Volume 13, No. 07
July 2017

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JULY 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

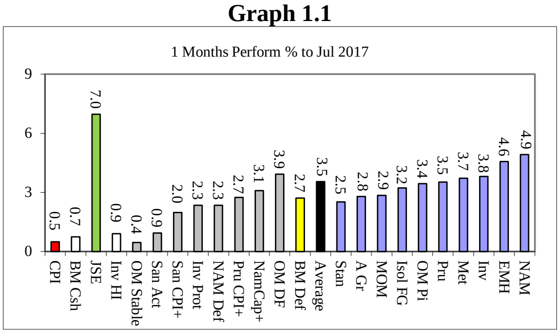
In July the average prudential balanced portfolio returned 3.55% (June: 1.21%). Top performer is Nam Asset Management (4.92%); while Stanlib (2.51%) takes the bottom spot. For the 3 month period, EMH takes top spot, outperforming the 'average' by roughly 0.92%. On the other end of the scale Stanlib underperformed the 'average' by 1.10%.

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.

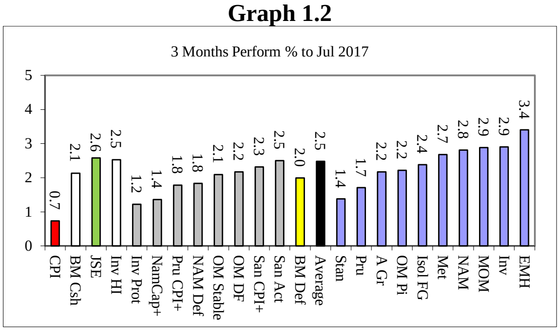
Below is the legend to the abbreviations reflected on the graphs:

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)

