Volume 15 No. 5
May 2019

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 MAY 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

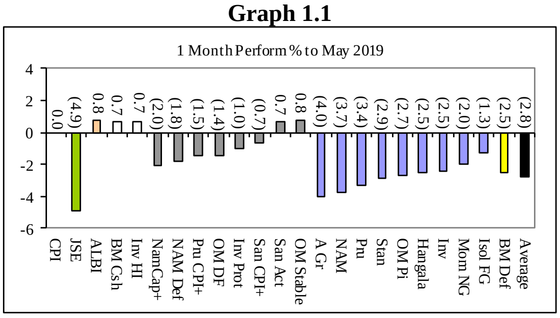
In May 2019 the average prudential balanced portfolio returned -2.8% (April 2019: 2.7%). Top performer is Investment Solutions Balanced Fund with -1.3%, while Allan Gray Balanced Fund with -4.0% takes the bottom spot. For the 3-month period, Stanlib takes top spot, outperforming the 'average' by roughly 1.1%. On the other end of the scale Allan Gray Balanced Fund underperformed the 'average' by 1.0%. 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.

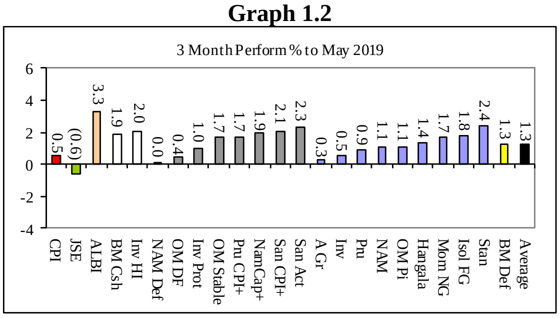
Below is the legend to the abbreviations reflected on the graphs:

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	Mom NG (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)

