Volume 6, No. 2, February 2010

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 28 FEBRUARY 2010

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 **February** the **average prudential balanced portfolio** returned 0.94% (minus 0.83% January). Best and worst performance **for the month** was delivered by Stanlib (1.43%) and Allan Gray (0.67%), respectively. Here is an analysis of performance of the best and worst performing manager based on our asset and sector allocation information as at 31 December 2009:

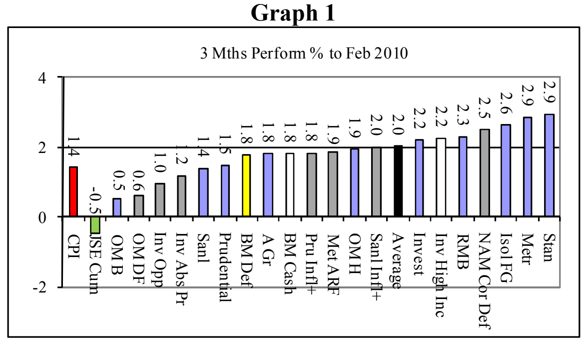
Asset Class	**Average**		**Stanlib**		**Allan Gray**	
	Asset alloc	**Perfor**	**Asset alloc**	**Perfor**	**Asset alloc**	**Perfor**
Local Eq	55.5%	0.4%	61.8%	0.4%	49.7%	0.1%
Local Bnds	10.3%	0.2%	8.6%	0.1%	6.6%	0.1%
Local Csh	12.4%	0.0%	10.9%	0.1%	15.4%	0.1%
Local Prop	1.9%	0.0%	0.0%	0.0%	1.1%	0.0%
Intern Eq	13.9%	0.5%	11.9%	0.4%	13.6%	0.5%
Intern Other	5.6%	0.1%	6.7%	0.1%	13.9%	0.3%
Projected Perf		**1.3%**		**1.2%**		**1.1%**
Proj error		- 0.4%		0.2%		- 0.4%
Actl Perf		**0.9%**		**1.4%**		**0.7%**

'Perfor' = asset class weighted performance

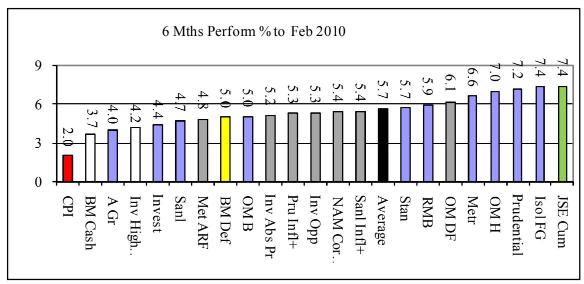
Graphs 1 to 7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential balanced 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 and Metropolitan Namibia Absolute Return. Below is the legend to the abbreviations reflected on the graphs:

Benchmarks	
Namibian Consumer Price Index	CPI Cum (red)
JSE Allshare Index	JSE Cum (green)
Benchmark Default Portfolio	BM Def (yellow)
Average Portfolio (prudential, balanced)	Aver (black)
Special Mandate Portfolios	
Money market	BM Cash (no colour)
Investec High Income (interest bearing assets)	Inv High (no colour)
Investec Absolute Protector	Inv Abs Pr (grey)
Investec Opportunity Fund	Inv Opp (grey)
Metropolitan Absolute Return	Metr ARF (grey)
Prudential Inflation Plus	Pru Infl+ (grey)
Old Mutual Dynamic Floor	OM DF (grey)
Sanlam Inflation Plus	Sanl Infl+ (grey)
NAM Coronation Balanced Def	NAM Prot (grey)
Market related portfolios	
Allan Gray Balanced	A Gr (blue)
Investec Managed	Invest (blue)
Investment Solutions Bal Growth, prev. Focused Growth (multimanager)	Isol FG (blue)
Prudential Managed	Prudential (blue)
Metropolitan Managed	Metr (blue)
Old Mutual Profile Balanced	OM B (blue)
Old Mutual Profile Growth	OM H (blue)
RMB Managed	RMB (blue)
Sanlam Managed	Sanl (blue)
Stanlib Managed	Stan (blue)

