Volume 15 No. 1
January 2019

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JANUARY 2019

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

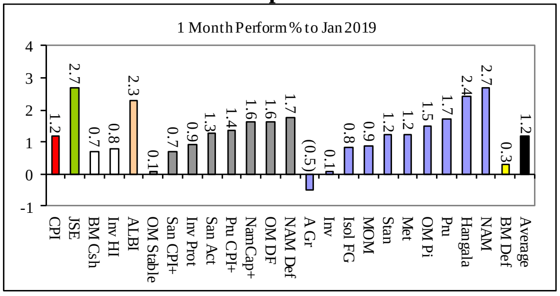
In January 2019 the average prudential balanced portfolio returned 1.2% (December 2018: 0.74%). Top performer is Namibia Asset Management Fund (2.7%); while Allan Gray Balanced Fund (-0.49%) takes the bottom spot. For the 3-month period, Hangala Prescient Absolute Balance Fund takes top spot, outperforming the 'average' by roughly 2.78%. On the other end of the scale Allan Gray Balanced Fund underperformed the 'average' by 3.25%. Note that these returns are before asset management fees.

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.

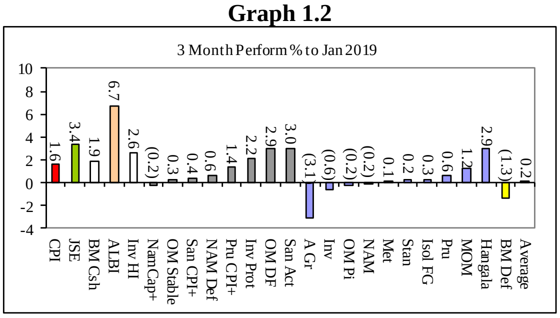
Below is the legend to the abbreviations reflected on the graphs:

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)

