Volume 13, No. 06
June 2017

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 JUNE 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

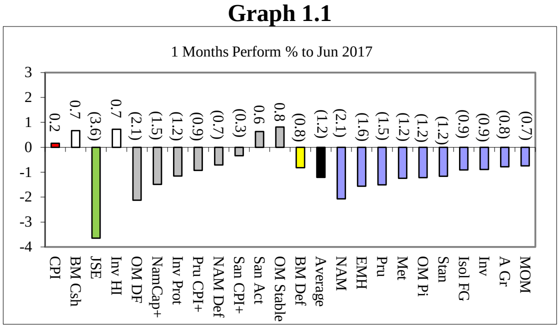
In June the average prudential balanced portfolio returned -1.21% (May: 0.21%). Top performer is Momentum (-0.72%); while Namibia Asset Management (-2.12%) takes the bottom spot. For the 3 month period, Momentum takes top spot, outperforming the 'average' by roughly 1.17%. On the other end of the scale Prudential underperformed the 'average' by 0.55%.

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.

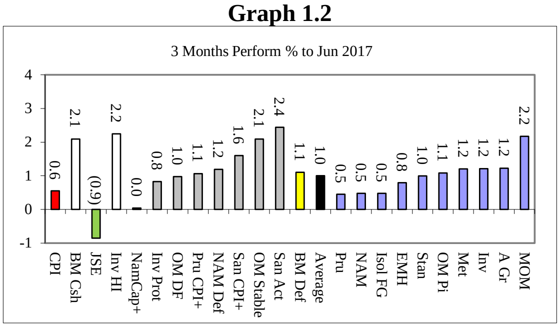
Below is the legend to the abbreviations reflected on the graphs:

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)
Smooth bonus portfolios	
Old Mutual AGP Stable	OM Stable (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)