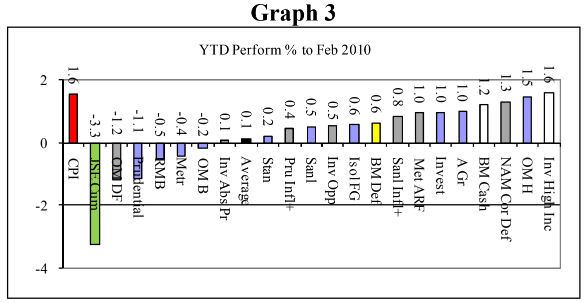
Graph 1



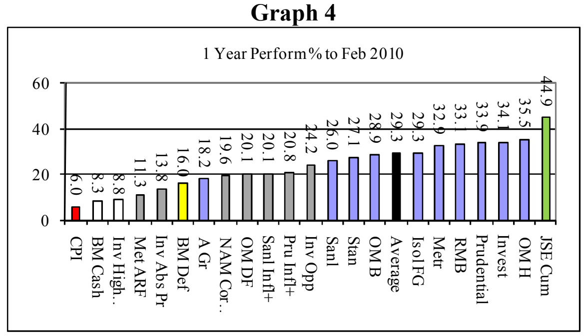
Graph 2



Graph 3



Graph 4



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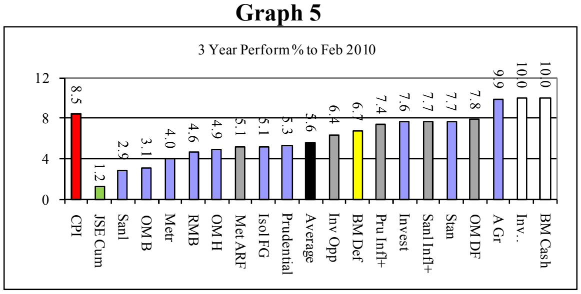
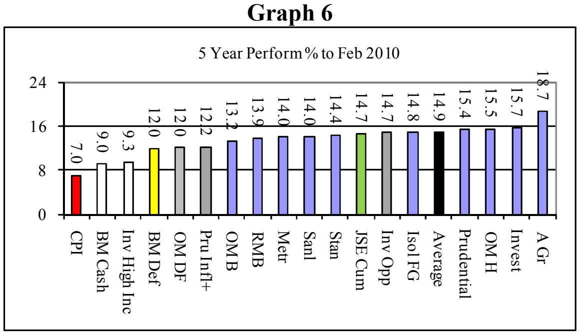
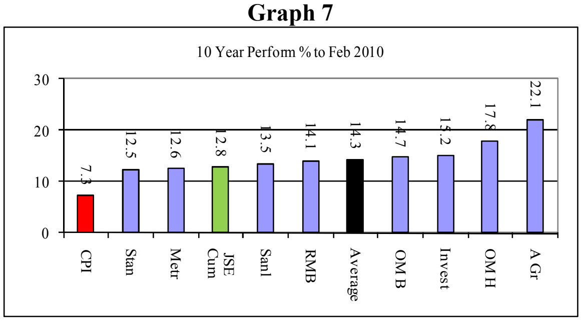
Graph 5



Graph 6

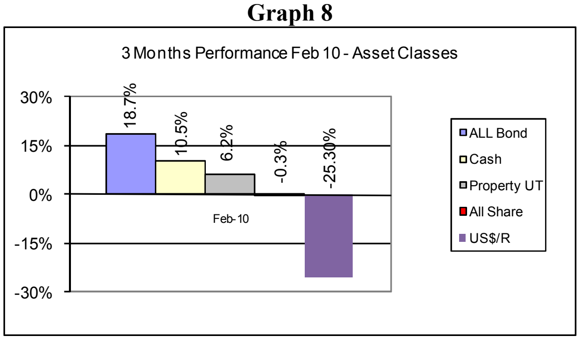


Graph 7

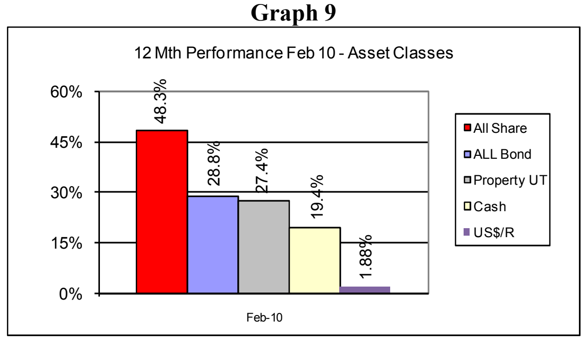


2. **Performance of Key Indices** (index performance by courtesy from pointBreak/Deutsche Securities)

