Volume 15 No. 6
June 2019

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 JUNE 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

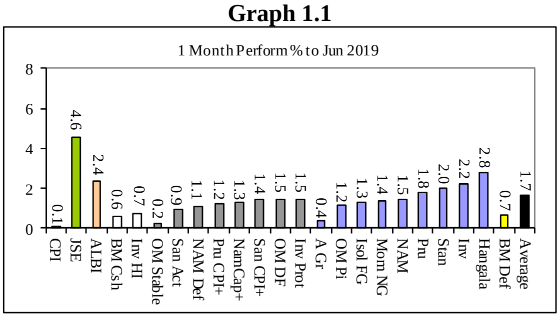
In June 2019 the average prudential balanced portfolio returned 1.7% (May 2019: -2.8%). Top performer is Hangala Prescient Balanced Fund with 2.8%, while Allan Gray Balanced Fund with 0.4% takes the bottom spot. For the 3-month period, Hangala Prescient Balanced Fund takes top spot, outperforming the 'average' by roughly 1.7%. On the other end of the scale Allan Gray Balanced Fund underperformed the 'average' by 3.3%. 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.

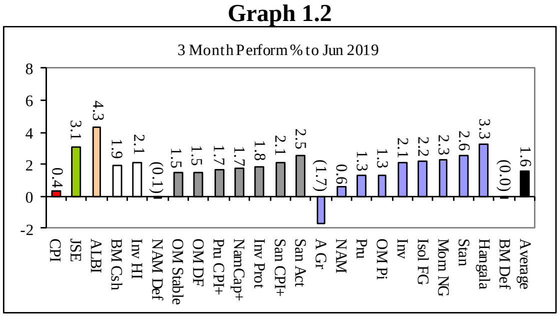
Below is the legend to the abbreviations reflected on the graphs:

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)

