Volume 13, No. 12
December 2017

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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

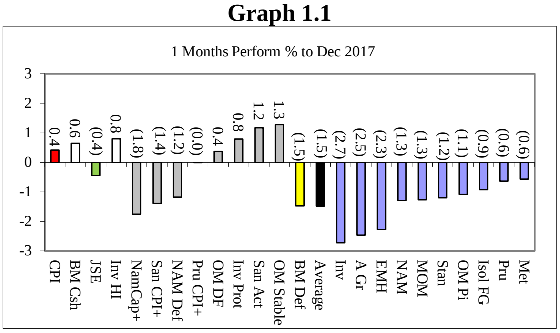
In December the average prudential balanced portfolio returned (-1.49%) (November: 0.40%). Top performer is Metropolitan (-0.60%); while Investec (-2.73%) takes the bottom spot. For the 3 month period, Stanlib takes top spot, outperforming the 'average' by roughly 1.13%. On the other end of the scale Allan Gray underperformed the 'average' by 1.34%.

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.

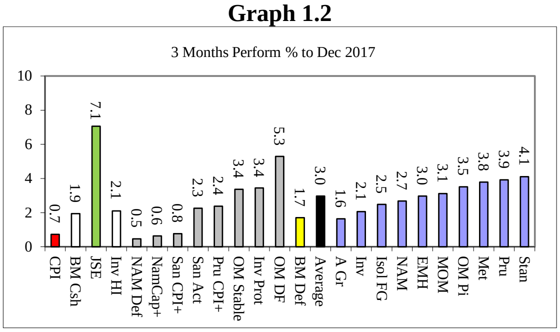
Below is the legend to the abbreviations reflected on the graphs:

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)

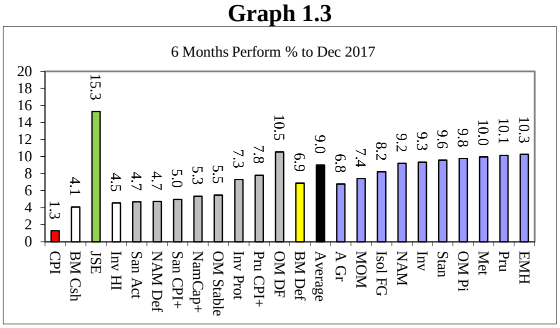
Graph 1.1



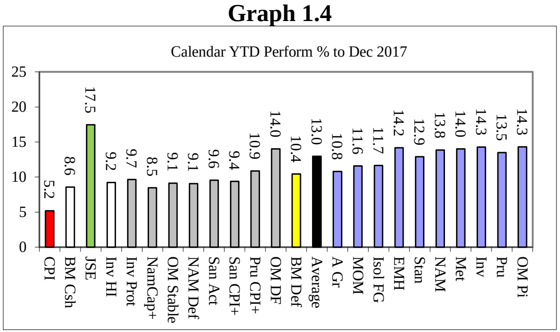
Graph 1.2



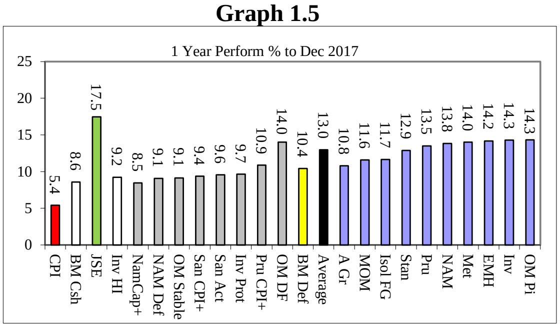
Graph 1.3



Graph 1.4



Graph 1.5



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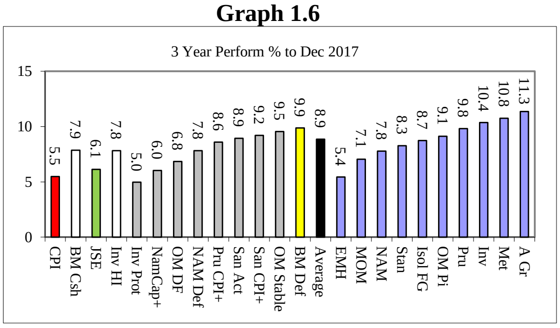
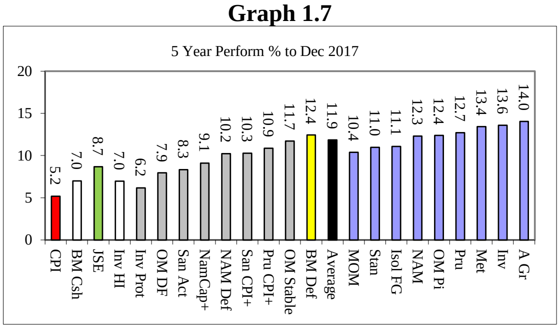
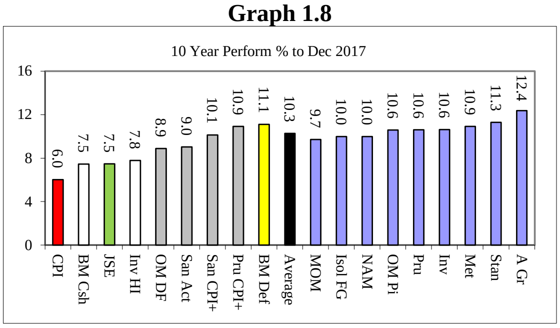
Graph 1.6



