Volume 13, No. 02
Feb 2017

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 28 FEBRUARY 2017

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

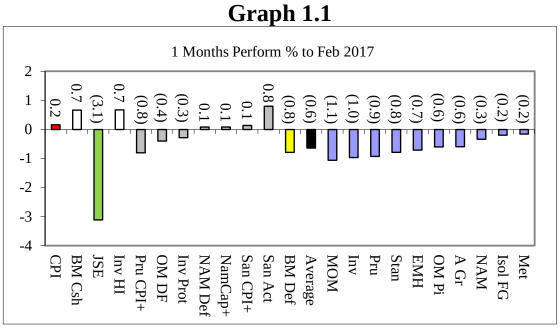
In **February** the **average prudential balanced portfolio** returned -0.64% (January: 1.32%). Top performer is Metropolitan (-0.16%); while Momentum (-1.06%) takes the bottom spot. For the 3 month period Old Mutual Pinnacle Profile, takes top spot, outperforming the 'average' by roughly 1.0%. On the other end of the scale Momentum underperformed the 'average' by 1.4%.

Graphs 1.1 to 1.9 reflect the performance for periods from 1 month to 15 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 represents a combination of Prudential Namibia Inflation Plus and Allan Gray Namibia Balanced Fund.

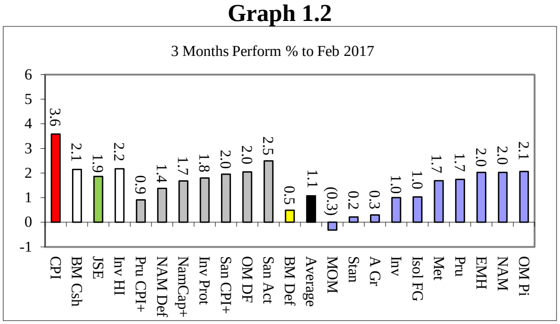
Below is the legend to the abbreviations reflected on the graphs:

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)
Investment Solutions Bal Growth, (multimanager)	Isol FG (blue)

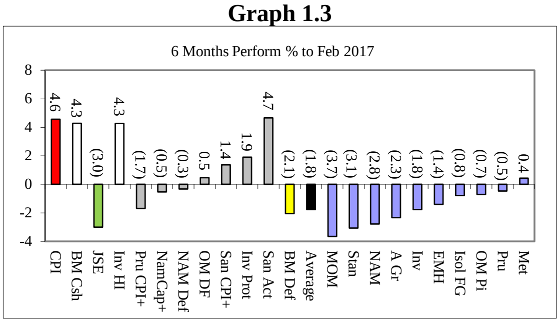
Graph 1.1



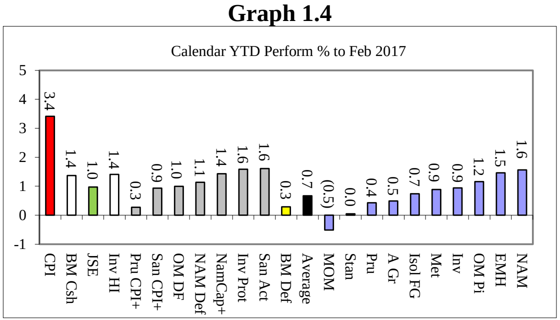
Graph 1.2



Graph 1.3



Graph 1.4



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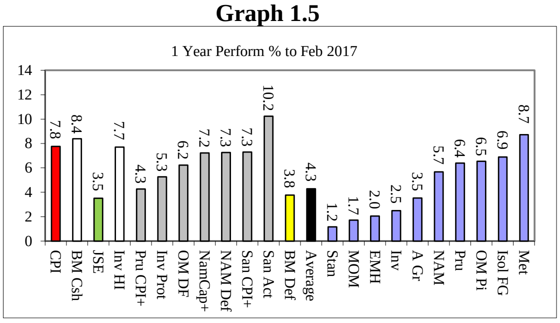
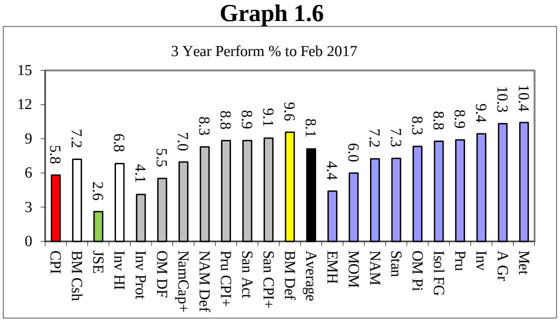
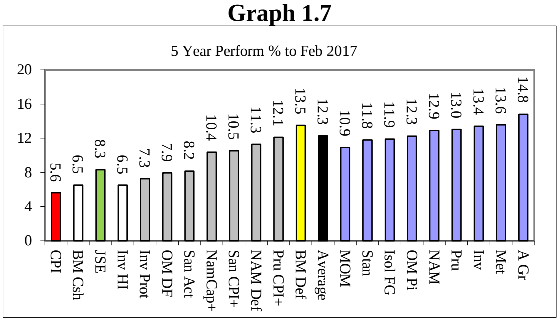
Graph 1.5