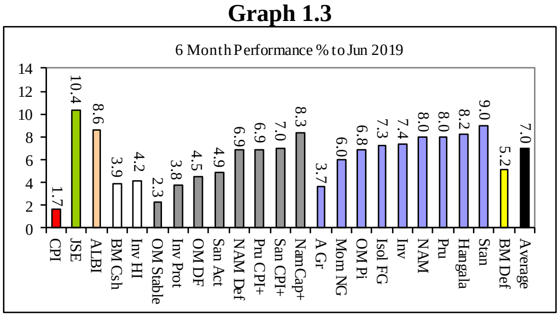
Graph 1.1



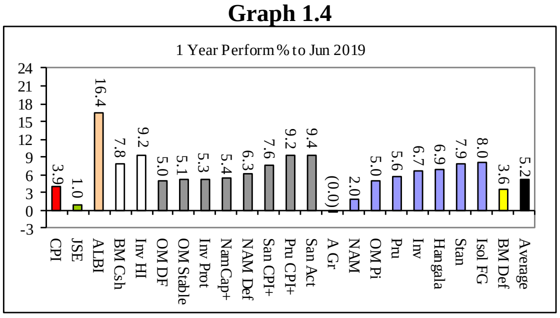
Graph 1.2



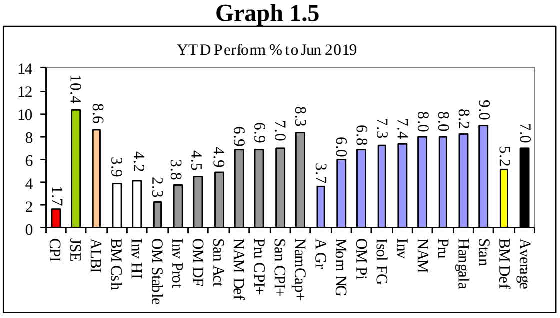
Graph 1.3



Graph 1.4



Graph 1.5



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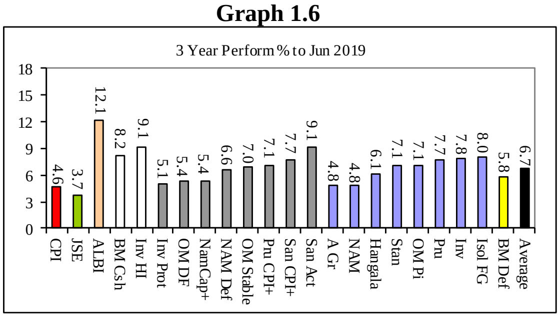
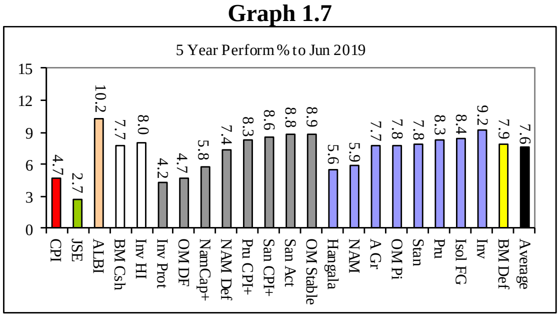
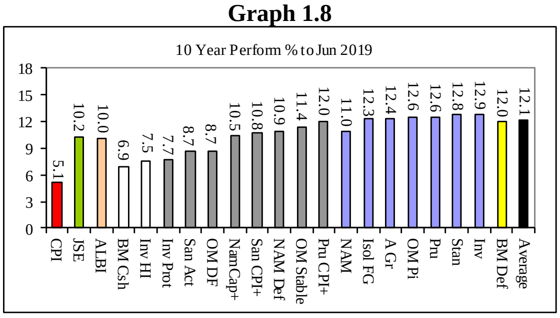
Graph 1.6



