Volume 16 No. 08
August 2020

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 August 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

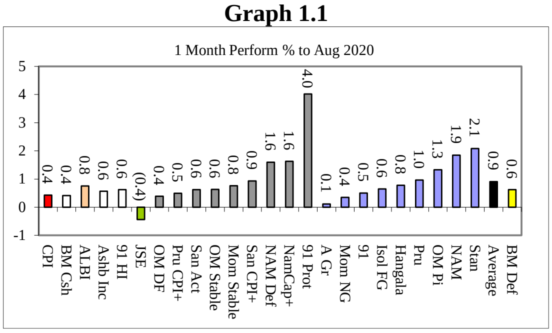
In August 2020 the average prudential balanced portfolio returned 0.9% (July 2020: 1.7%). Top performer is Stanlib Managed Fund with 2.1%, while Allan Gray Balanced Fund with 0.1% takes the bottom spot. For the 3-month period, NAM Coronation Balanced Plus Fund takes the top spot, outperforming the 'average' by roughly 2.2%. On the other end of the scale Allan Gray Balanced Fund underperformed the 'average' by 2.7%. 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.

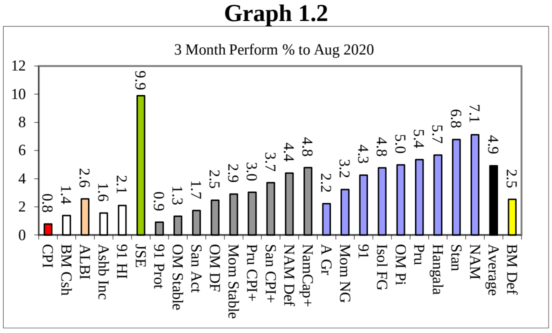
Below is the legend to the abbreviations reflected on the graphs:

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)
NinetyOne High Income (interest bearing assets)	91 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)

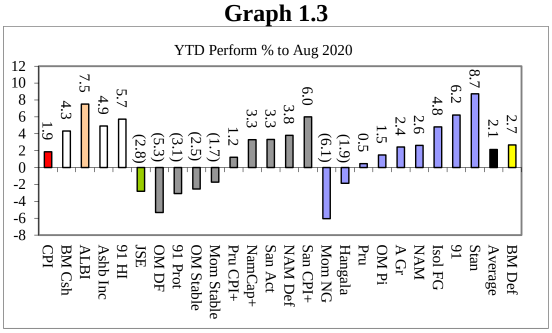
Graph 1.1



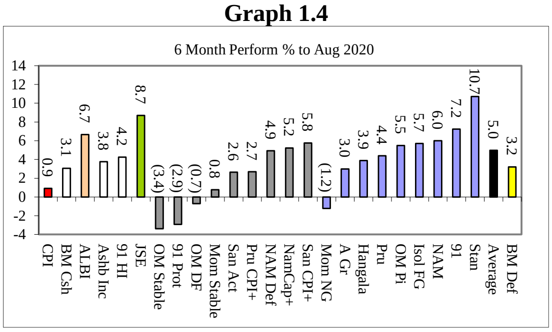
Graph 1.2



Graph 1.3



Graph 1.4



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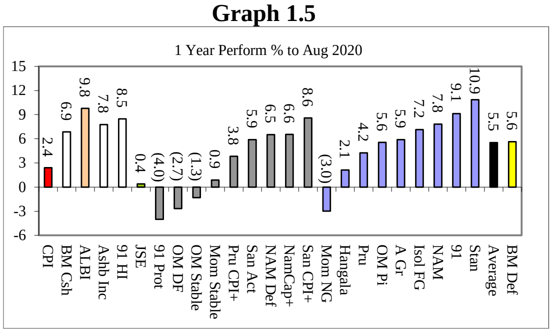
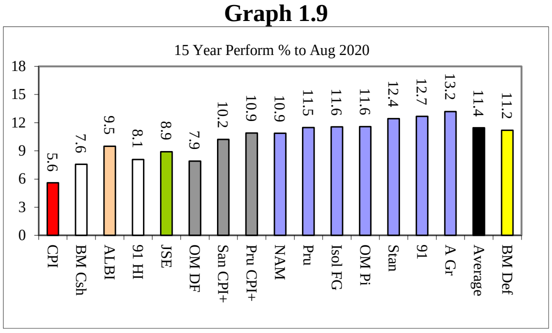
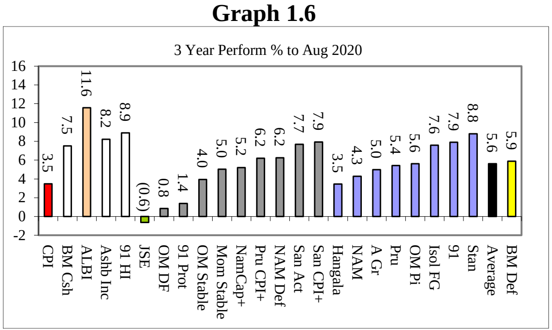
Graph 1.5



