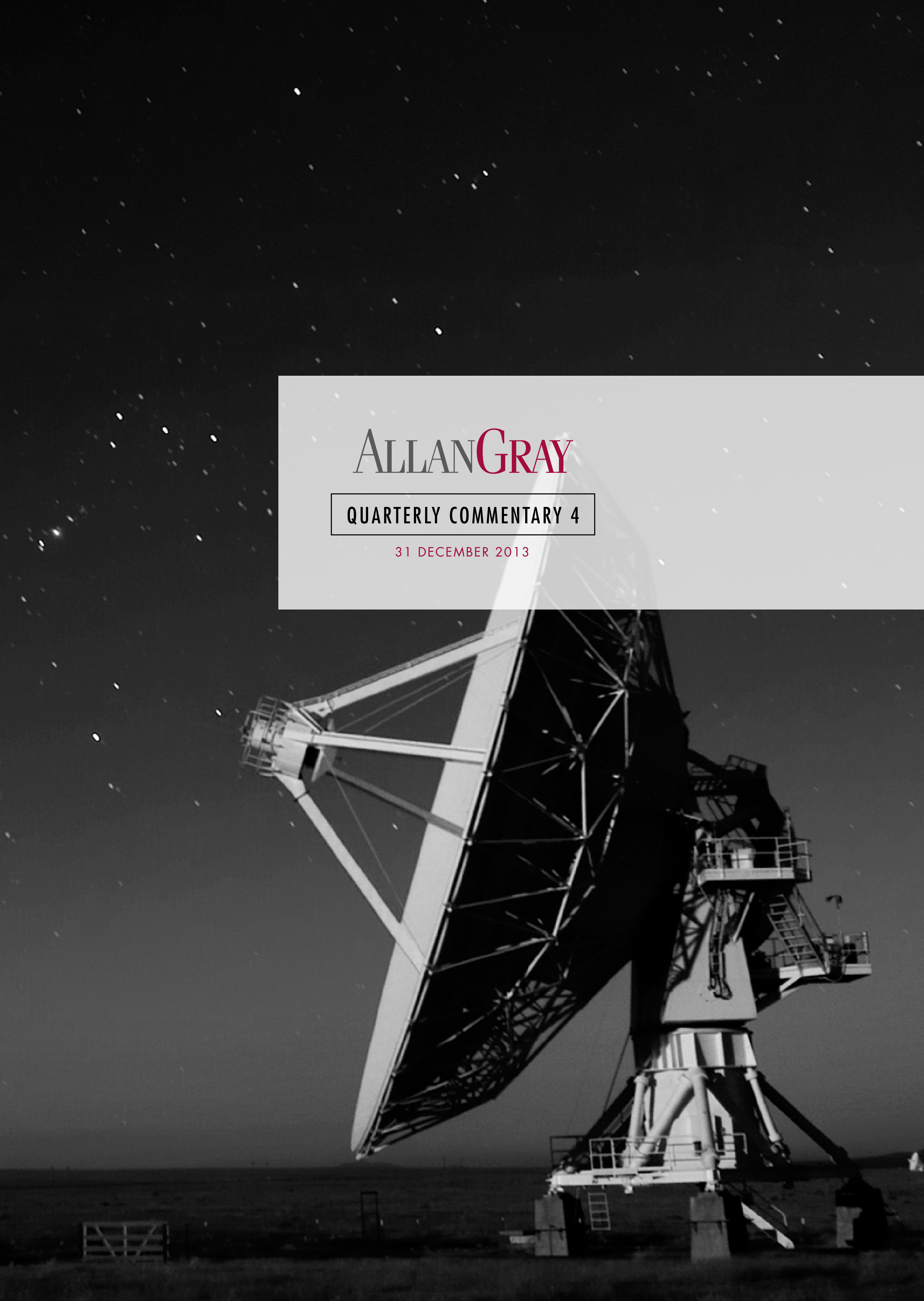


AllanGray

QUARTERLY COMMENTARY 4

31 DECEMBER 2013

LONG-TERM THINKING IN ACTION

The cover of this Quarterly Commentary features an antenna dish like the 64 others that will make up the MeerKAT – a "pathfinder" telescope that is the precursor to the Square Kilometre Array (SKA). The SKA is envisaged to be the most powerful radio telescope in the world and is due for completion in 2023 near the town of Carnarvon in the Northern Cape region of South Africa.

Currently not all of the technology required to build the final SKA exists, which is why scientists are building the MeerKAT to further our understanding of a range of fields. This includes everything from high-performance computing to store the masses of data that will be generated, to new concrete mixes that will guarantee absolute stability for the antenna dish foundations.

This will ensure that when the SKA is finished, it will be the most precise astronomical instrument ever constructed, which will one day allow us to understand how galaxies are formed, how they evolve over time and even if there is intelligent life out there. The SKA scientists are taking a long-term view, investing in the very cutting edge of their disciplines so that this epic undertaking bears fruit for all mankind in years to come.

For us as investors, the lesson is to do all the necessary groundwork and to adopt a long-term approach.

The Allan Gray Quarterly Commentary is printed on LumiSilk, a paper made from trees grown specifically for paper manufacturing.
The paper is certified by the Forest Stewardship Council (FSC), an organisation which promotes responsible management of the world's forests.

CONTENTS

ROB DOWER

COMMENTS FROM THE CHIEF OPERATING OFFICER

Is investor behaviour improving?

It has been more than a year since I last reported to you on investor returns being distinct from fund returns in our unit trusts. The average investor in a unit trust can do better or worse than the fund's track record depending on when he or she invests and disinvests from the fund. On average, investors switch between funds at the wrong times and tend to destroy value by trying to time their investments. As shown in **Table 1**, for the 10 years to the end of 2013 the average investor in our Balanced Fund earned 1.4% p.a. less than the Fund's track record, which is based on a single lump sum investment at the beginning of the 10 years. This is not good, but it is a great deal better than the 4.4% gap I reported for the 10 years to August 2010, and the 2.8% gap for the 10 years to June 2012, in the same Fund. This improvement is also evident in our fund churn rates, which have averaged just over 20% p.a., reflecting a weighted average holding period for investors of almost five years.

The Allan Gray-Orbis Global Equity Feeder Fund doesn't yet have a 10-year track record (it will reach this milestone in April 2015), but over the five years to the end of 2013, mostly by patience but also by taking advantage of the strong rand, the average investor in this Fund actually beat the Fund's performance by about 1.7%. This is even more impressive since the Fund's five-year annualised performance of 20.3% didn't come in a straight line – after some leaner years the Global Equity Feeder Fund was the top performing unit trust in South Africa in 2013, delivering over 78%, thanks to strong global markets, careful stock picking and a weakening rand.

Offshore restrictions and opportunities

As you may know, the South African Reserve Bank restricts the amount our unit trusts can invest overseas collectively to 35% of total retail client funds. Because of this limit and our recent strong offshore performance and flows, the Allan Gray unit trust management company is now almost out of offshore capacity, and our rand-priced offshore funds will be forced to close temporarily to inflows from individual investors in discretionary accounts at the end of January.

When this happens you will not be able to invest directly into the Allan Gray-Orbis Global Equity Feeder Fund, Global Fund of Funds and Global Optimal Fund of Funds; however, you will still be able to select these funds in your retirement funds, living annuity or endowment. Remember that you can also access the Orbis Funds, and other offshore managers, via our locally administered

TABLE 1 **ANNUALISED INVESTOR RETURNS IN MAJOR FUNDS FOR THE 10 YEARS ENDING 31 DECEMBER 2013**

	INVESTOR	FUND	INVESTOR ALPHA
Allan Gray Equity Fund	19.4%	19.6%	-0.2%
Allan Gray Balanced Fund	15.6%	17.0%	-1.4%
Allan Gray Stable Fund	10.6%	12.0%	-1.4%

Sources: Allan Gray research

offshore platform. For more information please read Johann Grandia's piece in Quarterly Commentary 3, 2013, 'Access global investment opportunities via our offshore platform'.