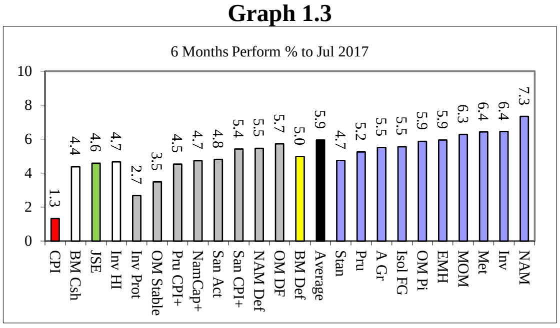
Graph 1.1



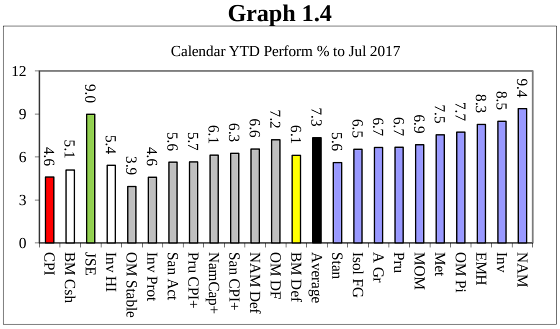
Graph 1.2



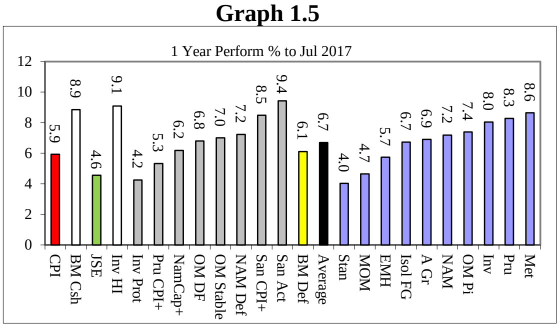
Graph 1.3



Graph 1.4



Graph 1.5



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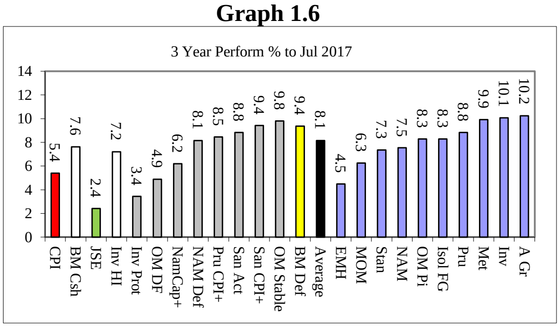
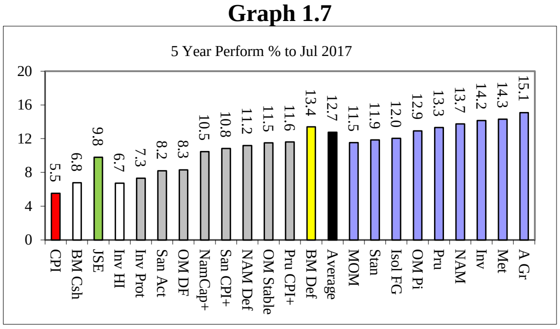
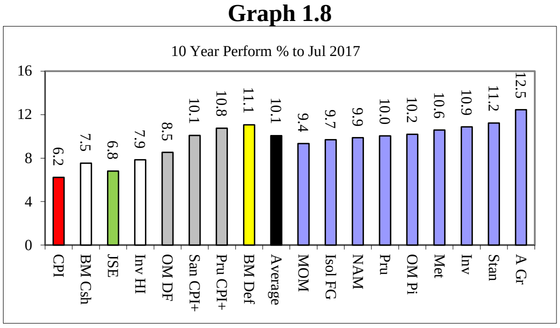
Graph 1.6