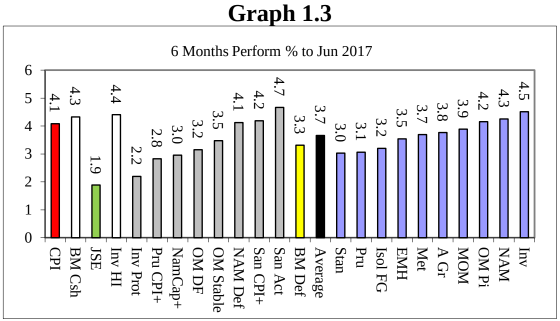
Graph 1.1



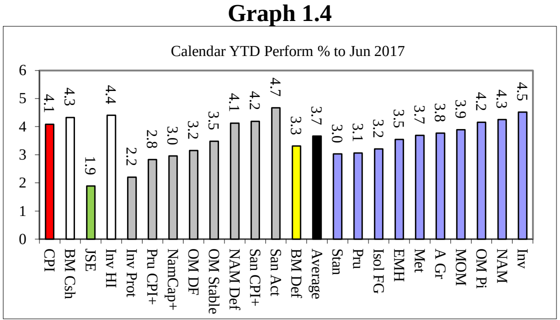
Graph 1.2



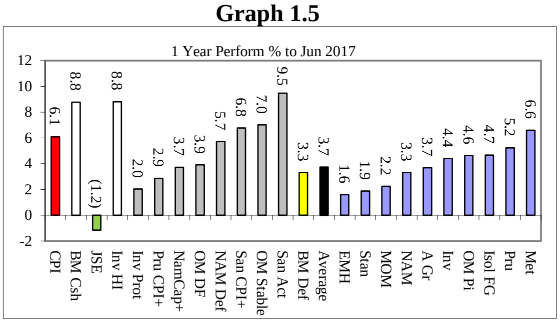
Graph 1.3



Graph 1.4



Graph 1.5



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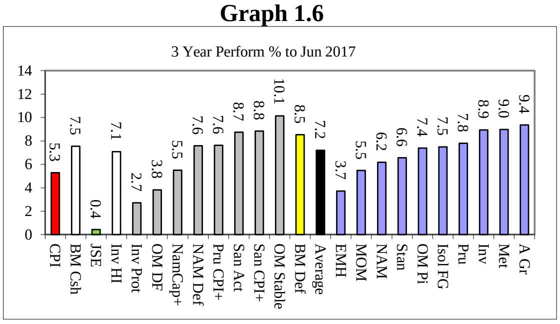
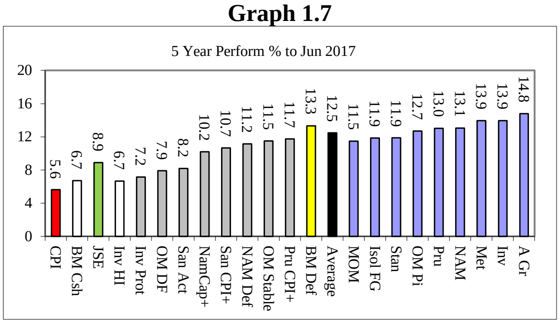
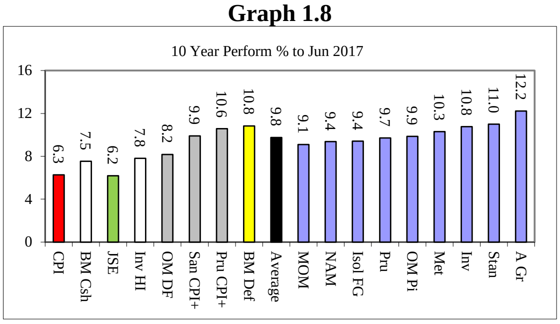
Graph 1.6



