BENCHTEST

Volume 4, No. 9, September 2008

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 September 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.

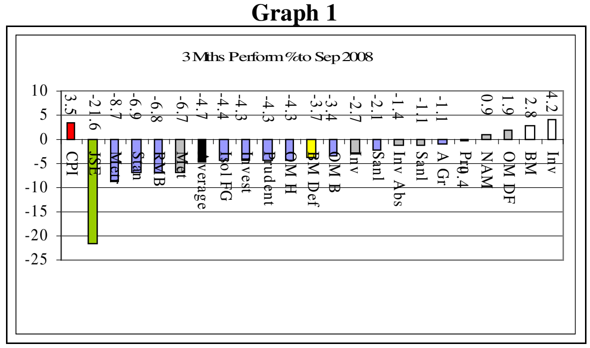
1. Review of Portfolio Performance

In September the average prudential balanced portfolio returned minus - 5.05% (August 1.79%). Best and worst performance **for the month** was delivered by Allan Gray (minus 1.1%) and Metropolitan (minus 7.86%), respectively. Metropolitan's under performance was explained to be due to mark-to-market pricing of its offshore structure that has produced aggregate under performance for the quarter in excess of 2%. Although Allan Gray added some value through sector allocation, its outperformance of the average manager by close to 4% appears to be due to stock selection.

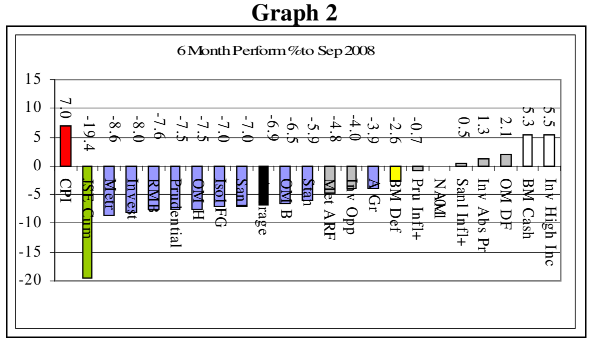
Graphs 1 to 7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential balanced portfolios (black bar) and the CPI (red bar). Benchmark investors should take note of the performance of the default portfolio (yellow 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)
Investec Absolute Protector	Inv Abs (grey)
Investec Opportunity Fund	Inv Opp (grey)
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)
Namibia Asset Management	NAM (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)