Available foreign capacity is affected dramatically by offshore assets under- or outperforming local assets in rand terms, and the strength of the local currency. When local assets are not doing that well and the rand weakens, the demand for offshore capacity tends to increase, sometimes very rapidly, at exactly the point when less capacity is available. Conversely, when the rand is strong and local assets outperform their offshore equivalents, flows into offshore funds tend to decline at exactly the point that more capacity is opened up. The temporary closure may turn out to be a good thing if it prevents fickle investors from buying into the offshore funds after a year of extraordinary performance expecting more of the same, and then disinvesting if the next 12 months are not as good.

On the point of future offshore returns, in the Orbis contribution this quarter, Adam Karr discusses what the recent Global Equity Fund and market gains mean for Orbis' ability to continue hunting down attractive stocks. He notes that, with US shares near all-time highs, it is prudent to expect lower market returns from current levels. Should that prove to be the case, investors in Global will be well served by owning companies that are resilient and positioned to control their own destiny.

Do gold and platinum mining shares make good assets for owning, or are they only good for trading?

In his in-depth analysis of South African deep level miners, Ian Liddle takes a look at the performance of gold and platinum mining stocks over the past decade. With major economic and operational challenges and demanding and powerful labour and government stakeholders to keep happy, it can be hard to see how these companies will be able to deliver acceptable returns to long-term shareholders. The counter-argument is that significant resources remain unmined and our mines can once again become valuable assets that generate significant free cash flows for shareholders if various prerequisites are met. The challenge we face as fund managers is making the right assessment of the probabilities of these prerequisites being met, and therefore of the potential risks versus rewards of investing.

Are you in the right fund?

Investors themselves face similar challenges when making investment decisions and often make decisions in response to market noise or macroeconomic events over which they have no control. It usually serves you better to make changes to your investment in response to changes in your life stage or personal requirements. Remember, the longer you remain invested, the more you will benefit from the effects of compounding – as discussed by Wanita Isaacs in this quarter's Investing Tutorial – and the more likely you are to benefit from returns similar to those of your chosen fund.

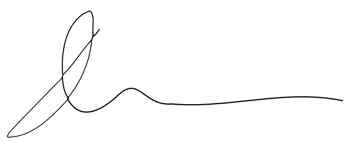
Becoming familiar with the parts of a fund that make up the whole will give you a better understanding of your fund's mechanics. Using the Allan Gray Balanced Fund as an example, Fiona Jeffery explains how it can be useful to drill a bit deeper into the composition of a fund to understand contributors to and detractors from performance. Engaging with this analysis over time reflects how yesterday's losers are often tomorrow's winners, illustrating how critical it is for our analysts to have thorough research to support their long-term investment ideas, and how important it is to invest with conviction.

A life of purpose

Finally, in his update this quarter Anthony Farr discusses how the Allan Gray Orbis Foundation seeks out individuals as Candidate Fellows who are likely to pursue a life of purpose. Potential Fellows should be motivated not simply to make money, but rather to make a difference in the world and in other people's lives through their entrepreneurial efforts.

Allan Gray's purpose is to create wealth for you, our clients. Thank you for your ongoing support and best wishes for the year ahead.

Kind regards



Rob Dower

IAN LIDDLE

GOLD AND PLATINUM MINES: 'EATING SARDINES' OR 'TRADING SARDINES'?

"There is the old story about the market craze in sardine trading when the sardines disappeared from their traditional waters in Monterey, California. The commodity traders bid them up and the price of a can of sardines soared. One day a buyer decided to treat himself to an expensive meal and actually opened a can and started eating. He immediately became ill and told the seller the sardines were no good. The seller said, 'You don't understand. These are not eating sardines, they are trading sardines.'"

Seth Klarman, Margin of Safety

Are South African gold and platinum mines 'eating sardines' or 'trading sardines'? Or more directly, as posed by Ian Liddle: would you buy a South African gold or platinum mining company today if you knew that the stock market would be closed for the next 100 years, and that you would depend solely on dividends from the company for the return of and on your capital?

Performance review

Let us start by reviewing the companies' historic share price performance compared to the relevant metal price over the last decade. See **Graphs 1** and **2**. The track record of our gold mines is rotten. The platinum miners have performed better from the beginning to the end of the 10-year period, but their performance is divided into a great first half to mid-2008, followed by a woeful second half to 2013. The share price performance of both groups has been especially disappointing in light of rising metal prices (in rands) for most of the decade. Clearly the market has been disappointed by the underlying financial performance of these companies.

GRAPH 1 **FTSE/JSE GOLD MINING INDEX VS GOLD PRICE***

*Both in rands, based to R100 at the start.
Source: I-Net Bridge

GRAPH 2 **FTSE/JSE PLATINUM MINING INDEX VS PLATINUM PRICE***

*Both in rands, based to R100 at the start.

Source: I-Net Bridge

Table 1 displays some key metrics: Column B shows the total dividends per share paid by each of the major miners over the last 10 years. The dividends paid by the gold miners have been pitiful compared with the starting share prices. They are even low compared to today's much lower share prices (see Column D). This could be excused if the companies had re-invested to grow or if they had paid back debt, but the gold miners' annual production per share has more than halved over the last 10 years (a combination of falling production and dilution from issuing new shares) and net debt per share has grown (or remained flat in Harmony's case). So arguably the gold miners could not really afford to pay even these paltry dividends. These are pathetic fundamentals, especially considering that the gold price almost tripled over the decade.

The dividend yield calculated in Column D for the platinum miners is better than that of the gold miners, but still fairly low for a limited life asset. It is also misleadingly favourable. Most of the dividends paid by the platinum miners over the last decade were paid in the boom years leading up to the peak in 2008. Dividends since then have been patchy. Arguably the companies paid dividends that with hindsight they could not afford: Angloplat asked its shareholders for more capital in 2004 and 2010, and Lonmin returned cap in hand to shareholders in 2009 and 2012. Although Impala has not yet asked its shareholders for more capital, the company is now suffering the consequences of having delayed investing in new shafts to replace ageing shafts in the Impala lease area. Platinum production per share has fallen and net debt per share has risen (except at Lonmin which had a big rights offer in 2012 to reduce debt).

TABLE 1 **MINING COMPANIES: KEY METRICS**

	A	B	C	D=B/(10xC)	E	F
	PRICE*	TOTAL DIVIDENDS PER SHARE*	PRICE	DIVIDEND YIELD^	ANNUAL PRODUCTION PER SHARE*	ANNUAL PRODUCTION PER SHARE
Units	US$	US$	US$	%	1/1000 oz	1/1000 oz
Date/Period	31/12/2003	2003-2013	31/12/2013	31/12/2013	2003	2013
Gold per oz	417.3	-	1201.5	-	-	-
AngloGold	44.4	3.5	11.9	2.9%	25.1	9.6
Gold Fields~	14.4	2.1	3.2	4.8%	9.2	2.7
Sibanye~			1.2			1.7
Harmony	16.4	0.5	2.5	2.0%	16.8	2.6
Platinum per oz	814.0	-	1358.0	-	-	-
Angloplat	42.4	23.4	38.1	6.1%	10.6	8.5
Impala	11.0	7.8	11.9	6.6%	3.1	2.6
Lonmin	9.8	2.5	5.1	4.8%	3.2	1.3

* Historic share prices, dividends and production per share have been adjusted for stock splits (Impala) and for the bonus element of rights offers (AngloGold, Angloplat, Lonmin).
^ Dividend yield calculated by dividing average annual dividend over the last decade by the current share price. See text for observations on the limitations of this measure.
~ Gold Fields unbundled Sibanye in 2013.

Sources: I-Net Bridge, Datastream and Allan Gray research

Based on this evidence, one would have to conclude that our gold mines are 'trading sardines' and our platinum mines are turning bad too. But it was not always this way – they were 'eating sardines' for large parts of the 1970s and 80s when they offered competitive dividend yields.

