Volume 4, No. 12, December 2008

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 December 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.

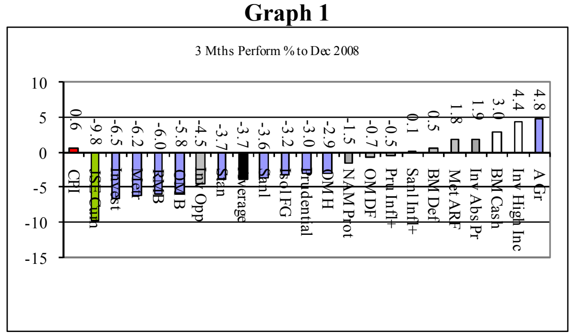
1. Review of Portfolio Performance

In December the average prudential balanced portfolio returned 1.72% (November minus 0.32%). Best and worst performance **for the month** was delivered by Investec (3.29%) and Sanlam (0.7%), respectively. Comparing the composition of these two portfolios, it would appear that Sanlam was punished for being underweight 'Industrials' and 'Consumer Services' relative to Investec by 19% and 14%, respectively, sectors that produced 5.1% and 7.7%, respectively for the month, while its relative overweight in 'Basic Materials' and 'Financials' of 7% and 21%, respectively cost it as well, these sectors having produced 0.4% and minus 1.2%, respectively.

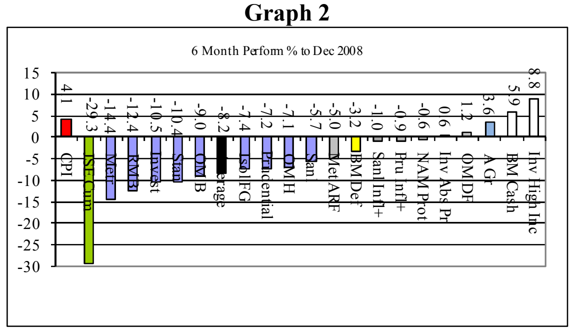
Graphs 1 to 7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential balanced portfolios (black bar), 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 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 (red)
JSE Allshare Index	JSE Cum (green)
Benchmark Default Portfolio	BM Def (yellow)
Average Portfolio (prudential, balanced)	Aver (black)
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)