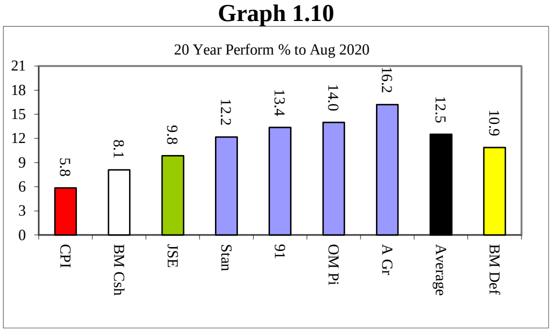
Graph 1.9



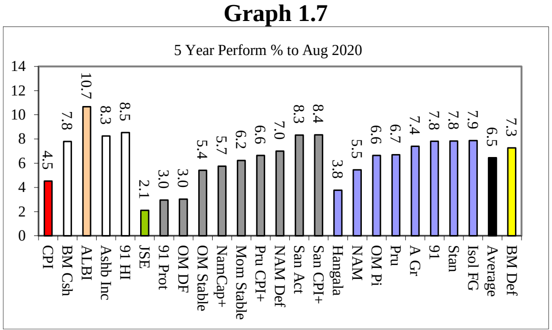
Graph 1.6



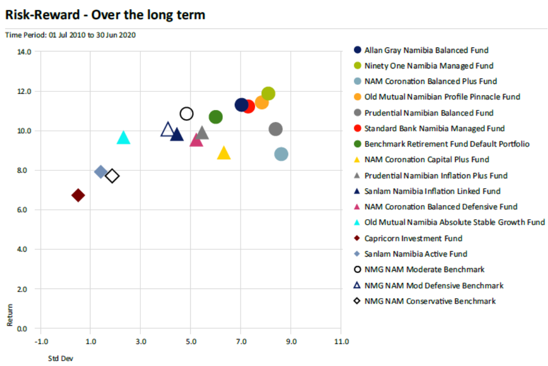
Graph 1.10



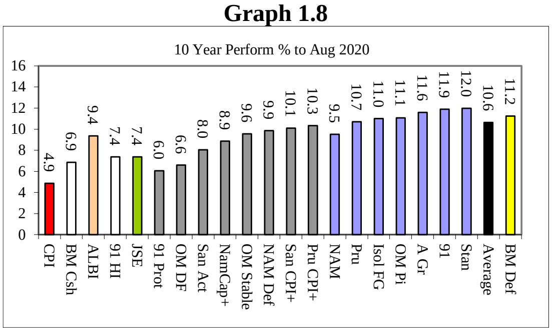
Graph 1.7

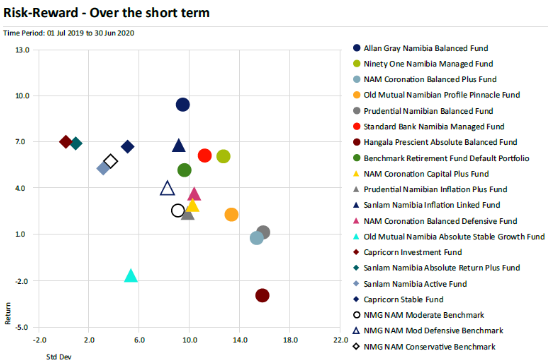


Risk/ Return



Graph 1.8





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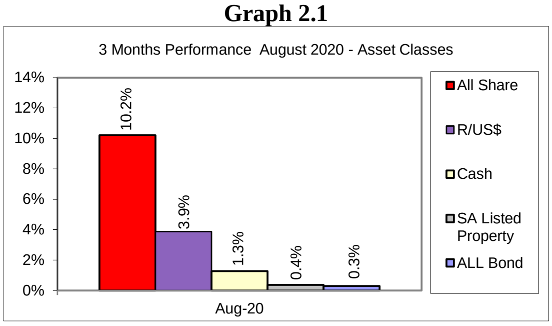
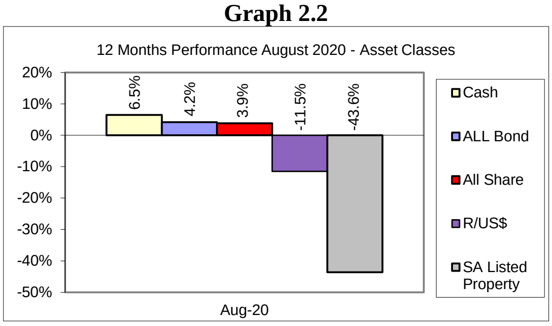
2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

