Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 30 June 2020

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

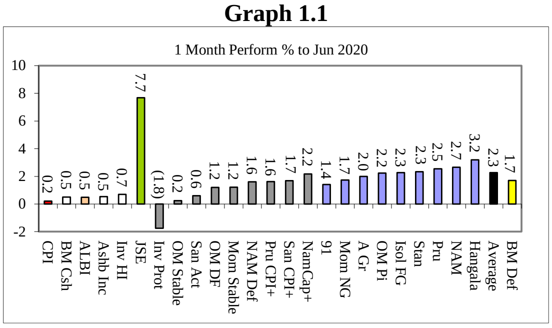
In June 2020 the average prudential balanced portfolio returned 2.3% (May 2020: 0.7%). Top performer is Hangala Prescient Absolute Balanced Fund with 3.2%, while NinetyOne Managed Fund with 1.4% takes the bottom spot. For the 3-month period, Prudential Managed Fund takes the top spot, outperforming the 'average' by roughly 2.3%. On the other end of the scale Allan Gray Balanced Fund underperformed the 'average' by 2.0%. 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.

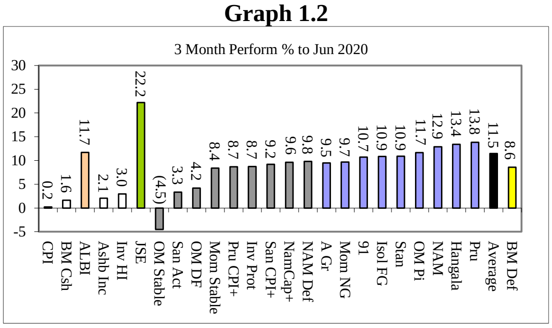
Below is the legend to the abbreviations reflected on the graphs:

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)
NinetyOne Managed	91 (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)

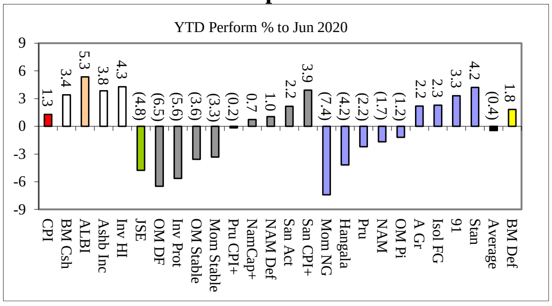
Graph 1.1



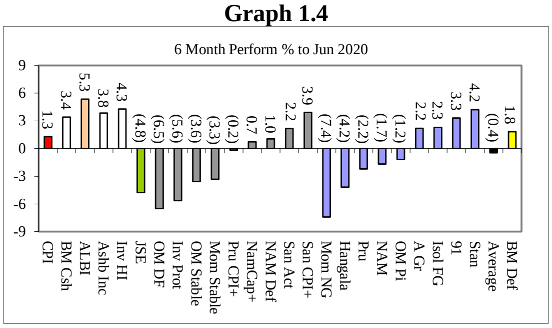
Graph 1.2



Graph 1.3



Graph 1.4



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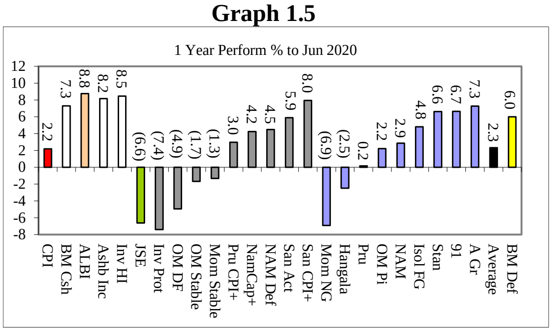
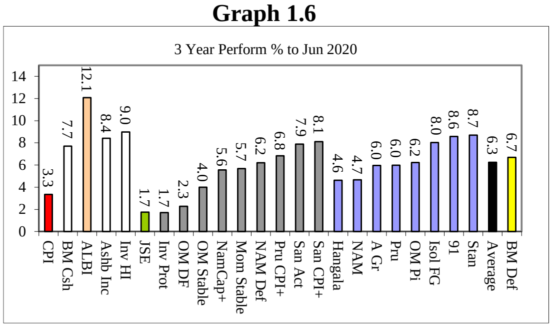
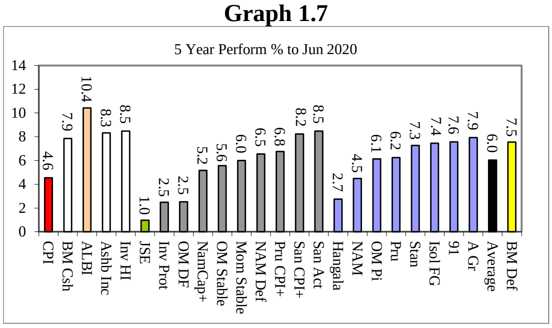
Graph 1.5



