Volume 18 No. 8
August 2022

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 2022

By Staff Writer – RFS Fund Administrators (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

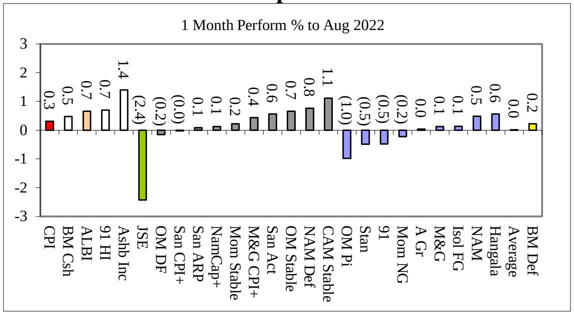
In August 2022, the average prudential balanced portfolio returned 0.0% (July 2022: 2.9%). The top performer is Hangala Prescient Absolute Balanced Fund with 0.6%, while Old Mutual Pinnacle Profile Growth with -1.0% takes the bottom spot. For the 3-months Allan Gray Balanced Fund takes the top spot, outperforming the 'average' by roughly 1.0%. Momentum Namibia Growth Fund underperformed the 'average' by 2.3% 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.

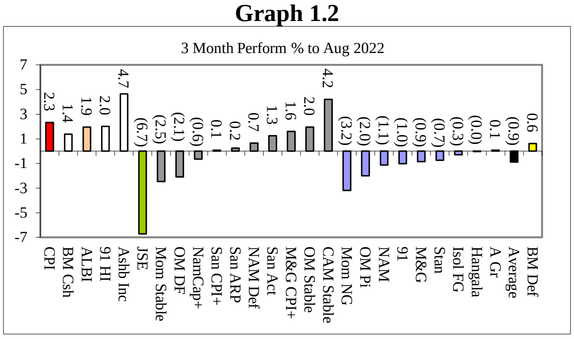
Below is the legend to the abbreviations reflected on the graphs:

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	B.M. Csh (no color)
NinetyOne High Income (interest bearing assets)	91 H.I. (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)
M&G Inflation Plus	M&G CPI+ (grey)
Sanlam Active	San Act (grey)
Sanlam Inflation Linked	San CPI+ (grey)
Smooth bonus portfolios	
Old Mutual AGP Stable	O.M. 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	O.M. Pi (blue)
M&G Managed	M&G (blue)
Stanlib Managed	Stan (blue)

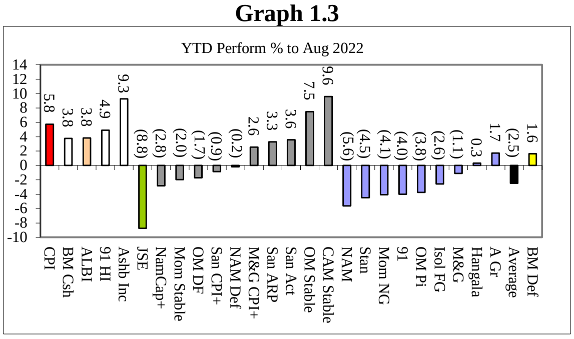
Graph 1.1



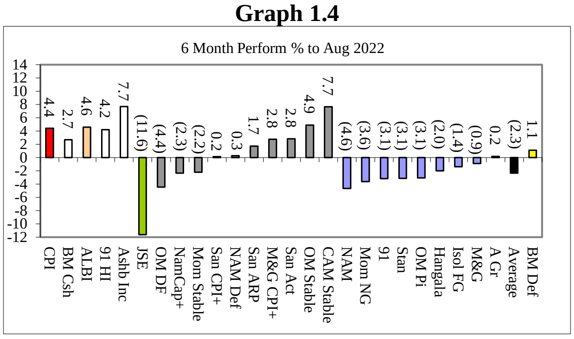
Graph 1.2



Graph 1.3



Graph 1.4



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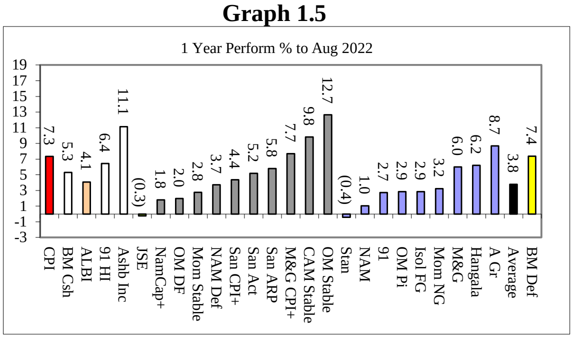
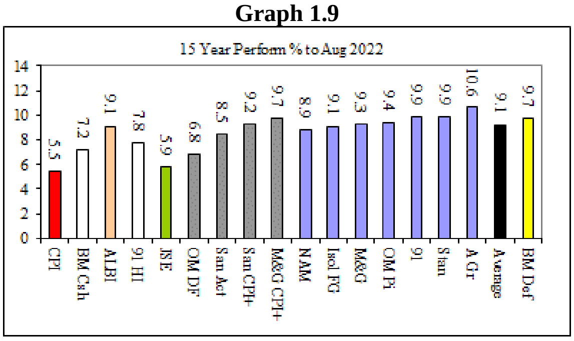
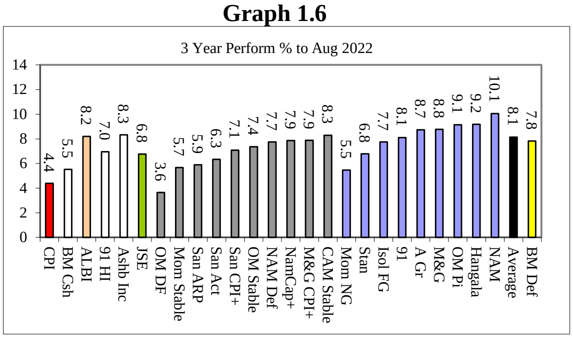
Graph 1.5



