Volume 13, No. 10
October 2017

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 OCTOBER 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

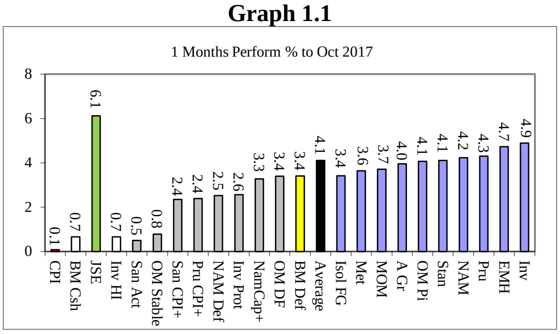
In October the average prudential balanced portfolio returned 4.1% (September: 1.35%). Top performer is Investec (4.89%); while Investment Solutions (3.42%) takes the bottom spot. For the 3 month period, Investec takes top spot, outperforming the 'average' by roughly 1.83%. On the other end of the scale Momentum underperformed the 'average' by 1.39%.

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.

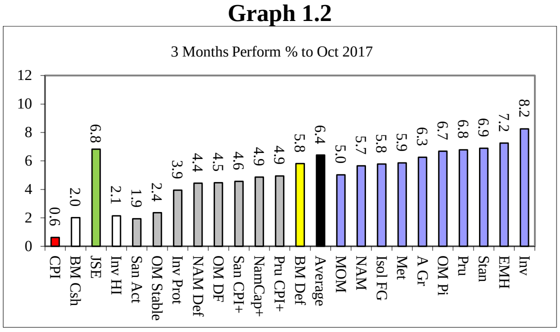
Below is the legend to the abbreviations reflected on the graphs:

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)

