Volume 14, No. 12
December 2018

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 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

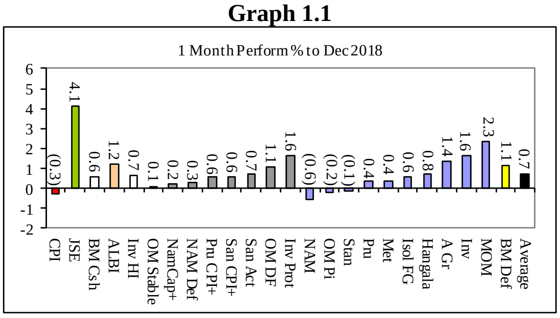
In December 2018 the average prudential balanced portfolio returned 0.74% (November 2018: -1.73%). Top performer is Momentum (2.33%); while Namibia Asset Management (-0.56%) takes the bottom spot. For the 3-month period, Momentum takes top spot, outperforming the 'average' by roughly 1.74%. On the other end of the scale Namibia Asset Management underperformed the 'average' by 2.50%.

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.

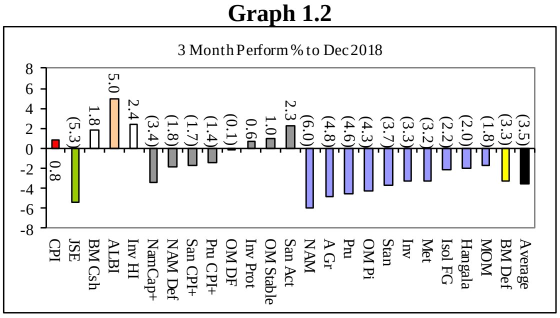
Below is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Consumer Price Index	CPI (red)
All Bond Index	ALBI (orange)
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)
Hangala Prescient Absolute Balanced	Hangala (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 Namibia Growth	MOM (blue)
Stanlib Managed	Stan (blue)
Investment Solutions Bal Growth (multimanager)	Isol FG (blue)

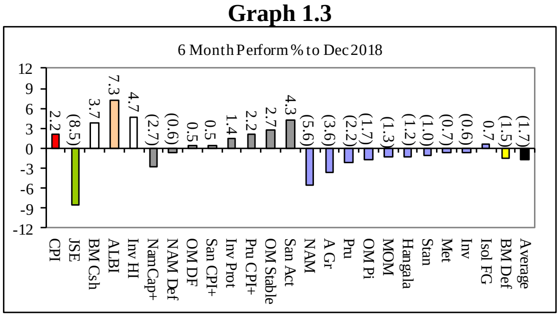
Graph 1.1



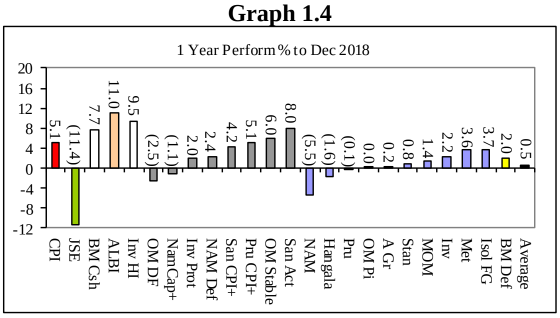
Graph 1.2



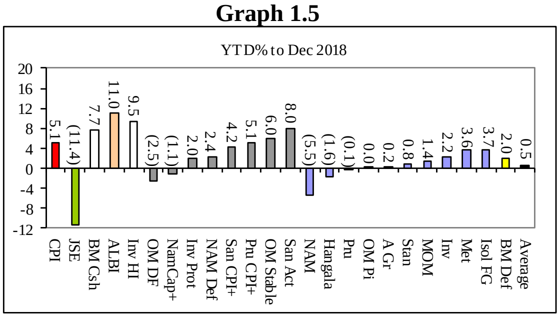
Graph 1.3



Graph 1.4



Graph 1.5



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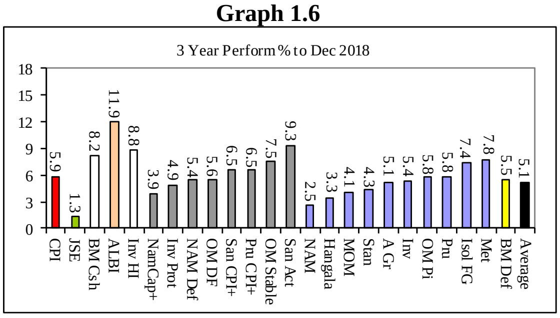
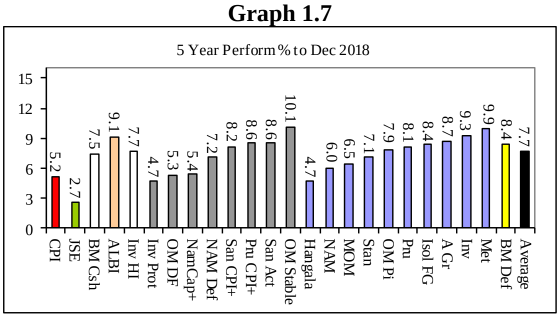
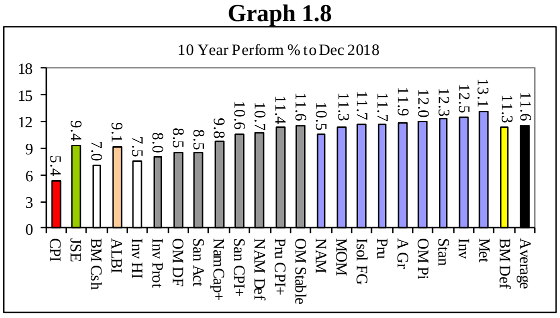
Graph 1.6



