Volume 6, No. 10, October 2010

Benchmark Retirement Fund

MONTHLY REVIEW OF PORTFOLIO PERFORMANCE TO 31 OCTOBER 2010

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

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

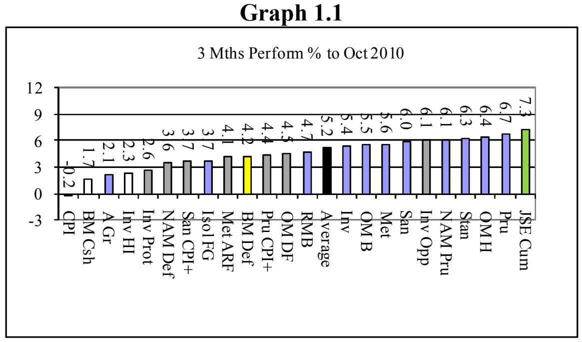
1. Review of Portfolio Performance

In **October** the **average prudential balanced portfolio** returned 1.99% (September 4.89%). Last month's top performer, Prudential, managed to retain top spot (3.08%), worst performance once again delivered by Allan Gray (0.62%). In very broad terms, Allan Gray had around 9% lower exposure to onshore equities and a 5% lower exposure to bonds, with a 9% higher exposure to offshore asset and a 5% higher exposure to cash, relative to the average manager. This only explains roughly 0.3% of it's under performance, the remainder of around 1% requiring a more detailed investigation.

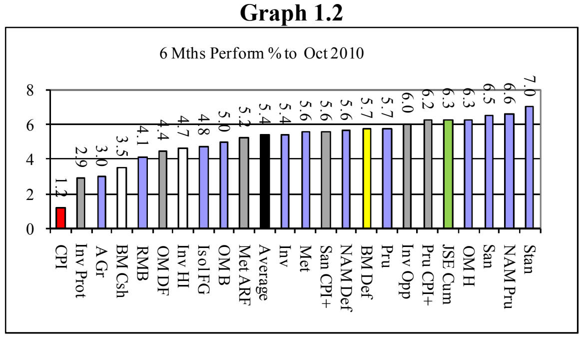
Graphs 1.1 to 1.7 reflect the performance for periods from 3 months to 10 years of a number of the most prominent prudential balanced portfolios (blue bars), 'special mandate portfolios' with lower volatility risk (grey bars), fixed interest portfolios (no colour bars), the average of prudential balanced portfolios (black bar), the JSE Allshare Index (green bar), and the CPI (red bar). Benchmark investors should take note of the performance of the default portfolio (yellow bar), which represents a combination of Prudential Namibia Inflation Plus and Metropolitan Namibia Absolute Return. Below is the legend to the abbreviations reflected on the graphs:

