Volume 14, No. 2
February 2018

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 28 FEBRUARY 2018

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

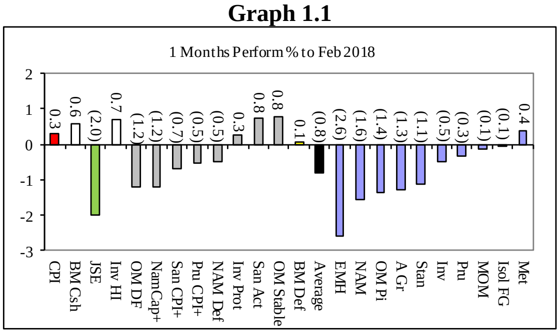
In February 2018 the average prudential balanced portfolio returned minus 0.79% (January 2018: 0.57%). Top performer is Metropolitan (0.39%); while EMH (-2.58%) takes the bottom spot. For the 3 month period, Metropolitan again takes top spot, outperforming the 'average' by roughly 2.74%. On the other end of the scale EMH underperformed the 'average' by 3.14%.

Graphs 1.1 to 1.10 reflect the performance for periods from 1 month to 20 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, Sanlam Inflation Linked and Allan Gray Namibia Balanced Funds.

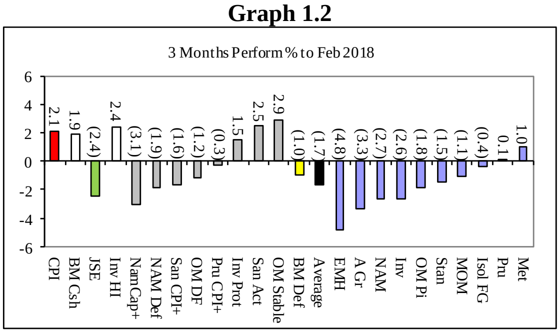
Below is the legend to the abbreviations reflected on the graphs:

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)

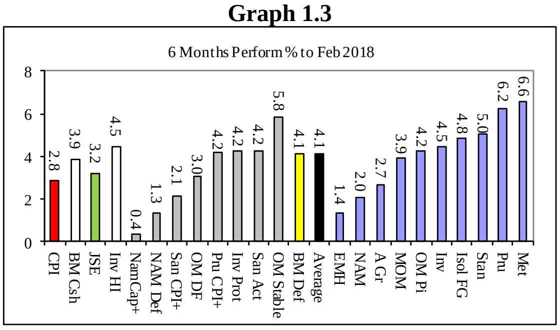
Graph 1.1



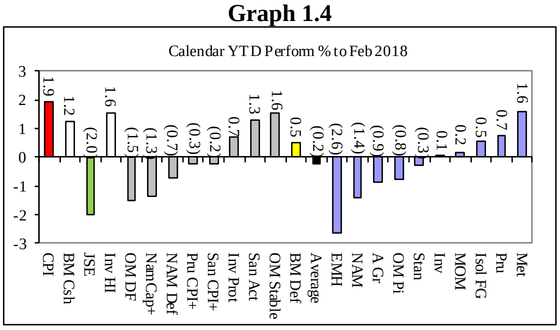
Graph 1.2



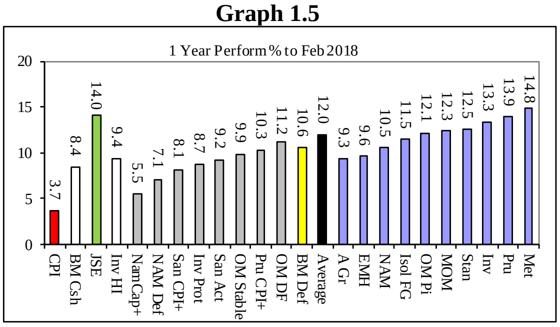
Graph 1.3



Graph 1.4



Graph 1.5



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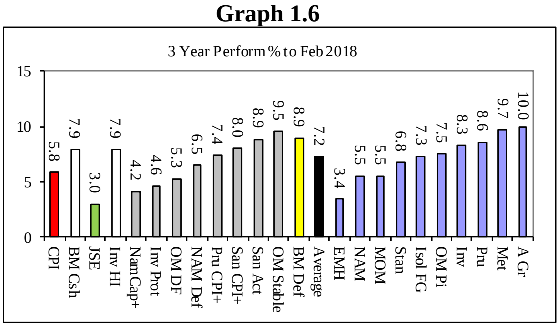
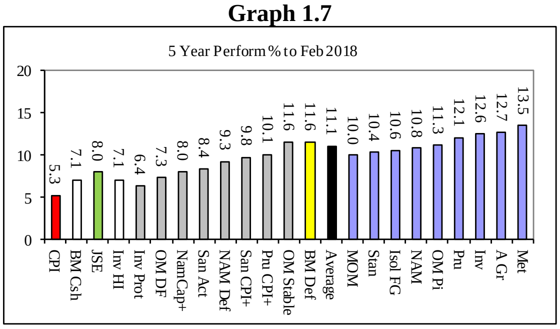
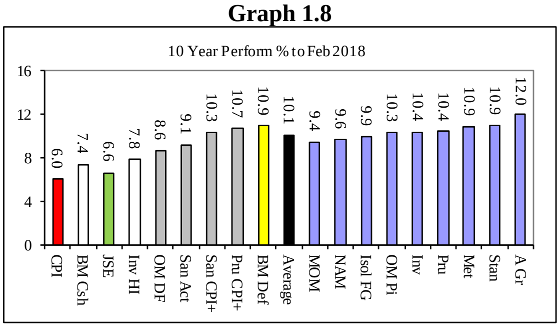
Graph 1.6