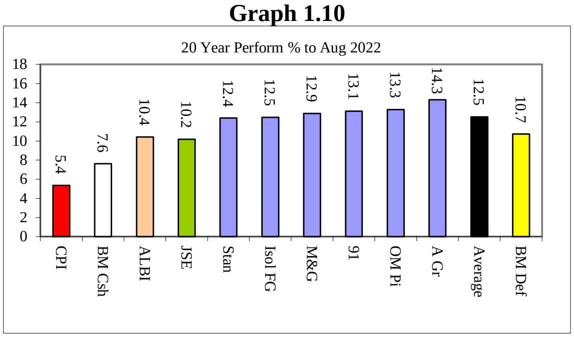
Graph 1.9



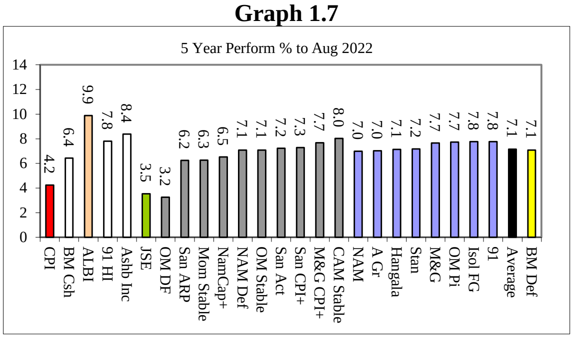
Graph 1.6



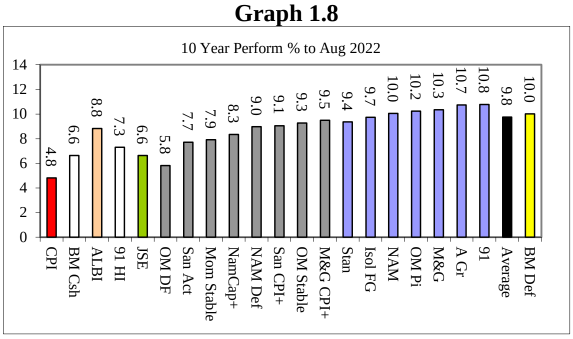
Graph 1.10



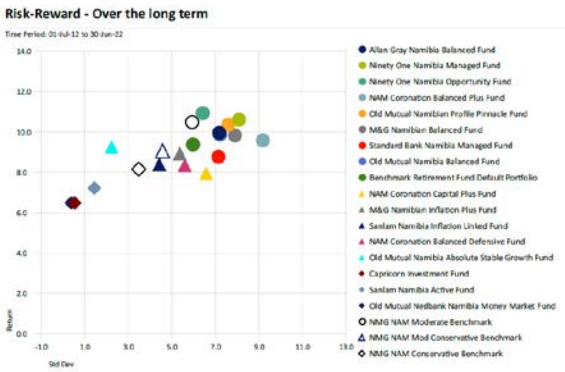
Graph 1.7

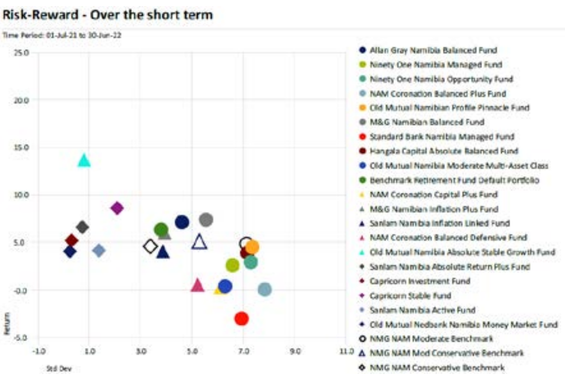


Graph 1.8



Risk/ Return





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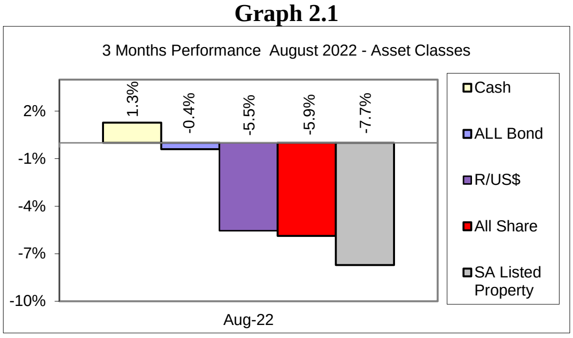
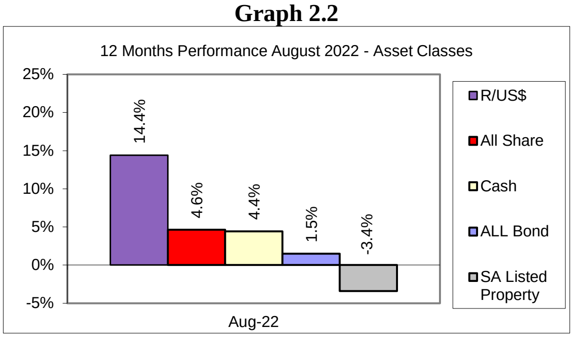
2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