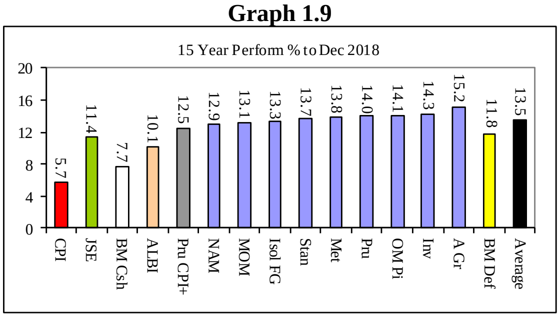
Graph 1.7



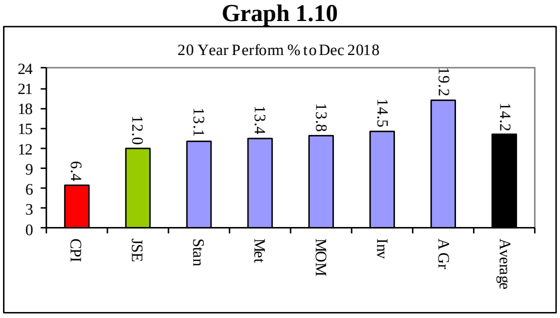
Graph 1.8



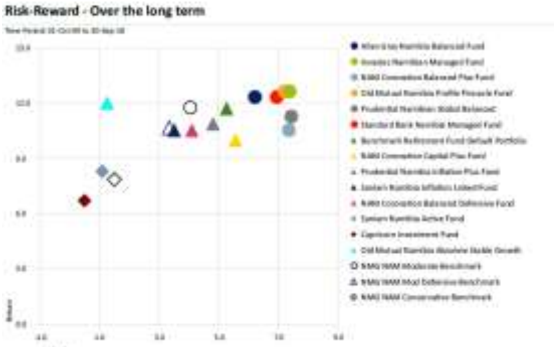
Graph 1.9

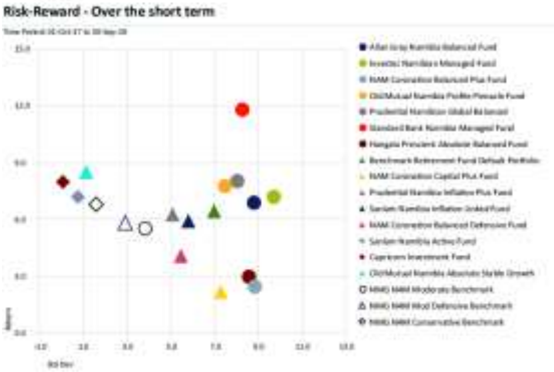


Graph 1.10



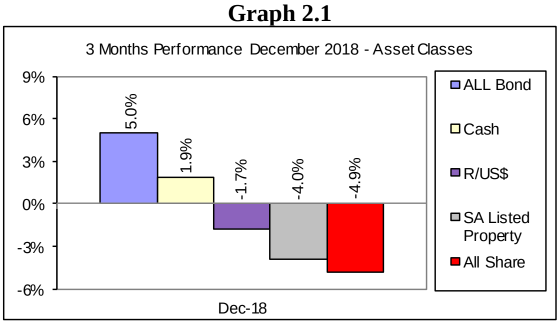
Risk/ Return



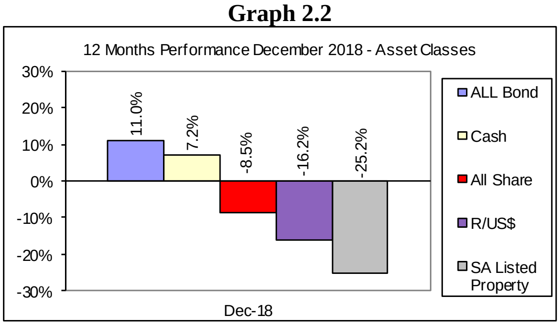


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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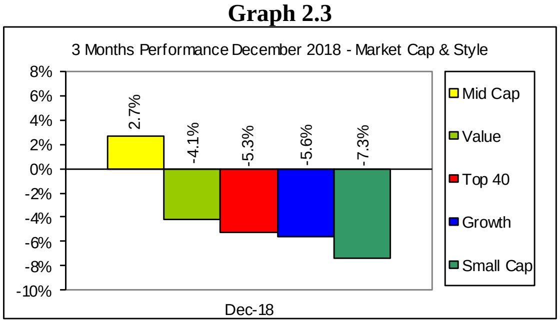