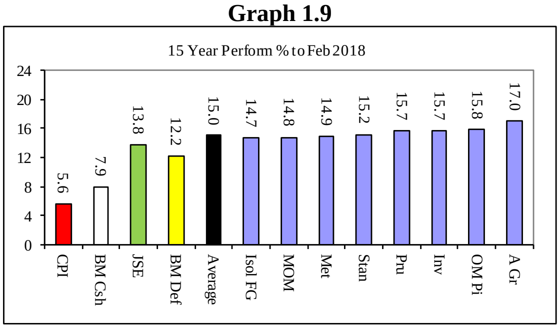
Graph 1.7



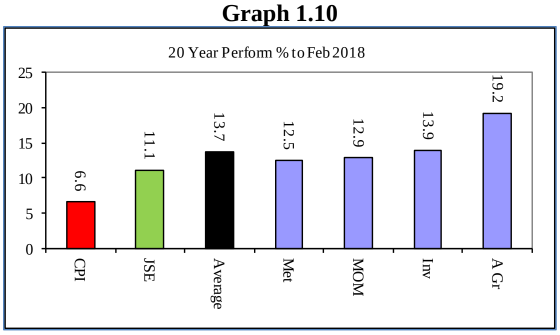
Graph 1.8



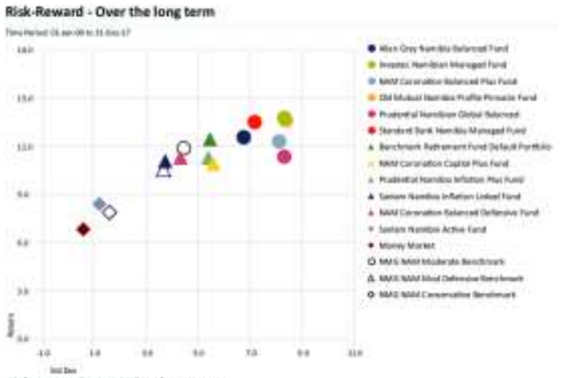
Graph 1.9

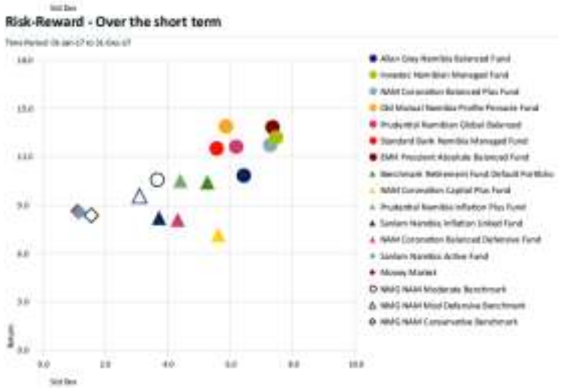


Graph 1.10



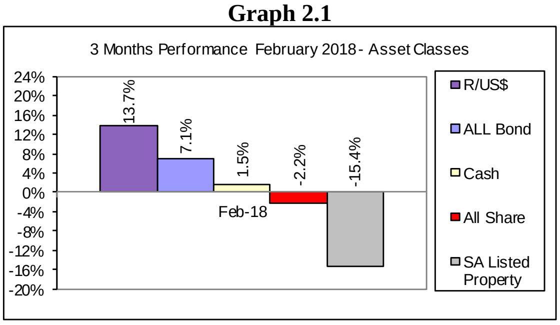
Risk/ Return



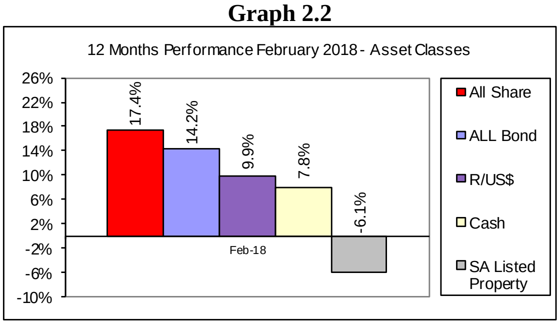


2. **Performance of Key Indices** (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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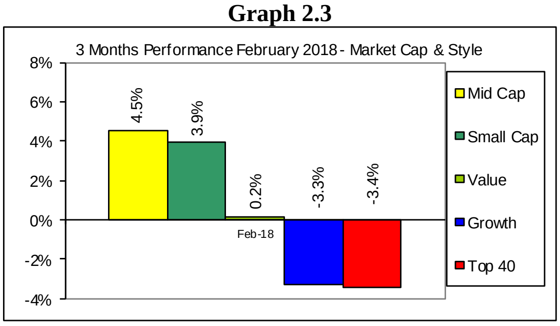