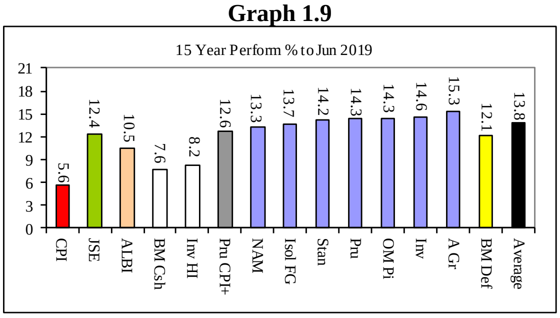
Graph 1.7



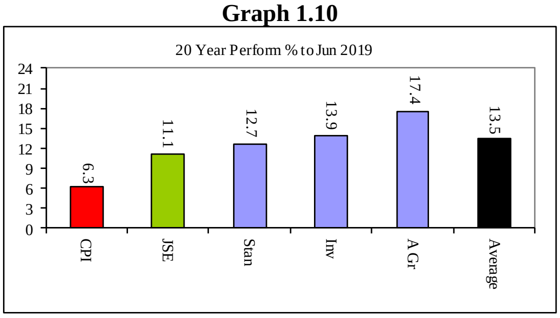
Graph 1.8



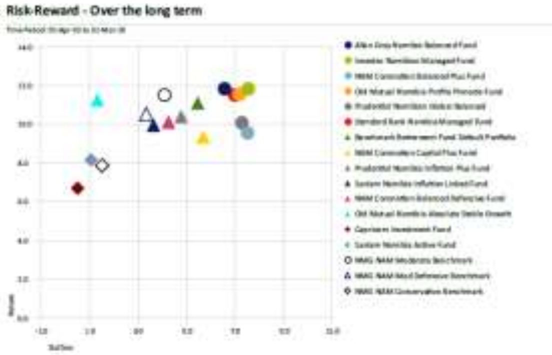
Graph 1.9

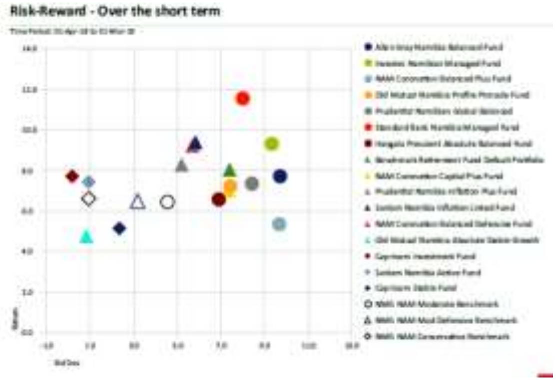


Graph 1.10



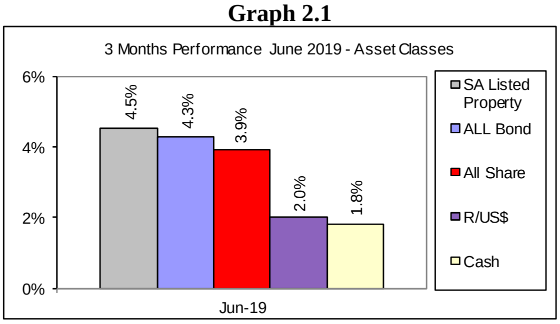
Risk/ Return



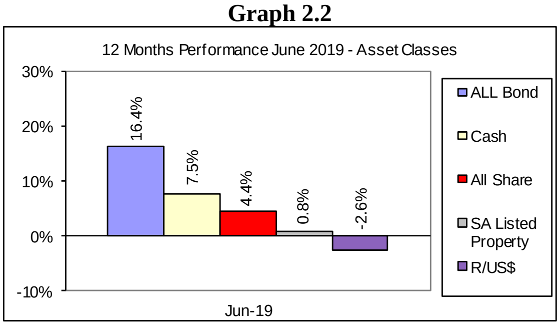


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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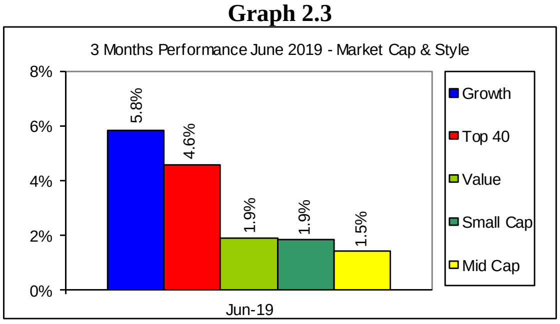
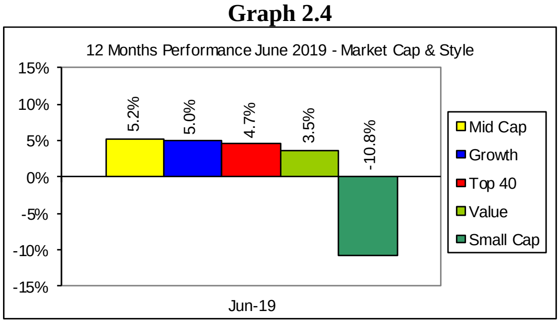
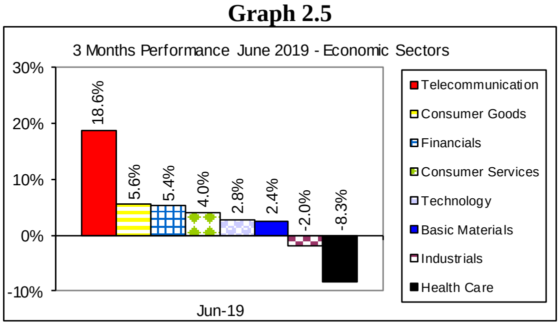
Graph 2.3



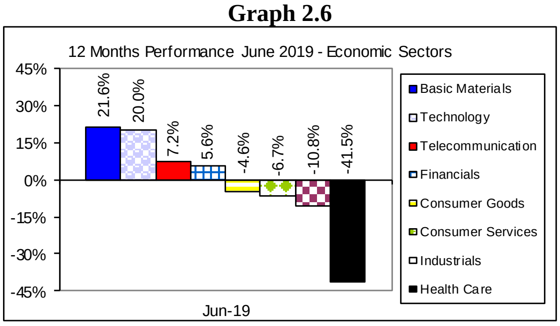
Graph 2.4



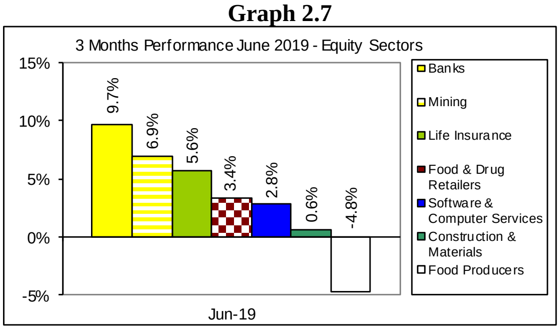
Graph 2.5



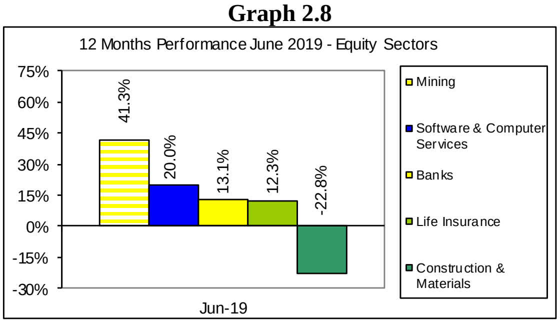
Graph 2.6



Graph 2.7



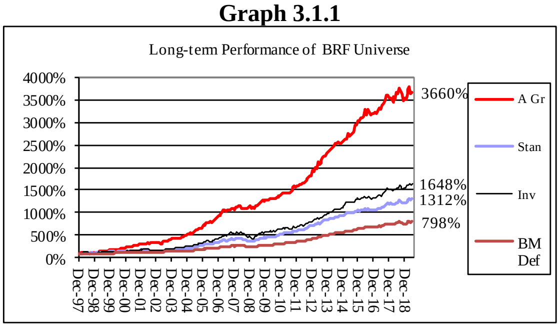
Graph 2.8



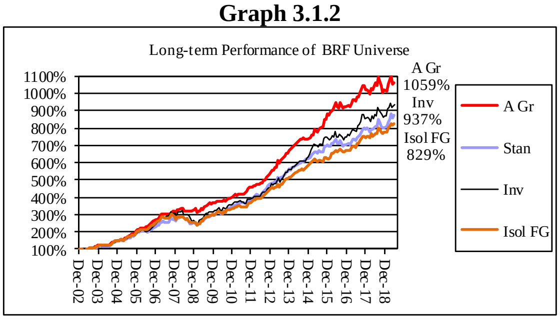
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1