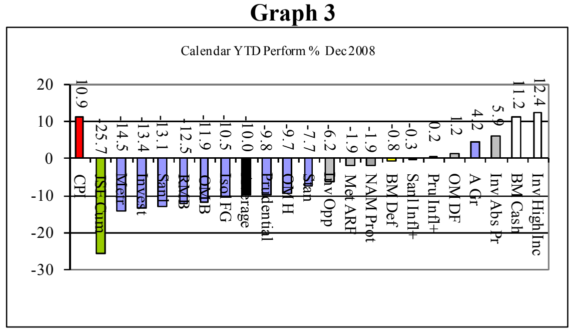
Graph 1



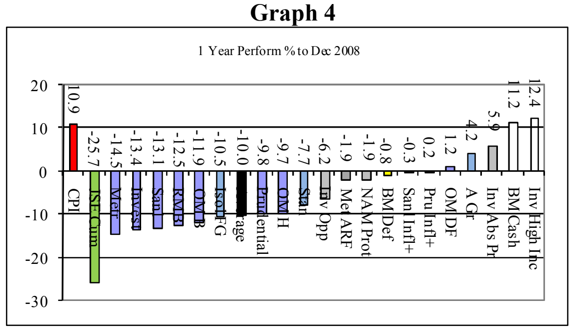
Graph 2



Graph 3



Graph 4



BENCHTEST

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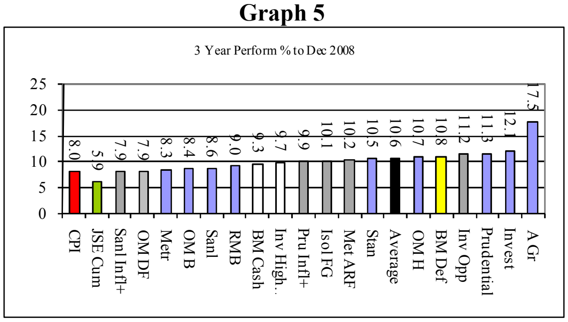
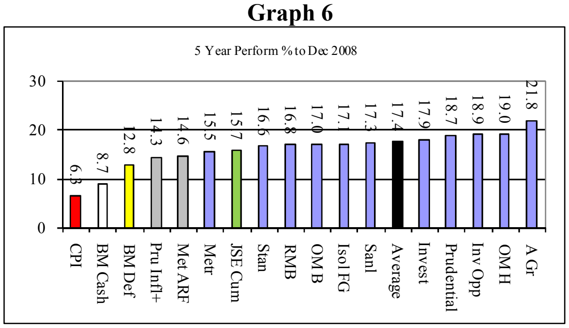
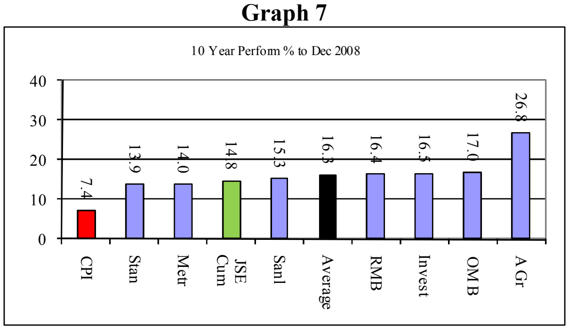
Graph 5



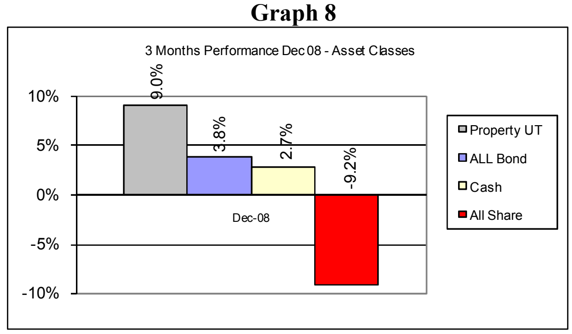
Graph 6



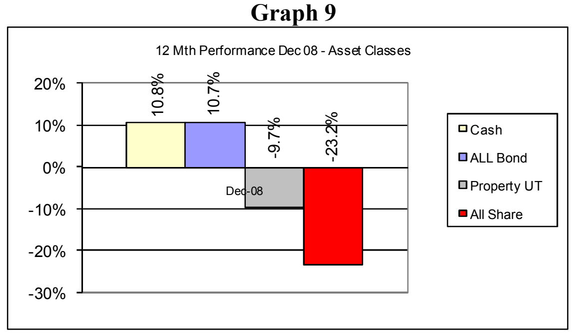
Graph 7



Graph 8



Graph 9

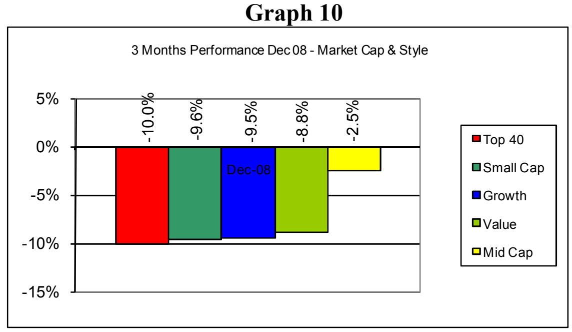


2. **Review of Performance of Key Indices** (index performance by courtesy from pointBreak/Deutsche Securities)

Graph 8 and **graph 9** show that the 'fortunes' of Property UT* improved considerably from 12 months to the last quarter as best performing asset class over the latest quarter with a return of 9%, compared to 3.8% produced by the Allbond Index* in second position for the quarter. Over 12 and 3 months, cash remains king though, with Bonds in second position. The Allshare index was the worst performer for the latest quarter and for the 12 months.