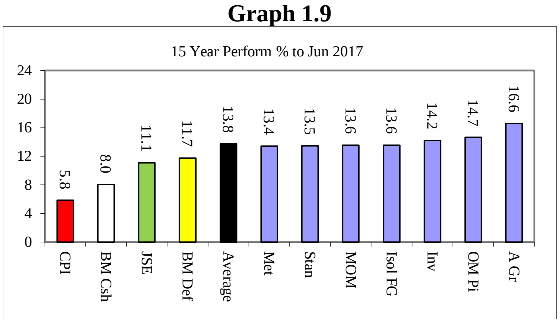
Graph 1.7



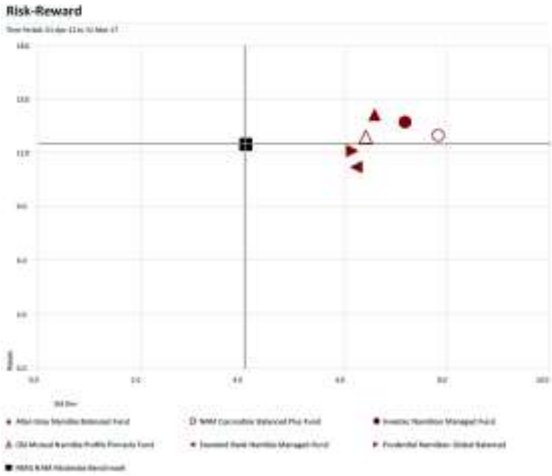
Graph 1.8



Graph 1.9

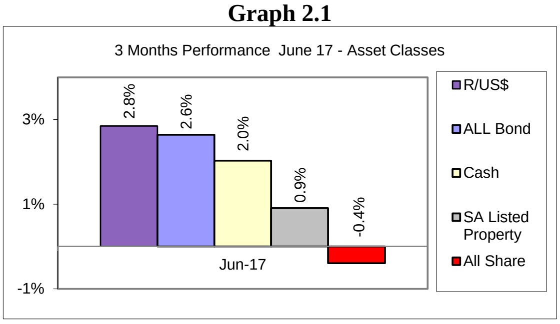


Risk/ Return

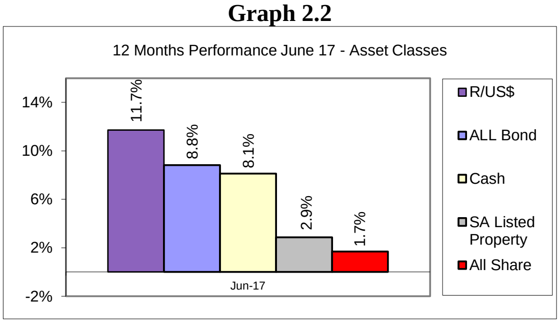


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

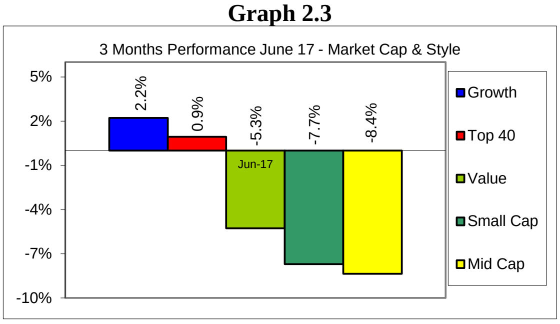
Graph 2.1



Graph 2.2



Graph 2.3



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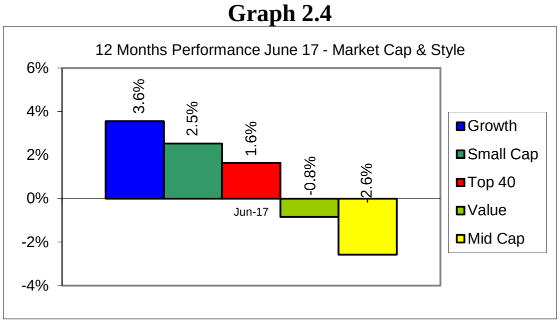
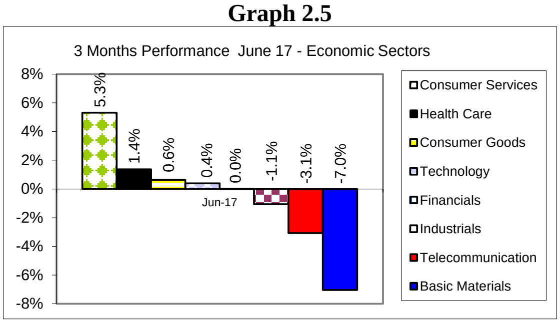
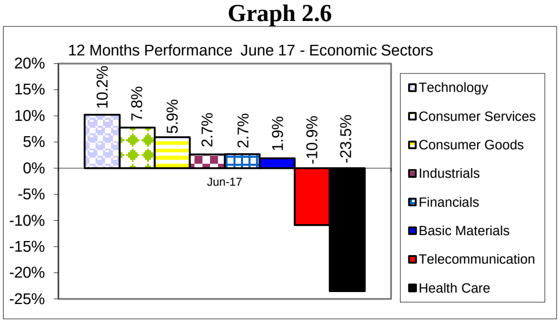
Graph 2.4



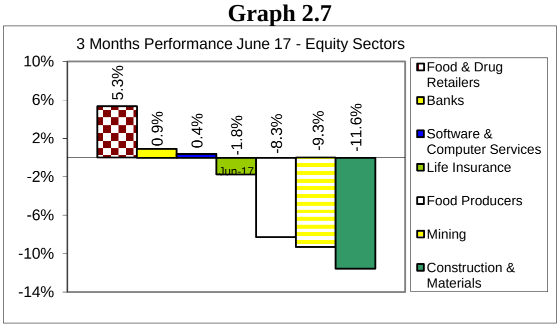
Graph 2.5



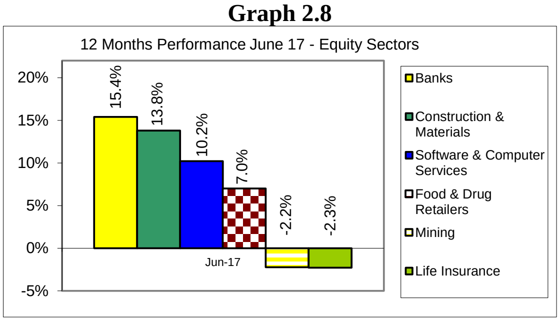
Graph 2.6



Graph 2.7



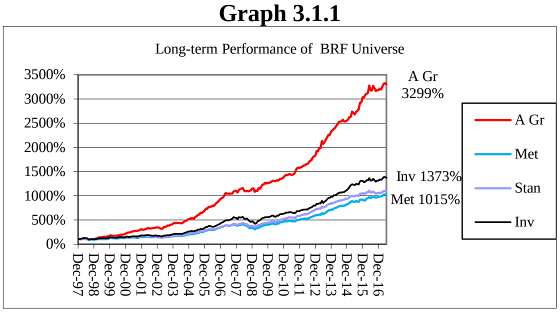
Graph 2.8



3. Portfolio Performance Analysis

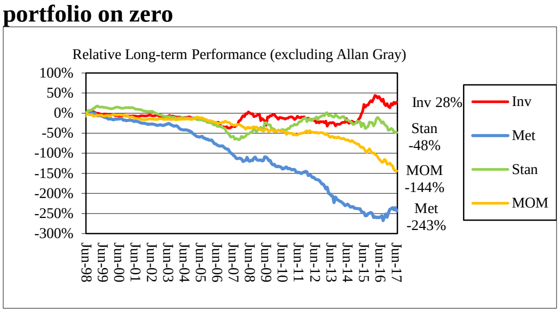
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

