Volume 15 No. 11
November 2019

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 NOVEMBER 2019

By T H Friedrich – 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

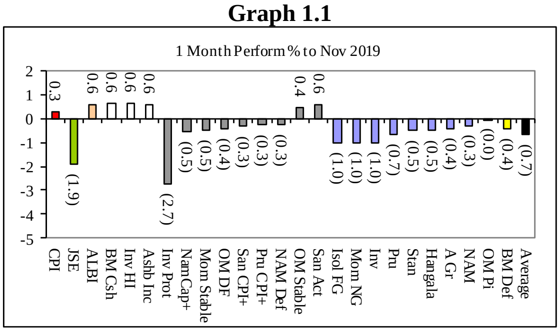
In November 2019 the average prudential balanced portfolio returned -0.7% (October 2019: 1.6%). Top performer is Old Mutual Pinnacle Profile Growth with 0.0%, while Investment Solutions with -1.0% takes the bottom spot. For the 3-month period, Namibia Asset Managers takes top spot, outperforming the 'average' by roughly 1.2%. On the other end of the scale Stanlib Managed Fund underperformed the 'average' by 1.4%. Note that these returns are before (gross of) 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.

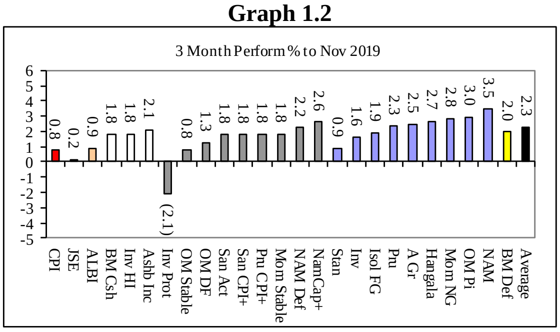
Below is the legend to the abbreviations reflected on the graphs:

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)
Ashburton Namibia Income Fund	Ashb Inc (no color)
Momentum Nam Stable Growth	Mom Stable (grey)
NAM Capital Plus	NamCap+ (grey)
NAM Coronation Balanced Def	NAM Def (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Prudential Inflation Plus	Pru CPI+ (grey)
Sanlam Active	San Act (grey)
Sanlam Inflation Linked	San CPI+ (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)
Investment Solutions Bal Growth (multimanager)	Isol FG (blue)
Momentum Namibia Growth	Mom NG (blue)
NAM Coronation Balanced Plus	NAM (blue)
Old Mutual Pinnacle Profile Growth	OM Pi (blue)
Prudential Managed	Pru (blue)
Stanlib Managed	Stan (blue)