How have the fundamentals deteriorated?

Apart from rising rand metal prices, circumstances have been challenging. New legislation resulted in the companies' 'old-order' mineral rights effectively being expropriated. This has placed the companies in a much weaker position when negotiating the terms of their 'licence to operate', and they have to pay an additional royalty on their production. Safety standards have been raised considerably. This has resulted in wider stopes (and thus lower head grades), slower and more expensive mining (e.g. roof-bolting and safety nets) and the sterilisation of some high grade areas. While the improved safety objectives are noble, implementation has at times been overly bureaucratic, resulting in entire mines being shut down for days at a time for minor infringements. Electricity prices and wages have been rising faster than CPI inflation. As mines age and mining activity moves deeper and further from the shafts, travelling time to the face increases and ventilation becomes more expensive. Companies struggle for the labour flexibility they need to operate efficiently. Labour relations are fraught with violence and intimidation as rival unions/union officials battle for control of an 'annuity' stream of membership fees deducted directly from employees' wages. Worker productivity is declining.

To make matters worse, pain has been self-inflicted by poor overhead cost control, misguided capital allocation and misdirected incentives for executives. In an effort to correct apartheid-era abuses, company directors have concentrated on meeting the demands of all stakeholders, including various arms of government, employees, former employees, unions, empowerment shareholders and local communities. The shift to a more equitable sharing of the value created by our mining enterprises is necessary and understandable, but based on recent evidence it appears that the pendulum has swung too far and that shareholders are now right at the back of the queue.

Prerequisites for redemption

Clearly, 'trading sardines' cannot revert back to being 'eating sardines'. Some would argue that the analogy is fitting for our limited life mining companies – very few deep mines recover once they start to struggle. Resource depletion is a powerful undertow on production, as illustrated by the rapid decline in South African gold production since the 1980s (see **Graph 3**). The platinum mines are challenged by the depletion of the richer Merensky reef. The counter-argument is that significant resources remain unmined and our mines can once again become valuable assets that generate significant free cash flows for shareholders. In our view, there are three prerequisites for such a cure (but they need to happen soon):

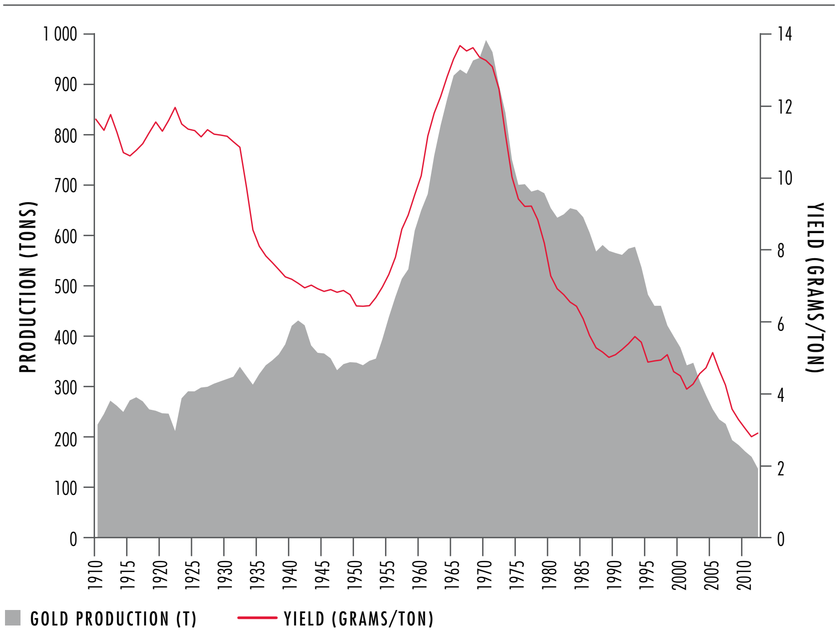
1. Self-help

   The directors of these companies are beginning to internalise shareholders' discontent. They seem more open to constructive criticism of their executive incentive schemes. Many of the companies are now under new leadership. These new CEOs appear more focused on shareholder value and more likely to grasp the nettle of stakeholder demands. There is some opportunity for improving efficiencies with new technology.

2. Higher rand metal prices

   Self-help will not be enough to fully offset continuing electricity and labour cost pressures. Our mines will need higher rand metal prices. Dollar prices are high. The world is reliant on platinum supply from South Africa, but on the other hand higher dollar platinum prices incentivise thrifting/substitution of platinum in vehicle emission control

GRAPH 3 **SA GOLD PRODUCTION**



Source: Chamber of Mines

systems and recycling supply. Commodity prices are hard to predict, but one can probably have more confidence in one's forecast of rand precious metal prices (as opposed to dollar prices) given the continuing importance of commodity exports to South Africa's trade balance. Please refer to 'How healthy is the South African economy?' in Quarterly Commentary 2, 2012 for a fuller explanation of the asymmetric risk to the rand exchange rate.

3. Shareholders are rewarded with their fair share of any additional margin

   Even if both of the first two prerequisites come to pass, it will not do shareholders any good unless company executives maintain stringent cost control, do not kowtow to every demand from other stakeholders, and allow the additional margin to flow through to shareholders (as dividends) and to the state (as income taxes).

If you believe any one of these prerequisites to have a zero probability, then clearly the companies will remain 'trading sardines' and should not be bought at any price (unless you are in the business of speculating, of course). However, if you believe the probability of each of these prerequisites is non-zero, then the companies may still be redeemed as 'eating sardines', and the key question becomes whether the current share prices properly reflect the probability and possible extent to which these prerequisites come to pass.

While there are many common themes, the investment merits of each company still need to be assessed separately. For example: the dominant market share of our platinum producers is a plus versus the gold miners; Gold Fields has only one remaining mine in South Africa, South Deep, and it is more mechanised than typical South African gold mines; Harmony has discovered a significant undeveloped resource in Papua New Guinea; the new shafts being sunk in its lease area are probably make-or-break for Impala; some boards/executives appear bolder and more shareholder-focused than others.

How does this impact your investments?

In managing our clients' portfolios over the last decade, we erred in over-estimating the probabilities of prerequisites 1 and 3, by not recognising the full extent of the many challenges facing the mining companies sooner, and by not reducing our exposure to South African miners more aggressively at opportune times. Our investment in the Newgold debenture in our clients' balanced and stable portfolios has been a much better way to profit from our past bullish view on the rand gold price.

One of the reasons we previously over-estimated the probability of prerequisite 3 is explained by our view that it would be irrational for public policy to be stacked against mining companies to such an extent that they were unable to provide reasonable returns on shareholders' capital. Unfortunately, public policy can remain irrational for a long time. At least some policymakers are realising that capital can also go on strike. The dive in the share prices of our mining companies is investment managers' rendition of a *toyi-toyi*. If public policy towards mining companies remains hostile, and their share prices continue to fall, our mining companies will find it increasingly difficult to raise capital. If the current trends persist, there may come a time when shareholders decline to bail out a mining company again, and South Africa will prematurely lose mines that could have continued to operate for the benefit of all stakeholders.

The three prerequisites listed above are critical, but their probabilities are clearly difficult to ascertain. This means that fund managers subscribing to similar valuation-based investment philosophies may put widely differing values on our mining companies depending on their subjective assessment of the probabilities. This is even the case internally. Our portfolio managers differ over the intrinsic value of our mining companies, and each has the freedom to structure his own 'manager' portfolio accordingly, within the discretion allowed by our internal rules and parameters. We believe that the individual discretion and accountability afforded our portfolio managers are critical ingredients of our successful long-term track record. The outcome for clients is hopefully a portfolio weight which appropriately reflects the probabilities and possible extent of the potential risks and rewards (see **Table 2** for the Balanced Fund's exposures to the gold and platinum miners and precious metals as at the end of 2013).

