Volume 17 No. 08
August 2021

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 2021

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

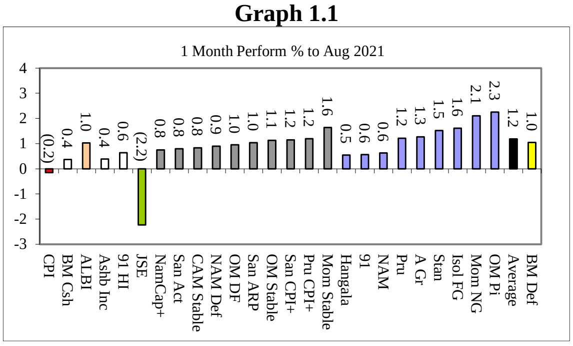
In August 2021, the average prudential balanced portfolio returned 1.2% (July 2021: 1.9%). The top performer is Old Mutual Pinnacle Profile Growth Fund with 2.3%, while Hangala Prescient Absolute Balanced Fund with 0.5% takes the bottom spot. For the 3-months Old Mutual Pinnacle Profile Growth Fund takes the top spot, outperforming the 'average' by roughly 1.6%. Hangala Prescient Absolute Balanced Fund underperformed the 'average' by 1.6% on the other end of the scale. 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 note 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. **Take note that we have added a new graph 3.5.3 which reflects the returns of the low-risk special mandate funds**.

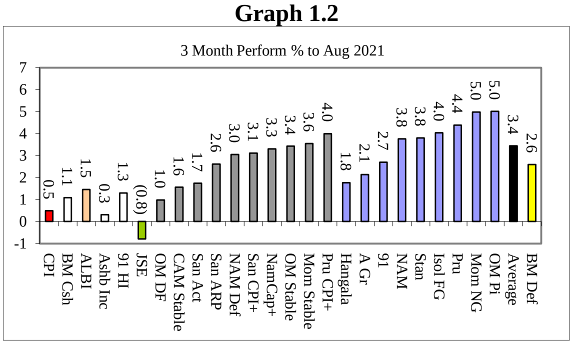
Below is the legend to the abbreviations reflected on the graphs:

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)
Capricorn Stable	CAM Stable (grey)
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)
Sanlam Absolute Return Plus	San ARP (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)

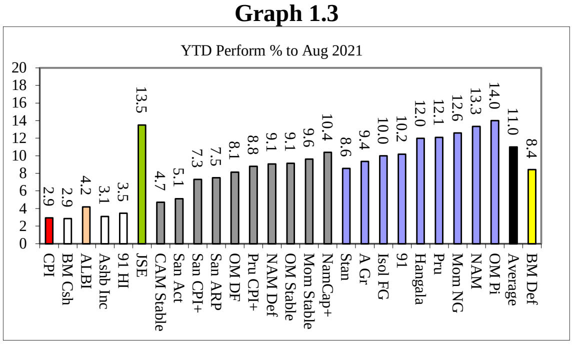
Graph 1.1



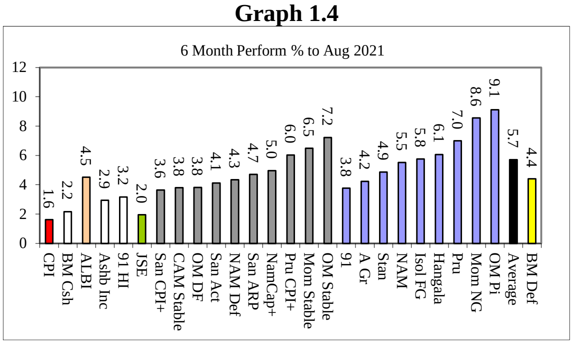
Graph 1.2



Graph 1.3



Graph 1.4



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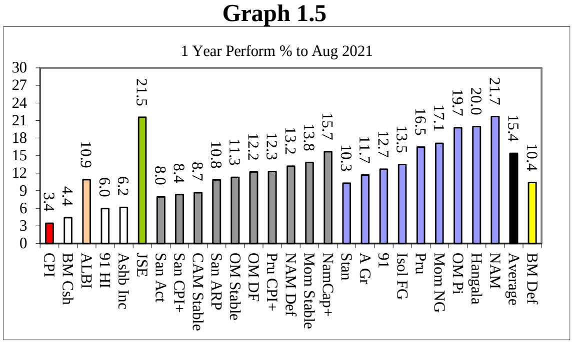
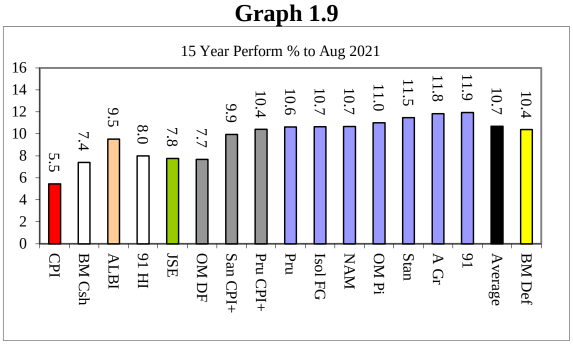
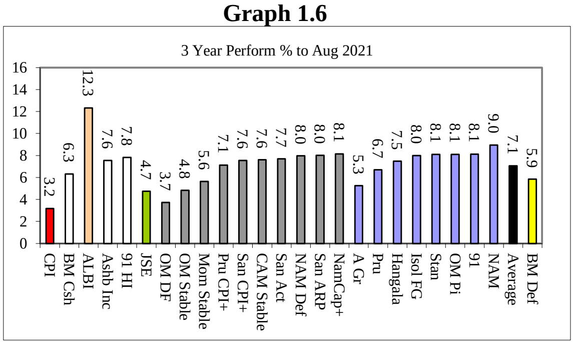
Graph 1.5