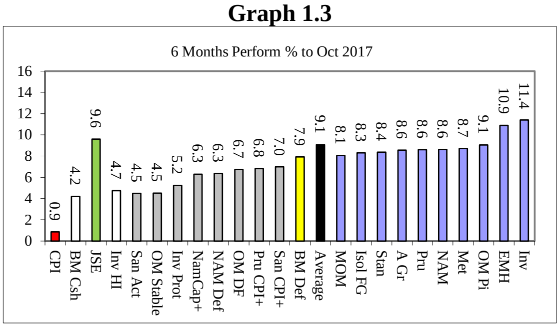
Graph 1.1



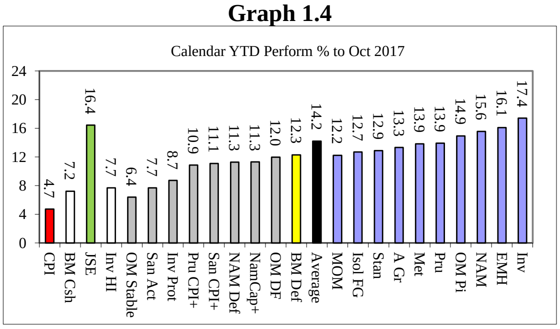
Graph 1.2



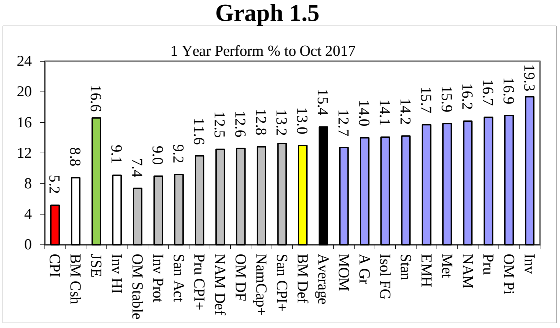
Graph 1.3



Graph 1.4



Graph 1.5



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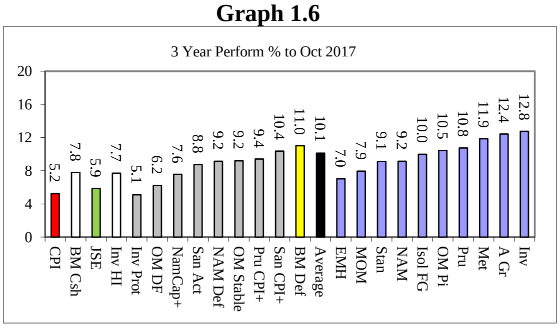
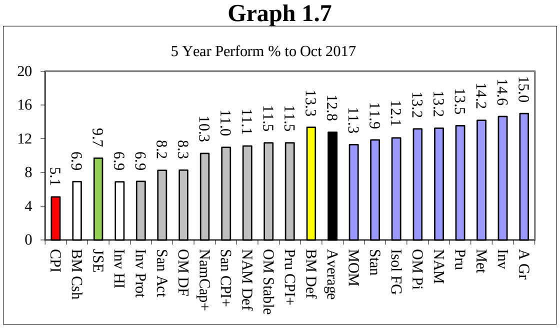
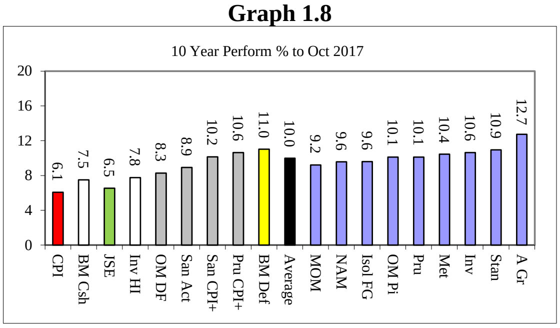
Graph 1.6



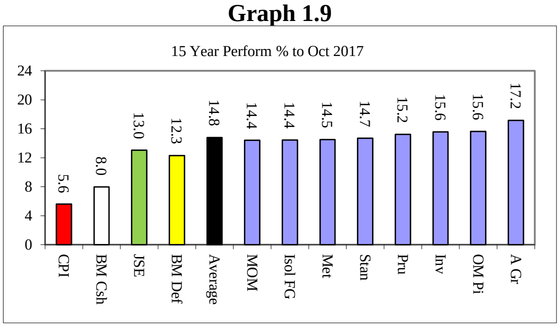
Graph 1.7



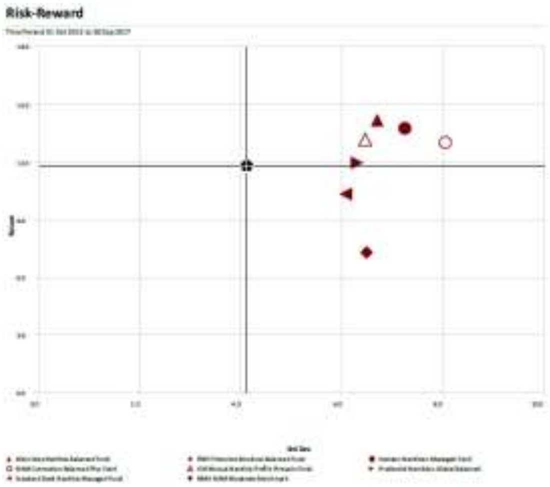
Graph 1.8



Graph 1.9

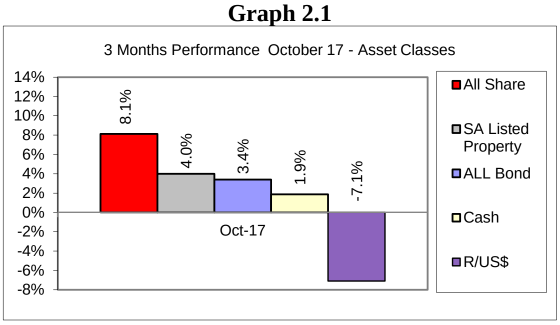


Risk/ Return

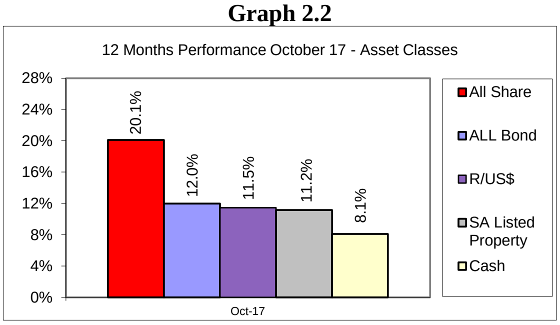


2. **Performance of Key Indices** (index performance by courtesy of IJG/Deutsche Securities)