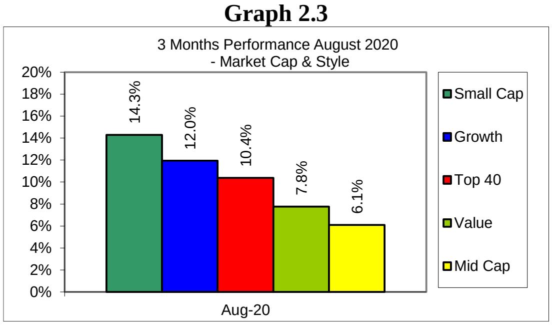
Graph 2.1



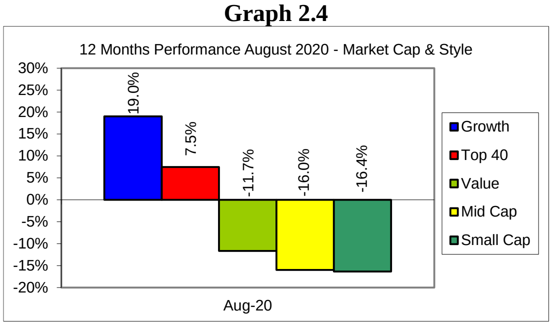
Graph 2.2



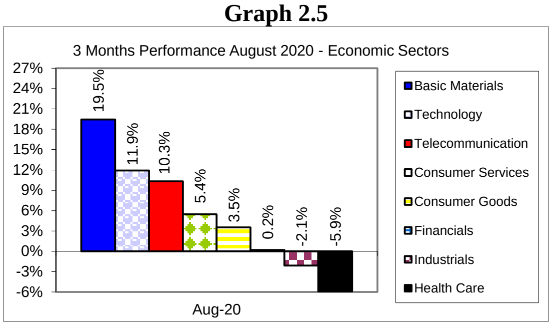
Graph 2.3



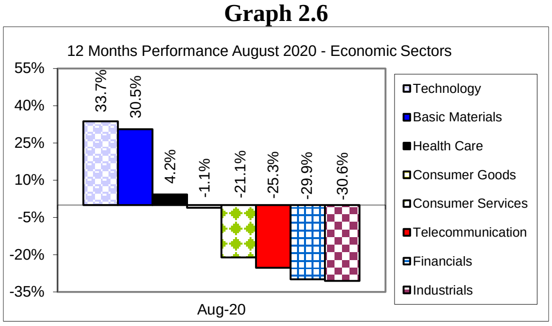
Graph 2.4



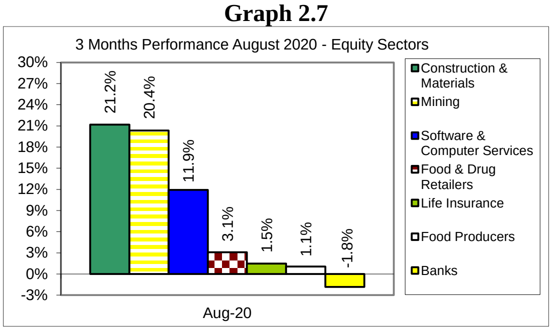
Graph 2.5



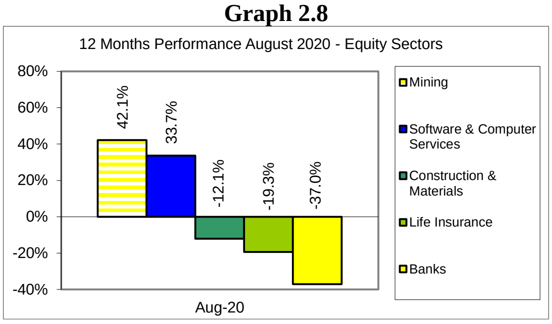
Graph 2.6



Graph 2.7



Graph 2.8



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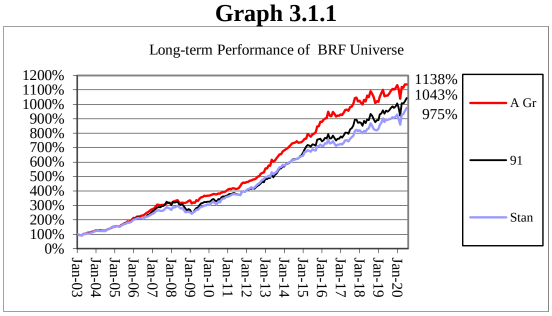
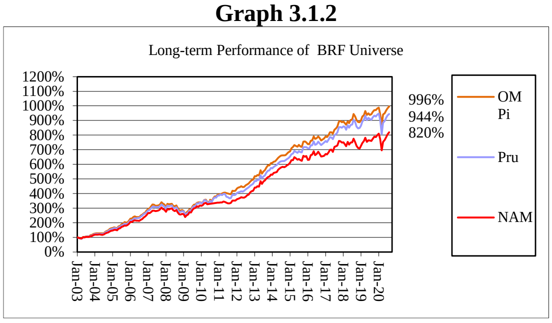
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