TABLE 2 **ALLAN GRAY BALANCED FUND PORTFOLIO WEIGHTS (AS PERCENTAGE OF FUND) AT THE END OF 2013**

Gold (gold bars in a vault, via the Newgold debenture)	2.50%
Gold mining shares	1.30%
Platinum (platinum bars in a vault, via the Newgold platinum debenture)	1.10%
Platinum mining shares	0.50%

Source: Allan Gray research

Ian is our chief investment officer, with overall responsibility for the investment team and portfolio management. He joined Allan Gray in 2001 after several years as a management consultant.

FIONA JEFFERY

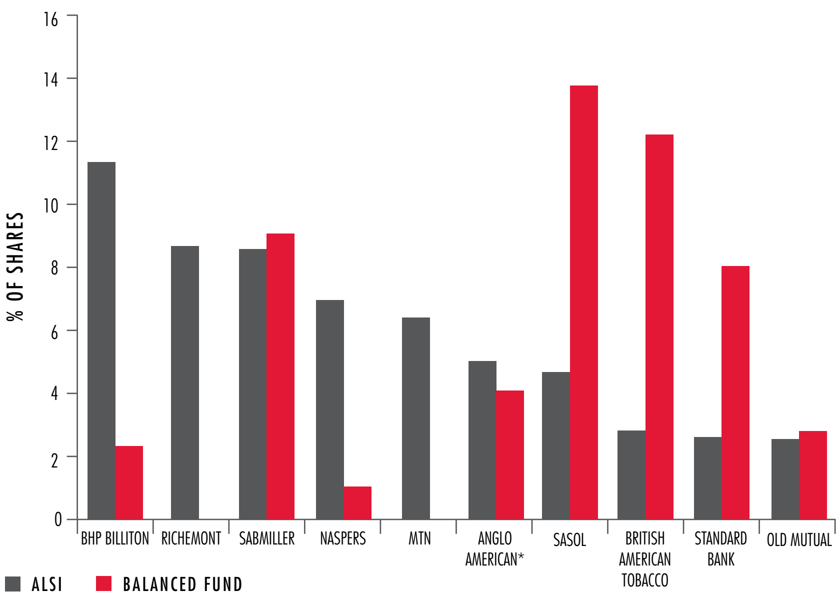
ANALYSING YOUR FUND'S PERFORMANCE

Regular readers of our Quarterly Commentary will know that at Allan Gray we are focused on generating superior returns for our clients over the long term. One way to evaluate whether or not we are delivering on this goal, is to consider the total return our funds have generated (also known as the absolute return). Another way to evaluate our performance, is to look at how our funds have performed relative to their benchmarks. Using the Allan Gray Balanced Fund (Balanced Fund) as an example, Fiona Jeffery explains how it can be useful to drill a bit deeper into the composition of a fund to understand contributors to and detractors from performance (also known as an 'attribution analysis').

Understanding the benchmark

While we use benchmarks to assess performance, the composition of the benchmark plays no role in the positioning of most of our funds. Our portfolio managers use a bottom-up approach to selecting shares, looking for companies they believe are priced below their fair value. They are not constrained by the benchmark. This is illustrated in **Graph 1**, which shows that there are several large shares in the FTSE/JSE All Share Index (ALSI) which we either do not hold in the equity component of the Balanced Fund[1], or hold to a much smaller degree. For example, Richemont is the second biggest share in the index but it is not included in the Balanced Fund. This does not mean our portfolio managers and analysts do not spend time researching and thinking about stocks like Richemont – they do. Including or excluding a share is a considered decision, which will have an impact on relative performance. This is important in the context of our local market, as a few large stocks make up a big portion of the ALSI.

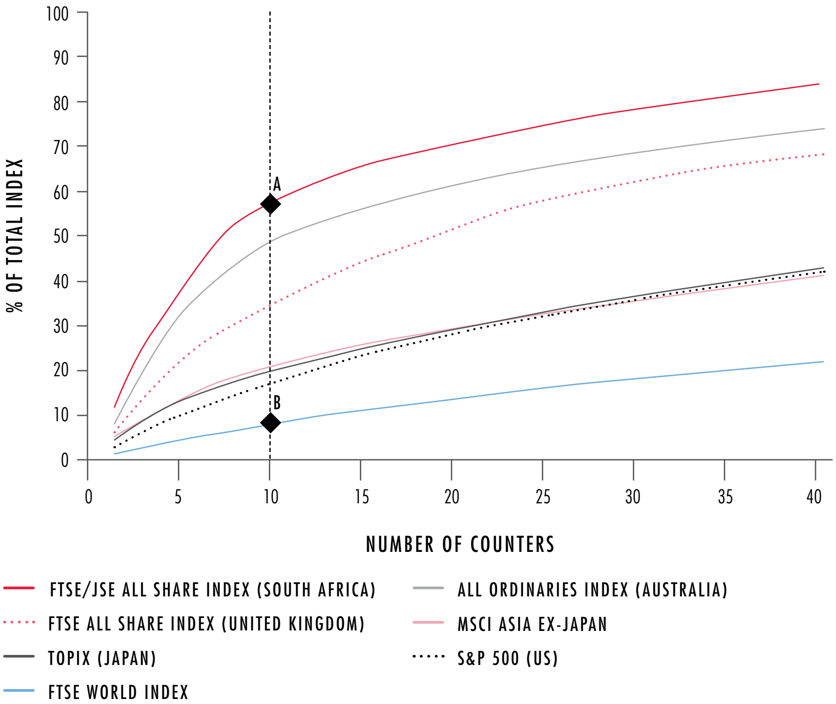
GRAPH 1 **TOP 10 SHARES IN THE ALSI AND THE COMPARATIVE POSITIONS IN THE ALLAN GRAY BALANCED FUND**



* Including positions in Anglo American stub certificates.

Sources: JSE, Allan Gray research

GRAPH 2 CONCENTRATION OF VARIOUS REGIONAL INDICES



Sources: JSE, FTSE, Tokyo Stock Exchange, S&P, MSCI

To illustrate this point further, **Graph 2** shows that our local index is fairly concentrated compared with larger country and global indices. Each line represents a different index and shows the cumulative weight of the largest counters in the index (starting at one and ending at 40). For example, the top 10 shares of the ALSI (illustrated in Graph 1) represent almost 60% of the total index (point A in Graph 2). However, at point B, the largest 10 constituents of the FTSE World Index represent just over 8% of the total index. It is not surprising that a small regional index such as the ALSI is more concentrated than a global index like the World Index, which has many more constituents. When comparing these indices it becomes evident that a global manager has a much larger group of shares to choose from than we do. The returns of the individual constituents of the benchmark therefore are an important aspect in understanding the drivers of performance for our market. Likewise, the benchmark is useful in evaluating our returns (as part of an attribution analysis) as relative performance is shaped just as much by the shares we don't hold, as by the shares we do on behalf of our clients.