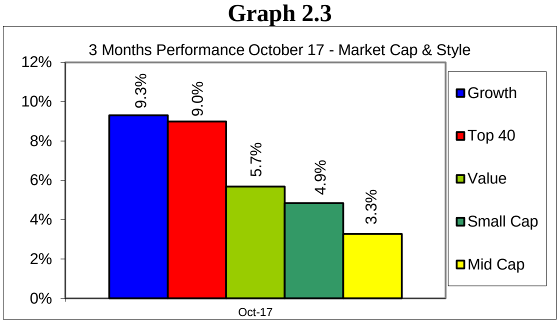
Graph 2.1



Graph 2.2



Graph 2.3



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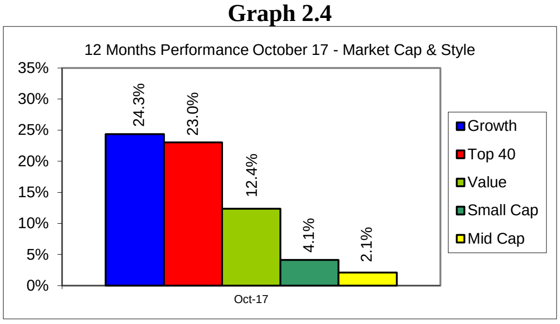
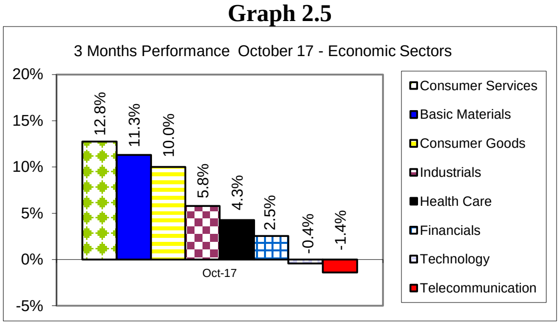
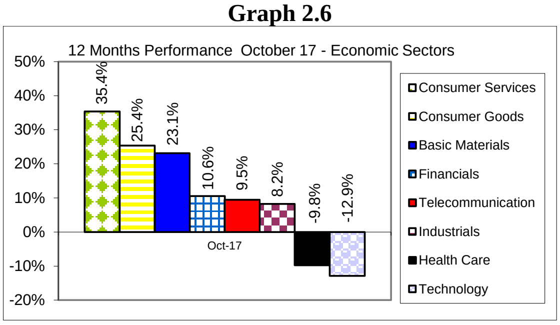
Graph 2.4



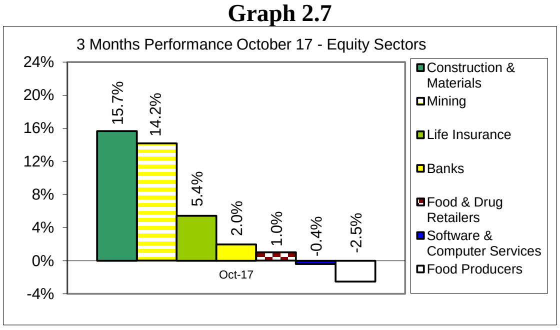
Graph 2.5



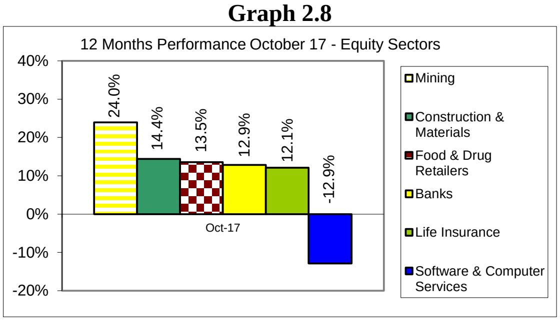
Graph 2.6



Graph 2.7



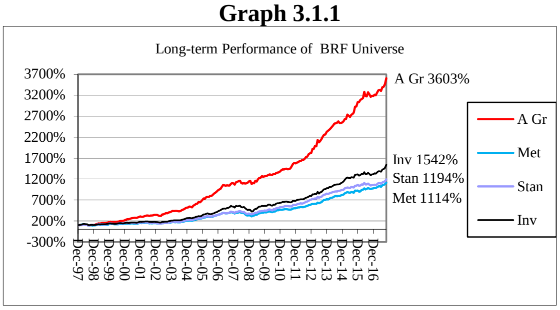
Graph 2.8



3. Portfolio Performance Analysis

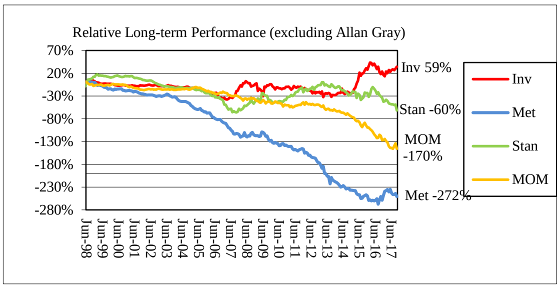
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