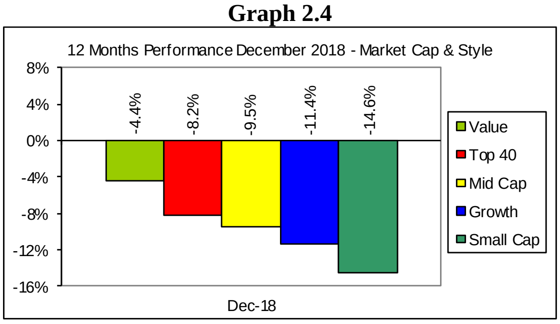
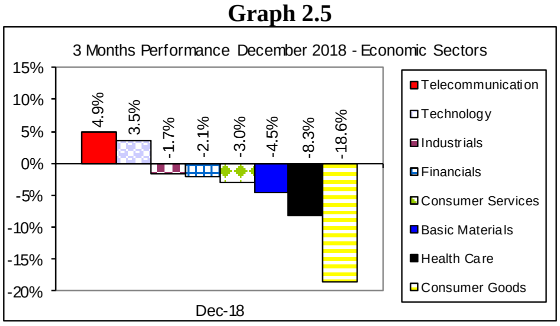
Graph 2.3



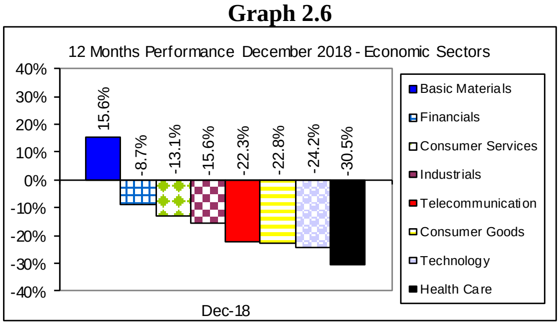
Graph 2.4



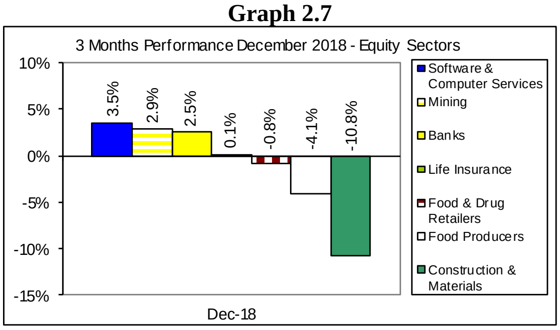
Graph 2.5



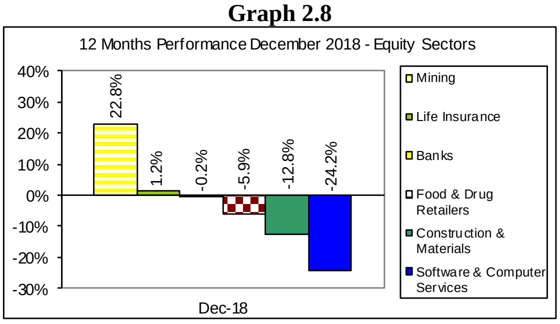
Graph 2.6



Graph 2.7



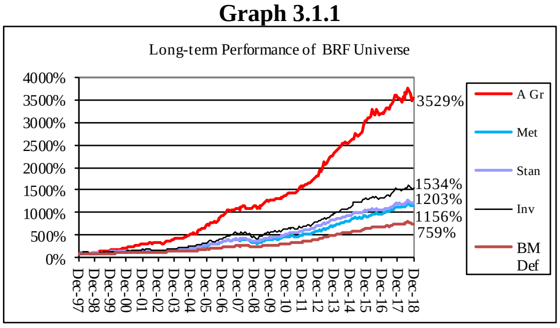
Graph 2.8



3. Portfolio Performance Analysis

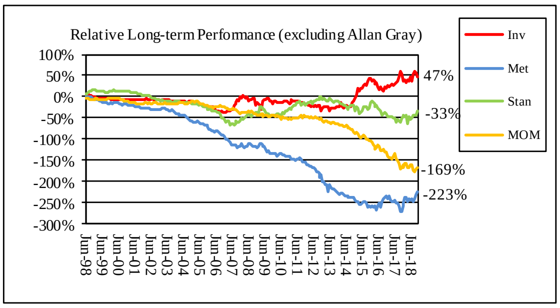
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