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

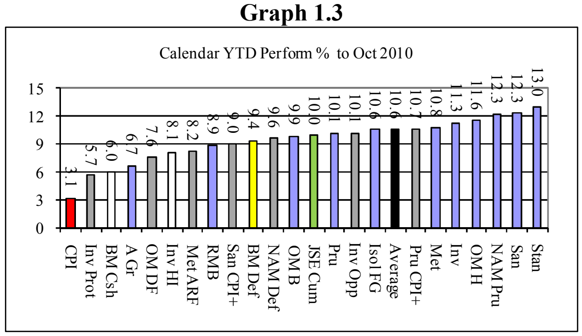
Graph 1.1



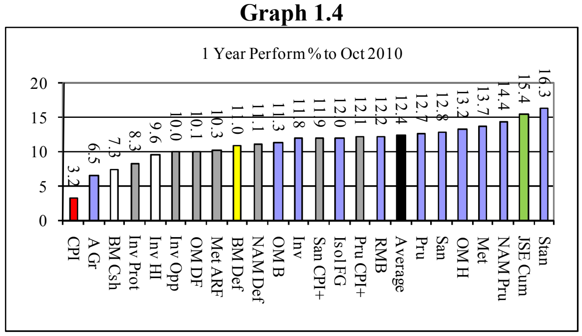
Graph 1.2



Graph 1.3



Graph 1.4



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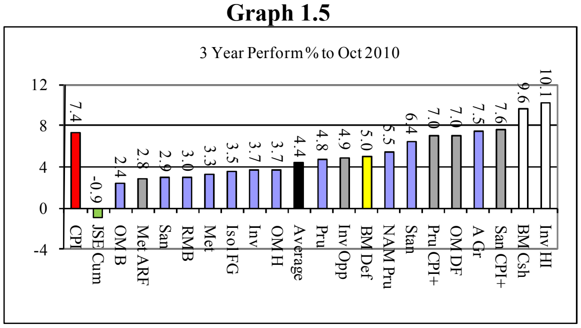
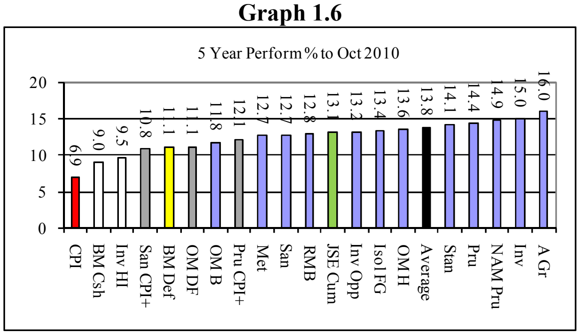
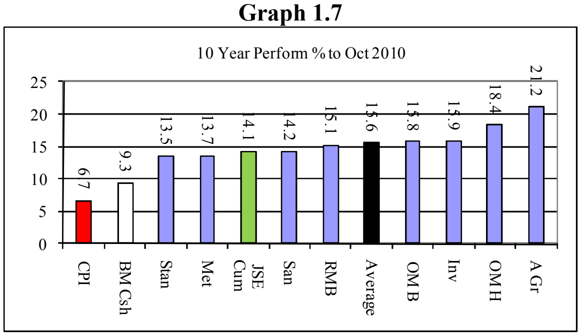
Graph 1.5