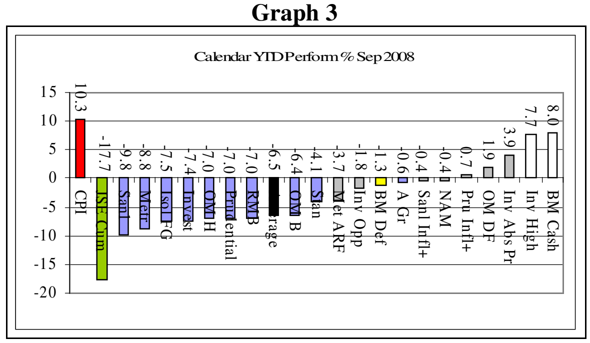
Graph 1



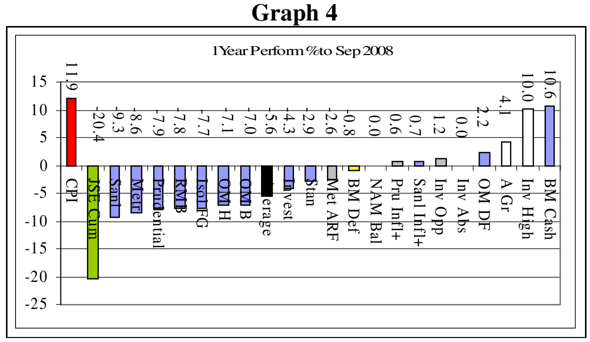
Graph 2



Graph 3



Graph 4



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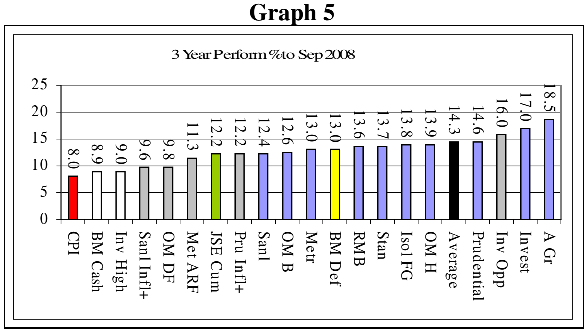
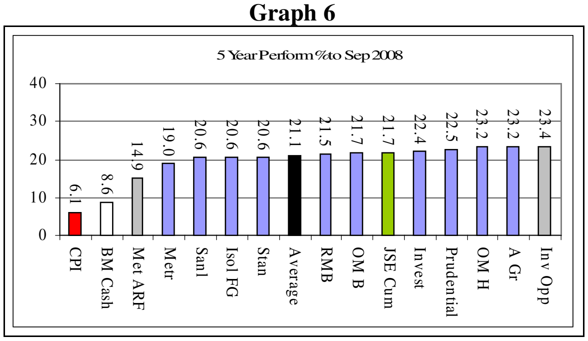
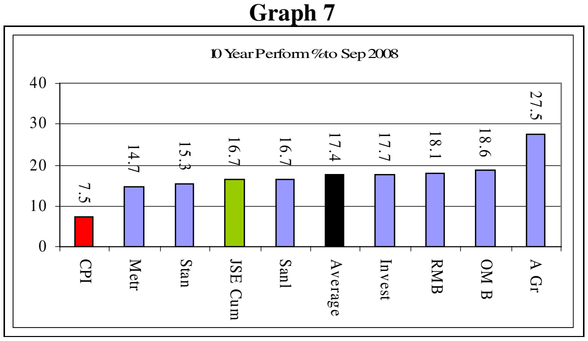
Graph 5



Graph 6



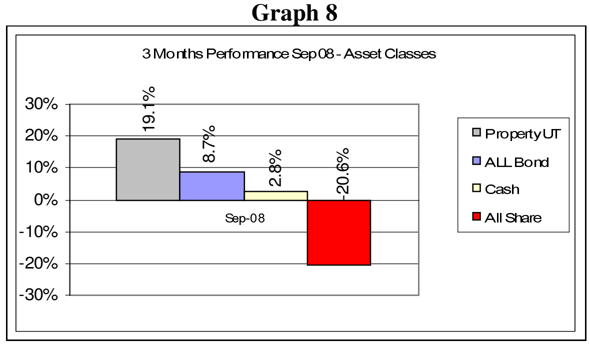
Graph 7



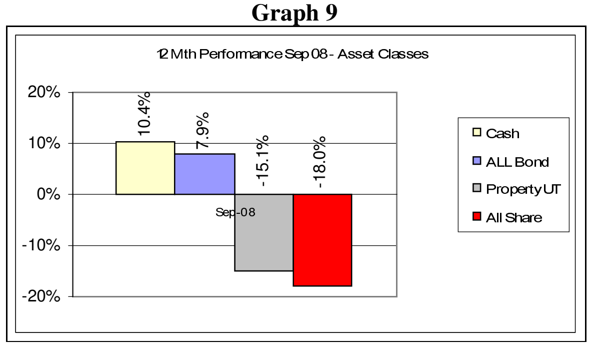
2. Review of Performance of Key Indices (index performance by courtesy from pointBreak/Deutsche Securities)

Graph 8 and **graph 9** show that Property UT* has moved from second lowest performance over 12 months to best performing asset class over the latest quarter. Bonds remain in second position but managed to outperform Cash over the latest quarter. The Allshare index was the worst performer for the latest quarter and for the 12 months.

Graph 8

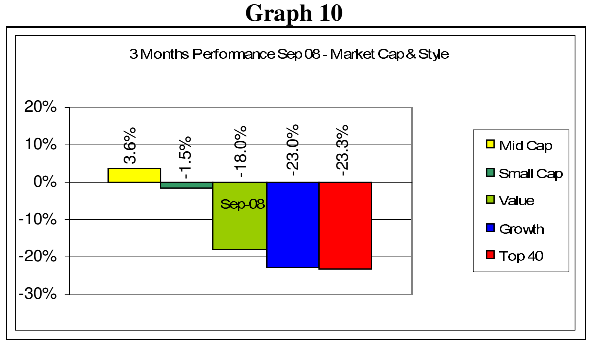


Graph 9



Graph 10 and **graph 11** reflect a significant change in rankings, over 3 and 12 months, of type of company and market capitalization, occasioned by the prevailing volatility. Since our large caps are predominantly resource companies, the decline in the resources indices is reason for the more recent under performance of the large caps.