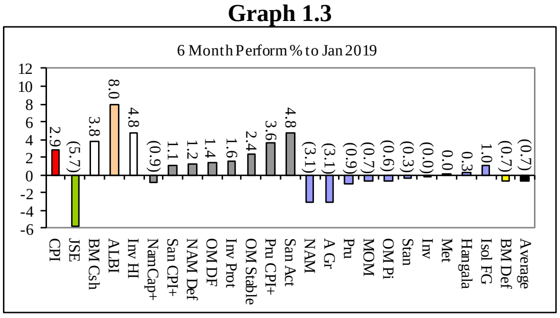
Graph 1.1



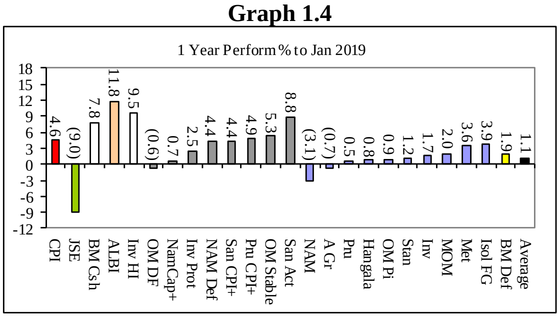
Graph 1.2



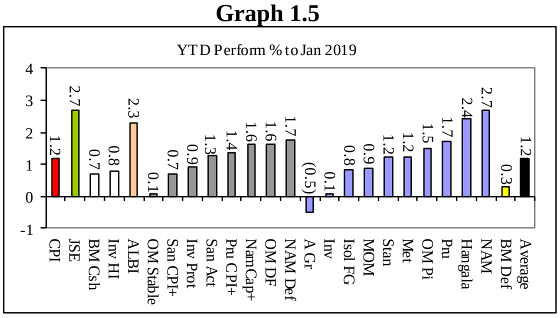
Graph 1.3



Graph 1.4



Graph 1.5



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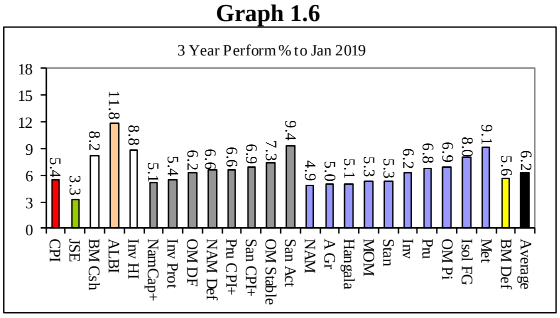
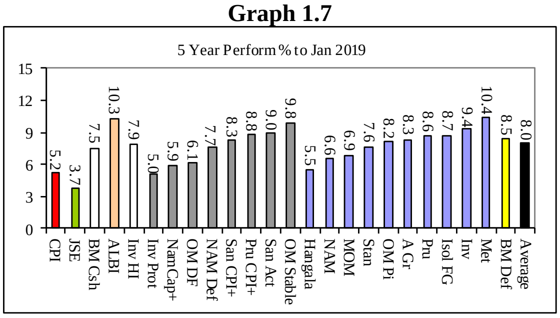
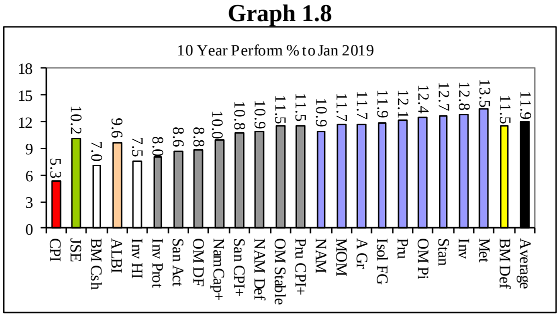
Graph 1.6