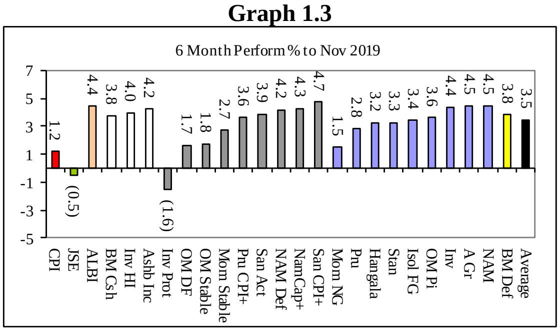
Graph 1.1



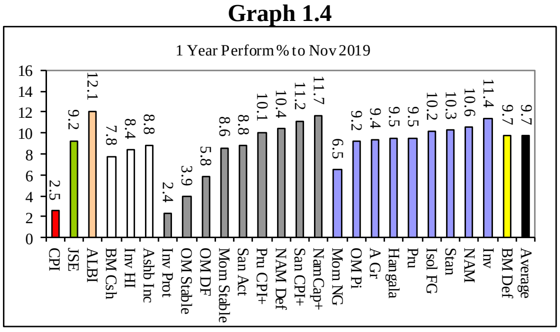
Graph 1.2



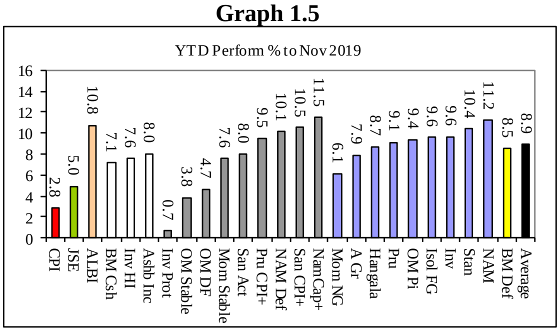
Graph 1.3



Graph 1.4



Graph 1.5



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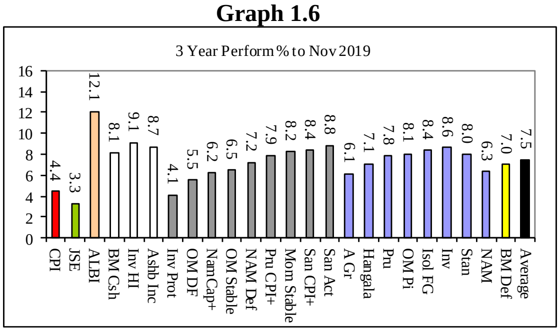
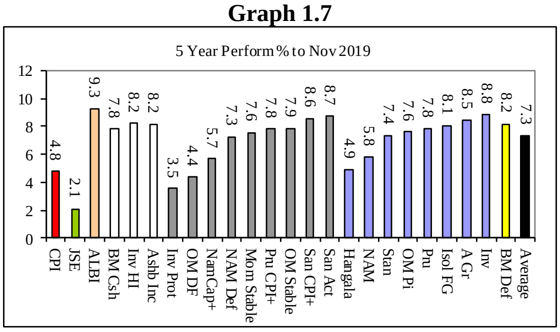
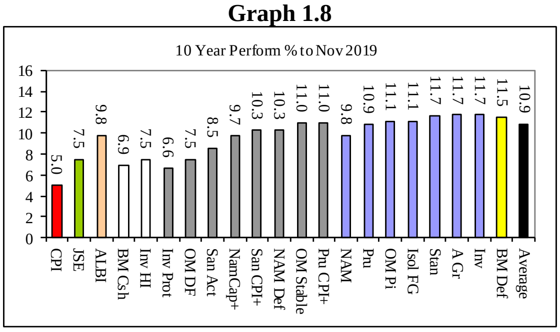
Graph 1.6