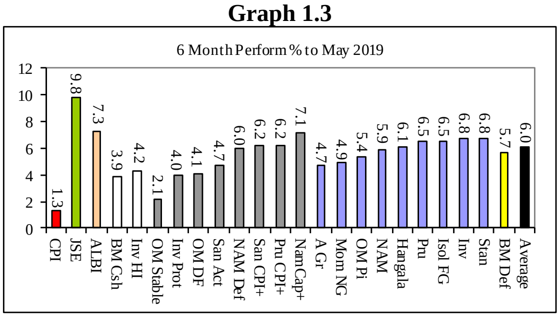
Graph 1.1



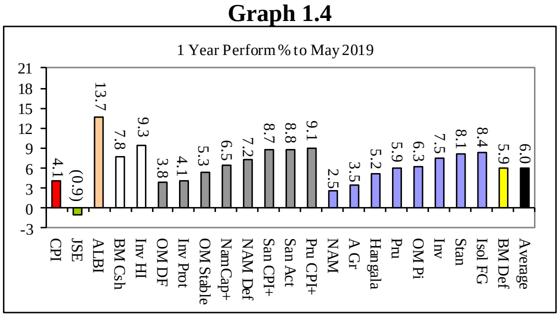
Graph 1.2



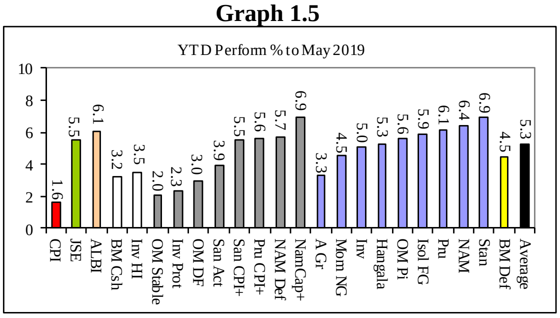
Graph 1.3



Graph 1.4



Graph 1.5



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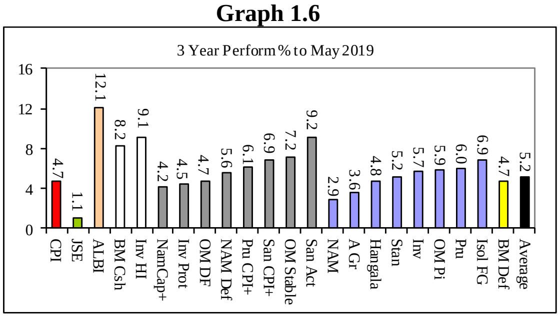
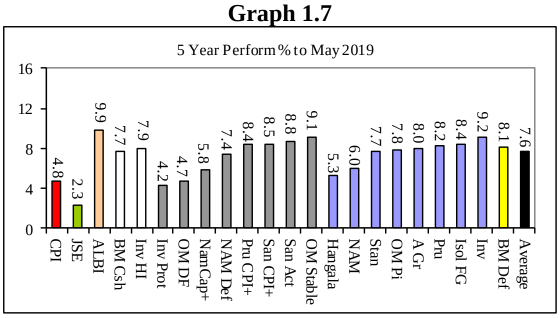
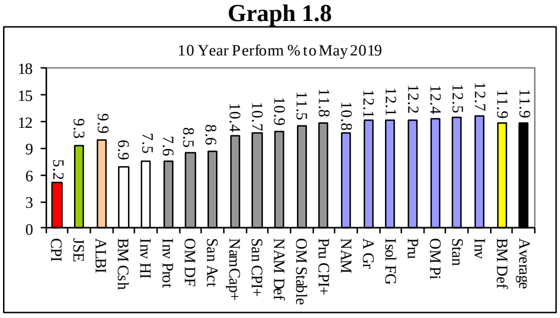
Graph 1.6



