Volume 13, No. 04
April 2017

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 APRIL 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

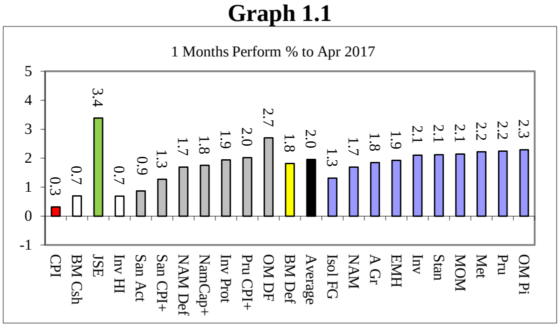
In April the average prudential balanced portfolio returned 1.95% (March: 1.95%). Top performer is Old Mutual (2.29%); while Investment Solutions (1.31%) takes the bottom spot. For the 3 month period, Metropolitan takes top spot, outperforming the 'average' by roughly 0.3%. On the other end of the scale EMH Prescient underperformed the 'average' by 0.8%.

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.

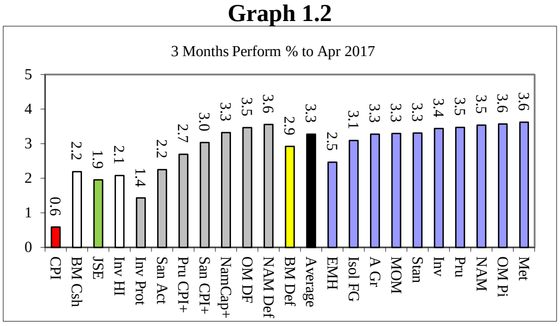
Below is the legend to the abbreviations reflected on the graphs:

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)

