Volume 15 No. 3
March 2019

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MARCH 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

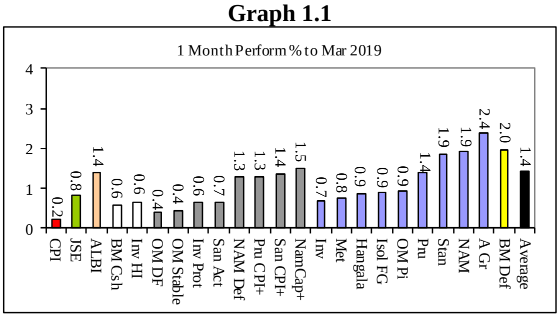
In March 2019 the average prudential balanced portfolio returned 1.4% (February 2019: 2.8%). Top performer is Allan Gray Balanced Fund (2.4%); while Investec Namibia Management Fund (0.7%) takes the bottom spot. For the 3-month period, Nam Coronation Balanced Plus Fund takes top spot, outperforming the ‘average’ by roughly 1.9%. On the other end of the scale Momentum Namibia Growth Fund underperformed the ‘average’ by 1.8%. 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.

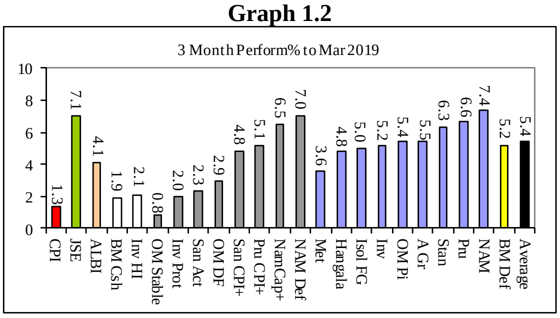
Below is the legend to the abbreviations reflected on the graphs:

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)
Momentum Namibia Growth	Met (blue)
NAM Prudential Balanced	NAM (blue)
Old Mutual Pinnacle Profile Growth	OM Pi (blue)
Stanlib Managed	Stan (blue)
Investment Solutions Bal Growth (multimanager)	Isol FG (blue)