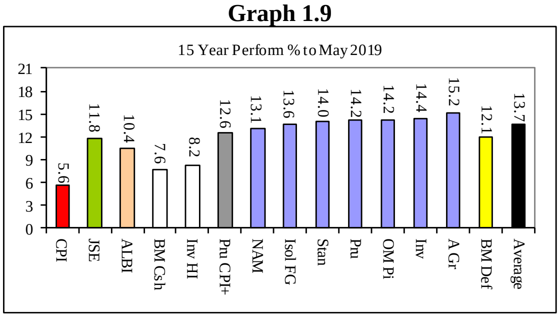
Graph 1.7



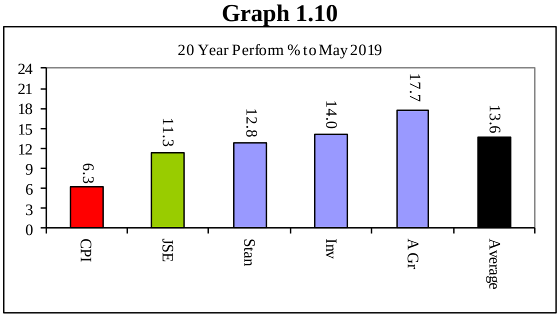
Graph 1.8



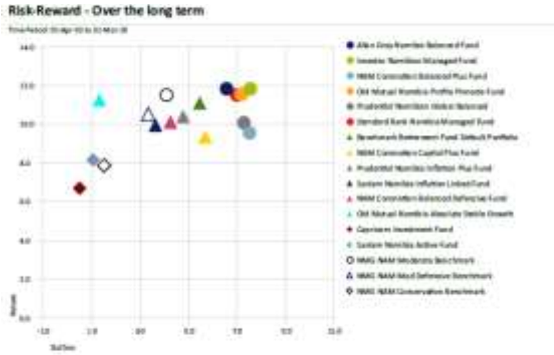
Graph 1.9

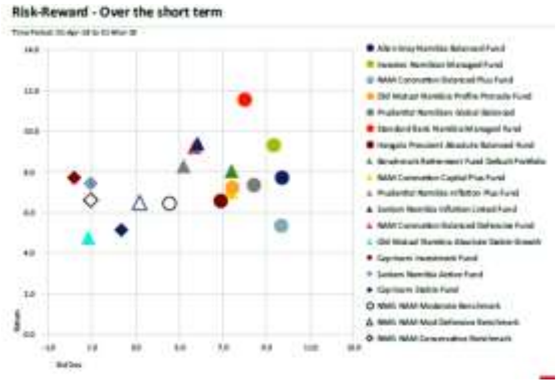


Graph 1.10



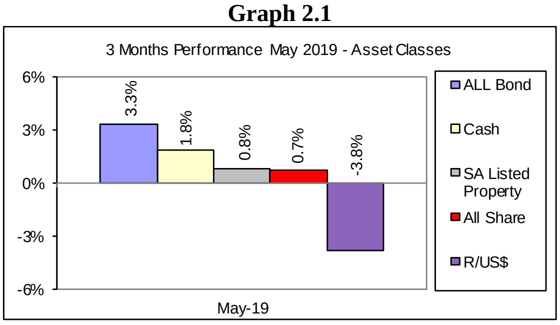
Risk/ Return



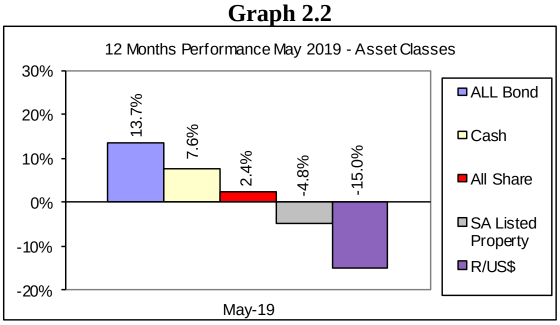


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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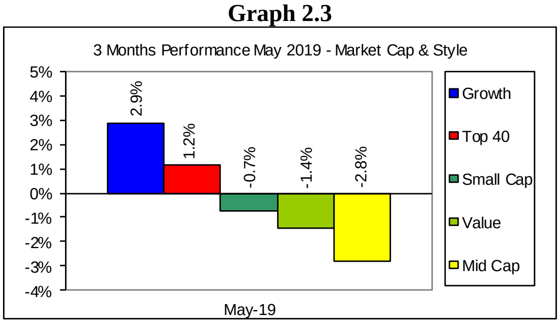
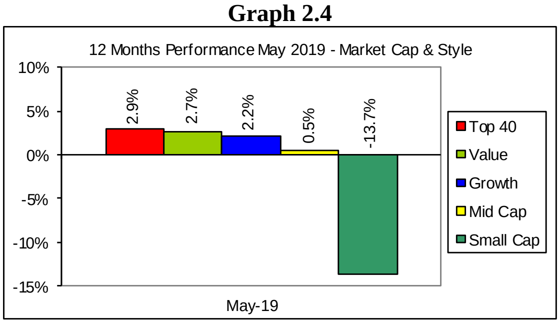
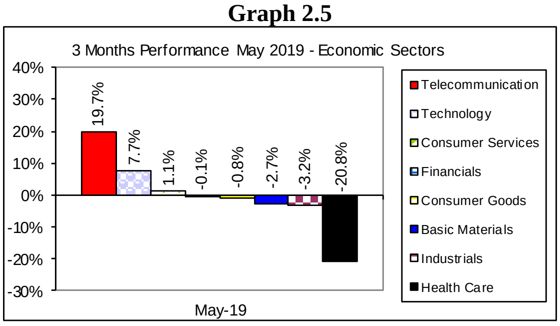
Graph 2.3



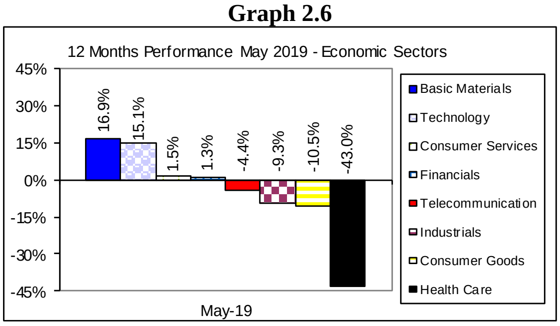
Graph 2.4



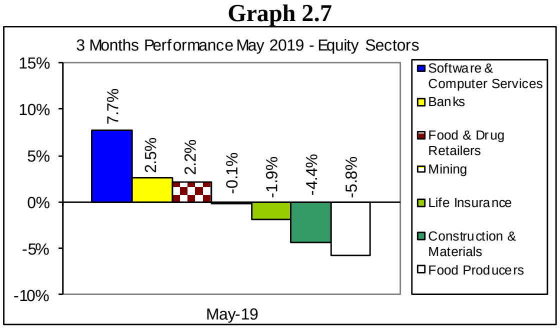
Graph 2.5



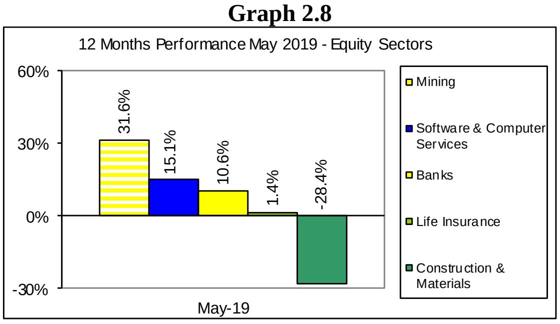
Graph 2.6



Graph 2.7



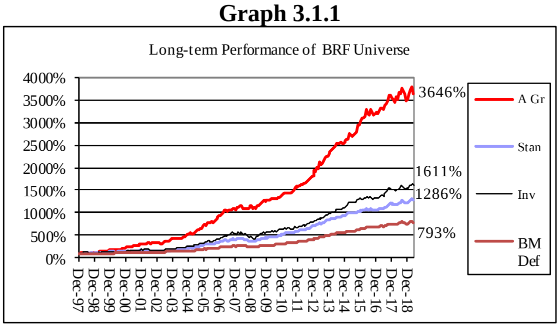
Graph 2.8



3. Portfolio Performance Analysis

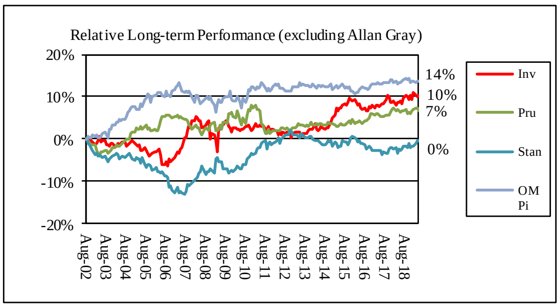
3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