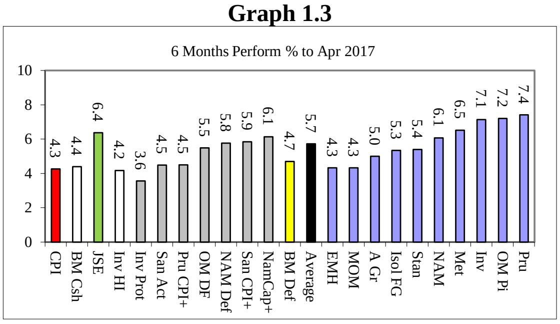
Graph 1.1



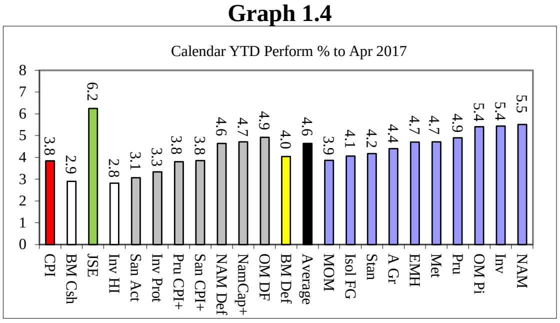
Graph 1.2



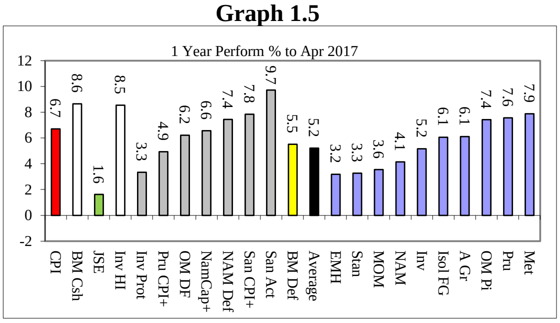
Graph 1.3



Graph 1.4



Graph 1.5



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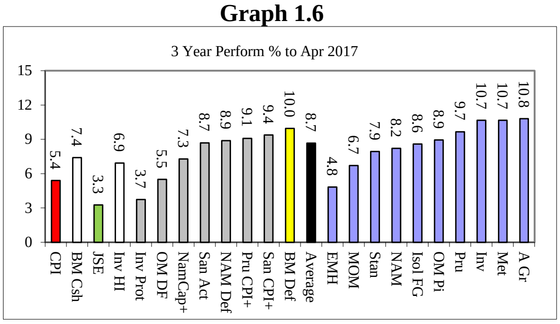
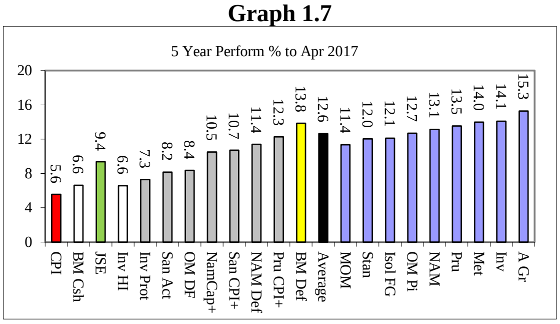
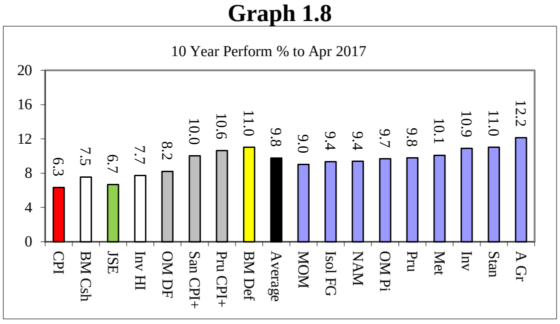
Graph 1.6