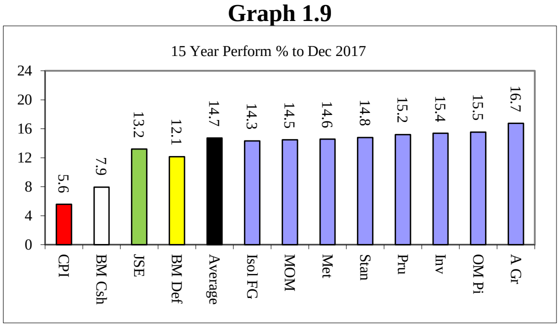
Graph 1.7



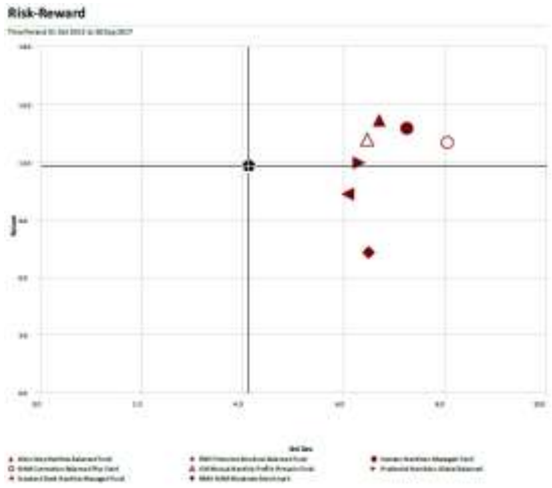
Graph 1.8



Graph 1.9

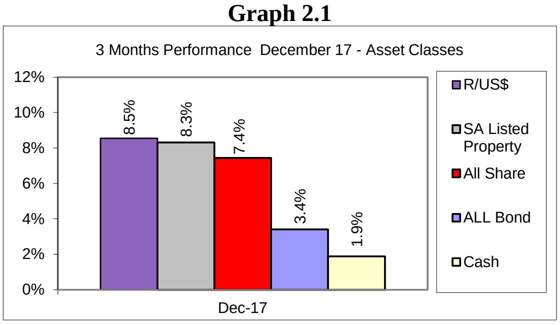


Risk/ Return

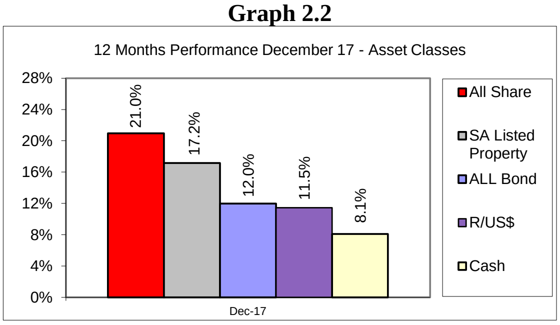


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

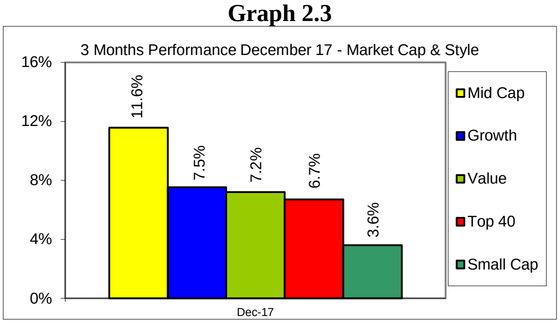
Graph 2.1



Graph 2.2



Graph 2.3



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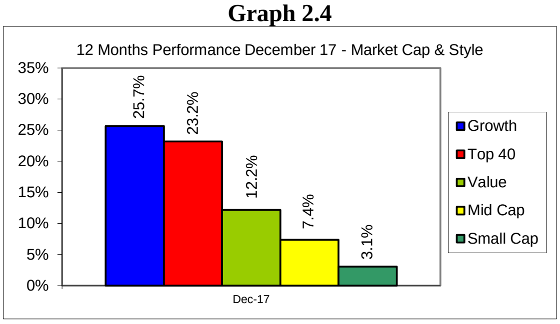