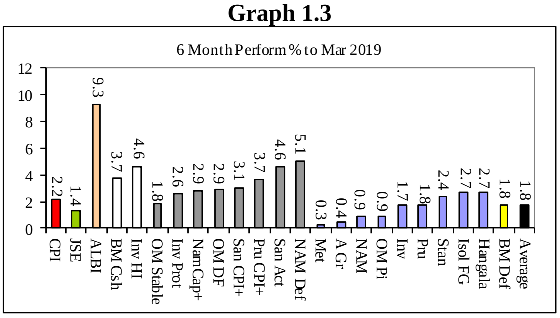
Graph 1.1



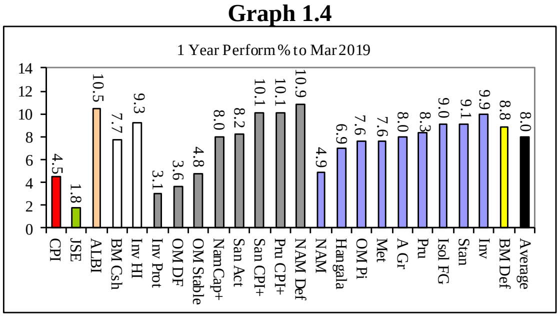
Graph 1.2



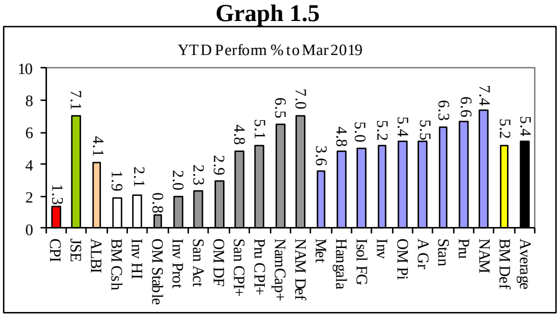
Graph 1.3



Graph 1.4



Graph 1.5



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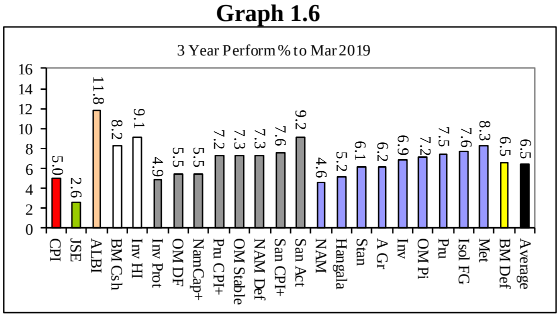
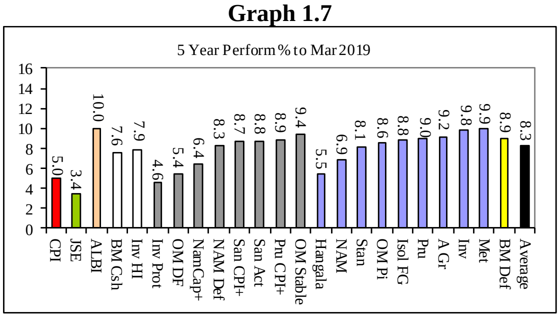
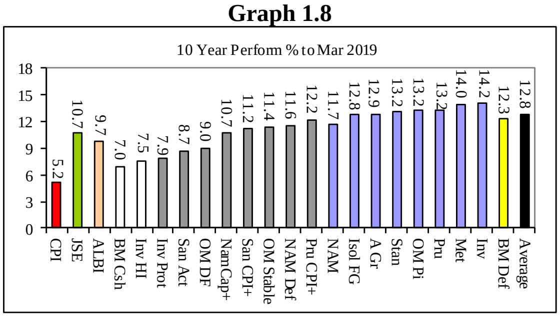
Graph 1.6