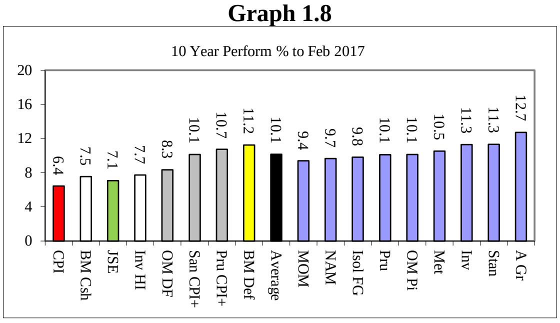
Graph 1.6



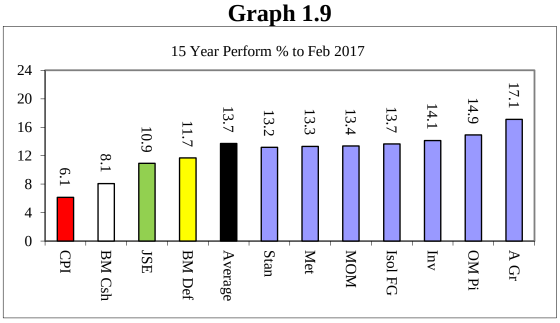
Graph 1.7



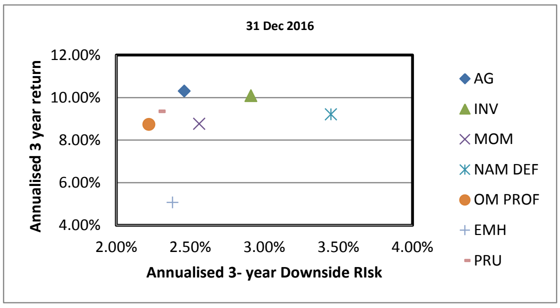
Graph 1.8



Graph 1.9

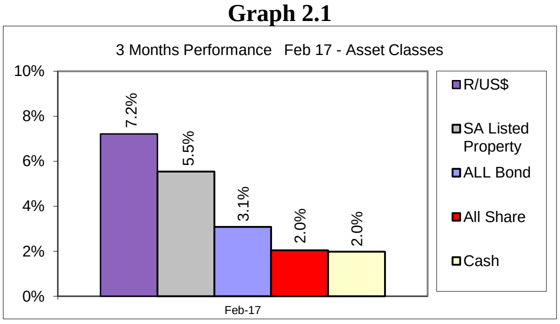


Risk/ Return

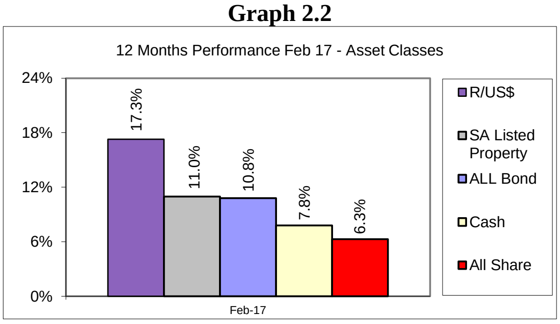


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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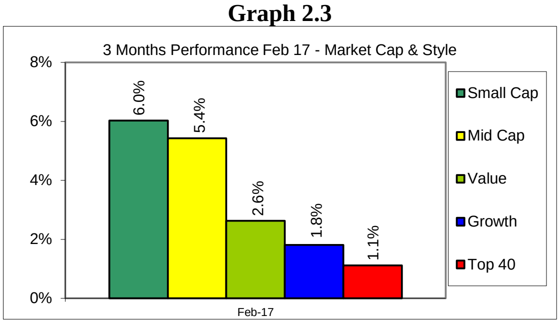
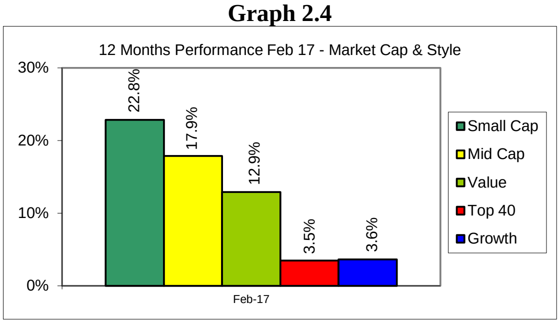
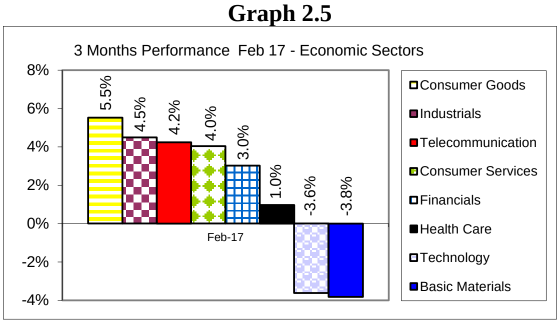
Graph 2.3