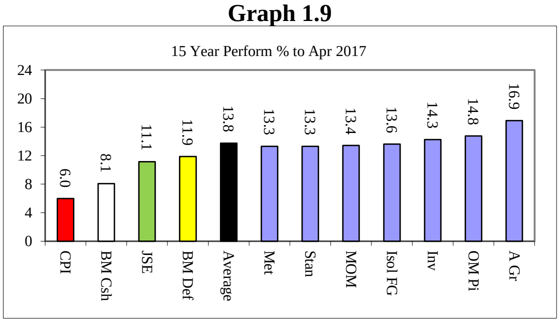
Graph 1.7



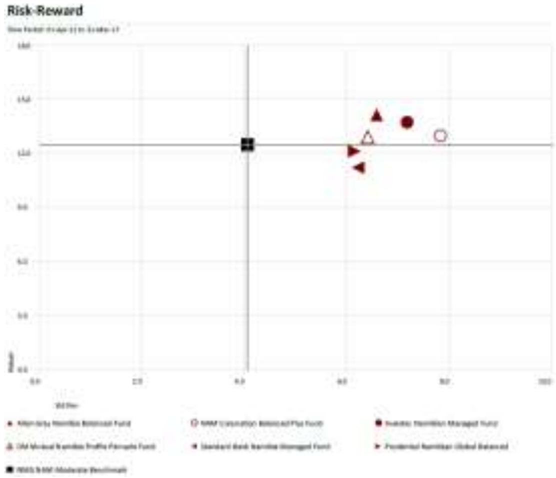
Graph 1.8



Graph 1.9

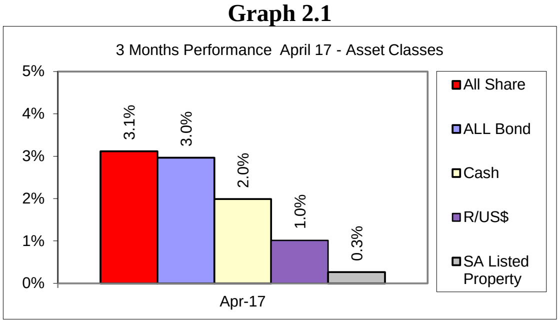


Risk/ Return

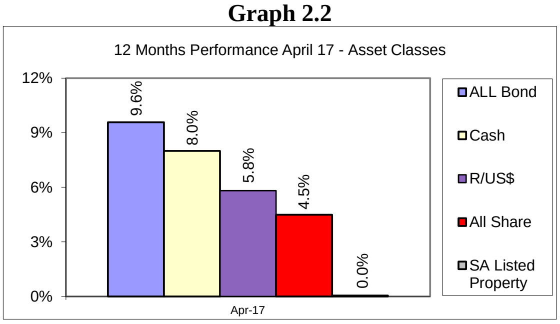


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

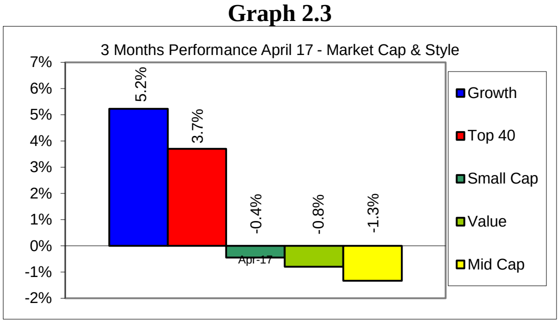
Graph 2.1



Graph 2.2



Graph 2.3



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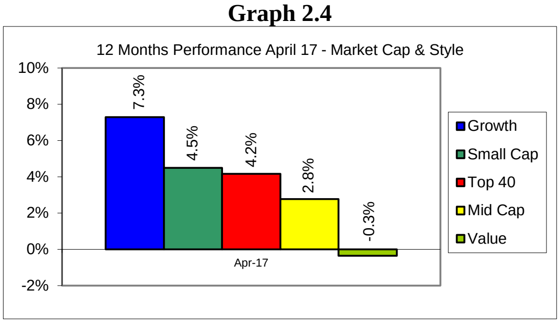
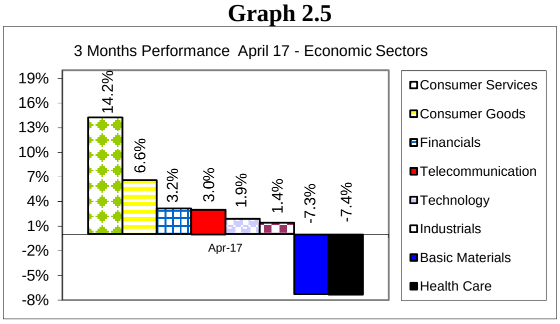
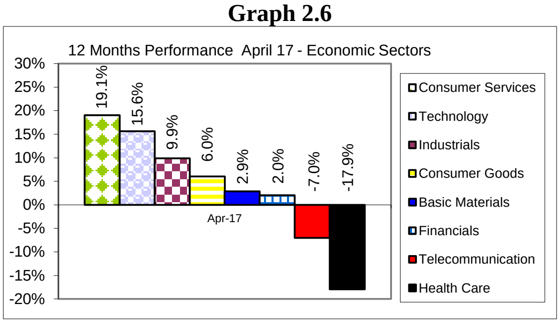
Graph 2.4



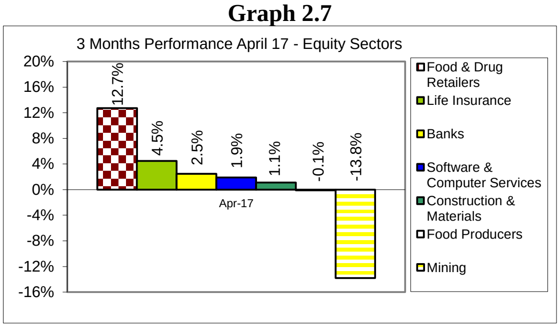
Graph 2.5



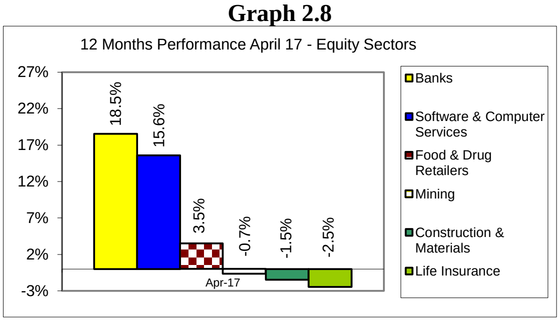
Graph 2.6



Graph 2.7



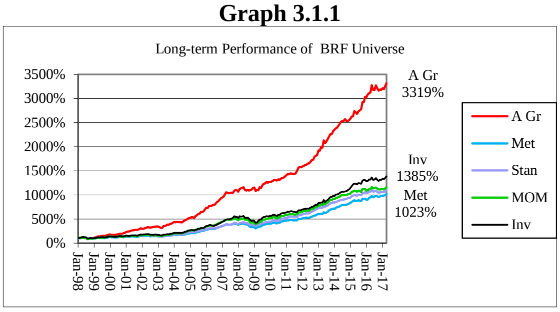
Graph 2.8



3. Portfolio Performance Analysis

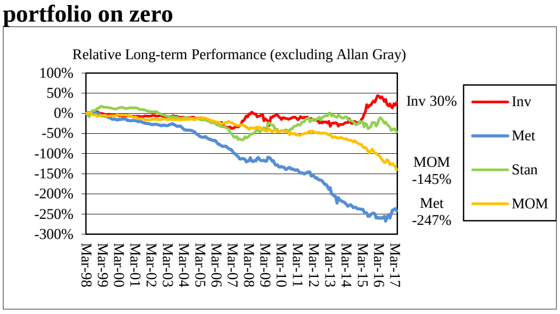
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