Graph 10



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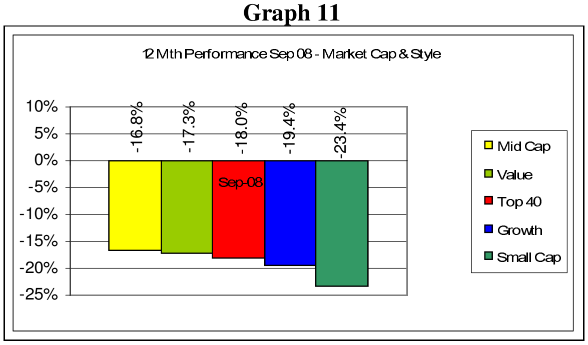
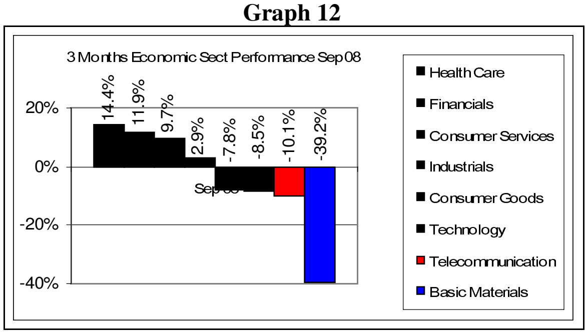
Graph 11

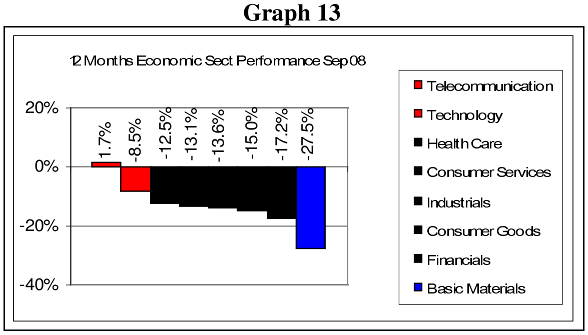


Graph 12 and **graph 13** depict the performance of the main equity sectors. Evidently, Financials* and Telecoms* have switched positions where former was the second best and latter the second poorest performing sector over the latest quarter. Basic Materials* retained its position as poorest performing sector for the 12 months and latest quarter.

Graph 12

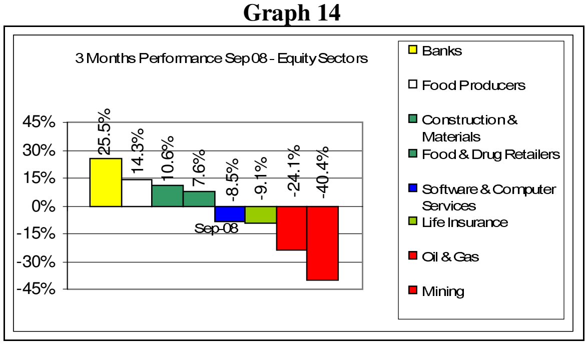


Graph 13

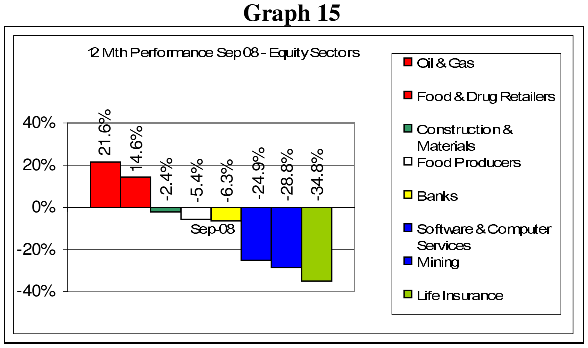


Drilling down one level into the main equity sectors, **graph 14** and **graph 15** show that Oil & Gas* and Mining* have moved to the bottom of the log over the latest quarter. The Construction & Materials* sector has retained its third place position.