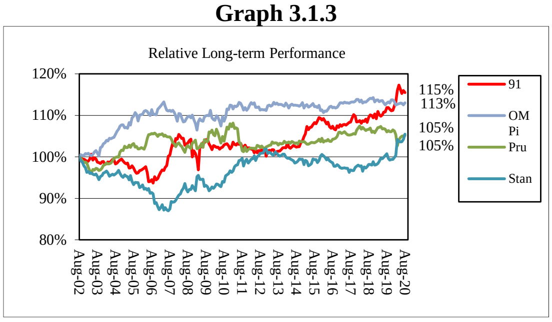
Graph 3.1.1



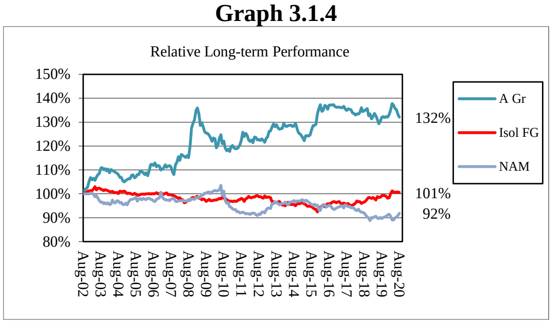
Graph 3.1.2



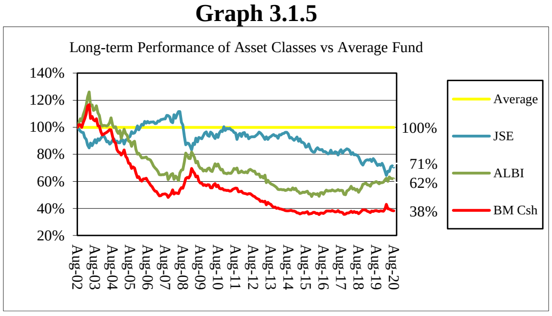
Graph 3.1.3



Graph 3.1.4

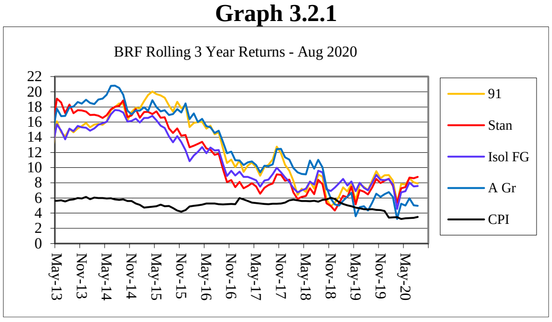


Graph 3.1.5

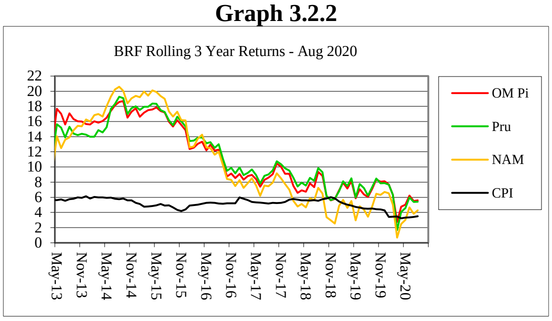


3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

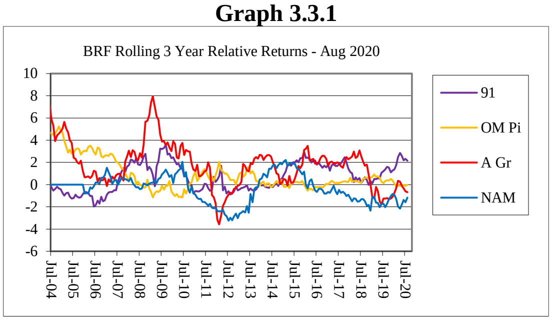


Graph 3.2.2



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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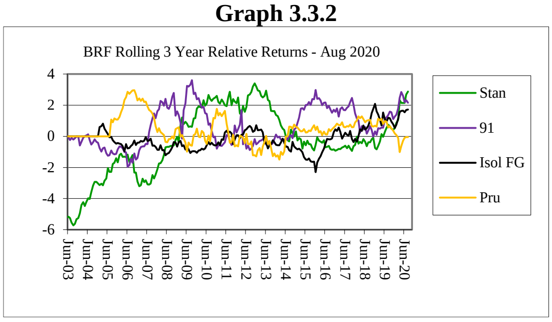
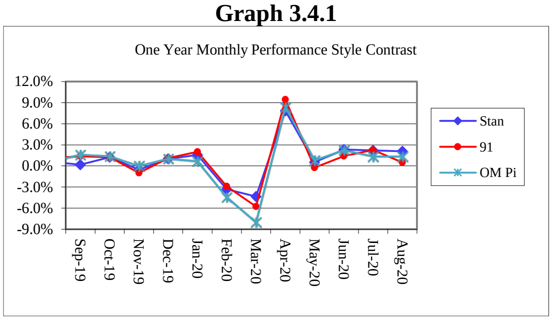
Graph 3.3.2