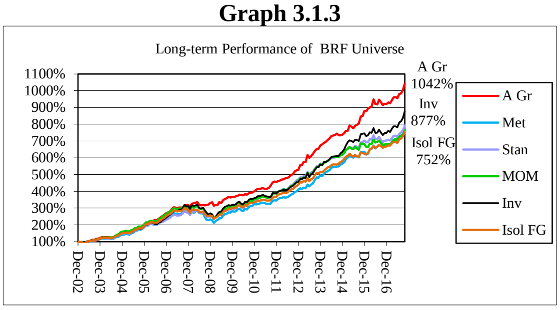


Graph 3.1.2

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

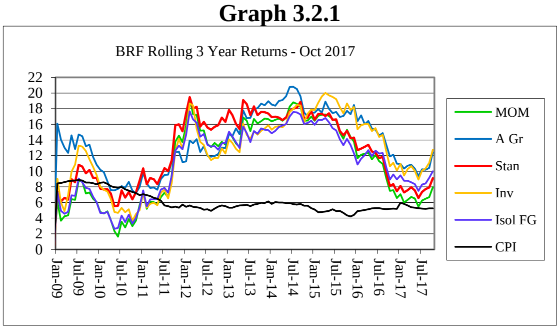


Graph 3.1.3



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

Graph 3.2.1



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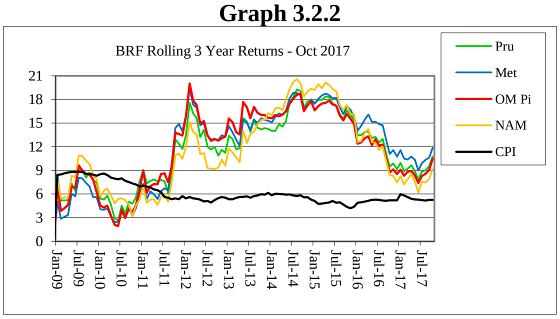
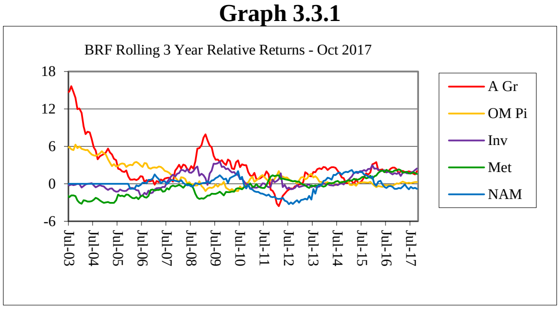
Graph 3.2.2