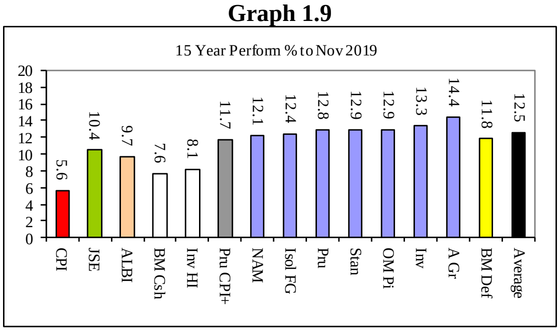
Graph 1.7



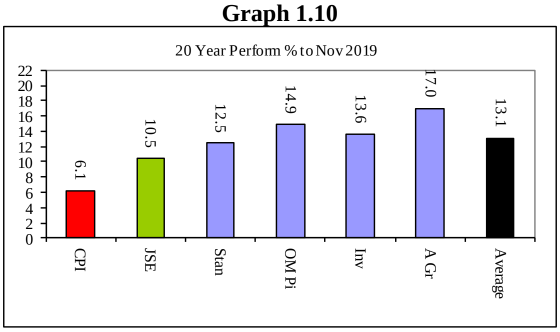
Graph 1.8



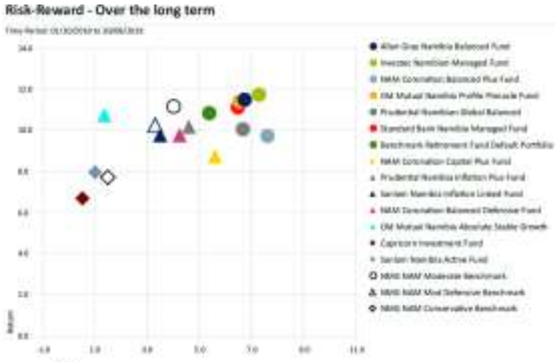
Graph 1.9



Graph 1.10

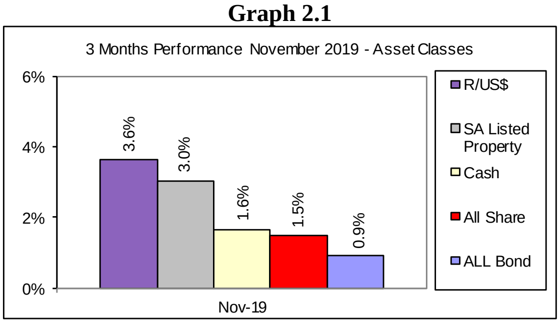


Risk/ Return

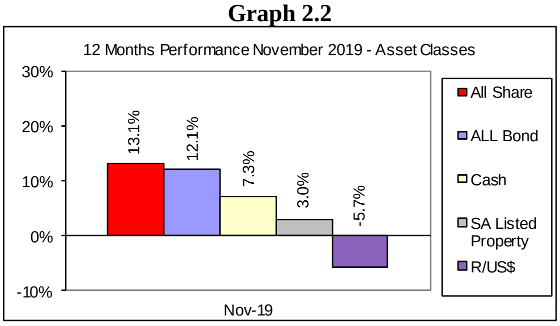


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

Graph 2.1



Graph 2.2



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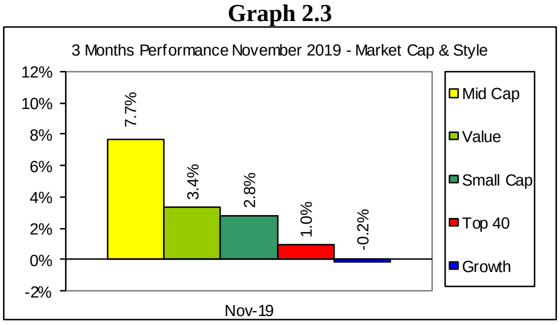
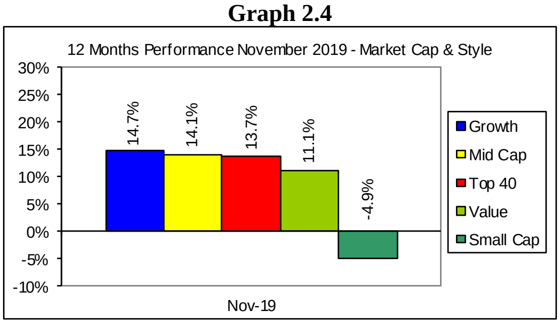
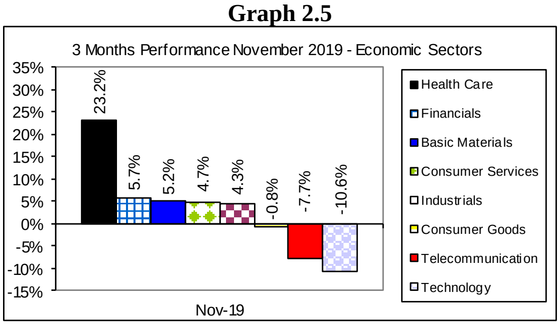
Graph 2.3



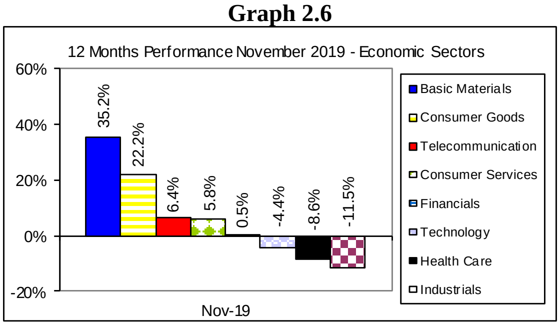
Graph 2.4



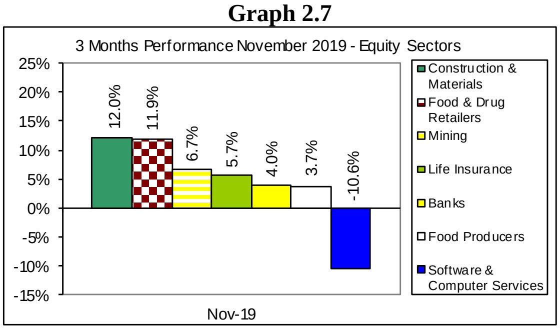
Graph 2.5



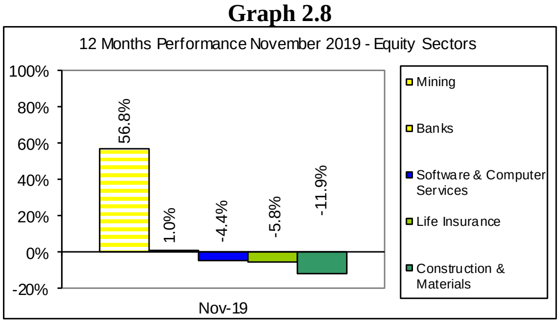
Graph 2.6



Graph 2.7



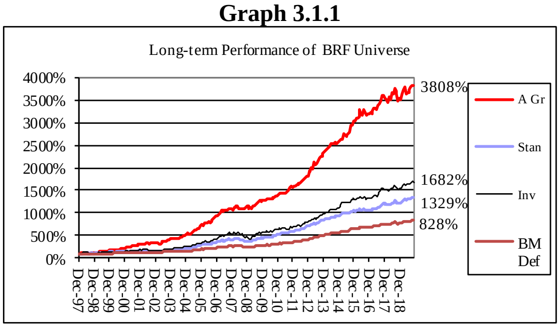
Graph 2.8



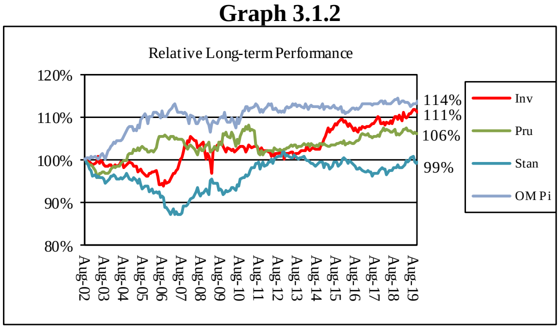
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