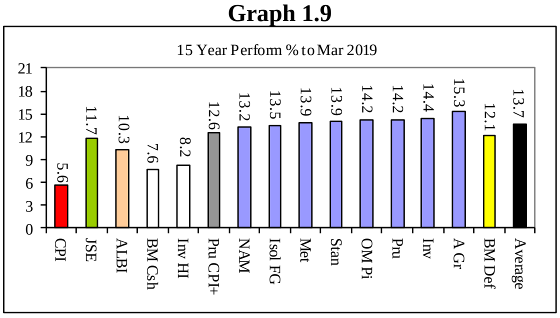
Graph 1.7



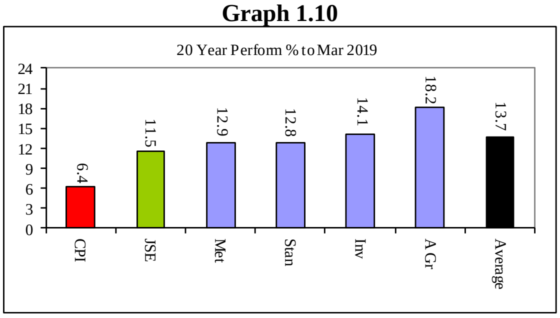
Graph 1.8



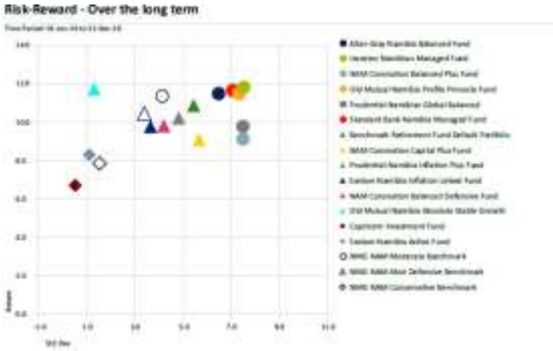
Graph 1.9

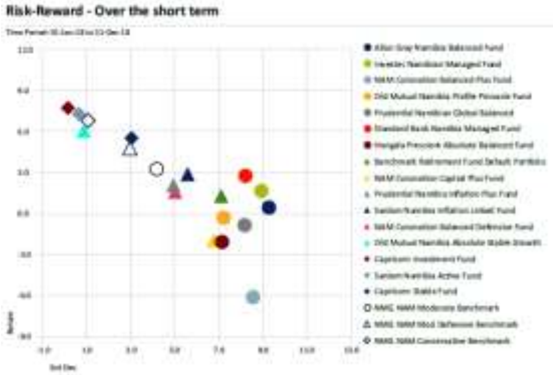


Graph 1.10



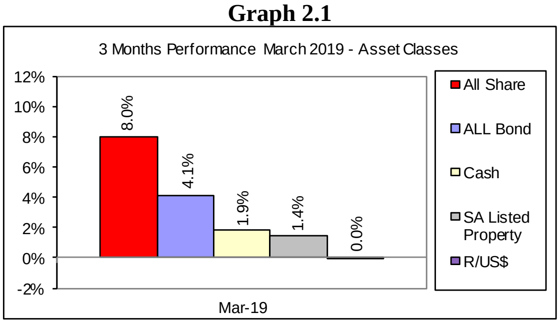
Risk/ Return



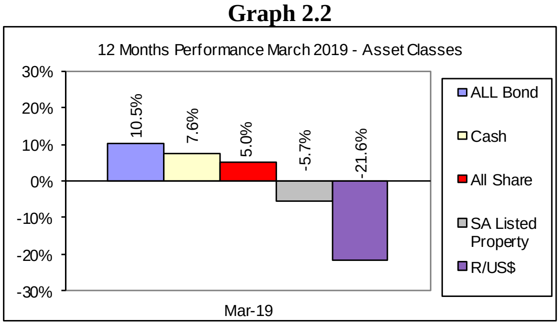


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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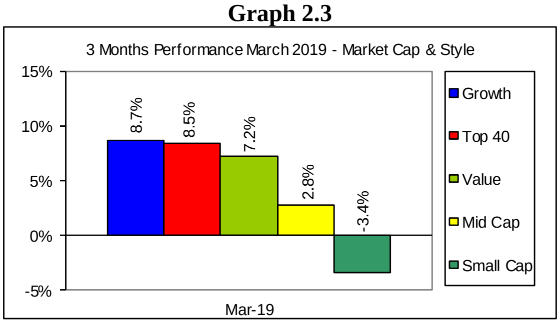
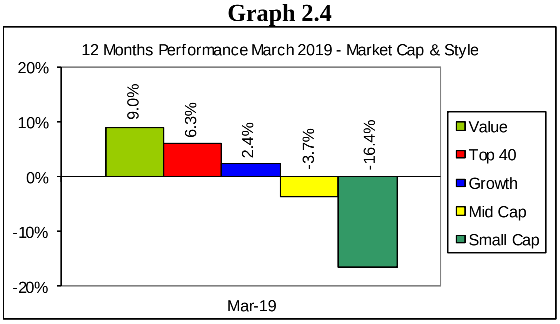
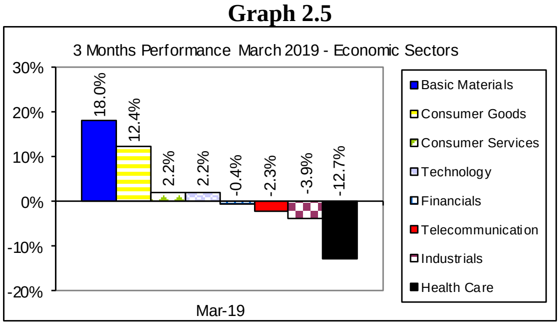
Graph 2.3



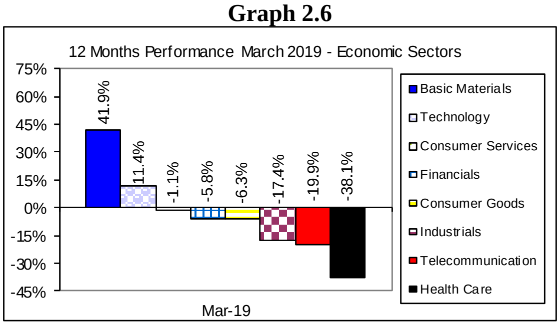
Graph 2.4



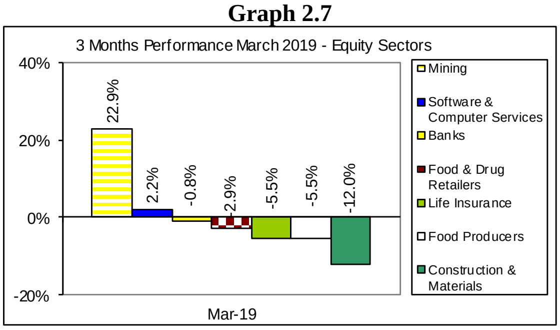
Graph 2.5



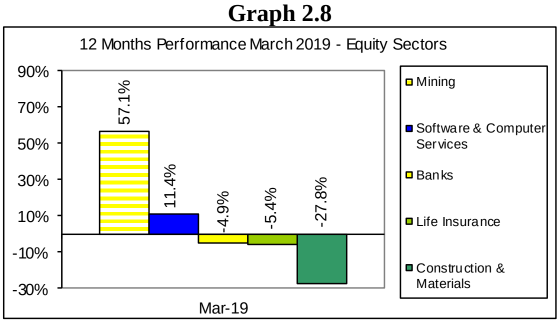
Graph 2.6



Graph 2.7



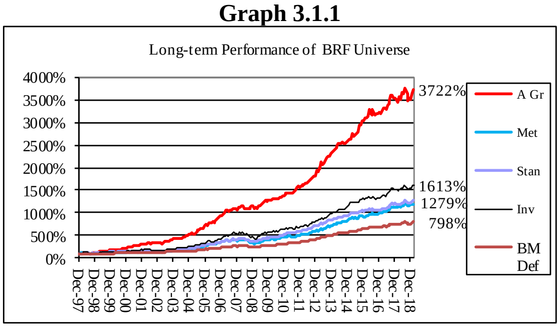
Graph 2.8



3. Portfolio Performance Analysis

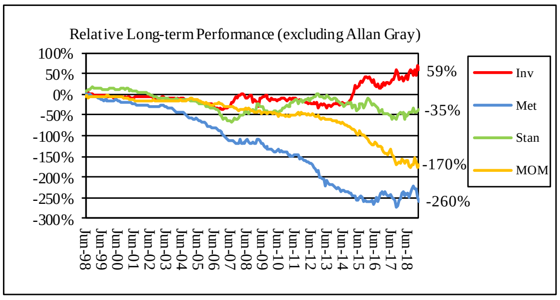
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