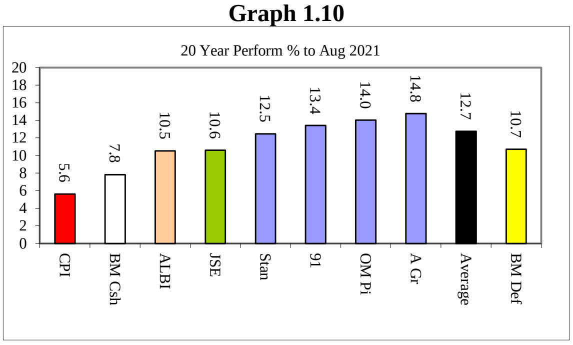
Graph 1.9



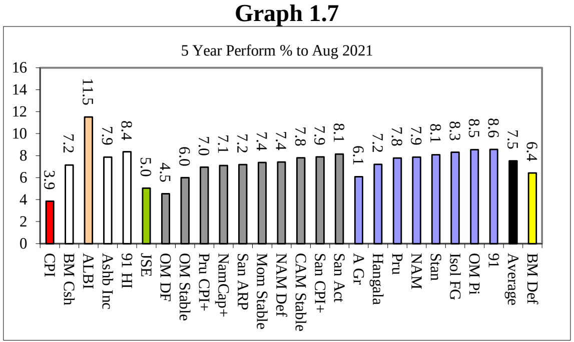
Graph 1.6



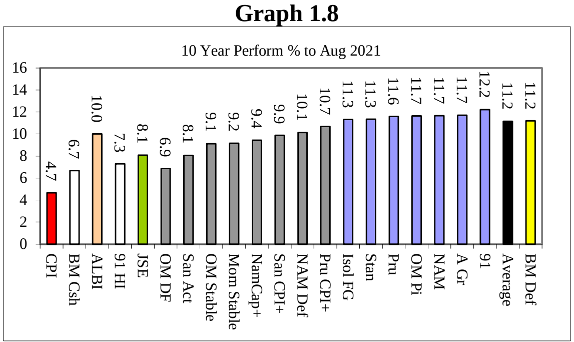
Graph 1.10



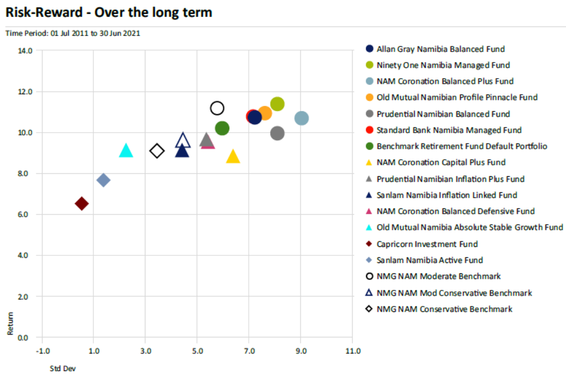
Graph 1.7

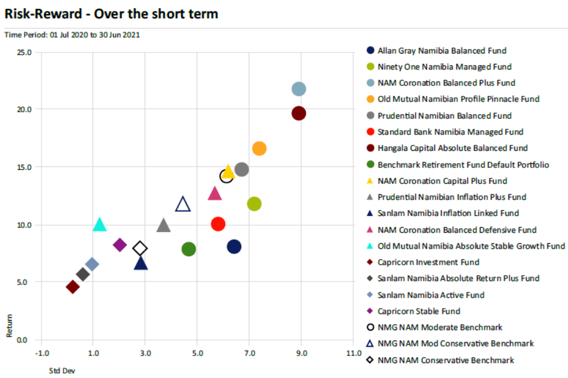


Graph 1.8



Risk/ Return





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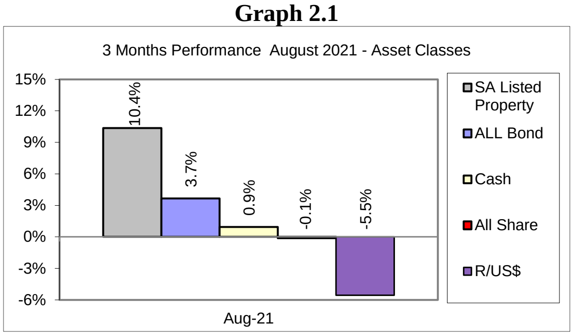
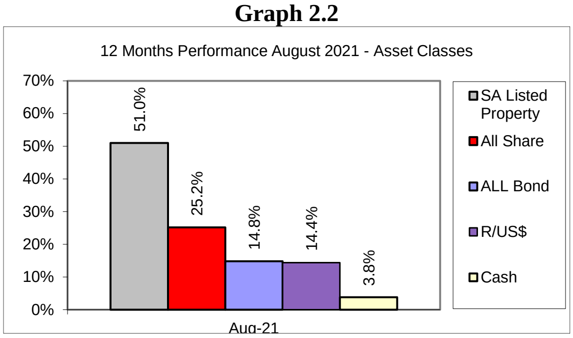
2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