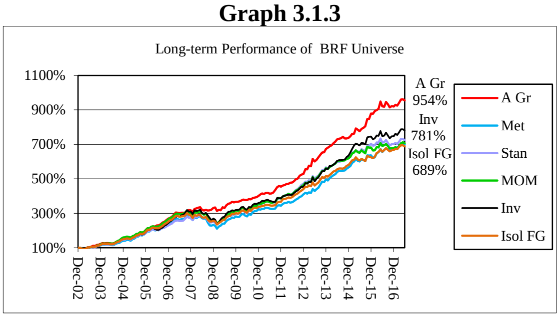


Graph 3.1.2

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

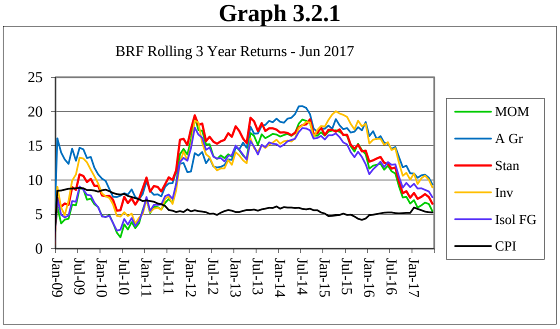


Graph 3.1.3



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

Graph 3.2.1



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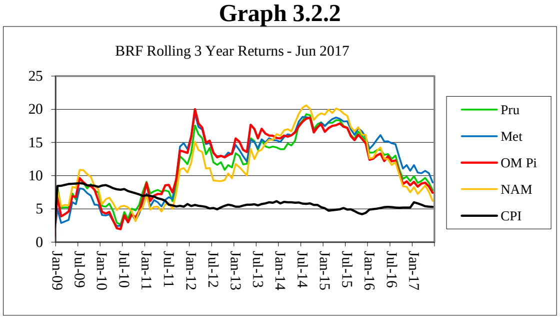
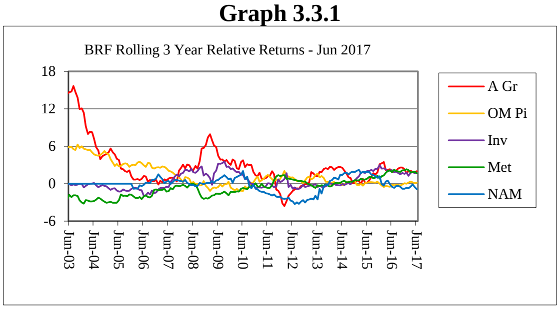
Graph 3.2.2