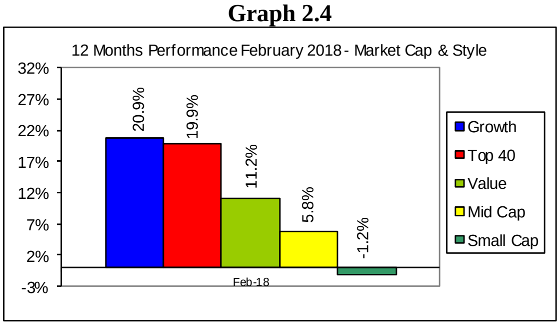
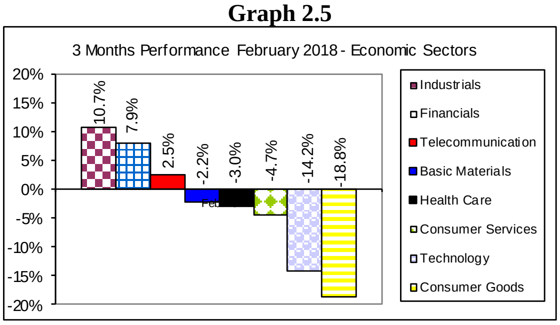
Graph 2.3



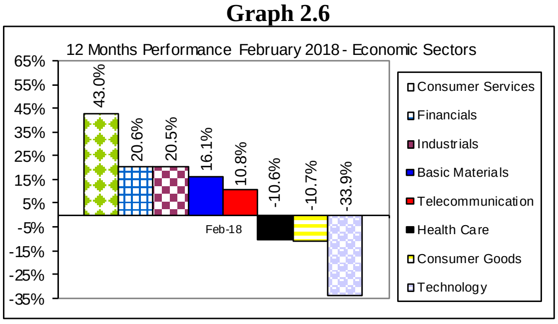
Graph 2.4



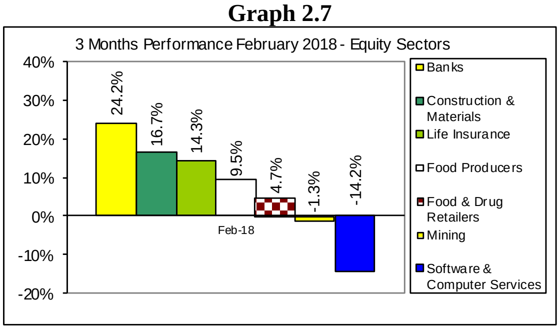
Graph 2.5



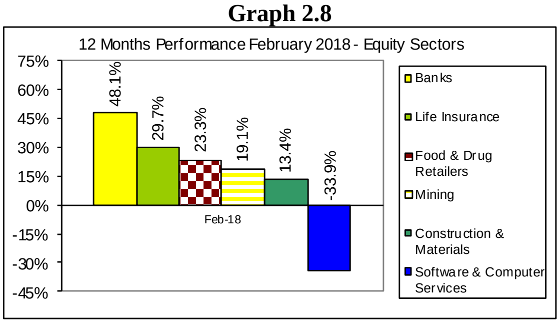
Graph 2.6



Graph 2.7



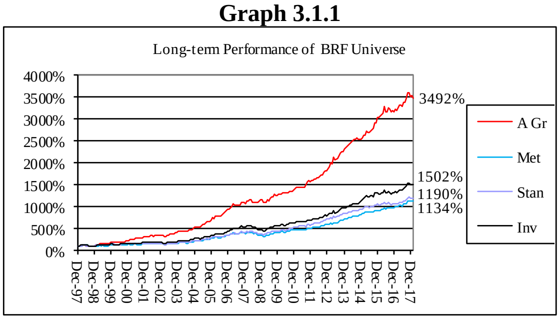
Graph 2.8



3. Portfolio Performance Analysis

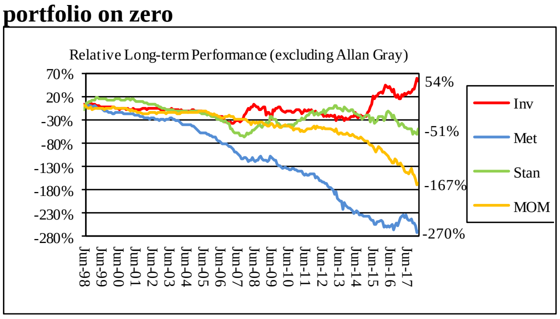
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