Graph 1.6

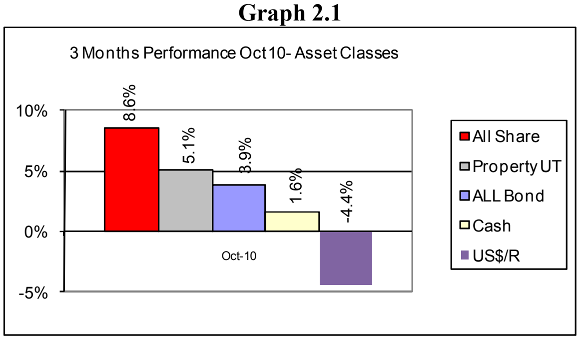


Graph 1.7

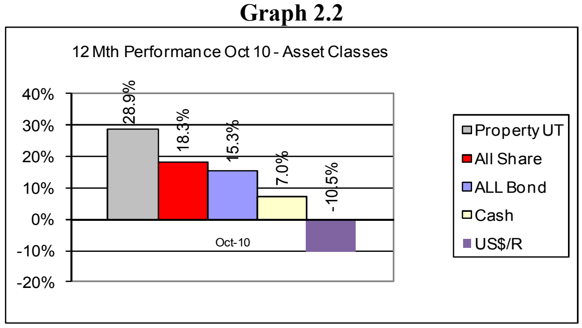


2. Performance of Key Indices (index performance by courtesy of IJG/Deutsche Securities)

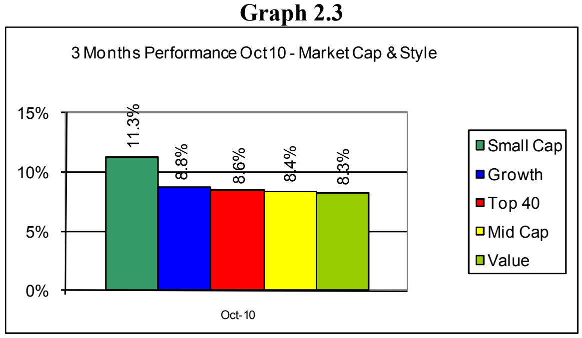
Graph 2.1



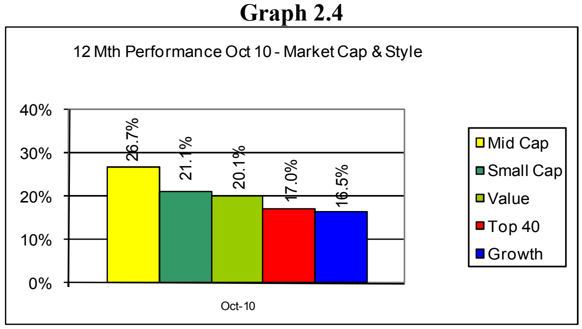
Graph 2.2



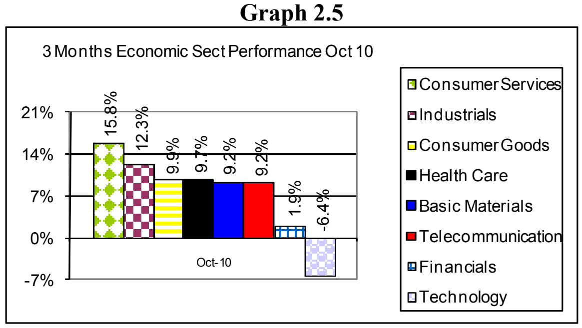
Graph 2.3



Graph 2.4



Graph 2.5



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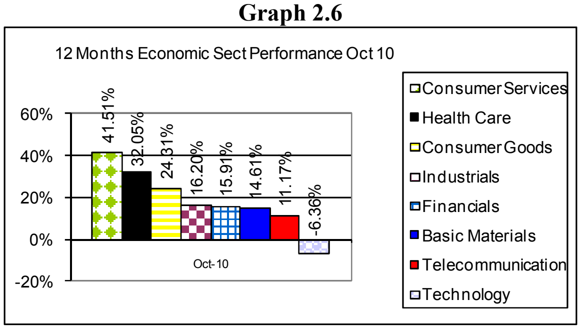
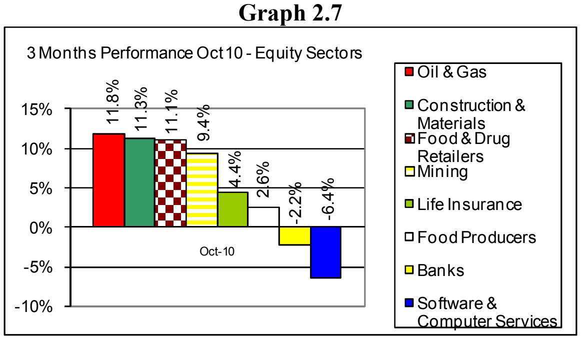
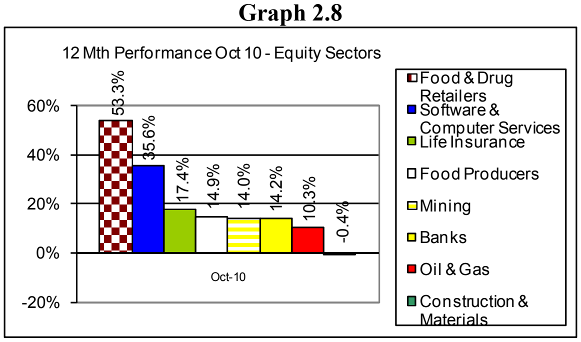