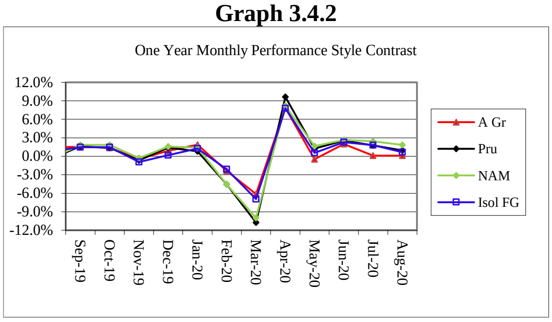


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

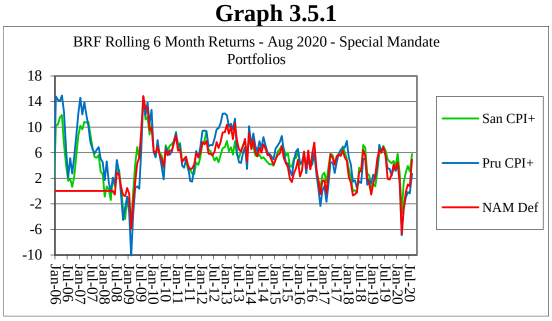


Graph 3.4.2

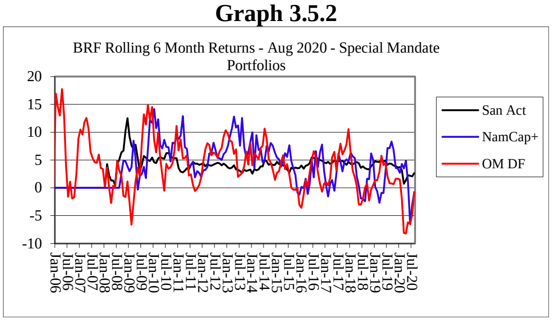


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

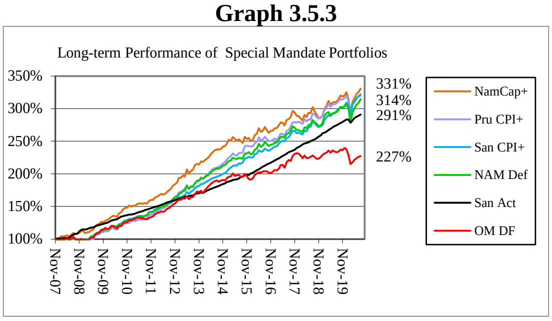
Graph 3.5.1



Graph 3.5.2

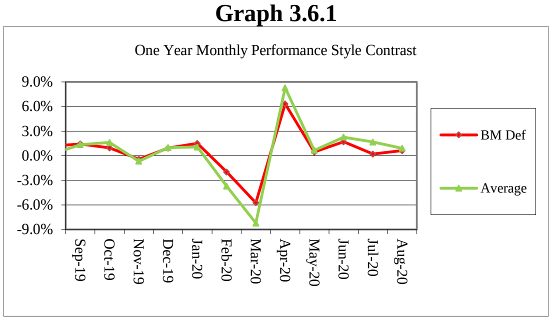


Graph 3.5.3

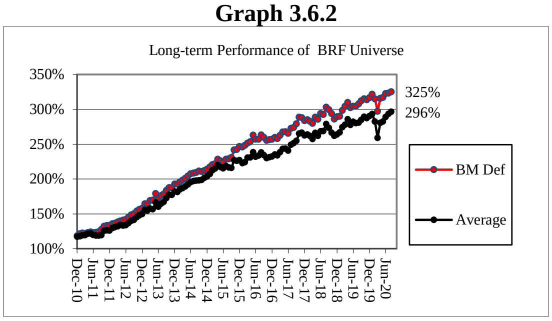


3.6 Monthly and cumulative performance of 'Benchmark Default' portfolio relative to average prudential balanced portfolio

Graph 3.6.1



Graph 3.6.2



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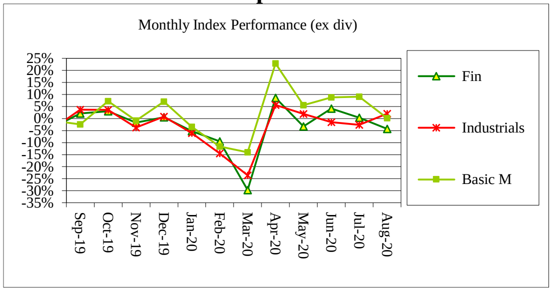
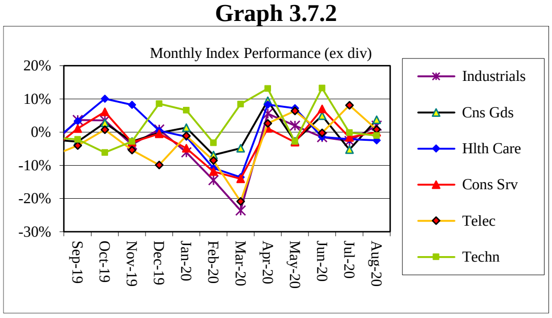
3.7 One-year monthly performance of key indices (excluding dividends)

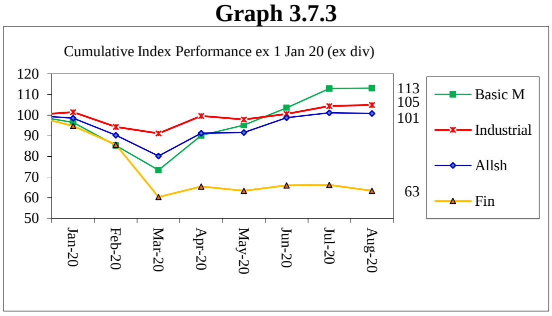
Graph 3.7.1



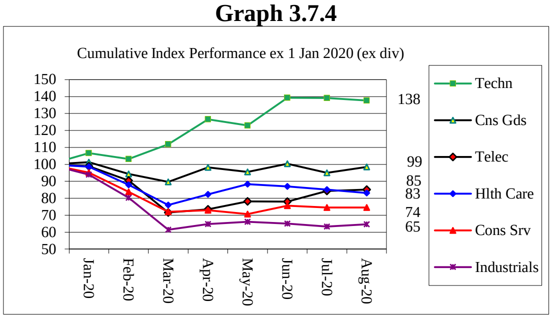
Graph 3.7.2



Graph 3.7.3



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.	7.3	6.5
5-year real return - % p.a.	2.8	2.0
Equity exposure - % of portfolio (qtr end June 2020)	45.8	63.2
Cumulative return ex Jan 2011	174.16	152.66
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	7.5%	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%	7.3%	6.8%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years September 2017 to August 2020. This gives an indication of volatility of the performance of these 3 risk profiles.