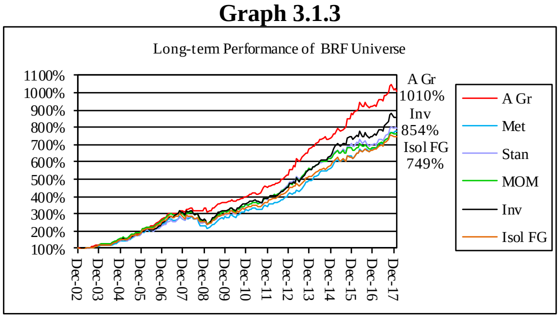


Graph 3.1.2

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



Graph 3.1.3



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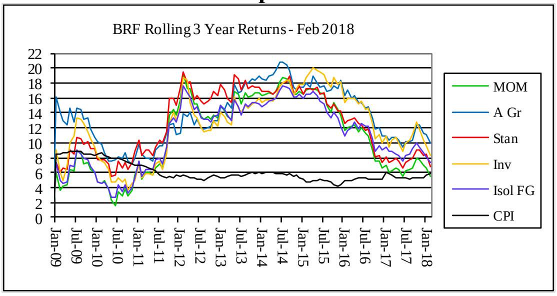
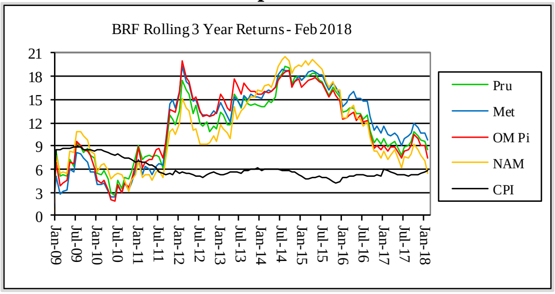
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