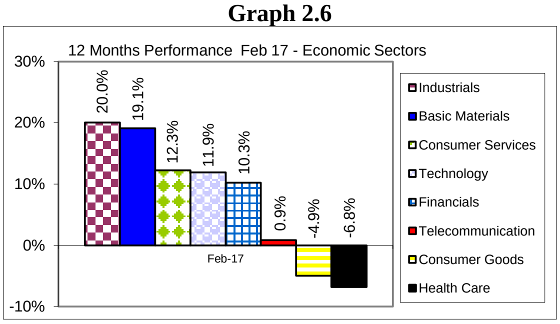
Graph 2.4



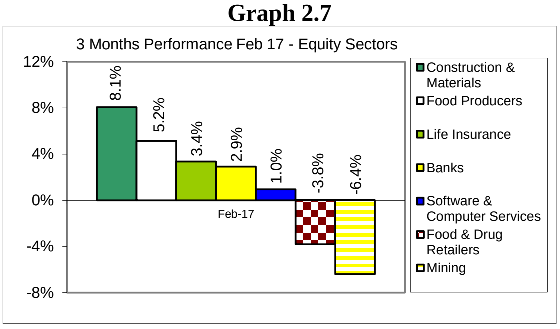
Graph 2.5



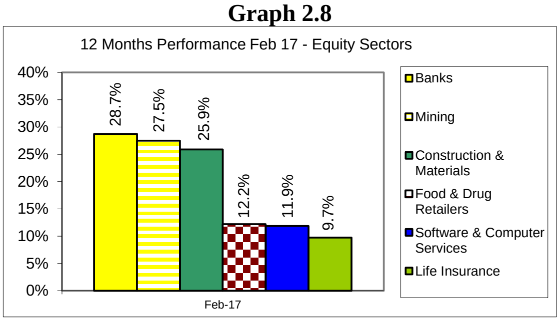
Graph 2.6



Graph 2.7



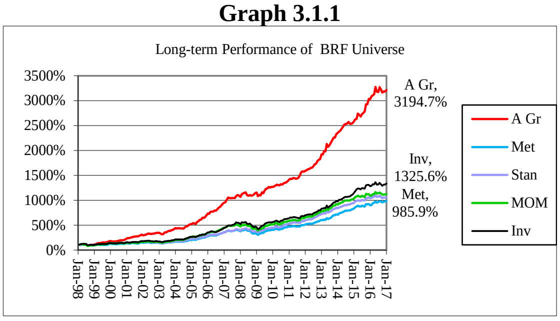
Graph 2.8



3. Portfolio Performance Analysis

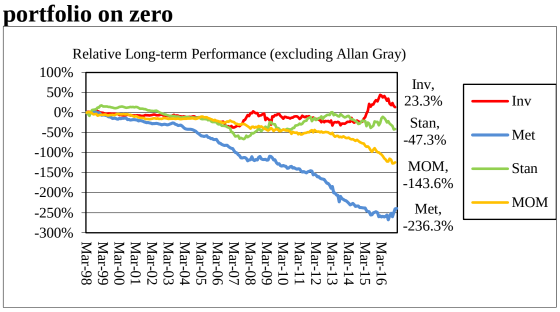
3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1