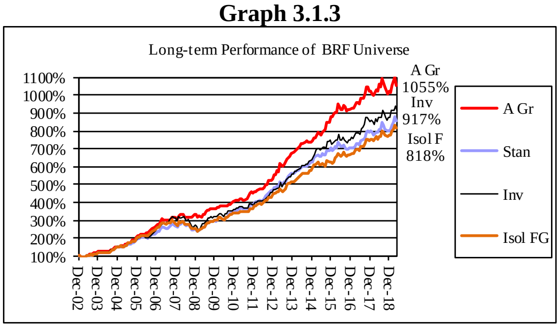


Graph 3.1.2

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



Graph 3.1.3



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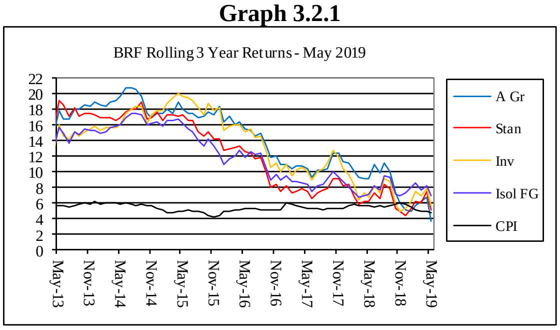
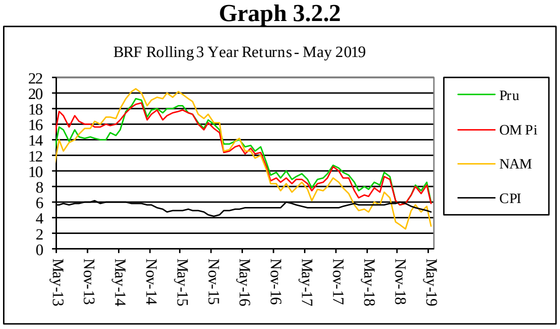
3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