Graph 2.7



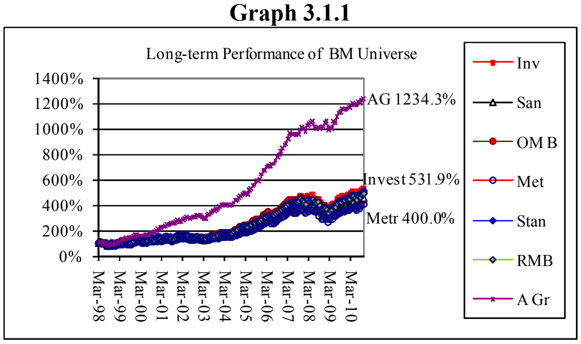
Graph 2.8



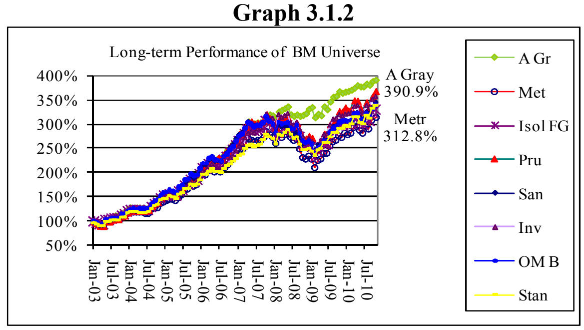
3. Portfolio Performance Analysis

3.1. Cumulative performance of prudential balanced portfolios

Graph 3.1.1

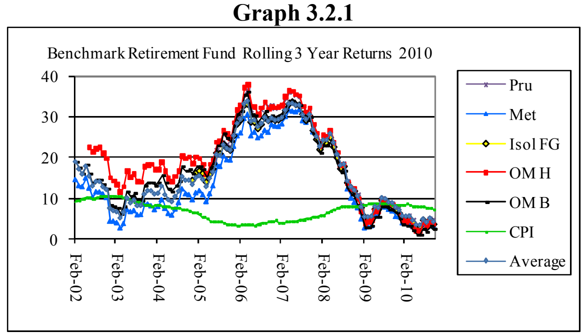


Graph 3.1.2

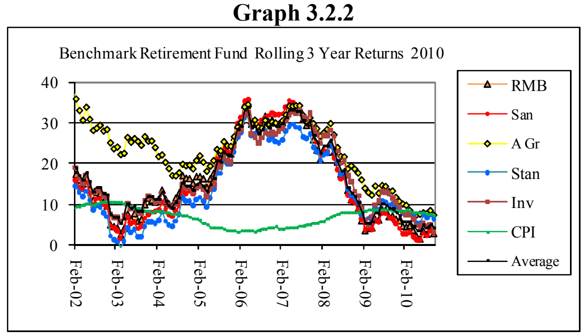


3.2. 3-year rolling performance of prudential balanced portfolios relative to CPI

Graph 3.2.1



Graph 3.2.2



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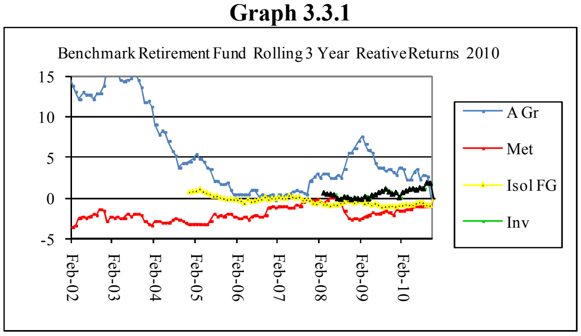
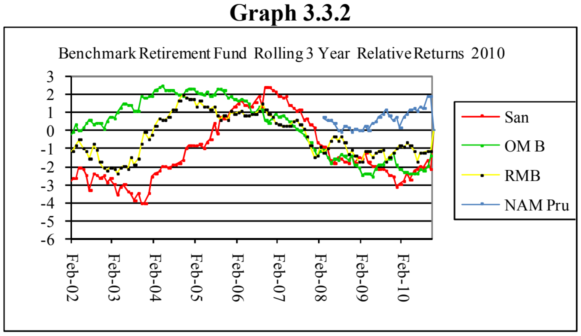
3.3. 3-year rolling performance of prudential balanced portfolios relative to average prudential balanced portfolio on zero