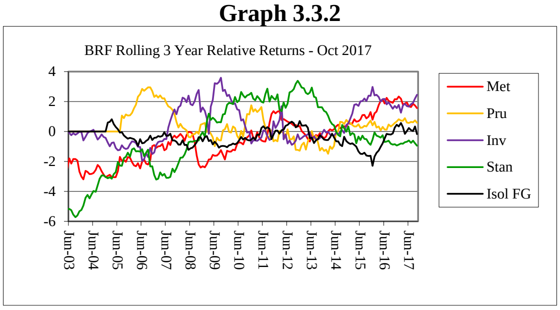


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

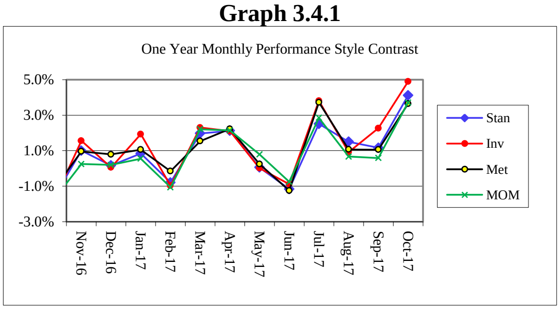


Graph 3.3.2

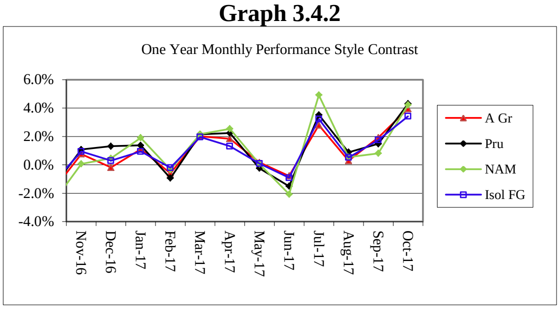


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

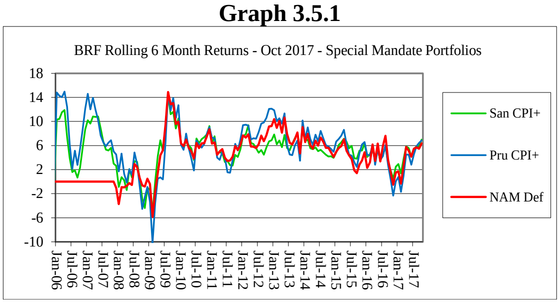


Graph 3.4.2

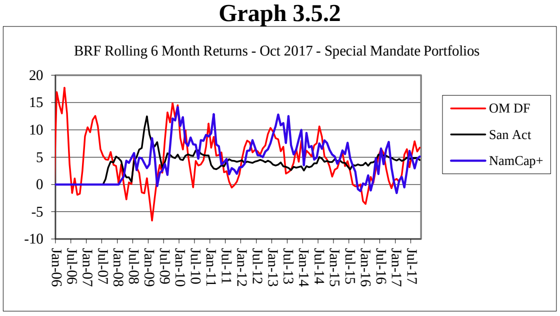


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

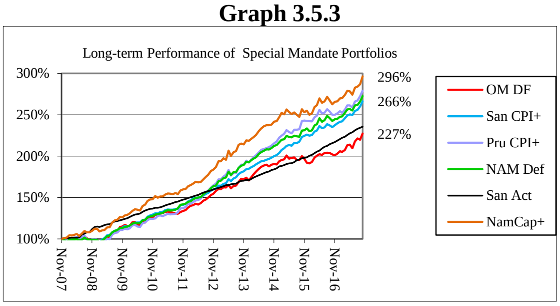
Graph 3.5.1



Graph 3.5.2



Graph 3.5.3



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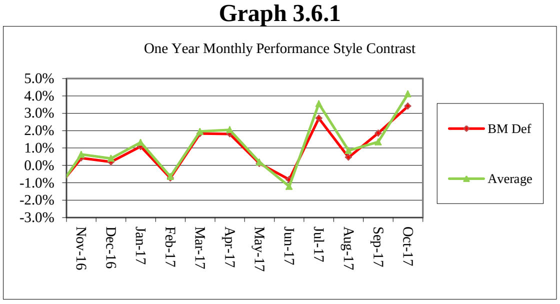
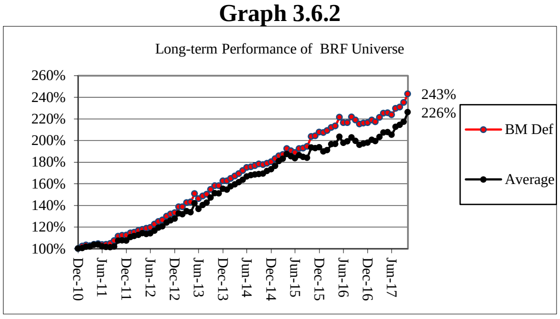
3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