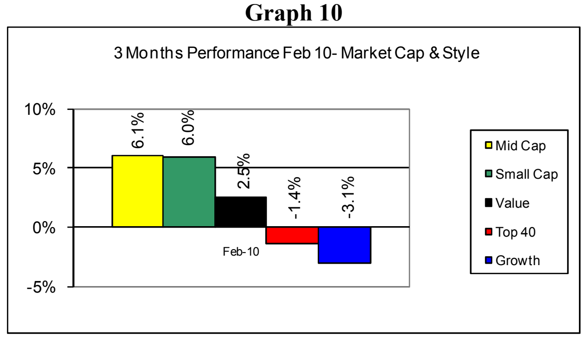
Graph 8



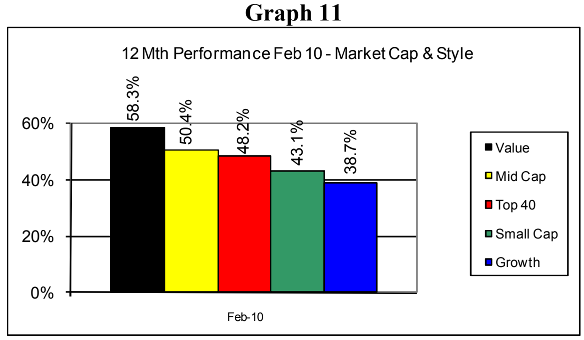
Graph 9



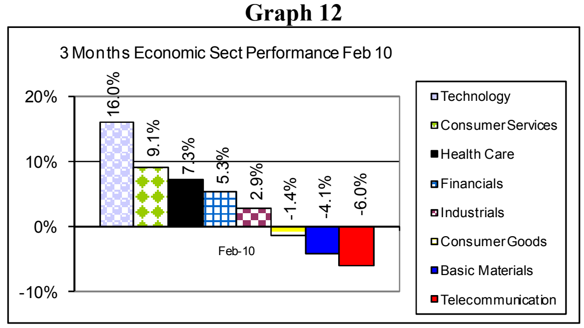
Graph 10



Graph 11



Graph 12



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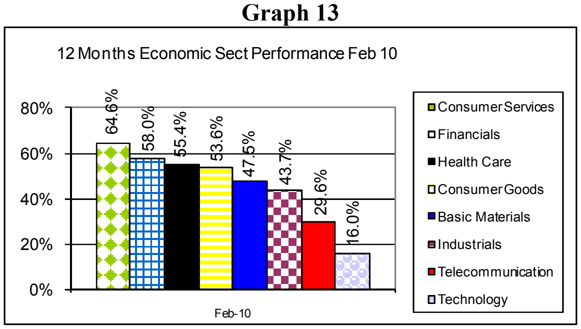
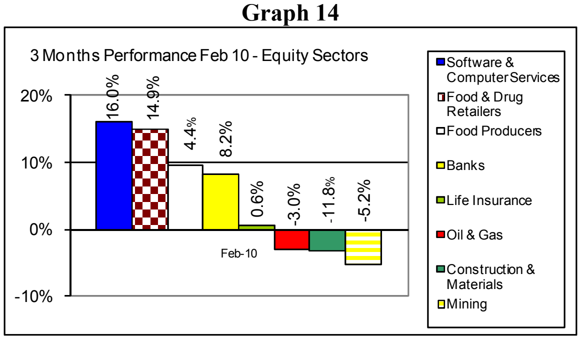
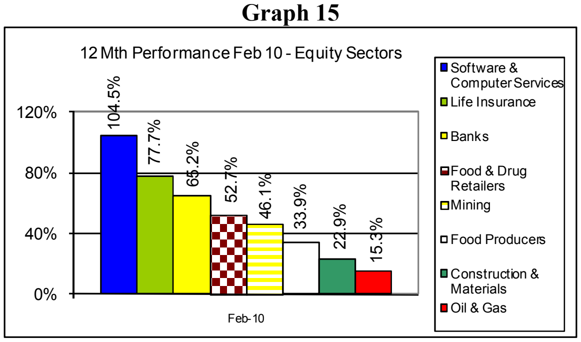
Graph 13