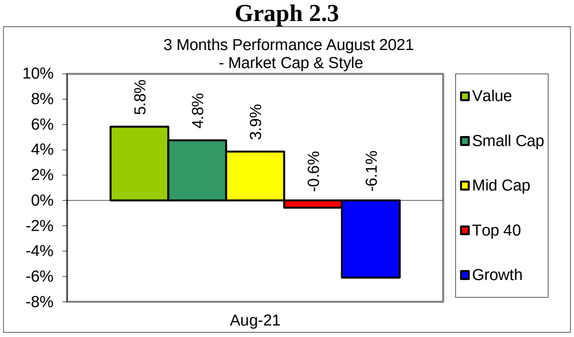
Graph 2.1



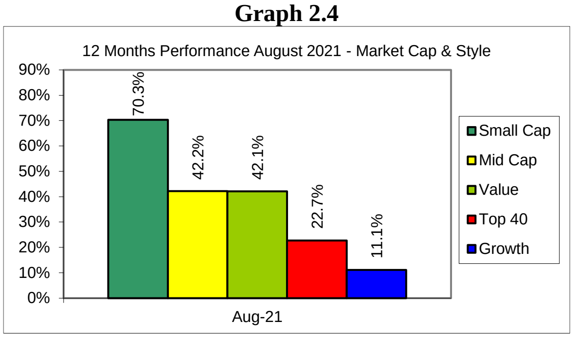
Graph 2.2



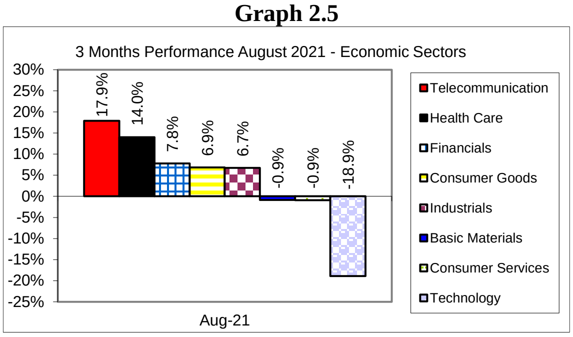
Graph 2.3



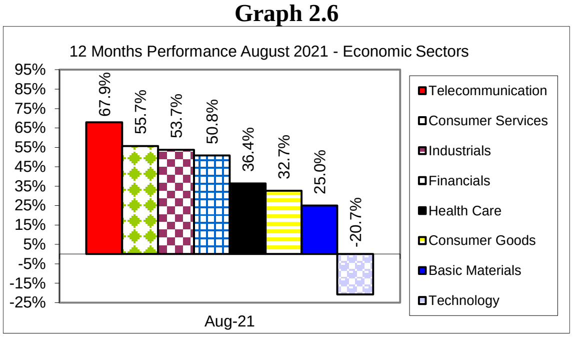
Graph 2.4



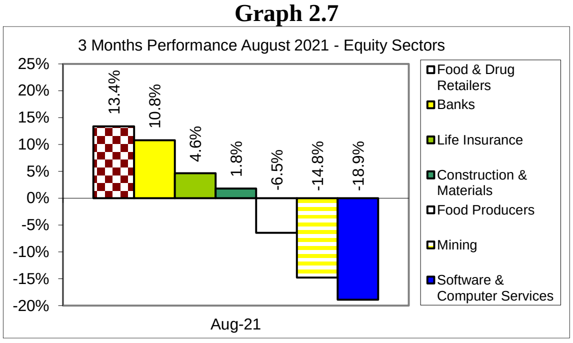
Graph 2.5



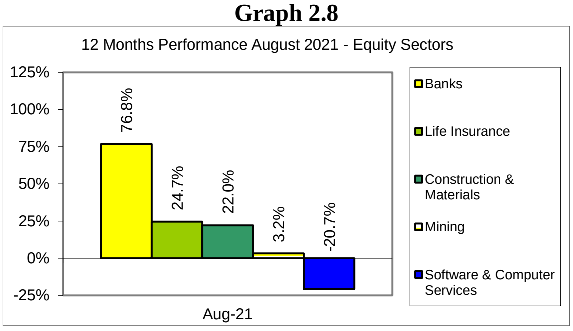
Graph 2.6



Graph 2.7



Graph 2.8



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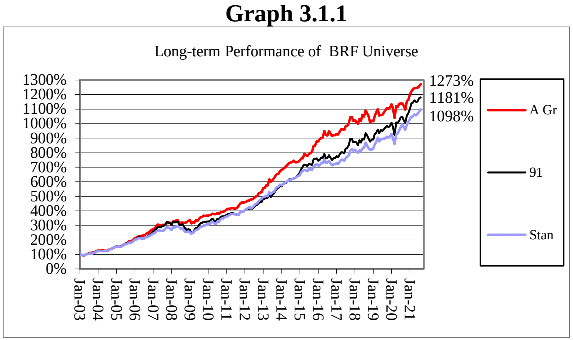
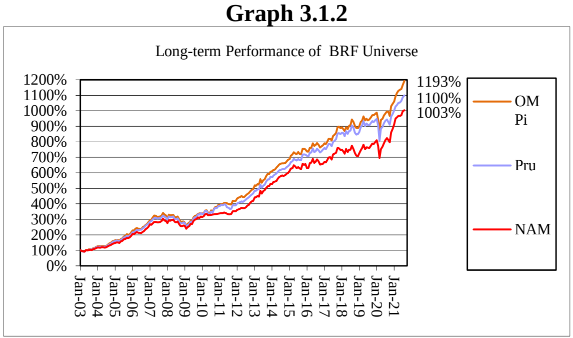
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