Graph 10 and **graph 11** reflect rankings, over 3 and 12 months, of type of company and market capitalization. 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. Interestingly, Value Shares improved their relative ranking, something one would expect under current volatile market conditions.

Graph 10



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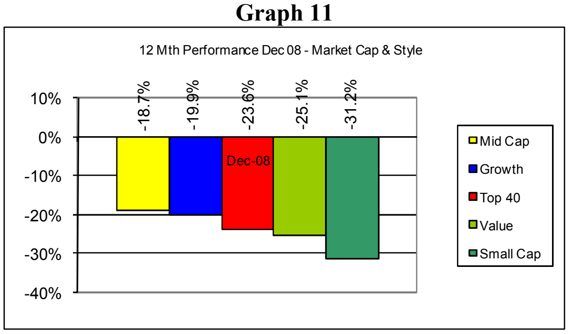
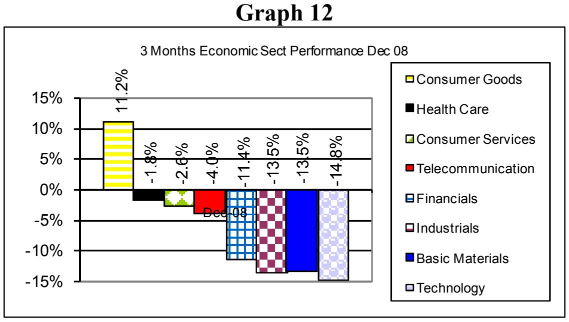
Graph 11

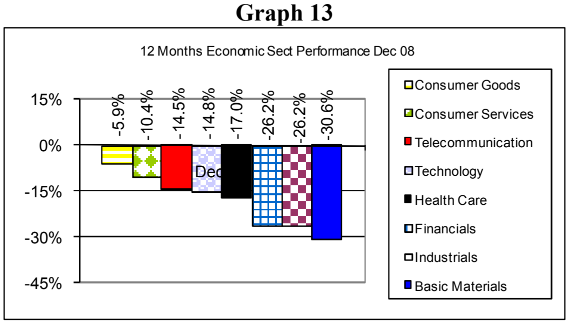


Graph 12 and **graph 13** depict the performance of the main equity sectors. Evidently, there was very little change in the rankings. Amongst the 'heavy weight' sectors, Basic Materials*, Industrials* and Financials* retained their positions as poorest performing sectors for the 12 months and 3 months. Consumer Goods* in turn improved its positions substantially, producing the only positive return (11.2%) of all sectors for the quarter.

Graph 12

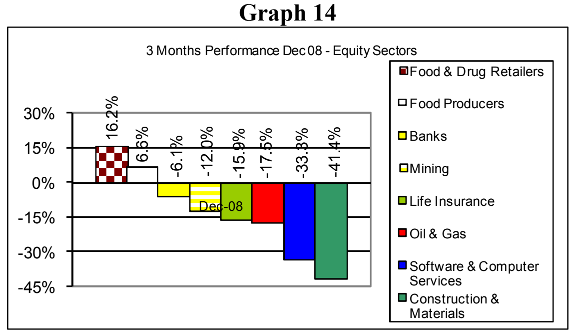


Graph 13

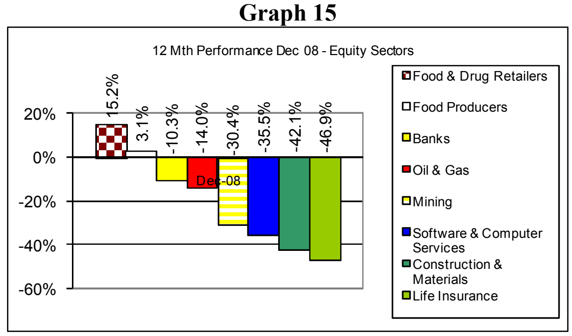


Drilling down one level into the main equity sectors, **graph 14** and **graph 15** changes in rankings between 12 month and 3 month performance are more evident. More significantly, 'Life Insurance' improved its position noticeably, while the Food* related sectors retained their position at the top of the log, producing positive returns over 12 months as well as over 3 months.