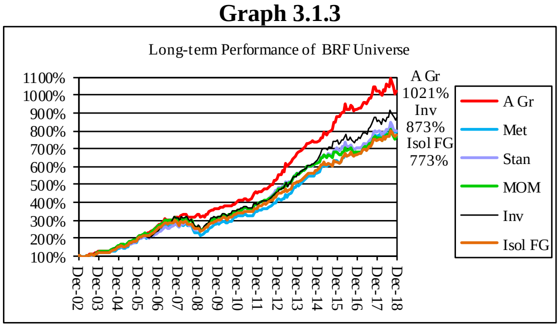


Graph 3.1.2

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



Graph 3.1.3



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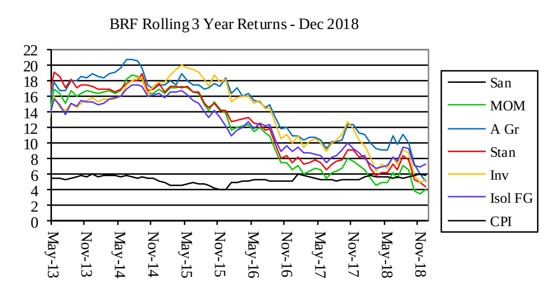
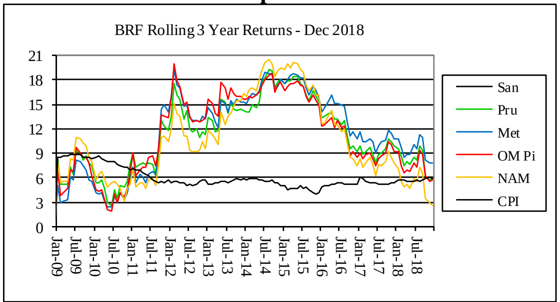
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