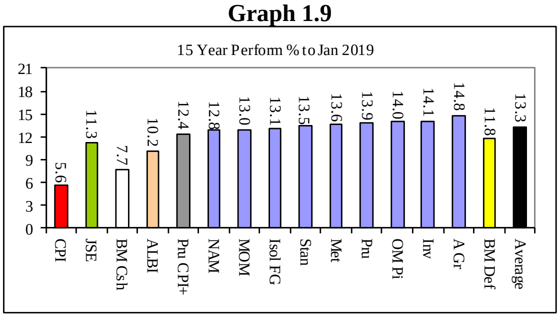
Graph 1.7



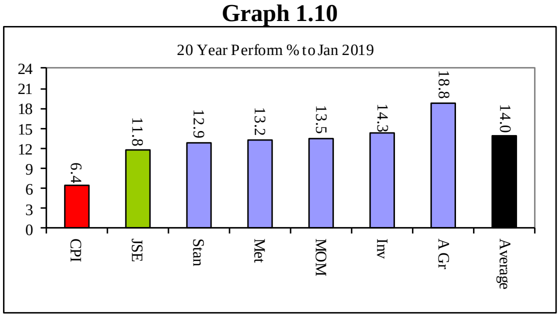
Graph 1.8



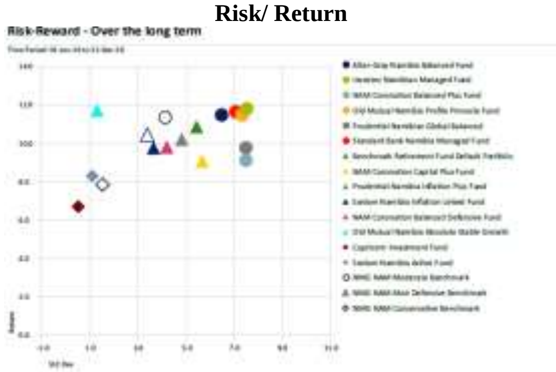
Graph 1.9

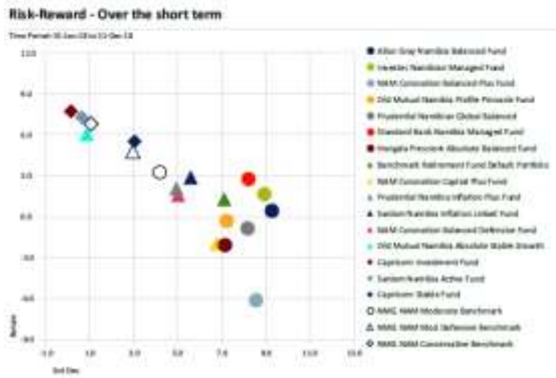


Graph 1.10



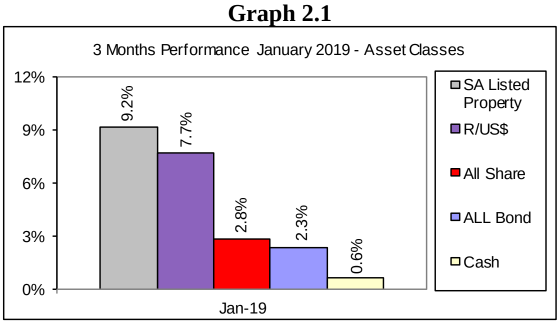
Risk/ Return



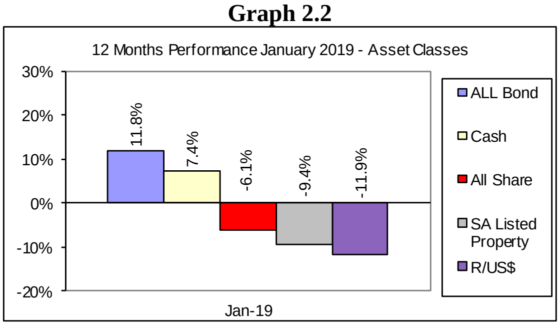


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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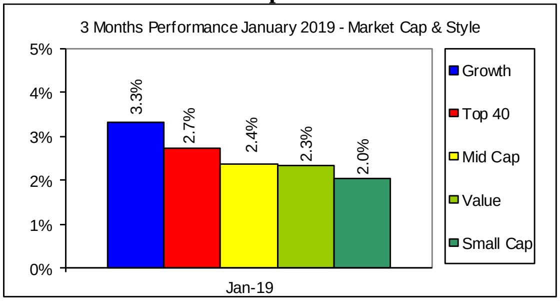
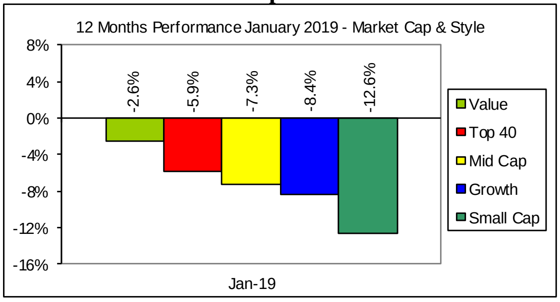
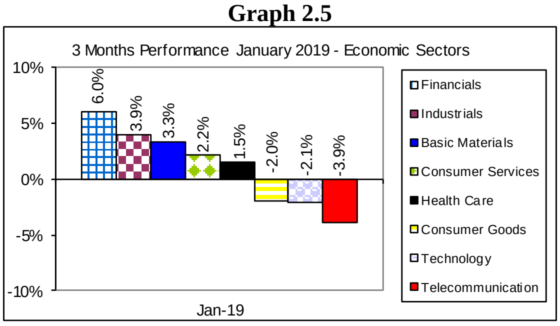
Graph 2.3