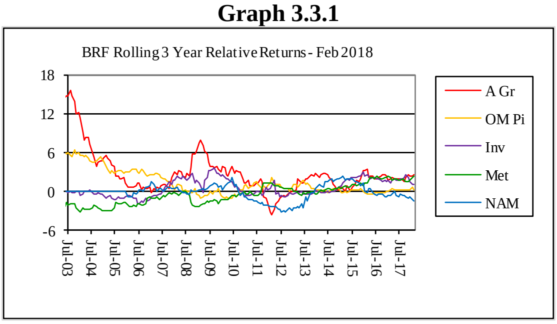


Graph 3.2.2

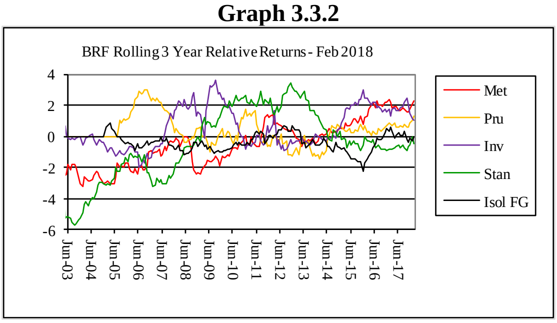


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

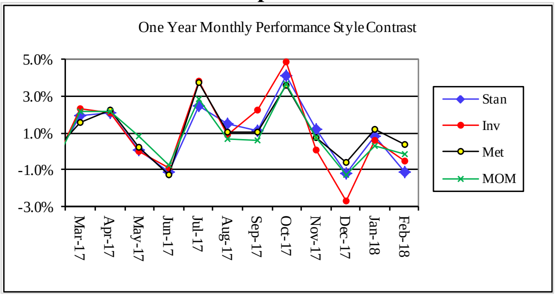


Graph 3.3.2

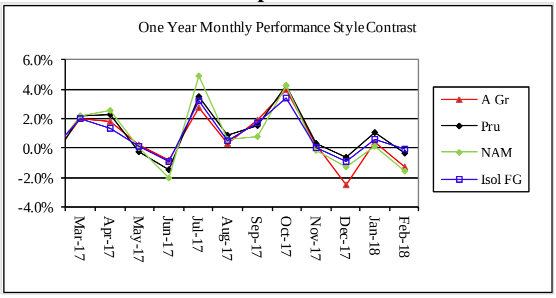


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

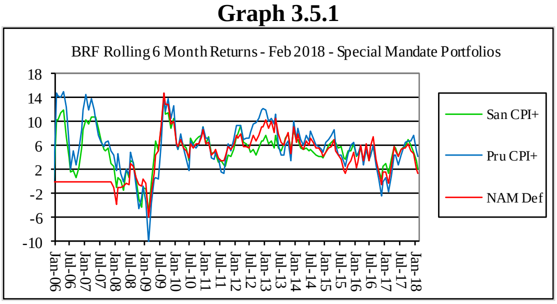


Graph 3.4.2

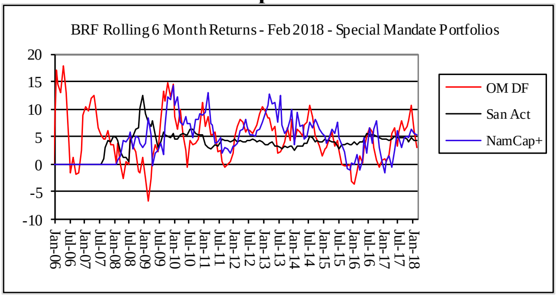


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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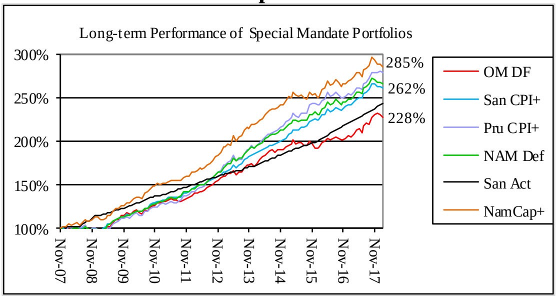
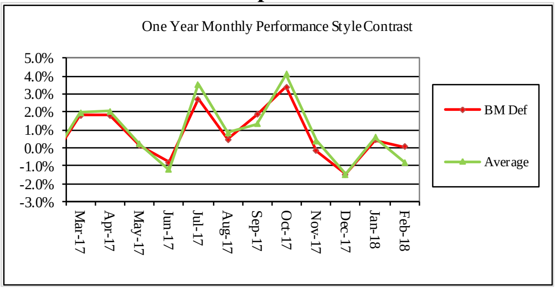
Graph 3.5.3

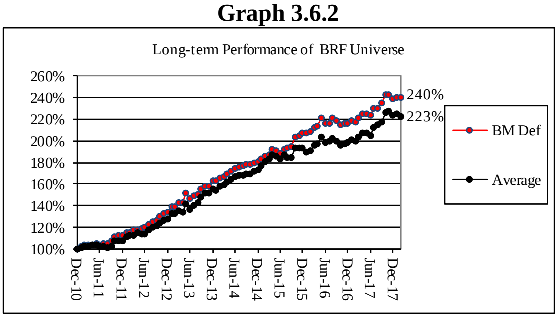


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

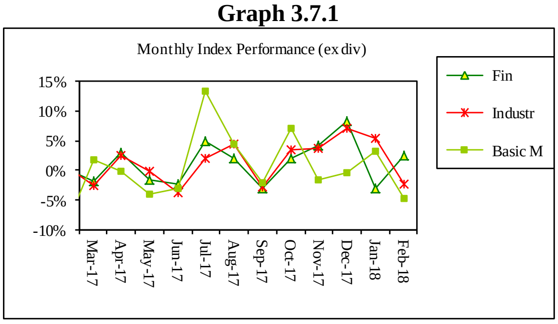


Graph 3.6.2

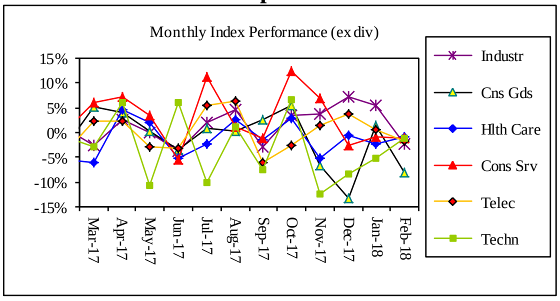


3.7 One year monthly performance of key indices (excluding dividends)

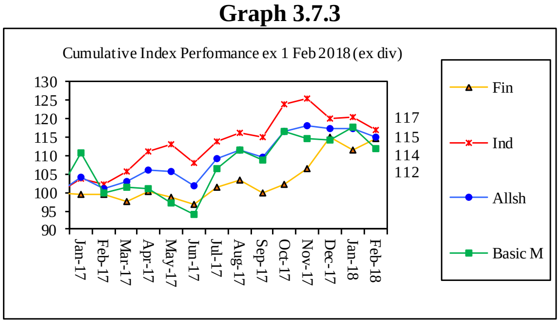
Graph 3.7.1



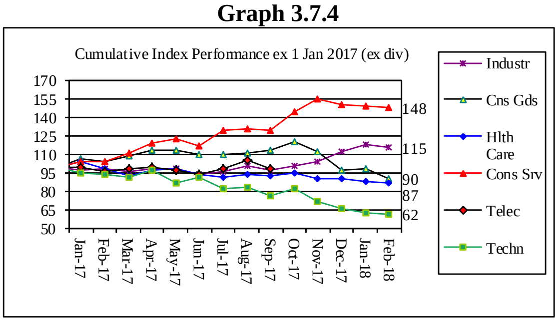
Graph 3.7.2



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.	11.6	11.1
5 year real return - % p.a.	6.3	5.8
Equity exposure - % of portfolio (qtr end Dec 2017)	47.8	61.1
Cumulative return ex Jan 2011	140.2	123.1
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