Graph 3.1.1



Graph 3.1.2



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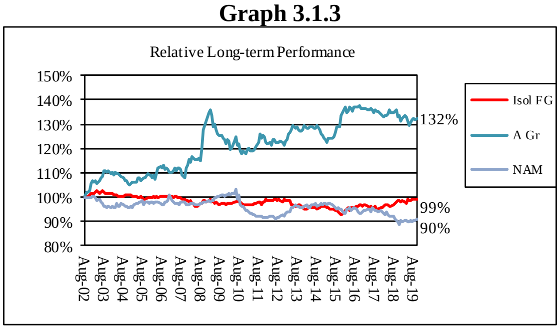
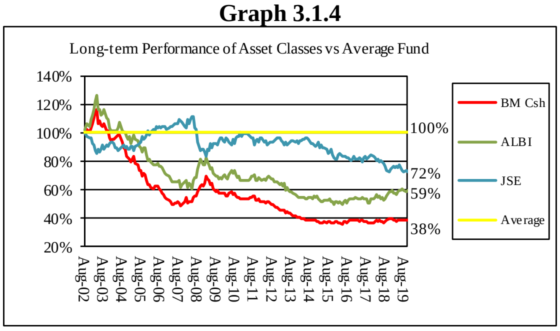
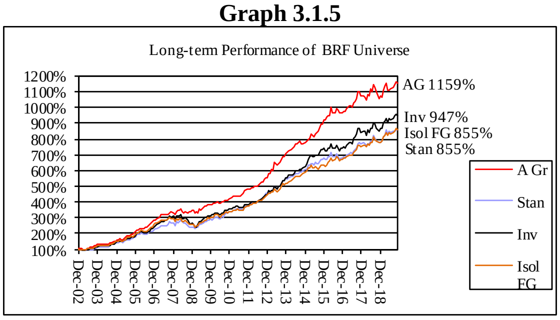
Graph 3.1.3



Graph 3.1.4

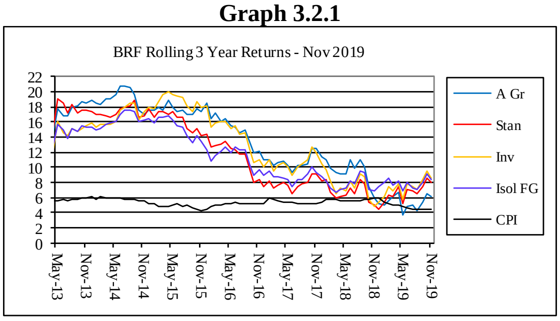


Graph 3.1.5

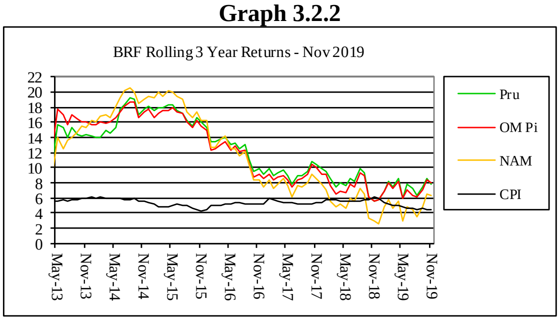


3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

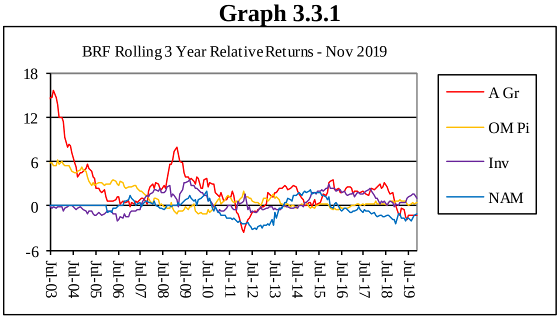


Graph 3.2.2

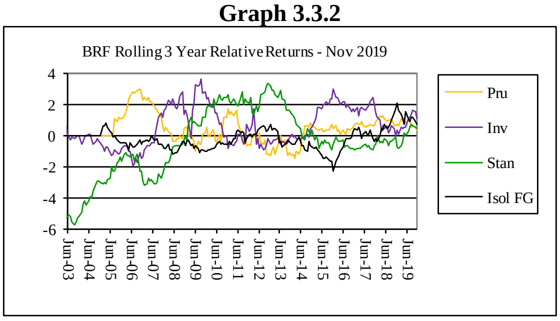


3.3 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

Graph 3.3.1

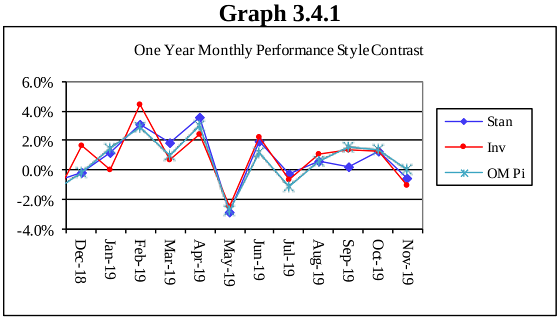


Graph 3.3.2



3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1



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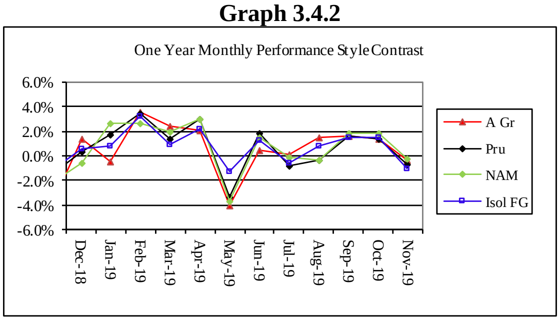
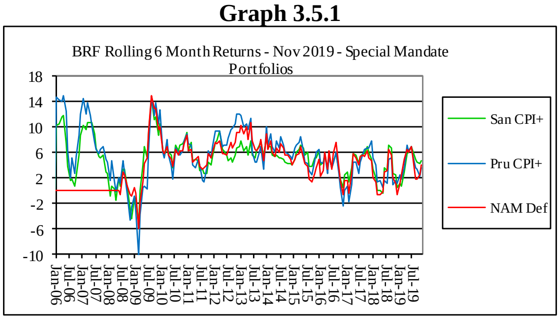
Graph 3.4.2