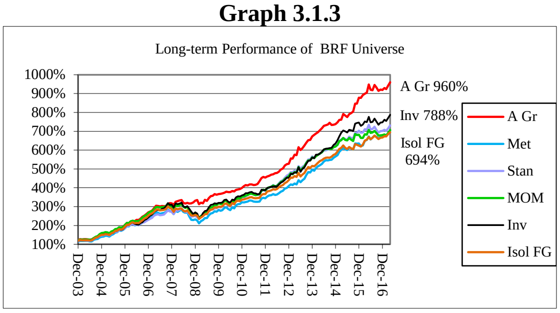


Graph 3.1.2

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

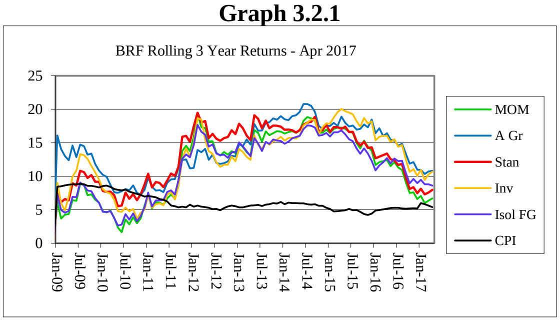


Graph 3.1.3



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

Graph 3.2.1



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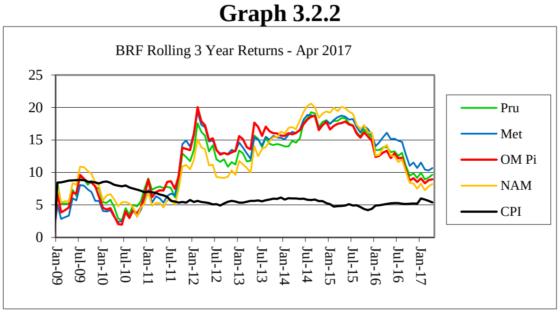
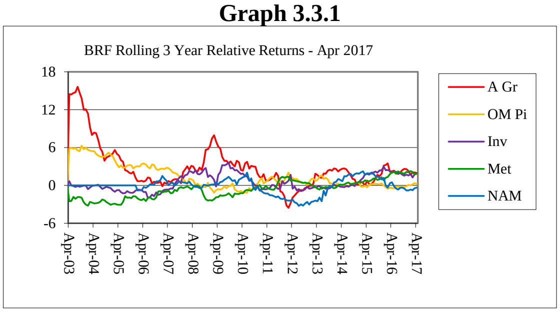
Graph 3.2.2