Graph 3.1.2

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



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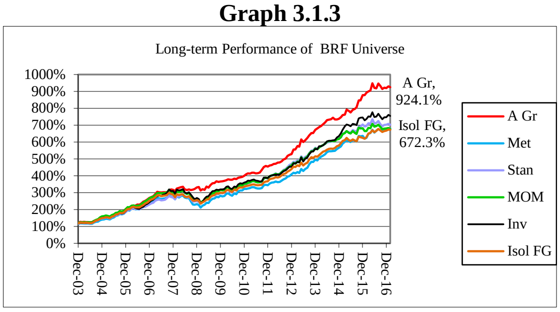
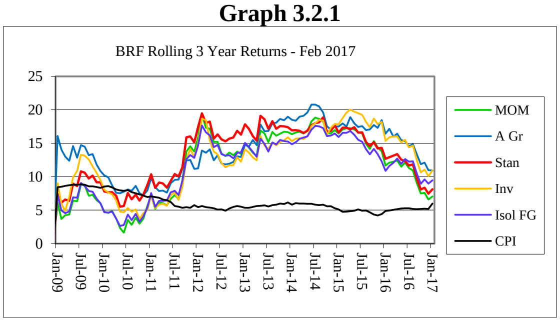
Graph 3.1.3

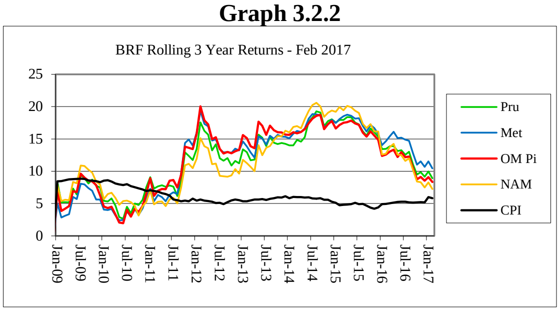


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

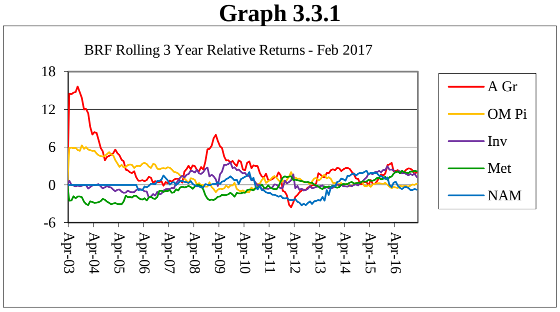


Graph 3.2.2

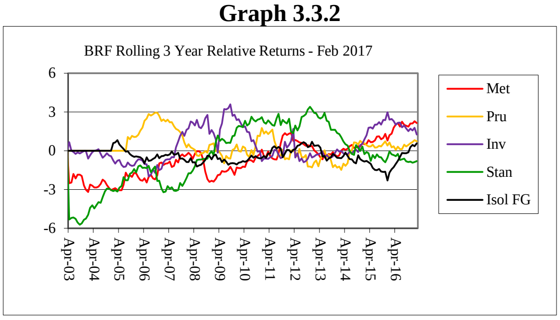


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

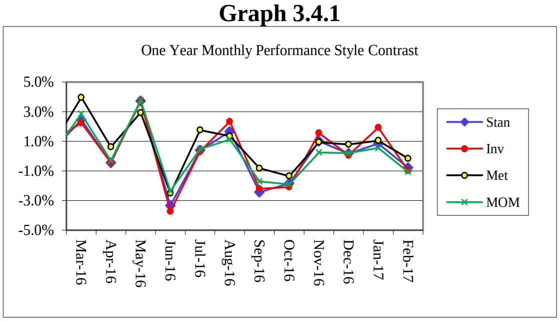


Graph 3.3.2

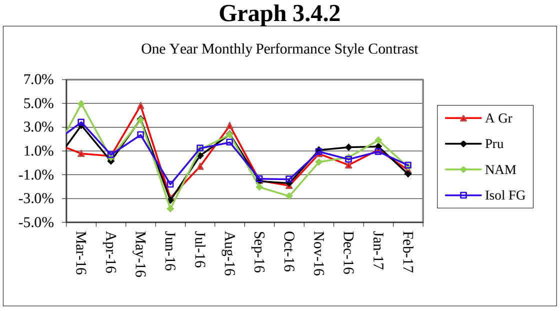


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

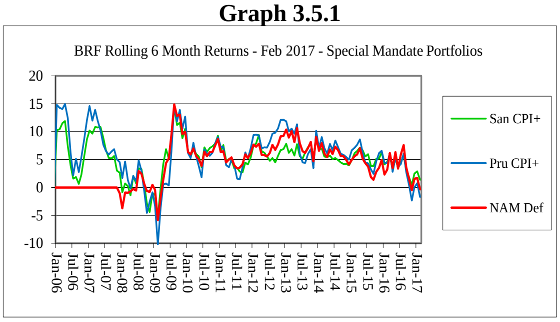


Graph 3.4.2



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

Graph 3.5.1



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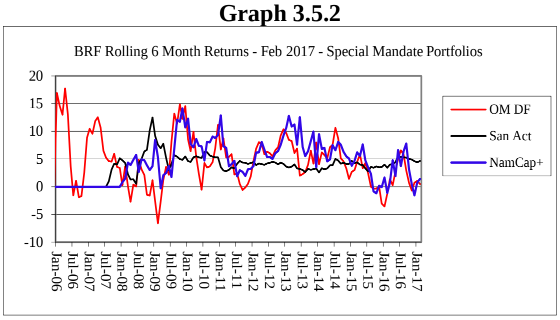
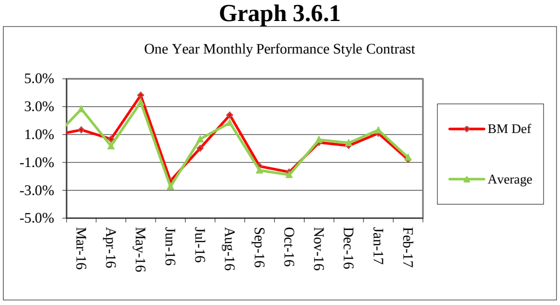