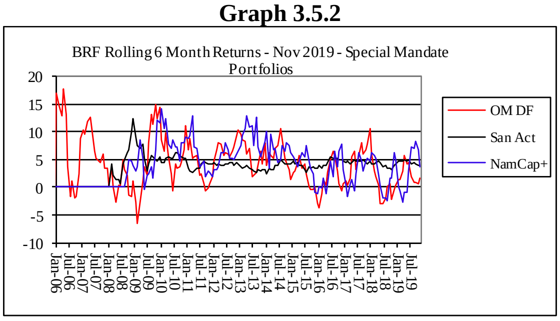


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

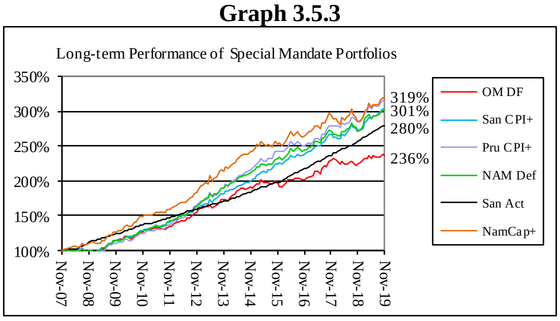
Graph 3.5.1



Graph 3.5.2

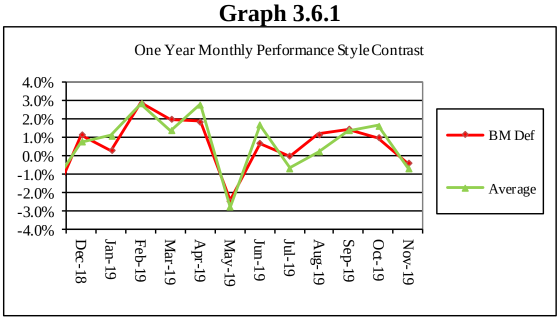


Graph 3.5.3

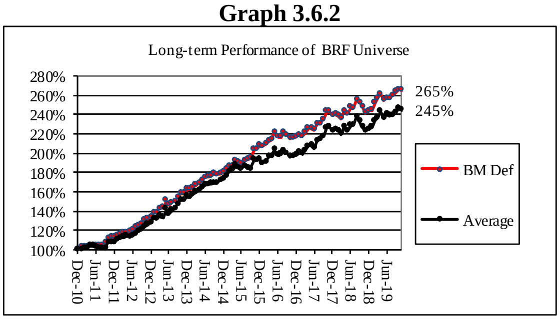


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1

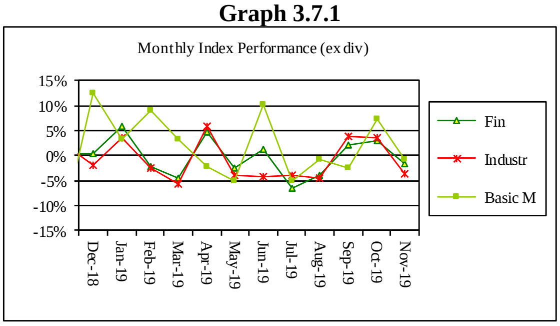


Graph 3.6.2

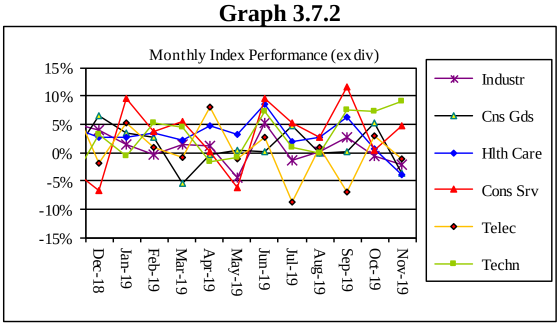


3.7 One-year monthly performance of key indices (excluding dividends)

Graph 3.7.1



Graph 3.7.2



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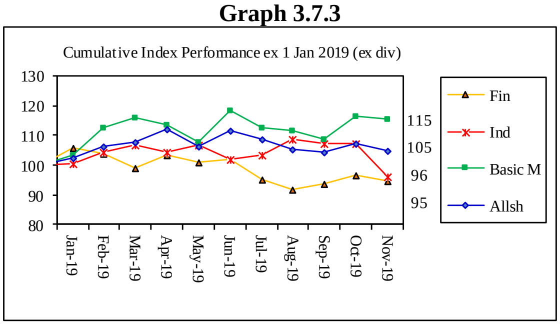
Graph 3.7.3