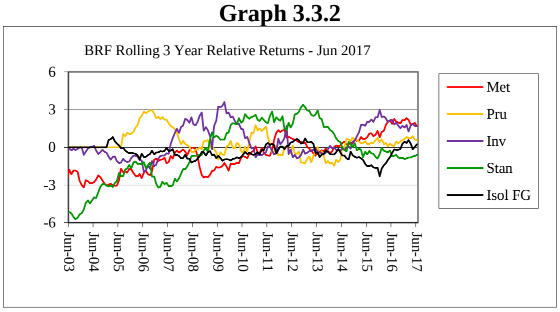


3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

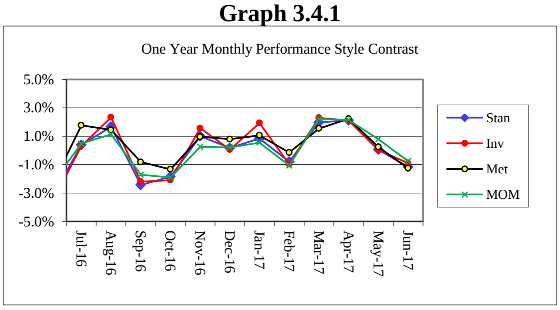


Graph 3.3.2

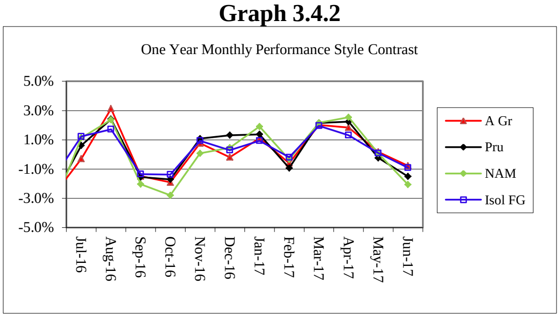


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

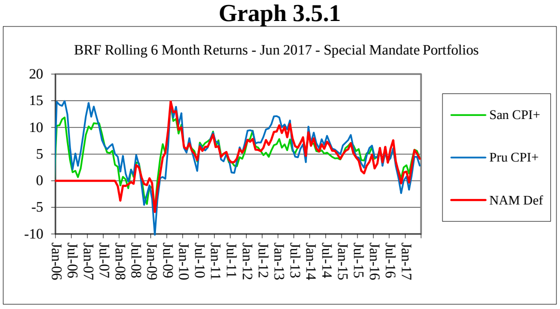


Graph 3.4.2

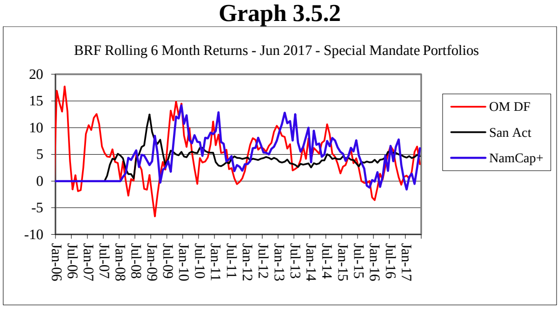


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

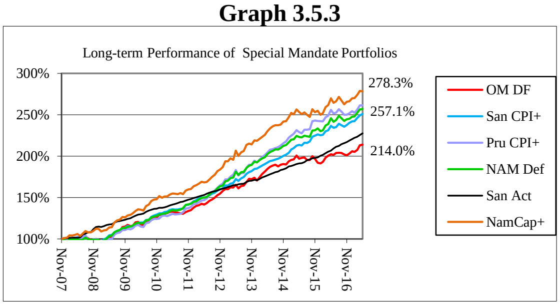
Graph 3.5.1



Graph 3.5.2



Graph 3.5.3



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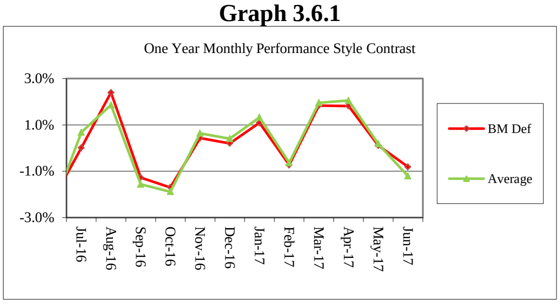
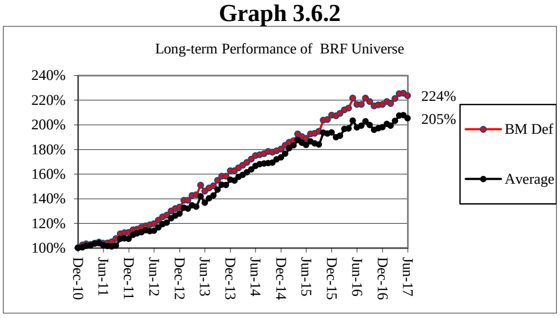
3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