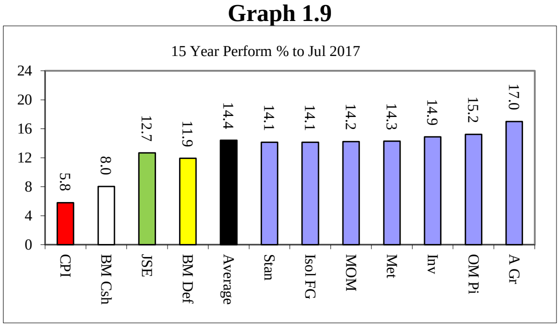
Graph 1.7



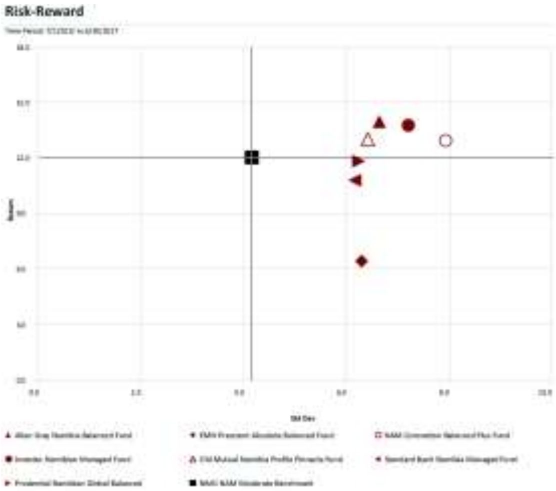
Graph 1.8



Graph 1.9

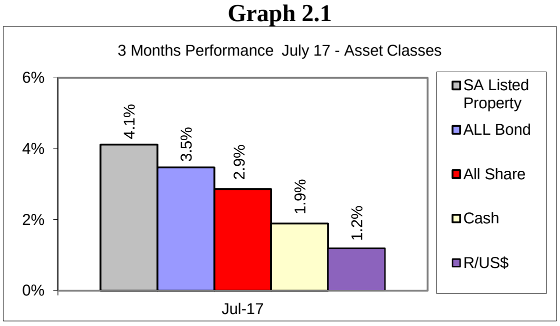


Risk/ Return

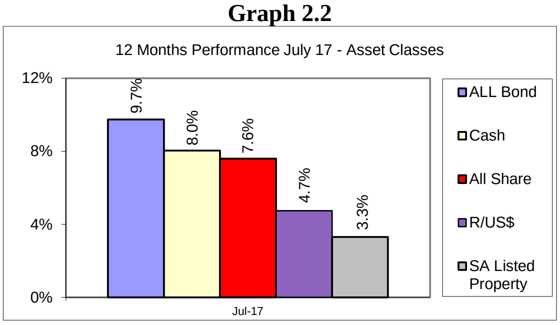


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

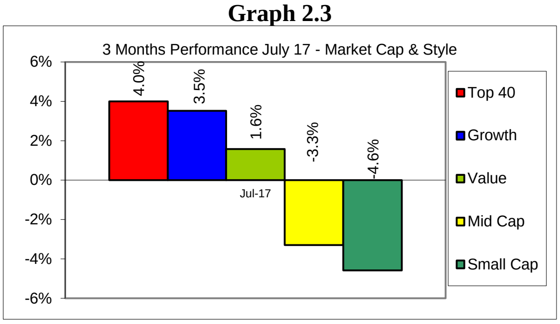
Graph 2.1



Graph 2.2



Graph 2.3



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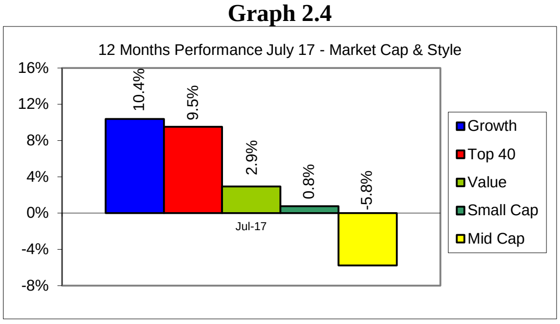
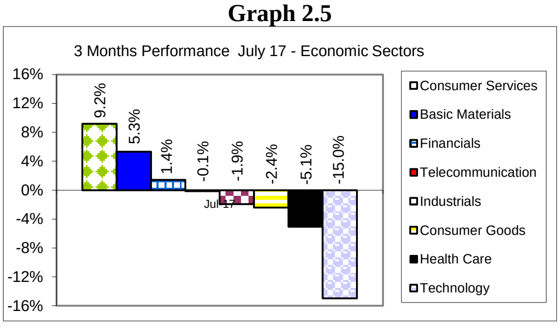
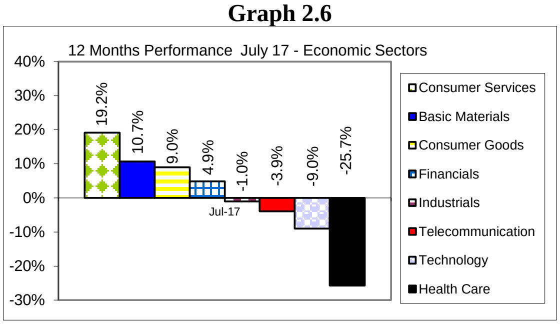
Graph 2.4



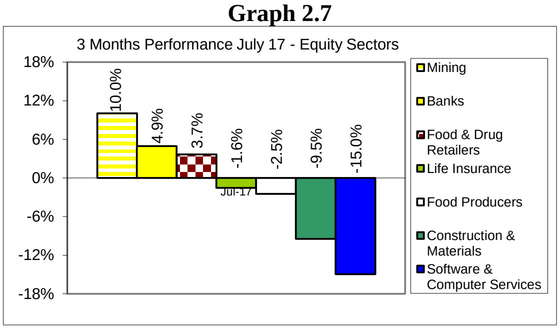
Graph 2.5



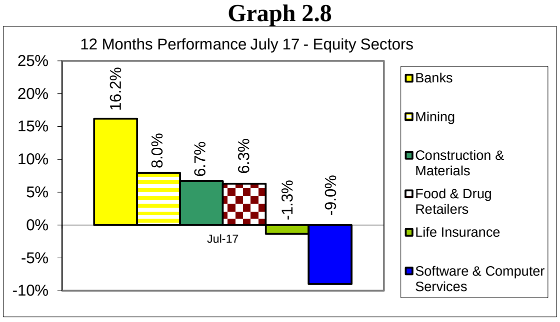
Graph 2.6



Graph 2.7



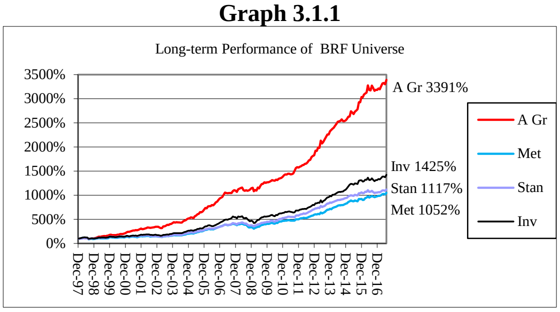
Graph 2.8



3. Portfolio Performance Analysis

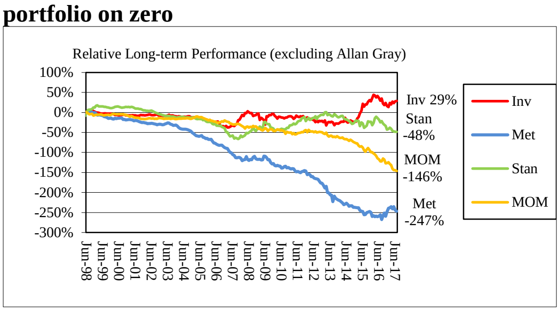
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