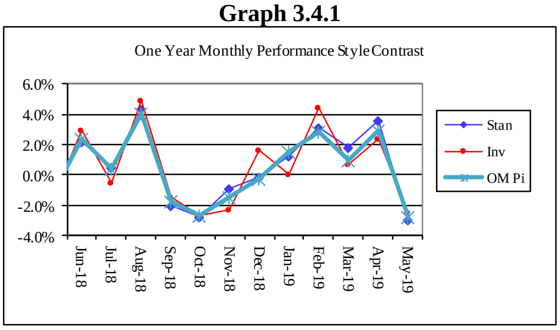


Graph 3.2.2

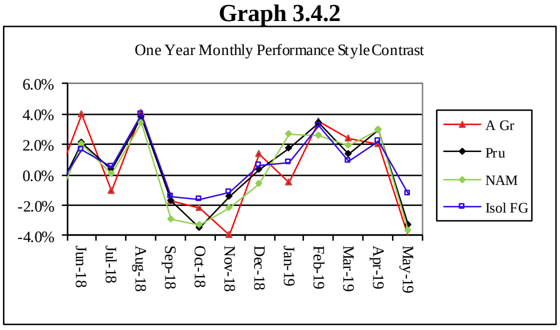


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

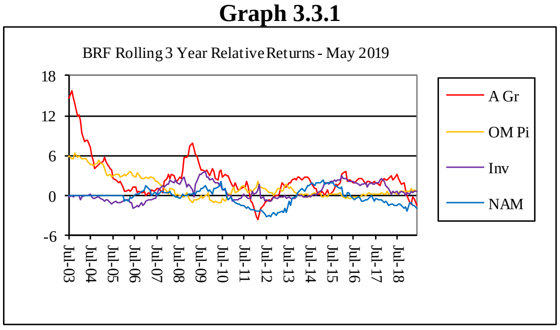


Graph 3.4.2

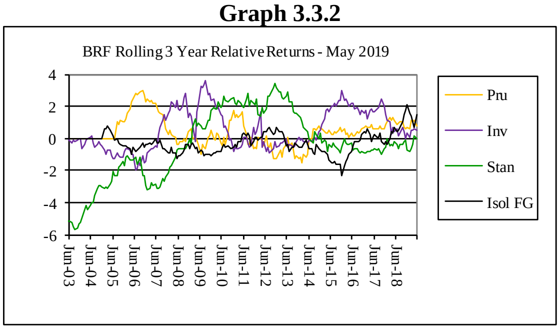


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

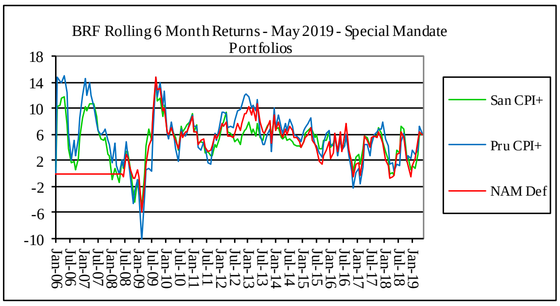


Graph 3.3.2

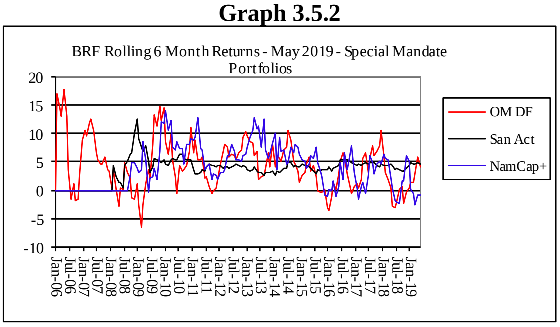


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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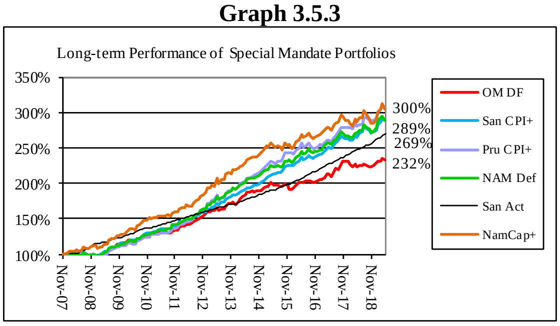
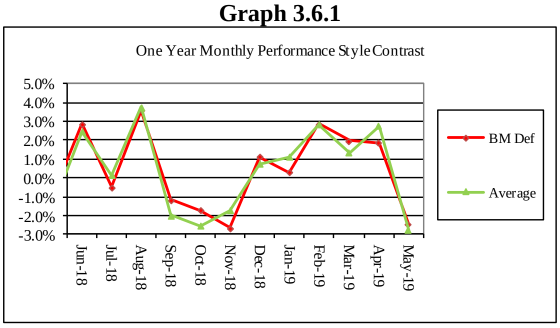
Graph 3.5.3