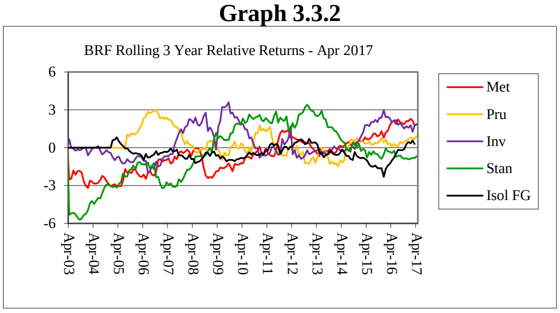


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

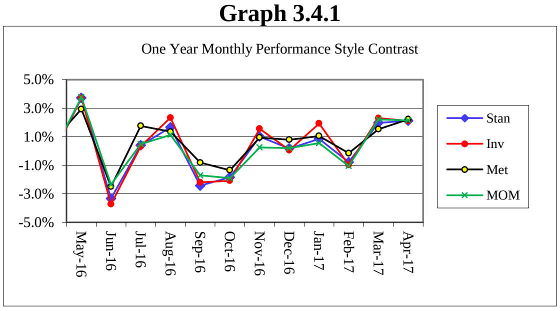


Graph 3.3.2

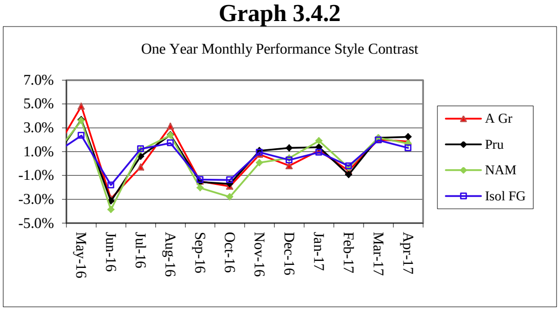


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

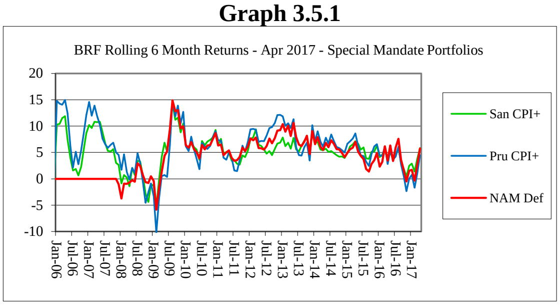


Graph 3.4.2

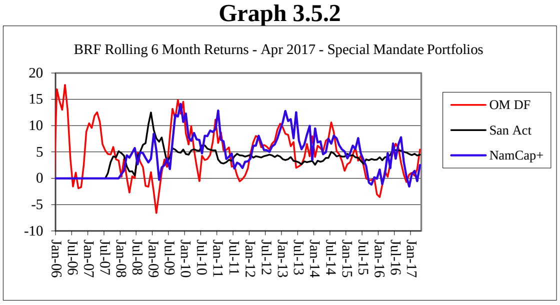


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

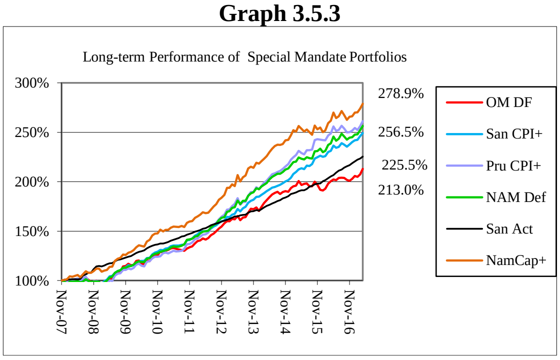
Graph 3.5.1



Graph 3.5.2



Graph 3.5.3



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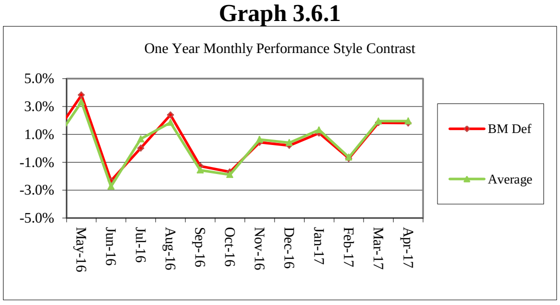
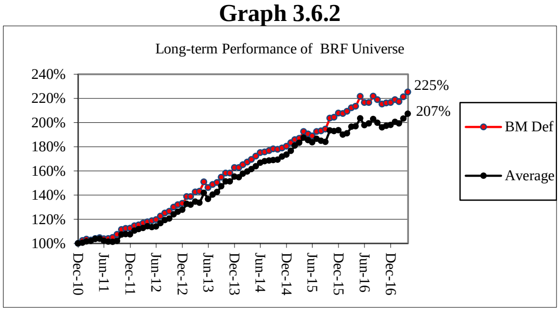
3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