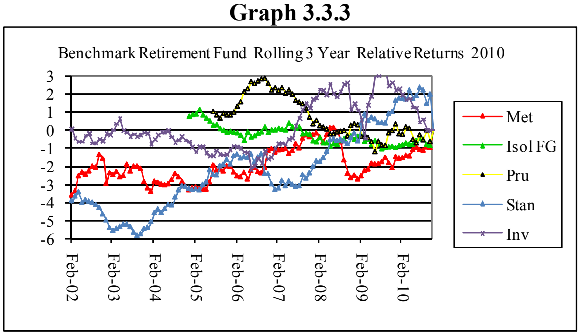
Graph 3.3.1



Graph 3.3.2

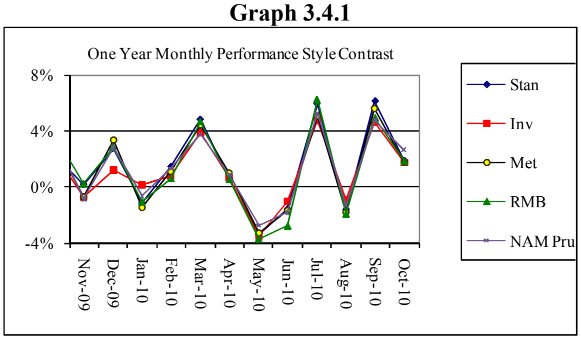


Graph 3.3.3

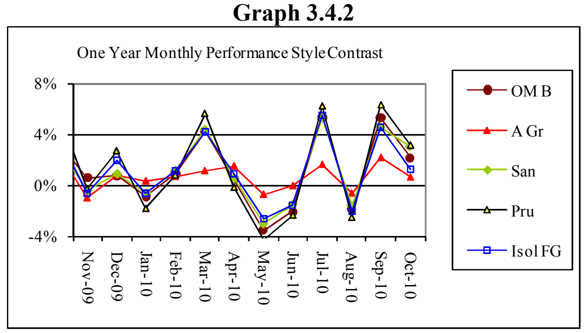


3.4. Monthly performance of prudential balanced portfolios

Graph 3.4.1

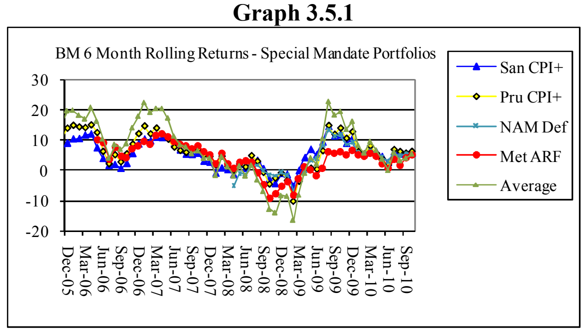


Graph 3.4.2

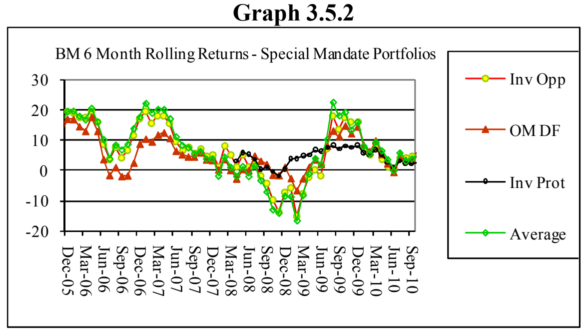


3.5. 6-month rolling returns of 'special mandate' portfolios

Graph 3.5.1



Graph 3.5.2



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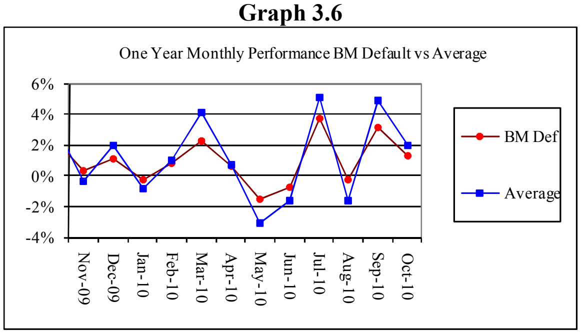
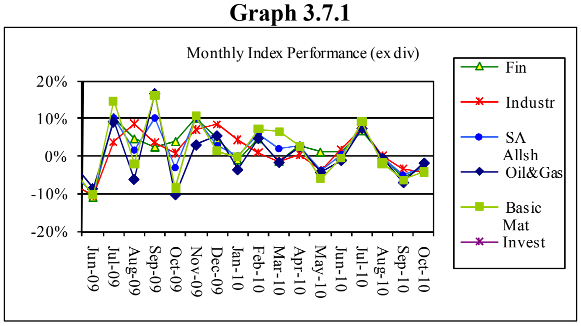
3.6 Monthly performance of 'Default' portfolio relative to average prudential balanced portfolio