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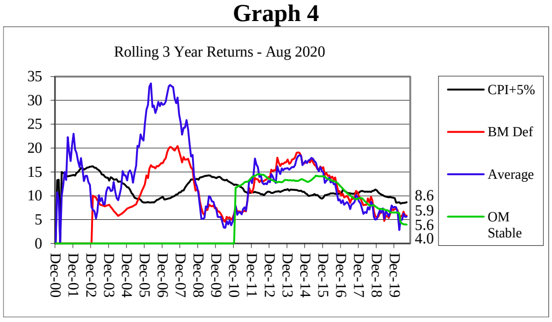
Graph 4



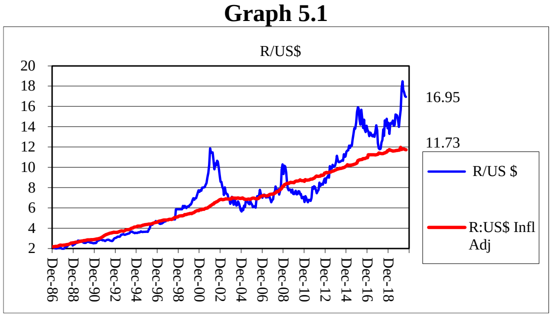
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3-year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end August was 5.9%, the average was 5.6.% vs CPI plus 5% currently on 8.6%.

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 11.73 to the US Dollar while it actually stood at 16.95 at the end of August. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

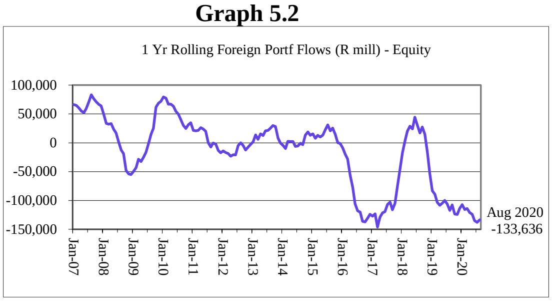


The Rand strengthened by 0.4% in August with net foreign investment outflows from bonds and equities of R24.4bn. Over the past 12 months the Rand weakened by 11.46%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 217.1bn (outflow of R 234.8bn to end of July 2020).

Since the beginning of 2006, total net foreign portfolio outflows amounted to R 62.1bn (July R 37.7bn outflows).

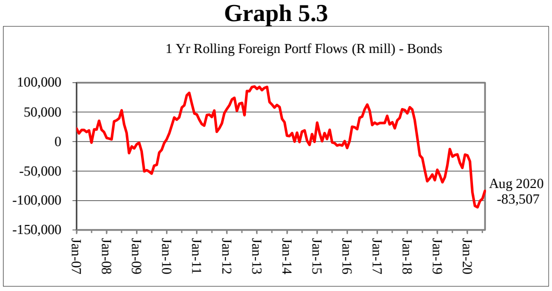
Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 133.6 bn at the end of August (outflow of R 137.9 bn year-on-year to end July). The month of August experienced a net outflow of R 20.2 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 241.2 bn (end July net investment outflow of 221.0bn). This represents roughly 1.4% of the market capitalization of the JSE.

Graph 5.2



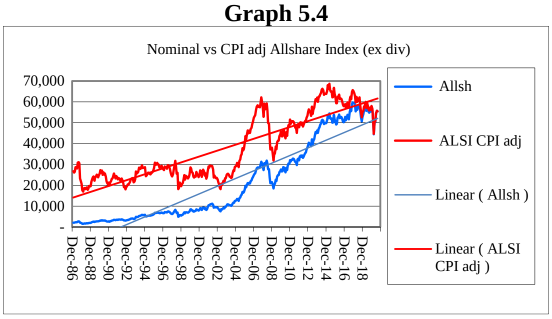
Graph 5.3 on a rolling one-year basis reflects foreign portfolio outflows in respect of SA bonds of R 83.5 bn over the past 12 months to end of August (outflow of R 96.8 bn over the 12 months to end of July). The month of August experienced a net outflow of R 4.2 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 179.1 bn (to July R 183.3 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 10.4% per year since January 1987, and this excludes dividends of 3.1%. 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 5.7% 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 7.9% 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 5.3%

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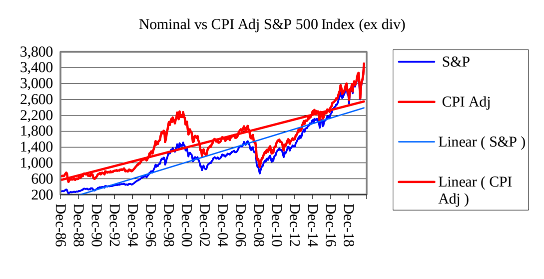
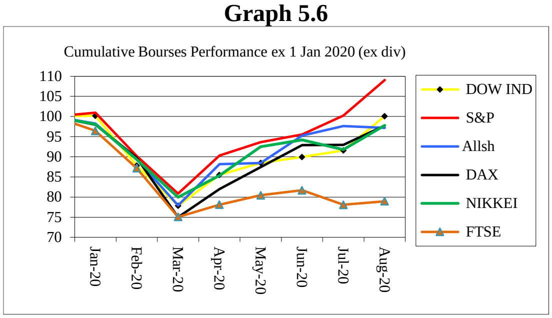
p.a. over this period, excluding dividends or around 7.5% including dividends.