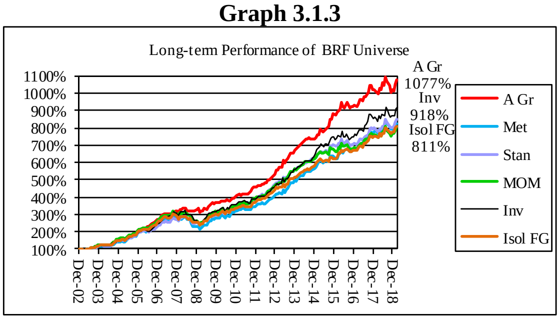


Graph 3.1.2

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



Graph 3.1.3



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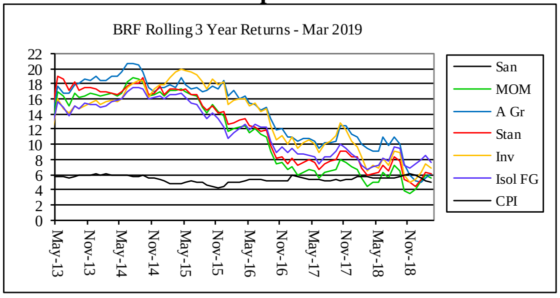
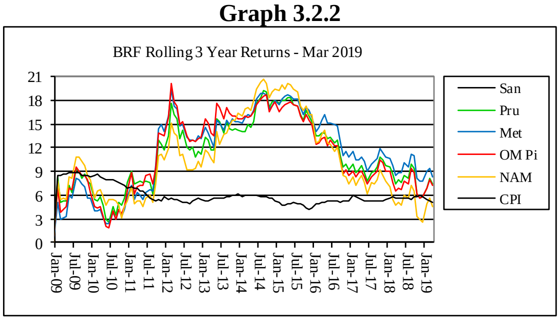
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