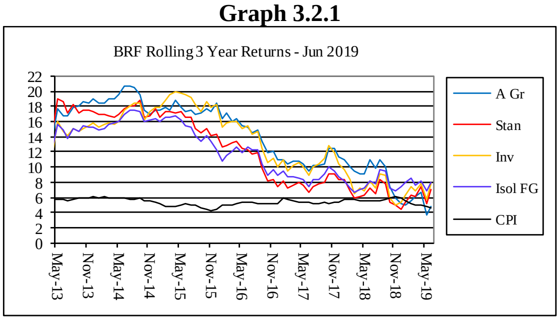


Graph 3.1.2



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

Graph 3.2.1



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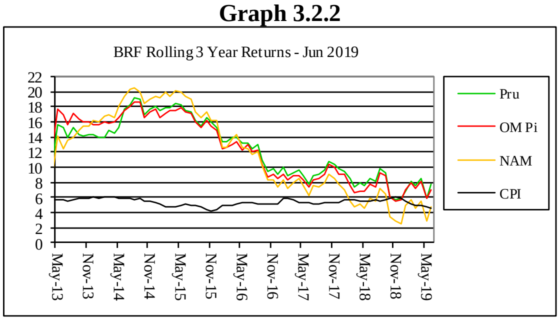
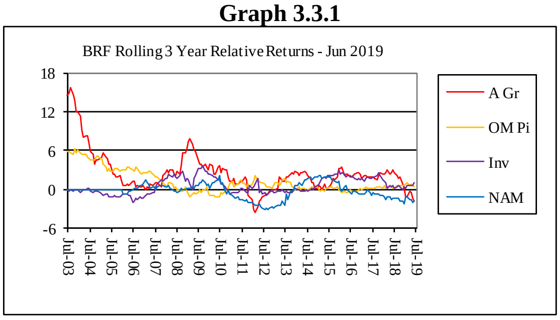
Graph 3.2.2