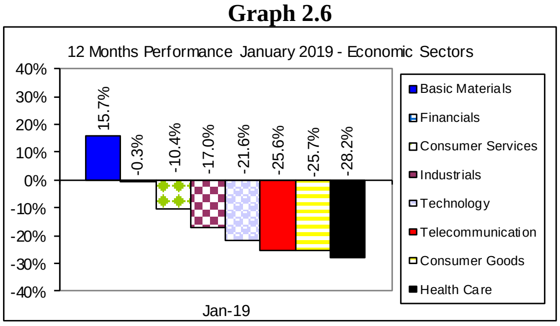
Graph 2.4



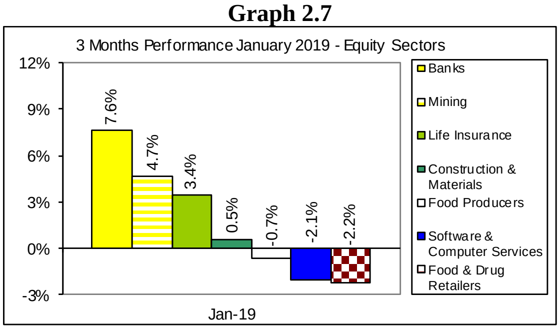
Graph 2.5



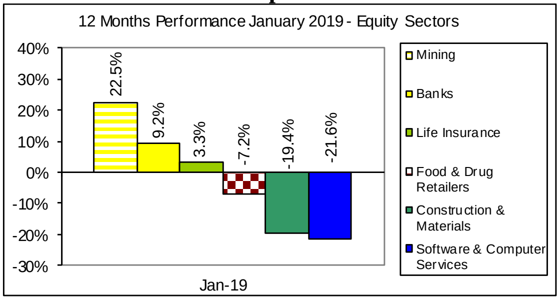
Graph 2.6



Graph 2.7



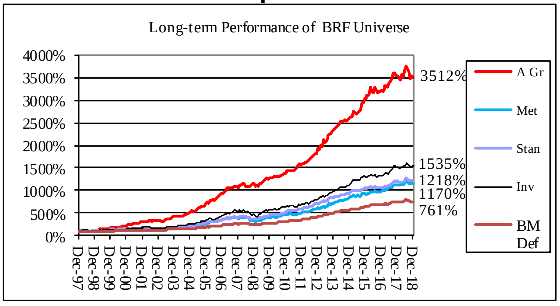
Graph 2.8



3. Portfolio Performance Analysis

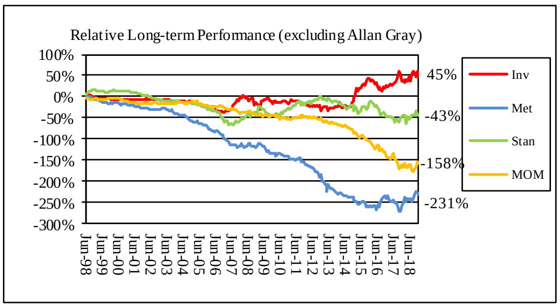
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

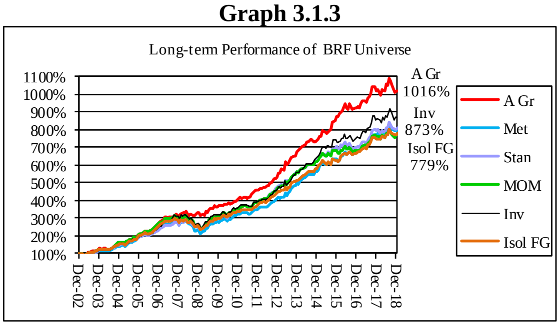


Graph 3.1.2

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



Graph 3.1.3



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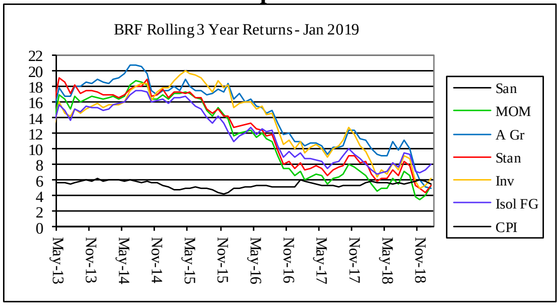
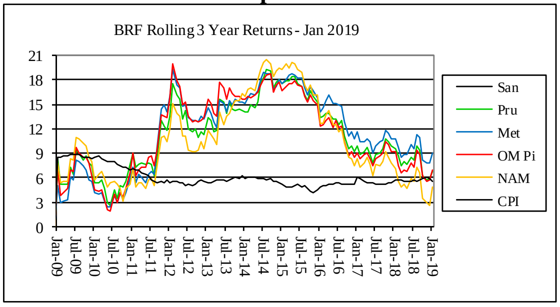
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