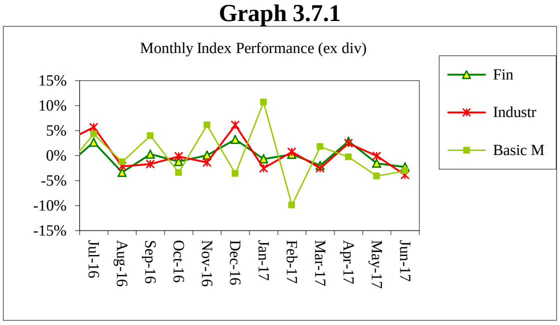


Graph 3.6.2

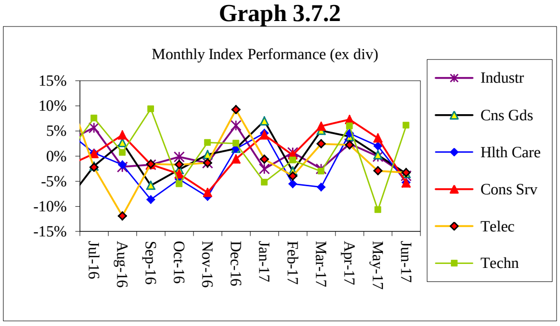


3.7 One year monthly performance of key indices (excluding dividends)

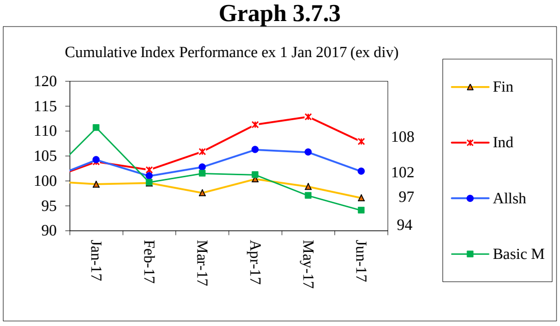
Graph 3.7.1



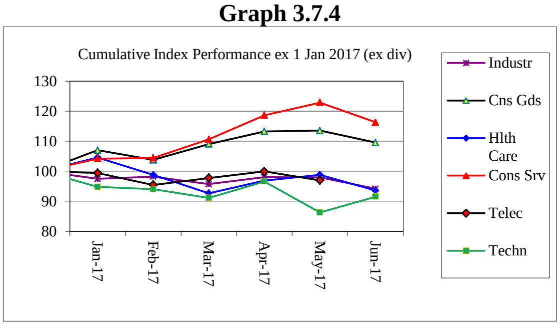
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio – Facts in figures

Table 4.1

Portfolio	Default portfolio	Average Prud Bal
5 year nominal return - % p.a.	13.3	12.5
5 year real return - % p.a.	7.7	6.8
Equity exposure - % of portfolio (qtr end)	48.7	62.5
Cumulative return ex Jan 2011	123.6	105.2
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 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%	8.5%	7.2%
Best annual performance	7.6%	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	6.3%	14.4%	13.8%

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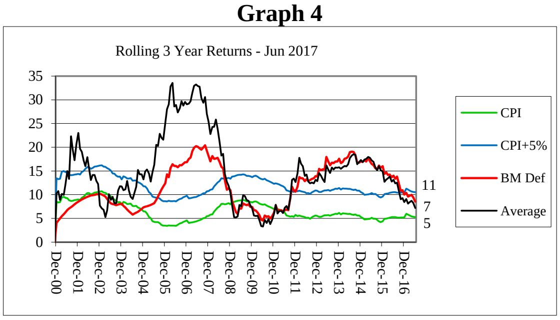
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years July 2014 to June 2017. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4

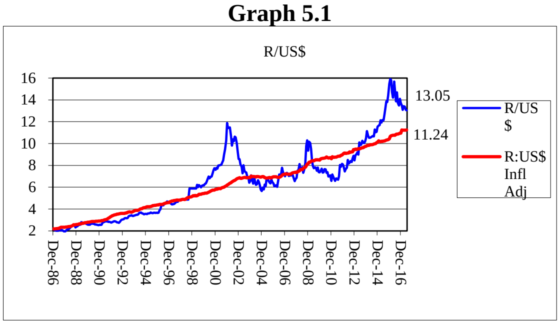


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end June was 8.5%, the average was 7.2% vs CPI plus 5% currently on 10.5%.

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 11.24 to the US Dollar while it actually stood at 13.05 at the end of June. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

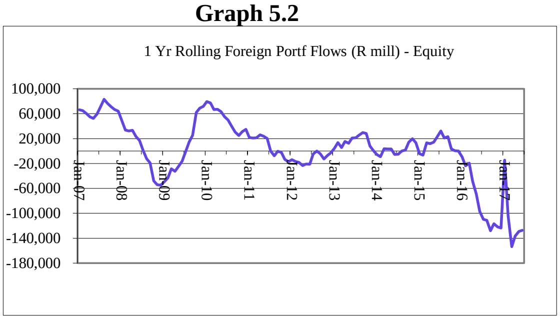


The Rand weakened by 0.47% in June with net foreign investment outflows from bonds and equities of R 20.3 bn. Over the past 12 months the Rand strengthened by 11.7% on net outflows of foreign capital from equity and fixed interest securities of R 91.2 bn (outflow of R 78.7 bn to end May 2017).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 278 bn (May R 298 bn).