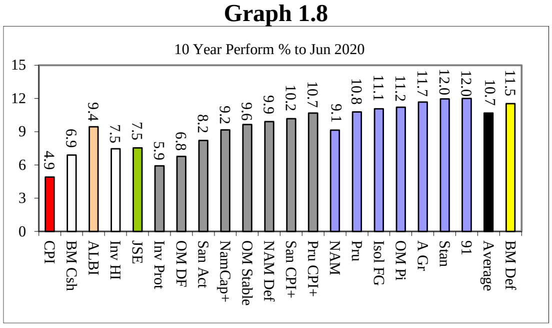
Graph 1.6



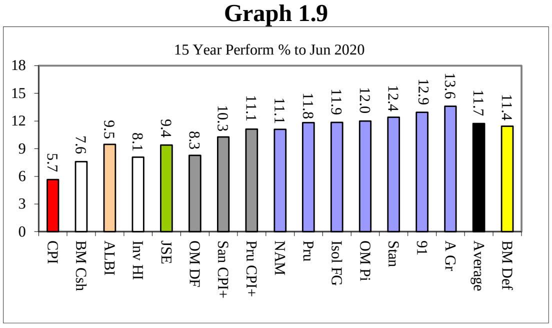
Graph 1.7



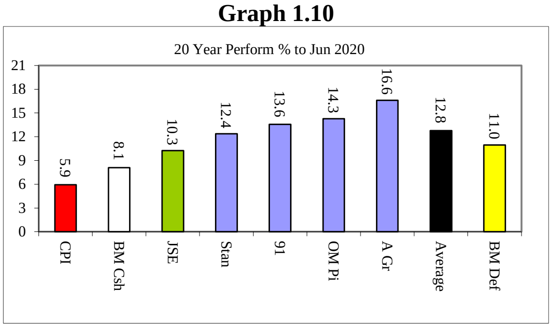
Graph 1.8



Graph 1.9



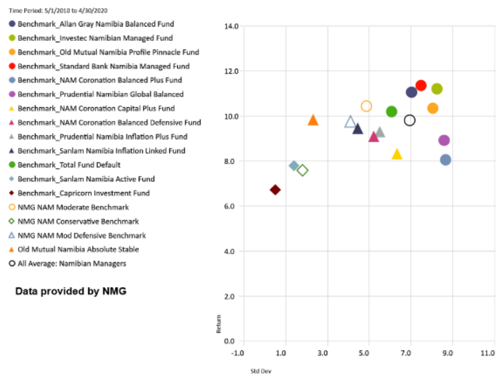
Graph 1.10



Risk/ Return

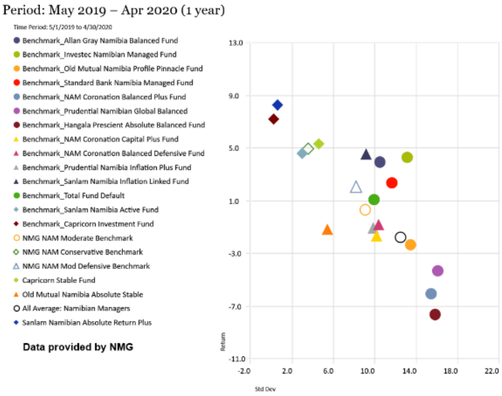
Risk-Reward – Over the long term

Time Period: May 2010 – Apr 2020 (10 years)



Risk-Reward – Over the short term

Time Period: May 2019 – Apr 2020 (1 year)



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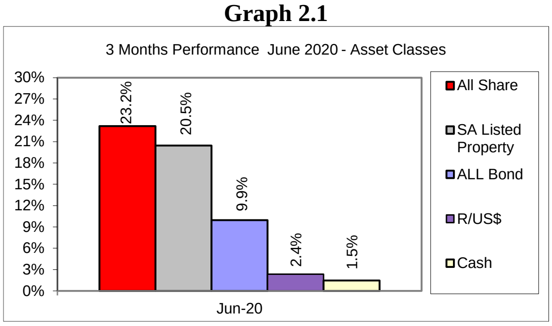
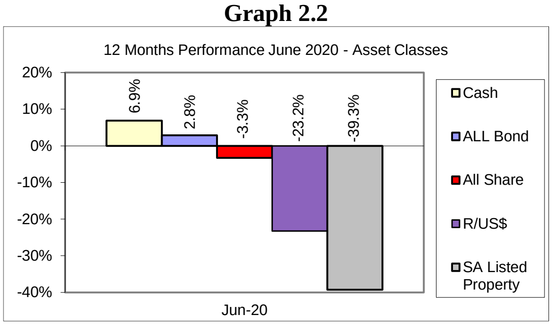
2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