Graph 3.6

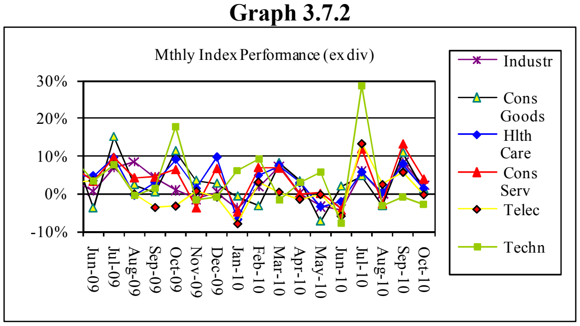


3.7 Monthly and one year cumulative performance of key indices (excluding dividends)

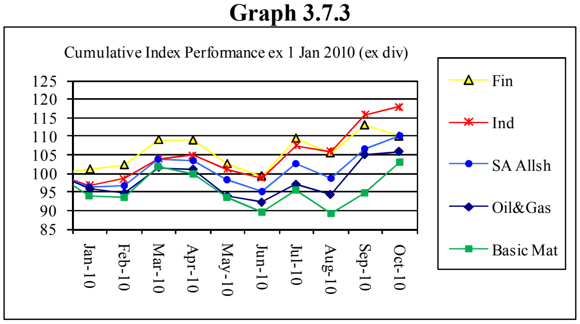
Graph 3.7.1



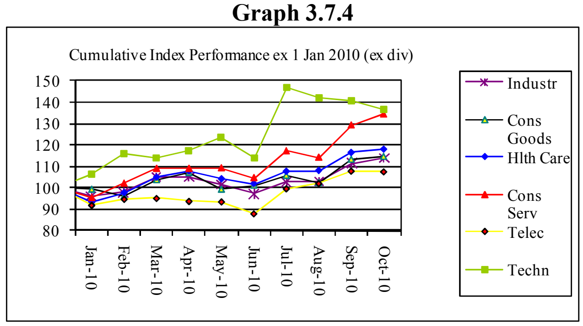
Graph 3.7.2



Graph 3.7.3



Graph 3.7.4



4. The Benchmark Default Portfolio

Graph 1.6 shows that the average prudential balanced portfolio returned 13.8% p.a. in nominal terms, or 6.9% p.a. in real terms, over the past 5 years while the Benchmark Default portfolio returned 11.1% p.a. in nominal terms, or 4.2% p.a. in real terms. We would expect the average prudential balanced portfolio to deliver a real return before management fees (typically 0.75%), of roughly 6% per year and the Default portfolio to sacrifice around 2% to 3% for the benefit of lower volatility, thus an expected real return before management fees (typically 0.75%), of around 4% per year.

The performance of the prudential balanced portfolios is significantly more volatile than that of the Default portfolio, which produces significantly more volatile performance than the Money Market portfolio. The table below presents one year performance statistics over the 3 years November 2007 to October 2010:

Table 4.1

Measure	Money Market	Default Portf	Average Prud Bal
Worst annual performance	7.3%	- 8.0%	- 19.1%
Best annual performance	12.1%	17.1%	29.7%
No of negative 1 year periods	n/a	10	11
Average of negative 1 year periods	n/a	- 3.7%	- 10.3%
Average of positive 1 year periods	9.9 %	9.9%	13.3%

This table represents the different characteristics of the three types of portfolio quite well. The Default portfolio is a more conservative investment aimed at minimising negative returns and with a long-term return objective of inflation plus 4% before fees and roughly 3.3% after fees.

It is also important to realize that at this rate of return, the net contribution towards retirement by both, member and employer should be roughly 16% of remuneration, in order to achieve a reasonable income replacement ratio of 2% per year of service. In contrast, the expected long term net rate of return of 5.3% that the average prudential balanced portfolio should achieve, should produce an income replacement ratio of roughly 3% per year of service.

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

5. A Contrarian Preview Of The Next 12 Months

The US Federal Reserve extended its 'quantitative easing' measures. Various countries have expressed their concern about this policy describing it as an unfair trading practice to support the US economy at their cost. The questions that beg to be asked is, firstly, whether there is any limit to the levels of debt a country can take on, and secondly, what the implications of this policy will be on global markets in the medium term.

Under these circumstances it is extremely difficult to express any views on the development of global economies and hence our own economy and of financial markets over the next 12 months. We believe that global markets are a the cross roads. Some writers already refer to the Fed's policy of quantitative easing as the biggest monetary experiment in history. Should it work, markets and economies are due to head north, but will it and if not, what's going to happen then?