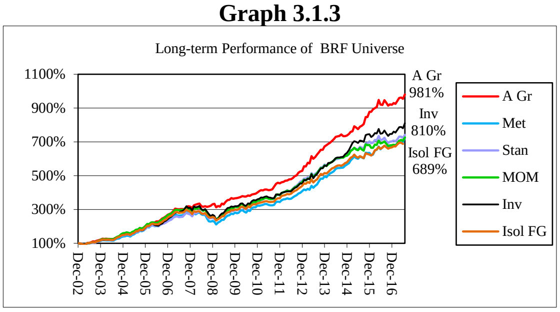


Graph 3.1.2

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

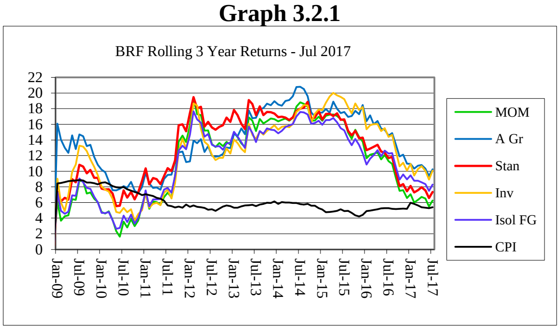


Graph 3.1.3



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

Graph 3.2.1



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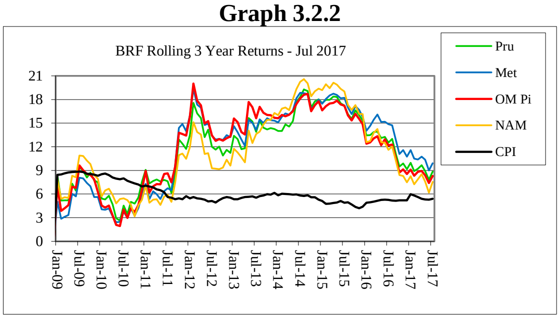
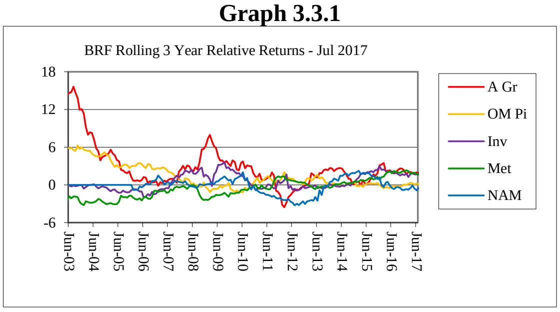
Graph 3.2.2