Graph 3.5.2

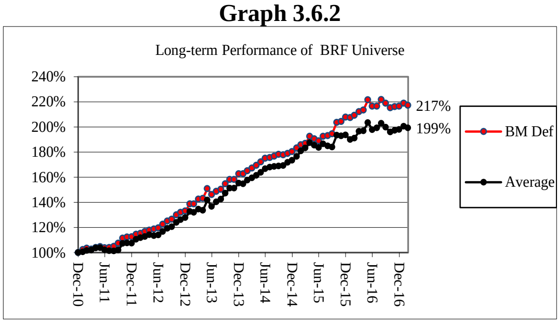


3.6 Monthly and cumulative performance of ‘Benchmark Default’ portfolio relative to average prudential balanced portfolio

Graph 3.6.1

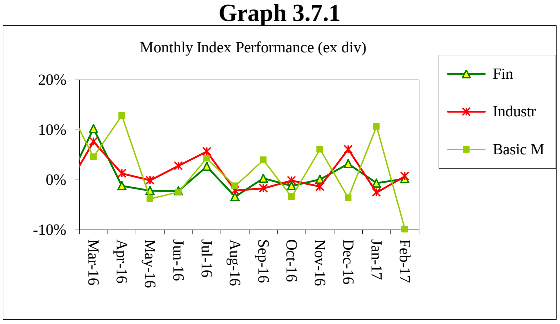


Graph 3.6.2

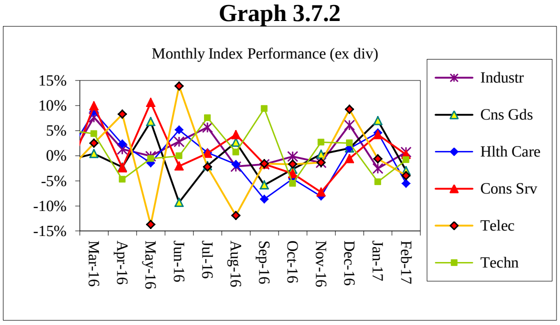


3.7 One year monthly performance of key indices (excluding dividends)

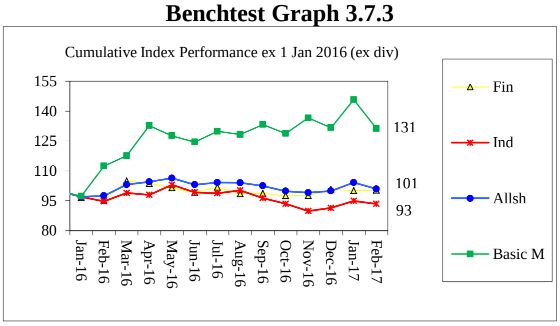
Graph 3.7.1



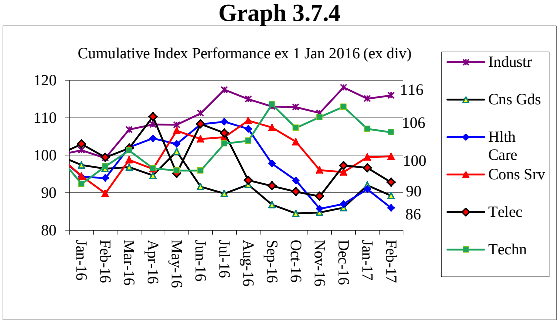
Graph 3.7.2



Benchtest 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.	13.5	12.3
5 year real return - % p.a.	7.9	6.7
Equity exposure - % of portfolio(qtr end)	47.7	60.9
Cumulative return ex Jan 2011	117.1	99.2
5 year gross real return target - % p.a.	5	6
Target income replacement ratio p.a. - % of income per year of membership	2	2.4
Required net retirement contribution - % of salary	13.0	11.6

