Volume 12, No. 1,
January 2016

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JANUARY 2016

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

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

1. Review of Portfolio Performance

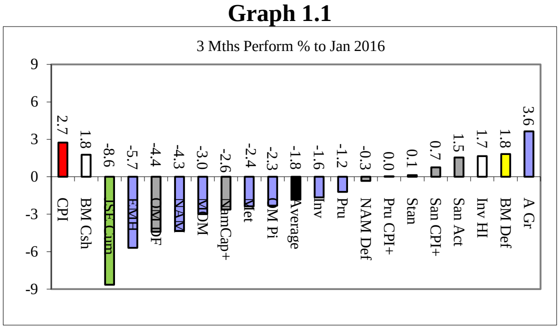
In **January** the **average prudential balanced portfolio** returned -2.08% (Dec: 0.57%). Top performer is Allan Gray (-0.12%); while Namibia Asset Management (-4.03%) takes the bottom spot. For the 3 month period Allan Gray, for the 6th consecutive month takes top spot, outperforming the 'average' by roughly 5.4%. On the other end of the scale EMH Prescient underperformed the 'average' by 3.9%.

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.

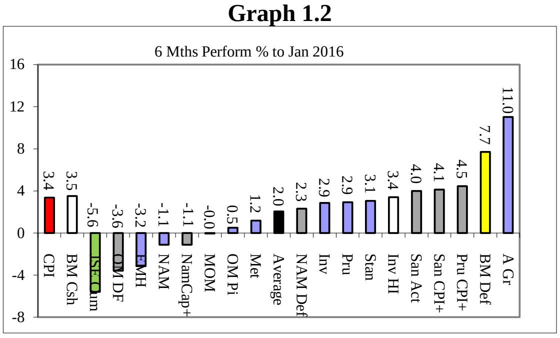
Below is the legend to the abbreviations reflected on the graphs:

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)
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)

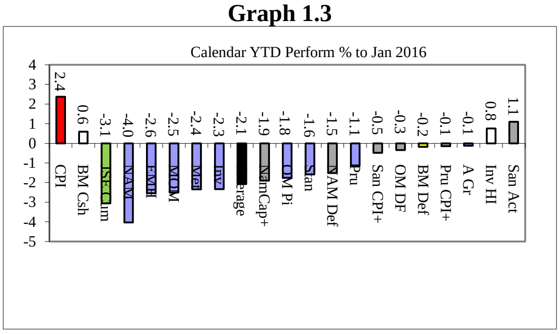
Graph 1.1



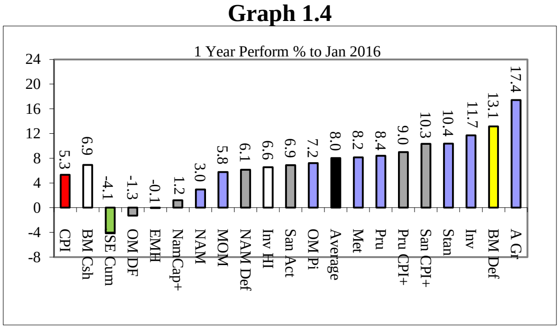
Graph 1.2



Graph 1.3



Graph 1.4



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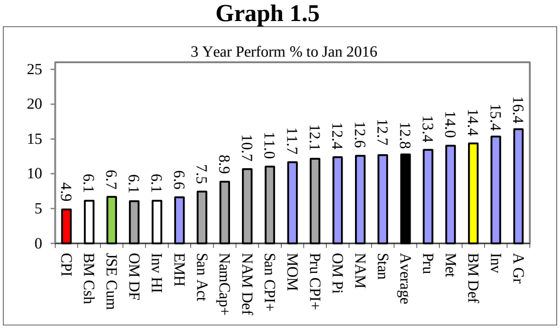
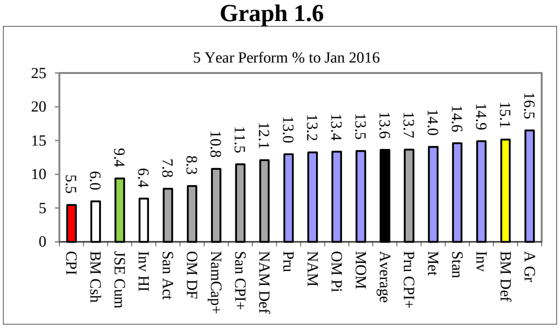
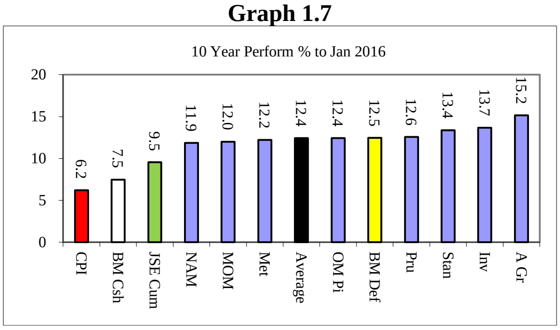
Graph 1.5