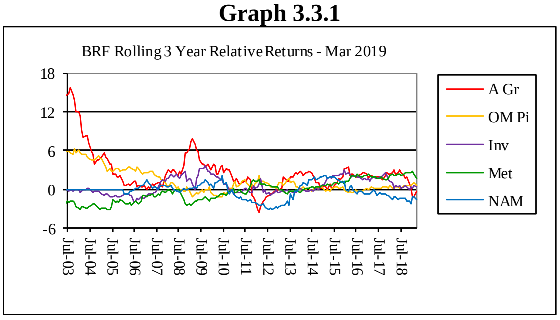


Graph 3.2.2

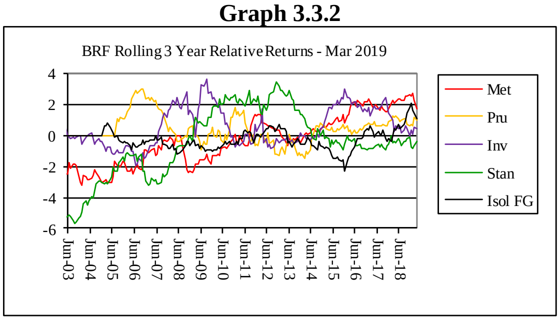


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

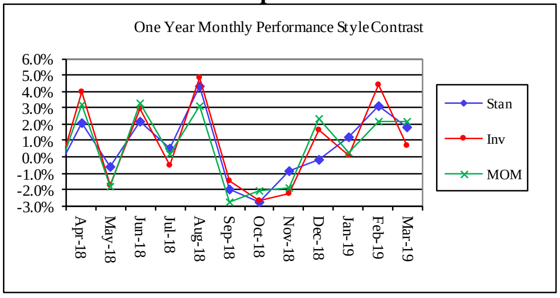


Graph 3.3.2

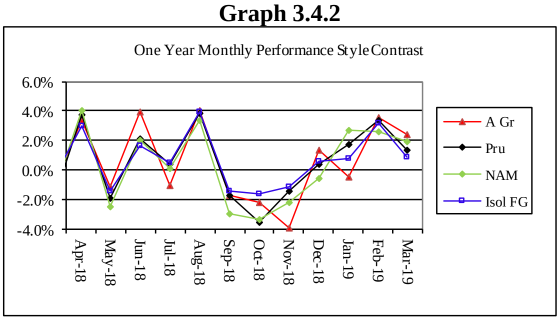


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

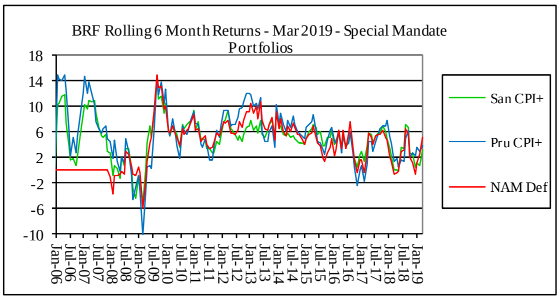


Graph 3.4.2

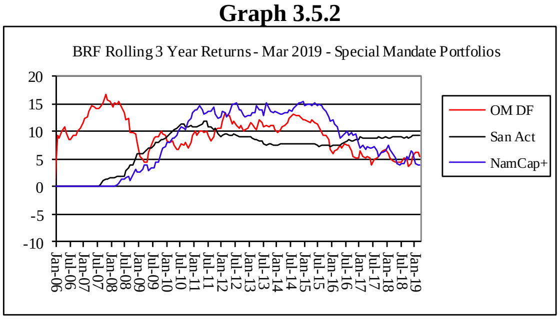


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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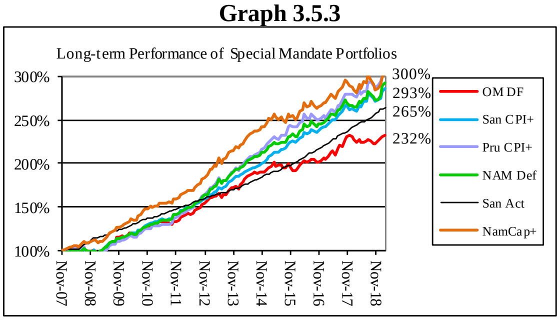
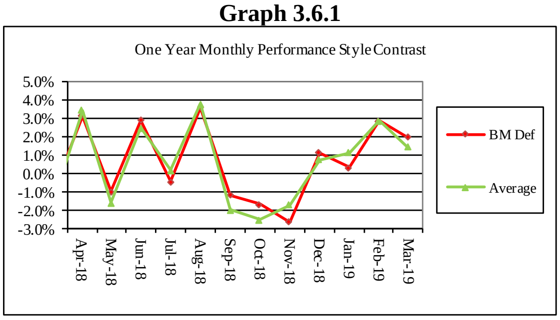
Graph 3.5.3