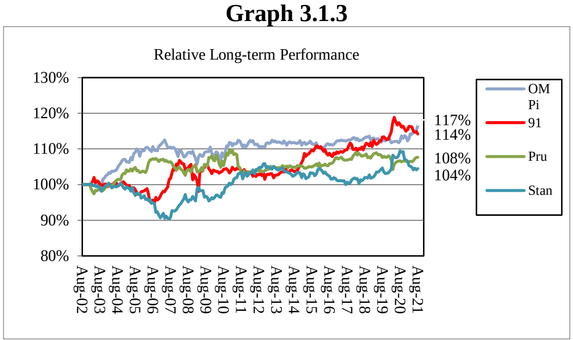
Graph 3.1.1



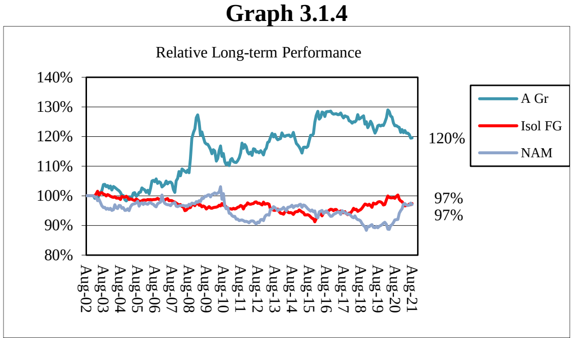
Graph 3.1.2



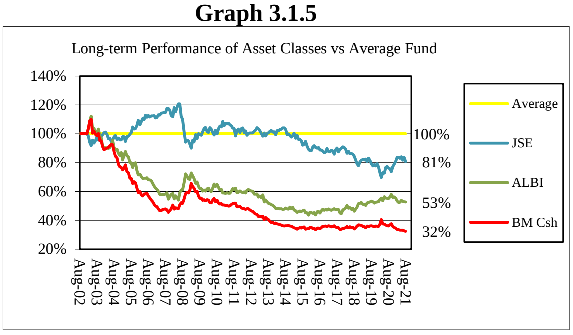
Graph 3.1.3



Graph 3.1.4

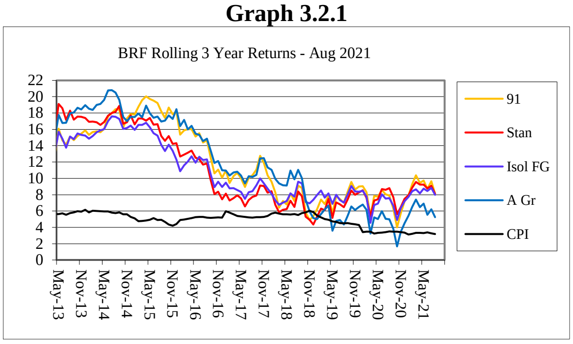


Graph 3.1.5

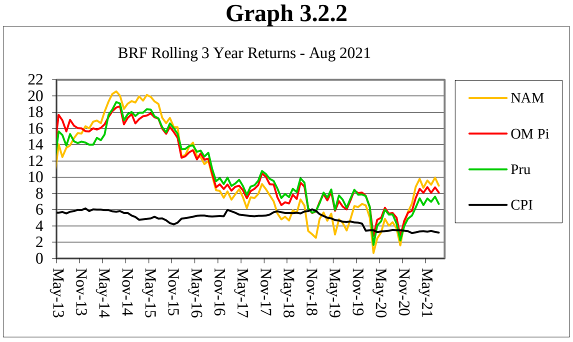


3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

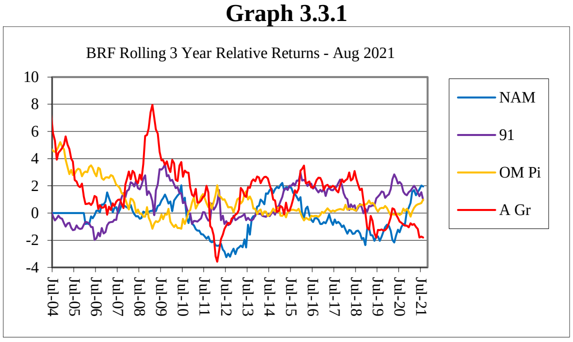


Graph 3.2.2



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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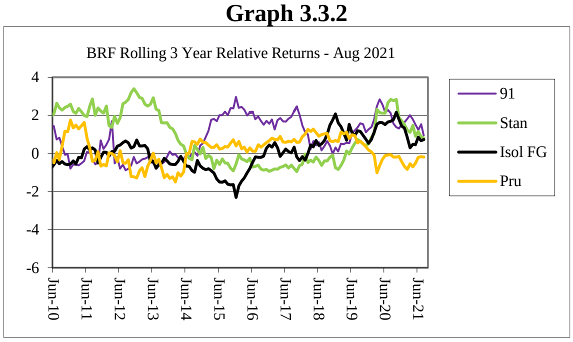
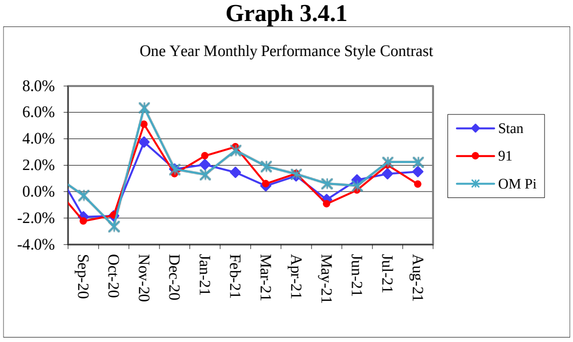
Graph 3.3.2