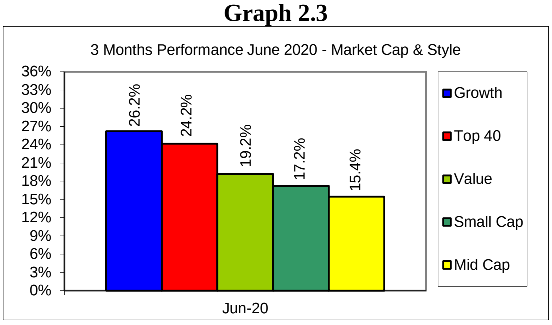
Graph 2.1



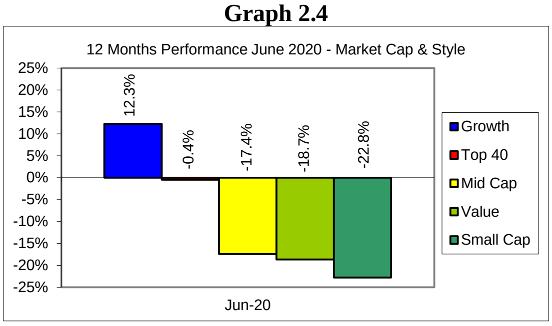
Graph 2.2



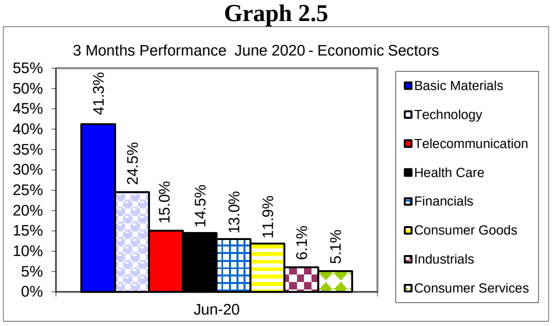
Graph 2.3



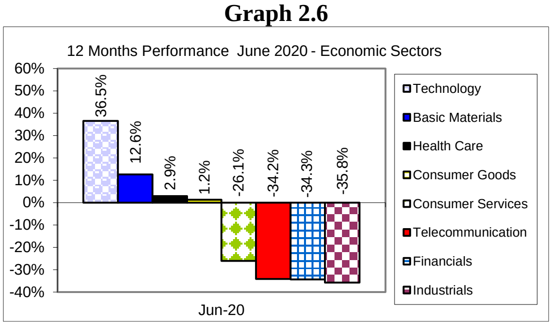
Graph 2.4



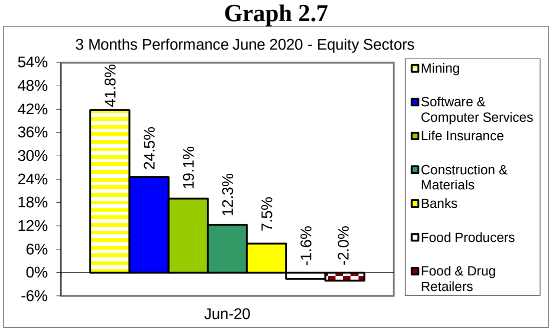
Graph 2.5



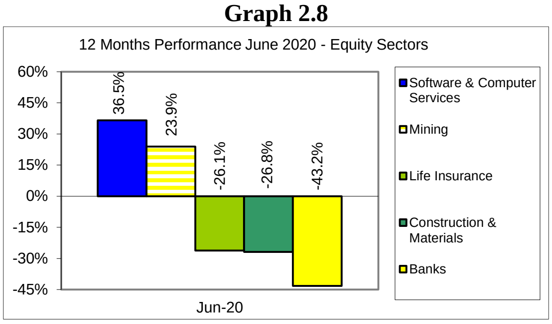
Graph 2.6



Graph 2.7



Graph 2.8



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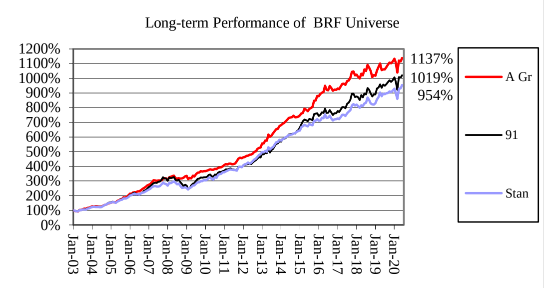
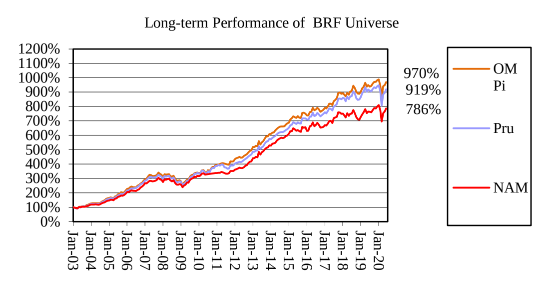
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