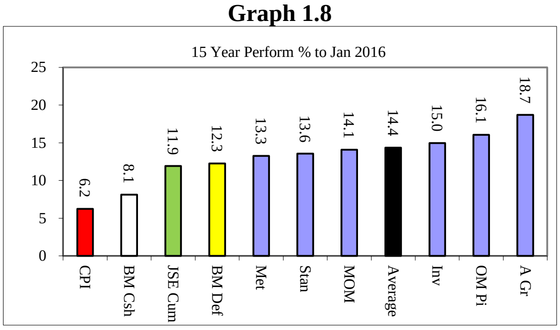
Graph 1.6



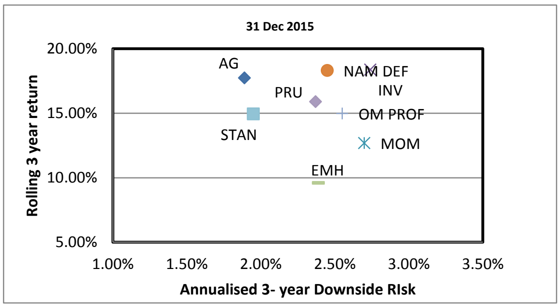
Graph 1.7



Graph 1.8

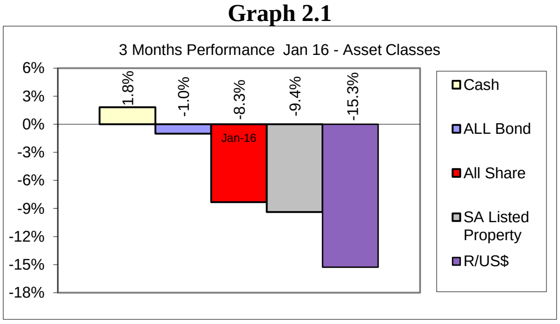


Risk/ Return

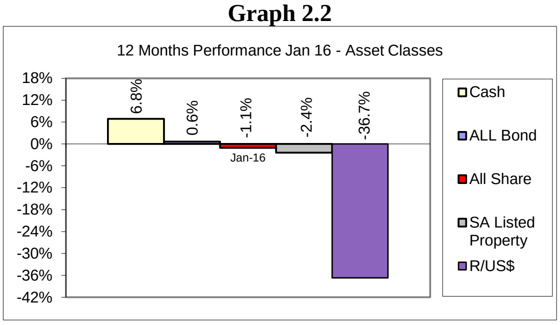


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

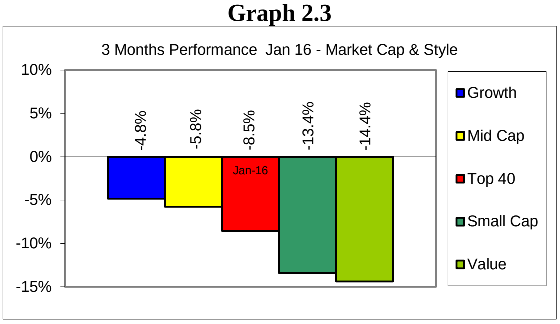
Graph 2.1



Graph 2.2



Graph 2.3



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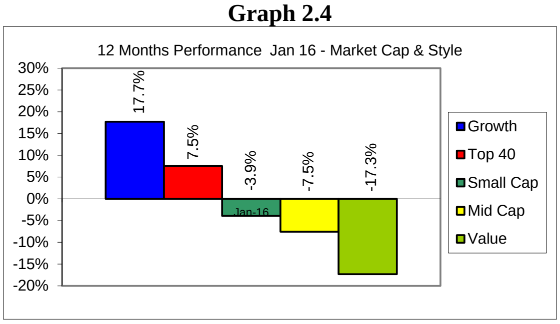