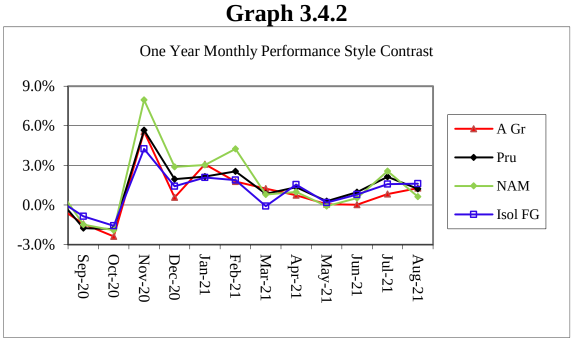


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

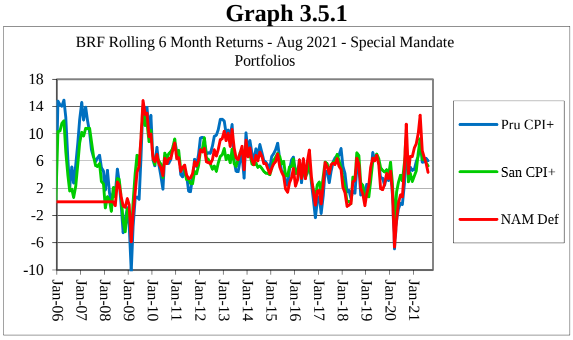


Graph 3.4.2

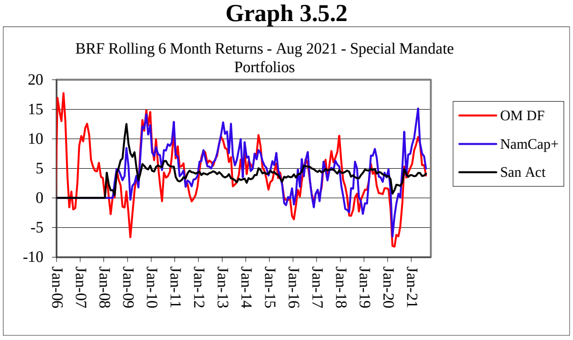


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

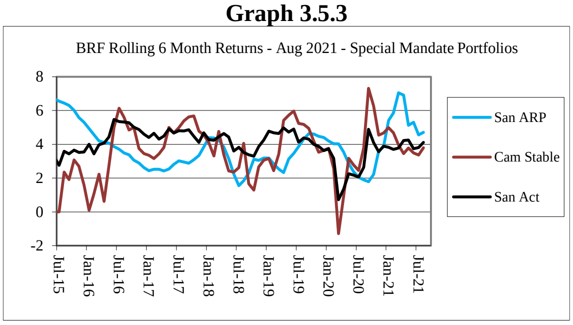
Graph 3.5.1



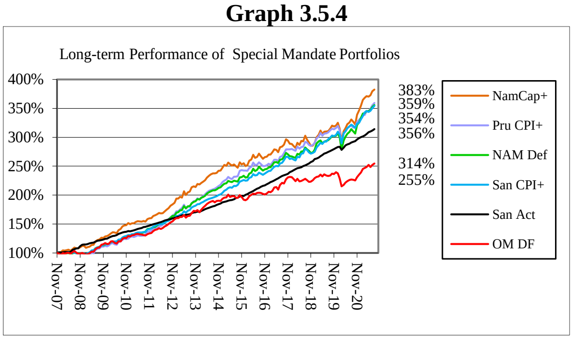
Graph 3.5.2



Graph 3.5.3

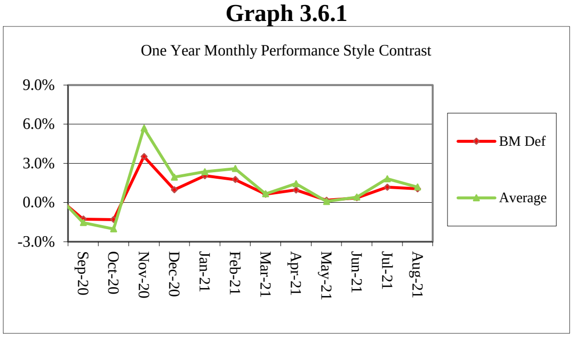


Graph 3.5.4



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

Graph 3.6.1



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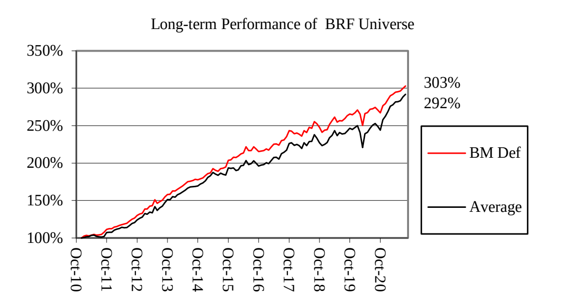
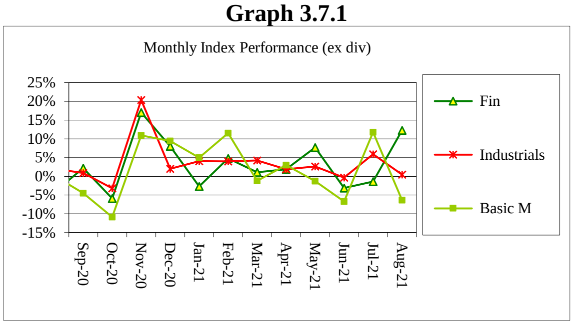
Graph 3.6.2

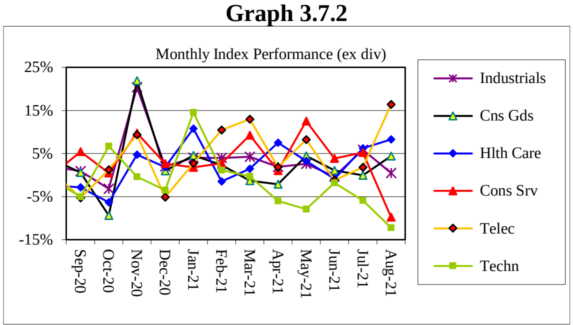


3.7 One-year monthly performance of key indices (excluding dividends)

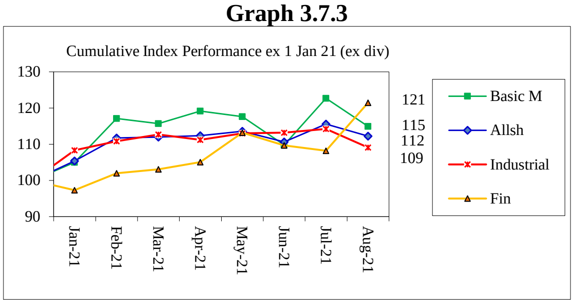
Graph 3.7.1



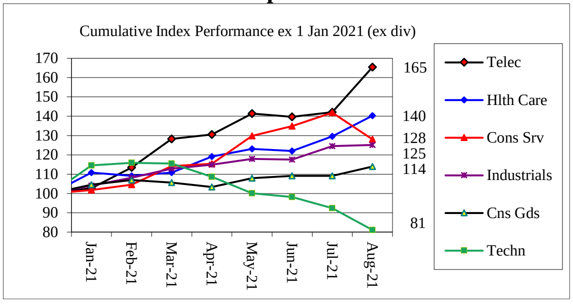
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio – Facts in figures

Table 4.1

Portfolio	Default portfolio	Average Prud Bal
5-year nominal return - % p.a.	6.4	7.5
5-year real return - % p.a.	2.5	3.6
Equity exposure - % of portfolio (qtr end June 2021)	47.1	64.8
Cumulative return ex Jan 2011	202.92	191.74
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 of late under-performed the average prudential balanced portfolio, although still ahead since January 2011, when it was restructured to its present structure. This is the result of its significantly more conservative structure with an equity exposure of only 47% compared to the average prudential balanced portfolio's exposure of 65%. When equities significantly out-perform the other main asset classes, the default portfolio will under-perform the average prudential balanced portfolio. Over the past 12 months and as the result of the further significant increase in central banks' bond buying activities, equities have indeed significantly outperformed the other asset classes except property. This intervention of course distorts financial markets and causes significant volatility and artificially increased valuations of equities, in particular.