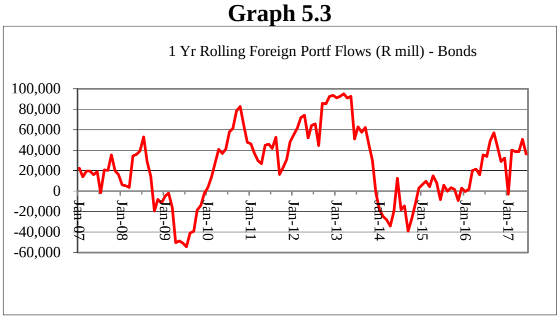
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 127 bn on a year-on-year basis at the end of June (outflow of R 129 bn year-on-year to end May). The month of June experienced a net outflow of R 19.2 bn. Since the beginning of 2006, foreign net disinvestment from equities amounts to R 16.0 bn (end May net investment of R 3.2 bn). This represents roughly 0.12% 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 36 bn over the past 12 months to end of June (inflow of R 50.5 bn over the 12 months to end of May). The month of June experienced a net outflow of R 1.1 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 293 bn (to May R 295 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 11.2% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.2% per year. This is equivalent to a growth in real terms of 3% p.a. over this period, excluding dividends, or around 6% including dividends.

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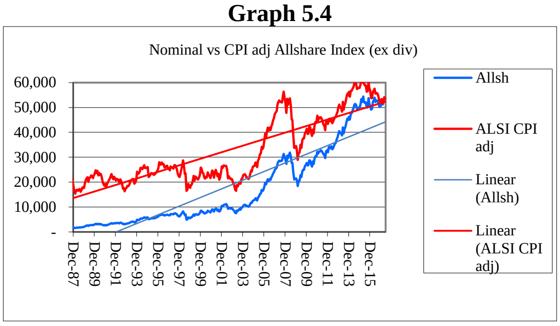
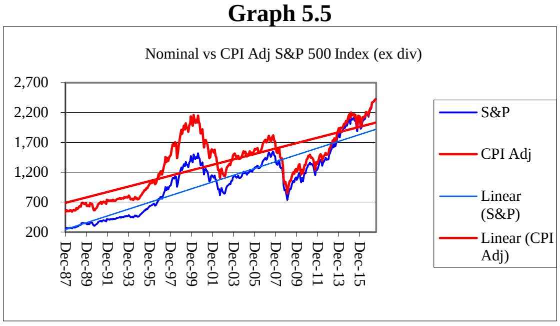
Graph 5.4



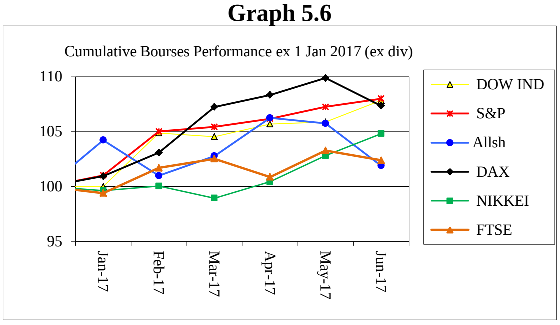
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.3% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.7% p.a. over this period, excluding dividends.

Graph 5.5



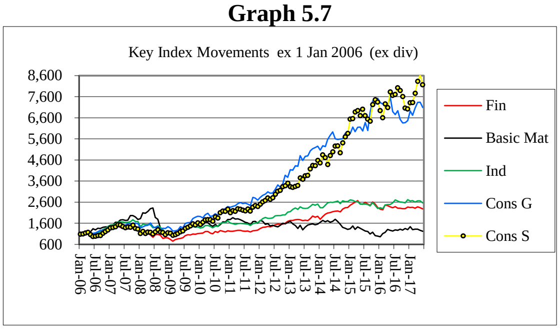
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Dow Jones, DAX, S&P 500 and FTSE as the top performing share indices since the start of 2016.

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%; Consumer Goods: 18.6%; Industrials: 8.5%; Financials: 7.5%; and Basic Materials: 1.8%.

Graph 5.7



6. Money market, smooth bonus or prudential balanced?

by Tilman Friedrich

Looking at investment returns over the past 3 years the time of reckoning has finally arrived and will shadow us for some time to come, as we have expected and written on in a number of previous columns in this journal.