4. The Benchmark Default Portfolio – Facts in figures

Table 4.1

Portfolio	Default portfolio	Average Prud Bal
5-year nominal return - % p.a.	8.2	7.3
5-year real return - % p.a.	3.4	2.5
Equity exposure - % of portfolio (qtr end September 2019)	58.3	66.0
Cumulative return ex Jan 2011	164.9	145.8
5-year gross real return target - % p.a.	5	6
Target income replacement ratio p.a. - % of income per year of membership	2	2.4
Required net retirement contribution - % of salary	13.0	11.6

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

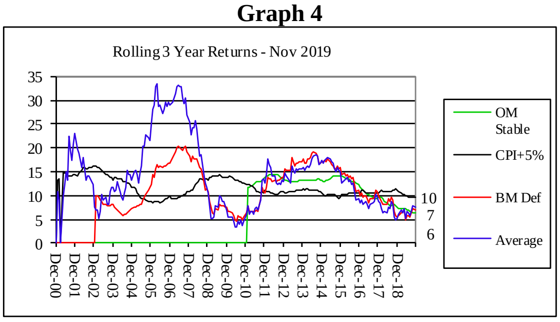
The default portfolio's long-term return must be read in the context of it initially having been managed with a low risk profile that was only changed from the beginning of 2011 when the Metropolitan Absolute Return fund was replaced with the Allan Gray balanced portfolio.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	7.0%	4.8%	5.0%
Best annual performance	8.2%	11.0%	10.1%
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	7.9%	8.2%	7.4%

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

Graph 4



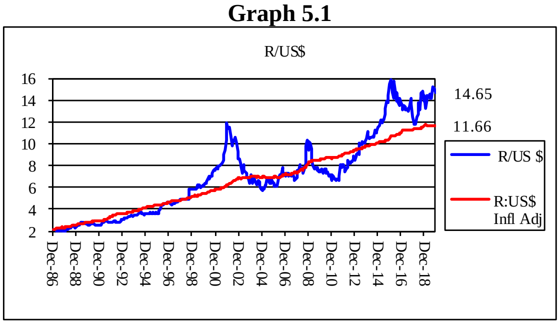
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3-year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end September was 7.0%, the average was 7.5% vs CPI plus 5% currently on 9.5%.

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 11.66 to the US Dollar while it actually stood at 14.65 at the end of November. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1



The Rand strengthened by 3.0% in November with net foreign investment outflows from bonds and equities of R28.0 bn. Over the past 12 months the Rand weakened by 5.7%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 169.0 bn (outflow of 159.4 bn to end of October 2019).

Since the beginning of 2006, total net foreign portfolio inflows amounted to R 81.5 bn (October R 110.0 bn).

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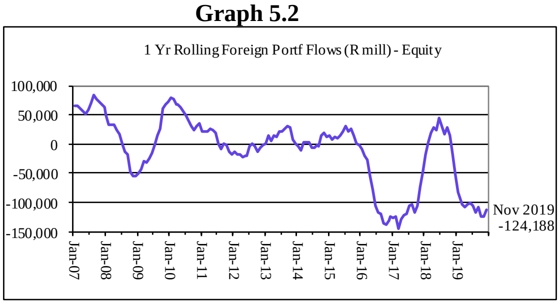
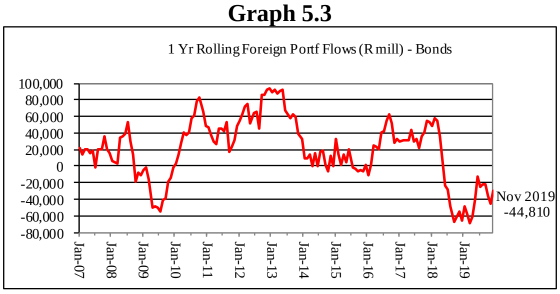
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 124.2 bn at the end of November (outflow of R 123.5 bn year-on-year to end October). The month of November experienced a net outflow of R 20.8 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 156.1 bn (end October net investment outflow of R 135.3 bn). This represents roughly 0.92% of the market capitalization of the JSE.

Graph 5.2



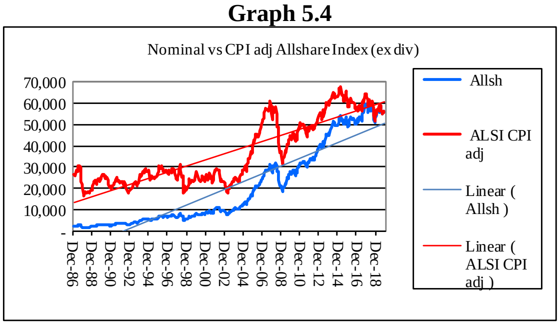
Graph 5.3 on a rolling one-year basis reflects foreign portfolio outflows in respect of SA bonds of R44.8 bn over the past 12 months to end of November (outflow of R 35.9 bn over the 12 months to end of October). The month of November experienced a net outflow of R 7.7 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 237.7 bn (to October R 245.3 bn).