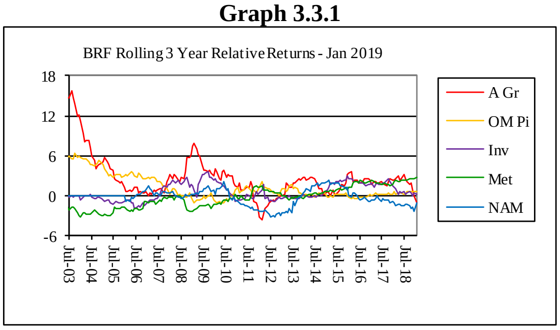


Graph 3.2.2

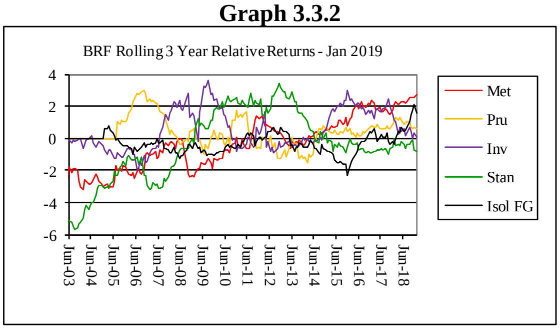


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

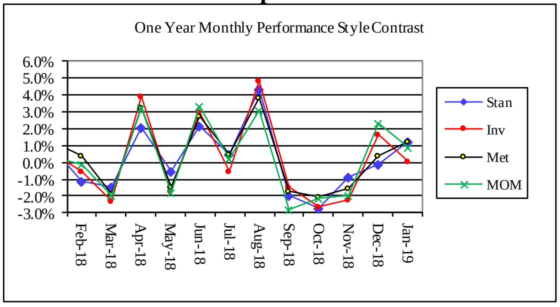


Graph 3.3.2

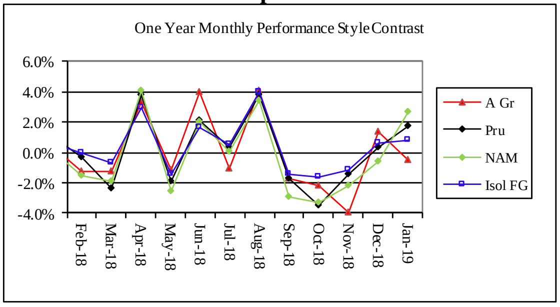


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

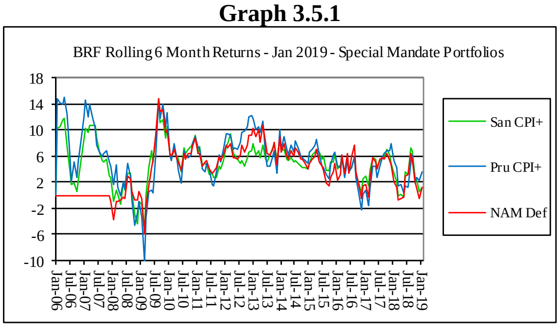


Graph 3.4.2

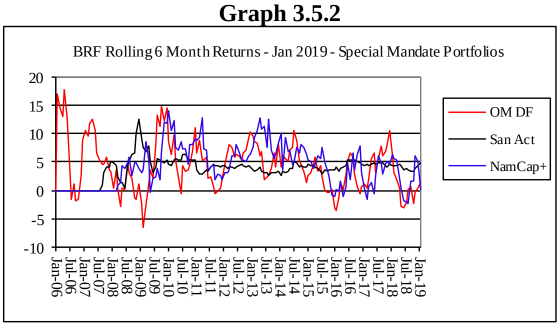


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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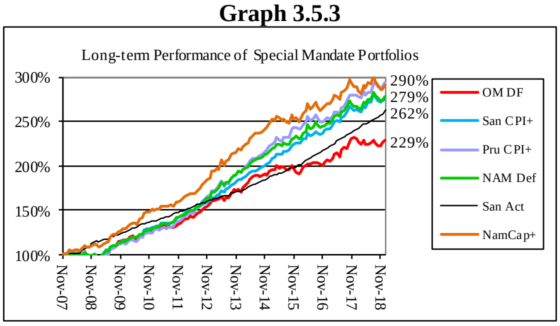
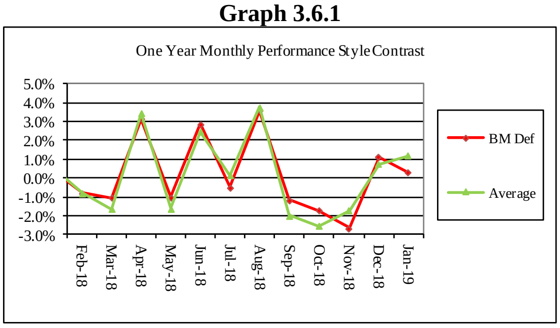
Graph 3.5.3

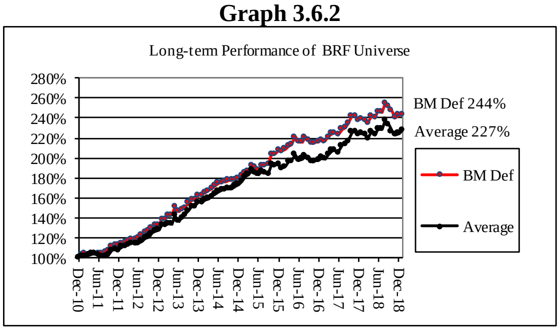


3.6 Monthly and cumulative performance of ‘Benchmark Default’ portfolio relative to average prudential balanced portfolio