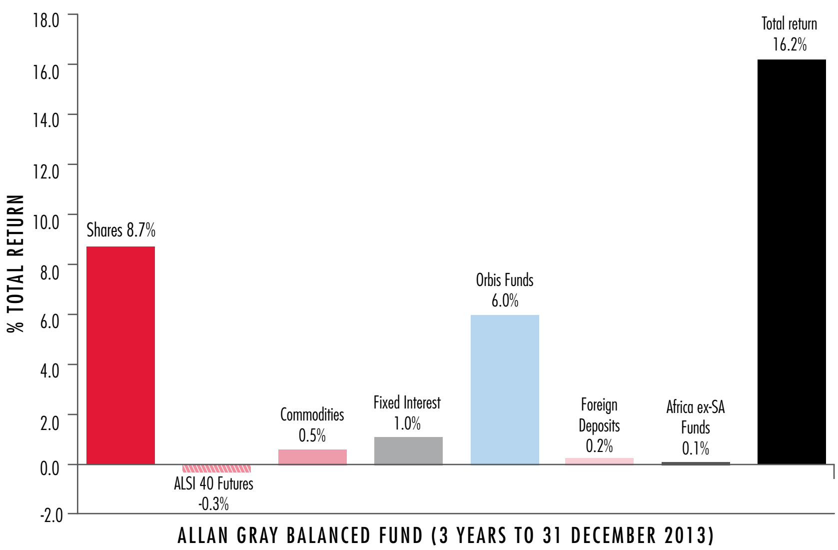
Attribution of the Allan Gray Balanced Fund

There are different ways of analysing the return of the Allan Gray Balanced Fund over the most recent three-year period. **Graph 3** allows us to see how various components contributed to the return of 16.2% p.a. over the period. It is evident that the biggest source of returns has been the South African shares in the Fund (red area), contributing 8.7% p.a. out of the total return. By investigating these share returns further, we are able to see the underlying drivers of this return in more detail (see **Graphs 4** and **5** on page 9).

An *absolute share attribution* is useful because it tells us simply if the shares we invested in contributed to or detracted from returns. Graph 4 provides further insight, indicating which shares had the largest effect on total share returns. For example, the position in British American Tobacco was the biggest contributor (adding 3.5% p.a. to share returns) over the period and the position in AngloGold Ashanti was the biggest detractor (0.7% p.a.). After adding up all the shares which contributed to performance and all the shares which detracted from performance, the total absolute unweighted return from SA shares held by the Balanced Fund was 18.2%.

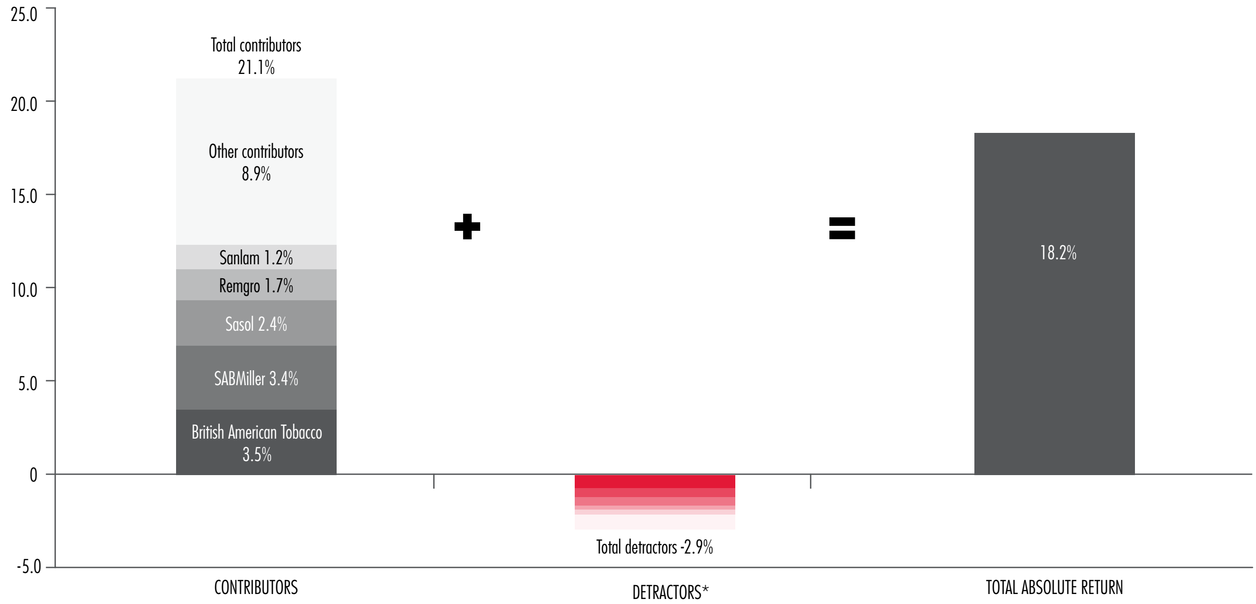
It is also useful to see how our

GRAPH 3 CONTRIBUTION OF DIFFERENT ASSET CLASSES TO THE BALANCED FUND RETURN



Source: Allan Gray research

GRAPH 4 **TOP ABSOLUTE CONTRIBUTORS AND DETRACTORS TO SHARE RETURNS (3 YEARS TO 31 DECEMBER 2013)**



* Detractors from performance

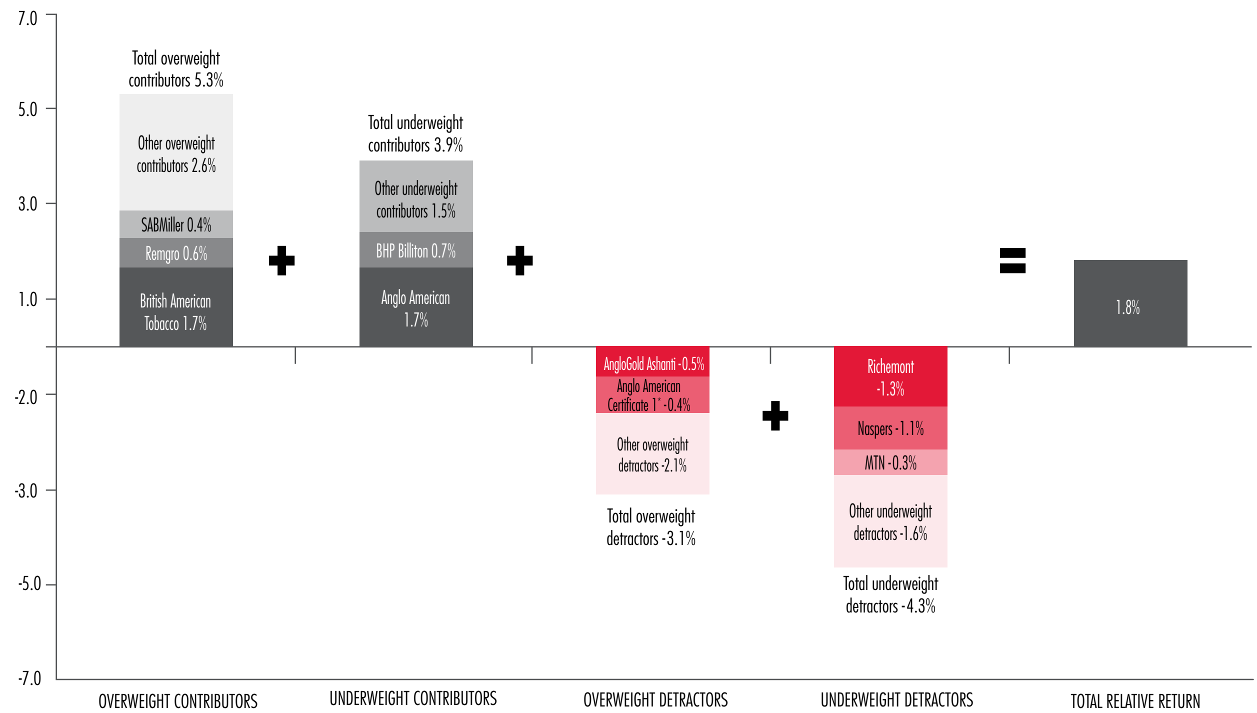
AngloGold Ashanti	-0.7%	Impala Platinum	-0.4%	Anglo American Certificate1**	-0.2%
Gold Fields	-0.2%	Sappi	-0.2%	Other detractors	-1.1%

** Anglo American Certificate 1 excludes investments in Amplats and Kumba Iron Ore.
There may be slight discrepancies in the totals due to rounding.