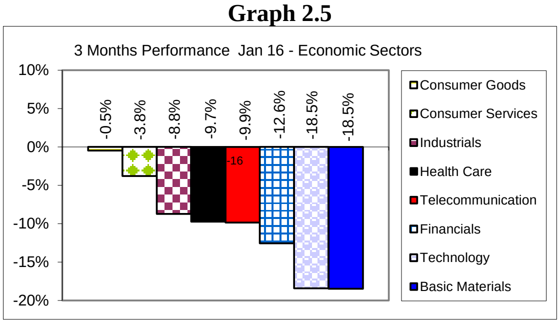
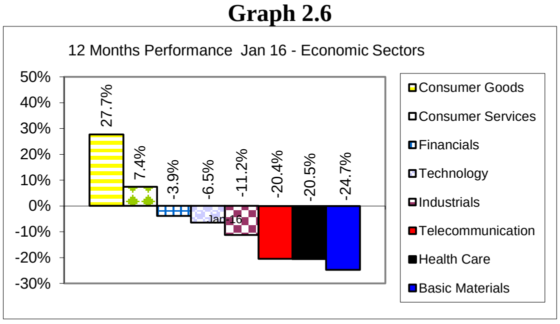
Graph 2.4



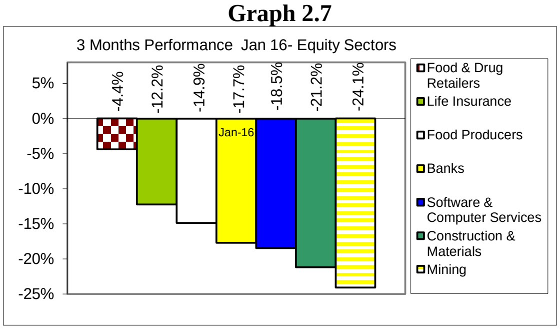
Graph 2.5



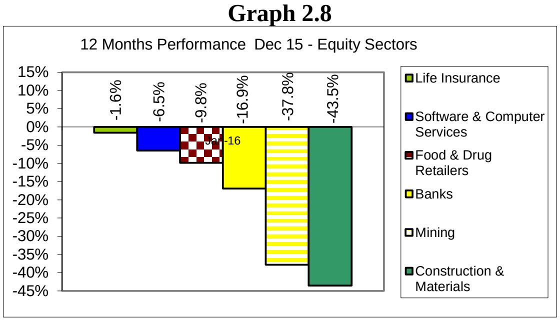
Graph 2.6



Graph 2.7



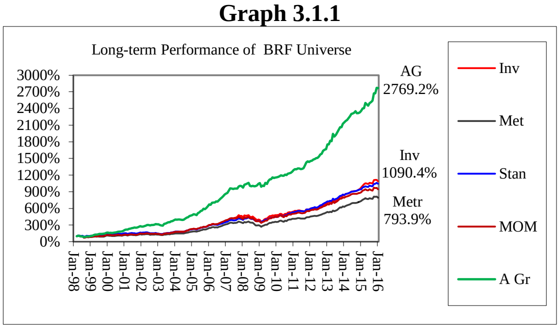
Graph 2.8



3. Portfolio Performance Analysis

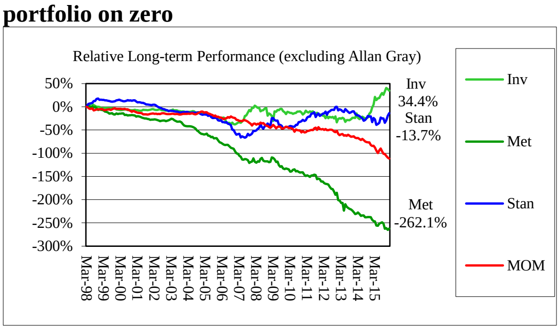
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