Graph 3.6.1

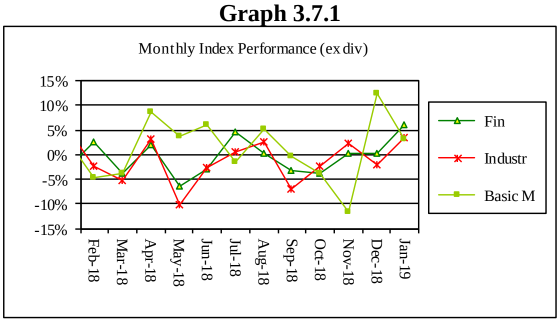


Graph 3.6.2

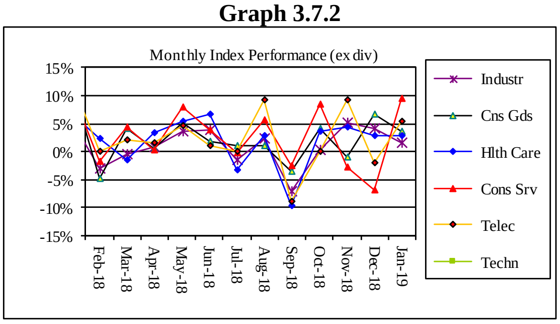


3.7 One-year monthly performance of key indices (excluding dividends)

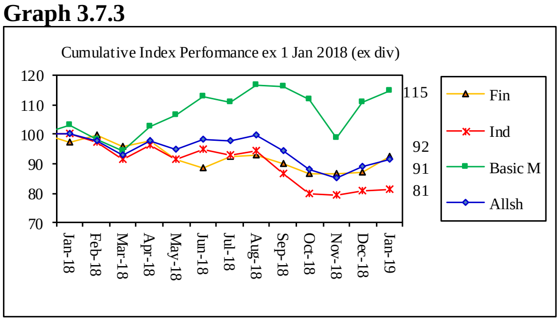
Graph 3.7.1



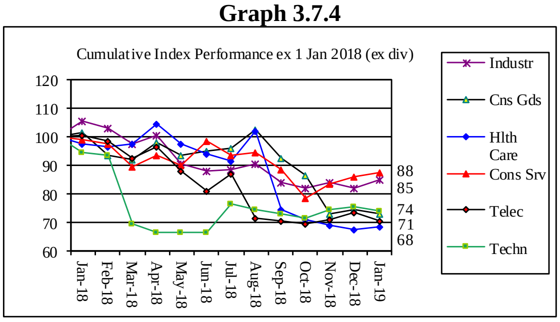
Graph 3.7.2



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.	8.5	8.0
5-year real return - % p.a.	3.3	2.8
Equity exposure - % of portfolio (qtr end December 2018)	45.9	67.7
Cumulative return ex Jan 2011	144.0	127.4
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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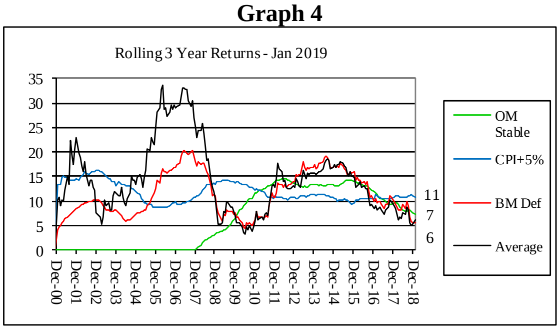
Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.2%	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%	10.0%	8.9%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years February 2016 to January 2019. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4

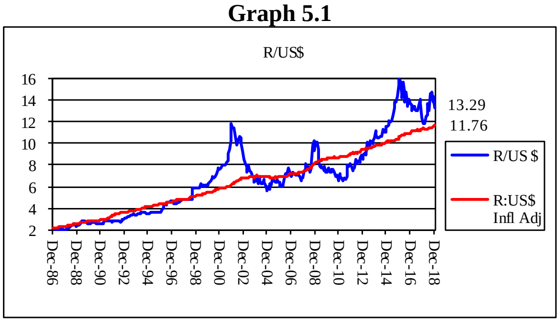


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end January was 5.6%, the average was 6.2% vs CPI plus 5% currently on 10.5%.