Graph 5.3



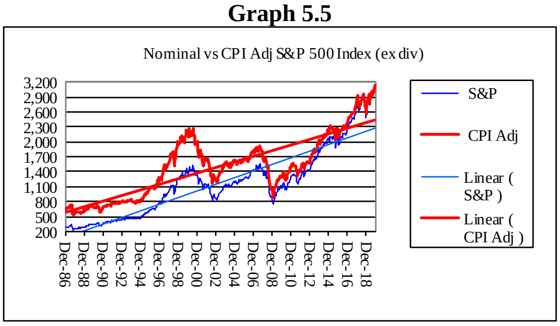
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.6% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 30 years was 7.9% per year. This is equivalent to a growth in real terms of 2.7% p.a. over this period, excluding dividends, or around 5.7% including dividends.

Graph 5.4



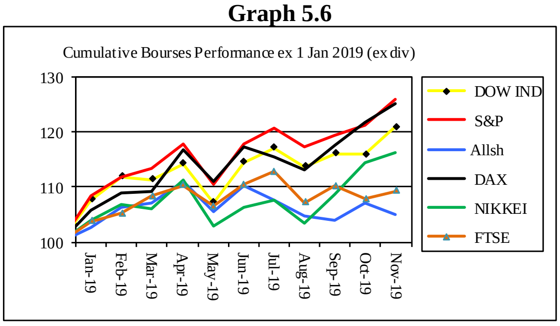
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 7.7% per annum, over this period of 30 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 5.1% p.a. over this period, excluding dividends or around 7.7% including dividends.

Graph 5.5



Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2019.

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: 17.1%; Consumer Goods: 12.8%; Financials: 5.9%; Industrials: 5.8%; and Basic Materials: 4.7%.

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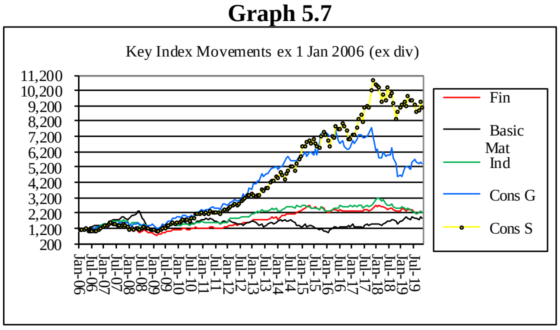
Graph 5.7



6. What do we expect of investment markets in 2020?

by Tilman Friedrich

Going into the New Year hurt by poor returns on pension fund investments, this is a relevant question when thinking of our stakeholder, the pension fund member and more specifically his investment.

Graph 6.1 below shows the 5 year rolling returns rolled forward by one month at a time from December 2008 to November 2019. Why 5 years? Well that is a period more relevant to a long-term fund member as opposed to any shorter period. So it should reflect a more appropriate picture. Why 'rolling' returns? Well 'rolling returns' give a much better insight than point in time returns, reflected as bar charts in performance reviews. The point in time returns are those as at the end of every month, sometimes showing the peak, sometimes the trough, hiding what happened in between and as graph 6.1 shows, the returns vary widely from one month to the next.

Turning to the story revealed by graph 6.1, the fairly stable black line represents the returns on the Benchmark money market portfolio, which is usually the benchmark for fund members when their typical prudential balanced pension fund portfolio does not do well.

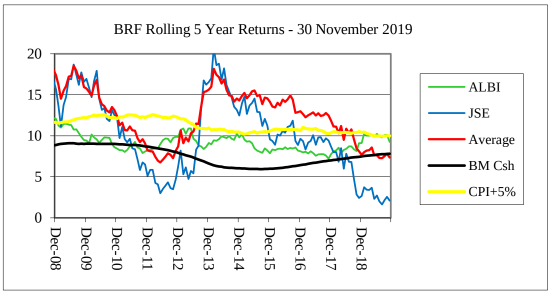
The also fairly stable yellow line represents the return one would expect to earn on your pension fund investment over the long-term and what is required to secure a comfortable pension after retirement, offering an income replacement ratio of 2% per year of membership, assuming the contributions towards retirement have been in the region of 14% of pensionable remuneration throughout.

If we now consider the rolling 5 year return of the Benchmark money market portfolio (stable black line), it has constantly been below the yellow line (CPI plus 5%), the shortfall in expected long-term return being anything between 2% and close to 5% per annum! This is not where a pension fund member can afford to be unless it is for a specific purpose and with a short-term horizon only.

Turning to the red line, reflecting the rolling 5 year returns of the average prudential balanced portfolio, we see that the fund member would have done well until the end of 2010, some disappointment then setting in to the middle of 2013, then a long stretch of outperforming until the end of 2017 and since then more disappointment. While the current underperformance is very much in line with that of the Benchmark money market performance and about 2% short of where one would want to be, it is also evident that the outperformance is generally much more pronounced than the underperformance.

Anecdotally graph 6.1 also reflects the returns of an all share investment as the blue line and of an all bond investment as the green line. I venture to say that the most satisfactory line is indeed the red line, i.e. the performance of the average prudential balanced portfolio.