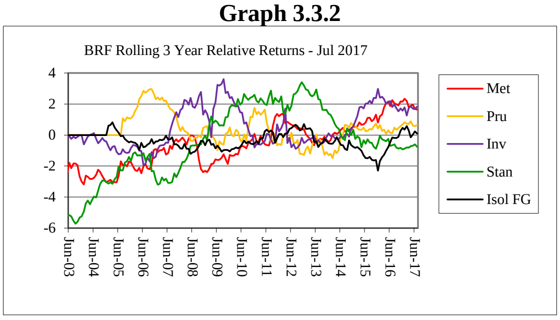


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

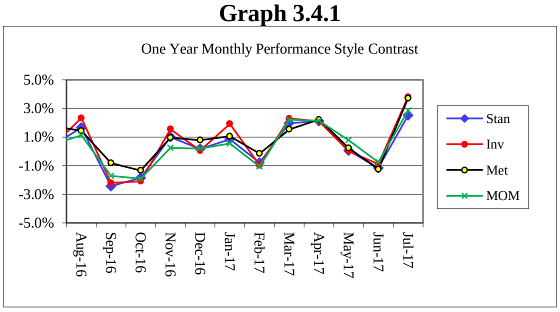


Graph 3.3.2

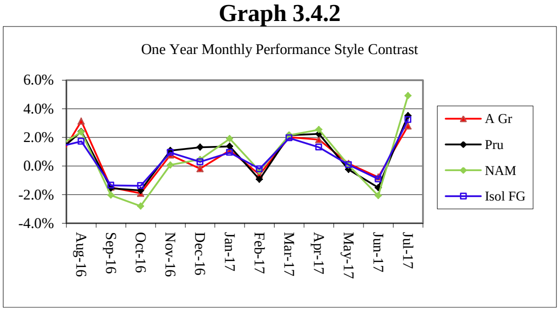


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

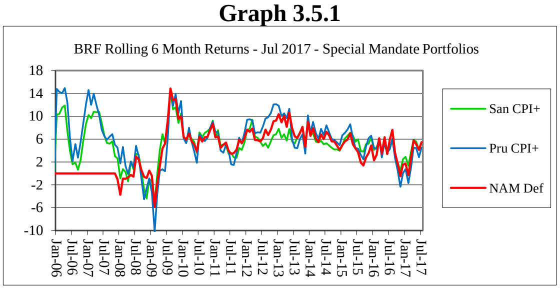


Graph 3.4.2

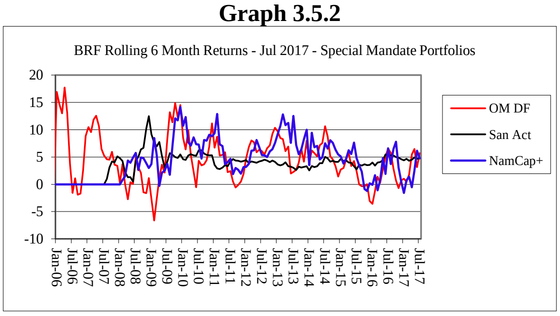


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

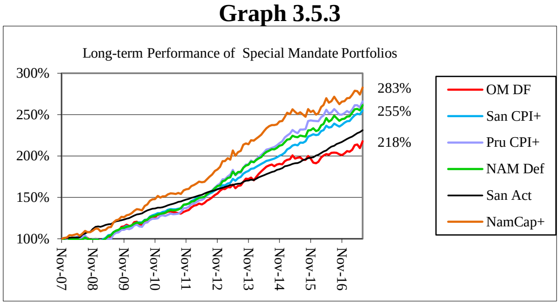
Graph 3.5.1



Graph 3.5.2



Graph 3.5.3



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

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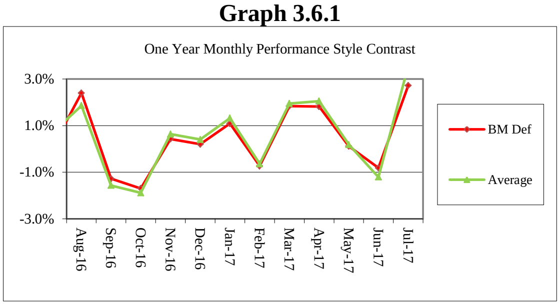
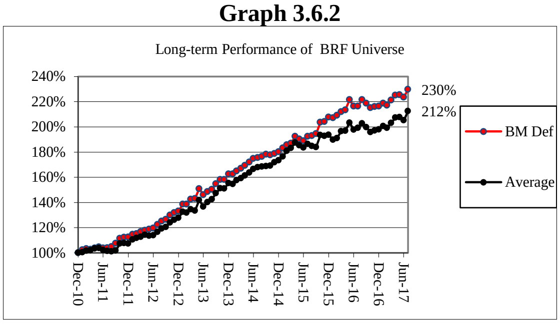
Graph 3.6.1