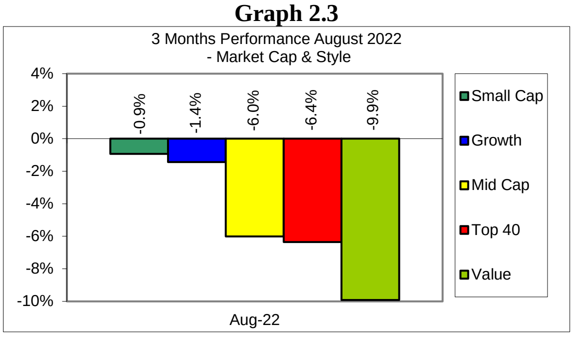
Graph 2.1



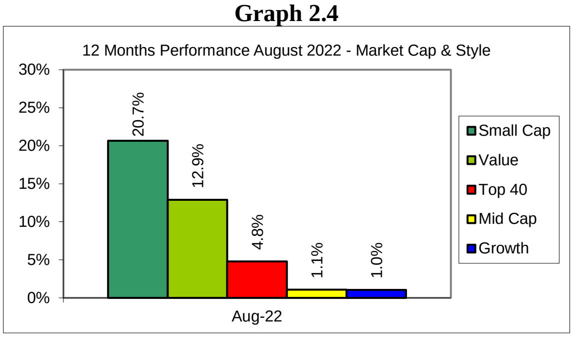
Graph 2.2



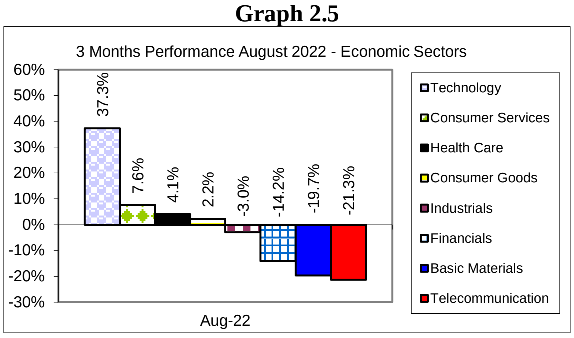
Graph 2.3



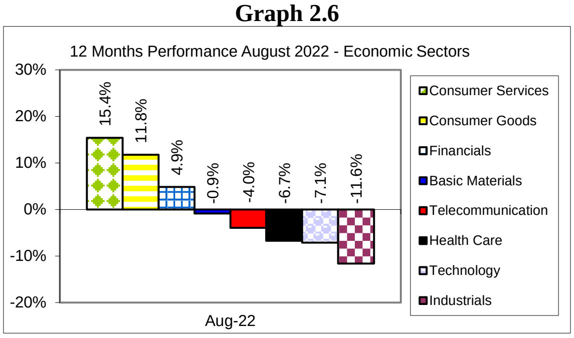
Graph 2.4



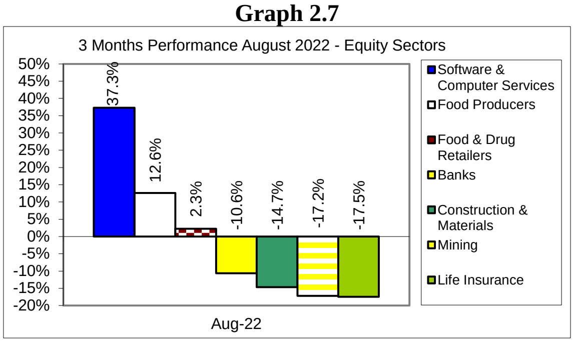
Graph 2.5



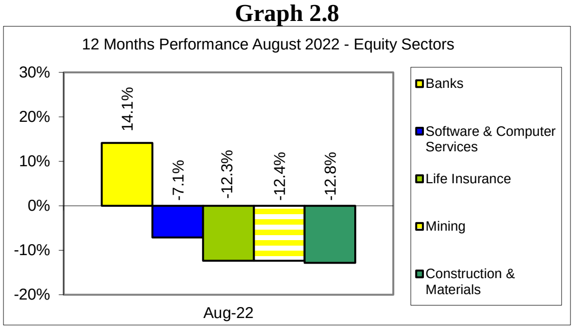
Graph 2.6



Graph 2.7



Graph 2.8



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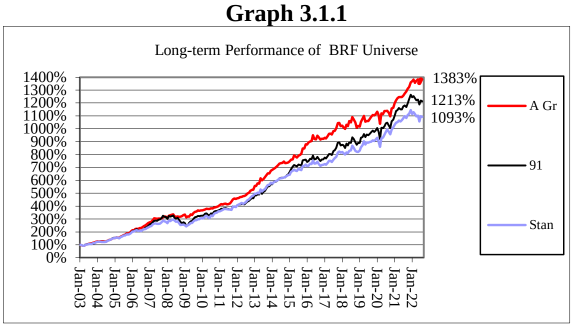
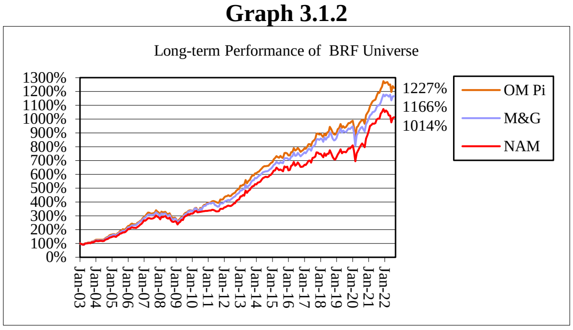
3. Portfolio Performance Analysis