Annualised returns of the typical prudential balanced portfolio over the past 3 years just managed to match the money market returns over this period. Over shorter periods, although quite volatile, the average prudential balanced portfolio has mostly underperformed the money market portfolio.

Since the beginning of 2009 I commented that bourses are likely to perform sluggishly in the face of rising interest rates. If I had then acted by moving out of a typical prudential managed portfolio, where should I have shifted my money to and what does that experience tell me about the alternatives I should consider now? Fixed interest investment would not have been an alternative as prospective interest rate hikes would have produced a capital depreciation of these investments. This would have left me with a money market portfolio as the only other alternative.

Now let's look at what my investment of N$ 100,000 on 31 December 2008 would have looked like by 30 June 2017 had I moved it on 1 January 2009 (inflation over this period averaged 5.7% p.a.):

- had I moved into cash it would have amounted to N$ 176,264 (6.9% p.a.)
- had I stayed in the typical prudential balanced portfolio, it would have amounted to N$ 273,173.

Let's assume I was not fully convinced of my view at the time and delayed the decision by another 1 year, my N$ 100,000 on 31 December 2009 would have been (inflation over this period averaged 5.5% p.a.):

- had I moved into cash it would have amounted to N$ 161,588 (6.6% p.a.)
- had I stayed in the typical prudential balanced portfolio, it would have amounted to N$ 230,746 (11.8% p.a.).

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Now let's assume I was really hesitant to move too early and delayed the decision by 3 years, my N$ 100,000 on 31 December 2011 would have been (inflation over this period averaged 5.6% p.a.):

- had I moved into cash it would have amounted to N$ 142,411 (6.6% p.a.)
- had I stayed in the typical prudential balanced portfolio, it would have amounted to N$ 190,984 (12.5% p.a.).

This clearly sketches the dilemma of the investor. Now interest rates have actually started to lift off and market have been moving sideways since July 2014. Yet, despite the FTSE/JSE Allshare not having moved at all, the average prudential balanced portfolio still managed to produce the same return as the money market portfolio, namely 7.2% p.a.

Looking forward with the expectation that the US market is likely to produce a real return of only 2% p.a. over the next 10 years, maybe outperforming cash by 1% to 1.5%, and the local market by our expectation moving sideways for another 4 to 5 years, probably also just outperforming cash, what are the risks of doing worse and how should you structure your investment? One risk is a shock to the global economic system such as a war which is a real risk in our assessment. For one, global financial markets will take a knock and interest rates will lift off while there will be a flight of capital into perceived safe havens. This will weaken our local currencies.

Another risk is that a local political or economic development will lead to a severe depreciation of our local currencies – the opposite risk not being discernible at all, even though we believe the Rand is currently undervalued by roughly 16%. To correct would in our view require not only a conducive local political environment, but also a conducive global economic environment.

Based on the risks referred to, clearly one strategy must be to diversify offshore as much as one can. So the portfolios you choose should maximise your offshore exposure for one. What else can you do to protect your retirement nest egg given that pension funds would limit your choice to a low volatility money market portfolio, a lower volatility smooth bonus portfolio or to remain in the prudential balance portfolio?

The money market portfolio will give you protection against a global economic shock paired with a drop in global financial markets but it will not protect you against the simultaneous depreciation of our local currencies. The prudential balanced portfolio in turn will be exposed to the drop in global financial markets but will benefit from the concomitant currency fall-out. It's hard to choose under such a scenario although global financial markets are likely to digest shocks sooner than what emerging market currencies will do and hence we still favour the prudential balanced portfolio over the money market portfolio.

But what about the smooth bonus portfolio? Well these portfolios do not have a magical formula to negate the laws of financial markets. All they do is to take when things are going well and to give back when things are not going well, provided of course they have taken enough when things went well. As an investor you do not really know at what point in time you are buying in and when you are selling out – you might be a bit lucky or a bit unlucky. On average you will be on the average return line minus the 'guarantee premium' that you will have to pay for possibly being lucky.

Conclusion

Although we have not changed our views from those of last month, we would conclude once again but in very short. Offshore diversification must be part of the investor's strategy. As far as local investments are concerned there is currently little to choose between the more and the less volatile asset classes in our opinion. We have a slight preference for equities over cash and would be wary of bonds in the medium term although there may still be opportunity in the shorter term while SARB may still reduce interest rates against the global trend.

7. Important notice and disclaimer