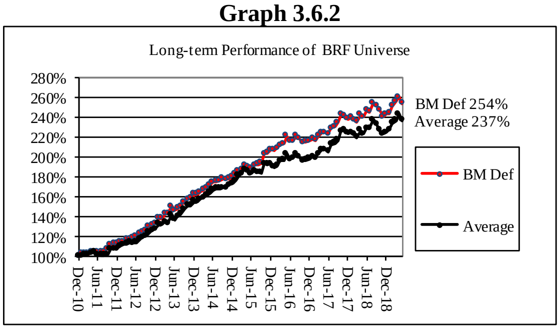


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

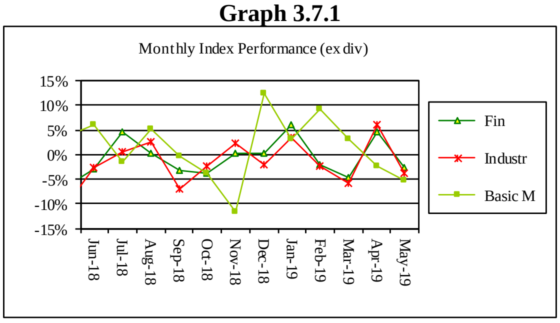


Graph 3.6.2

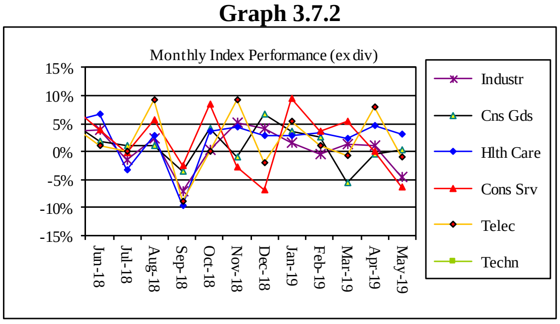


3.7 One-year monthly performance of key indices (excluding dividends)

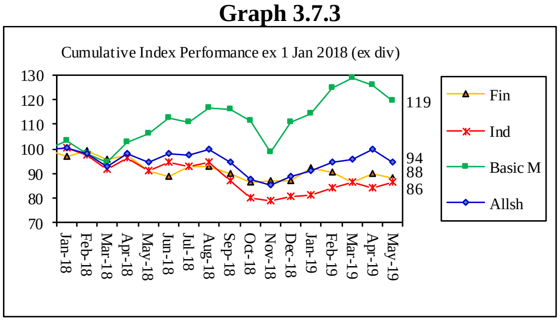
Graph 3.7.1



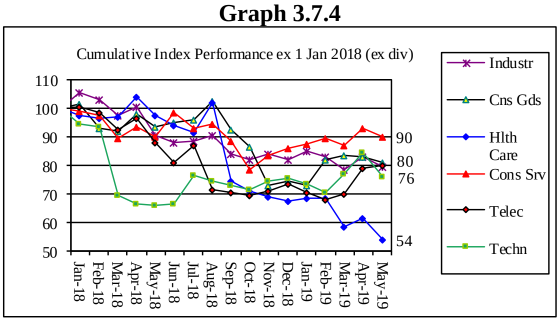
Graph 3.7.2



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.	8.1	7.6
5-year real return - % p.a.	3.3	2.8
Equity exposure - % of portfolio (qtr end March 2019)	48.1	67.2
Cumulative return ex Jan 2011	154.2	136.6
5-year gross real return target - % p.a.	5	6
Target income replacement ratio p.a. - % of income per year of membership	2	2.4
Required net retirement contribution - % of salary	13.0	11.6

The above table reflects the actual returns of the Default Portfolio versus target returns required to produce an income replacement ratio of 2% of salary per year of fund membership that should secure a comfortable

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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.

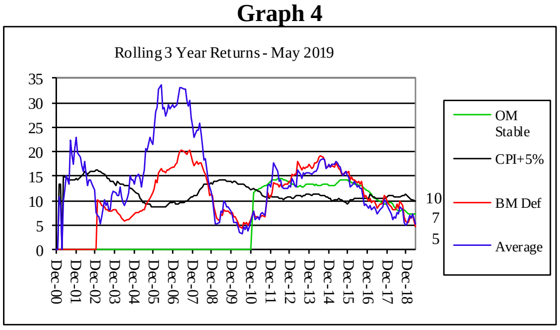
The default portfolio's long-term return must be read in the context of it initially having been managed with a low risk profile that was only changed from the beginning of 2011 when the Metropolitan Absolute Return fund was replaced with the Allan Gray balanced portfolio.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.5%	4.7%	5.0%
Best annual performance	8.2%	14.0%	13.1%
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%	9.1%	8.2%

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

Graph 4



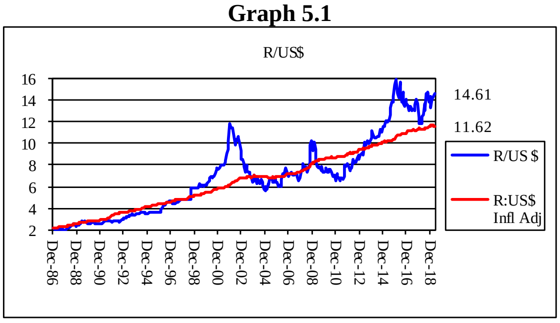
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3-year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end May was 4.7%, the average was 5.2% vs CPI plus 5% currently on 10.4%.

5. Review of Foreign Portfolio Flows and the Rand

How is the Rand doing?

Graph 5.1 indicates that the Rand by our measure is at fair value at 11.62 to the US Dollar while it actually stood at 14.61 at the end of May. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

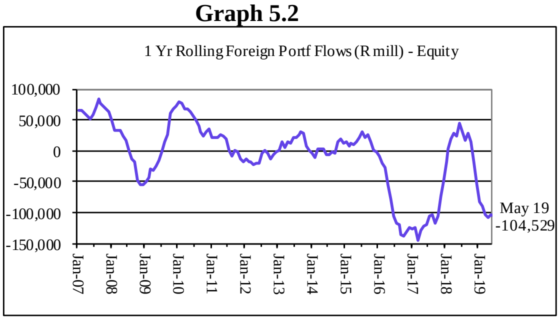


The Rand weakened by 2.00% in May with net foreign investment outflows from bonds and equities of R 11.6 bn. Over the past 12 months the Rand weakened by 15.01%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 144.7 bn (outflow of R169.0 bn to end of April 2019).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 209.7 bn (April R 221.2 bn).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 104.5 bn at the end of May (outflow of R 108.5 bn year-on-year to end April). The month of May experienced a net outflow of R 9.7 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 79.4 bn (end April net investment outflow of R 69.7 bn). This represents roughly 0.51% 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 40.2 bn over the past 12 months to end of May (outflow of R 60.5 bn over the 12 months to end of April). The month of May experienced a net outflow of R 1.8 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 289.1 bn (to April R290.9 bn).