Source: Allan Gray research

selection of shares performed compared with an equity index like the ALSI. Graph 5 shows us that the shares in the Balanced Fund returned 1.8% more per year than the ALSI over the last three years. A *relative share attribution* illustrates how our selection of shares performed when compared with the index to produce that outperformance. The results mostly depend on whether a share makes up a smaller or greater percentage of the

GRAPH 5 **TOP RELATIVE CONTRIBUTORS AND DETRACTORS TO SHARE RETURNS (3 YEARS TO 31 DECEMBER 2013)**



* Anglo American Certificate 1 excludes investments in Amplats and Kumba Iron Ore.
There may be slight discrepancies in the totals due to rounding.
Source: Allan Gray research

equities in the Fund (i.e. whether it is an underweight or overweight position) compared to the ALSI, and how that share performed relative to the ALSI. We have split the shares into four different categories for the purposes of explaining relative returns: over- and underweight contributors, which add to relative performance over a given period, and over- and underweight detractors, which reduce relative performance.

an underweight position in Richemont and Naspers[2], both of which have performed significantly better than the ALSI over the period and are a large part of the index (i.e. they have been underweight detractors). When investing in a concentrated market like South Africa's, the shares we miss out on can be just as important in determining our relative performance as those we get right.

"...RELATIVE PERFORMANCE IS SHAPED JUST AS MUCH BY THE SHARES WE DON'T HOLD, AS BY THE SHARES WE DO ON BEHALF OF OUR CLIENTS."

Over the period, British American Tobacco was also an overweight contributor – a share which outperformed the ALSI and in which the Fund held an overweight position. Anglo American was an underweight contributor, i.e we held an underweight position in an underperforming stock. AngloGold Ashanti was an example of an overweight position which underperformed the index. Graph 5 also indicates that our most recent relative performance has been hurt by

Attribution methods differ

The methods described above are not the only way a fund manager can perform an attribution analysis. It is important to bear in mind that one method is not necessarily more correct than another and that different types of attributions serve different purposes. Attributions also become more complicated when there are more moving parts. Orbis invests globally in a range of different countries and currencies. This makes their attribution more complicated than the analysis we perform. However, all these methods ultimately have one common goal – to better assist in understanding how the performance of a particular fund has been achieved over a given time frame.

The analysis of fund returns described in this article assists our portfolio managers in identifying and understanding the successes they have enjoyed and the mistakes they have made. This goes hand in hand with the knowledge that, in the face of a constantly changing investment environment, past performance is not a guarantee of future returns. One constant our clients can gain comfort from, is that we will continue striving to best implement the investment philosophy which has delivered superior returns for our clients over the last 39 years.

StatPro Performance and Attribution systems are used to perform the attributions described in this article.

[1] Whilst the overall benchmark for the Balanced Fund is the market value-weighted average return of funds in the South African – Multi Asset – High Equity category (excluding the Allan Gray Balanced Fund), it is useful to compare the composition/performance of the equity component to the ALSI.
[2] Ian Liddle wrote about these two shares in the September 2013 Balanced Fund factsheet commentary. Duncan Artus wrote about some of the biggest shares in the FTSE/JSE All Share Index in the December 2013 Equity Fund factsheet commentary. Fund factsheets can be found under the 'Quick links' tab on our homepage www.allangray.co.za

Fiona joined Allan Gray in 2009 as a business analyst in the Institutional Client Servicing team. She has a BCom (Hons) from the University of Stellenbosch and is a CFA charter holder.

ADAM KARR

HUNTING FOR COMPELLING OPPORTUNITIES IN THE CURRENT ENVIRONMENT

2013 was a good year for global stock markets. The FTSE World Index returned 24.7% in US$ terms since the start of 2013 and is near an all-time high. The Orbis Global Equity Fund has had an even better year, delivering 43.2%. Adam Karr, from our offshore partner Orbis, discusses what this means for Orbis' ability to continue hunting down attractive stocks.

While Orbis and Allan Gray have a single-minded focus on picking stocks from the bottom up, one technique Orbis analysts use to advance their reasoning and to assess the broader opportunity set, is a proprietary quantitative measure that they call 're-rated total rate of return' or 'RTRR'. The calculation is based on the principle that valuation multiples, growth rates and the quality of a company's fundamentals tend to revert to long-term historical averages over time. If the future ends up being similar to the past, this number can be thought of as a crude estimate of the future annualised return that we expect from a given stock. The higher the RTRR percentage, the better. Of course, it is often a big 'if' to assume that the future will resemble the past, which is why we obsess over company-specific, fundamental analysis.

Likewise, the difference between the RTRR of a particular portfolio and the stock market benchmark can be a crude way to gauge the opportunities for stock picking that are available, particularly when there are sizable divergences between the stocks that Orbis has selected and the market's overall RTRR.

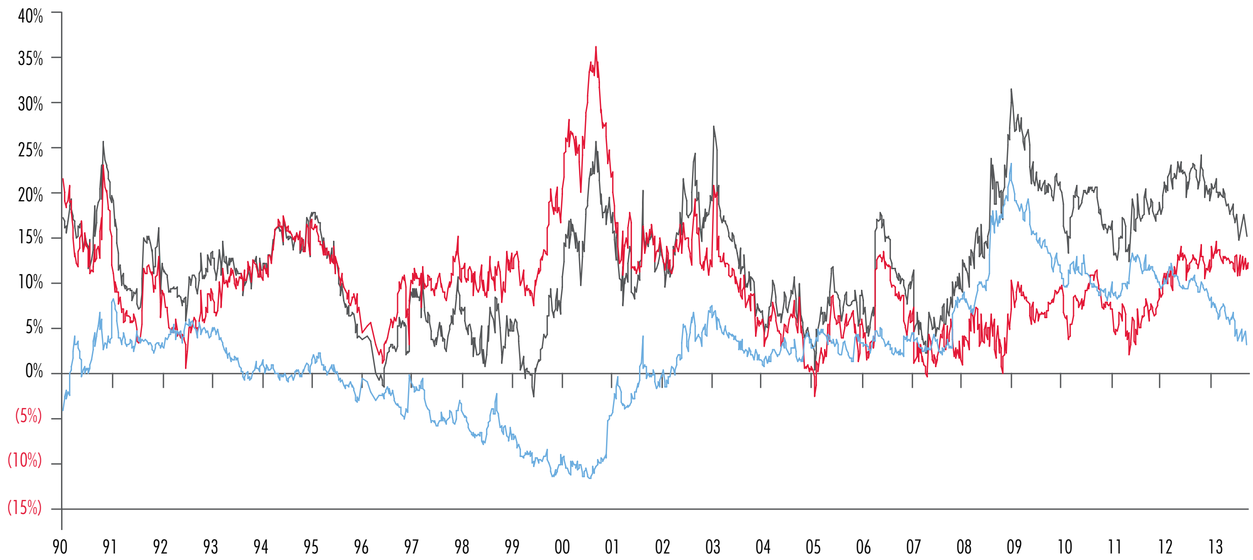
"... IT IS OFTEN A BIG 'IF' TO ASSUME THAT THE FUTURE WILL RESEMBLE THE PAST, WHICH IS WHY WE OBSESS OVER COMPANY-SPECIFIC, FUNDAMENTAL ANALYSIS."

What does the data say about the current environment?

The dark grey line in **Graph 1** shows the weighted median RTRR for the stocks in the Orbis Global Equity Fund since its inception, the light blue line shows the same for those in its benchmark, and the red line shows the difference between the two. The higher the red line, the greater the amount by which the Fund is expected to outperform the benchmark, again assuming that future fundamentals are similar to those of the past. Notably, the median RTRR of stocks in the benchmark has hovered near just 5% in recent months. This is the lowest since 2007-08 and suggests only modest stock market returns from today's levels. Of course, that does not mean stocks cannot or will not keep going up. It is not impossible to see negative RTRRs if share prices race far enough ahead of fundamentals, as was the case during the technology bubble of the late 1990s.