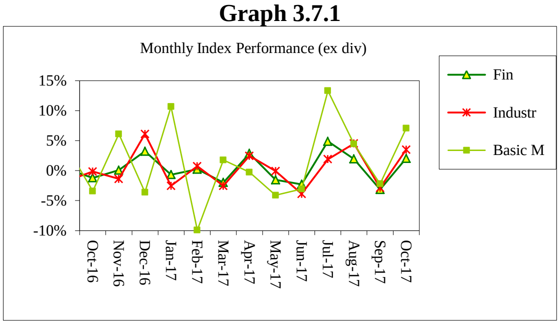


Graph 3.6.2

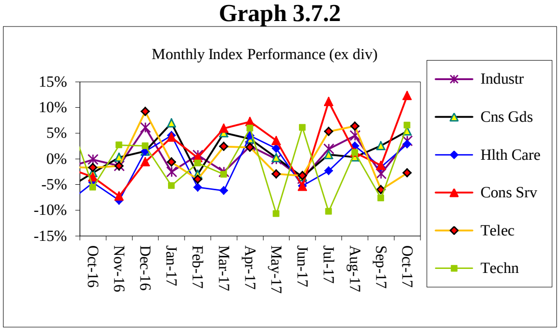


3.7 One year monthly performance of key indices (excluding dividends)

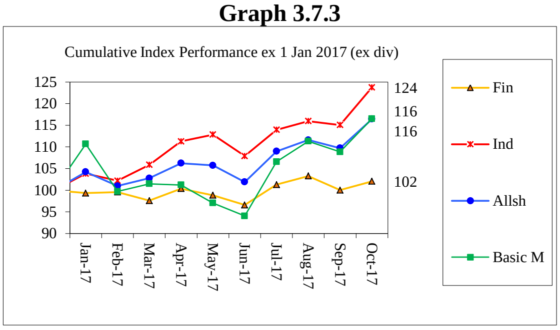
Graph 3.7.1



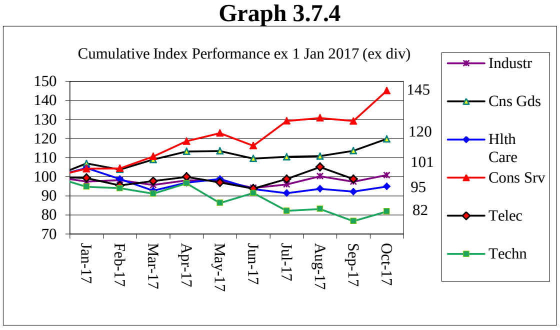
Graph 3.7.2



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	12.8
5 year real return - % p.a.	8.2	7.7
Equity exposure - % of portfolio (qtr end Sep 2017)	46.1	61.3
Cumulative return ex Jan 2011	143.1	126.1
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	5.7%	8.5%	7.2%
Best annual performance	7.8%	17.8%	18.0%
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	6.5%	13.5%	12.8%

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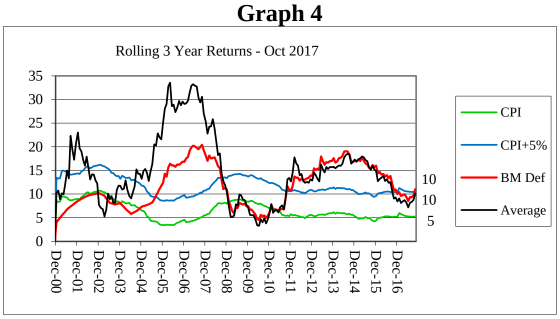
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years November 2014 to October 2017. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



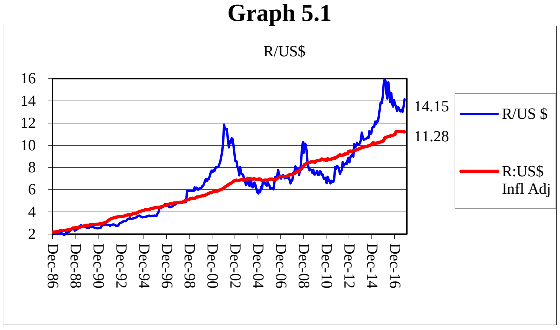
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end October was 11.0%, the average was 10.01% 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 11.28 to the US Dollar while it actually stood at 14.15 at the end of October. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

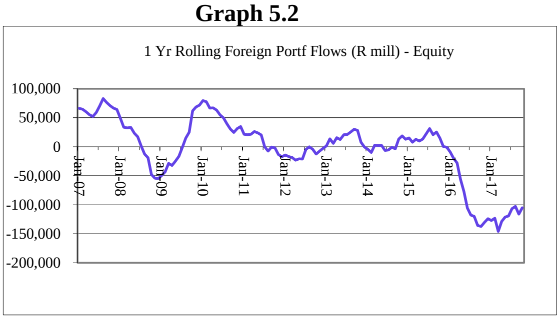


The Rand weakened by 4.49% in October with net foreign investment inflows from bonds and equities of R 0.4 bn. Over the past 12 months the Rand weakened by 4.98%. Net outflows of foreign capital from equity and fixed interest securities amount to R 65.0 bn (outflow of R 80.3 bn to end October 2017).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 316 bn (September R 316 bn).

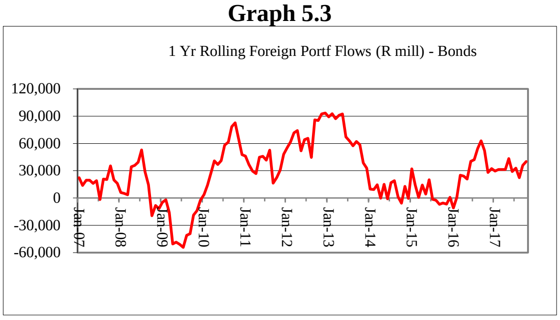
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, with a net outflow of R 105 bn on a year-on-year basis at the end of October (outflow of R 116 bn year-on-year to end September). The month of October experienced a net inflow of R 6.6 bn. Since the beginning of 2006, foreign net disinvestment from equities amounts to R 26.7 bn (end September net investment of R 33.4 bn). This represents roughly 0.17% of the market capitalization of the JSE.