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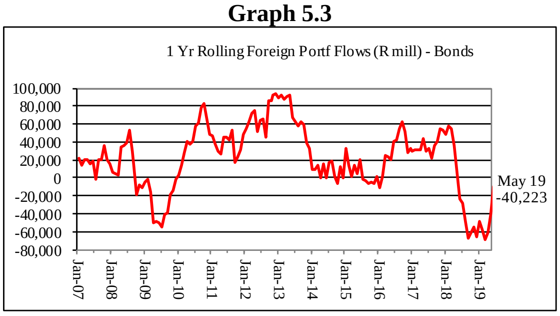
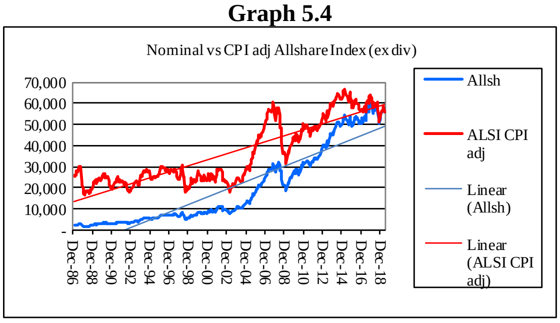
Graph 5.3



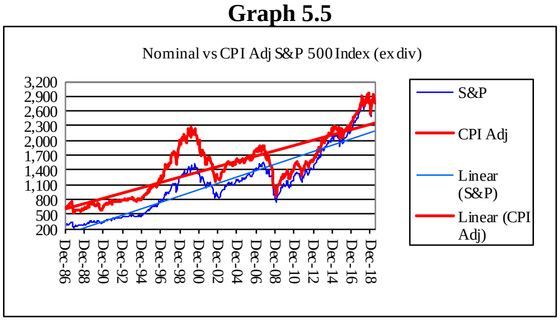
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.8% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 8.0% per year. This is equivalent to a growth in real terms of 3% p.a. over this period, excluding dividends, or around 6% including dividends.

Graph 5.4



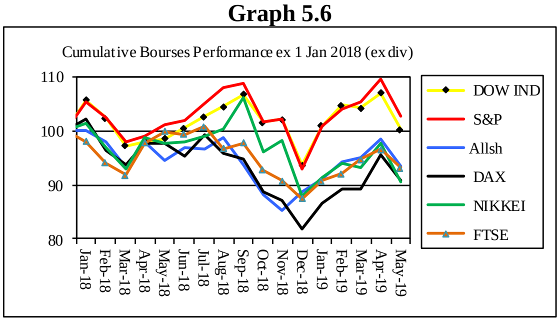
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.4% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.8% p.a. over this period, excluding dividends or around 7.8% including dividends.

Graph 5.5



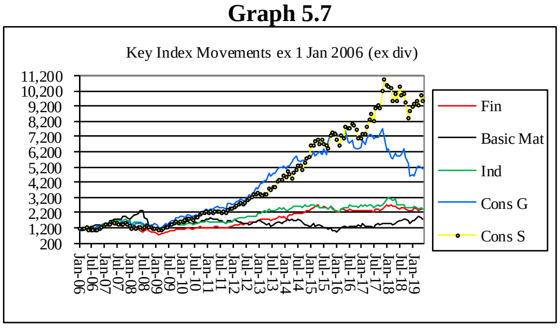
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 18.2%; Consumer Goods: 12.8%; Industrials: 6.8%; Financials: 6.7%; and Basic Materials: 4.3%.

Graph 5.7



6. Have investment markets normalised?

By Tilman Friedrich

It is pretty much common knowledge that the situation we are and have been facing in investment markets globally for the past nearly 10 years, is the result of 'ultra-loose' monetary policy by central banks across the world, including Namibia. After the financial crisis, central banks poured money into the financial markets in order to encourage the consumer to pick up spending levels again after these had fallen flat in the aftermath of the financial crisis. Artificially low interest rates, designed to encourage spending, were great for the borrower, but bad news for the depositor, pensioners to a significant extent. In many instances depositors would earn negative real interest rates. To avoid this they would have been looking around for any asset class that offered any real returns. This is what we have seen, where all assets other than fixed interest investments experienced significant inflows resulting in their artificial and unsustainable growth.