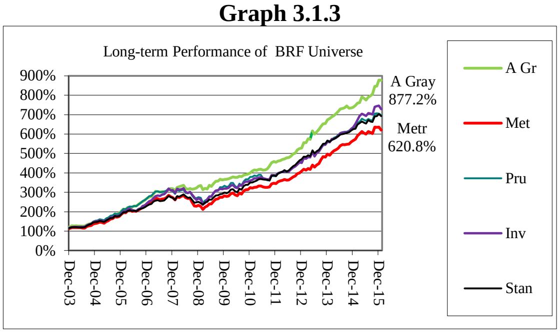


Graph 3.1.2

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

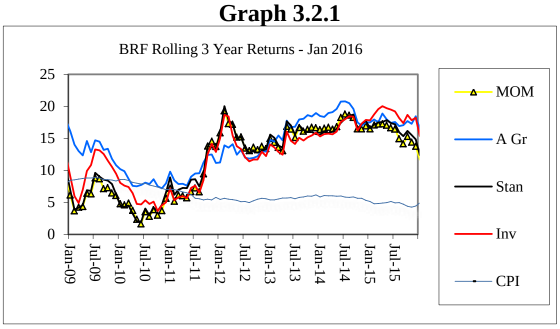


Graph 3.1.3



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

Graph 3.2.1



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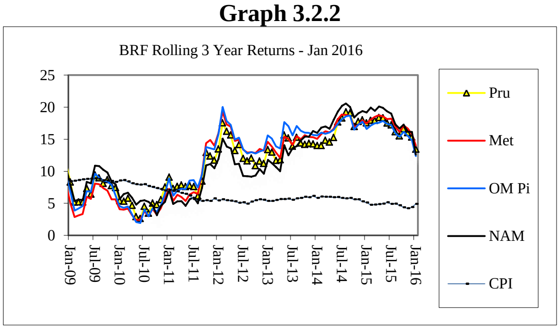
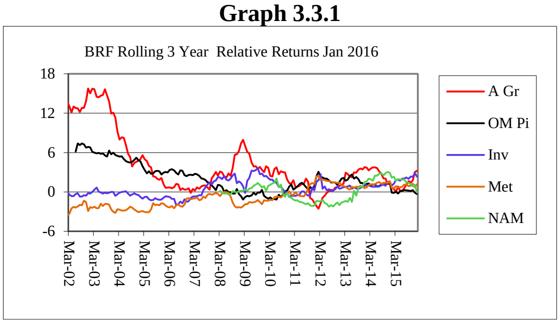
Graph 3.2.2