3.1 Cumulative performance of prudential balanced portfolios

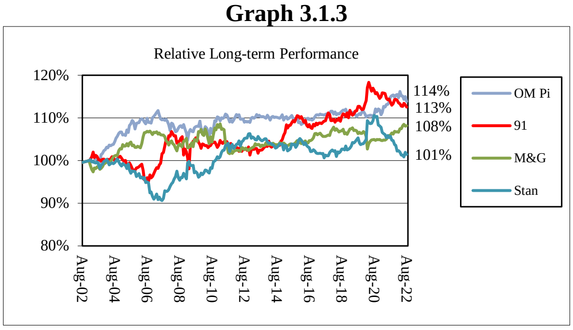
Graph 3.1.1



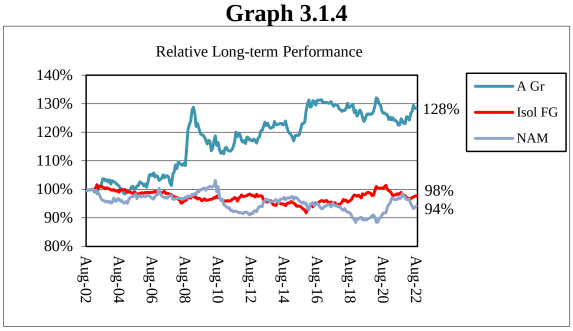
Graph 3.1.2



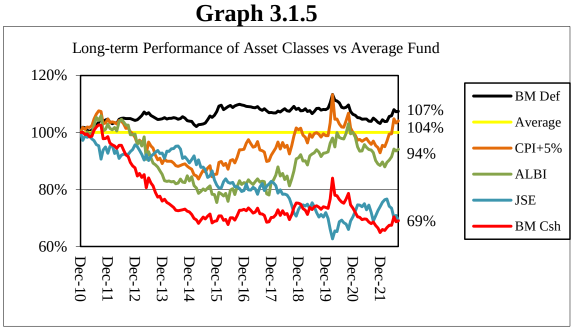
Graph 3.1.3



Graph 3.1.4

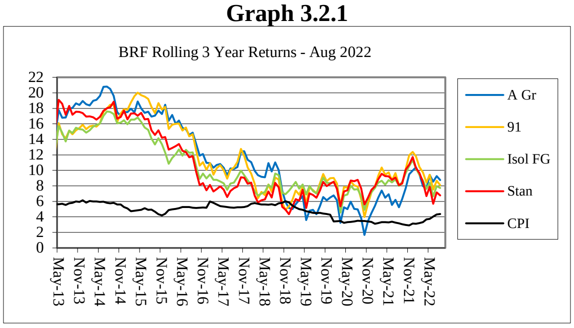


Graph 3.1.5

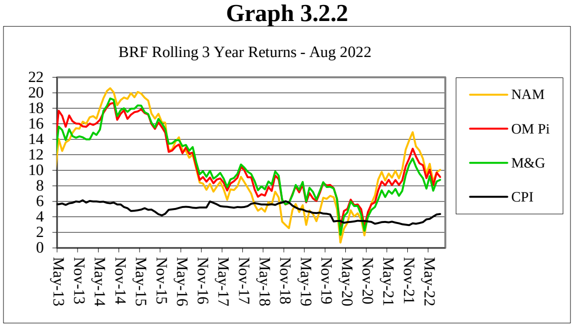


3.2 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1

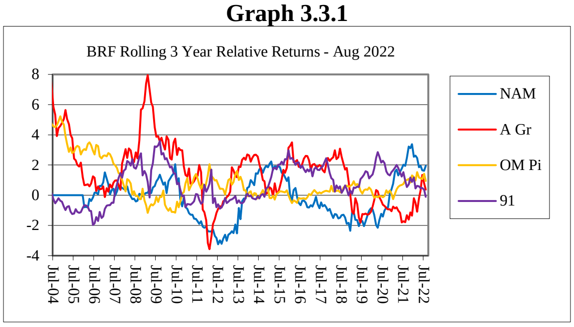


Graph 3.2.2



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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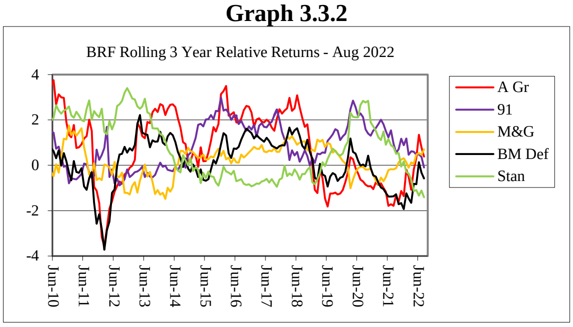
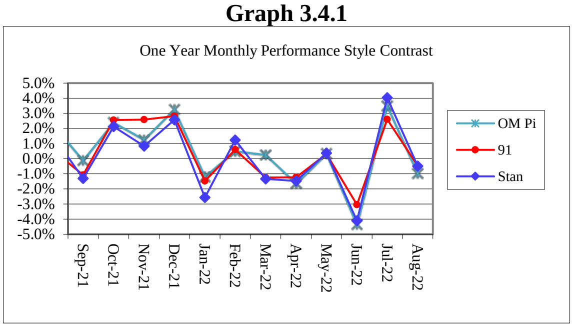
Graph 3.3.2