This was certainly the case until the US Fed thought that it had achieved its objective of re-igniting economic growth. It started to raise the Fed rate for the first time in

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December 2015 when it looked like inflation was ticking up. At that point inflation has just turned positive and grew to 2.95% by April 2018, only to start turning down again since then to currently only 1.7%. The Fed rate was increased to 2.5% in December 2018 to stagnate since then and recent talk being for it to be lowered again.

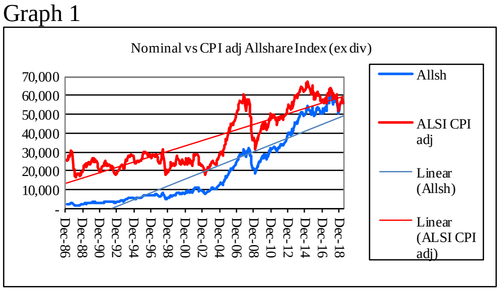
The US Fed rate currently represents a real return of only 0.8%. Going by its long-term average the real rate should be around 1.7% in a normal interest rate environment. The likelihood is that the Fed will start reducing its policy rate which will imply a further decline in the real rate unless inflation continues to decline as well. While these trends continue, investment markets will remain distorted in favour of all asset classes other than fixed interest investments.

Furthermore we have seen a change of mind of foreign investors who have become nervous of developing countries and have consequently moved their capital to safer havens on a large scale. This has lead to a depression of values in financial markets in the developing countries.

Asset classes that have been and still are benefiting from the artificially low interest rate environment have run so far ahead of themselves, particularly in the developed world, that there is little scope for further prudent growth. A normalization of the interest rate environment will have to happen but this does not seem to be imminent. In addition global financial markets are depressed as the result of the economic war the US is waging against all global economic adversaries. There is no end in sight to this either.

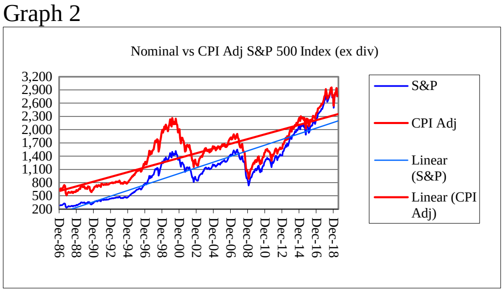
This is not a good time for the investor. Despite presenting a higher risk than cash and bonds, equities have been and are likely to continue yielding returns similar to those of cash over longer periods, but due to their volatility there will be shorter periods of them even under performing cash.

Graph 1



Considering above graph 1, it is interesting to note that the JSE Allshare index did not grow at all in real terms (the red line) over a 19 year period from January 1986 up to the end of 2004, the start of the commodity bubble that eventually burst in October 2007. Since then the market effectively moved sideways. Taking the full 33 year plus period, the JSE Allshare grew a meager 2.6% p.a. in real terms. Adding the dividend yield of 3%, the JSE Allshare index returned 5.6% p.a. in real terms, substantially below a 100 year plus average of over 7%. In addition, if one removed the impact of the stellar performance of a few large cap shares such as Naspers, the performance of the JSE Allshare index has in fact been significantly worse that the index suggests.

Graph 2



Contrasting our local market with the US S&P 500, the US market in graph 2 above evidently showed a much more consistent growth over the same 33 year plus period. Despite posing a lower risk than the JSE, the US S&P 500 grew by a real rate of 4.7% p.a. Adding its dividend yield of 2.1% p.a., the S&P 500 returned 6.8% p.a., on par with its 100 years plus return, or 1.2% more than the JSE Allshare return.

Conclusion

Going by the graph 1 and 2 above and in the light of our expectation that markets will continue to move sideways for at least another 1 to 2 years, we will expect the local market to stand a much better chance of turning around than the US market. Investing in cash is a safe option for avoiding short term market volatility, but at the same time it means that one will most probably miss the opportunity of a turnaround of the local market. An investor with a time horizon of 6 months or longer should rather be in the market so as not to miss the turning point. In the light of an expected decline in interest rates, it is likely that fixed interest investments should do well over the next 1 to 2 years.

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 and in the light of the fact that for most of us, our largest investment by far will be local. 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 slightly more philosophical approach to these considerations should be helpful.

Important notice and disclaimer

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