Graph 14



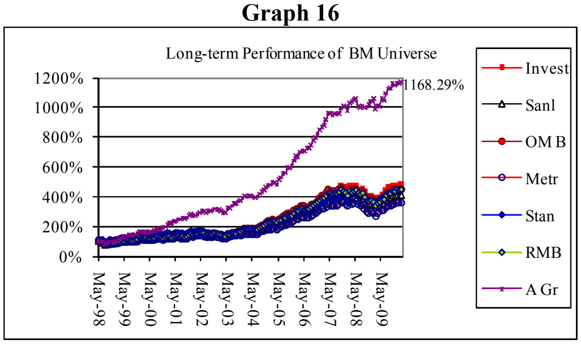
Graph 15



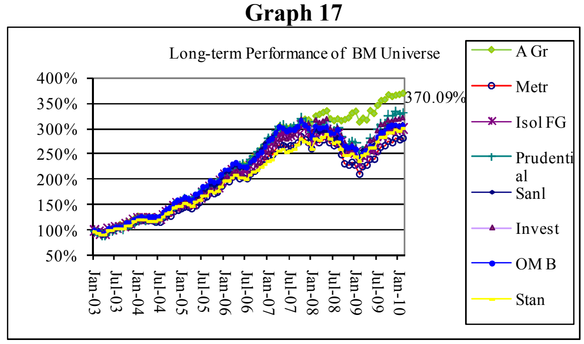
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 16