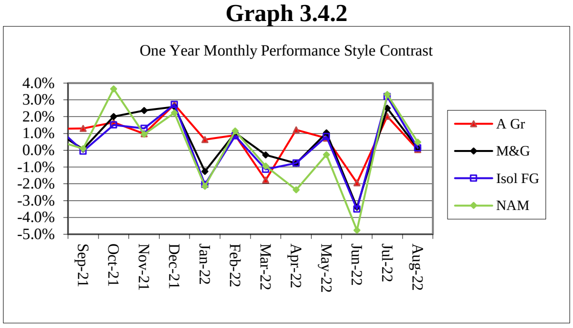


3.4 Monthly performance of prudential balanced portfolios

Graph 3.4.1

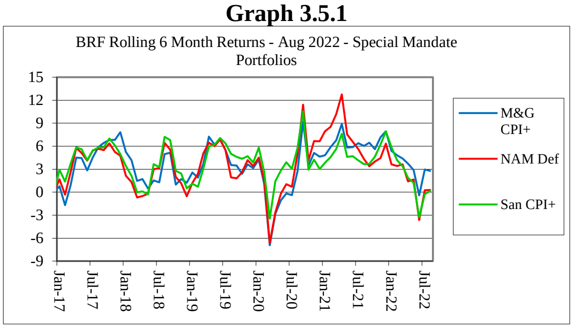


Graph 3.4.2

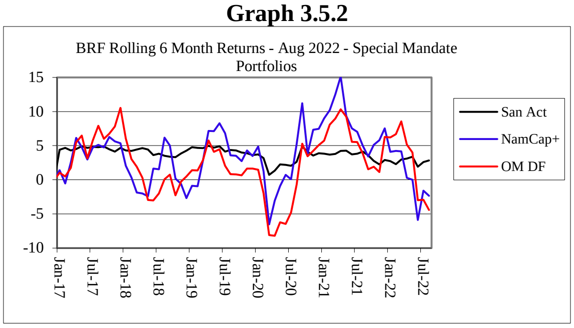


3.5. 6-month rolling and cumulative returns of 'special mandate' portfolios

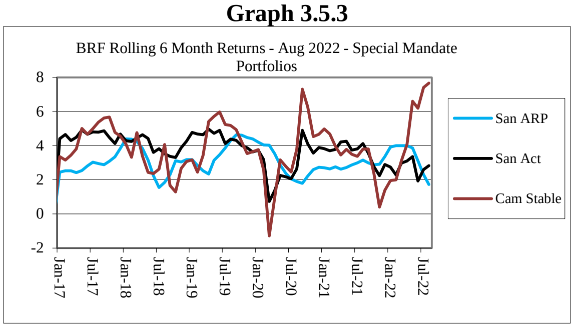
Graph 3.5.1



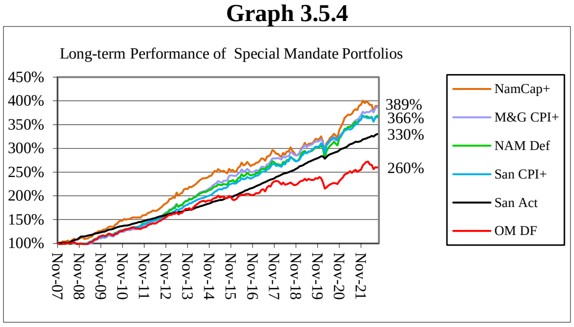
Graph 3.5.2



Graph 3.5.3

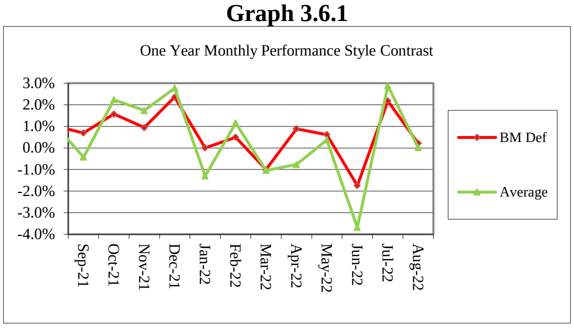


Graph 3.5.4



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

Graph 3.6.1



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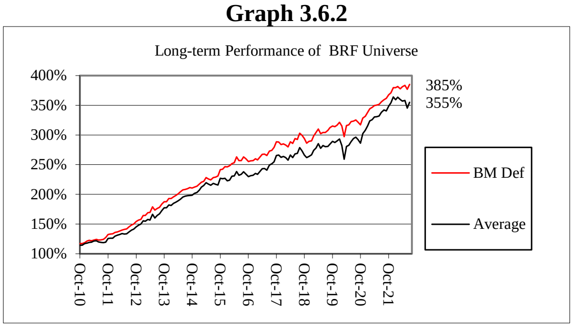
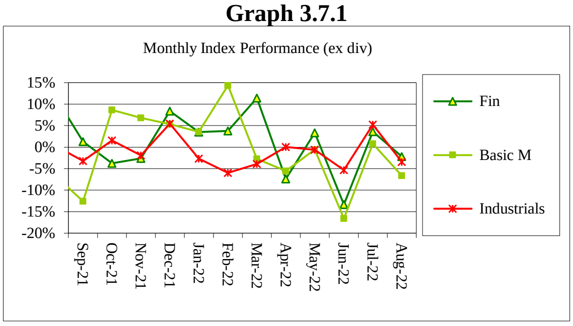
Graph 3.6.2