5. Review of Foreign Portfolio Flows and the Rand How is the Rand doing?

Graph 5.1 indicates that the Rand by our measure is at fair value at 11.76 to the US Dollar while it actually stood at 13.29 at the end of January. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

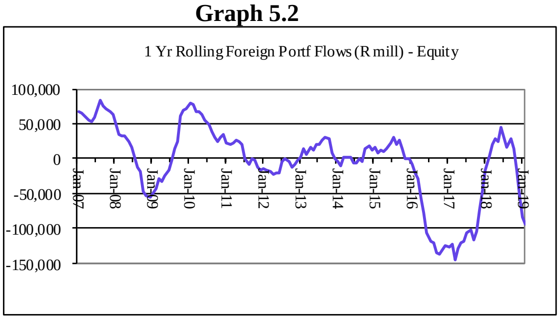


The Rand strengthened by 7.66% in January with net foreign investment outflows from bonds and equities of R 6.1 bn. Over the past 12 months the Rand weakened by 11.9%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 131.2 bn (outflow of R118.4 bn to end December 2018).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 216.8 bn (December R 222.9 bn).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R83.3 bn at the end of January (outflow of R 52.8 bn year-on-year to end December). The month of January experienced a net outflow of R 15.0 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 59.1 bn (end December net investment outflow of R 44.1 bn). This represents roughly 0.46% 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 48.0 bn over the past 12 months to end of January (outflow of R 65.6 bn over the 12 months to end of December). The month of January experienced a net inflow of R 8.9 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 275.9 bn (to December R 266.9 bn).

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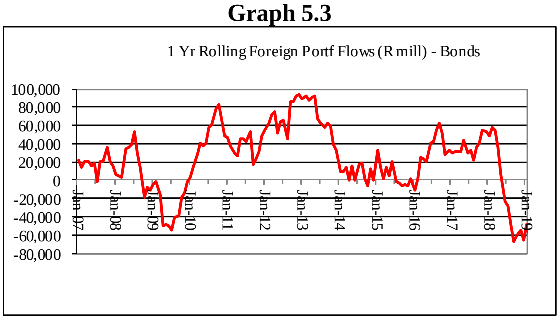
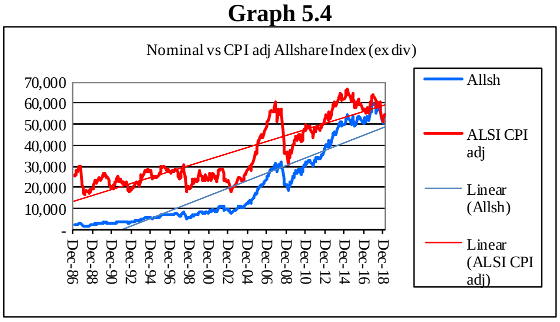
Graph 5.3



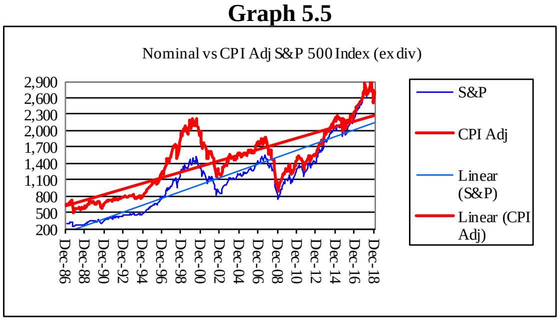
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.8% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.0% per year. This is equivalent to a growth in real terms of 2.8% p.a. over this period, excluding dividends, or around 5.8% including dividends.

Graph 5.4



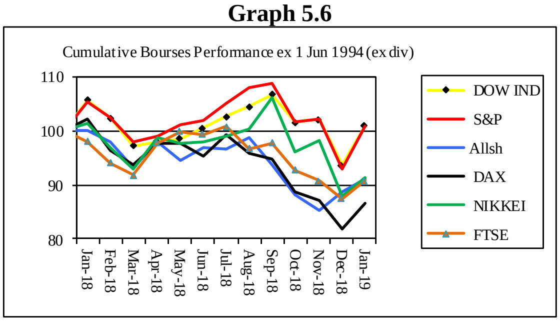
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.3% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.7% p.a. over this period, excluding dividends or around 6.6% including dividends.