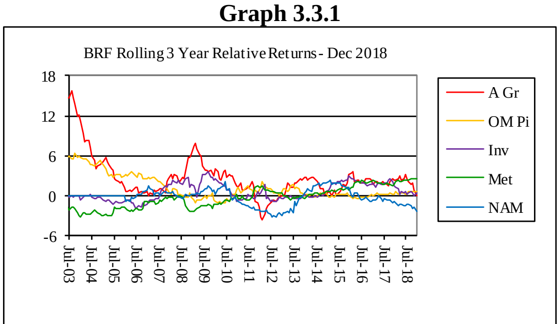


Graph 3.2.2

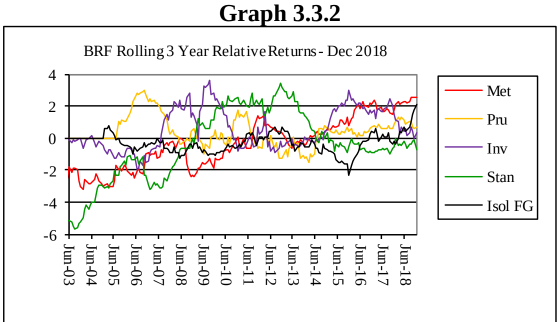


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

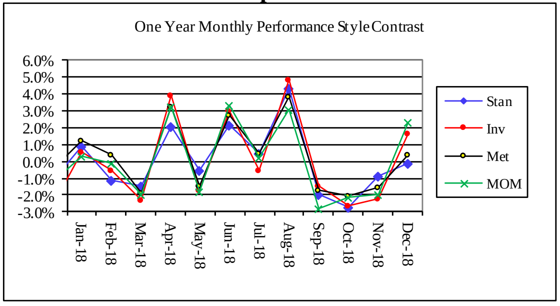


Graph 3.3.2

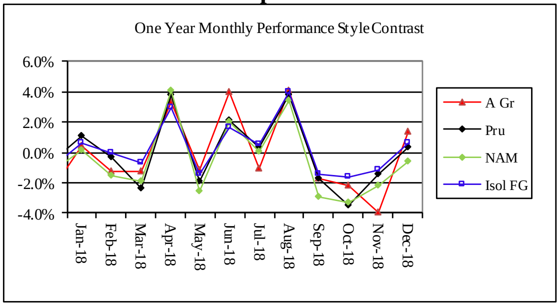


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

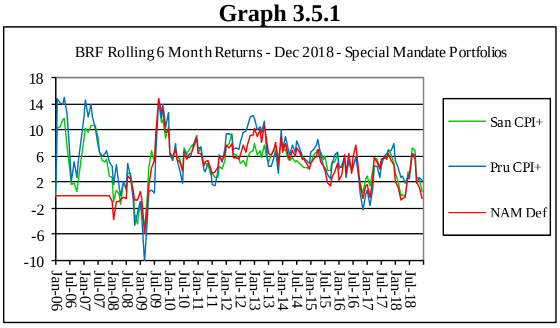


Graph 3.4.2

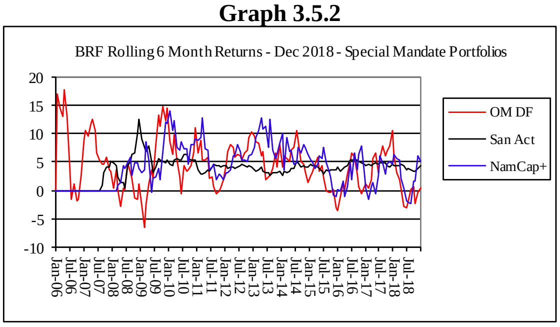


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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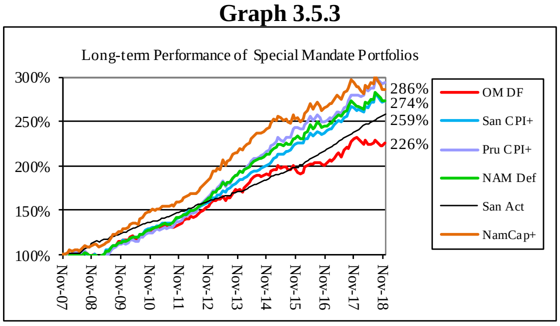
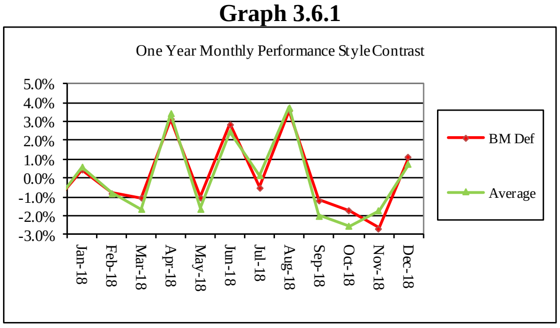
Graph 3.5.3

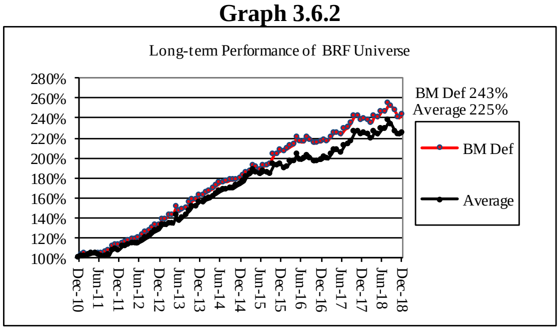


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

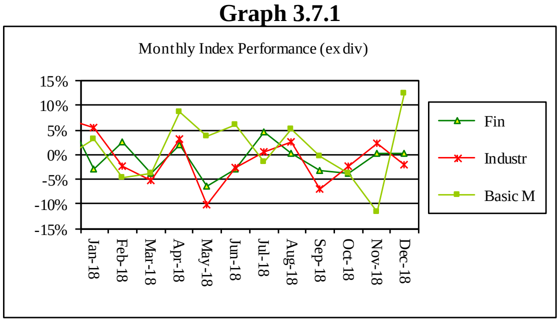


Graph 3.6.2

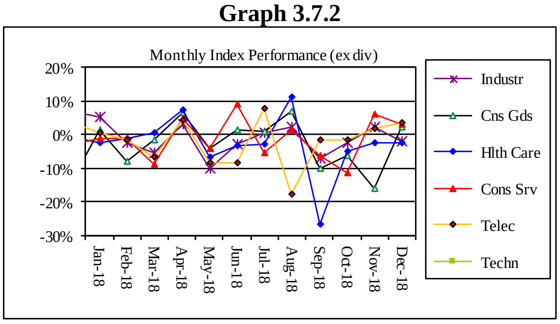


3.7 One-year monthly performance of key indices (excluding dividends)

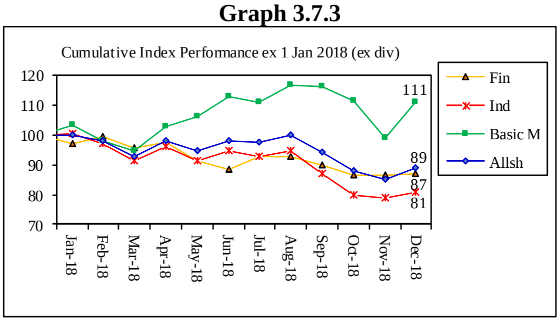
Graph 3.7.1



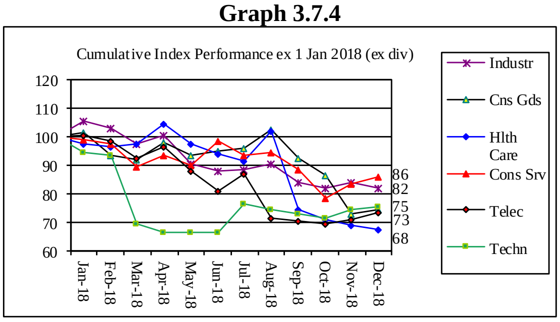
Graph 3.7.2



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.	8.4	7.7
5-year real return - % p.a.	3.2	2.5
Equity exposure - % of portfolio (qtr end September 2018)	45.4	70.2
Cumulative return ex Jan 2011	143.3	124.8
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.