Graph 14



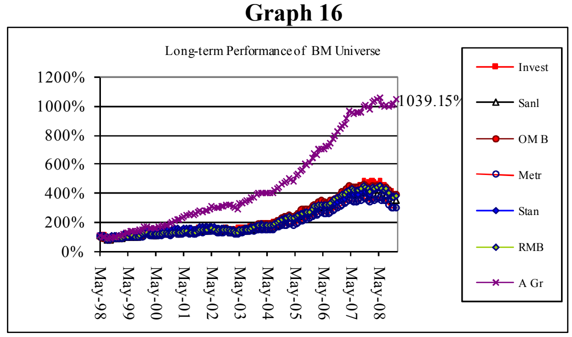
Graph 15



3. Portfolio Performance Analysis

Namibian prudential balanced portfolios essentially only acquired their own identity in 1998 when changes were brought about 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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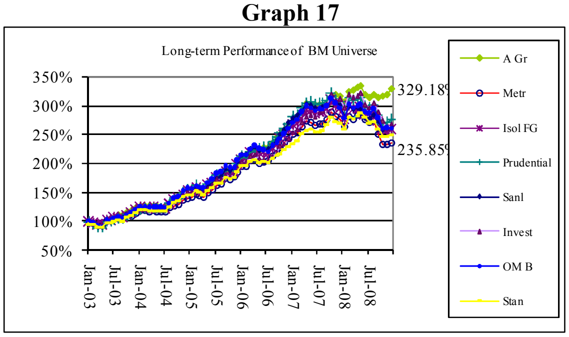
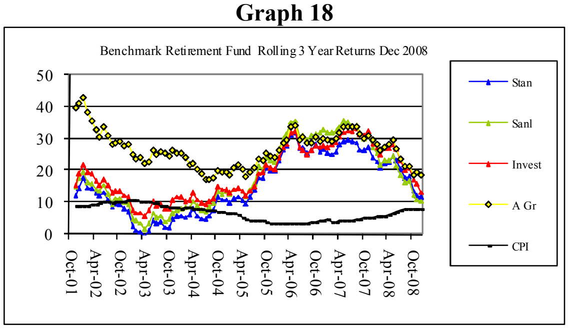
Graph 17

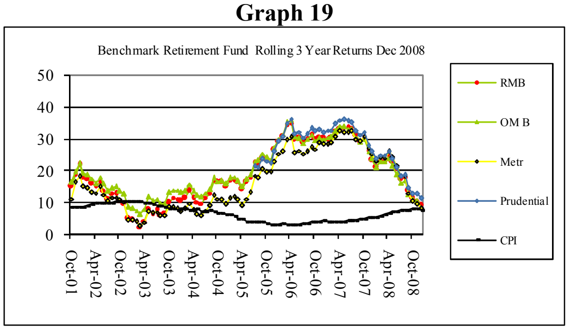


Graphs 18 and graph 19 reflect rolling 3 year returns since October 1998. For long-term projection and planning purposes the general assumption is that prudential balanced portfolios should outperform the CPI by between 3 and 5%. The latest position reflects outperformance of the CPI between 0.3% (Metropolitan) and 9.5% (Allan Gray), and has over this period only been achieved throughout by Allan Gay. The gap has closed and we are back into more sustainable territory, in fact we are now seeing unsustainably low returns of most prudential balanced portfolios relative to CPI, on a risk return basis.