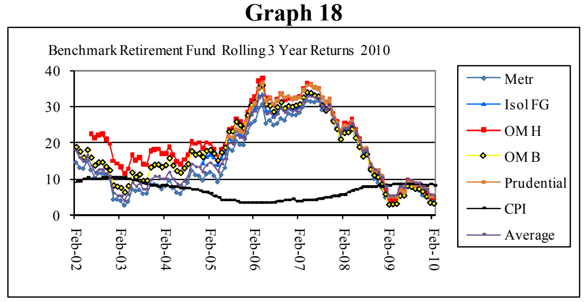


Graph 17

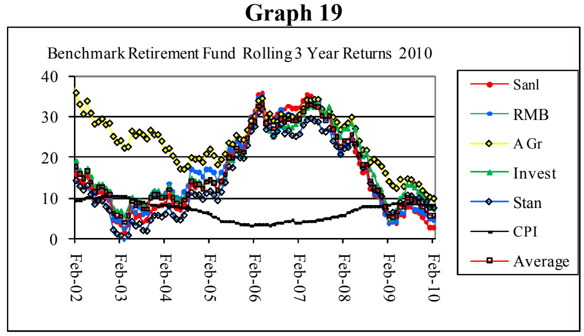


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 18

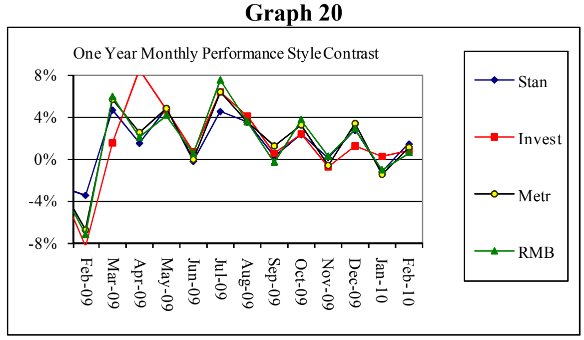


Graph 19



3.3. Monthly performance of prudential balanced portfolios

Graph 20



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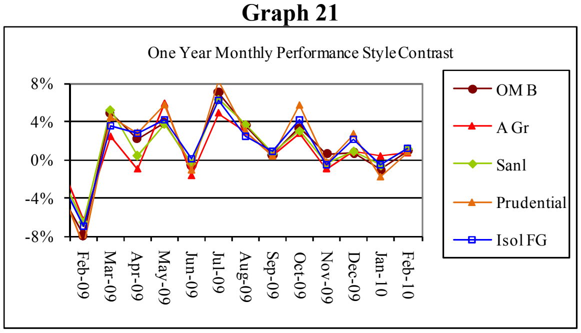
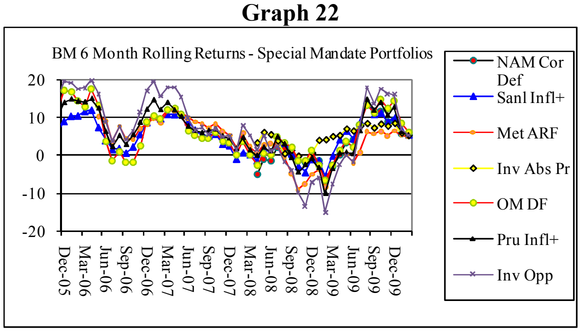
Graph 21



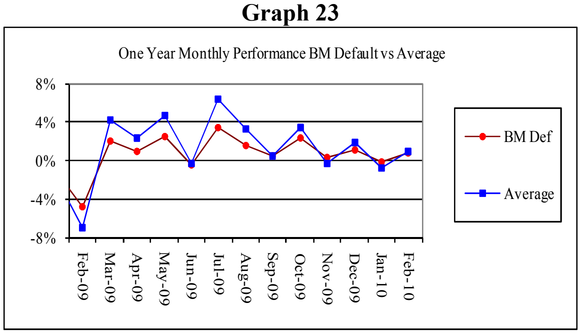
3.4. 6-month rolling returns of 'special mandate' portfolios

Graph 22



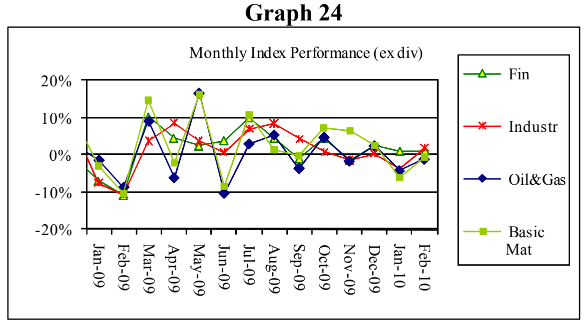
3.5 Monthly performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 23

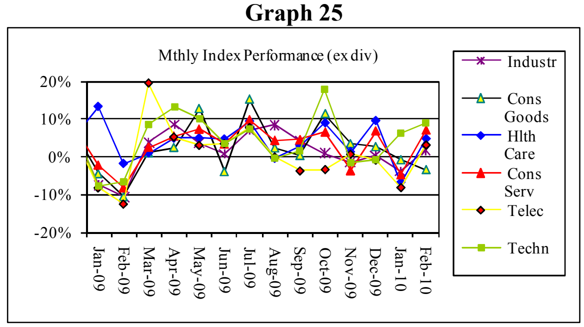


3.6 Monthly and one year cumulative performance of key indices (excluding dividends)

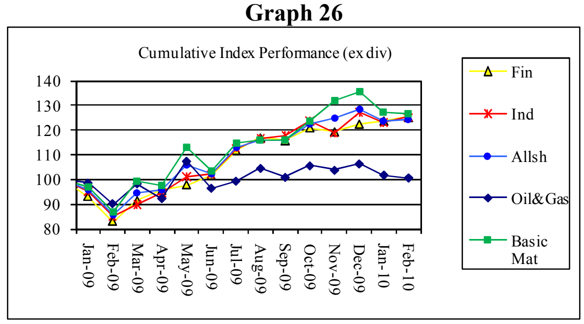
Graph 24



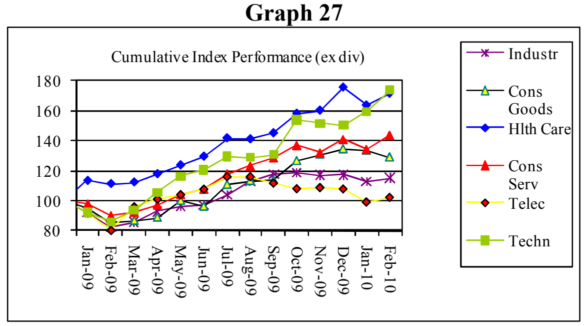
Graph 25



Graph 26



Graph 27



4. The Benchmark Default Portfolio

Graph 6 shows that the average prudential balanced portfolio returned 14.9% in nominal terms, or 7.9% in real terms, over the past 5 years while the Benchmark Default portfolio returned 12.0% in nominal terms, or 5.0% in real terms. We believe that the past 5 years are now much more representative of the expected long-term performance differential between the Default portfolio and the average prudential balanced portfolio, probably still slightly skewed in favour of latter portfolio. We would expect the average prudential balanced portfolio to deliver a real return of roughly 6% per year and the Default portfolio to sacrifice around 2% for the benefit of lower volatility, thus an expected real return of around 4% per year.