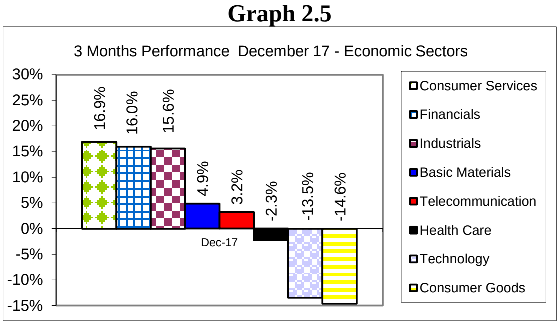
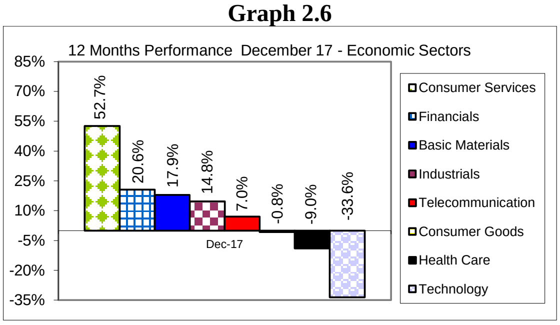
Graph 2.4



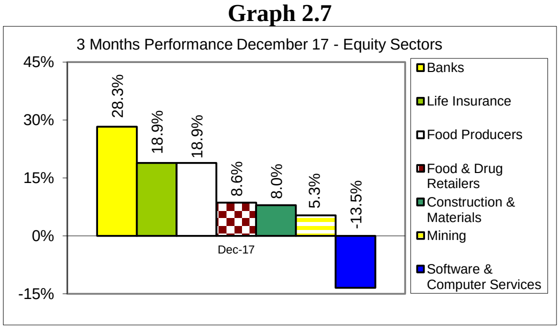
Graph 2.5



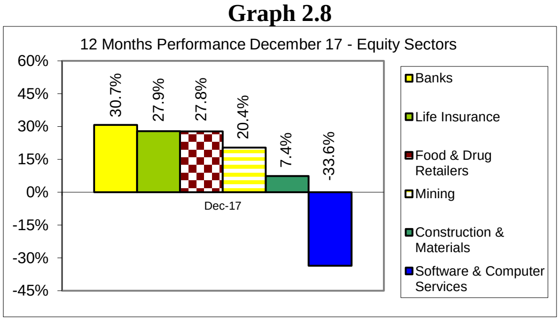
Graph 2.6



Graph 2.7



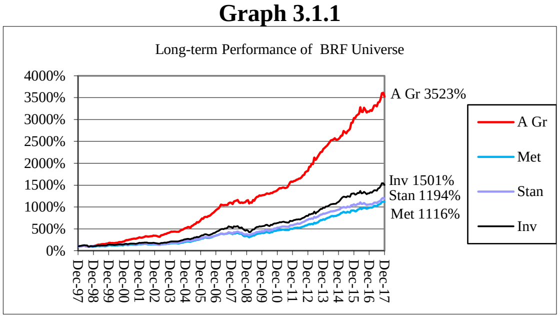
Graph 2.8



3. Portfolio Performance Analysis

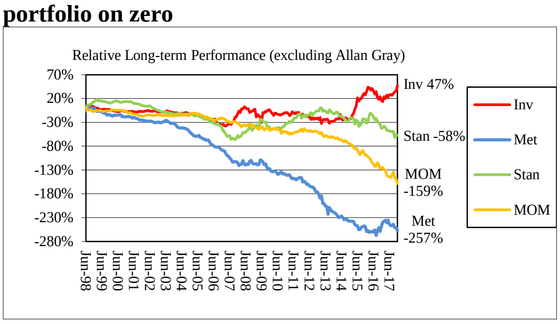
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