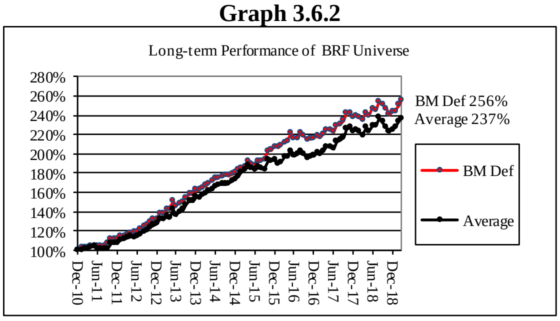


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

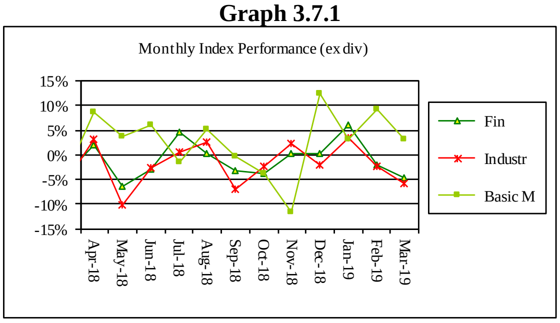


Graph 3.6.2

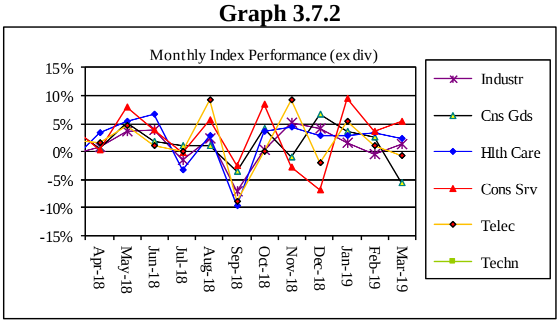


3.7 One-year monthly performance of key indices (excluding dividends)

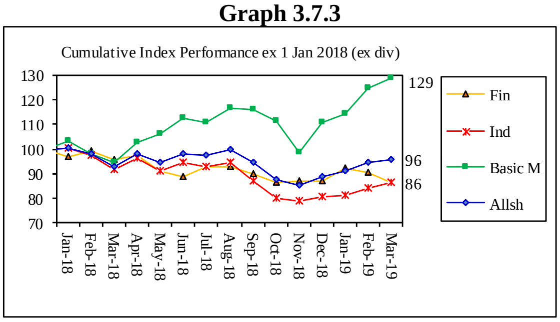
Graph 3.7.1



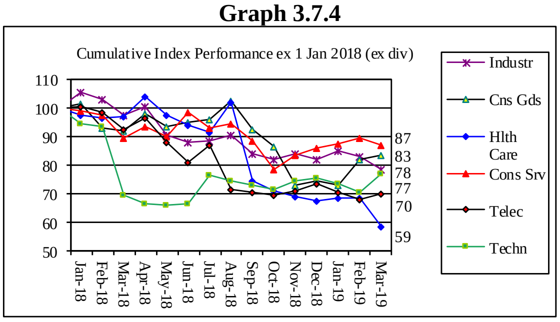
Graph 3.7.2



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.	8.9	8.3
5-year real return - % p.a.	3.9	3.3
Equity exposure - % of portfolio (qtr end December 2018)	45.9	67.7
Cumulative return ex Jan 2011	155.9	137.0
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

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retirement income. It is to be noted that the default portfolio managed to out-perform the average prudential balanced portfolio despite its significantly lower risk profile as represented by its equity exposure.

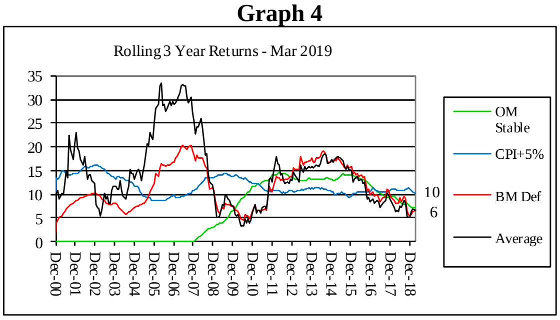
The default portfolio's long-term return must be read in the context of it initially having been managed with a low risk profile that was only changed from the beginning of 2011 when the Metropolitan Absolute Return fund was replaced with the Allan Gray balanced portfolio.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.3%	5.5%	5.0%
Best annual performance	8.2%	14.2%	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	7.6%	9.6%	8.5%

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

Graph 4



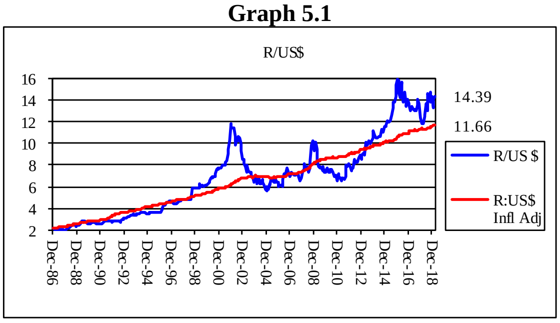
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3 year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end March was 6.5%, the average was 6.5% vs CPI plus 5% currently on 10.0%.

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

Graph 5.1

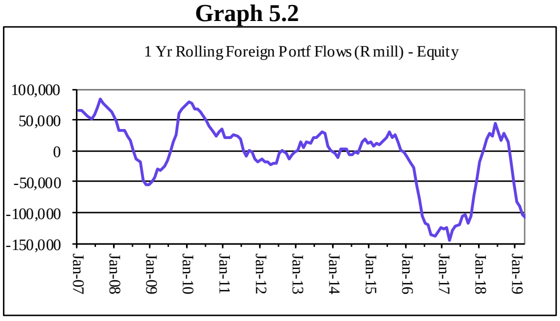


The Rand weakened by 2.32% in March with net foreign investment outflows from bonds and equities of R 11.4 bn. Over the past 12 months the Rand weakened by 21.6%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 172.2 bn (outflow of R146.8 bn to end of February 2019).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 214.8 bn (February R 226.3 bn).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 103.2 bn at the end of February (outflow of R 89.2 bn year-on-year to end February). The month of March experienced a net outflow of R 15.5 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 69.1 bn (end February net investment outflow of R 53.6 bn). This represents roughly 0.43% 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 68.9 bn over the past 12 months to end of March (outflow of R 57.6 bn over the 12 months to end of February). The month of March experienced a net inflow of R 4.0 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 283.9 bn (to February R 279.9 bn).