Graph 18

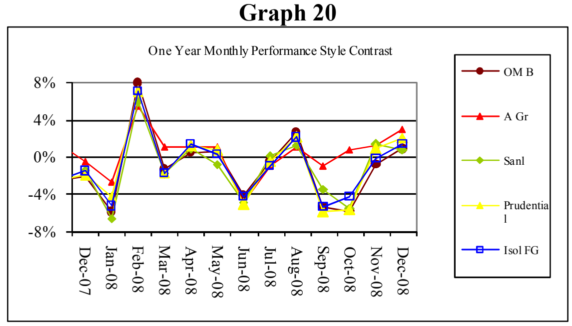


Graph 19

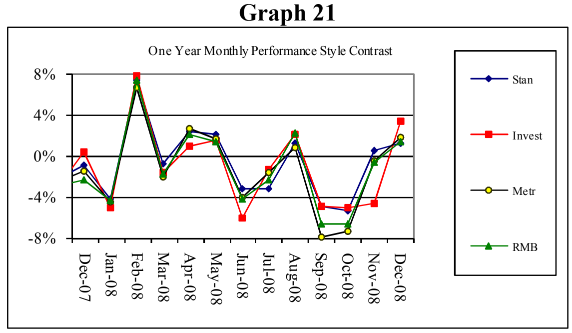


Graph 20 and **graph 21** depict the monthly performance of the prudential balanced portfolios in this survey. It shows that managers do generally perform very similarly but it also affords the opportunity to identify odd trends for further investigation and for drawing conclusions about expected future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

Graph 20

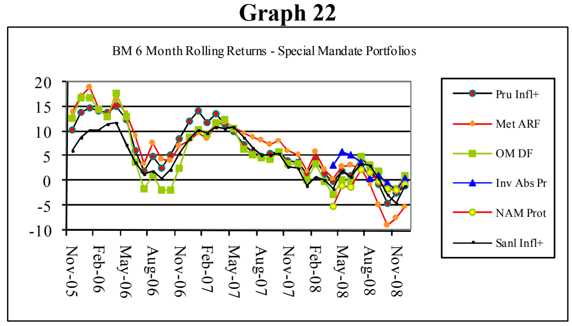


Graph 21



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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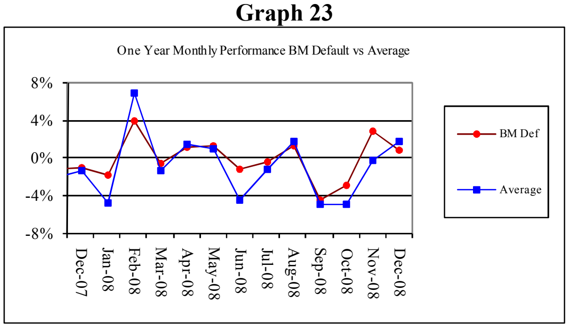
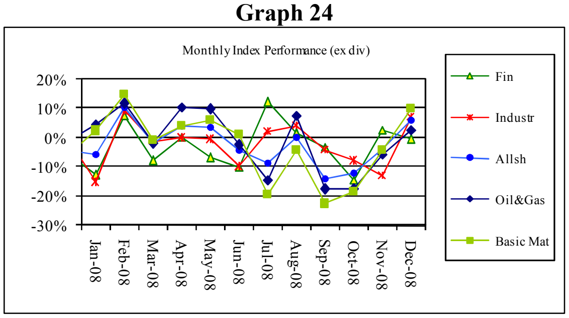
Graph 23

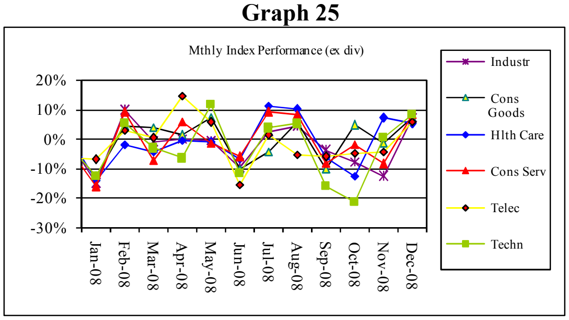


Graph 24 and **graph 25** afford the investor the opportunity to compare managers' monthly performance (as depicted in graph 20 and graph 21) against various equity sectors and to draw his conclusions regarding a manager's investment style and philosophy. **Graph 26** and **graph 27** serve a similar purpose, but with regard to cumulative performance since January 2008. Note that all sectors lost 20% or more over the 12 months.