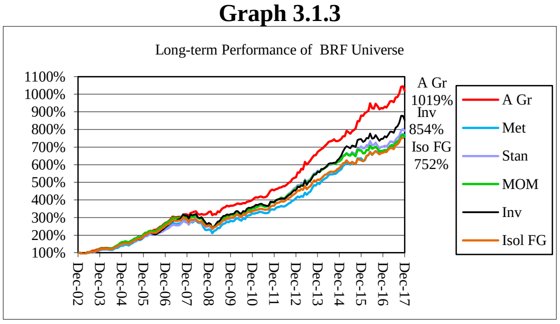


Graph 3.1.2

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

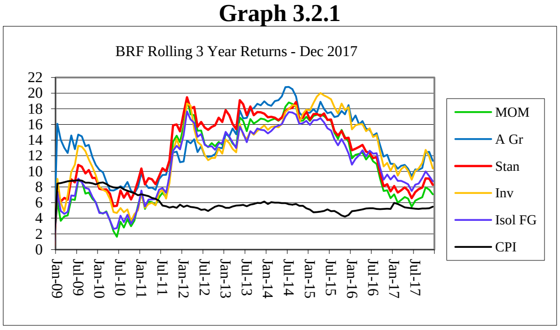


Graph 3.1.3



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

Graph 3.2.1



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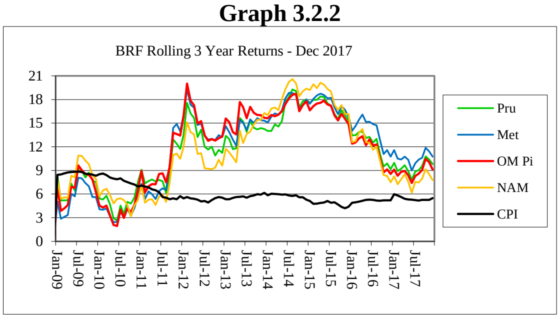
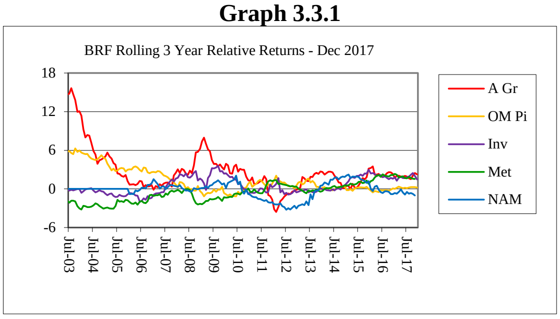
Graph 3.2.2