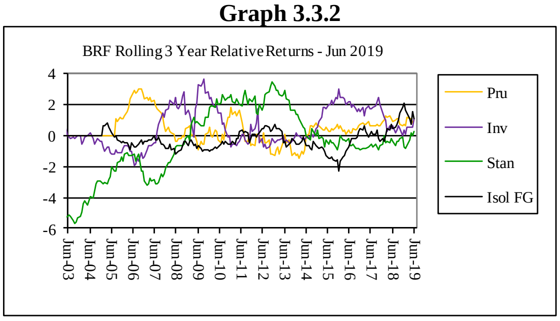


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

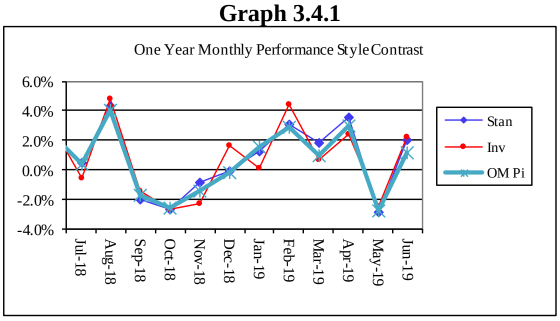


Graph 3.3.2

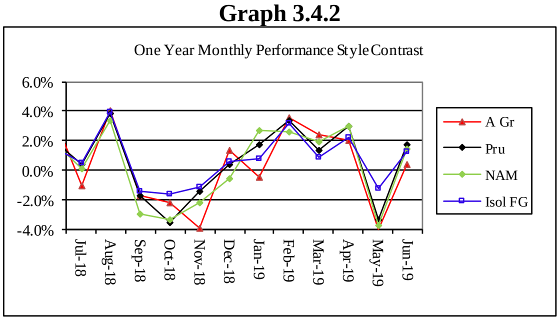


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

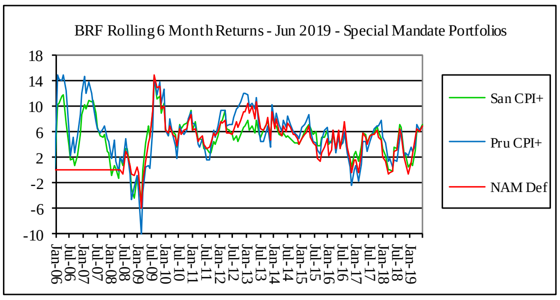


Graph 3.4.2

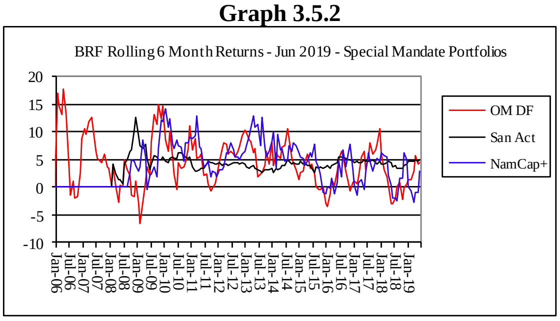


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

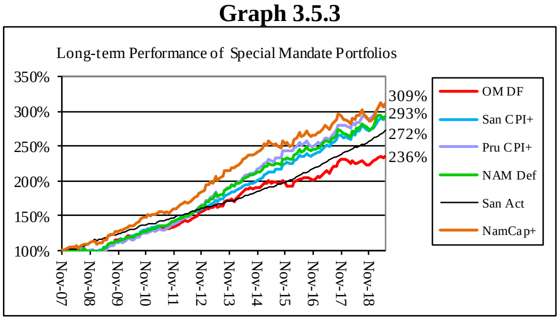
Graph 3.5.1



Graph 3.5.2



Graph 3.5.3



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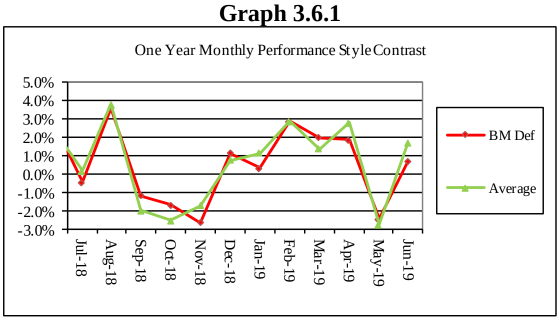
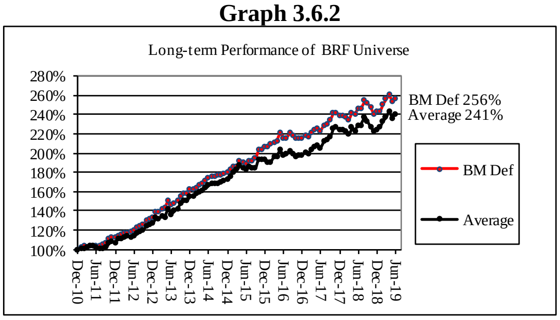
3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