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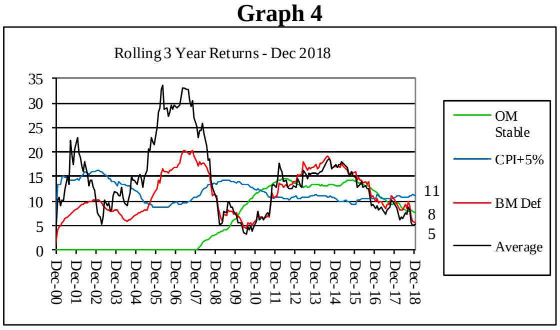
Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.1%	5.5%	5.0%
Best annual performance	8.2%	14.7%	13.8%
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	7.4%	10.3%	9.1%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years January 2016 to December 2018. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4

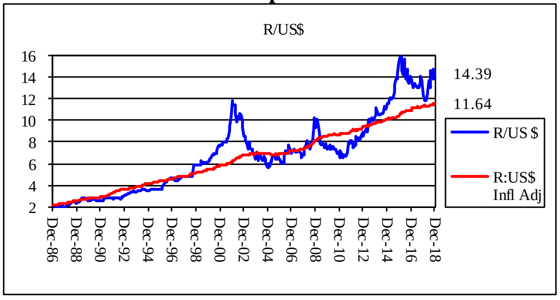


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end December was 5.5%, the average was 5.1% vs CPI plus 5% currently on 10.9%.

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 11.64 to the US Dollar while it actually stood at 14.39 at the end of December. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

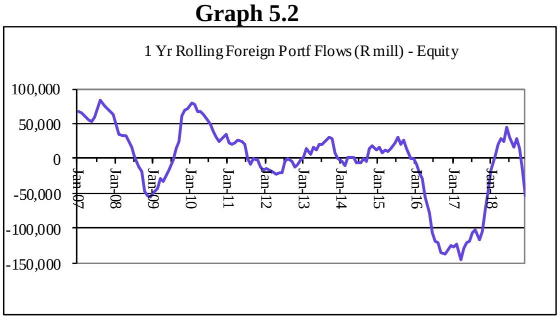


The Rand weakened by 3.8% in December with net foreign investment outflows from bonds and equities of R 27.6 bn. Over the past 12 months the Rand weakened by 16.2%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 118.4 bn (outflow of R72.4 bn to end November 2018).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 222.9 bn (November R 250.5 bn).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R52.8 bn at the end of December (outflow of R 16.7 bn year-on-year to end November). The month of December experienced a net outflow of R 12.1 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 44.1 bn (end November net investment outflow of R 31.9 bn). This represents roughly 0.34% of the market capitalization of the JSE.

Graph 5.2



Graph 5.3 on a rolling one-year basis reflects foreign portfolio outflows in respect of SA bonds of R 65.6 bn over the past 12 months to end of December (outflow of R 55.7 bn over the 12 months to end of November). The month of December experienced a net outflow of R 15.5 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 266.9 bn (to November R 282.5 bn).

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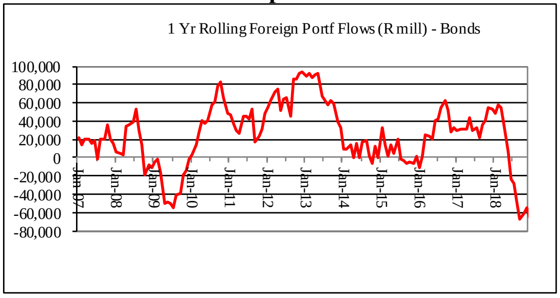
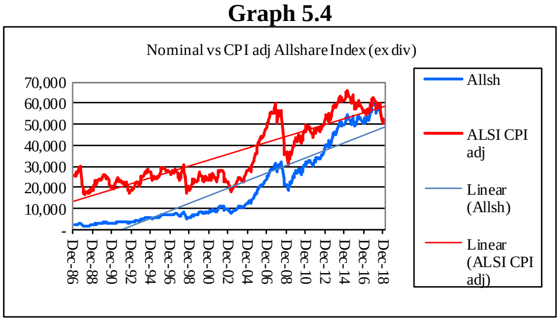
Graph 5.3