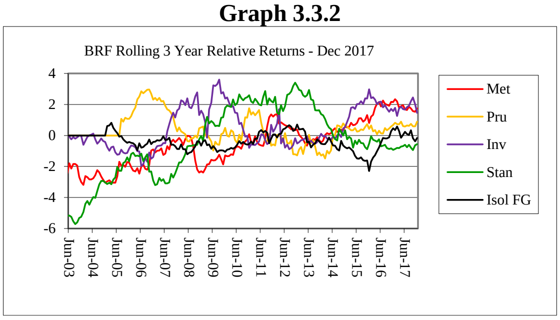


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

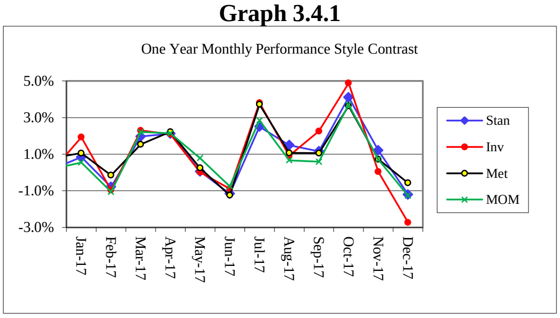


Graph 3.3.2

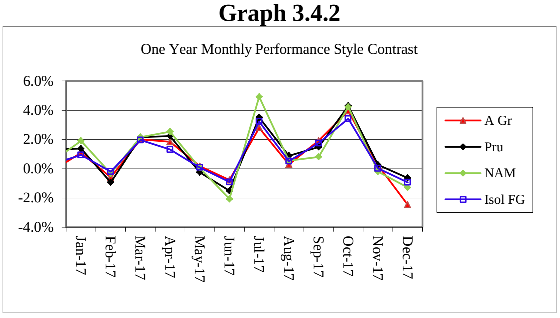


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

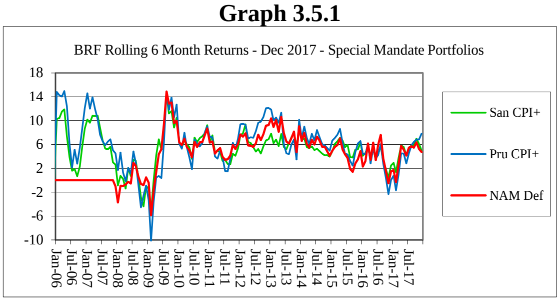


Graph 3.4.2

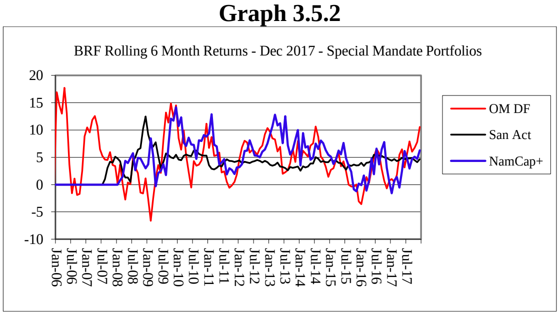


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

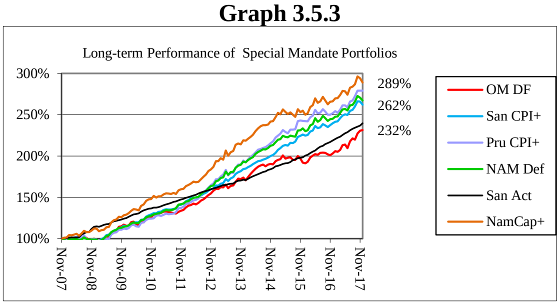
Graph 3.5.1



Graph 3.5.2



Graph 3.5.3



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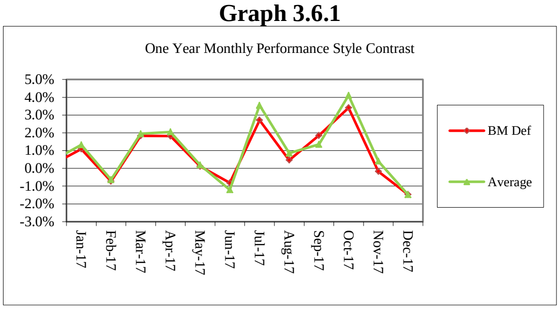
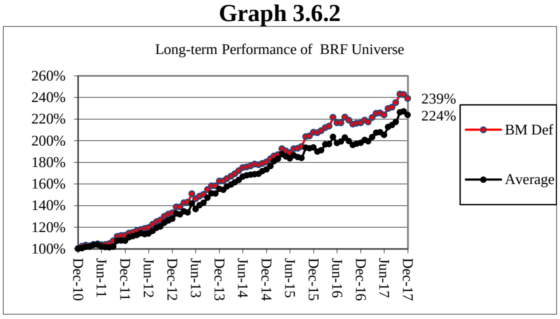
3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

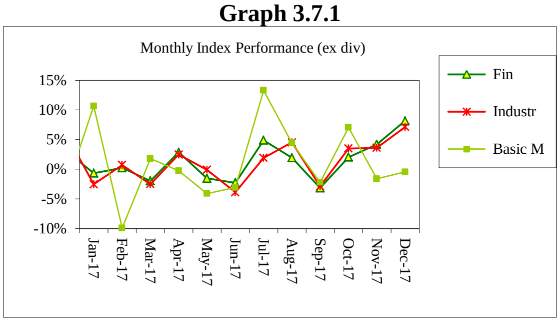


Graph 3.6.2

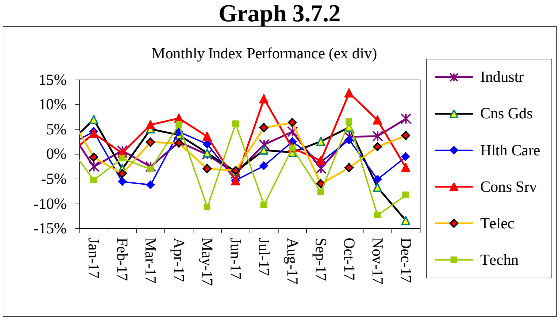


3.7 One year monthly performance of key indices (excluding dividends)

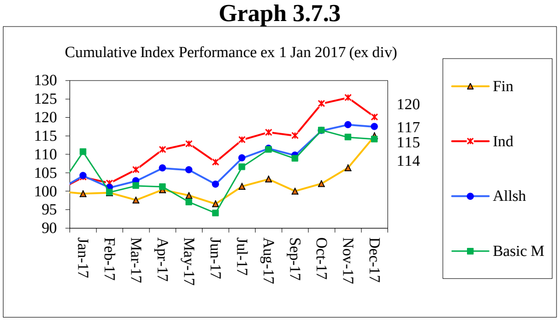
Graph 3.7.1



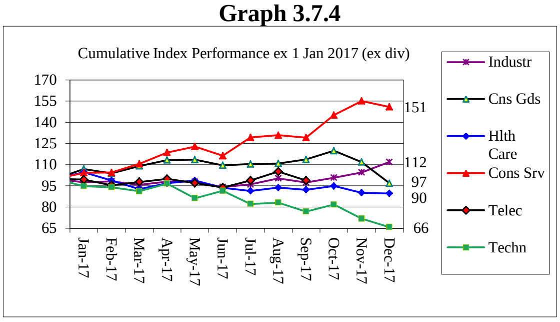
Graph 3.7.2



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.	12.4	11.9
5 year real return - % p.a.	7.3	6.7
Equity exposure - % of portfolio (qtr end Sep 2017)	46.1	61.3
Cumulative return ex Jan 2011	139.0	123.6
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	6.6%	13.1%	12.3%