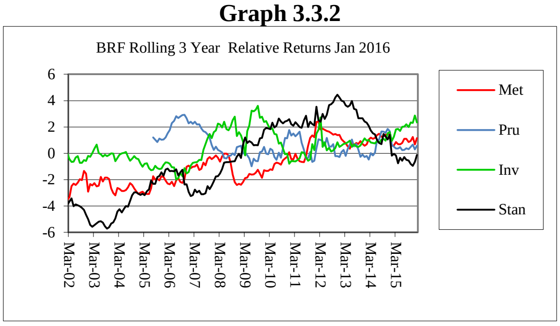


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

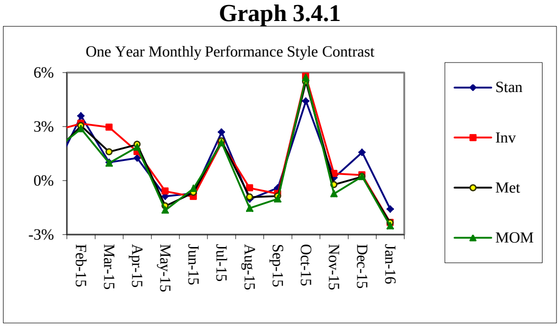


Graph 3.3.2

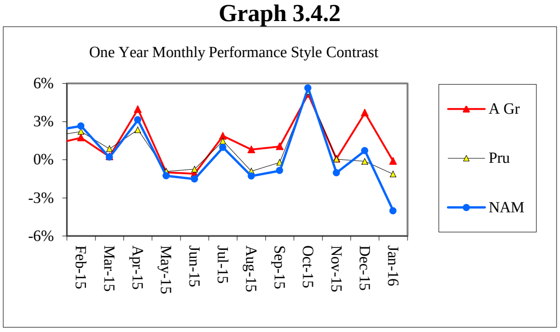


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

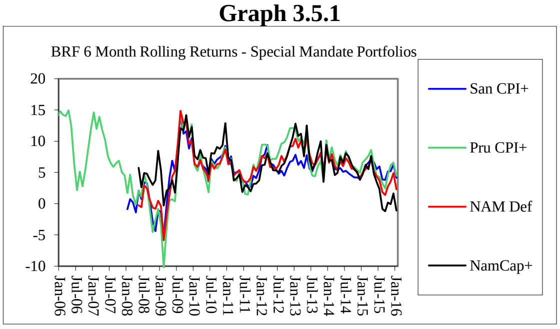


Graph 3.4.2

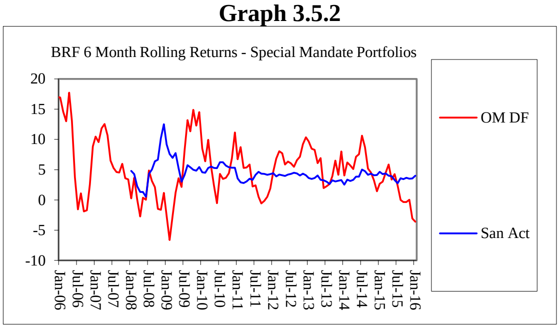


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1

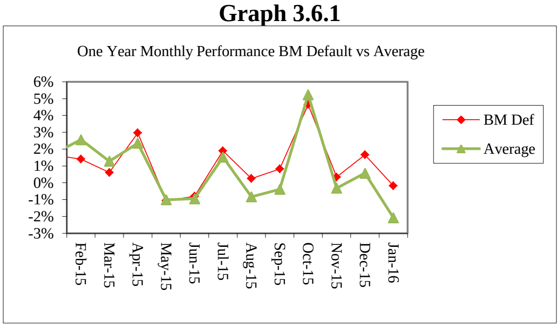


Graph 3.5.2



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

Graph 3.6.1



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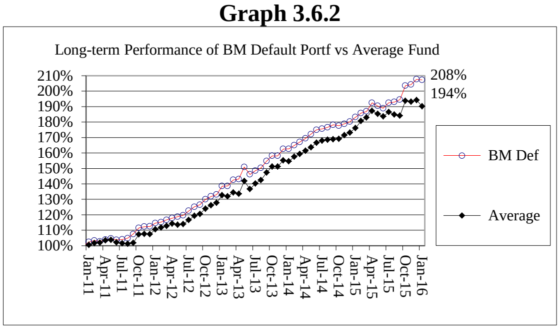
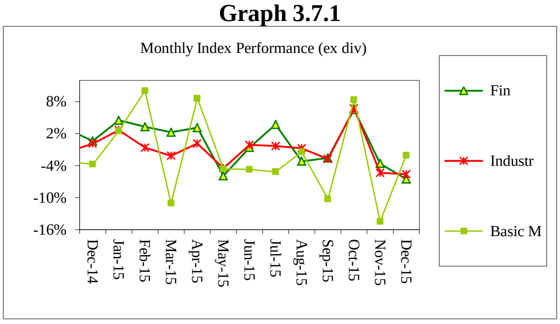
Graph 3.6.2

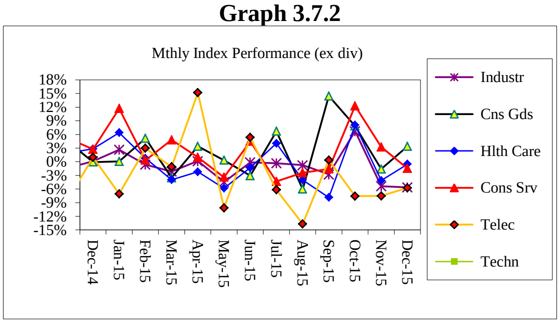


3.7 One year monthly performance of key indices (excluding dividends)

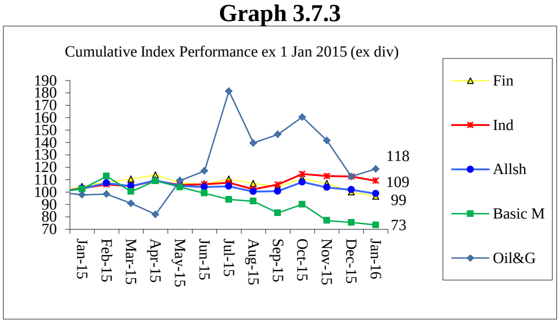
Graph 3.7.1



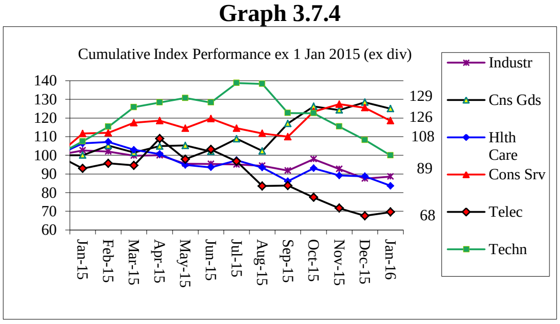
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio – Facts in figures