The above table reflects the actual returns of the Default Portfolio versus target returns required to produce an income replacement ratio of 2% of salary per year of

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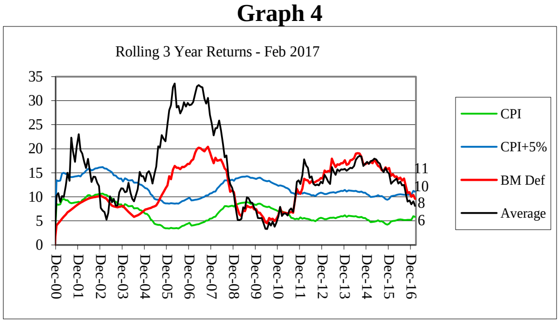
fund membership that should secure a comfortable retirement income.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.6%	9.6%	8.1%
Best annual performance	7.2%	19.1%	18.5%
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	6.1%	15.4%	14.7%

The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years March 2014 to February 2017. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



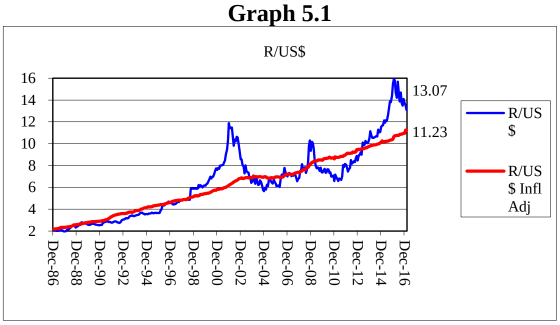
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end February was 9.6%, the average was 8.1% vs CPI plus 5% currently on 11.1%.

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 at fair value at 11.23 to the US Dollar while it actually stood at 13.07 at the end of February. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1



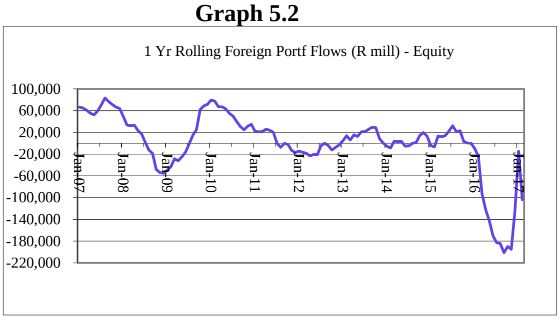
Rand continues to strengthen with foreign capital outflows in February

The Rand strengthened by 3.23% in February with net foreign investment outflows from bonds and equities of N$ 53.1 bn. Over the past 12 months the Rand strengthened by 17.3% on net outflows of foreign capital from equity and fixed interest securities of R 63.8 bn (outflow of 17.7 bn to end January 2017). This indicates that the weakness of the Rand may have been driven by negative sentiment rather than by fundamentals and that fundamentals are once again asserting themselves on the Rand.

Over the 12 months to end of February 2016 SA experienced an outflow of R 22.1 bn (outflow of R 9.9 bn to end of January 2016). Since the beginning of 2006, total net foreign portfolio inflows amounted to R 264 bn (January R 317 bn).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 104 bn on a year-on-year basis at the end of February (outflow of R 14 bn year-on-year to end January). The month of February experienced a net outflow of R 101 bn. Since the beginning of 2006, foreign net investment in equities amounts to R34 bn (end January R 135 bn). This represents roughly 0.3% 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 40.2 bn over the past 12 months to end of February (outflow of R 3.2 bn over the 12 months to end of January). The month of February experienced a net inflow of R 48 bn. Since

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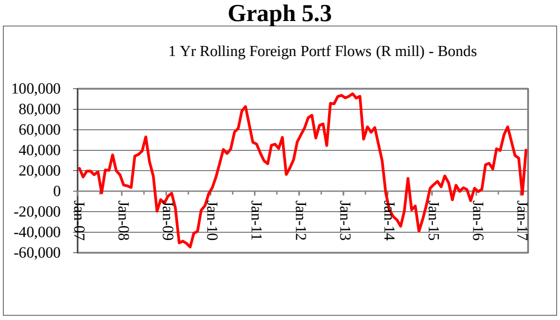
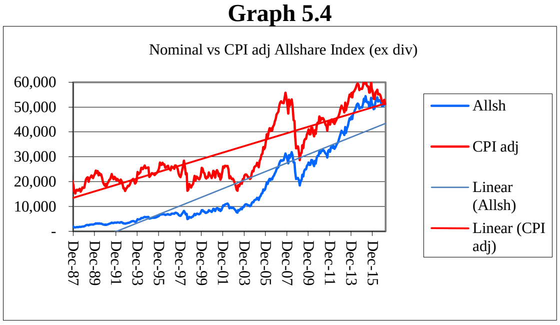
the beginning of 2006, foreign net investment in bonds amounts to R 230 bn (to January just over R 182 bn).