Graph 5.2



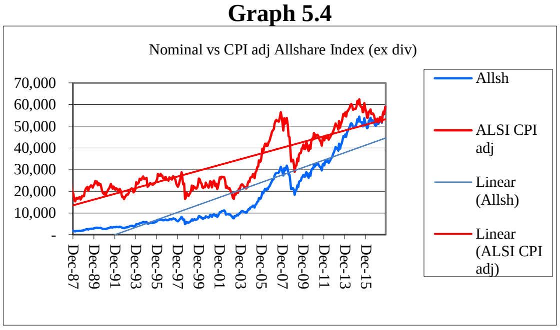
Graph 5.3 on a rolling one year basis reflects foreign portfolio inflows in respect of SA bonds of R 40.1 bn over the past 12 months to end of October (inflow of R 36.0 bn over the 12 months to end of September). The month of October experienced a net outflow of R 6.2 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 343.2 bn (to September R 349.3 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 11.6% 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 3.4% p.a. over this period, excluding dividends, or around 6.4% including dividends.

Graph 5.4



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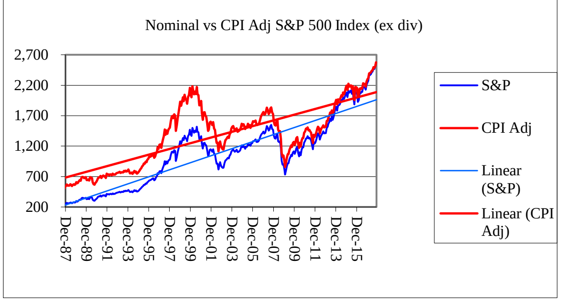
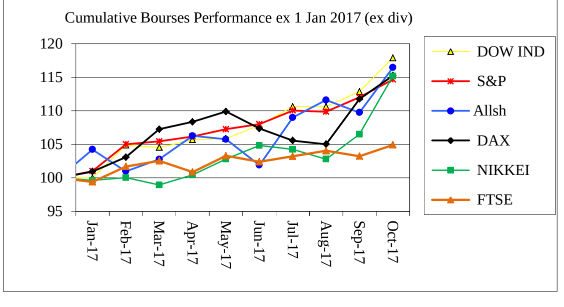
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.5% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.9% p.a. over this period, excluding dividends.

Graph 5.5



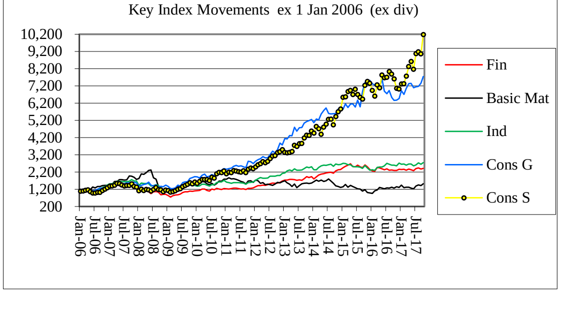
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Dow Jones, DAX, S&P 500 and FTSE as the top performing share indices since the start of 2016.

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: 21.5%; Consumer Goods: 18.8%; Industrials: 8.8%; Financials: 7.9%; and Basic Materials: 3.6%.

Graph 5.7



6. Should you take your money and run?

by Tilman Friedrich

The outlook for pension funds in Namibia is not great, unfortunately. The industry is facing a revolution that it may not survive! Firstly, a new body of law to be called Financial Institutions and Markets Act, the 'FIM Act', will present a revolution of the financial services industry. Secondly the regulator has made it his purpose to tighten the thumb screws ever more on pension funds and their financial service providers in terms of reporting. Thirdly, we are facing the introduction of a National Pension Fund that is poised to seriously undermine the financial services industry in general and the pension funds industry in particular. To round it all off, we have a government in dire financial straits that is looking for every possible avenue to capture financial resources to fund its operations. Unfortunately for the consumers of financial services but fortunately for government, their savings in regulated financial services institutions in general, and in pension funds more specifically are all easy prey for government and it is thus unashamedly pouncing on this opportunity.