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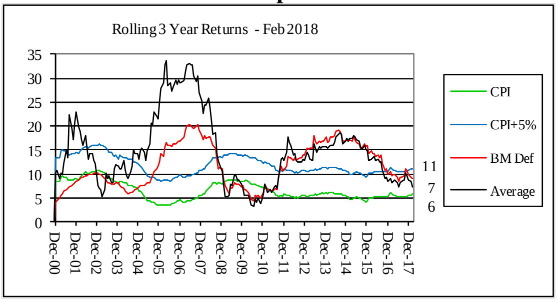
Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.8%	8.5%	7.2%
Best annual performance	7.9%	17.8%	18.0%
No of negative 1 year periods	n/a	0	0
Average of negative 1 year periods	n/a	n/a	n/a
Average of positive 1 year periods	6.8%	12.7%	11.8%

The table above presents one year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years March 2015 to February 2018. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4

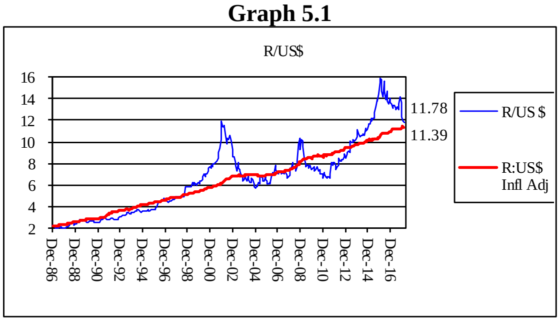


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3 year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3 year CPI. The Benchmark default portfolio 3 year return to end February was 8.94%, the average was 7.25% vs CPI plus 5% currently on 11.11%.

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 11.39 to the US Dollar while it actually stood at 11.78 at the end of February. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

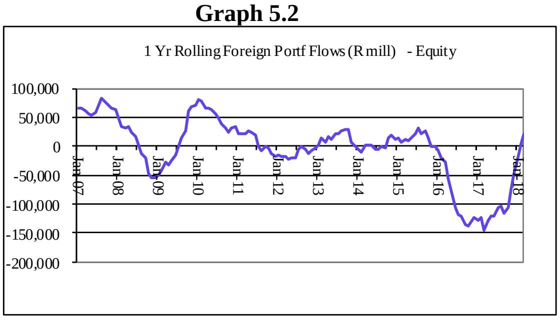


The Rand strengthened by 0.80% in February with net foreign investment inflows into bonds and equities of R 25.0 bn. Over the past 12 months the Rand strengthened by 9.89%. Net inflows of foreign capital into equity and fixed interest securities over the past 12 months amounted to R 61.9 bn (inflow of R 30.7 bn to end January 2018).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 373 bn (January R 348 bn).

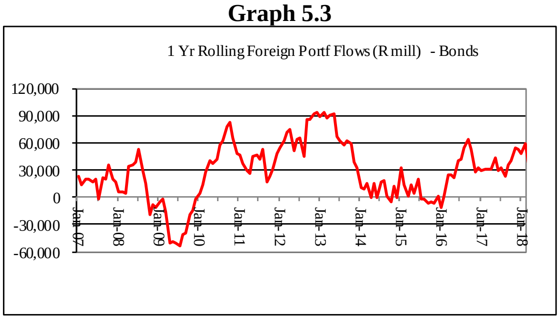
Graph 5.2 reflects a net inflow of capital from South African equities on a rolling one year basis, of R3.4 bn at the end of February (outflow of R 17.1 bn year-on-year to end January). The month of February experienced a net inflow of R 11.4 bn. Since the beginning of 2006, foreign net disinvestment from equities amounts to R 35.6 bn (end January net investment of R 24.2 bn). This represents roughly 0.24% 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 58.4 bn over the past 12 months to end of February (inflow of R 47.8 bn over the 12 months to end of January). The month of February experienced a net inflow of R 13.6 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 337.5 bn (to January R 323.8 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 11.4% 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 3.2% p.a. over this period,

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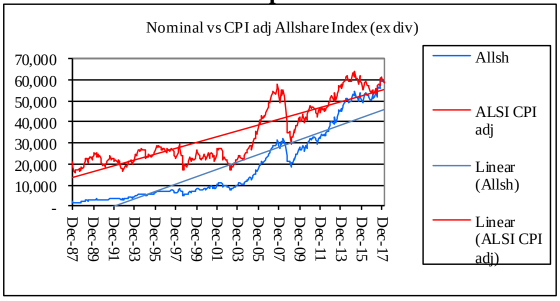
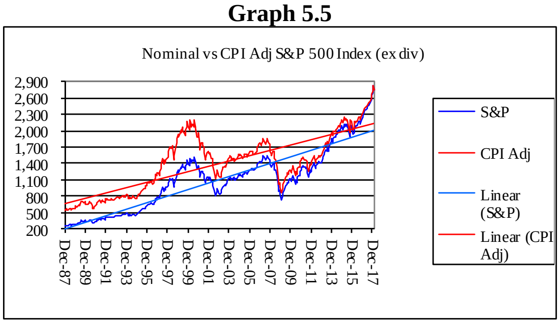
excluding dividends, or around 6.3% including dividends.