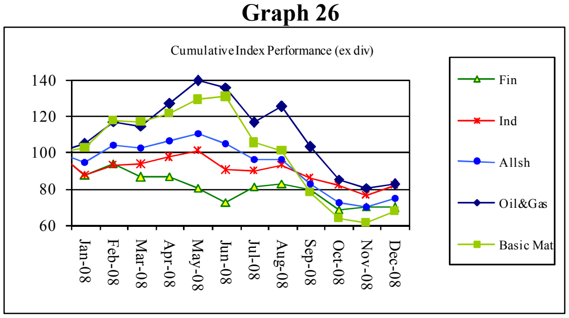
Graph 24



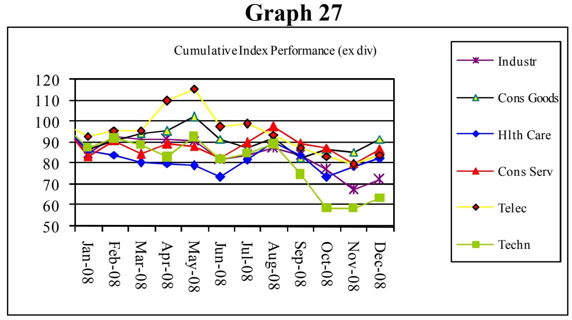
Graph 25



Graph 26



Graph 27



4. A Contrarian Preview Of The Next 12 Months

"So, with all these rather depressing trends and results", we have been asked, "why haven't you warned us and why haven't you advised us to invest in cash?" Not an easy question to answer, we admit. Of course we have warned for nearly 3 years that in our view, the market was unsustainably high. Those that followed our advice would have been highly upset with us for the next one-and-a-half years, because the market forged ahead from around 20,000 in March 2006, to 33,000 in October 2007, the average prudential balanced portfolio still picking up another 42% over this period, while our more conservative portfolio only managed to grow another 29%. Taking this comparison further to end December 2008, the average prudential balanced portfolio produced 23% compared to our more conservative portfolio's 25%, and guess what, cash delivered 28% over the same period. Does this validate the view of rather investing in cash? We would like to sketch an analogy of a prospective farming venture. Should the prospective farmer be advised to buy a farm in the Namib desert, because for that area you can be pretty certain that it is not going to rain, rather than buying in the Omaheke region for the risk of there going to be years of drought? The past 30 years or longer for those with longer memories, have proven that the Namib is dry and Omaheke not, but who dares to say that the Namib is not going to get rain in the next 3 years while Omaheke region is going to experience a drought? The past 30 years have also shown that cash will not out perform inflation, in other words it's not going to grow, while equities will, but who dares to say it's not going to do better than equities over the next 3 years? Would you prefer to farm in the Namib? If you are, conventional investment 'wisdom' is not for you!

As we concluded previously the oil price and commodities were driven by speculation, the result of excessive legislative leeway granted to financial institutions.