Table 4.1

Portfolio	Default portfolio	Average pru man portfolio
5 year nominal return - % p.a.	15.2	13.6
5 year real return - % p.a.	9.7	5.5
Equity exposure - % of portfolio	49.7	57.4
Cumulative return ex Jan 2011	107.3	90.2
5 year gross return target - % p.a.	5	6
Target income replacement ratio p.a.	2	2
Required net retirement contribution - % of salary	13.0	11.6

The above table reflects the actual returns versus target returns required to produce an income replacement ratio of 2% of salary per year of fund membership that should secure a comfortable retirement income.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.3%	8.0%	8.0%
Best annual performance	6.9%	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	5.9%	16.3%	16.3%

The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years February 2013 to January 2016. This gives an indication of volatility of the performance of these 3 risk profiles.

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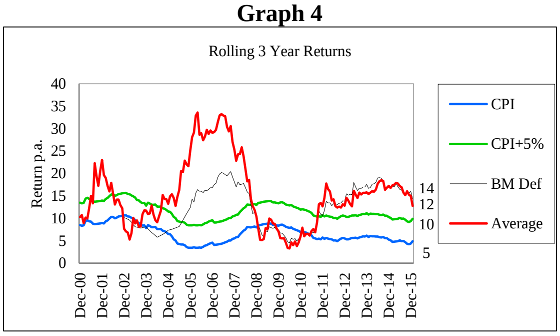
Graph 4

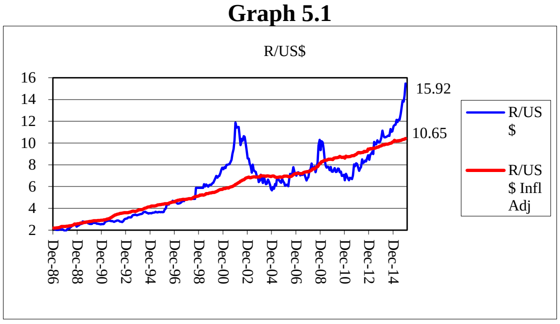


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end January was 14.37%, the average was 12.77% vs CPI plus 5% currently on 9.9%.

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 10.65 to the US Dollar while it actually stood at 15.92 at the end of January. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

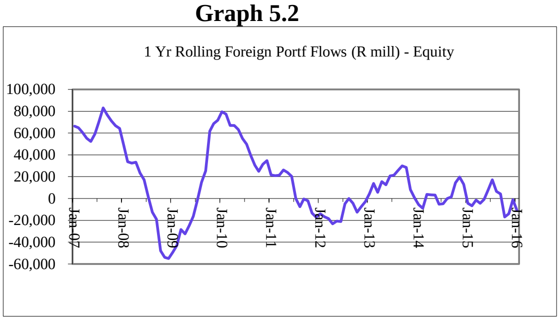
Graph 5.1



Rand weakened with foreign capital outflows

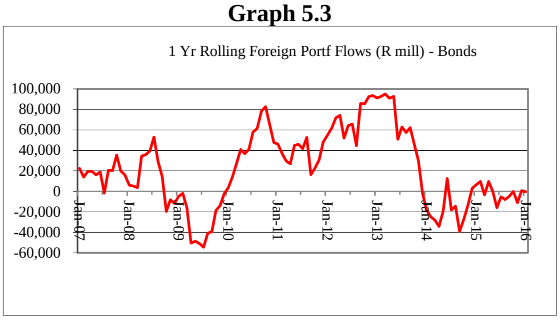
Graph 5.2 reflects an outflow of capital into South African equities on a rolling one year basis, with a net outflow of 11.1 bn on a year-on-year basis at the end of January (outflow of R 0.97 bn year-on-year to end December).The month of January experienced a net outflow of R 32.5 bn. Since the beginning of 2006, foreign net investment in equities amounts to R148 bn (end December R 181 bn). This represents roughly 1.0% 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 0.4 bn over the past 12 months to end of January (inflow of R 0.8 bn over the 12 months to end of December). Since the beginning of 2006, foreign net investment in bonds amounts to R 205 bn (to December just over R216 bn). The month of December experienced a net outflow of R 10.6 bn.