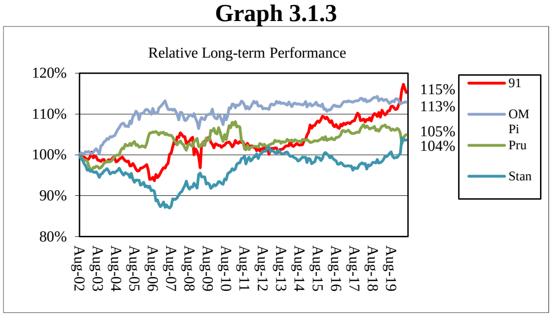
Graph 3.1.1



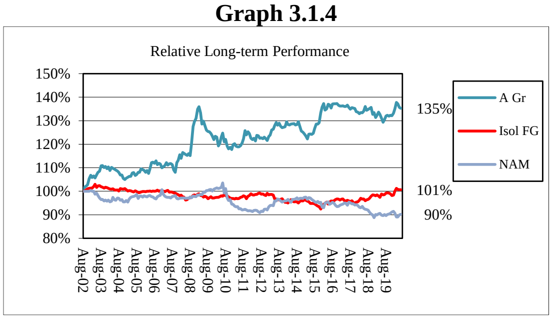
Graph 3.1.2



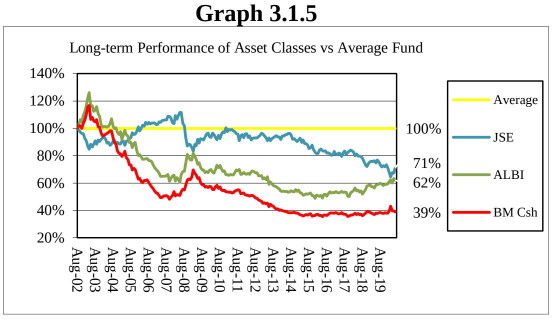
Graph 3.1.3



Graph 3.1.4

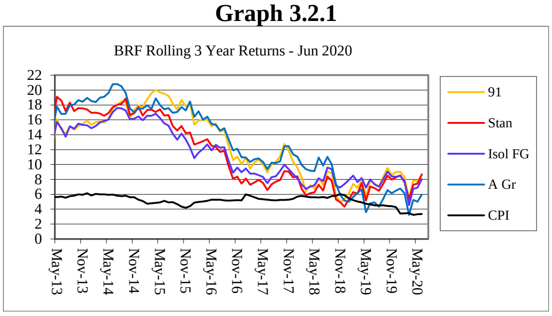


Graph 3.1.5

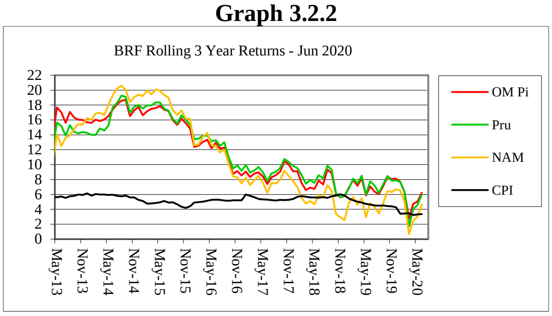


3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

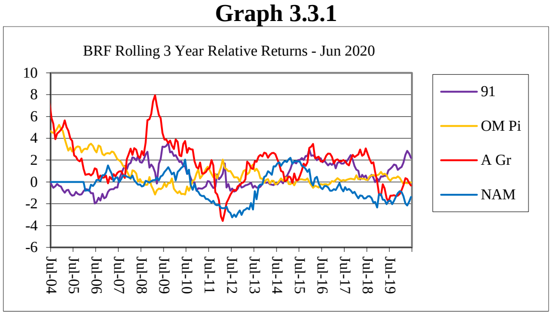


Graph 3.2.2



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

Graph 3.3.1



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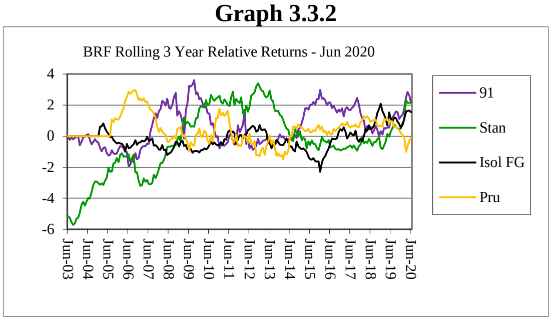
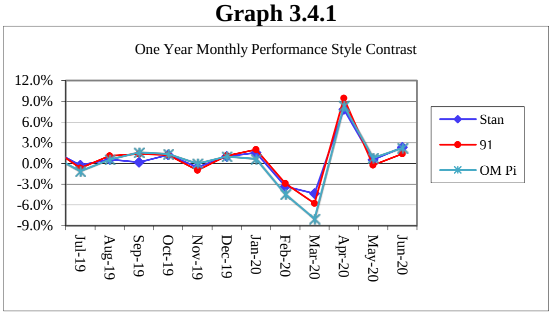
Graph 3.3.2