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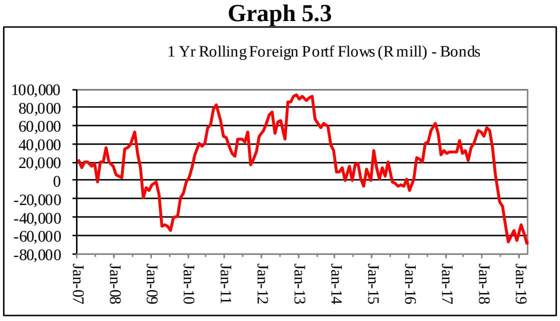
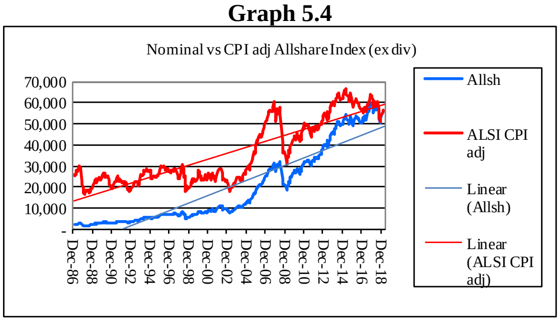
Graph 5.3



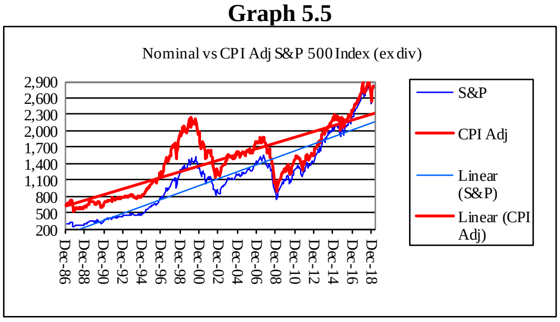
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.9% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.1% per year. This is equivalent to a growth in real terms of 2.8% p.a. over this period, excluding dividends, or around 5.8% including dividends.

Graph 5.4



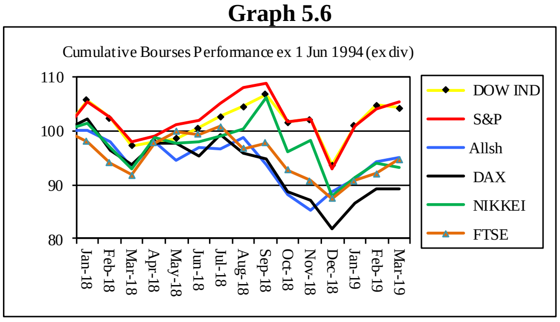
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.5% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.9% p.a. over this period, excluding dividends or around 6.6% including dividends.

Graph 5.5



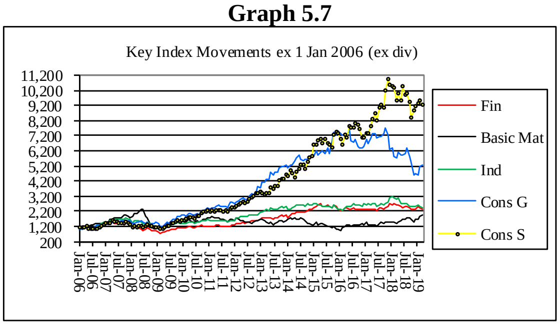
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 18.1%; Consumer Goods: 13.2%; Industrials: 6.8%; Financials: 6.6%; and Basic Materials: 5.0%.

Graph 5.7



6. What history tells us about the current state of the JSE

an article by Patrick Cairns in Moneyweb of 29 March 2019

The following article that we quote echoes the views I have expressed in this column in the past. It is a very insightful analysis that should provide investors in local equities which typically comprise a substantial portion of around 40% of a prudential balanced portfolio.

"After the weak returns on the JSE over the past five years, it's difficult to remember where the market was back in 2014. At that point, South African equities had delivered 19.9% per year for the five years following the 2008 financial crisis.

It was an exceptional period of growth, fuelled by the stimulus injected by the world's central banks. Investors had rarely enjoyed such sustained high returns. However, as Graham Tucker, portfolio manager with the Old Mutual MacroSolutions boutique points out, it was never going to be sustainable.

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"What we said at the time was that we were borrowing from the future, because returns were so great," he says. "The 80-year history told us that this was well above average and that it couldn't continue."

At the time, however, there were those who argued that this time was different – that markets could keep going up because there was so much cheap money in the system. There was no end to their optimism.

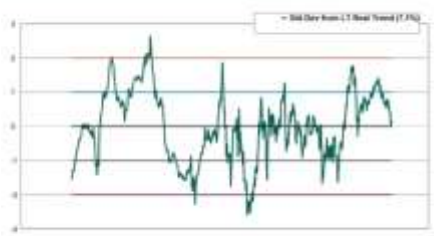
However, it turned out to be misplaced. Since the highs it reached in mid-2014, the market has stagnated and optimism has turned to despair.

The irony is that once again many investors are saying that this time it is different. Now they believe that the JSE cannot deliver attractive returns ever again because of political uncertainty and local economic weakness.

The historical reality

Where both of these arguments suffer is that they ignore history. A 90-year view of the JSE shows that these periods of outperformance and underperformance are not unprecedented.