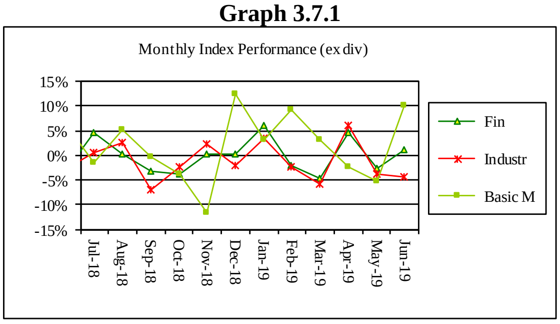


Graph 3.6.2

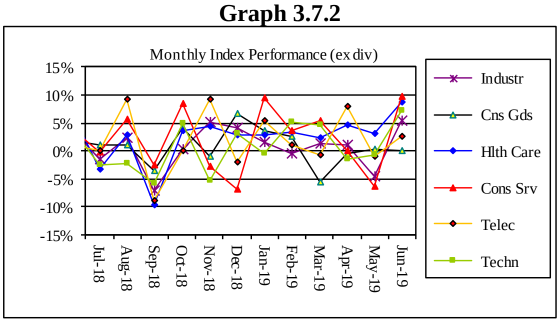


3.7 One-year monthly performance of key indices (excluding dividends)

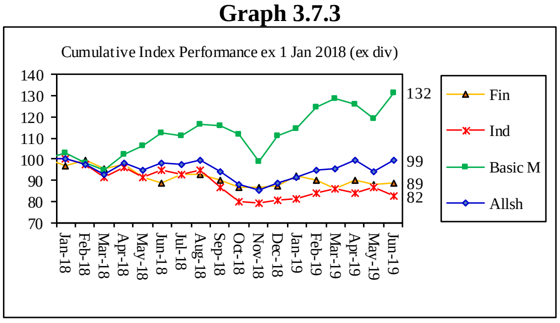
Graph 3.7.1



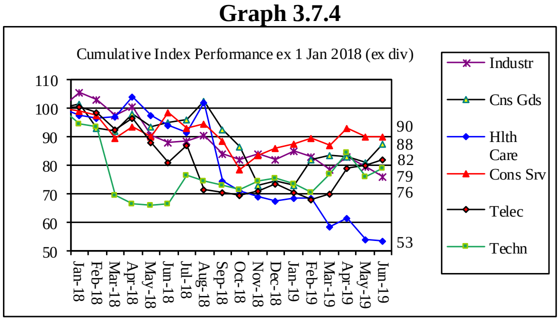
Graph 3.7.2



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.	7.9	7.6
5-year real return - % p.a.	3.2	2.9
Equity exposure - % of portfolio (qtr end March 2019)	48.1	67.2
Cumulative return ex Jan 2011	155.9	140.6
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 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.

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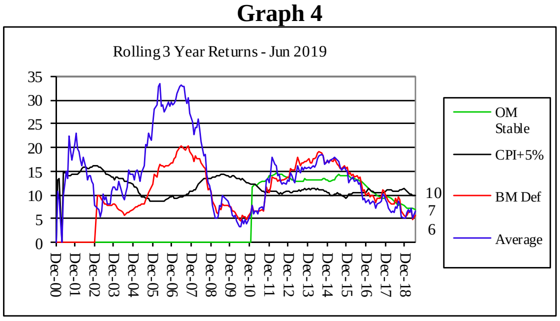
Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.6%	4.7%	5.0%
Best annual performance	8.2%	13.8%	12.5%
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	7.7%	5.8%	6.7%

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

Graph 4



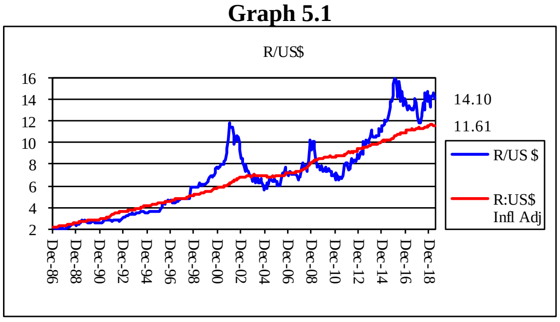
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3-year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end June was 5.8%, the average was 6.7% vs CPI plus 5% currently on 9.6%.

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 11.61 to the US Dollar while it actually stood at 14.10 at the end of June. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

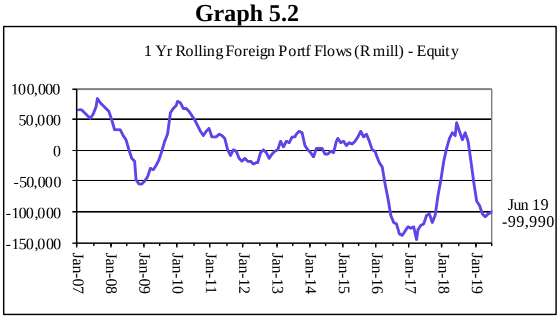


The Rand strengthened by 3.46% in June with net foreign investment inflows from bonds and equities of R 2.7 bn. Over the past 12 months the Rand weakened by 2.56%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 112.8 bn (outflow of R144.7 bn to end of May 2019).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 212.3 bn (May R 209.7bn).

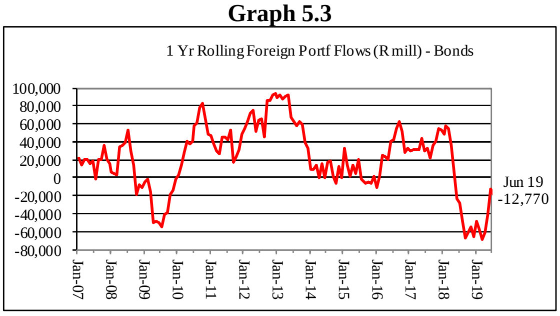
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 100 bn at the end of June (outflow of R 104.5 bn year-on-year to end May). The month of June experienced a net inflow of R 5.6 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 73.8 bn (end May net investment outflow of R 79.4 bn). This represents roughly 0.45% 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 12.8 bn over the past 12 months to end of June (outflow of R 40.2 bn over the 12 months to end of May). The month of June experienced a net outflow of R 2.9 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 286.2 bn (to May R289.1 bn).

Graph 5.3



Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.9% 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 2.9% p.a. over this period, excluding dividends, or around 6% including dividends.