Graph 5.3



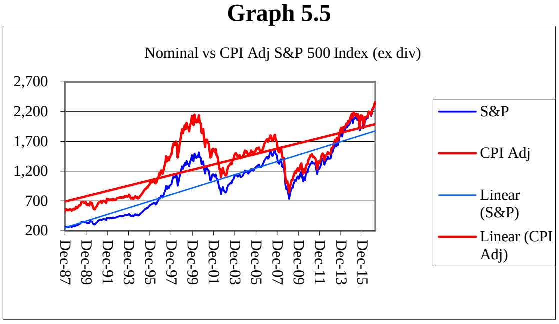
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 11.4% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.4% per year. This is equivalent to a growth in real terms of 3.0% p.a. over this period, excluding dividends, or around 6.0% including dividends.

Graph 5.4



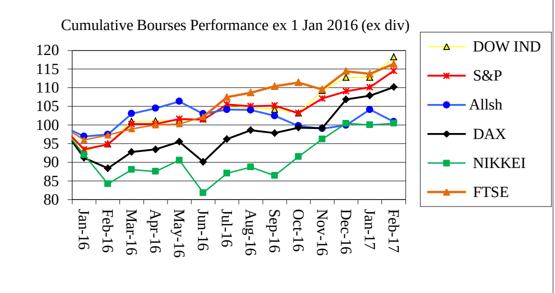
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.4% per annum, over this period of 30 years. US inflation over this period was 2.7%. This is equivalent to a growth in real terms of 4.7% p.a. over this period, excluding dividends.

Graph 5.5



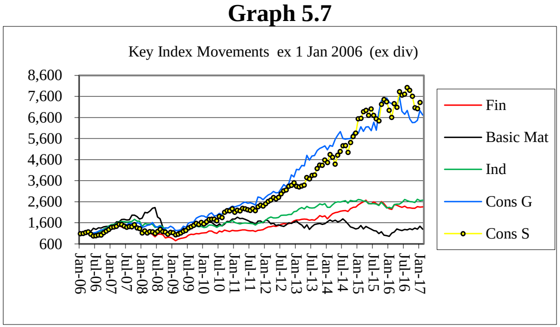
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Dow Jones and FTSE as the top performing share indices.

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: 19.7%; Consumer Goods: 18.7%; Industrials: 9.3%; Financials: 8.0%; and Basic Materials: 2.4%.

Graph 5.7



6. Where are markets heading?
by Tilman Friedrich

It is always interesting to study the movement of indices over time and in particular it is interesting to study relationships between different indices in an effort to get a feeling for where markets are likely to head. In this commentary we will be looking at a few interesting relationships.

Firstly, graph 1 has been indicating to us for a long time that the Rand was undervalued and the recent movement corroborates this assertion. The graph indicates that the Rand is currently fairly valued at 11.23, it being at 12.45 at the time of writing this article. The Rand now only requires a further appreciation of 10% to get to fair value by our measure. This graph also shows that the Rand tends to significantly overshoot only in one direction, probably as the result of overly negative sentiment

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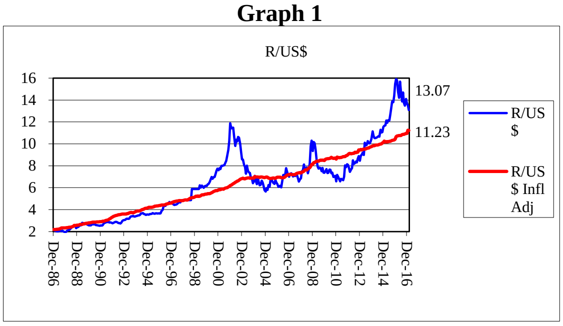
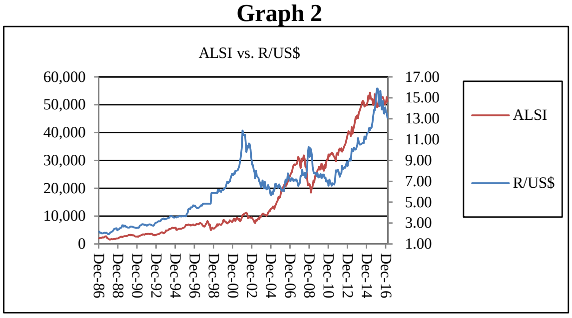
towards the currency from time to time with 3 severe bouts of undervaluation.