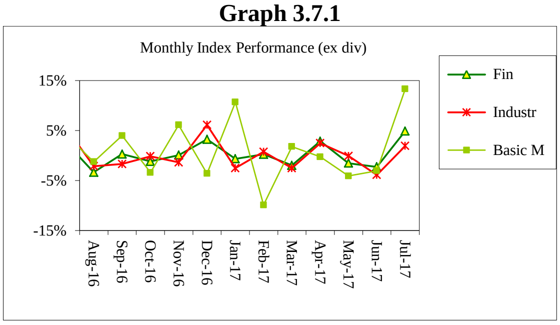


Graph 3.6.2

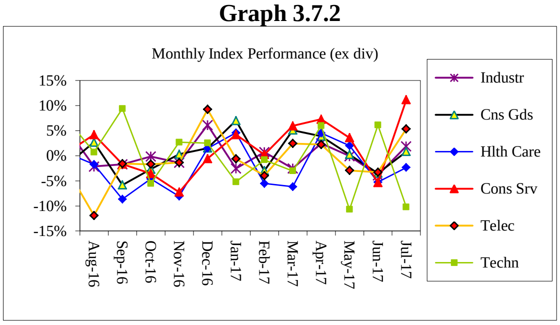


3.7 One year monthly performance of key indices (excluding dividends)

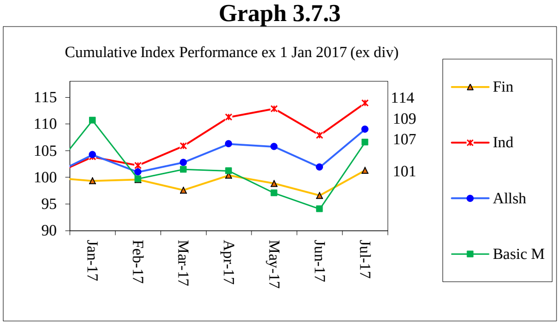
Graph 3.7.1



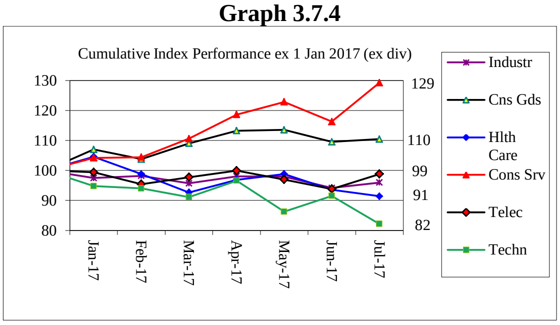
Graph 3.7.2



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.	13.4	12.8
5 year real return - % p.a.	7.9	7.2
Equity exposure - % of portfolio (qtr end Jun 2017)	50.5	56.2
Cumulative return ex Jan 2011	129.7	112.5
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%	18.9%	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	6.4%	14.1%	13.5%

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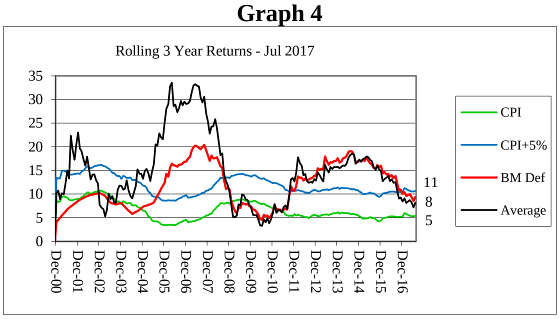
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years August 2014 to July 2017. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



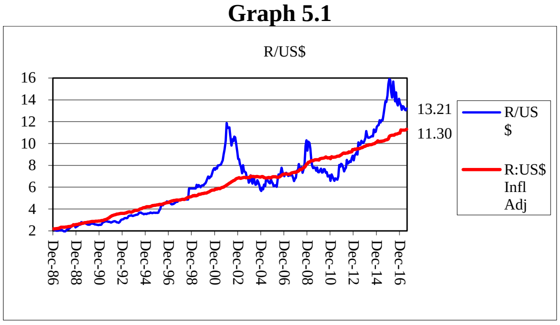
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end July was 9.4%, the average was 8.2% 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 11.30 to the US Dollar while it actually stood at 13.21 at the end of July. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

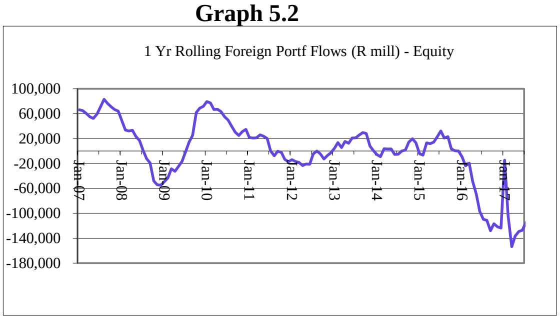


The Rand weakened by -1.26% in July with net foreign investment inflows from bonds and equities of R 21.4 bn. Over the past 12 months the Rand strengthened by 14.7% on net outflows of foreign capital from equity and fixed interest securities of R 74.7 bn (outflow of R 91.3 bn to end June 2017).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 299.0 bn (June R 278 bn).