Legislator were 'naughty' to grant this leeway and bankers were 'naughty' in the way they used the leeway to dispose of the flood of money taken from the pockets of the man in the street to be stuffed into the pockets of a relatively small number of beneficiaries of this speculative boom. Financial

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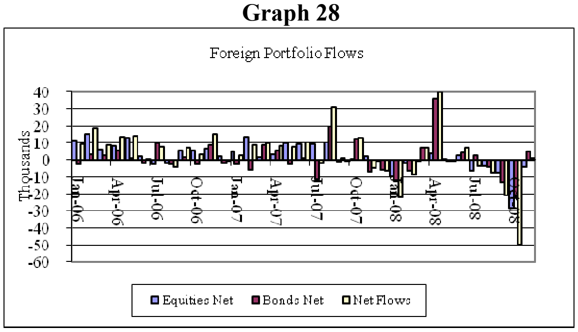
institutions are sitting with fixed liabilities and assets valued at a fraction of their book value. We suggest that there are essentially only two ways to deleverage these institutions, the swift very painful way that will punish the culprits more directly, and the drawn out but less painful way that will punish everybody including the poorest who already suffered disproportionately from high commodity prices.

The chosen route at this stage appears to be the drawn out process of deleveraging. This requires the re-inflation of asset values and the deflation of liabilities by means of inflation and low interest rates, in the US in particular as main destination of global capital flows.

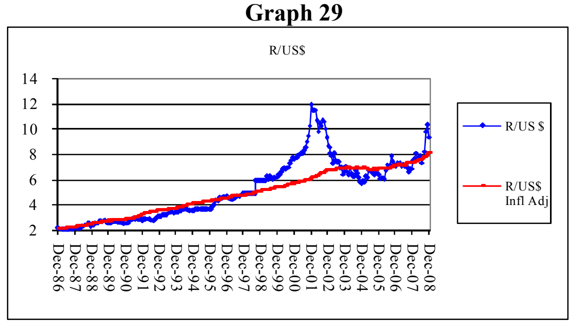
Based on this view, we will see low, probably even negative real interest rates and increasing inflation in the developed world with sideways movement in global equity markets for an extended period of time of between 3 and five years. Volatility will remain in financial market for probably another year until all surprises are out of the global financial system.

Locally, we believe that the exodus of foreign investment flows into equities should be largely behind us, as evident from **Graph 28**, so that one may expect sentiment driven negative swings soon no longer to be a serious threat for the investor. In the mean time we expect local inflation and local interest rates to continue declining in measured fashion to cushion the negative impact on the Rand, but the Rand will remain under pressure for a while. **Graph 29** indicates that the Rand is oversold at 9.30 to the US$ at end of December, and should be around 8.20, on a relative inflation adjusted basis. The weaker Rand should be beneficial for local manufacturing while declining inflation and interest rates should be beneficial for local consumption, particularly with regard to food and clothing and of course for property investments.

Graph 28

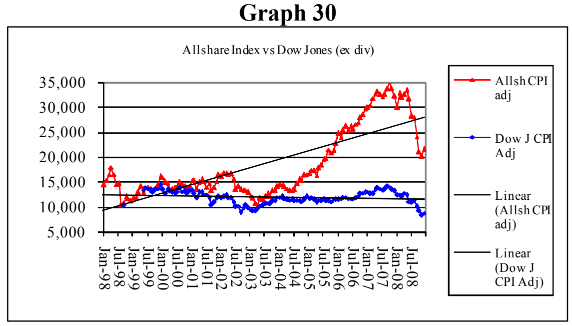


Graph 29



Graph 30 shows clearly to what extent the South African share market had departed from the US market. Having touched 18,000 just a few weeks ago, it's now back to around 20,000 by the time of writing, this departure has corrected substantially in nominal values. Interestingly, both the Dow Jones and the SA Allshare Index are now around 15% below the CPI adjusted trend line.

Graph 30



5. Conclusion

We believe that volatility in global equity markets will remain for a while, but with a declining tendency. On the basis of fundamentals, it would seem that global markets are now in more sustainable territory.

In view of our expectation of declining inflation and interest rates, bonds should be a more attractive asset class on the basis of fundamentals. Local industrial and commercial property should offer fair returns in times of higher inflation and an environment of negative 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 selectively consider investment in equity again, specifically local manufacturing and exporters. Commodities should also start offering opportunities on a selective basis again. The focus should be on stock selection and dividend yield.

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.