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

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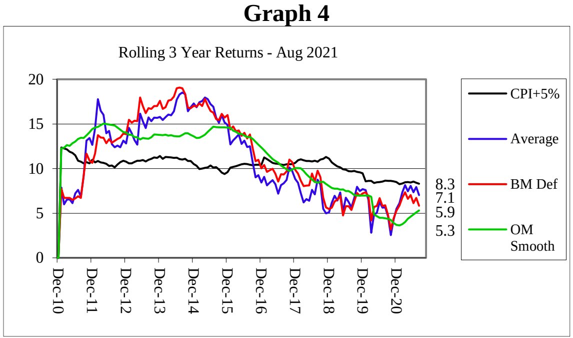
Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	6.1%	3.2%	2.5%
Best annual performance	8.2%	9.0%	8.2%
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	7.6%	6.1%	6.2%

The table above presents one-year performance statistics. It highlights the performance differences between the 3 portfolios over the 3 years September 2018 to August 2021. This gives an indication of volatility of the performance of these 3 risk profiles.

Graph 4



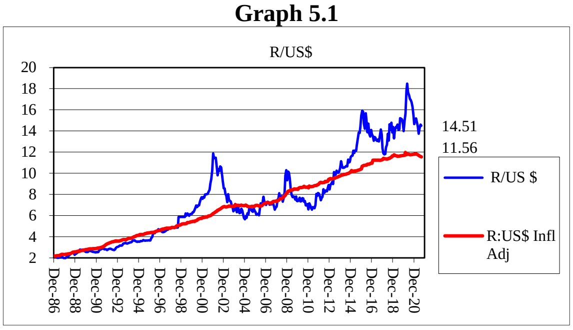
Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5%, on a rolling 3-year basis. It also shows rolling 3-year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio 3-year return to end August was 5.9%, the average was 7.1% vs CPI plus 5% currently on 8.3%.

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 11.56 to the US Dollar while it actually stood at 14.51 at the end of August. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

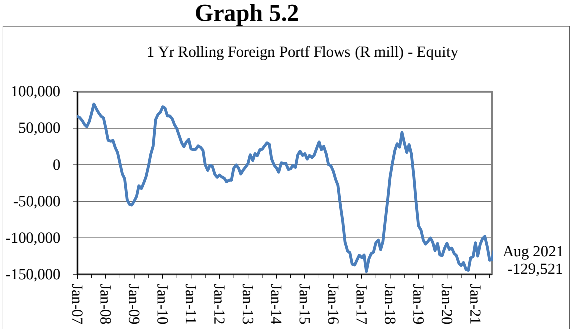


The Rand strengthened by 0.69% in August with net foreign investment outflows from bonds and equities of R58.3 bn. Over the past 12 months the Rand strengthened by 14.4%. Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 199.0 bn (outflow of R 165.1 bn to end of July 2021).

Since the beginning of 2006, total net foreign portfolio outflows amounted to R 261.1 bn (July R 202.8 bn outflows).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis, of R 129.5 bn at the end of August (outflow of R 130.7 bn year-on-year to end July). The month of August experienced a net outflow of R 19.1 bn. Since the beginning of 2006, foreign net investment outflows from equities amounts to R 370.7 bn (end July net investment outflow of R 351.7 bn). This represents roughly 1.9% 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 69.5 bn over the past 12 months to end of August (outflow of R 34.4 bn over the 12 months to end of July). The month of August experienced a net outflow of R 39.3 bn. Since the beginning of 2006, foreign net investment in bonds amounts to R 109.6 bn (to July R 148.9 bn).

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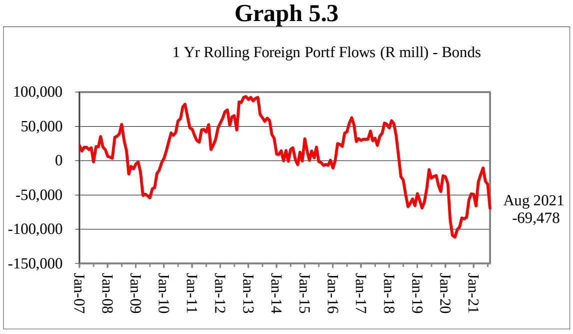
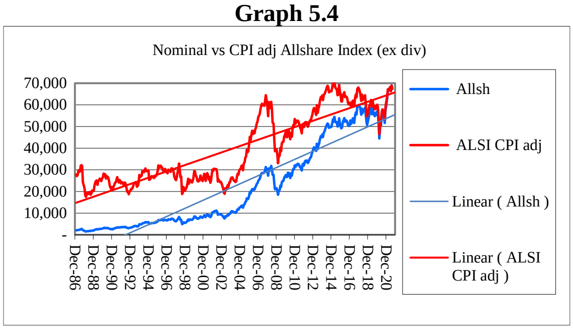
Graph 5.3



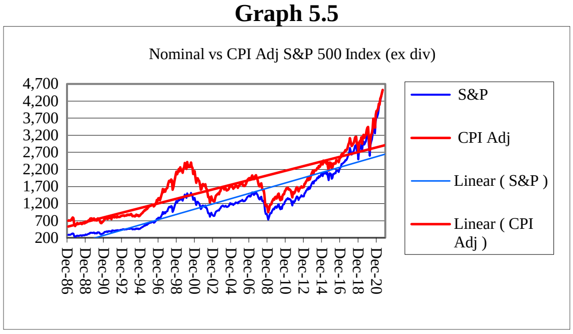
Graphs 5.4 reflects the movement of the JSE since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.7% per year since January 1987, and this excludes dividends of 3.1%. Namibian inflation over this period of 34 years was 7.7% per year. This is equivalent to a growth in real terms of 3.0% p.a. over this period, excluding dividends, or around 6.1% including dividends.