Graph 5.4



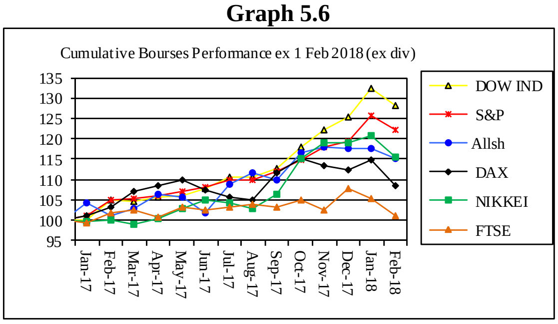
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.7% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 5.1% p.a. over this period, excluding dividends.

Graph 5.5



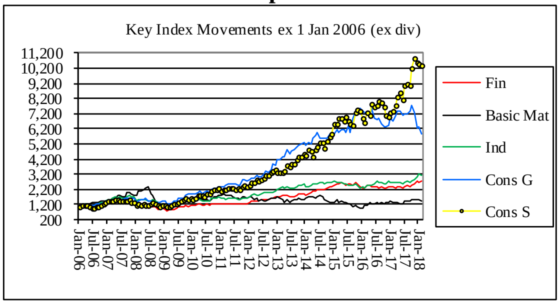
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the Dow Jones as the top performing index indices since the start of 2017.

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: 21.3%; Consumer Goods: 15.5%; Industrials: 9.9%; Financials: 8.5%; and Basic Materials: 3.1%.

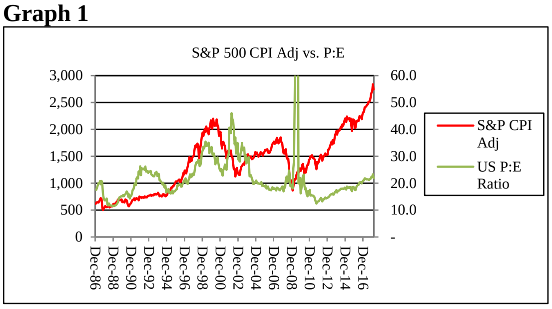
Graph 5.7



6. **Why should we be concerned about the prospect of the US equity market?**
by Tilman Friedrich

Many experts are - and have been for quite some time - deeply concerned about the severely inflated levels of the US equity market. In the March newsletter (Benchtest 03.2017) we present an article titled 'Mother of all yield shocks is about to crush stocks' wherein David Stockman, the so-called "Father of Reaganomics," hasn't been shy — or close to right — about his frantically bearish calls in recent years. This justified concern is supported by graph 1 below. The red line depicts the growth of the S&P 500 over the past 31 years, and this in US CPI adjusted terms, thus removing the impact of inflation. Clearly the S&P 500 lingers at dizzy heights of around 2,700. The green line depicts the price: earnings ratio of the S&P 500. This puts the movements in the S&P 500 index into some context. What is evident from this graph is that the growth of the index has been largely supported by growth in earnings up until 2009. While earnings have picked up since the end of the financial crisis in 2009 the divergence between the two lines is now massive meaning that investors in the S&P 500 are today prepared to pay more than twice the multiple of earnings for the index than they have in general been over the past 30 plus years. On that basis the index should rather be in the region of 1,500!

Graph 1



Having said this the article in our Benchtest 03.2017, headed 'How tax reforms will net the US big returns' reports that big US corporates are sitting on a huge offshore cash stockpile of US$ 1 billion much of which is likely to be repatriated to the US under the tax reforms.

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Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 28 FEBRUARY 2018

By T H Friedrich – Managing Director, Retirement Fund Solutions Namibia (Pty) Ltd

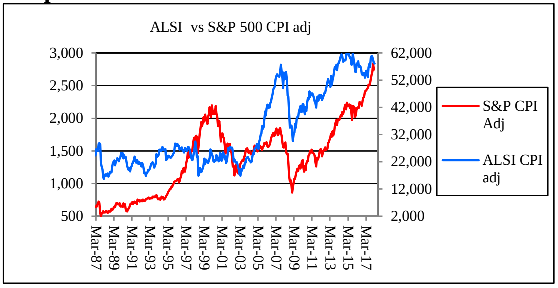
The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

This will clearly provide an underpin to US financial markets, meaning support of US equities and bonds, which in turn will put a lid on interest rate increases in the US.

We know that investors across the globe were driven out of fixed interest investments as the result of quantitative easing having kept interest rates at artificially low levels, often at negative real rates. We are also aware by now that the US Fed is now on a drive to contract its balance sheet by selling bonds back into the market. It has started to raise the Fed rate by 0.25% at a time three times since March 2017, to now 1.75% and has given notice that more interest rate hikes are lying ahead. It has typically been maintaining this rate at around 1% above US inflation. US inflation is currently running at 2.2%. This indicates that the Fed rate still needs to be increase to around to more normal levels of 3.2% based on current inflation levels. The US 10 year bond offered a real return of around 1.5% until the financial crisis. Currently it is at around 2.9% representing a real return of 0.5%. Both these rates indicate that US interest rates are not attractive to the investor and have to still rise meaningfully before they will present attractive returns to the investor once again. Until then investors will continue to look for alternative investment opportunities such as equities. However, equities being as high as they are in the US, investors are likely to snoop around for opportunities elsewhere.