Graph 14



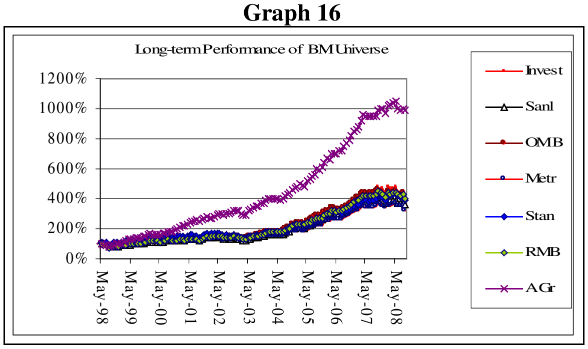
Graph 15



3. Portfolio Performance Analysis

Namibian prudential balanced portfolios essentially only acquired their own identity in 1998 when changes were brought about by 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. Take note of the decline in returns since May 2008.

Graph 16



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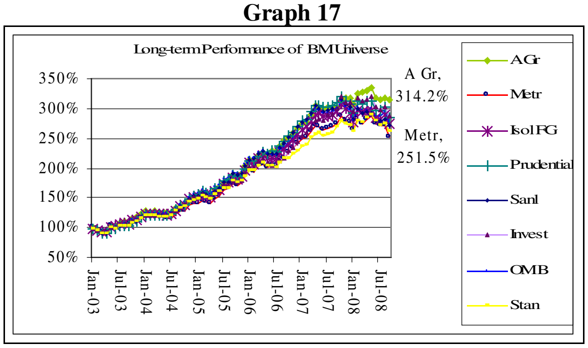
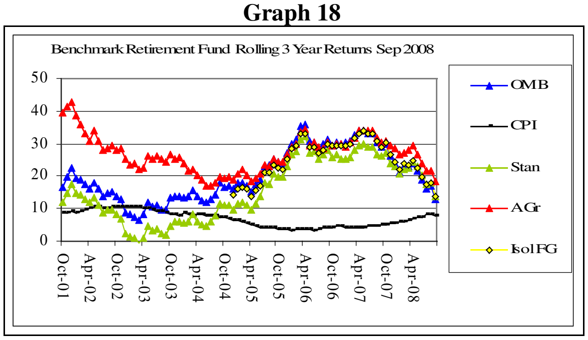
Graph 17

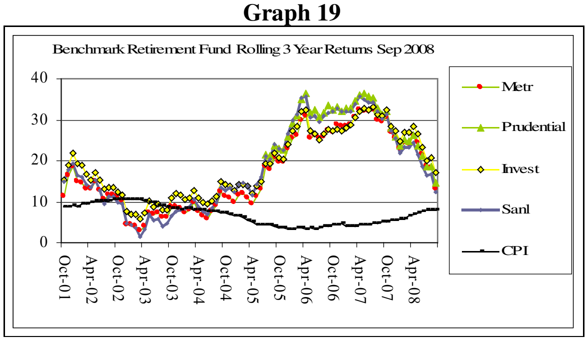


Graphs 18 and graph 19 reflect rolling 3 year returns since October 1998. For long-term projection and planning purposes the general assumption is that prudential balanced portfolios should outperform the CPI by between 3% and 5%, which has over this period only been achieved throughout by Allan Gay. Evidently the gap is closing and is now in more sustainable territory of between 4% and 11%.