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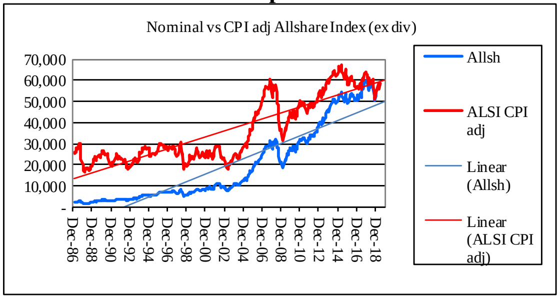
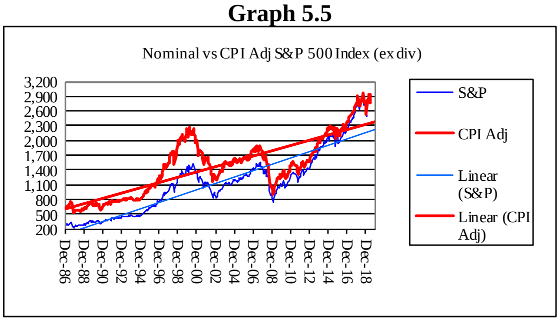
Graph 5.4



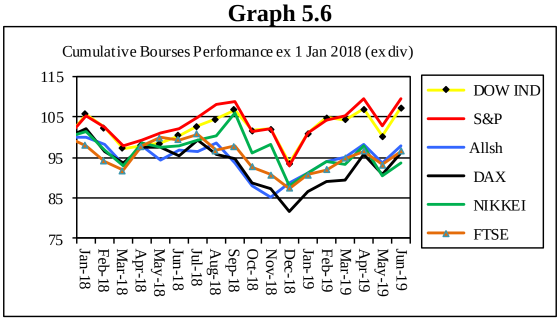
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.5% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 4.9% p.a. over this period, excluding dividends or around 7.1% including dividends.

Graph 5.5



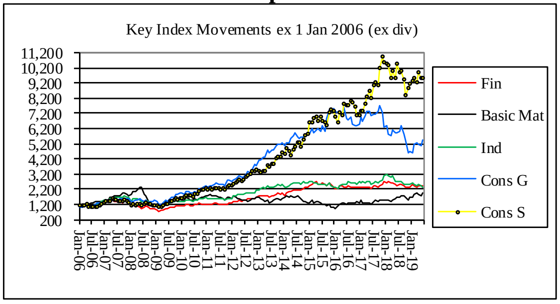
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2018.

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: 13.4%; Financials: 6.7%; Industrials: 6.4%; and Basic Materials: 5.0%.

Graph 5.7



6. Avoid permanent loss but be prepared to give up value

By Tilman Friedrich

If you own something you do not use, chances are you will lose – "use it or lose it" is a rugby rule. It applies to all spheres of life. What you use, no one will be able to take from you, if we equate 'using' to 'consuming.

This wisdom also applies to your investments. Your capital is something you do not use and chances are you will lose. This is not to say that you will always lose, but there will be times when you will lose. The best thing you can do is to be prepared for losing at times.

One also needs to distinguish between different types of losses namely, a temporary loss and a permanent loss. A permanent loss is something you cannot recover as opposed to a temporary loss.

Since we are dealing with pension fund and personal investments, in terms of market conditions we find ourselves in a situation where we feel we have been on a losing streak for quite some time. But how do you actually define loss in these circumstances? Is it a loss relative to something inflation or is it a loss relative to the types of returns one has seen in investment markets until the advent of the financial crisis at the end of 2008 and from the middle of 2011 up until the middle of 2015? I suspect many investors are still clamouring for returns in the 20% and more. Important however should only be your real return, with inflation being your bottom line!

Where would you have invested had you anticipated developments in financial markets since the financial crisis? It was not too difficult to anticipate what the impact of quantitative easing and the low interest rate environment would be, but, no one would have anticipated such a strong recovery for a 4 year period followed by a flattening of financials markets thereafter. The readers that have been following this column would be aware that I have been anticipating flat markets for quite some time.

What alternative investments could you possibly have made in anticipation of what was to be expected -

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 JUNE 2019

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

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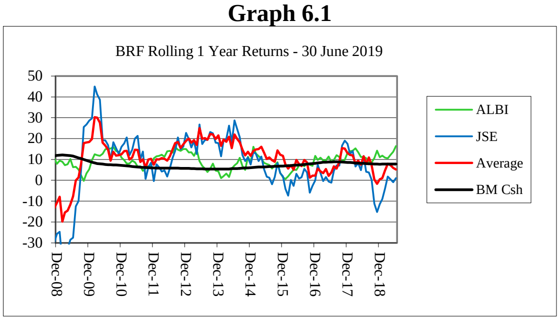
property, life stock, vintage cars or other exotic objects? Well test them one-by-one. Property in Namibia would not have been a good idea. Life stock in Namibia would have been a disaster. Gold or any other exotic object? Try and sell them when you need money for consumption!