Graph 1



If one now relates the JSE ALSI to the Rand: US$ exchange rate as depicted in graph 2, there appears to be a close correlation between these two indices, barring the sudden swings in the exchange rate that do not always reflect in the ALSI. One may conclude from this that a further appreciation of the Rand will be paired with a depreciation of the ALSI. Should it appreciate to 11.23 as per our above assertion, it could mean that the also may decline to 40,000.

Graph 2



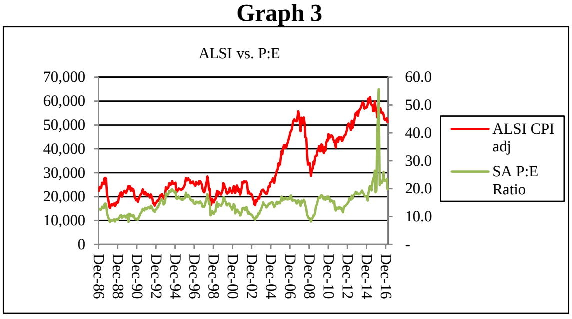
Graph 3 tracks the CPI adjusted ALSI against the SA P:E ratio, one can see that these two indices were very closely correlated until the end of 2004. Over this period the CPI adjusted ALSI hovered around 22,000 with an average P:E of around 13. Average earnings over this period would thus have been around 1,700. Over this period investors in the ALSI would have earned a real return equal to the dividend yield of just over 3%.

From 2004 to the middle of 2012, the P:E averaged marginally higher at 15 while the ALSI increased steeply to an average of 41,000. This implies that the increase in the ALSI since 2004 was driven by an increase in underlying earnings that average around 2,700 over this period. The dividend yield over this period averaged 2.7% while the earnings growth of shares would have added another 6% per annum for a total return of around 11% per annum, adding in the slight re-rating of shares!

From the middle of 2012, however, the average CPI adjusted ALSI moved up to 54,000 and the P:E up to 20, with the same average earnings of 2,700 as over the preceding period. Investors were thus prepared to pay substantially more for the same earnings since the end of 2004. Dividend yield over this period averaged 3%. Over this period the investor would have thus earned around 7%, 4% derived from a re-rating of shares.

Graph 3 appears to indicate that the P:E may now return to its long-term average of between 13 and 15. Current earnings are around 2,600. This would then produce a ALSI of between 35,000 and 40,000. The current 1 year forward P:E of 14.8 indicates that earnings are expected to grow by 34% over the next 12 months. This would indicate that if an earnings growth of 34% were to be realized over the next 12 months the current ALSI level would support a decline in the P:E to more normal levels.

Graph 3



Conclusion

Clearly there is a substantial risk of the earnings growth no being 34% for the next 24 months as analysts are forecasting. There is also a substantial risk that of the P:E ratio declining to below 15 which means that there is a substantial risk that the ALSI will decline from its current levels. This risk is also supported by the Rand: US $ exchange rate that indicates the Rand is still undervalued and as may be concluded from graphs 1 and 2 above, a return to fair value of 11.23, as per our measure, also indicates a potential decline in the ALSI to 40,000.

As the SARB can influence the Rand exchange rate through manipulation of the repo rate, the question is how SARB assesses the impact of Rand strength on the SA economy. Clearly a strong Rand favours imports over exports and vise-versa. With a prevailing negative trade balance, it is likely that SARB does not support Rand strength and might consider reducing the repo rate. If this were to happen and were to reverse further Rand strengthening, the risk of a significant decline in the ALSI diminishes. We believe that SARB will be under pressure to reduce the repo rate in the course of the next 12 months to prevent a further strengthening of the Rand, in the light of the negative consequences of a strong Rand on the SA economy.

In view of the current backdrop of the risk of a declining ALSI, a strengthening Rand and a possible reduction in the SA repo rate over the next 12 months, index investing in SA should be viewed with circumspection. The JSE should offer individual investment opportunities on a selective basis though. The current backdrop also offers the opportunity of raising one's offshore exposure.

Whilst we do not expect great returns from equities as an asset class equities remain our preferred asset class as it allows you to spread the risk widely across the world. The wide choice you have also provides the opportunity to find equities that will outperform.

For a Namibian whose investments are largely concentrated in Namibia, discretionary capital should be moved outside Namibia for the sake of spreading risk. Any money transfer off-shore should be spread over time for the benefit of Rand cost averaging to limit the currency risk.

7. 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. The views expressed herein are those of the author and not necessarily those of Benchmark Retirement Fund or Retirement Fund Solutions.