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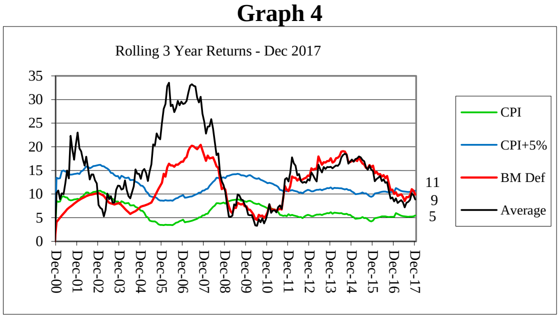
The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years January 2015 to December 2017. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



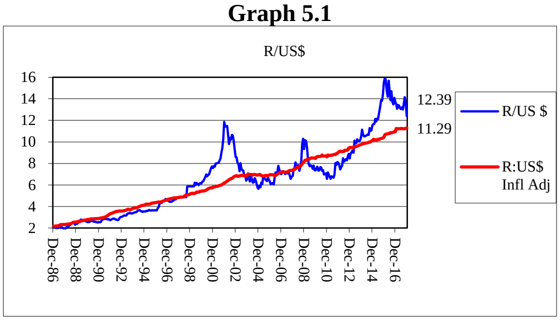
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end December was 9.87%, the average was 8.85% vs CPI plus 5% currently on 10.4%.

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 11.29 to the US Dollar while it actually stood at 12.39 at the end of December. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

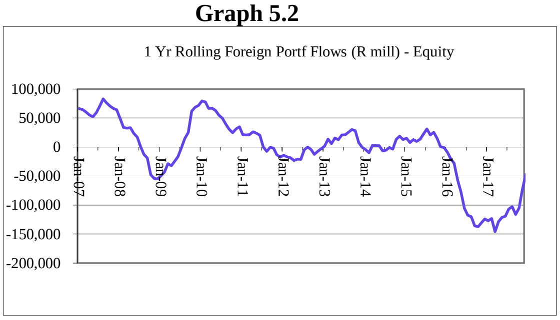


The Rand strengthened by 9.33% in December with net foreign investment inflows into bonds and equities of R 18.4 bn. Over the past 12 months the Rand strengthened by 9.60%. Net inflows of foreign capital into equity and fixed interest securities over the past 12 months amounted to R 6.3 bn (outflow of R 19.4 bn to end November 2017).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 341 bn (November R 323 bn).

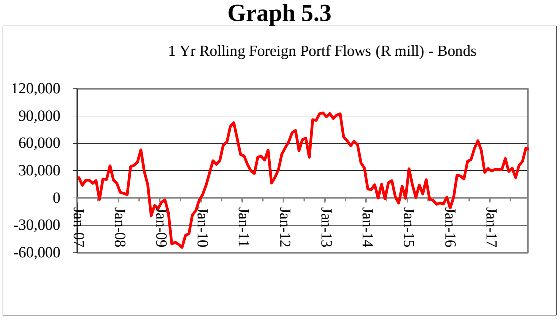
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one year basis, of R 47.1 bn at the end of December (outflow of R 71.1 bn year-on-year to end November). The month of December experienced a net inflow of R 24.0 bn. Since the beginning of 2006, foreign net disinvestment from equities amounts to R 8.8 bn (end November net investment of R 15.2 bn). This represents roughly 0.06% of the market capitalization of the JSE.

Graph 5.2



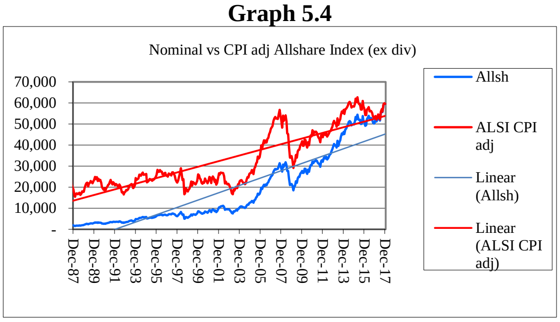
Graph 5.3 on a rolling one year basis reflects foreign portfolio inflows in respect of SA bonds of R 53.5 bn over the past 12 months to end of December (inflow of R 59.0 bn over the 12 months to end of November). The month of December experienced a net outflow of R 5.5 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 332.6 bn (to November R 338.1 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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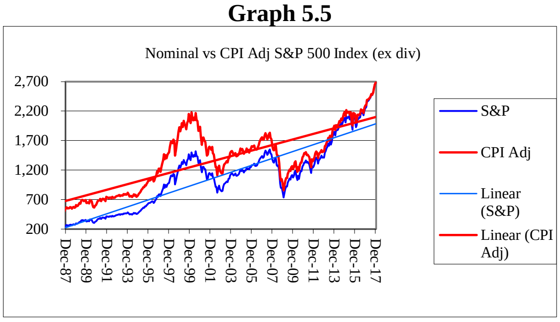
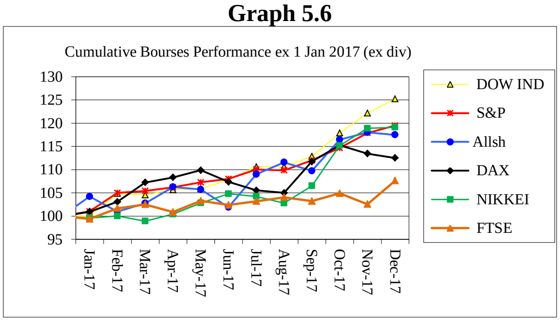
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.6% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 5.0% p.a. over this period, excluding dividends.