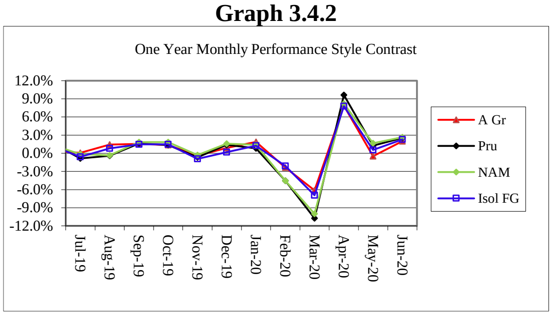


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

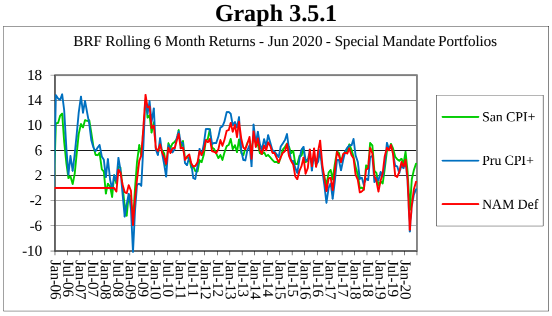


Graph 3.4.2

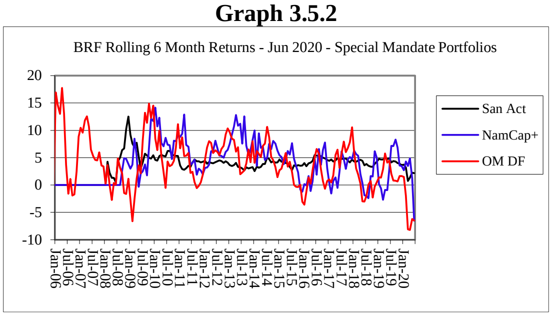


3.5. 6-month rolling and cumulative returns of ‘special mandate’ portfolios

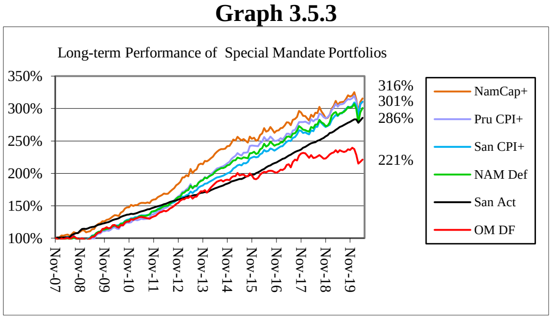
Graph 3.5.1



Graph 3.5.2

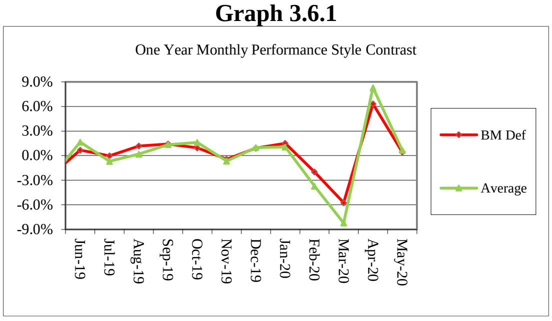


Graph 3.5.3

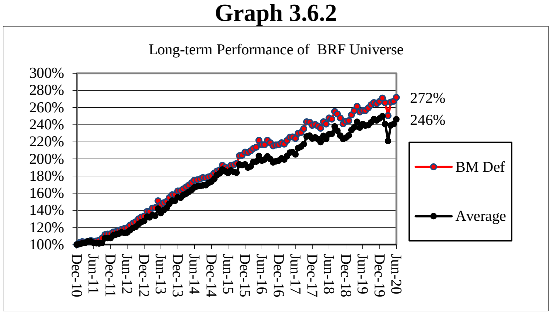


3.6 Monthly and cumulative performance of ‘Benchmark Default’ portfolio relative to average prudential balanced portfolio

Graph 3.6.1



Graph 3.6.2



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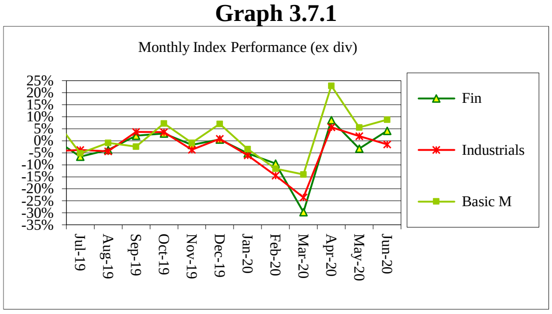
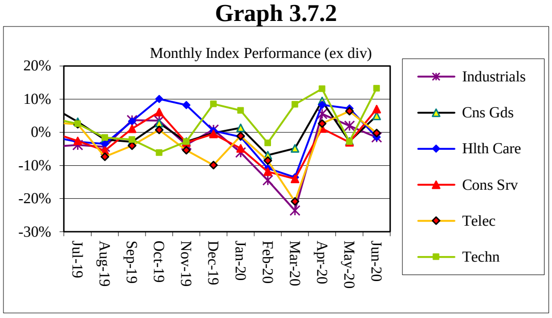
3.7 One-year monthly performance of key indices (excluding dividends)

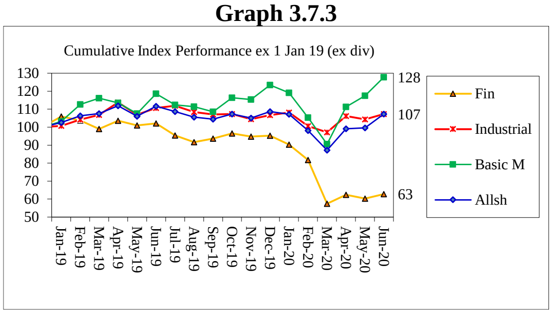
Graph 3.7.1



Graph 3.7.2



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.	7.5	6.0
5-year real return - % p.a.	2.9	1.4
Equity exposure - % of portfolio (qtr end March 2020)	45.4	63.0
Cumulative return ex Jan 2011	171.93	146.27
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.