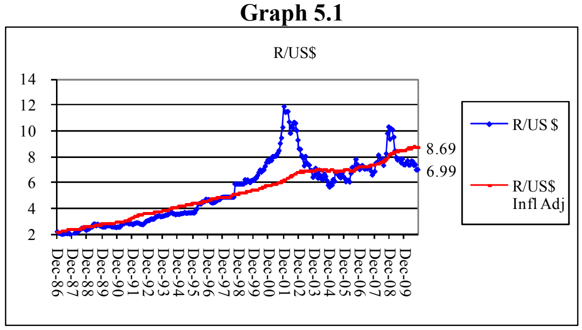
Where we have expected equity markets to move sideways in 2010, they have in fact shown exceptional growth (the Allshare index increased by 41% from end December 2008 to end October 2010), spurred on by massive money supply. One would have expected inflation to rise on the back of the massive money supply. This has not happened as the monetary interventions have failed to stimulate consumer demand in the US.

The housing bubble in the US is far from resolved and there remains a massive debt problem and oversupply of housing that will have to first dissolve slowly over an extended period of time. While unemployment is at exceptionally high levels, consumers prefer to repay debt rather than taking up cheap money that would stimulate the economy and create jobs. Since the US economy represents over 20% of the global economy this has to put a significant damper on global growth.

The heating up in equity markets is therefore not due to healthy diversified demand but rather due to an oversupply of money at an institutional level and is probably another bubble that will either burst, or deflate slowly over an extended period of time. While the oversupply of money remains in the institutional domain, it is likely that we will continue to see lots of volatility and capital flows swinging in various directions across the globe, based on government interventions at different times in different parts of the world, witness the Irish debt problem and the dilemma it presents to the EU, of late.

Graph 5.1 indicates that the Rand is fairly valued at 8.69 to the US Dollar. This is based on adjusting the two currencies by the respective domestic inflation rates.

Graph 5.1

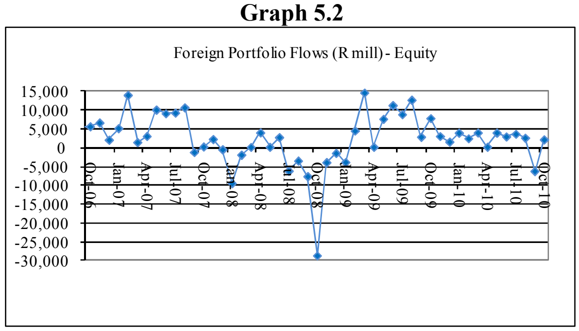


Graphs 5.2 and **5.3** now start to reflect an ebbing of the flow of capital into South Africa, particularly into fixed interest area as the result of the declining opportunity for interest arbitrage. Low demand in SA's and Namibia's main export markets and the strong Rand should put a damper on our export performance, while cheaper imports should result in our local industries being less competitive. They will be forced to increase productivity and reduce costs and employment, which will in turn put a damper on local consumer sentiment.

We expect these trends to only start reversing within the next 12 to 24 months. In the mean time, equity markets are likely to move sideways while interest rates will remain stable with some scope for downward adjustment in SA and Namibia still. This is to say, on the basis of fundamentals. We may still see another bubble in equity market blowing up though, only to eventually burst and to revert back to normal levels.

For the year to end of October, the FTSE/JSE still experienced a strong net inflow of R 25 billion (R 30 billion, 12 months to end September), compared to a net inflow of R 62 billion for the year to end October 2009 (net inflow of R 25 billion, year to end September 2009).

Graph 5.2



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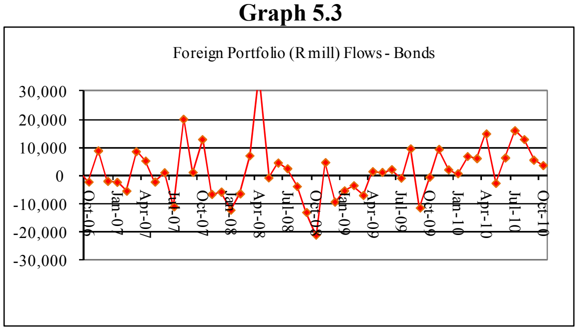
Graph 5.3 reflects the net flows into fixed interest instruments, which amounted to R 83 billion for the 12 months to end October (R 78 billion for the 12 months to end September), compared to an outflow of R 19 billion for the 12 months to end October 2009 ($ 39 billion outflow for the 12 months to end September 2009).