As the graph below shows, the 2014 peak was the sixth time since 1924 that the FTSE/JSE All Share Index moved one standard deviation above its long-term trend in terms of real returns. Those upward market moves are never sustained for long.



Source: Old Mutual Investment Group, MacroSolutions

The lack of growth in the market since then has also only brought the JSE back to its long-term average. We are therefore very far from anything exceptional.

Long-term clarity

The reality is that the market will always go through these cycles, and they will always tend to appear more significant than anything that has happened before while they are taking place. Nothing is as compelling as the present.

However, markets are long-term machines. They have to be seen as such.

An objective assessment of the current state of South Africa would also have to acknowledge that the country has been in far worse economic positions than it finds itself in now. In the 1980s, the country lost billions of dollars as foreign companies withdrew and sanctions put a stop to investment flows. The country's debt levels had grown to such an extent that it was on the verge of defaulting.

For much of that decade, GDP growth was also zero or negative. By the end of the 1980s South Africa's per capita GDP had fallen back to the levels it had been at in 1970.

The JSE had not been a great place to be invested either. The 1987 market crash wiped out over 20% of its value in a single day, and this followed negative years in 1981 and 1984. Returns were below trend for most of this decade.

At that point, if recent market performance and the state of the country were anyone's criteria for investing, the JSE would not have been an unappealing choice. Yet, for the 40 years since, local equities have delivered an annualised return of 17.9%.

What matters is the future

"Too often as investors we are reactive, and often those reactions are exactly the wrong action to take," says Tucker. "We need to step back, assess the situation and look forward."

MacroSolutions believes that if one does that, then the local equity market is now offering good opportunities for the first time in nearly a decade. As the following graph shows, the forward price-to-earnings multiple on the market minus Naspers is currently below its long-term average.

Source: Old Mutual Investment Group, MacroSolutions

This doesn't mean that the market is exceptionally cheap. However, history suggests that future returns from this point should be in line with what they have been in the past.

"The market has moved back to fair value," Tucker argues. "We are not back at the same valuations or price levels we saw after the global financial crisis, but we are seeing more opportunities."

As the graph below illustrates, the real market return (after inflation) over the last 10 years is only slightly below average. It is far better than the worst period the JSE has seen. It also shows that, over the long term, the JSE has always delivered positive outcomes for investors.

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MARCH 2019

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

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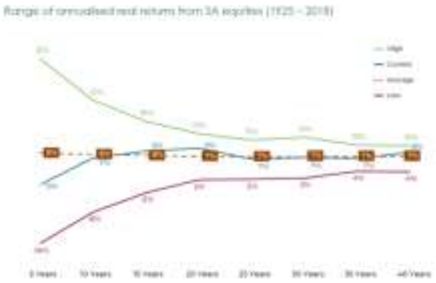

Source: Old Mutual Investment Group, MacroSolutions

This is why Tucker argues that investors should be prepared to stay invested in the equity markets. As history has shown, this has been the best way to ensure inflation-beating returns over long periods.

"While a lot of investors are looking to run to cash because of the returns they have observed over the last few years, we are looking forward and seeing more opportunities," says Tucker. "They are not going to deliver in the next three months or six months, but we are positioning for the long term."

Conclusion

Running for cash at this point in time is most probably too late having endured the pain of low returns on equities relative to cash over the past 5 years, give or take another few months. The difficulty of moving between asset classes is the correct timing. The chance of one's timing being spot-on, is 50: 50 at the very best, but probably substantially lower than that. Moving between asset classes for the sake of improving long-term investment returns obviously requires moving out of equities into cash and back again. On the basis of probability the chance of moving out of equities at the right time is small and moving back into equities at the right time is small once again. The aggregate probability of these two moves is much smaller as one multiplies the two probabilities of a fraction of 1 with each other.

Those investors who moved out of equities some time ago because of their poor performance must move back into equities sooner or later. Unfortunately one will not know up front whether it should be sooner like immediately, or only in a few months. This is the risk the investor has to take after having moved out of equities.

A very similar argument as that presented in the article above can be presented in favour of property that had a torrid time, so this is another asset class worth considering for investment at this juncture.

Local bonds, on the other hand have done quite well relative to property and equity. In view of renewed stimulatory measures being taken by the Fed that will result in declining bond yields in the US and elsewhere, this asset class should be avoided. Of course cash still offers real returns of 3% and may fulfill a specific objective.

Investing offshore remains not negotiable in the light of the ever increasing dilution of investment returns as the result of legislative, regulatory and supervisory requirements. In this regard timing is important to the extent that it concerns the exchange rate but this must be tempered by offshore market movement consideration. It will be very difficult to time both correctly and a bit of a more philosophical approach to these considerations should be helpful.

Important notice and disclaimer