Graph 5.5



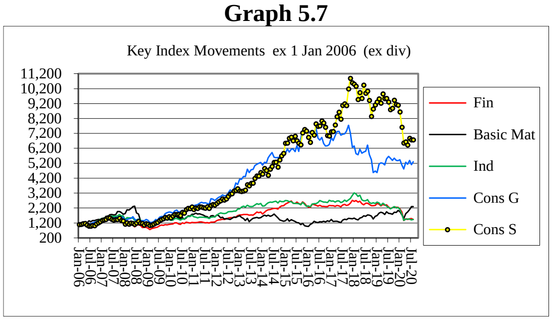
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P as the top performing index since the start of 2020.

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: 13.9%; Consumer Goods: 12.0%; Basic Materials: 5.8%; Financials: 2.5% and Industrials: 2.5%.

Graph 5.7



6. Pensioners beware - this is not the time to raise your investment risk!

by Tilman Friedrich

As we all know, COVID-19 has changed the world and global economies. Closer to 'home' for fund members and pensioners, it has changed financial markets across the world and this has impacted investment performance of all asset classes.

In the first instance, all asset classes barring gold, took a deep dive. Central banks then intervened by flooding markets with money and reducing interest rates to zero and even into negative territory. As the result, key equity markets took an about turn recovering to pre-COVID levels. This was until the later part of September when equity markets have let off quite a bit of steam again, and rightfully so as the recovery is by no means supported by any economic recovery. It's really only been hot air driving this apparent recovery in equities. At the same time, developing countries' currencies such as the Rand took a deep dive and are still very far from where they were just before COVID measures struck. Against the US Dollar the Rand currently is around 17. At the end December it was at 14 and just before the global financial crisis at the end of December 2007, it was at 7! Clearly this change in the exchange rate could have significantly impacted investment returns, either positively or negatively, depending on where one was invested.

Neither of these crises could have been foreseen. Despite the ferociously negative impact of these crises on markets and economies, a few investors could have been fortunate, had they for example speculated on currencies or specific assets such as gold and a few other commodities or more recently certain IT based shares. Others will have had the opposite experience. Both by their good or bad luck rather than by knowledge or skill.

Retirement capital should not be exposed to speculative investment. Over many, many years, the typical prudential balanced portfolio has shown to be the most appropriate investment for a pension fund member with a long-term investment horizon. We have been tracking over a 20-year period, the performance of the typical pension fund portfolio, which is a medium risk prudential balanced portfolio that invests primarily in equities, to the tune of between 60% and 75% maximum, the cautious portfolio that typically only invests in equities to the tune of around 40% and the bond and cash portfolio with not equity exposure. The other asset classes all these portfolios invest in are property, bonds, treasury bills and cash. Besides the prudential balanced portfolios, the other more cautious portfolios are capped with regard to their equity exposure by their mandates, whereas the prudential balanced portfolio effectively grants the manager a free hand with regard to which asset classes to invest in and to what extent to invest in these, capped only by the limits set by regulation. The relevant regulation referred to has evolved over many, many years of experience with the view to ensure that a pension fund member's investment is not subjected to undue risk.

Graph 6.1 shows the performance of the prudential balanced portfolios that have been around for the past 20 years to the end of August, compared to the returns on cash and.

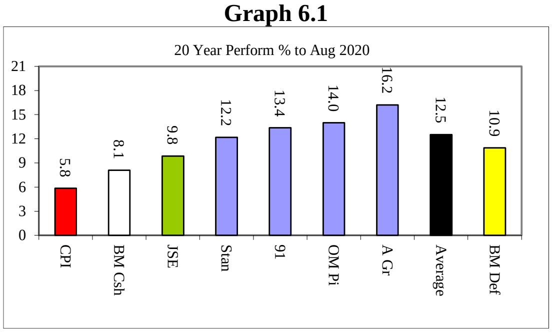
Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 August 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.

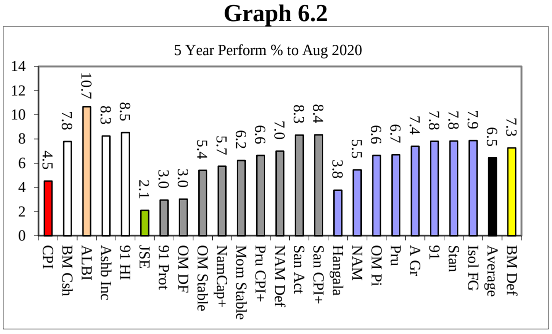
Graph 6.1



It is interesting to note that over the past 20 years, cash delivered a return of 8.1% per year, equities, the asset class to which the prudential balanced portfolios have the largest exposure by far, returned 9.8% per year while the average prudential balanced portfolio produced a return of 12.5%, ranging between 12.2% and 16.2%. What is also to be noted is that the average prudential balanced portfolio outperformed CPI (at 5.8% per year) by 6.7% per year, well in line with the implicit real return of typical pension fund benefit structures. So, the average is nearly 3% higher than the return on the biggest component of the total return. This speaks volumes of the skill of the managers of prudential balanced portfolios to outperform all the constituent asset classes of their portfolios. How do they manage to achieve this? Well, they move between the constituent asset classes constantly based on what they expect the asset classes to return going forward and they have evidently done a great job over the past 20 years!