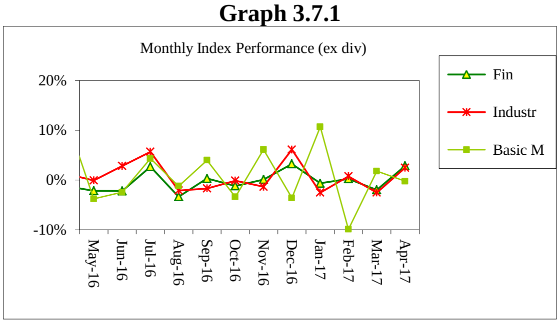


Graph 3.6.2

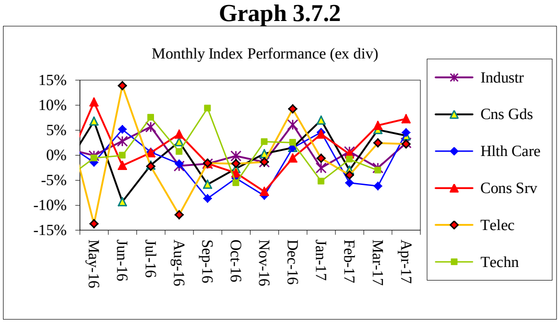


3.7 One year monthly performance of key indices (excluding dividends)

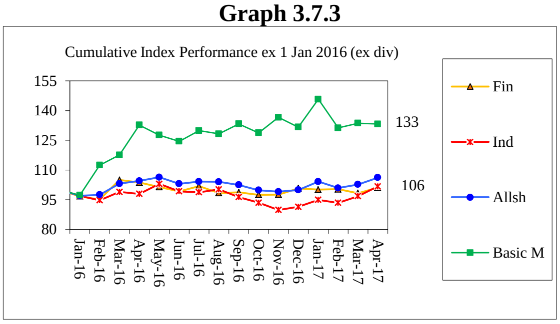
Graph 3.7.1



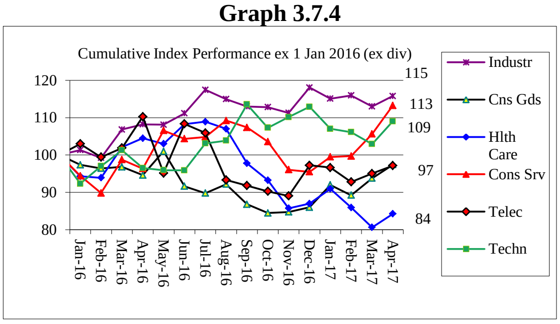
Graph 3.7.2



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.	13.9	12.6
5 year real return - % p.a.	8.3	7.1
Equity exposure - % of portfolio (qtr end)	48.7	62.5
Cumulative return ex Jan 2011	125.2	107.1
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 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	7.4%	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	6.2%	14.9%	14.3%

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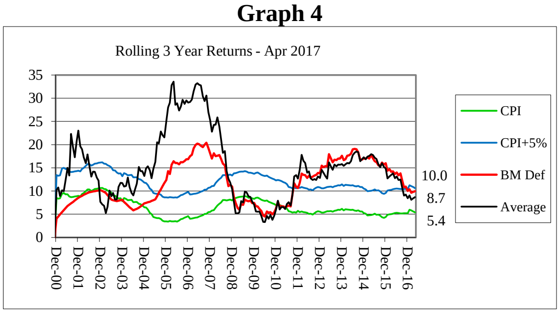
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years May 2014 to April 2017. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4

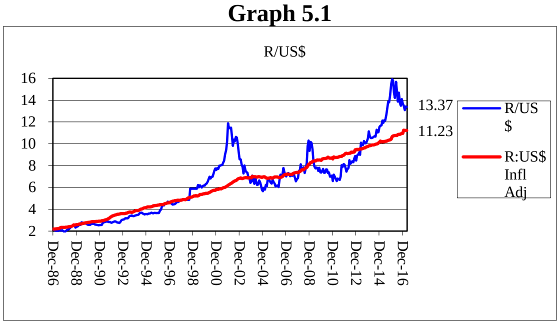


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end April was 10.0%, the average was 8.7% vs CPI plus 5% currently on 10.6%.

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

Graph 5.1



Rand strengthens slightly on the back of foreign capital inflows in April

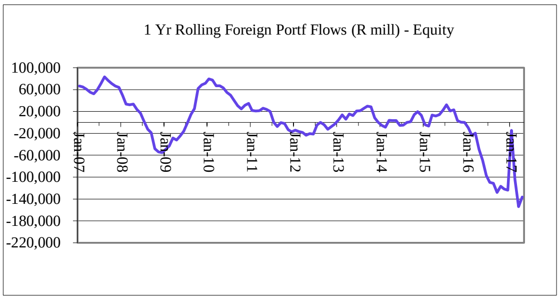
The Rand strengthened slightly by 0.44% in April with net foreign investment inflows from bonds and equities of N$ 12.0 bn. Over the past 12 months the Rand strengthened by 5.8% on net outflows of foreign capital from equity and fixed interest securities of R 98.1 bn (outflow of 115.4 bn to end March 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 April 2016 SA experienced an outflow of R 27.1 bn (inflow of R 0.6 bn to end of March 2016).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 298 bn (March R 286 bn).