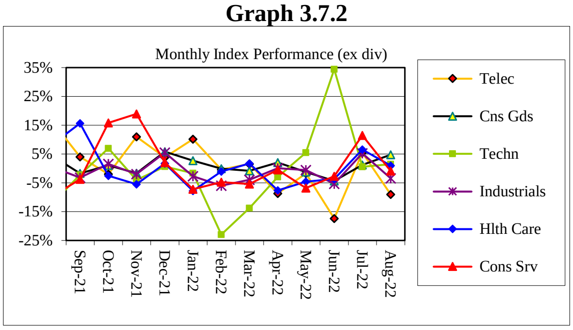


3.7 One-year monthly performance of key indices (excluding dividends)

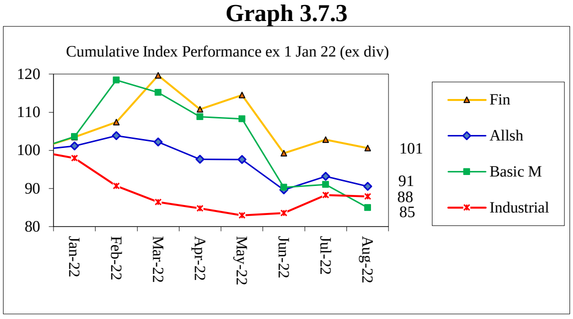
Graph 3.7.1



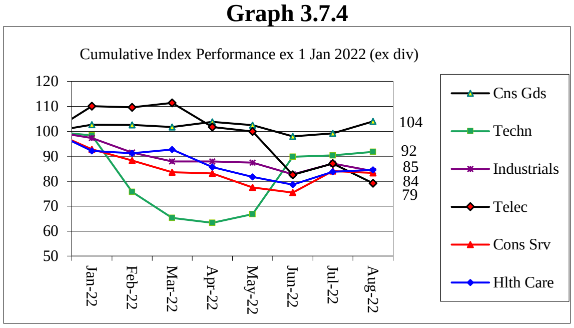
Graph 3.7.2



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.	7.1	7.1
5-year real return - % p.a.	2.9	2.9
Equity exposure - % of portfolio (quarter end June 2022)	46.2	64.0
Cumulative return ex Jan 2011	225.3	202.7
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. Please note that the default portfolio of late underperformed the average prudential balanced portfolio, although still ahead since January 2011, when the trustees restructured by raising the equity exposure. It still has a significantly more conservative structure with an equity exposure of only 46% compared to the average prudential balanced portfolio's exposure of 64%. When equities significantly out-perform the other main asset classes, the default portfolio will underperform the average prudential balanced portfolio. Over the past 12 months, due to the further significant increase in central banks' bond-buying activities, equities have performed well. Property outperformed equities, though, recovering from its severe slump due to COVID. Of course, the central banks' interventions distort financial markets, causing significant volatility and artificially increased valuations of equities.

One must read the default portfolio's long-term return in the context of its initially low-risk profile that the trustees only changed from the beginning of 2011 when they replaced the Metropolitan Absolute Return fund with the Allan Gray balanced portfolio.

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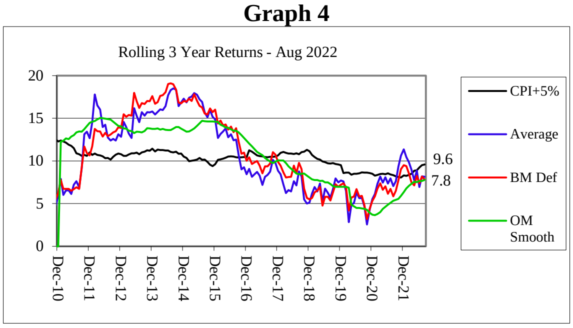
Table 4.2

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	5.5%	3.2%	2.5%
Best annual performance	8.1%	9.5%	11.4%
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	6.9%	6.8%	7.2%

The table above presents one-year performance statistics. It highlights the performance differences between the three portfolios over the three years from September 2019 to August 2022. These statistics show up the performance volatility of these three risk profiles.

Graph 4

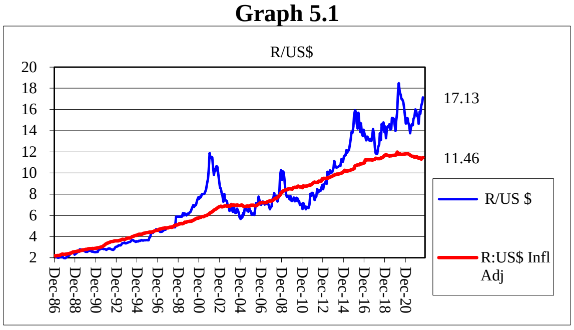


Graph 4 measures the success of the Benchmark Default portfolio in achieving its long-term gross investment return objective of inflation plus 5% on a rolling 3-year basis. It also shows rolling 3-year returns of the average prudential balanced portfolio and rolling 3-year CPI. The Benchmark default portfolio's 3-year return to the end of August was 7.8%, the average was 8.1% vs. CPI plus 5%, currently on 9.5%.

5. Review of Foreign Portfolio Flows and the Rand How is the Rand doing?

Graph 5.1 indicates that the Rand's fair value by our measure is 11.46 to the U.S. Dollar, while it stood at 17.13 at the end of August. Our measure is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

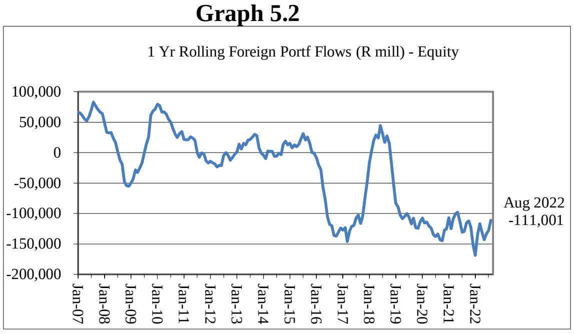


The Rand weakened by 2.88% in August with a net foreign investment outflow from bonds and equities of R4.0 bn. Over the past 12 months, the Rand weakened by 18.1% (July Rand weakened by 14.0%). Net outflows of foreign capital from equity and fixed interest securities over the past 12 months amounted to R 292.9 bn (outflow of R 347.2 bn to the end of July 2022).

Since 2006, total net foreign portfolio outflows amounted to R 554.0 bn (July R 550.0 bn outflows).

Graph 5.2 reflects a net outflow of capital from South African equities on a rolling one-year basis of R 111.0 bn at the end of August (outflow of R 127.5 bn year-on-year to the end of July). The month of August experienced a net outflow of R 2.5 bn. Since 2006, foreign net investment outflows from equities amounted to R 481.7 bn (end July net investment outflow of R 479.2 bn). It represents roughly 2.5% 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 S.A. bonds of R 181.9 bn over the past 12 months to the end of August (outflow of R 219.7 bn over the 12 months to the end of July). The month of August experienced a net outflow of R 1.5 bn. Since 2006, foreign net investment outflows in bonds amounted to R 72.3 bn (net investment outflows to July R 70.8 bn).