What intrigues us as stock pickers, is that the median RTRR of the stocks in Global is currently about 15%. It is a noisy estimate, but it implies that there is still real scope for the Fund to deliver satisfying returns, provided, of course, that our fundamental assessment of Global's stock selections and the broader opportunity set proves to be correct. The key message from the data is that, while lower absolute returns

GRAPH 1 **USING RTRR* TO ASSESS OPPORTUNITIES**



* Weighted median re-rated total rate of return for Orbis Global and the FTSE World Index (US$), and the difference between them, 1990 through 2013.

Source: Orbis

from the benchmark relative to the past few years can probably be expected, we continue to see some compelling opportunities in select stocks.

Investment case for Motorola Solutions

A good example, and one of the Fund's top 10 holdings, is Motorola Solutions (MSI). For most of its life, Motorola Solutions was the industrial division of Motorola Inc., alongside Motorola Mobility, which pioneered the flip phone and later the full-screen RAZR. In January 2011, Motorola Solutions was split from its more cyclical and lower-quality sibling to trade as a separately listed company. For the first time, this empowered MSI management to capitalise the company, structure incentives and run the business based on its unique and more durable industrial characteristics. We believe the spin-off has been, and will continue to be, a powerful catalyst to unlock value for MSI's shareholders.

MSI's crown jewel is its public safety business: it is the world's dominant supplier, with market share in excess of 60%, of mission-critical radio equipment for public safety networks used by police and emergency responders. This business accounts for about two-thirds of the company's revenue and almost 80% of current profits. The remaining third of revenue is from 'rugged' mobile computers and other highly durable devices used by large companies. In this area, which is known as its 'enterprise' business, MSI has a leading 40-45% market share. To measure the quality of a business, Orbis and Allan Gray most often look at the durability and magnitude of its return on capital. And in this respect, MSI shines. It generates an after-tax return on invested capital in excess of 30%, more than three times the average for companies in the S&P 500 Index. These returns are the combined result of MSI's long product cycles, significant intellectual property, high switching costs, sizable recurring revenue, massive installed base and return-focused management team.

A dose of fear is often a key ingredient in the most profitable investments. When MSI spooked investors in mid-2013 by trimming guidance due to product adoption delays in their enterprise business, these delays stoked fears that MSI's enterprise segment was under threat from consumer devices, like the iPhone, and the stock got punished. Where others see a threat, however, we see an enterprise business that is solidly positioned and poised to recover as information technology spending improves. Even if there were a threat, its potential impact is limited: only about 20% of MSI's profits come from enterprise sales and less than 5% from products that can realistically be replaced by consumer smartphones.

"A DOSE OF FEAR IS OFTEN A KEY INGREDIENT IN THE MOST PROFITABLE INVESTMENTS."

As always, we look to buy shares for less than they are worth

In MSI's case, intrinsic value is driven largely by its public safety franchise, which has been an impressive cash generator. The company currently generates adjusted annual free cash flow (FCF) of over US$5 per share, which implies a FCF yield to enterprise value of approximately 8%. This yield compares favourably to the FCF yield of the S&P 500 Index at less than 7% and the 10-year US Treasury yield at 3% per annum. Global is thus able to own an above-average franchise at a discount to the market at a time when shares of many other businesses in the US are more expensive and of lower quality.

At Orbis and Allan Gray we certainly cannot predict the direction of the stock market, but with US shares near all-time highs, we believe it is prudent to expect lower absolute market returns from current levels. Should that prove to be the case, we believe Orbis Global will be well served by owning companies such as MSI that are resilient and well positioned to control their own destiny.

Adam joined Orbis in 2002 having previously worked in private equity and investment banking. He is the managing director of Orbis Investment Management (US) LLC and a director of Orbis Investment Management Limited.

CLAUDIA DEL FANTE & LISE-MARI CRAFFORD

UNDERSTAND YOUR STABLE FUND INVESTMENT

We have written on many occasions about the role investors play in their investment success. Key to this is understanding your fund's risk profile and objectives and how your fund manager goes about picking investments for your fund. This will help you to remain focused and not lose heart during periods of underperformance. Claudia Del Fante and Lise-Mari Crafford take a look at the Allan Gray Stable Fund's objectives and explain why investors should expect some short-term volatility.

The Stable Fund aims to meet the needs of the more conservative investor with a low tolerance for capital loss over any two-year period. The Fund's positioning may be suitable for the risk-averse investor who requires capital stability, while simultaneously seeking to capture long-term returns in excess of bank deposits.

Fund composition

The Stable Fund is an asset allocation fund. Also known as 'solution funds', asset allocation funds invest in a range of asset classes, such as shares, bonds, cash, property or offshore assets. Exposure to these asset classes varies, depending on the opportunities presented at a point in time, and in keeping with retirement fund regulations (Regulation 28 of the Pension Funds Act limits exposure to certain asset classes).

One of the key benefits of investing in an asset allocation fund, is that the fund manager (not the investor), bears the responsibility of managing the underlying asset class exposure within the fund. The fund manager has the flexibility to alter the exposure to various asset classes, based on available opportunities. The returns investors ultimately experience come from all the different components that make up the fund (see page 7 for a more detailed description of performance attribution).

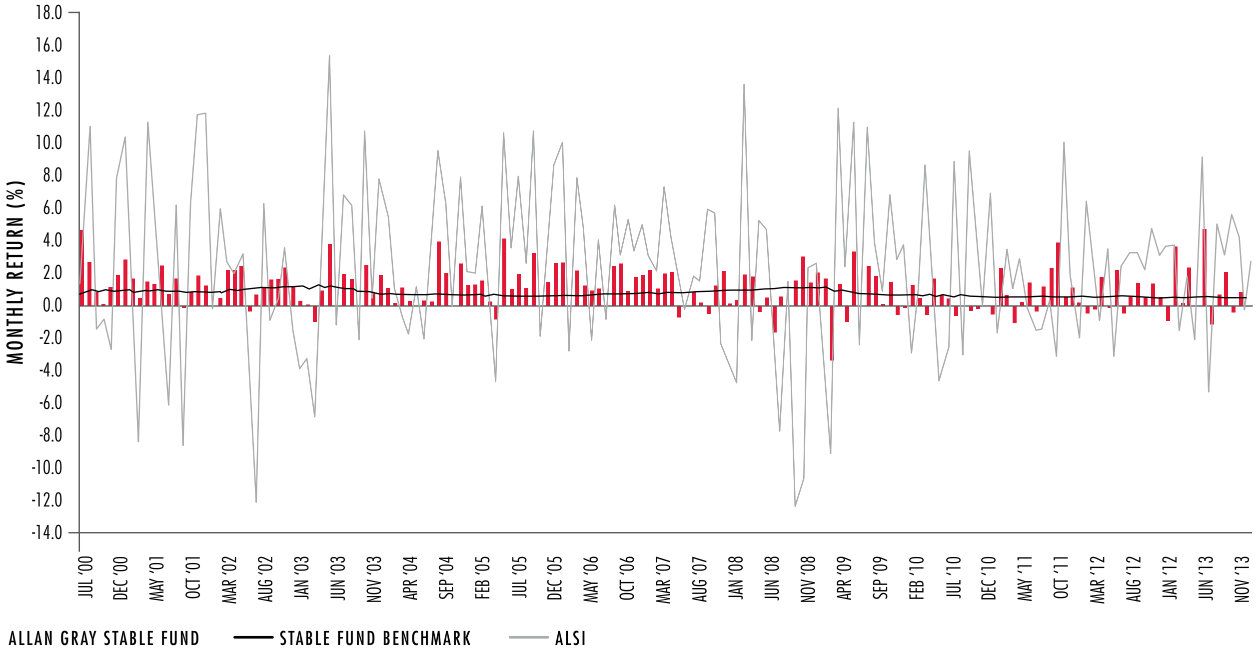
The Stable Fund's large cash holding acts as the foundation to its stability, with the alternate asset class exposure used to generate superior returns to cash over the long term. The fund managers use a bottom-up equity selection process, meaning they look for shares which they believe are priced below fair value, with emphasis placed on picking shares with limited risk of capital loss, high current or prospective dividend yields and shares that tend to perform differently from the overall market.