Graph 5.5



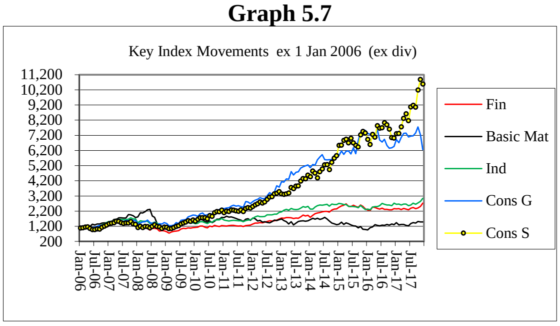
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Dow Jones as the top performing index indices since the start of 2017.

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: 21.6%; Consumer Goods: 16.4%; Industrials: 9.7%; Financials: 8.6%; and Basic Materials: 3.3%.

Graph 5.7



6. What will 2018 hold in store for us?

by Tilman Friedrich

The US tax code revision, the backlash against unfettered globalization, Bitcoin, the prospective withdrawal of quantitative easing by the ECB, the steep increase in crude oil prices, the possible return to a gold standard and the Korean crisis currently are probably the hottest topics that may impact financial and investment markets in 2018 and beyond.

The backlash against unfettered globalization has already led to the election of Donald Trump as president of the US in 2015 true to the adage that the wheel keeps turning. When the largest global economy is moving towards more protectionism and less globalization, other smaller economies will have to move towards more protectionism as a matter of course. Whatever one may think or say about president Trump's lack of diplomacy and finesse, he is a businessman and not a diplomat unlike his predecessor, and he is starting to make an impact on the US economy that will reverberate on the global economy, with his America first credo. In its December 2017 approval of the most extensive tax-code revisions since 1986, the US Congress scrapped the previous international tax system for corporations - an unusual arrangement that allowed companies to defer U.S. income taxes on foreign earnings until they returned the income to the U.S. That "deferral" provision led companies to stockpile an estimated $3.1 trillion offshore and many were criticized for the moves. In the wake of these developments, Apple just recently announced it will bring hundreds of billions of overseas dollars back to the U.S., pay about $38 billion in taxes on the money and spend tens of billions on domestic jobs, manufacturing and data centers in the US in the coming years. The iPhone maker plans capital expenditures of $30 billion in the U.S. over five years and will create 20,000 new jobs at existing sites and a new campus it intends to open. The California-based company's shares rose 1.7 percent to a record closing price of $179.10. Apple also told employees that it's issuing stock-based bonuses worth $2,500 each following the new U.S. tax law, according to people familiar with the matter. These moves by Apple will certainly be felt in the US economy and most certainly Apple will not be the only company but many others are likely to follow this example. While some implications of these developments in the US can be foreseen many others cannot. It can be foreseen that it will lead to the depreciation of currencies relative to the US$. US investors are likely to become more optimistic about their local economy and investment markets and are likely to move at least some of their investments from offshore markets to the US market. This will underpin the US investment market and remove some underpin from foreign investment markets particularly those in developing countries. What can also be foreseen is volatility in global financial and investment markets resulting from the uncertainty that will be caused by these changes in global capital flows. The movement towards a more protectionist economic policy will undoubtedly lead to more international friction and potentially even military confrontation which in turn will cause uncertainty and volatility.

Bitcoin is probably the hottest topic of the man in the street. We have seen extreme volatility in what is referred to as a ‘digital commodity’ rising to nearly US$ 20,000 and more recently having declined to around US$ 11,000. Whatever this ‘animal’ is, I do not understand it and therefore I would not invest in it. From my layman’s understanding it aims to replace banks in the international payments system on the basis of its convenience and speed of transacting. We all know of course that banks are well regulated and supervised by their governments for very good reasons. I cannot see that governments will give up this control and supervision of any financial institution or product that presents a systemic risk to its economy. Bitcoin further circumvents countries tax nets and is ideally suited for financing of terrorism and money laundering, enough reasons for no government really having any interest in such a mechanism. Bitcoin for all I know is nowhere regulated or supervised and one may ask the question why this is so. The reason seems to be that it currently is not really a factor in financial markets and that it will take time for regulators to catch up with such a ‘new kid on the block’. Some countries like China and Korea have taken steps to clamp down on Bitcoin though, and it is inconceivable that the rest of the world will not do the same. Federal Reserve Chair Janet Yellen described Bitcoin as "a highly speculative asset" that "plays a very small role in the payments system," adding it is not a "stable store of legal tender." Incoming Fed Chair Jerome Powell has also weighed in on the matter, arguing that "innovation does not come at the cost of a safe and secure payment system that retains the confidence of its end users." He added, in an October speech, that "fintech firms and banks must each play a role in assuring that enhancements to convenience and speed do not undermine safety and security", a clear hint to the relevant role players. Bitcoin is thus unlikely to impact global financial markets despite being the hottest topic amongst investors.