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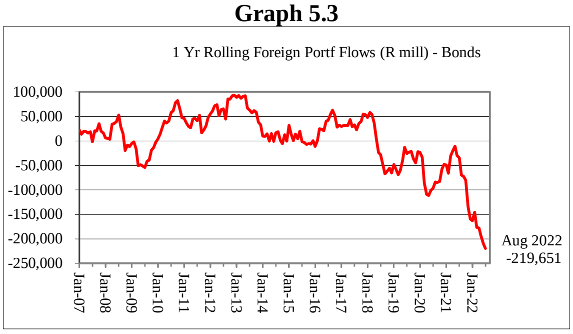
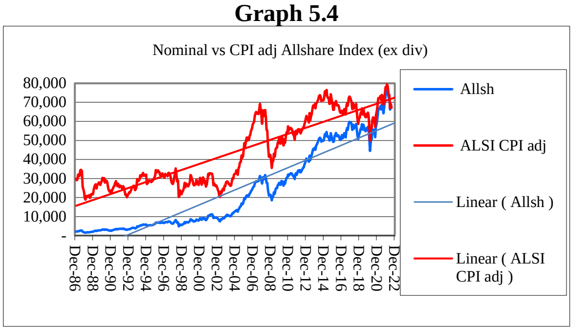
Graph 5.3



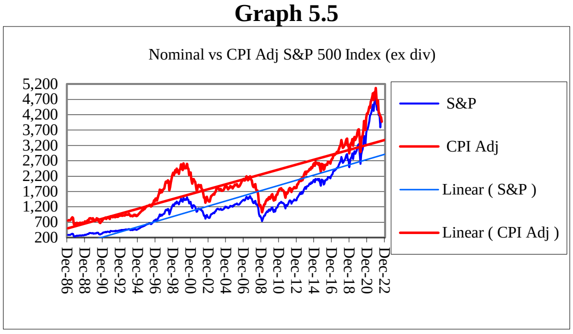
Graph 5.4 reflects the movement of the JSE since January 1987 in nominal and inflation-adjusted terms, with trend lines for these. In nominal terms, the JSE grew by 10.4% per year since January 1987, excluding dividends of 3.2%. Namibian inflation over these 35 years was 7.7% per year. It is equivalent to growth in real terms of 2.5% p.a. over this period, excluding dividends, or around 5.7% including dividends.

Graph 5.4



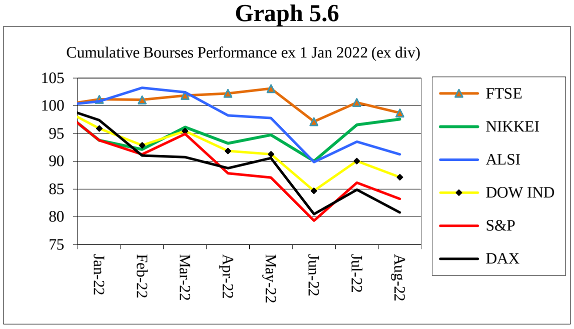
Graph 5.5 reflects the movement of the S&P500 Index since January 1987 in nominal and inflation-adjusted terms, with trend lines for these. Over 35 years since January 1987, the S&P500 Index grew by 7.8% per annum. U.S. inflation over this period was 2.8%. It represents growth in real terms of 5.0% p.a. over 35 years, excluding dividends, or around 7.1% (including dividends).

Graph 5.5



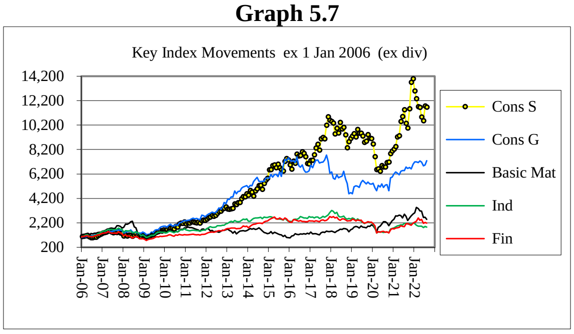
Graph 5.6 provides an interesting overview of some of the major global share indices, showing the FTSE as the top-performing index since the start of 2022.

Graph 5.6



Graph 5.7 provides an overview of the relative movement of the key equity sectors on the FTSE/JSE since December 2005, when the JSE introduced these indices. From this graph, the investor can deduce which sectors offer better value and poorer value based on fundamentals. Annualised returns for these indices since the beginning of 2006 were: Consumer Services: 15.3%; Consumer Goods: 12.4%; Basic Materials: 6.1%; Financials: 5.0% and Industrials: 3.3%.

Graph 5.7



6. Foreign investment – a time to reassess your risk!

By Tilman Friedrich

Western media and politicians would want to make us believe we live in an open global economy. However, where international trade is concluded in a single currency and fiscal and monetary authorities intervene massively in financial markets, more will have to be done to make the public believe.

Demand and supply has no bearing on the behaviour of markets today. Savers are paying off the debt of borrowers through artificially low interest rates set by monetary authorities. Safe-haven investments are earning negative real interest rates. The investor is conditioned to accept that he will have to work until he drops dead instead of realising his dream of retiring at an age where one might still be able to enjoy life for a while. Retirement ages are extended while pension entitlements are at best being questioned and even reduced in some countries.

With negative real interest rates seemingly becoming the 'new norm,' asset valuation models are flawed. Why should this be of concern to a pension fund member? Well, the

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 AUGUST 2022

By Staff Writer – RFS Fund Administrators (Pty) Ltd

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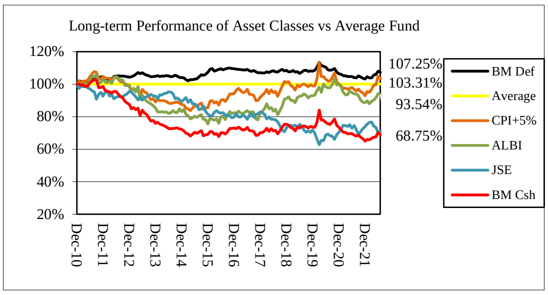
point is that pension fund contribution structures were established over the past century or more based on the assumption of cash returning around 2% above inflation, bonds around 4% above inflation, property around 5% above inflation, and equity around 8% above inflation. The pension model expects a typical prudential balanced portfolio, comprising a mix of these assets, to return roughly 5% above inflation after fees. Pension theory then arrived at a net retirement funding contribution rate of 11% or more to produce an income replacement ratio of 2% per membership year.