Graph 5.5



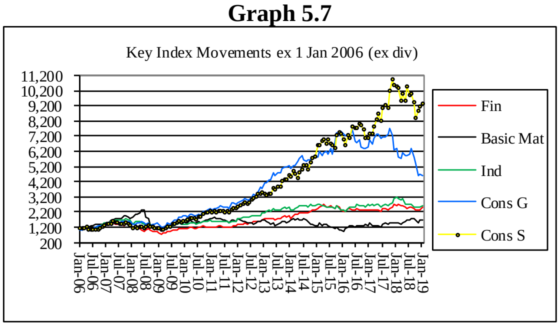
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 18.5%; Consumer Goods: 12.2%; Industrials: 7.5%; Financials: 7.2%; and Basic Materials: 4.1%.

Graph 5.7



6. The world of investments and retirement is not what it used to be!

by Tilman Friedrich

Politicians, particularly those of the western world, would want to make us believe we live in an open global economy. However, where international trade is concluded in a single currency, where fiscal and monetary authorities intervene massively in financial markets, more will have to be done by the politicians to make the public believe.

The law of demand and supply, has no bearing on the behaviour of markets today. Savers are paying off the debt of borrowers through artificially low interest rates that are set by monetary authorities. So-called 'safe haven' investments are earning negative real interest rates and the investor is now conditioned to accepting that he will have to work until he drops dead, instead of realising his dream of retiring at an age where one might still be able to enjoy life for a while. Retirement ages are extended while pension entitlements are at best being questioned and already reduced in some countries.

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With negative real interest rates seemingly having become the 'new norm', asset valuation models are now being questioned. Why should this be of concern to a pension fund member? Well the point is that pension fund contribution structures were established over the course of the past century or more based on the assumption of cash returning around 2% above inflation, bonds around 4% above inflation, property around 5% above inflation and equity around 8% above inflation. A typical balanced portfolio comprising of a mix of these assets based on conventional investment theory was expected to return roughly 5% above inflation, net of fees. Pension theory then arrived at a net retirement funding contribution rate of 11%+, to produce an income replacement ratio of 2% per year of membership.

Indications based on the 'new norm' are that one is now only looking at a net return of between 2% and 3% p.a. If this were to be true, the retirement funding contribution rate would have to be raised from 11% to at least 16%. Add to this a typical cost element of 6% for risk benefits and management costs, the 'new norm' for a total retirement fund contribution rate is now at least 22% instead of the 17% before the advent of the 'new norm'. Alternatively the retiree would now have to settle on an income replacement ratio of only around 40% after 30 years of service, instead of his expected 60%! No wonder the mortals are being conditioned by politicians to be prepared to work until they drop dead.

We are certainly living in a different world today to what it was 30 years ago. What we expected of the future will be materially different and we will have to find ways and means to deal with the impact these changes have on our lives and on our retirement planning. One can only find some comfort in the fact that we are all 'in the same boat', the answers have not been found and a lot of energy and time will be spent all across the globe to find answers how to still have time in retirement to enjoy.

For local pension fund investors, one probably needs to take a different view of the risks of investing offshore. In the past, developing countries and Africa in particular was loaded with a political risk premium. Today the political risks in developed countries are probably as high, if not higher than those in developing countries. Sanctions and trade war are the weapons the US employs today to achieve its political goals and being the largest economy in the world such actions have serious repercussions for any country arousing the fret of the US, such as Iran, Turkey, Russia and so on. Add to this huge demographic risks, for a more callous view on investment in developed countries. In contrast the demographic risks Africa is facing appear to be receding going by general population growth rates.

Given this environment, where can a pension fund still invest? Fixed interest assets are evidently too risky being too exposed to monetary and fiscal manipulation. Even if we at the southern tip of Africa are living in a much more sheltered environment, our financial markets are shackled to global developments. This essentially leaves real business as the asset class to invest in. We all have to live, eat, drink, dress, get to work, nurture our health, go on holiday, learn, find shelter and so on. The 'real economy' will continue and is best represented by commerce and industry, in short, investment in equity appears to be really the most appropriate asset class for the normal investor who shies away from the more exotic asset classes such as gold, works of art etc.

Conclusion

As we usually say, based on fundamentals, equity is our preferred asset class, more specifically value companies offering a high dividend yield. 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. Despite all we have said about the risks presented by offshore markets, sound risk diversification principles still dictate that investments should be spread across the globe, the prevailing exchange rate allowing, and again with an equity bias. If one can find value in property, it should also be an appropriate asset class, being closely tied into the 'real economy'.

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 based on current inflation. 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

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Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 JANUARY 2019

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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.