The prospective withdrawal of quantitative easing by the ECB will also impact global financial markets considering its extent. It can clearly be foreseen that interest rates in the Euro zone will increase. This will lead to capital flows into the Euro zone and to an appreciation of the Euro relative to other currencies, particularly those of developing economies. Again this change in global investment flows also entails unforeseeable consequences that will raise uncertainty and volatility in global financial and investment markets.

The steep increase in global crude prices we have seen over the last few months will have an impact on the global economy. Primarily it became apparent during the previous high altitude flight that it has been the accelerator for the global economic engine. This is probably the consequence of it pushing the velocity or turning of money. Despite predictions that fossil fueled mobility and electricity generation will steeply decline within the near future, we believe that the multitude of usage of crude oil is just too wide for it to fade as a key global commodity and no doubt its sphere of influence in other areas is likely to increase as its usage for fueling motor vehicles will decline. The positive impact of its recent price resurrection is likely to drive the local economy over the next year and beyond.

A possible return to a gold standard will drive the gold price to US$ 10,000 as US author, lecturer, international speaker and economic commentator believes, based on a simple arithmetic for an equilibrium of global gold reserves and the amount of global currency required to be backed up by gold. China and Russia have both mooted the intention to move away from the Petrodollar and back to a gold standard in an effort to break the global financial shackles of the US. Undoubtedly, this is a non-negotiable for any self-respecting nation that wants to escape US hegemony. The US of course will make every effort to prevent this and this can conceivably go as far as waging war but in the meantime economic and financial repression will remain the tools to contain the threat to US dominance. Both measures will heighten global uncertainty and market volatility.

Finally, the Korean ‘crisis’ is another source of global uncertainty and market volatility that will be with us for a while, at least until the Olympic games are over to possibly be removed unilaterally by the US. Neighbouring China and Russia will have no interest in such development and in particular to have the US even closer on their doorsteps then they currently are. This would, however, be the logical development should the US apply military force to remove the nuclear threat posed by North Korea. We believe that between Russia and China every effort will be made to convince North Korea to abandon its nuclear capabilities in order to keep the US from their doorsteps and do not foresee any military action.

Conclusion

There are a number of potential developments visible on the horizon in 2018 that may impact global economies in 2018. Some of these are positive others the opposite. So it will clearly not be a one-way road. Although it appears that economies are starting to improve, such improvement will be undermined by protracted efforts to normalise monetary policy and to reign in excessive national debt and liquidity in financial markets. Short of causing another financial crisis, these efforts will be designed to implant a valve into the global asset bubble for taking out steam in a measured fashion. A number of political issues will keep the fear factor high for the foreseeable future and with it volatility will remain high and possibly even increase in the second half of the year. With improving economies, the demand for commodities is already and will continue to be on the rise which will be positive for resource based economies such as SA and Namibia.

For a number years we were of the opinion that the Rand was undervalued and by our measure fair value is currently around 11.3 to the US$. Its current level of 11.9 would thus only require a further 5% appreciation to reach fair value. In other words, we believe this will not be a temporary phenomenon assuming no political frailties happening in southern Africa. Unfortunately this will hurt local producers, but it affords an opportunity to reduce interest rates which in turn will benefit the consumer, consumption and the economy. The strong Rand now affords local investors the opportunity to further diversify investments offshore.

With an expected improvement in the local economies, local equities should offer medium term prospects of good returns. Fixed interest should offer good short-term prospects but this is only expected to be a window of opportunity as foreign interest rate increases will trickle down to SA and Namibia as well. Property should also offer good prospects as the economy improves.

Internationally, booming US equities is a cause of concern but in the absence of alternatives and in the light of the normalization of monetary policy, it is foreseen that the US market will continue on its trajectory given the absence of any unexpected global political crisis, for which there is quite a bit of potential. The same is likely to be true for European equity markets. We therefore expect offshore equity markets in general to do well but are weary of fixed interest assets in the light of a tightening of monetary policy. Amongst the various equity sectors, commodities have been in the doldrums for quite some time now and are thus expected to offer best prospects for 2018.

7. Important notice and disclaimer