As graph 6.1 depicts, since the global financial crisis, the average prudential balanced portfolio (the straight yellow line) produced a return before fees of 3.3% p.a. below inflation plus 5%. That is a real return of 1.6% before fees and minus 0.9% p.a., after fees. Note that, in contrast, the Benchmark Default portfolio produced a real return of 4% p.a. before fees and about 3% p.a. after fees. None of the main asset classes in which prudential balanced portfolios invest (bonds – green line; shares – blue line; cash – red line) returned anywhere close to inflation plus 5% over the twelve years shown. Bonds are the closest, at 4.9% below inflation!

Graph 6.1



With such low real returns, the retirement funding contribution rate would have to be raised from 11% to 18%+. Add to this a typical cost elements of 6% for risk benefits and management costs, and the 'new norm' for a total retirement fund contribution rate is now at least 24% instead of the 17% before the advent of the 'new norm.'

Alternatively, the retiree would have to settle for an income replacement ratio of only around 40% after 30 years of service, instead of his expected 60%! We live in a different world today than it was 15 years ago! What we had expected of the future will be materially different, and we will have to find ways and means to deal with the impact these changes have on our lives and retirement planning. One can only find comfort because we are all 'in the same boat.' The answers have not been found, and a lot of energy and time will be spent all across the globe to find solutions to still enjoy time in retirement.

For local pension fund investors, one probably needs to take a different view of the risks of investing offshore. In the past, developing countries, particularly in Africa, were loaded with a political risk premium. The Cyprus experience has exposed the political risk in developed countries. To quote John Mauldin's assessment of the Cyprus debacle for investors back in 2013 - "Capital controls have shattered the monetary unity of EMU. A Cypriot euro is no longer a core euro…. The complicity of EU authorities in the original plan to violate insured bank savings – halted only by the revolt of the Cypriot parliament – leaves the suspicion that they will steal anybody's money if leaders of the creditor states think it is in their immediate interest to do so. The IMF doesn't get off easy here, either: The IMF's Christine Lagarde has given her blessing to the Troika deal, claiming that the package will restore Cyprus to full health, with public debt below 100pc of GDP by 2020."

John Mauldin's suspicion that "authorities … will steal anybody's money if leaders … think it is in their immediate interest to do so" was justified! The US-lead western sanctions on countries such as North Korea, Iran, Venezuela, and Russia more recently, and the freezing and impounding of their foreign assets, caused severe losses for all who invested in those countries. These countries raised the irk of the US for challenging its dictates, and it can quickly happen to any other country, including SA and Namibia. Namibia accommodates a Chinese space station in Swakopmund that may double up to guide intercontinental rockets. Imagine what the US will do to Namibia, and Namibian investors' offshore assets should it come to an open conflict with China. It is currently a very realistic scenario! Add huge demographic risks for a more callous view on investment in developed countries. In contrast, the political and demographic risks in Africa are readily comprehensible.

The risk attached to an offshore investment for Namibian investors cannot be ignored anymore. While the US is the global hegemon, the only safe offshore investment is one in the US. How long the US can maintain the position is difficult to assess. It seems that the US is now hell-bent on subordinating Russia. The next target will undoubtedly be China. China must realise this strategy and cannot afford Russia being forced into the US hegemony. It will have to stand up now, ignoring President Biden's threat that it will make a colossal mistake supporting Russia. The US will take on China through its economic means and use Taiwan and perhaps even South Kore and Japan to confront China militarily, as it took on Russia with economic sanctions and using Ukraine.

Given this environment, where can a pension fund still invest? Fixed interest assets are too risky and exposed to monetary and fiscal manipulation. Even if we here at the southern tip of Africa live in a much more sheltered environment, our financial markets are linked to global developments. It essentially leaves real business as the asset class in which to invest. We all have to live, eat, drink,

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dress, get to work, nurture our health, go on holiday, learn, and find shelter. The 'real economy' will continue and is best represented by commerce and industry. In short, equity investment is the most appropriate asset class for the ordinary investor who shies away from the more exotic asset classes such as gold, works of art, etc.

Conclusion

We expect higher interest rates and higher inflation for the next year or two. The Fed will gradually increase its policy rate by another 2% over the next year, which should bring inflation under control. High interest rates will curb consumer demand and may result in a recession over the next two years. In addition, Governments may have to raise taxes to fund the higher interest rates. As a result, equity markets will likely not show much growth over the next two years. Coupled with the global political turmoil, local investors must expect foreign investors to withdraw from the local markets for safe havens. Their support of local equities and other assets will remain low, impacting our local currency negatively, as one has already seen.

Although the general backdrop to investments is negative, investment markets always offer opportunities arising from the political turmoil and shortages resulting from the Ukraine crisis and the sanctions the West instituted against Russia. Interestingly, 'politically correct' investments are likely to fall out of favour creating opportunities with alternatives. Europe, for example, will reduce the focus on climate-neutral energy as it is forced to return to fossil fuels and nuclear power, and scorned military technology industries will regain popularity.

As we usually say, based on fundamentals, equities are our preferred asset class, more specifically value companies offering a high dividend yield. While the investor should usually diversify globally, prevailing global risks and uncertainties suggest that one should keep one's investments closer to home. Political risks in Africa seem much more sedated than those in Europe and Asia. If one can find value in property, it should also be an appropriate asset class closely tied to the 'real economy.' In terms of local equity sectors, fundamentals indicate that consumer goods and consumer services and financials are back in the favour compared to industrials and resources.

Prudential balanced portfolios are ideal for the long-term investor who does not have the time and knowledge to make investment decisions. These vehicles avoid speculating on timing investments, choosing asset classes and exchange rates, and provide peace of mind that they will deliver positive real returns in the long term.

Important notice and disclaimer