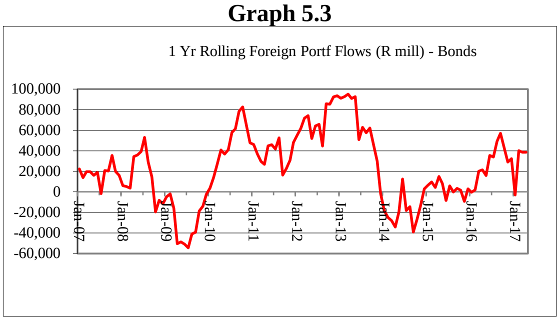
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 137 bn on a year-on-year basis at the end of April (outflow of R 154 bn year-on-year to end March). The month of April experienced a net outflow of R 4.4 bn. Since the beginning of 2006, foreign net investment in equities amounts to R12 bn (end March R 16 bn). This represents roughly 0.08% 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 38.5 bn over the past 12 months to end of April (inflow of R 38.5 bn over the 12 months to end of March). The month of March experienced a net inflow of R 16.4 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 286 bn (to March R 270 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 11.5% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.3% per year. This is equivalent to a growth in real terms of 3.2% p.a. over this period, excluding dividends, or around 6.2% including dividends.

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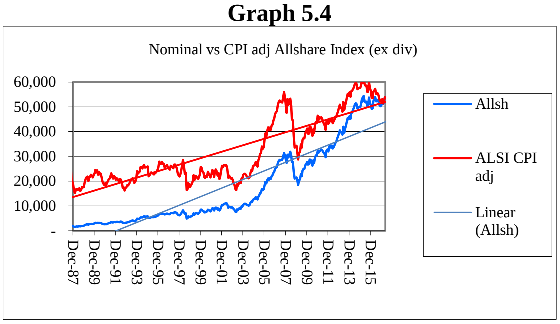
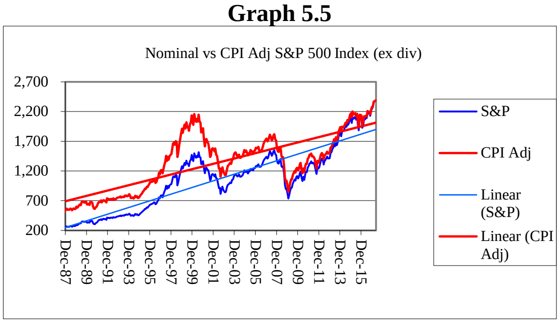
Graph 5.4



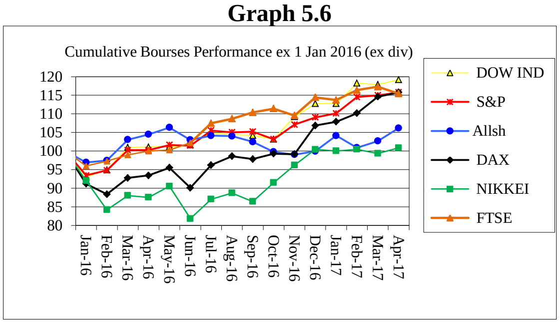
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.4% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.8% p.a. over this period, excluding dividends.

Graph 5.5



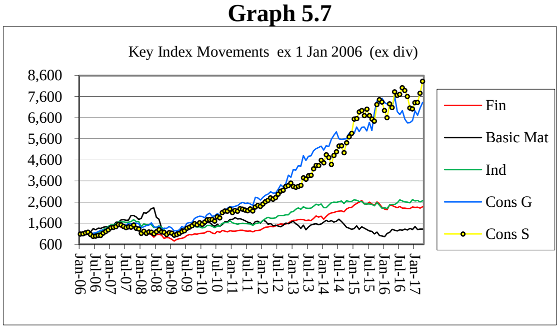
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Dow Jones, DAX, S&P 500 and FTSE as the top performing share indices since the start of 2016.

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: 20.4%; Consumer Goods: 19.1%; Industrials: 9.0%; Financials: 7.9%; and Basic Materials: 2.4%.

Graph 5.7

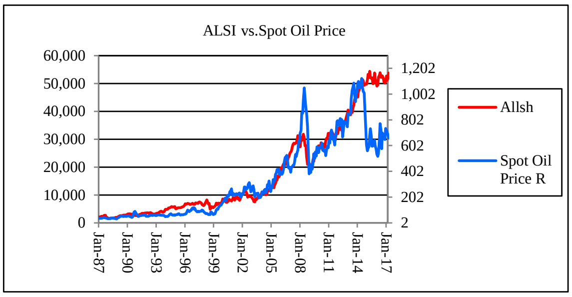


6. SA equities unlikely to show much growth for a while

by Tilman Friedrich

Since our previous newsletter, the global economic and political environment has not changed. Prevailing trends are thus likely to continue. One of these is the long-term close correlation between the SA ALSI and the spot oil price in Rand as depicted in chart 1 below, that became undone as from the middle of 2014. Does this represent a permanent delinking of the SA ALSI from the spot oil price or is this a temporary phenomenon? Well, unless the spot oil price has delinked from global commodity prices the close correlation will re-establish and we do not believe the oil price has permanently delinked from other commodities. As we know SA is a resources driven economy and commodities are driving the ALSI to a significant extent. An increase in global commodity prices will drive the ALSI. Global commodity prices and with this the spot oil price will have to rise substantially again to link up with the SA ALSI or the ALSI will have to decline substantially to link up with the spot oil price as chart 1 indicates.