Graph 18

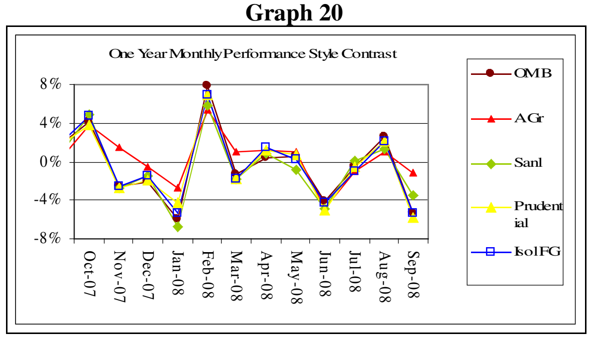


Graph 19

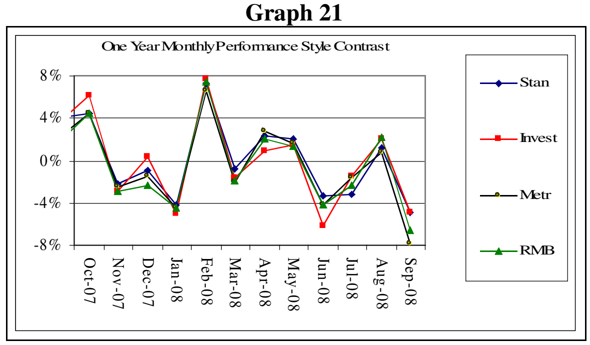


Graph 20 and **graph 21** depict the monthly performance of the prudential balanced portfolios in this survey. It shows that managers do generally perform very similarly but it also affords the opportunity to identify odd trends for further investigation and for drawing conclusions about expected future performance and historic skills of the managers. Allan Gray appears to be back on a more familiar trend of cutting the peaks and troughs.

Graph 20

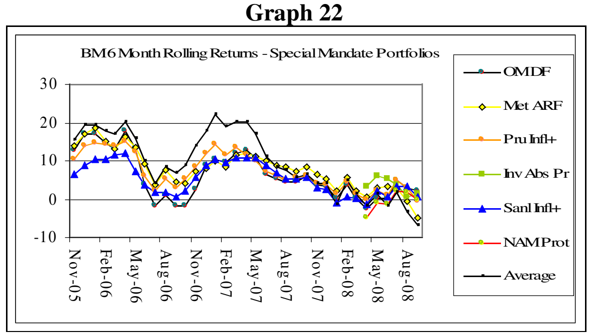


Graph 21



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 from the 'special mandate portfolios' vis-à-vis the average prudential balanced portfolio. In essence these portfolios have around 20% lower equity exposure for the benefit of less volatile but in the long term, in theory, around 2% lower returns.

Graph 22



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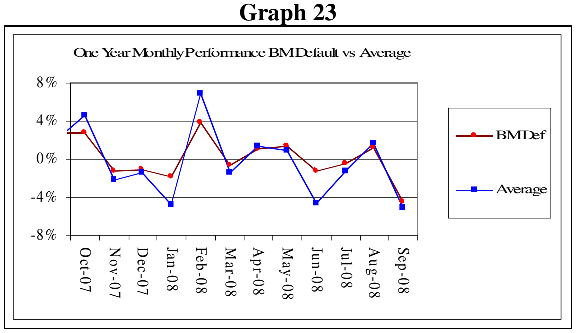
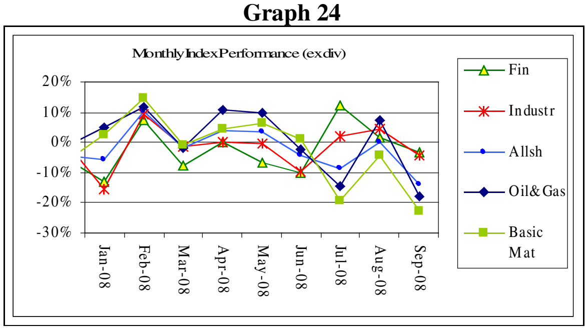
Graph 23

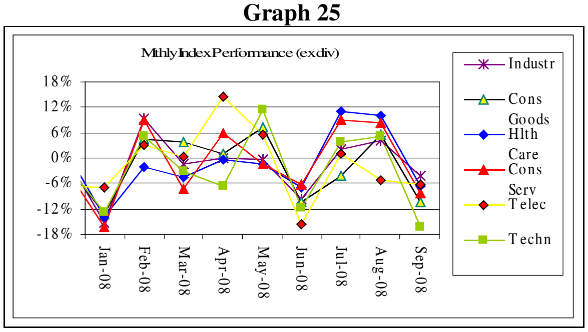


Graph 24 and **graph 25** afford the investor the opportunity to compare managers' monthly performance (as depicted in graph 20 and graph 21) against various equity sectors and to draw his conclusions regarding a manager's investment style and philosophy. **Graph 26** and **graph 27** serve a similar purpose, but with regard to cumulative performance since January 2008.