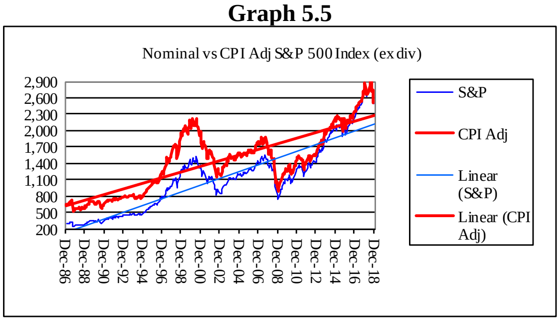
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.8% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.1% per year. This is equivalent to a growth in real terms of 2.7% p.a. over this period, excluding dividends, or around 5.7% including dividends.

Graph 5.4



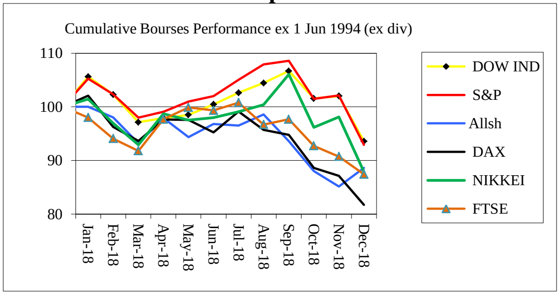
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.1% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.5% p.a. over this period, excluding dividends or around 6.7% including dividends.

Graph 5.5



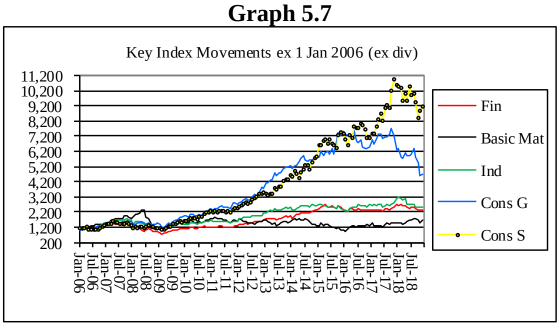
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018, yet still down by over 6% for the year.

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: 18.4%; Consumer Goods: 12.5%; Industrials: 7.3%; Financials: 6.8%; and Basic Materials: 3.9%.

Graph 5.7



6. Can you currently invest anywhere but in cash?

by Tilman Friedrich

The US Repo rate is currently 2.25%.While the US In this month's commentary we continue the discussion on the US repo rate and its implications for global financial markets and therefor on investment decisions. What is the risk of investing anywhere other than cash now and in which asset class can you otherwise invest? We have in last month's commentary shown how closely correlated the SA interest rates and the JSE is to its US equivalents. Fiscal policy is driven primarily by the state of the economy which drives inflation and the tools used to drive policy are interest rates and the supply of money to the market. If the economy overheats inflation rises and this will result in the lifting of the Fedrate (or repo rate in SA). If the economy is moving into recession, the Fed will attempt to stimulate it by dropping its policy rate. Inflation will follow the decline in the economy.

When the global financial crisis struck at the end of 2007, the US economy turned into recession. The Federal Reserve responded by lowering its policy rate from 5.25% in July 2007 to 0.25% in December 2008, and by flooding the market with money, in order to support the

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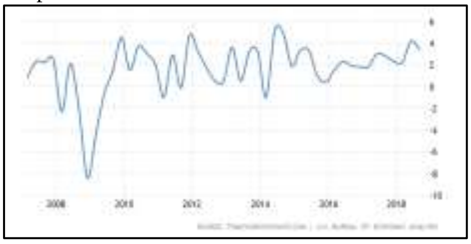
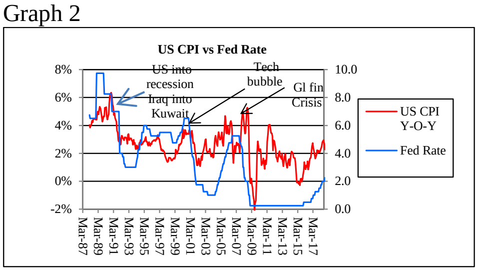
economy. GDP did recover rapidly out of negative territory up until the middle of 2009 to peak at just below 6% in quarter 2 of 2014. Since then it has declined steeply to steady at around 2% barring a blip taking it to just over 4% in the middle of 2018, probably the result of changes to US tax laws (refer graph 1).