Graph 5.4



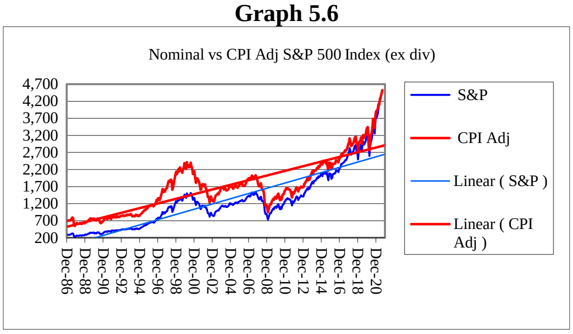
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and in inflation adjusted terms, with trend lines for these. Since January 1987 the S&P500 Index has grown by 8.4% per annum, over this period of 34 years. US inflation over this period was 2.6%. This is equivalent to a growth in real terms of 5.8% p.a. over this period, excluding dividends or around 8.0% including dividends.

Graph 5.5



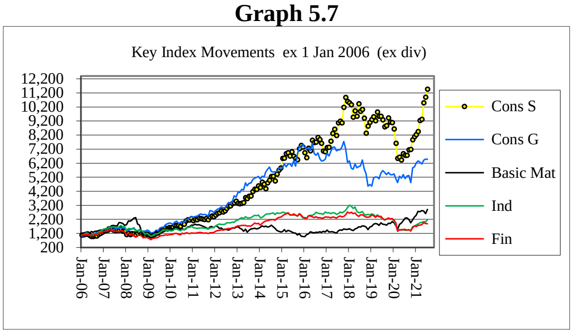
Graph 5.6 provides an interesting overview of some of the major global share indices, showing up the S&P500 as the top performing index since the start of 2021.

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 ones offer less value on the basis of fundamentals. Annualised returns for these indices since the beginning of 2006 were: Consumer Services: 16.1%; Consumer Goods: 13.0%; Basic Materials: 6.6%; Industrials: 5.0% and Financials: 4.9%.

Graph 5.7



6. Understanding Benchmark Retirement Fund investments – Part 5 (final)

By Tilman Friedrich

This series of articles aims to provide background and guidance on investments to assist Benchmark Retirement Fund members and employers taking charge of their fund investments. It covers the following topics:

1. Parties to fund and their roles and responsibilities
2. Investment choice and return objectives
3. Investment range and portfolio composition
4. Performance characteristics of asset classes and portfolios
5. The default portfolio
6. The default portfolio vs the smooth growth portfolio
7. Income replacement ratio and contribution rates
8. Selection of investment managers
9. Combining investment portfolios and when to switch
10. Investment manager risks and manager diversification
11. Performance measurement

In the previous four newsletters, I covered the first eight topics. In this newsletter, I will cover the remaining topics

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 2021

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

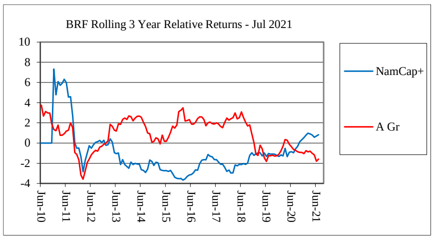
The monthly review of portfolio performance, as set out in this issue, is also available on our website at www.rfsol.com.na.

"Combining investment portfolios and when to switch," "Investment manager risks and manager diversification," and "Performance measurement."

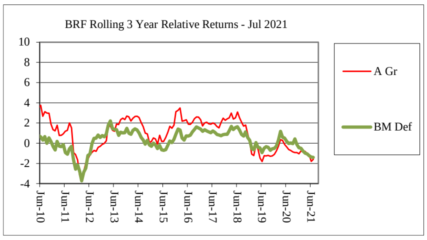
8. Combining investment portfolios and when to switch

Last month's column discussed the correlation between managers and presented a correlation table (table 6.2 on page 10). A correlation of 1 between 2 managers means they produce precisely the same returns from month to month. In contrast, a correlation of -1 means their monthly returns always move in the opposite direction. This table showed that Allan Gray (A Gr) and NAM Capital Plus (NAMCap+) portfolios had the lowest correlation of 0.44 while Allan Gray and the Benchmark Default portfolio (BM Def) had the highest correlation of 0.98. Latter is obvious because Allan Gray makes up about half the portfolio. Let us look at the graphs, nevertheless.

Graph 6.1



Graph 6.2



Graphs 6.1 and 6.2 depict rolling three-year returns relative to the average prudential balanced portfolio represented by the zero line.

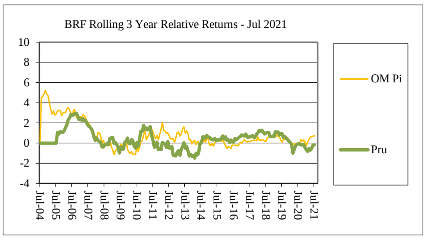
Looking at graph 6.1 first, it is evident that when A Gr is below the zero line, NAMCap+ is above the zero line most of the time and the opposite. The investor who invests in these two portfolios in equal proportions should experience rolling three-year returns very close to the average prudential balanced portfolio. The reason for such diverging return characteristics lies in their diverging asset allocation. The NAMCap+ fund is a moderate-to-low-risk portfolio. Its equity exposure is only around 50%, and its bond exposure about 30%. A Gr is a moderate-risk portfolio with an equity exposure of about 60% and a bond exposure of about 20%. NAMCap+ has an SA exposure of around 30% and an international exposure of about 20%, while Allan Gray's respective exposure is around 20% and 30%.