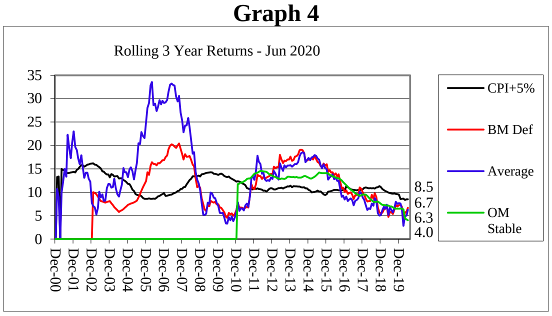
The default portfolio's long-term return must be read in the context of it initially having been managed with a low risk profile that was only changed from the beginning of 2011 when the Metropolitan Absolute Return fund was replaced with the Allan Gray balanced portfolio.

Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	7.6%	4.2%	2.8%
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	8.0%	7.5%	7.0%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years July 2017 to June 2020. 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 6.7%, the average was 6.3% vs CPI plus 5% currently on 8.5%.

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 11.78 to the US Dollar while it actually stood at 17.38 at the end of June. Our measure is based on

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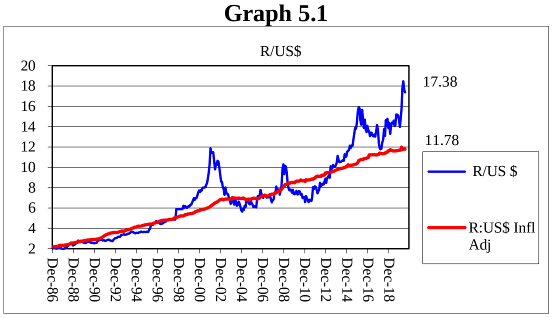
adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

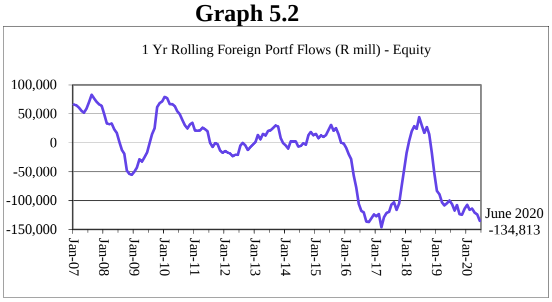


The Rand strengthened by 1.4% in June with net foreign investment inflows from bonds and equities of R2.7bn. Over the past 12 months the Rand weakened by 23.2%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 235.5bn (outflow of R 235.4bn to end of May 2020).

Since the beginning of 2006, total net foreign portfolio outflows amounted to R 23.1 bn (May R 25.8 bn outflows).

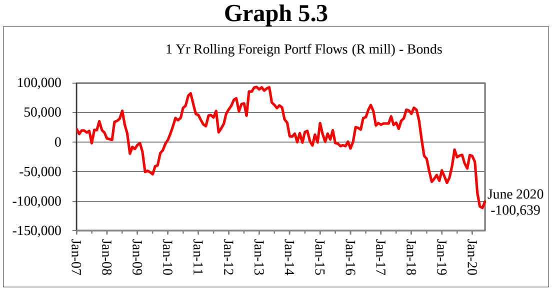
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 134.8 bn at the end of June (outflow of R 123.8 bn year-on-year to end May). The month of June experienced a net outflow of R 5.4 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 208.6 bn (end May net investment outflow of 203.2 bn). This represents roughly 1.25% of the market capitalization of the JSE.

Graph 5.2



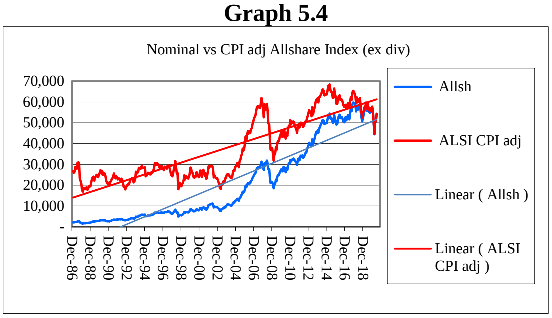
Graph 5.3 on a rolling one-year basis reflects foreign portfolio outflows in respect of SA bonds of R 100.6 bn over the past 12 months to end of June (outflow of R 111.6 bn over the 12 months to end of May). The month of June experienced a net inflow of R 8.1 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 185.5 bn (to May R 177.5 bn).