The Money Market portfolio returned 8.3% and the Default portfolio returned 16.0%, gross for the one year to end January. The more 'risky' average prudential balanced portfolio returned 29.3% gross over this period. A fee of roughly 0.75% p.a. still has to be deducted from all but the Money Market Portfolio. The performance of the prudential balanced portfolios is significantly more volatile than that of the Default portfolio, which produces significantly more volatile performance than the Money Market portfolio. The table below presents one year statistics over the 3 years March 2007 to February 2010:

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	7.8%	- 8.0%	- 19.0%
Best annual performance	12.1%	20.8%	33.3%
No of negative 1 year periods	0	10	10
Average of negative 1 year periods	0%	- 3.7%	- 11.4%
Average of positive 1 year periods	10.1%	11.9%	16.5%

This table represents the different characteristics of the three types of portfolio quite well. The Default portfolio is a more conservative investment aimed at minimising negative returns and with a long-term return objective of inflation plus 4%.

It is very important, though, that employers invested in the Default portfolio are comfortable with these investment characteristics and that they should be able to create comfort amongst their employees as well!

5. A Contrarian Preview Of The Next 12 Months

As shown in **Graphs 13 and 15** the main indices on local markets have produced somewhere between 15.3% ('Oil & Gas') and 104.5% ('Software & Computer Services') and the Allshare delivered a return of 48% over the 12 months to February 2010, including dividends. This compares well with the returns delivered by the DOW Jones (45%), the DAX (47%), the Nikkei (34%) and the Hang-Seng (61%). SA historic P:E was 17.5 at the end of February, on par with its highest point since January 2007 (17.6). The historic S&P 500 P:E was 21.4 at the end of February, compared to 18.1 in January 2007. With this dramatic recovery and in the light of the status of global economies and historically low interest rates, we believe that equity markets are unlikely to produce any meaningful positive returns in 2010.

The crude price has been around US$ 80 for an extended period now. Although we have not seen any recent cost statistics, our expectation would be that cost should be around US$ 40 per barrel. This would generate profits of around US$ 1.3 trillion and cash flows or around US$ 2.6 trillion p.a, representing around 2%, respectively 4% of global GDP. These flows represent significant proportions of global financial markets that will make themselves felt. The questions once again is - where? Much of it is probably funding government debts and flowing into global bourses and commodities.

We have previously based our expectations for the year on two alternative scenarios. One scenario assumes an inflated oil price that would create another bubble in commodity and share prices. This appears to explain what we are experiencing currently. This is good for the balance sheets of many, on paper. For many consumers this recovery will have come too late and, once bitten twice shy, these people are unlikely to start spending again soon. This recovery is not sustainable in our view.

The alternative scenario assumes a slow drawn out process of the consumer rebuilding his savings and spending propensity. Negative real interest rates should result in a gradual depreciation of debts and a consequential improvement of balance sheets. This scenario should produce a more sustainable recovery.

The termination of the Fed's 'quantitative easing programme' as from end March, and huge tax increases possibly looming in the US (and other countries, Greece being in the lime light right now) later this year, is likely to put a cap on any meaningful improvement of sentiment and this is likely to be mirrored in other economies as well.

Zero or low interest rate policies are likely to become unsustainable in the course of 2010 as huge government deficits will be vying for hesitant financiers globally. This should also put a damper on equity markets.