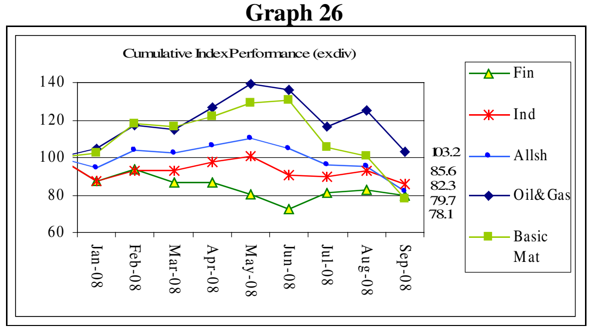
Graph 24



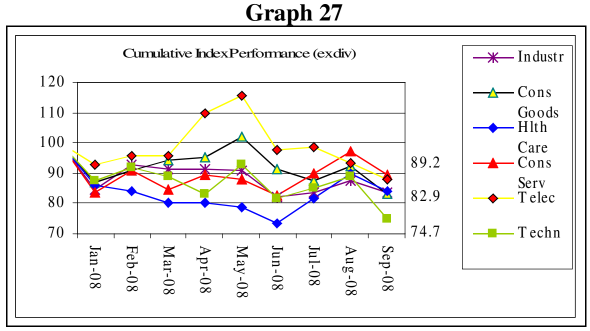
Graph 25



Graph 26



Graph 27



4. A Contrarian Preview Of The Next 12 Months

For the past few years, the oil price has been the, and still is a, but much less pronounced, defining factor in the global economy in our view and our expectations are significantly dependent on how it will behave going forward. We sided with those commentators that believed the oil price was driven by speculation and this appears to be corroborated by latest developments. Evidently, as admitted by no lesser prominence than Allan Greenspan, speculation was pretty much unchecked and the result of excessive legislative leeway. All of a sudden now everyone seems to realize this and there is consensus that this must be checked. The FASB was still due to implement new accounting conventions with regard to hedge funds, but by the time it gets to this, it may be too late to bother as they may only be an anachronism. Lobbying by banks has apparently delayed further action on it. So banks can now try to quietly get their house in order, by disposing of their prime assets first to reduce their gearing to more acceptable levels. Looking at what's been happening on global bourses, we now see how this impacts on the values of such assets. Interestingly there is now also talk about the wisdom of 'mark-to-market' accounting, insinuating some form of actuarial valuation of assets aimed at smoothing peaks and troughs in market valuations. This is certainly a principle common

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to the pension fund industry and might merit some consideration.

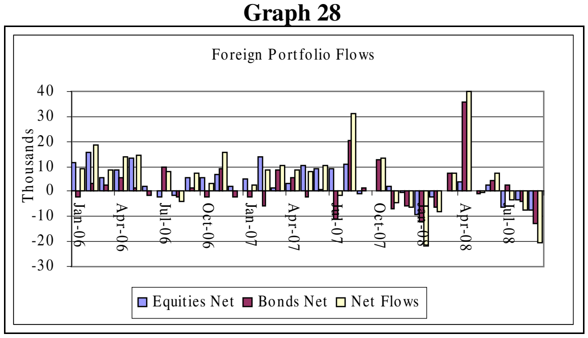
We believe that the removal of speculation now resulted in the oil price entering a new era of significantly lower levels probably in the region of US$ 35-US$ 50 per barrel, going by economic principles. At its current level of around US$ 70, there is still a significant, but rapidly reducing flow of money seeking investment, probably in the region of US$ 1 trillion p.a. (close to 7% of US GDP), and flowing into the US in the first place. At this rate, it has now become much more digestible and we are unlikely to continue seeing the extent of bubbles blown up by this flood of money, as we have seen in the past. What was to be expected and we are seeing now, is the great ebb of capital being sucked back into the US, weakening all currencies other than the US Dollar leaving much of the paper gains in the host countries across the globe. For our domestic economies, what they lost through the high oil price, they should, by and large, have gained through the commodity boom. With an Allshare Index of between 16,000 and 18,000 we should, broadly speaking, be on an 'even keel' again, as if the oil price surge and the commodity boom never happened. In the mean time the weak Rand/Namibia Dollar should provide positive impetus to local manufacturing and exporters, which in turn should benefit the domestic consumer over time.