Graph 5.3



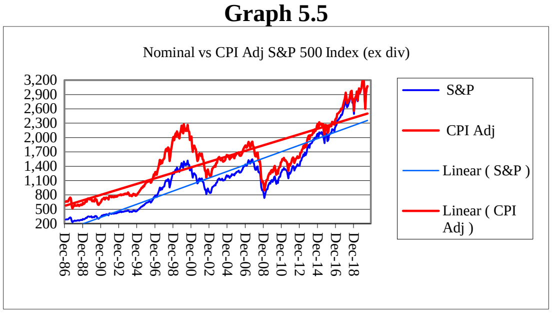
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.4% per year since January 1987, and this excludes dividends of 3%. Namibian inflation over this period of 33 years was 7.8% per year. This is equivalent to a growth in real terms of 2.6 % p.a. over this period, excluding dividends, or around 5.6% 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 7.5% per annum, over this period of 33 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 2019.

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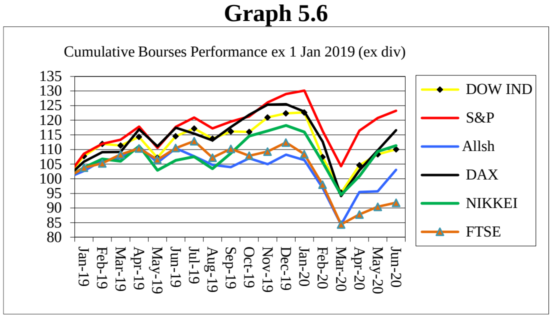
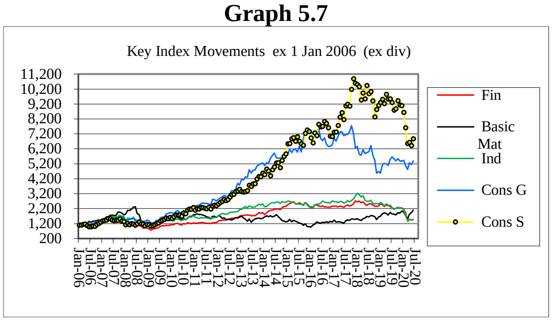
Graph 5.6



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: 14.2%; Consumer Goods: 12.3%; Basic Materials: 5.3%; Financials: 2.8% and Industrials: 2.6%.

Graph 5.7

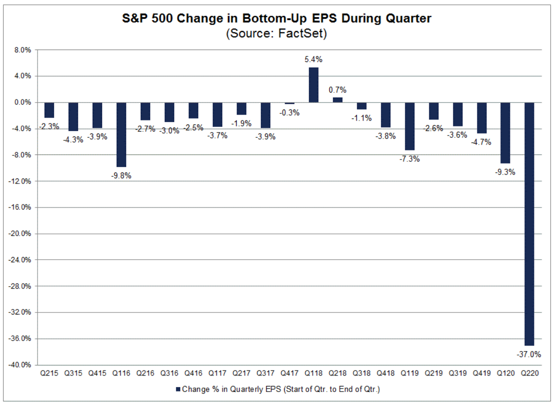


6. Should you now buy, sell or stay put?

by Tilman Friedrich

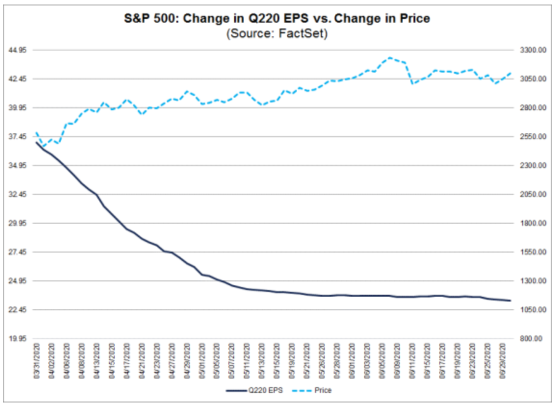
'Factset' journal recently published some rather disturbing statistics on the S&P 500 share index as depicted in graph 1 below. It shows record high cuts to earnings per share estimates for the second quarter of 2020. The Q2 bottom-up EPS estimate (which is an aggregation of the median Q2 EPS estimates for all the companies in the index) declined by 37.0% (to $23.25 from $36.93) during this period. This is the largest decline since a 34.3% decline which occurred in quarter 4 of 2008, when the global financial crisis struck global economies. This is evidently the result of COVID-19 and the lockdown imposed on the US economy.

Graph 1



What is further worrying is the fact that the S&P 500 index continued to increase despite the collapse in earnings estimates for this index as depicted in graph 2. Where the S&P 500 index represented about 68 times earnings per share estimates at the end of March, this multiple has now doubled to 136 times at the end of June.