Graph 5.3



The net outflows of foreign capital from equity and fixed interest securities was R 11.5. bn for the rolling 12 months to end January 2016 (outflow of R 0.2 bn to end December 2015), compared to an inflow of R 2.2 bn for the 12 months to end January 2015 (inflow of R 16.0 bn to end of December 2014). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 354 bn (December 400 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 11.7% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of just over 29 years was 8.4% per year. This is equivalent to a growth in real terms of 3.3% p.a. over this period, excluding dividends, or around 7% including dividends.

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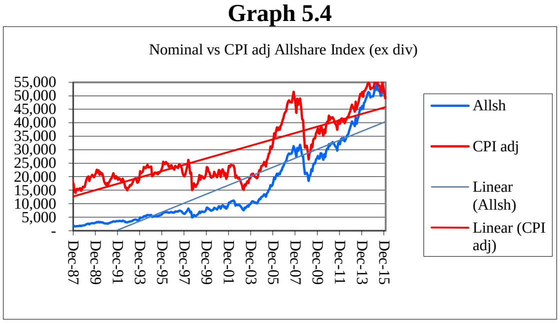
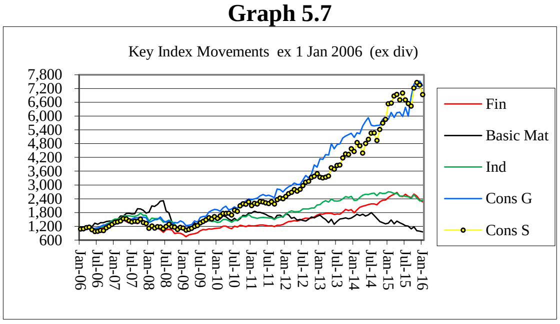
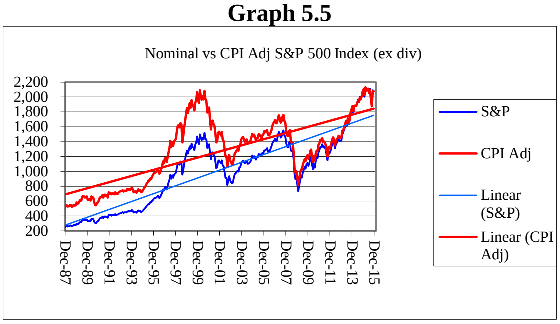


Graph 5.7



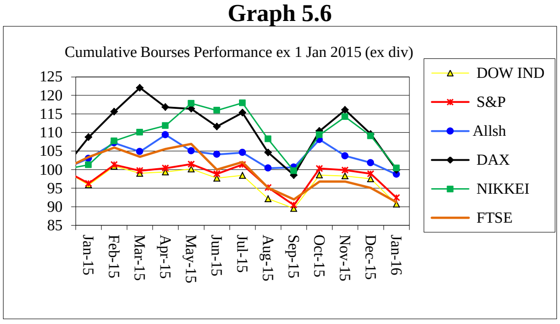
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 6.9% per annum, over this period of just over 29 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.3% p.a. over this period, excluding dividends.

Graph 5.5



Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the DAX and the 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 Goods: 21.8%; Consumer Services 21.2%; Industrials 8.8%; Financials 8.5%; and Basic Materials -0.4%.

6. The winds have changed

By Tilman Friedrich

For many years Namibia's big brother SA, and with it Namibia too, has experienced a tidal lift of its entire financial system. It started off with the commodity run that led to SA ALSI growing by a nominal 15.8% per annum from August 1998 to its peak in April 2015, equivalent to a real growth of 8.3%, excluding dividends. And this period includes the financial crisis that saw the index declining from its October 2007 peak of 28,400 to a trough of 16,500 in February 2009.

Foreigners piled into local equities at an annualised rate of between R 60 billion and R 80 billion. For a long time the Rand held up well on an exchange rate to the US Dollar of between 5 and 8 up until the first quarter of 2012. Interest rates were very low as the result of the US Fed's stabilization of its financial system post financial crisis with its large scale asset purchase programme that had money flowing freely across the globe and in particular into commodity based economies like SA.

These good times have come to an end now, even though much later than we had anticipated where we expected the Fed to start raising interest rates in 2012. As we know now, this only happened in December 2015. The fact that the Fed stopped its large scale asset purchase programme was largely negated by a virtually simultaneous entry by the ECB with a similar programme.