Concluding on the financial crisis, it would seem to us that the global financial system has to be re-engineered as it was clearly incapable of dealing with this situation. Speculation is one thing and can be, has to be and will be checked, but does it make sense to have all global trade denominated in one currency? Isn't this a contradiction of the free market principles? Unraveling the situation to the extent that stock exchanges and other financial markets have not already done, appears to be possible by way of one of two approaches. It is either the swift painful 'big bang approach' where the investment banks, hedge funds and other hoarders of the windfall profits from the commodity boom are allowed to implode, or the inflation approach, where governments prop up these institutions in order to achieve equilibrium by way of inflation and negative real interest rates over a prolonged period. It would seem that latter approach is the one that has been chosen by most countries.

It is likely to still take a while before a lower oil price will start impacting positively on rising price levels globally. In addition it appears that inflation has been chosen as the preferred approach for achieving equilibrium. Consequently, inflation negative real interest rates are likely to be around for some time. The consumer, particularly in the US, will be under pressure for a while and this should put a lid on consumption and more specifically on global demand for resources, as we have started to experience. This should lead to greater stability and predictability returning to global financial markets. Inflation and negative real interest rates should benefit property and equity while discouraging investment in interest bearing assets.

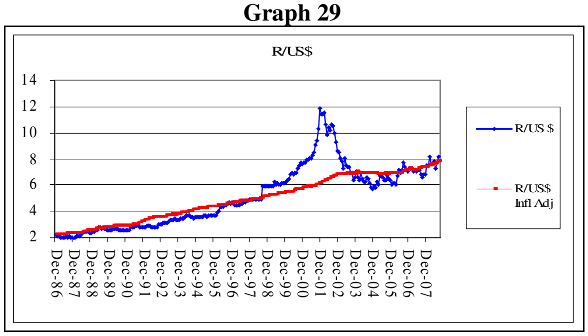
Going by our scenario of higher inflation and negative real interest rates, we would not expect interest rates to be hiked in the US soon. With a strengthening US Dollar, we do not expect local interest rates to be lowered soon either. The increase in imported inflation has so far been counter acted by the declining oil price and we would expect this situation to improve as the Rand regains some of its strength following the current sell off by foreign investors as clearly evident from **Graph 28**. For the local economies we expect that real interest rates will be maintained for a while. Should inflation remain at current levels as the result of the weak Rand, chances are thus that interest rates may yet be hiked again to support the Rand. This threat we would expect to dissipate over the next 6 to 12 months though, where after we would expect inflation to lead the decline of interest rates by 6 to 12 months.

Graph 28



Graph 29 indicates that at a rate of 8.22 to the US Dollar, the Rand was slightly undervalued and is thus grossly undervalued at its current rate of between 10 and 11 to the US Dollar. This should correct over the next 6 to 12 months.

Graph 29



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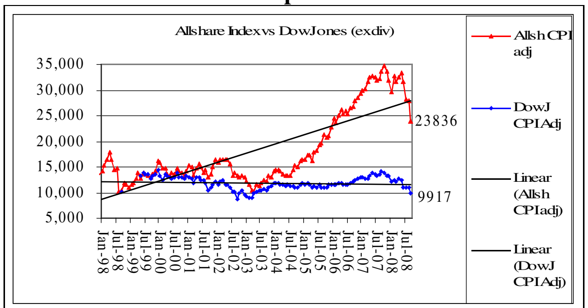
Graph 30 shows clearly to what extent the South African share market had departed from the US market. Standing at below 18,000 at the time of writing, this departure has been all but eliminated. This indicates that our local markets are now back in 'normal territory'.

Graph 30



5. Conclusion

We believe that one can now start looking past the oil price and return to focusing on fundamentals. Volatility in share markets will remain for a while fueled by fear and sentiment. On the basis of fundamentals, it would seem that our local markets are back in normal, sustainable territory.

In the short-term, we would be slightly cautious about interest bearing investments on the basis of a potential increase in interest rates. Local industrial and commercial property should offer fair returns in times of higher inflation and an environment of real interest rates. We see no value in cash other than as short term protection against further market volatility.

With the steep correction of equity markets, we believe the time has approached when one should seriously consider investment in equity again, specifically local manufacturing and exporters. Commodities should also start offering opportunities on a selective basis again.

Taking our view of a significantly undervalued Rand, we would not raise the offshore exposure at this stage. A correction though should encourage a fair spread of investment in global equity.

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.