Graph 1



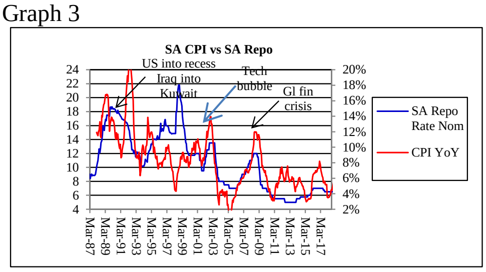
Over the past just over 30 years the US Fed Rate was on average around 0.7% above inflation. However, excluding the period since the start of the global financial crisis from December 2007 to date the differential was 1.7%. Graph 2 shows how well correlated these two metrics have been since 1987 (Fed Rate measured on the right hand axis) but it shows a large gap between these currently. The graph also confirms that a 2% shift between the two axes produces a good fit of the two lines. The gap between these two lines can close through a decline in inflation or an increase in the Fed Rate or both. As things stand, it seems that the Fed has stalled further rate increases for the time being while the inflation rate is on a downward slide. This is not what the Fed wants to see as it means that the economy is in reverse gear and therefor it cannot afford to lift the Fed Rate, the chance being that it will be reduced if inflation continues to sag. Currently the differential between the Fed Rate (2.5%) and US annual inflation (1.9%) is 0.6%. This is still around 1% lower than the long term average.

Graph 2



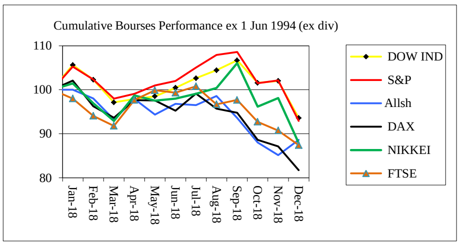
Tracking the red (CPI) lines and the blue (policy rate) lines in graph 2 and 3, it is indeed surprising how closely they resemble the other, as I referred to in last month's column, "the dog wags the tail". Note that on graph 3 the SA Repo is measured on the left hand axis and the CPI (Namibian) on the right hand axis. Evidently SA had nothing to do with global politics, e.g. Kuwait invading Iraq or with the Tech Bubble yet our market moved in sympathy with the US market. Currently the differential between the Repo Rate (6.75%) and Namibian annual inflation (5.1%) is 1.8%. That represents a real rate of 0.6%. Over the past just over 30 years the Repo Rate was on average around2.5% above inflation. However, excluding the period of artificially low interest rates since the start of the global financial crisis, from December 2007 to date, the differential was 3.6% and this is where we have to get back to for a normalization of asset class valuations. A normalization will probably be delayed due to the state of the SA economy. Undoubtedly also due to the absence of sufficient risk premium for foreign investors, we saw R 120 billion foreign portfolio investment leaving local markets for the year 2018. To lure foreign investor into SA, the repo will have to be raised substantially. Once the Federal Reserve resumes lifting of its policy rate, SA Reserve Bank's hand will in any event be forced.

Graph 3



It is evident from the above analyses that the US Fed Rate is still around 1% off its long-term inflation differential and a normalised interest rate environment. Since the Fed has stalled further increases in its policy rate for the time being it is difficult to foresee for how long global financial markets will remain in the current state of flux but markets will definitely not show any fireworks for the next 12 months and perhaps quite a bit longer. Graph 4 shows a noticeable, negative trend in global equity markets since the beginning of 2018, the DAX leading the pack with a decline of close to 20%.

Graph 4



The question is whether we will see this continuing or whether equity markets have now bottomed out. Since 1986 SA equities now delivered a real return of only 5.7%, including dividends where the long-term expectation is 7.4%. This indicates that our equity market is now 'behind the curve' and needs to catch up again. Looking at the US equity market, the S&P 500 produced

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 DECEMBER 2018

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a real return of 6.7% including dividends which is in line with the long-term expectation of 6.5%. From that perspective, the US market does not pose a threat of a significant downward correction.

Conclusion

We believe that the normalization of interest rates has largely been factored into equity valuations already and that the risk of a further downward correction is slim. We expect normal returns from US equities and believe that SA equities need to catch up as they are behind the curve in terms of long-term returns. They should present a buying opportunity. Since there is no evidence that the global economy is busy turning around, it is difficult to identify any economic sector that might produce some fireworks over the next 12 months meaning that one should spread your investments across all economic sectors but should preferably pick companies with quality earnings and high dividend yields. In SA Consumer Goods and Consumer Services should be viewed with caution as they are still ahead of the curve having delivered stellar performance over the past 13 years, despite their more recent sharp correction.

The Rand is currently substantially undervalued and should be closer to 12 to the US Dollar. It is probably to some extent weakened through the low Repo rate that should be around 2% higher than it currently is. An increase in the Repo will be forced by an increase in the Fed Rate but that looks like an unlikely course for the next 12 months. A weak Rand should allow the local economy to pick up which is what the SA Reserve Bank would like to see. We are therefor unlikely to see a change in interest rates for the next 12 months and we are likely to see a relatively weak Rand for the next 12 months

The relatively weak Rand that holds the prospects of strengthening over the next 12 months intimates that it is not a good time to move money offshore for the purpose of diversifying one's investments although that should remain the objective of any local investor who holds more than half his wealth in Namibia.