Graph 2



In last month's column in this newsletter, we pointed out that the 4 largest reserve banks globally have grown their balance sheets by 300% from US$ 6 trn to US$ 21 trn after the global financial crisis in 2007/ 2008 in order to prop up the economy and that between the Federal Reserve and the ECB alone, their balance sheets are set to increase by yet another roughly US$ 3 trn in response to the COVID-19 crisis this year. What these measures seem to have achieved is to prop up investor sentiment while they do not seem to have impacted company profits so far.

Although the market stress that was experienced in February and March has largely dissipated, it has not disappeared though, as the trajectory of COVID-19 and its economic consequences are still largely unknown. Volatility will persist and stresses will re-appear and will lead to market corrections.

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By T H Friedrich – Retirement Fund Solutions Namibia (Pty) Ltd
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In these circumstances, the investor is faced with three alternatives:

- He can cut his losses by selling out of the market
- He can take advantage of the depressed prices to buy into the market or
- He can stay put.

Selling out of the market is the instinctive response of many risk-averse investors. The goal is to prevent further investment loss. However, if one looks at risk as the probability of not meeting one's investment objectives, then selling out becomes "counter-intuitive" for a risk-averse client. First, this implies converting a paper loss into a realised loss. Secondly, this increases the probability of missing out on the recovery that will eventually come, and which generally cannot be predicted or timed. This in turn, decreases the probability of achieving one's investment objective and thus, selling out of the market can be construed to be taking on higher risk.

If selling out of the market is risky, how would one describe the opposite - buying into the depressed market? After all, isn't this the all too popular notion of buying low? While this is true, the decision should be based on the risk profile and the change in risk profile that occurs as a result of the decline in market values. It is also important to note that the huge decline in market prices comes with a huge increase in market volatility. The huge drop in the FTSE/JSE All Share Index also saw a huge increase in the SA volatility. The SA volatility index was at one of its the highest points, only second to its previous 2008 peak.

Understanding the inherent market risk at a time when prices appear very cheap, is very important when making the decision to buy into the market. If risk capacity is significantly above neutral, it means one is not reliant on one's investments to fund one's lifestyle. A significant market decline means investible assets are now an even smaller component of total net wealth. This means the investor can afford to take more risk with those investible assets. It is important however to take cognisance of the extreme amount of risk inherent in the market at such points and the possibility of further massive declines in market values as well as the possibility of a drawn-out recovery. It is impossible to predict exactly at which level the market will bottom out, it is also impossible to forecast the length of time for recovery. Ultimately, it is the risk capacity that will determine whether an investor should buy into the market to take advantage of depressed prices.

If the investor chooses to do nothing, paper losses are not converted to realised losses. There is no point getting out of the market now when prices have declined heavily. If one gets out hoping to buy in at a lower price, one won't. One will most likely wait for the new bull market to be confirmed and surpass the price at which one sold! If an investor holds an adequately diversified portfolio, it is possible to weather the storm without selling out of the market to meet expenses. The investor will also not miss the recoveries that eventually follow huge market declines. Doing nothing also means the investor is not taking on extremely high risks to benefit from highly depressed prices. For most investors doing nothing is the most prudent strategy. It is also the approach with the least risk.

Conclusion

Equity markets and other asset classes are evidently once again in a bubble as the result of the global flooding of markets by reserve banks. The question is whether this bubble is going to burst or whether it will be allowed to gradually deflate. Following the same measures taken by reserve banks after the global financial crisis in 2007/ 2008, asset markets experienced a similar bubble all over the world until the Fed first mooted the possibility of reducing its policy rate in the middle of 2014. From that point on the SA equity market first dipped and then moved largely sideways, a trend not followed by the S&P 500 though, as capital was withdrawn from developing economies into 'safe haven' economies.

Based on this experience, it is likely that the re-inflated bubble of late is unlikely to burst, everything else remaining equal, but will rather be allowed to slowly deflate. This bubble is purely based on sentiment rather than fundamentals as graph 2 above depicts. It may be expected that any larger military conflict or another unexpected global event such as we had with COVID-19 may cause sentiment to collapse again. However, at present there are no apparent dark clouds on the horizon and there is no immediate reason for getting out of the market, if one had not sold out already.

If one had sold out already and one had not re-entered the market, one will have lost out on the 27% recovery of the SA Allshare index since the March month-end low. In the face of prevailing volatility and the uncertainty of how the COIV-19 crisis will pan out, one should now best stay out of the market at least until the end of the year to use any opportunity a market correction will offer. Economic performance is not supporting any meaningful growth in equity markets.

Investing offshore is a great risk diversifier and must be part of one's investment strategy. As the SA Allshare

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index dropped by 22% since the beginning of the year to its March month-end low, the Rand fell by a similar percentage, effectively placing the investor in a neutral position. Since then the Allshare has grown by 27%. The Rand in turn strengthened by 11% since its April month-end low, indicating that it still has scope to make up some lost ground relative to the recovery in the SA Allshare index. This indicates that it is not a good time to expatriate investments at this stage and the suggestion to hold on to the end of the year may also bring with it a further strengthening of the Rand, presenting an opportunity to re-enter offshore equities.

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