Looking at graph 6.2 next, it is evident that A Gr returns and BM Def returns closely match each other and linger above or below the zero line simultaneously. The investor who invests in these two portfolios in equal proportions should experience rolling three-year returns generally above the average prudential balanced portfolio.

The fund member must know how he expects his investment portfolios to behave relative to the market and peers, and structure the portfolio accordingly.

Graph 6.1 also depicts that most managers experience performance cycles. A Gray (red line) outperformed the zero line (representing the average prudential balanced portfolio) from 2013 to the end of 2018. NAMCor+ (the blue line) depicts a cycle of underperformance at the same time.

Graph 6.3



When one tracks the performance of other managers, one will notice similar cycles of out-and under-performance of between 3 and 5 years. Graph 6.3 depicts the performance of the Old Mutual Pinnacle portfolio (OM Pi) and the Prudential balanced portfolio (Pru). Interestingly, both managers oscillate around the zero line but stay between the plus 2 and minus 2 lines. Compare this performance to the two managers in graph 6.1, whose deviation varies between the plus 4 and the minus 4 lines.

A decision to move from one portfolio to another portfolio must consider the managers' performance cycles and how they perform relative to the average prudential balanced portfolio. One must avoid selling out of a manager while at the start of his outperformance cycle and vice-versa. Managers whose performance displays a broader divergence from the average prudential balanced portfolio present a higher risk of selling out or buying in at the wrong time and vice-versa. When deciding to buy in or sell out of either Pru or OM Pi, timing is not a key consideration compared to a decision on A Gr or NAMCor+.

9. Investment manager risks and manager diversification

The following risks are typically associated with the selection of a manager. The Benchmark Retirement Fund trustees address some of these risks at the fund level, advised by their consultant and investment adviser. The

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fund member must consider the other risks and mitigate them primarily by choosing an appropriate combination of managers.

- Systemic risk (mitigated by trustees)
- Prudential risk (mitigated by trustees)
- Currency risk (mitigated by trustees)
- Scam risk (mitigated by trustees and regulation)
- Advice risk (mitigated by fund member)
- Market risk (mitigated by fund member)
- Volatility risk (mitigated by fund member)
- Lost opportunity risk (mitigated by fund member)
- Capital loss risk (mitigated by fund member)
- Underperformance risk (mitigated by fund member)

A combination of different managers will mitigate the following risks:

- The volatility of returns the member would earn.
- The risk of falling for a scam presented as an exceptional investment opportunity.
- The risk of incurring a capital loss.
- The risk of underperforming the average prudential balanced portfolio.

However, the fund member who chooses his investment portfolios must manage a few remaining risks:

- The advice risk arising from listening to wrong advice.
- The market risk arising from sudden dramatic changes in the investment markets.
- The lost opportunity risk arising from the incorrect timing of investment decisions and timing delays in implementing decisions.

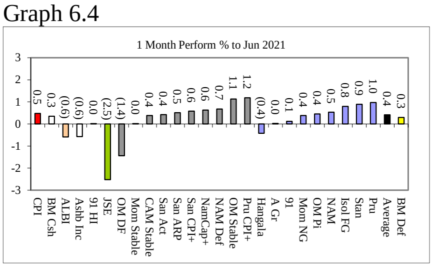
Another important decision that the fund member must take is how many portfolios he would employ. Having learnt that a combination of managers is always a good idea to mitigate risks, the fund member must consider the following factors:

- Each additional manager further dilutes the risks but moves the overall return towards the average.
- The “efficient frontier model” shows that adding managers reduces risk and increases return only to a point. Adding more portfolios then adds no additional value.
- The correlation of managers’ performance impacts the value add. A high correlation has little impact on the returns as opposed to a low correlation.

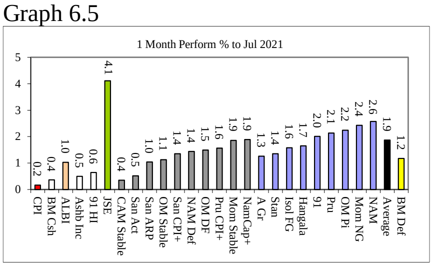
10. Performance measurement

Investment consultants often present investment performance in a bar graph. A bar graph measures performance at a point in time. The shorter the period and the higher the market volatility, the less meaningful are bar graphs in evaluating investment performance. Graphs 6.4 and 6.5 exemplify this principle.

Graph 6.4



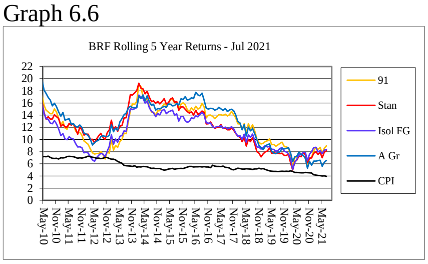
Graph 6.5



Graph 6.4 ostensibly shows Pru as the best performer and Hangala as the worst performer for June 2021 (amongst the blue bars). Graph 6.5 now shows NAM as the best performer and A Gr as the worst performer for Jul 2021.

Line graphs depict a more meaningful picture of managers’ absolute performance over a period and of their performance relative to other measures (e.g., CPI) and managers over the same period.

Graph 6.6



Graph 6.6 shows the rolling five-year returns of four prudential balanced portfolios and the CPI from 2013 to July 2021. It indicates that all managers’ performance increased steeply declined until July 2012 (due to the global financial crisis and then increased steeply until June 2014 due to massive international monetary and fiscal intervention. This graph also depicts a few other interesting points. One of these points is that they outperform CPI most of the time and often by a large margin. Another reflection is that there is not much to choose between these managers when one measures their performance over rolling five years and over an extended period.

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