Chart 1



Will the ALSI decline substantially to link up with the spot oil price or vise-versa? Considering that there is not much scope for the commodity prices and the oil price to decline, all having reached a trough that made many producers unprofitable and many to actually shut down. The risk of a further decline in commodity prices is thus remote while the likelihood of an increase is much higher, particularly as the US and other global economies

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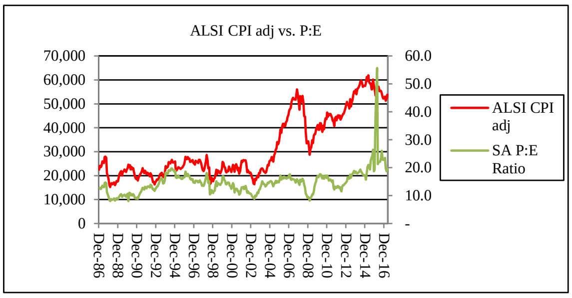
are in the process of recovering which will lead to an increase in the global demand for commodities.

What is the chance of the ALSI declining substantially to link up with the spot oil price again?

Chart 2



Since the underpin of the ALSI is the resources sector which depends on global commodity price the prospects of global commodity prices will determine whether the resource sector and with it the ALSI are likely to move up or down. As pointed out, we do not see much scope in global commodity prices declining further. The price investors are prepared to pay for the earnings generated by SA equities is a different question. Currently the average historic P:E is 19.6 having already declined significantly since the second half of 2015. However as the graph above shows, it is still above a 30 year average of 14.5. If a de-rating to this long-term average were to happen today, the ALSI would decline to 40,000. The ALSI would have to remain at its current level for just over 4 year to allow inflation of earnings to gradually reduce the P:E ratio to 14.5. Of course real economic growth will shorten this period. CPI adjusted earnings of the ALSI currently stand at 2,750, a level that was already reached at the end of 2006 and was surpassed up until the end of 2015. What direction can we expect earnings to follow?

Chart 3

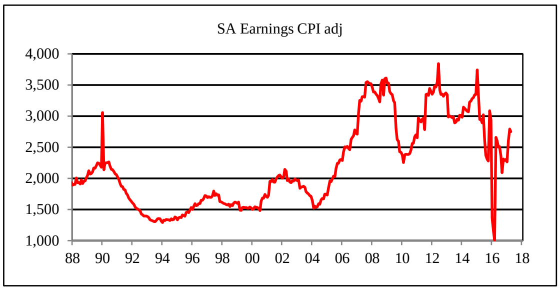


Chart 3 shows historic CPI adjusted earnings of the ALSI. Evidently earnings have been drifting sideways in the range between 1,500 to 2,000 for 16 years until 2004, to pick up steeply in step with global commodity prices. The chart also shows that CPI adjusted earnings are currently still elevated and that SA companies should find it hard to deliver more positive growth going forward.

Conclusion

The above charts seem to substantiate that there is a substantial risk of SA company earnings growth no being 34% for the next 24 months, as analysts are forecasting. There is also a substantial risk of the SA P:E ratio declining to below 15 which means that there is a substantial risk that the ALSI will decline from its current levels. At best one cannot expect much joy from SA equities as an asset class for the next 2 to 3 years. Shares should be considered for investment for the expected dividend yield and their likely growth but not for capital appreciation which is unlikely to happen for a while.

Whilst we do not expect great returns from SA 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. Offshore equity markets offer more opportunities and should be considered in preference to SA equities.

The strong Rand is likely to allow for a slight easing of the repo rate by SARB in due course. This will be positive for fixed interest investments in the short-term, and of course for the consumer as well. As US and Euro interest rates are on an upward trend SARB will however eventually be forced to raise its repo again over the next 2 years or so, with the opposite effect on fixed interest investments.

For a Namibian whose investments are largely concentrated in Namibia, discretionary capital should be moved outside Namibia for the sake of spreading risk, particularly now that the Rand is showing increasing strength. 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