Graph 6.1



We know that the situation we are in 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 here reflect in the sharp up-turn of the blue (all share portfolio) and the red line (average prudential balanced portfolio) from the end of 2012 to April 2014. Since then the US started to phase out it easy money policy with a consequent, continuous decline in the 5 year rolling returns of these two indices in particular.

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 NOVEMBER 2019

By T H Friedrich – 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.

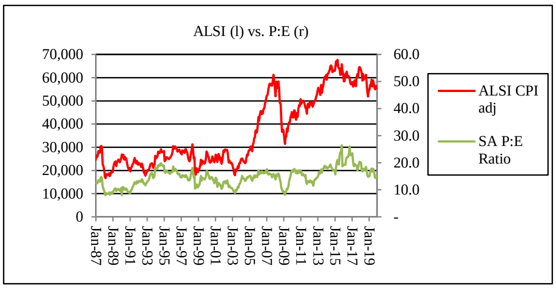
What can we expect of 2020 in terms of investment returns though? We just had a very long cycle of initially high, but consistently declining out-performance of the red line over a 7 year period and of underperformance only over the past 2 years in terms of rolling 5 year returns. A reversion to 'normal' investment returns, where risk is rewarded through higher returns, i.e. where an equity investment should yield the highest returns, followed by bonds and cash, restricting things to the main asset classes found in a typical pension fund portfolio, is dependent on central banks exiting their mode of manipulating the interest rate environment.

The US Fed rate of 1.75% currently represents a negative real return of 0.25% over prevailing inflation in the US of around 2%. Going by its long-term average the real rate should be around 1.7% in a normal interest rate environment. This is thus around 2% off the long-term average real rate. The expectation is that the US Fed's next move will be a further reduction of its policy rate. Unless US inflation were to increase, of which there is little evidence at the moment, the situation will worsen and we would currently not expect the interest rate environment to revert to 'normal' in 2020. In this regard we would expect SA interest rates to follow their global 'superiors'.

Equity of course comprises the largest asset class in the typical prudential balanced portfolio. The performance of equity is firstly driven by company profits which are driven by the economy, which is driven by consumer sentiment and the interest rate environment. Secondly equity performance is driven by investor sentiment. If company profits go up, the price of shares should go up, unless the investor sentiment turns more negative, and vise-versa. Low interest rates benefit companies with high debt and they benefit consumers who are generally indebted. But will company profits increase, will investor sentiment improve and will consumer sentiment improve from where it has been over the past 10 years and what will make the sentiment improve?

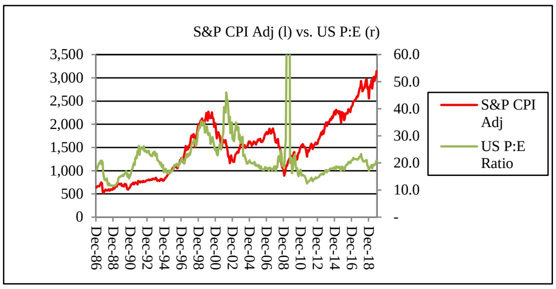
If we consider graph 6.2, we see that the JSE Allshare index (the red line) shows a clear declining trend. This could be due either to investor sentiment declining and the investor not being prepared to pay as much for a share as he was earlier on, or it could be due to company profits declining. The SA P:E ratio (the green line) shows a pretty synchronized decline which indicates that the missing factor here, the company earnings have largely been moving sideways. With what we know of the SA economy and the Escom predicament in particular, it cannot be foreseen that there will be a turnaround in SA over the next 12 months and local equities are thus likely to move sideways.

Graph 6.2



If we look at the same indicators as far as the US is concerned, we see that the US S&P 500 index (the red line) has shown a strong growth over the last number of years. In contrast to SA the US P:E ratio (the green line is moving sideways and slightly below its long-term average as show in this graph. US companies have thus been able to increase their earnings pretty consistently over the past number of years. Investor sentiment has certainly not been exuberant, probably in the light of the trade wars the US is involved in, so it is probably depressed with a prospect of it improving in the next 12 months if the trade war with China is settled amicably. Over this 30 year plus period the US S&P 500 index has grown by 5.1% inflation adjusted. That is not overly ambitious over this period. On that basis the US equity market should have some upward potential in 2020 and this should assist in propping up global equity markets that are not subject to their home made challenges.

Graph 6.3



Conclusion

Based on our above analysis, we do not foresee a return to a normal interest rate environment in 2020 but rather expect real interest rates to decline further, some into more negative territory. Global consumer and investor sentiment should stand a fair chance of improving rather than declining further. We believe locally consumer and investor sentiment is probably as low as it can get with a fair chance of also improving in 2020, just thinking of the early rains we thankfully experienced in parts of the region and a faint hope that the new Escom management may be able to make some progress. We would thus expect global equity markets to show some real growth in 2020. We expect the trend in interest rates to continue downward which in turn will impact positively on the performance of bonds. Bonds should also be able to produce a real return in 2020. Money market rates are consequently likely to decline globally. As the result, the typical prudential balanced portfolio should outperform the money market portfolio and we would expect it to achieve its long-term objective of inflation plus 5%.