Once the pressure is taken off global equity markets and commodities, the Rand is likely to weaken from its current level of around 7.4. **Graph 29** indicates that the Rand is fairly valued at 8.63 to the US. We expect a weakening further over the course of 2010 as the result of the inflation differential and an increasing risk premium likely to be

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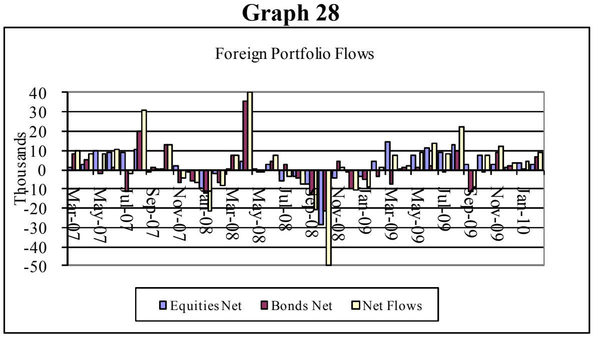
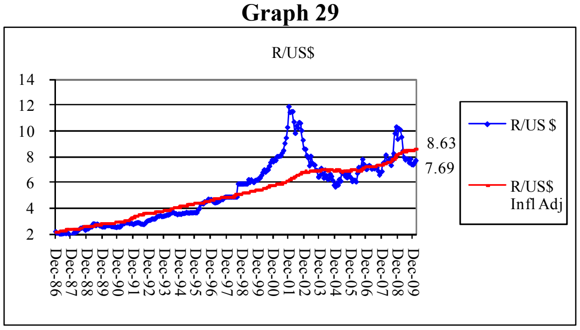
attached to weaker currencies in the light of the expected economic woes. We believe the Rand may weaken to 8.7 over the course of 2010, representing a potential return on a US$ investment of around 16%.

Graph 28 indicates that foreign equity purchases in SA have receded significantly of late and given our outlook this is likely to persist for an extended period of time putting pressure on the Rand and on local equity markets. For the year to 28 February, the FTSE/JSE still experienced a massive net inflow of R 77 billion, compared to a net outflow of R 43 billion over the year to 28 February 2009.

Graph 28

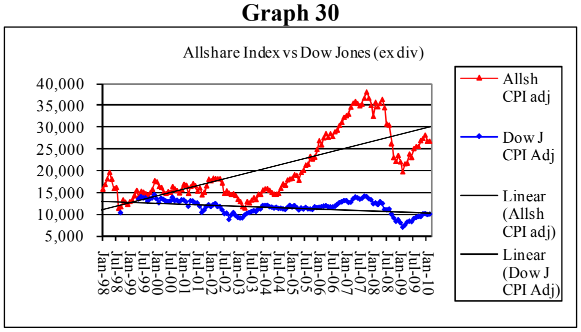


Graph 29



Graph 30 shows to what extent equity markets have recovered since their low at the end of February 2009. The 1 year trailing SA Allshare P:E gained 9.2 points to 17.4 from its bottom of 8.2 at the end of February.

Graph 30



6. Conclusion

It would seem that global markets are in risky territory. We believe that the oil price will now remain in a sustainable range of between US$ 45 and US$ 80.

In this scenario markets have probably run ahead of themselves and are likely to produce no or negative growth for the next 6 to 12 months. Interest rates will remain stable for another 6 months to start picking up from thereon, and consumer demand will be subdued for the next 12 months, while the Rand should start weakening once global interest rates start rising, which we expect to happen toward the latter part of the year.

An expected incline in global interest rates in the medium term will be negative for all interest bearing assets for a while. In terms of equity sectors, our shorter term view would indicate on the basis of fundamentals, that consumer goods and services should be overweight to neutral in one's portfolio, while commodities should be neutral to underweight. We expect financials to return to the higher quartiles later in the year once the interest cycle has turned. Industrials are expected to experience rather tough times over the next 12 months. In this environment the performance of most conventional asset classes will be muted. We do not expect equities in general to perform but stock picking can add value. Hedge funds should also be able to produce positive returns in this scenario. As far as precious metals are concerned, we expect prices do decline in US$ terms. Due to our expectation of the Rand depreciating, this will offset the decline in prices and produce a muted return for the year.

Taking our view on the Rand, an investment in the US$ could produce a return of between 5% and 20% in 2010. A lack of prospective investment opportunities suggests that one should be overweight offshore assets, specifically cash exposure in these circumstances. For pension funds, a conservative balanced portfolio with a high foreign and high local cash exposure is our choice for 2010.

7. Important notice and disclaimer