Unfortunately, over the last 5 years, reserve banks' intervention in financial markets led to a distortion in the markets and returns have not been great, as depicted in graph 6.2.

Graph 6.2



Here you can see that the average prudential balanced portfolio has only outperformed inflation by 2% per year, and that is before fees. However once again, the managers have outperformed equities as the biggest constituent, by 4.4% per year!

When one has been used to the longer-term achievements of the prudential balanced portfolio managers, one can understand that pension fund members and pensioners will be disappointed with the shorter term returns their pension investment will have produced. Tragically, shrewd brokers out in the market have seen this state of affairs as an opportunity to discredit proven prudential balanced portfolios and to coerce pensioners to transfer their retirement capital into high risk portfolios, using shorter-term investment returns some of these managed to produce, as the result of the distortions that occurred in the markets since the global financial crisis. In group schemes of course, reason is more likely to prevail than when a broker talks to a pensioner who may not have a proper appreciation of the background, the risks and the reasons for some specialised portfolios having done well over the last couple of years. By the same token there will have been a majority of these specialist portfolio that would have done atrociously, and I hope the reader does not fall into that category! Pensioners, however, are likely the ones who can least afford to take a higher risk than the prudential balanced portfolio that has been shown over many years, to be structured more conservatively, in the best interests of pension fund members in the long-term.

What is worse, insurance companies and investment platforms actually allow a pension fund member/ pensioner to circumvent the regulated prudential investment limits that have shown over many years to best protect a member's/ pensioner's interests in the long-term, by investing up to 100% in equities and within equities, in highly focused and specialised portfolios.

To put this into context, since December 2007, just before the global financial crisis struck, gold returned 14.9% per year in local currency and since December 2019 to end of August, gold produced an annualised return of 96.8%. Over the same periods, the average prudential balanced portfolio produced a return of 9.1% and 2.2% respectively. Who would at this stage put his retirement nest egg all into gold?

Being invested in a prudential balanced portfolio should give the pension fund member/ pensioner the peace of mind that his investment is looked after by the best investment experts in the market. The investor can easily compare the return he earned to the returns other prudential balanced portfolios earned and this information is readily available.

Where a member/ pensioner places his investment in a specialised, focused portfolio on the advice of a broker, he literally puts himself at the mercy of the broker. Comparable investment returns will often not be available. Benchmarking the returns of such a specialised and focused portfolio with those of prudential balanced portfolio, or any other portfolio that is not constructed in exactly the same manner is meaningless and it is a given that they will behave totally differently. The pensioner will be very difficult to relate to its returns as they are impacted by specific circumstances that may not be evident to the fund member/ pensioner. Certainly, the

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broker will not offer the level of expertise that professional portfolio managers offer. While the portfolio manager of the specialist portfolio is probably an expert as well, the most important element of timing investment ins and withdrawal from a specialist investment portfolio and switching between asset classes, is the responsibility of the broker and this requires expertise that a broker will not have.

Another important consideration for a member/ pensioner contemplating to put himself at the mercy of his broker is the cost the member incurs. One may argue that it is the investment return generated that is all important. And, yes, the return is important, but if I can earn the same underlying return but pay substantially less for investing my capital, I am still losing out and this can easily accumulate to significant amounts over the long-term. Generally, when one invests in a 'retail product' such as an investment platform or insurance product, the product provider charges retail fees for the management of the capital, whereas when one invests in a group pension fund, an institutional fee would apply. The difference in these costs can easily be 1% per year of the capital invested or a difference of 6% in the value accumulated at the end of 10 years at current returns.

Finally, before resolving to put oneself at the mercy of a broker, one should be sure to understand what termination conditions apply in the event one would want to move one's capital to another party and at what cost this will happen. Moving capital from one provider to another will mostly involve additional costs for no benefit other than the prospect of better returns that only the future will show.

Conclusion

I strongly advise pensioners, in particular, to be cognisant of the following before taking a decision concerning the investment of their retirement capital:

- The prudential balanced portfolio has proven itself to offer the best risk adjusted returns to the pension fund member/ pensioner in the long-term;
- Clamouring for returns higher than what the prudential balanced portfolio typically produces, means taking higher excessive risk as a matter of course;
- Retail products are generally more costly than institutional products; latter offer economies of scale, former offers more personalised structuring;
- Do not put yourself at the mercy of a single individual who may no longer be around tomorrow;
- Understand how the investment returns of your capital are produced;
- Have a benchmark for comparing your returns;
- Understand all the costs associated with your investment that detract from the returns your capital earns;
- Understand the termination conditions of the product you intend to invest in;

Last but not least, as a pensioner, you will lose confidence in taking your own decisions as you grow older. In a retail product you will then increase your dependence on your broker ever more, while many institutional products offer default options that the managers manage in the best interests of the member/ pensioner and that can relieve the member/ pensioner of the responsibility to take decisions when he no longer has the confidence or knowledge to do so. As a pensioner you must ascertain that you are at peace with the party/ies in whose custody your retirement capital is. You cannot afford and do not want to lose sleep over this!