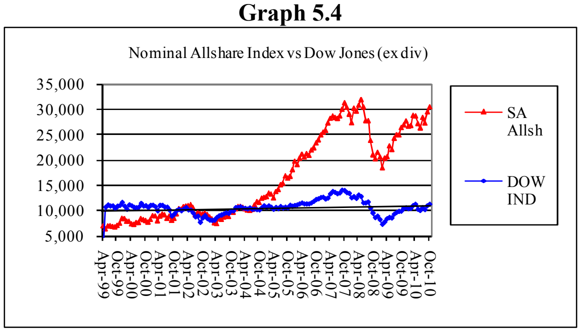
Graph 5.3



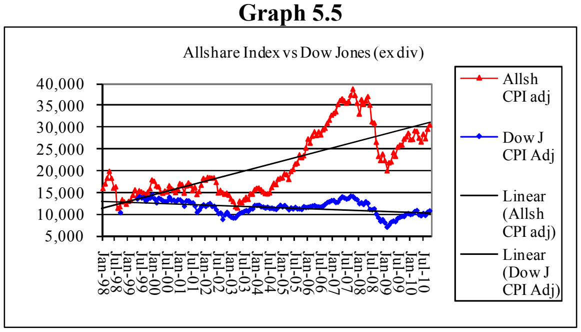
Graph 5.4 shows to what extent equity markets have recovered in nominal terms since their low at the end of February 2009.

Graph 5.5 reflects the same statistics but adjusted for US and SA inflation respectively.

Graph 5.4

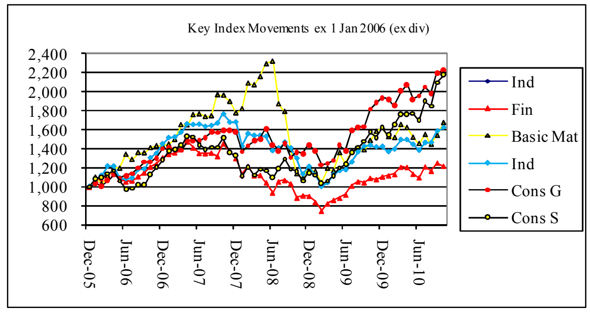


Graph 5.5



Graph 5.6 provides an interesting 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.

Graph 5.6



6. Conclusion

Our view remains that global equity markets are still fairly valued, but are likely to produce pedestrian growth for the next 12 months and longer, with considerable volatility. While some global interest rates have already been raised they will remain at low levels for a while, to start picking up once consumer demand picks up meaningfully. This we expect to only happen within the next 12 to 24 months. We still expect the Rand to remain pretty strong, trending weaker though. Volatility will prevail for a while and its reversion to normal levels to surface more markedly, once global economies start picking up steam.

Our local equity markets also remain fairly valued although not at very competitive levels compared to other global bourses. In terms of local equity sectors, **graph 5.6** indicates that consumer goods and consumer services had a good run. We do not expect too much joy out of these sectors anymore and these should hence be underweight. On the basis of fundamentals, one should be overweight financials and industrials locally, while commodities should be neutral to underweight. We believe that the performance of most conventional asset classes will be muted. We expect equities in general to perform sluggishly but stock picking can add value. Property currently is a high yielding asset class and should deliver superior returns in the current low interest environment in the short- to medium term with a significant risk of underperformance once the interest rate cycle turns. Shorter dated local bonds may also still produce fair returns in the short- to medium term

A lack of sparkling local investment opportunities and the current Rand strength suggests that one should be overweight offshore assets, more specifically in growing economies such as the BRIC countries.

For pension funds, a conservative balanced portfolio with a fair spread across equities, bonds and property and a high foreign exposure remains our call for now, to be on the safe side should the Fed's policies not produce the results hoped for. No doubt this will be a bit painful but prevention is always better than cure!

7. Important notice and disclaimer

Whilst we have taken all reasonable measures to ensure that the results reflected herein are correct, Benchmark Retirement Fund and Retirement Fund Solutions Namibia (Pty) Ltd do not accept any liability for the accuracy of the information and no decision should be taken on the basis of the information contained herein before having confirmed the detail with the relevant portfolio manager. The views expressed herein are those of the author and not necessarily those of Benchmark Retirement Fund or Retirement Fund Solutions.