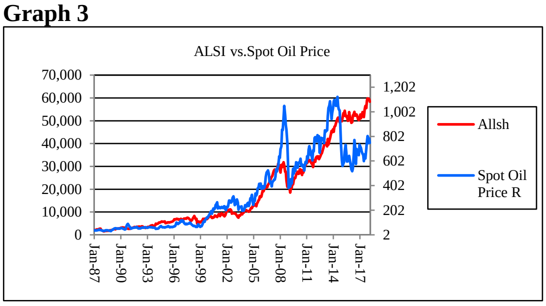
So what, you may think. Why should you be concerned about the prospects of the US equity market? Well, firstly, your asset manager/s are likely to invest around half their foreign investments in the US and most of this in the US equity market, considering that the US economy represents around 25% of the global economy and around 40% of global market capitalization. In all probability around 15% of your pension money will be invested in US equities. If you now look at graph 2 below, we will show why you should be concerned about what is happening in the US. The blue line depicts the SA Allshare Index while the red line depicts the S&P 500 index. Both data sets are adjusted for the impact of domestic inflation. You will note that these lines are quite closely correlated and since the dog usually wags the tail and not vise-versa, the US market calls the shots and our market tends to respond. Thus if the US market were to correct to a more normal level of say 1,500, the SA equity market should move in sympathy and this could be a significant downward adjustment! Considering that your asset manager is likely to hold around 25% in SA, mostly in equity, between 30% and 40% of your investment is at risk in the event of a steep correction in the US market! Of course the Namibia equity market comprising largely of dual listed South African shares and will thus move with the SA equity market

Graph 2



Looking at the SA equity market from another perspective our views as reflected above seem to be corroborated by the picture presented by graph 3 below. The blue line depicts the Brent Crude spot price and the red line the SA Allshare Index, over the past 30 plus years. For most of the time these two lines have been virtually on top of each other until the middle of 2014 when the spot price of crude collapsed. While the trend of these two lines since the collapse of the crude price has been similar the two lines currently diverge widely. To converge again either the price of crude would have to increase by around 40% from its current level of US$ 65 to around US$ 90 per barrel, or the Rand would have to weaken to around 16.6 to the US Dollar, or the Allshare index would have to decline by 35% to around 45,000, or a combination of the factors would have to occur. The US Dollar price of crude oil inflation adjusted has shown very pedestrian growth over many years. To some extent and more recently this has been result of lower production costs of the fracking process. This is likely to keep a lid on the price of crude for some time to come. We do not expect that the current strength of the Rand is sustainable particularly in view of global interest rates being on the incline while SA is still aiming for a rate reduction. It is unlikely though that it will fall to 16.5 to the US Dollar. This means that the SA Allshare Index presents a fair risk of a downward correction.

Graph 3



Conclusion

We believe that equities present a risk of either a steep, or a long drawn-out correction as interest rates in the US are moving to more normal levels again. Going by the Fed's forewarnings, and everything else being equal, one is probably looking at another one to two years until we will reach the point where fixed interest investments once again offer a fair risk adjusted return and where investors will rebalance their portfolios away from equities to fixed interest. In the meantime we expect equities to continue moving sideways and markets to become more volatile. We do not see any conventional asset class that is equities, property, bonds and cash that offers exiting prospects in the near future. Solid companies purchased at fair value should be able to produce reasonable real returns although we retain our equity bias. This should be the time for stock pickers who can identify value in the universe of the various asset classes.

The strong Rand still offers an opportunity to diversify offshore. In the light of announced changes to regulation 28 that require the Namibian exposure of pension fund investments to be lifted to 45%, the investor faces the dilemma of investments being highly concentrated in Namibia. The SA allocation will effectively be restricted to 25%, the balance of 30% invested offshore. This in itself presents an imbalance in the typical pension fund portfolio, too much being required to be invested in Namibia. Discretionary assets should thus now be expatriated to improve this imbalance.

Amongst the various equity sectors, commodities have been in the doldrums for quite some time now and should benefit from a slowly improving global economy and are thus expected to offer fair prospects for 2018. The expected improvement in consumer sentiment should benefit industrials and consumer goods and services.

7. Important notice and disclaimer

Whilst we have taken all reasonable measures to ensure that the results reflected herein are correct, Benchmark Retirement Fund and Retirement Fund Solutions Namibia (Pty) Ltd do not accept any liability for the accuracy of the information and no decision should be taken on the basis of the information contained herein before having confirmed the detail with the relevant portfolio manager. The views expressed herein are those of the author and not necessarily those of Benchmark Retirement Fund or Retirement Fund Solutions.