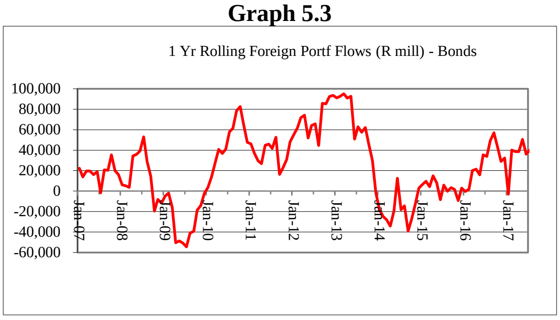
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 115 bn on a year-on-year basis at the end of July (outflow of R 127 bn year-on-year to end June). The month of July experienced a net inflow of R 10.5 bn. Since the beginning of 2006, foreign net disinvestment from equities amounts to R 5.5 bn (end June net investment of R 16.0 bn). This represents roughly 0.12% of the market capitalization of the JSE.

Graph 5.2



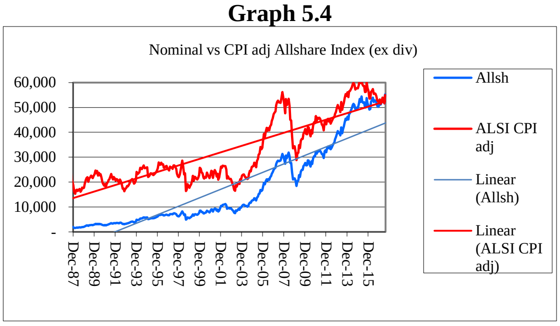
Graph 5.3 on a rolling one year basis reflects foreign portfolio inflows in respect of SA bonds of R 40.0 bn over the past 12 months to end of July (inflow of R 36 bn over the 12 months to end of June). The month of July experienced a net inflow of R 11.0 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 304.6 bn (to June R 293 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.

Graph 5.4



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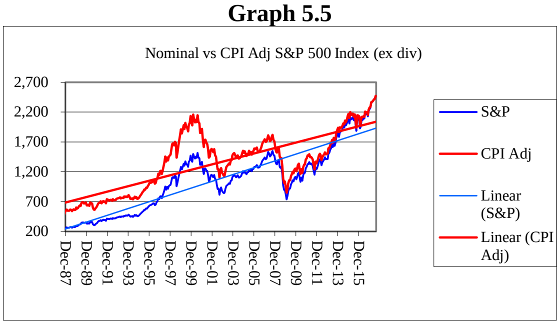
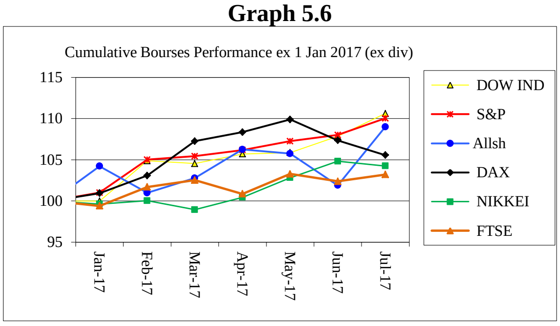
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.4% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a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

Graph 5.5



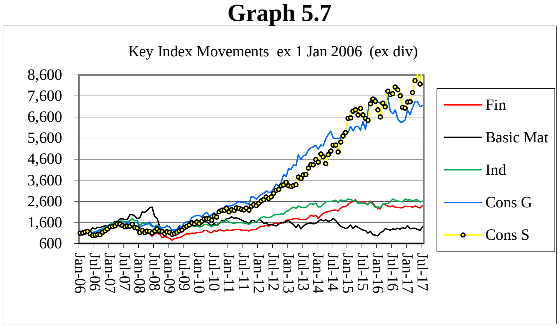
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Dow Jones, DAX, S&P 500 and FTSE as the top performing share indices since the start of 2016.

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: 20.8%; Consumer Goods: 18.4%; Industrials: 8.6%; Financials: 7.8%; and Basic Materials: 2.8%.

