 2015:

Period to June 2015	Equity Return %	Average Fund Return %
3 months	- 0.7	0.4
6 months	4.1	6.0
1 year	1.7	10.2
3 years	15.4	17.2
5 years	14.6	15.5
10 years	13.9	14.7
15 years	13.5	17.1

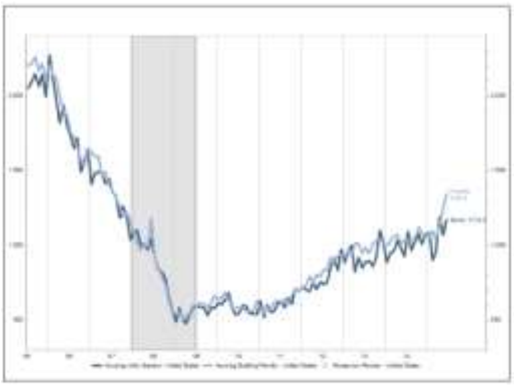
This table shows that over all periods in the table from 3 months to 15 years, the average prudential balanced portfolio managed to outperform the JSE Allshare Index. Most local individual investors will find it very difficult to achieve the returns that the average prudential portfolio has achieved. As the above tables show, had he been invested in cash, the winning asset class for the latest quarter, he would have had the lowest returns for the past 12 months. Had he been in property the winning asset class for the past year, he would have had the lowest return for the latest quarter.

There are a number of clues that indicate the US economy is on the mend. Here are just a few of these from Factset.

US GDP is on a steady upward trend:



Housing starts and housing permits are on an upward trend:



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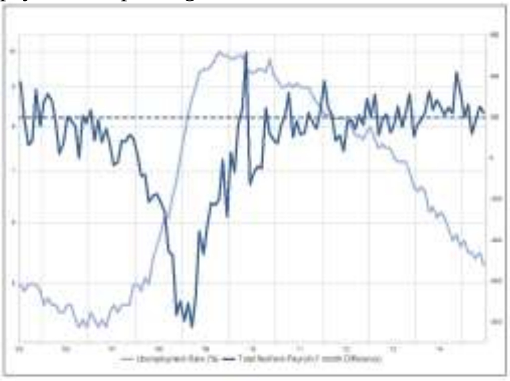
Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 JUNE 2015

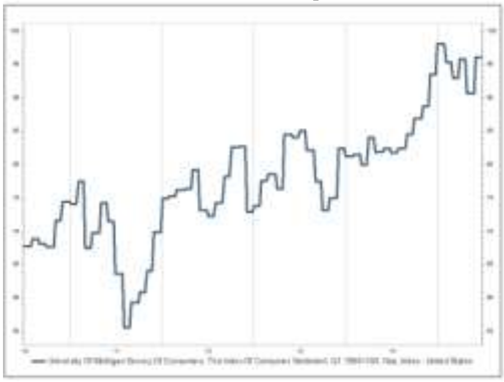
By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

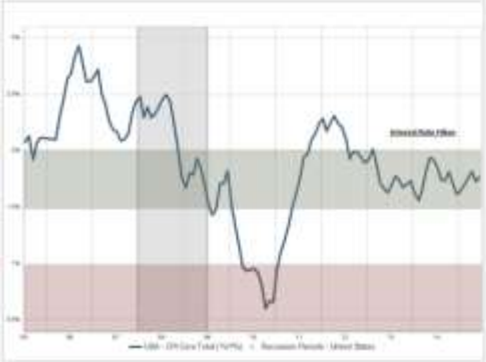
Unemployment is dropping sharply while the non-farm payroll is improving



Consumer sentiment is on a steep incline.



But inflation is stubbornly moving sideways.



In the light of these positive trends, there is a high likelihood of the Fed raising interest rates possibly this year still. When this happens there is a fair likelihood that equities will move sideways or may even turn down, while bonds and property are likely to produce negative returns, leaving only cash as the asset class that will offer positive returns. From a top-down perspective, this does not offer any exciting investment opportunities in any particular asset class for the next year or two. The near to medium term will thus require one skill above all, which is stock picking based on bottom-up stock analysis. Prudential balanced portfolios are affording their managers the opportunity to move between asset classes as they see opportunities or threats and if the portfolio manages to outperform the equity market, as the average manager has consistently been able to do, any investor should be reasonably comfortable that his investment is looked after better than what he would be able to do himself in most probability.

Our investment view remains unchanged

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. Turn down your return expectations, focus on inflation and aim to outperform inflation rather than aspiring for high absolute returns as these will not be achievable without taking significant risks.

With the expected upswing in consumer sentiment over the next year or two, is likely to be preceded by an upswing in commodities and to be followed closely by and upswing in financials. A soft Rand and a depressed local economy suggest that the investor should continue to diversify offshore. Lowly geared Rand hedge shares should benefit from increasing interest rates and improving consumer sentiment in developed economies.

7. Important notice and disclaimer