The anticipated increase of the Fed repo rate in 2015 was the turning point for our financial markets and the tail winds our markets experienced have turned into head winds. The Rand has weakened dramatically from a relatively stable level of around 8 to the US Dollar to currently roughly 16 to the US Dollar, foreign equity purchases have virtually dried up, our equity markets are moving sideways, the Allshare hovering around 50,000 while local interest rates have already moved up by 0.5% since November 2015. More pain is anticipated for the consumer.

The one prospective saving grace for the local consumer could have been a reduction in the fuel price which has however only been adjusted downward marginally. In Rand terms the barrel of oil has declined from a peak of

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R 1090 in August 2013 to its current level of R 535, a decline of 50%. In a previous newsletter we already made reference to the fact that local fuel prices actually only declined by around 5% from their peak and that someone is 'pocketing' the difference at an estimated rate of roughly N$ 2 billion per annum. The situation in SA will not be much different of course.

We believe that the current crude price is not sustainable and that there are very few if any producers that can still produce profitably at this level. These low price levels at the same impact negatively on commodities in general. Price levels must recover substantially in the not too distant future, but how soon this may be is very difficult to assess. Our guess is that it should recover within the next 12 to 24 months, probably to a level of between 60 to 80 US Dollar per barrel.

Of course, a consumer that is suffering will not invest and will rather use cash resources to reduce debt. This will also impact negatively on local equity markets.

The passive investor who does not have the time and knowledge of financial markets should consider investing in multi-asset flexible portfolios typically offered by unit trust companies. These are also typically employed by pension fund asset managers. The table below shows how successful these managers have been in achieving respectable returns for their pension fund members despite poor equity markets over various periods to end January 2016. While the equity market as a whole has not done well a number of times, asset managers have been able to move between equities, property, bonds and cash as well as between local and foreign investments and of course some have been very skillful in choosing shares that did well despite the market under-performing.

Period	Worst performer	Best performer	Average	JSE Allshare
YTD (1 month)	-4.0%	-0.1%	-2.1%	-3.1%
3 months	-5.7%	3.6%	-1.8%	-8.6%
6 months	-3.2%	11.0%	2.0%	-5.6%
1 year	-0.1%	17.4%	8.0%	-4.1%
3 years	6.6%	16.4%	12.8%	6.7%
5 years	13.0%	16.5%	13.6%	9.4%
10 years	12.0%	15.2%	12.4%	9.5%
15 years	13.3%	18.7%	14.4%	11.9%

Flexible diversification between different asset classes and different economies clearly reduces the risk of significantly underperforming the JSE and of delivering negative returns substantially. At the same time however, it reduces the opportunity of out-performance that should really only be the domain of an investment expert.

Conclusion
In the face of the head winds referred to above, investing in the right asset classes and in the right assets within each class is a skill that should still produce acceptable investment returns. By-and-large pension fund portfolio managers have not done a bad job, generally producing positive returns above inflation going by the average manager above. Of course some produced excellent results while others achieved dismal results as this table also shows. In the long run, pension funds are designed to achieve investment returns of about 5% to 6% above inflation to enable the pension fund member to retire in dignity. This is mostly the case for the average pension fund asset manager, and the exceptions per table above really only cover the very short term.

The investor should thus continue to focus on real returns and not be distracted by negative news and by short-term results. With an inflation rate now at around 5% with an investment return around 10% per annum. As an active fund member one should not shun equities but should be cautious and focus on stock picking. The commodity sector may offer selective buying opportunities but it may require patience to realise gains. The consumer facing increasing pains, and the fact that Consumer Goods and Consumer Services had a terrific run since the beginning of 2006, it is hard to see this sector continuing on its trajectory. The financial sector too is likely to suffer in sympathy with the consumer. The excessively depreciated Rand indicates that it should recover along with an increasing oil price and other commodities. The weak Rand eliminates the option of offshore diversification at this point in time. This leaves the Industrial sector as a sector we believe to also offer prospects, in the light of the weak Rand and low commodity prices.

In terms of diversification between different asset classes locally, the likelihood of further repo rate increases suggests that interest bearing investments do not hold good prospects at this stage. However the prospect of accelerating inflation favours inflation linked bonds.

7. Important notice and disclaimer

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