Revolutions as we all know will turn the inside out, the upside down. This is a revolution imposed by first world experts on a small developing country that cannot really afford this. Reminds me a bit of Mukorob, erstwhile Namibian landmark with its 'disconnect' between body and head!

The regulator will find it challenging to enforce this law starting with the challenge of attracting and retaining the required expertise. The regulator is likely to find that the envisaged staff complement will be significantly too small to managed this law and that its levies will have to be lifted further. Rumours have it that NAMFISA is looking to employ 20 qualified actuaries! Well there is currently only a handful resident qualified actuaries in Namibia and a number of these are probably not Namibian citizens. So we will have to import foreign actuaries, a clear symptom that the law is out of synch with the economy. Will we be able to retain these actuaries? It goes without saying then that service providers who have to provide the work for 20 actuaries will be horrifically short on matching expertise and will have to ramp up their expertise, once again from outside Namibia. While as a regulator NAMFISA may still stand a chance to import expertise the 'indians' are unlikely to have this privilege.

With the advent of the FIM Act all legal precedent established under the 70 year old Pension Funds Act and the other acts the FIM Act will replace, will be thrown out of the window. Namibian courts that are already reeling under a work load they find difficult to manage, will have to re-establish legal precedent, case-by-case, on so many ambiguities in the FIM Act which, by its nature and size will already encompass much more room for ambiguities than the predecessor laws that collectively are much shorter.

All of this implies steeply increasing costs to be borne by the consumer of financial services generally and the pension fund member more specifically. In fact, pension fund assets being by far the largest pool of assets in the financial services industry will bear the bulk of these costs and the cost increase we have seen on the part of the regulator is just the beginning. The industry will have to follow suit as a matter of course. It is simply inconceivable that service providers will get along with the fees currently levied in the face of steeply increasing duties and responsibilities under the new FIM Act.

Pension fund structures have been designed on the premise that investments should generate net real returns of around 5% over the working lives of the contributors. Contributions were set accordingly, also taking into account normal fund management costs, and the end result was supposed to be a livable pension in retirement, not anywhere near the salary the pension fund member earned before retirement but at least livable.

The avalanche of legislation, regulation, reporting- and other requirements will require a substantial increase in general management costs that should lead to higher contribution rates by members and employer. Furthermore, net real returns of 5% will no longer be achievable as the result of regulatory investment prescriptions which will lead to substantially reduced pensions in retirement.

A principal officer who attended the RFIN conference at The Dome in Swakopmund in September observed aptly -"*I'm also very much concerned regarding the future of pension funds in Namibia, and regulation is not making it easier or perhaps I'm paranoid but the fact that everybody wants something out of the Funds is scary and more than ever should we unite and stand our ground. The bigger part of the annual conference just focused on how the government and entities can get pension fund money for every project that they want. I'm scared, worried to the extent that I even want to quit my current position because I will not be able to tell the members, "your money is gone", there is nothing!"*

In the light of this sobering scenario pension fund members need to plan with what the implications are likely to be for their pension fund investments. Membership of a pension fund is compulsory where an employer offers a pension fund. These investments cannot be relied on anymore to provide a livable pension in retirement and there is nothing the pension fund member can do about it. All other regulated financial services industries are unfortunately in the same position as pension funds. It will thus serve no purpose to try and move pension fund capital into insurance policies, unit trusts, medical aid schemes or to banks, even if this were possible.

At the risk of being branded unpatriotic, investors may be forgiven contemplating to move discretionary capital into other jurisdictions with the hope to generate higher returns on their investments in an effort to still secure a livable post-retirement income from all sources. Of course one needs to be realistic about the prospects of realising this hope. If one looks at the US, Europe and the developed world in general, governments have been milking savers in general and pensioners specifically through artificially low interest rates that were also designed to rehabilitate their financial position. This in turn caused asset bubbles that are due to deflate sooner or later at the expense of the saver.

Although the green shoots become ever more visible in the economies of developed countries, which should eventually lead to the normalization of interest rates and asset prices, policy makers will always turn to the savings of the man in the street whenever the need might arise again.

Conclusion

In the light of the scenario sketched above, offshore diversification remains a must for reducing your chances of losing and improving your chances of better returns and should be considered once our currencies have strengthened. Pension fund investments are contractual obligations and you cannot change certain parameters, such as prescribed investment and 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