That basically leaves you with bonds, equity and cash. Nowadays, it is quite common for investors to say, I want to be in cash because its returns are, let's say, not worse than those of bonds and equity. So with that argument you are concerned about a loss of returns on equity and bonds relative to returns on cash. How about a loss relative to a real return. i.e. you are not achieving inflation plus 5% as the typical pension fund formula would expect?

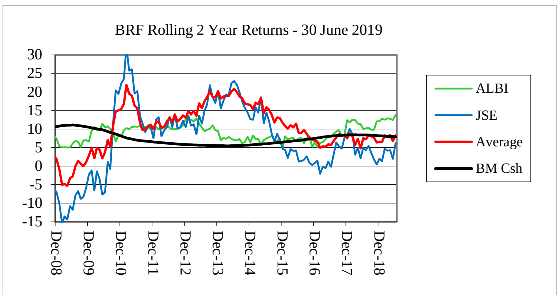
It is common cause that cash is only for investment with a short-term horizon. Look at graph 6.1 which reflects rolling 1 year returns (short-term horizon) of the main conventional asset classes pension funds typically invest in. You will note that cash depicted as the black line is sitting on around 10%. Compare this to the other asset classes and the average prudential balanced portfolio, in particular. You will notice that cash generates very smooth returns while the other lines are very volatile, moving between minus 30% and plus 50% on a rolling one year basis. If you add the number of months the other lines are below the black line, you should find that the other lines are more often above than below the black line.

Graph 6.1



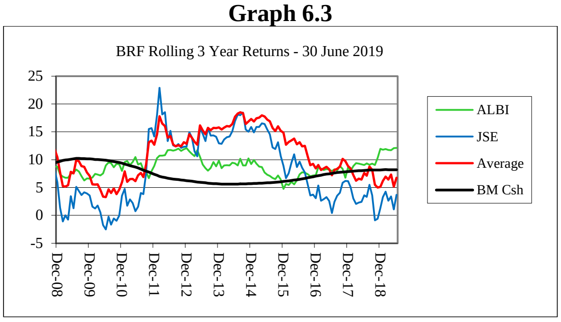
In graph 6.2 I have extended the period measured to rolling 2 year returns (short-term horizon). Note how the volatility decreases to between minus 15% and plus 30%. Note also that by-and-large cash returns are lower than those of the other asset classes.

Graph 6.2



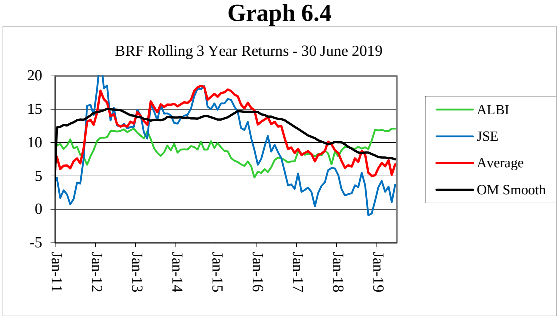
Finally in graph 6.2 I have extended the period measured to rolling 3 year returns (medium-term horizon). Note how the volatility decreases further to between zero % and plus 23%. Again, cash returns are mostly lower than those of the other asset classes.

Graph 6.3



There are also those investors who believe that the smooth bonus portfolios can avoid the downs of investment markets. If you look at graph 6.4 and track the red line against the black line, you will note that they actually produce returns, less volatile, but very closely resembling those of the average prudential balanced portfolio. After all, they invest in exactly the same assets as any conventional pension fund portfolio does.

Graph 6.4



Conclusion:

Going by the above facts, there is actually nowhere to hide. The assets you do not use will expose you to the probability of losing. The other assets that you do use, will give you the pleasure of their usage but you do not really know what they are worth.

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You should at all-time try to avoid a permanent loss of your investment but be prepared to give up value from time to time. How do you avoid a permanent loss? It's really about not putting all your eggs in one basket. Spread your investment across different asset classes, different continents and different countries. Know what your investment horizon is and invest accordingly. Have a strategy and stick to that, whether it means that you may not time the best moment for moving assets offshore or for buying into assets when it may not have been the ideal moment. You cannot time the market. As often as you may be right you will be wrong!

While the interest rate environment has not normalised, we will continue to experience low returns, not only in absolute terms but also relative to inflation.

If you have to live off your investments, you must adapt your cost of living to the returns your investments realise, i.e. the net rental income, net dividends and net interest earned. When you are in a pooled investment vehicle, you should work on a net return of approximately 3%.