Graph 5.7



6. Can you afford to be invested in the money market?

by Tilman Friedrich

In last month's column I tried to explain how difficult it is to get the timing right for switching to either more conservative, or to more aggressive portfolios and back. Take the last two months as a point in case. In June the average prudential balanced portfolio returned minus 1.2% for the month while the JSE Allshare index returned minus 3.6%. Had you taken this as your prompt to switch to the money market portfolio, you would have sacrificed July's return of 3.5% of the average prudential balanced portfolio and 7% of the JSE Allshare index. Cash would have given you 0.7% for July.

Switching investments because of last month's poor or good returns is clearly not the answer. One needs to have a goal and a strategy how to get there. Much like is implicit in a business' vision, mission and philosophy. In terms of retirement investment, pension funds actually are structured around the implicit vision that a person should be able to replace his or her income at a rate of 2% of remuneration for each year of fund membership – referred to as income replacement ratio. Empirical evidence suggests that an income replacement ratio of 2% should support a reasonable life style in retirement at a reasonable cost. This replacement ratio is critically dependant on two factors, firstly the net contribution rate towards retirement by employee and employer and the investment returns earned over the working life. The following table illustrates the interdependency of these two factors.

	Assumed NET contribution towards retirement i.e. AFTER all costs for risk and administration etc (as % of pensionable salary)				
Assumed Investment Return for 30 years before retirement (after fees)	**8%**	**10%**	**12%**	**14%**	**16%**
CPI + 5%	47%	59%	70%	82%	94%
CPI + 4%	39%	49%	59%	69%	79%
CPI + 3%	33%	42%	50%	58%	67%
CPI + 2%	28%	35%	42%	50%	57%

The greyed blocks indicate where these two factors produce the implicit vision of retirement saving. Prudential balanced portfolios aim to return inflation plus 5% in the long-term. The table shows that between you and your employer a net contribution rate towards

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The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

retirement of 12% is required. It also shows that a money market portfolio which is expected to return inflation plus 2%, will only get close to the vision if the net contribution towards retirement is raised to 16%. So, if you are prepared to pay an additional 4% plus of remuneration towards your retirement fund, you can afford to reduce your investment return objective to inflation plus 2%, i.e. you can afford to move your investment from the prudential balanced portfolio to the money market portfolio. To put it differently, if your retirement investment has achieved more than inflation plus 5%, do not take that for granted but work on a reversion of returns to the norm. If your retirement investment has achieved inflation plus 2% or less, you will not be able to retire in comfort.

If you have been so fortunate to have accumulated enough capital over 25 years of your working life to secure an income replacement ratio of 3%, you should not be too concerned about the replacement ratio possibly reverting to the norm of 2% over the last 5 working years as this would still be consistent with your initial vision. Yes, it is painful to experience negative investment returns, but if your vision is still on track, the mere prospect of negative investment returns should not seduce you to deviate from your long-term vision and possibly end up having got your timing wrong and having done more harm than good to your long-term vision. And remember, retirement is not the end of your journey. Once you do retire you will still live for many years to come, for a long-term in terms of pension fund philosophy so, no need to be overly concerned about a down turn in investments markets. When you are in the market you will experience pain and you will experience pleasure but when you are out of the market you will miss opportunities while you may avoid pain.

We live in volatile times. We have seen central banks venture into untested and unprecedented monetary experiments without any idea how they will pan out eventually. We will probably still live to see the outcome. We also live in politically turbulent times, so volatility will be around for a while. However we also live in exciting times in terms of the increasing pace of technological advancement. This ‘cocktail’ however will offer many, many opportunities as well – it will not be all doom and gloom but one needs to be versatile and able to adapt quickly.

Conclusion

Volatility has been around for as long as the world exists and will always be with us. The chances of losing are high. Therefore be always ready to lose but do what you can do to reduce the chance of losing – you will not be able to avoid losing.

Offshore diversification is a must for reducing your chances of losing. Pension fund investments are contractual obligations and you cannot change certain parameters, such as prescribed investment limits. You are also likely to be overweight Namibia with your total assets so you should use your liquid discretionary capital to diversify your risk away from Namibia. As far as local investments are concerned, in the short-term there is little to choose between the more and the less volatile asset classes in our opinion. We retain our 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