Expect some short-term volatility

Although conservatively managed, the Fund's equity and offshore exposure introduces a level of volatility to the returns of the Fund over short periods of time.

The offshore exposure is a case in point. In previous years, the Fund's offshore investments lagged its local holdings. As the Fund was at its maximum offshore exposure (25%, the maximum allowed under the retirement fund regulations), this detracted from relative performance. In 2013, however, our offshore partner Orbis experienced a sharp turnaround in relative and absolute performance at the same time as the rand weakened, and the offshore component became the largest contributor to the success of the Stable Fund over the year.

GRAPH 1 ALLAN GRAY STABLE FUND VS ALSI

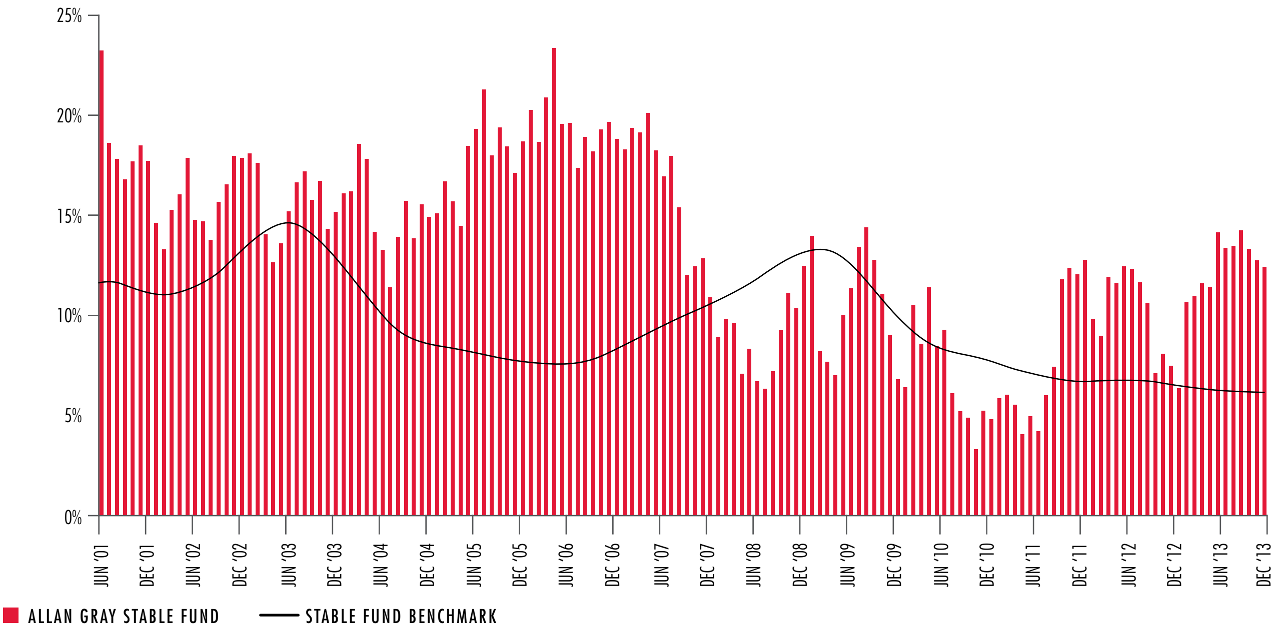


Source: Allan Gray

Reflecting the Fund's monthly returns since inception, **Graph 1** shows that it is not uncommon for the Fund to generate a negative return over a one-month period. While it would be nice for our funds to consistently top the short-term performance charts, this is not our aim. We believe an unhealthy focus on short-term performance can be detrimental to us creating long-term wealth for our clients.

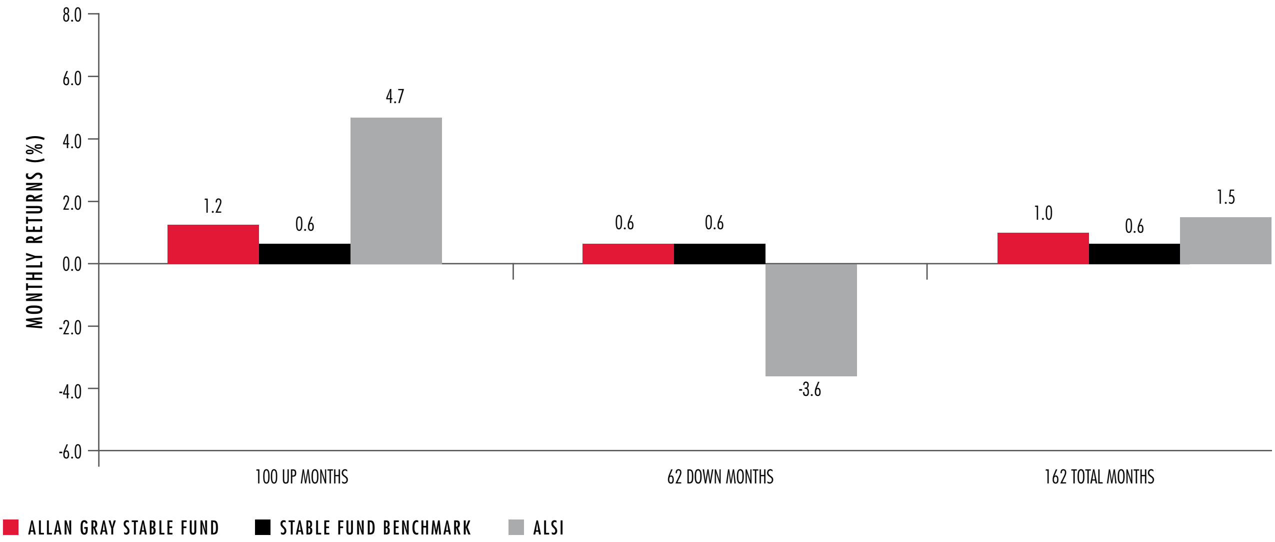
Minimising the risk of permanent capital loss over a two-year period is an explicit objective of the Fund. **Graph 2** shows that despite the short-term volatility described above, over a one-year rolling period, the Fund has managed to achieve its primary goal of protecting clients' capital consistently for 13 years. In addition to this, it is pleasing to see the level to which the Fund reduces the volatility of the asset classes inherent in the Fund. This is shown in Graph 1, which compares the volatility of the returns of the FTSE/JSE All Share Index (ALSI) to that of the Fund. Equity exposure offers a great opportunity for significant reward, however only if purchased at the right price. The Fund is comfortable foregoing short-term upside to avoid taking on unnecessary levels of risk.

GRAPH 2 ALLAN GRAY STABLE FUND ONE-YEAR ROLLING RETURNS



Source: Allan Gray

GRAPH 3 **UNIT TRUST RETURNS IN BULL & BEAR MARKETS JULY 2000 – DECEMBER 2013**



Source: Allan Gray

Returns in different market conditions

Even amongst its peers, the Stable Fund is a relatively low risk fund and therefore maintains a low net equity exposure. By virtue of its conservative equity positioning, the Fund tends to lag its peers when the market is rising but provides protection for its investors when the tide turns. **Graph 3** shows the average monthly returns of the Fund since inception (versus its benchmark) during months when the ALSI delivered a positive return (100 months) and during months when the ALSI delivered a negative return (62 months).

In the 100 months of a positive return, the ALSI had an average monthly return of 4.7%. The average monthly return for the Fund was 1.2%, outperforming its benchmark by 0.6% per month on average and capturing about a quarter of the average monthly return of the ALSI. It is in the 62 months when the market declined that the true nature of this Fund is evident. The Fund protected its capital by returning 0.6% per month on average, whereas the ALSI had an average monthly return of -3.6%. Combining both up and down months for the full 162-month period, the ALSI delivered an average monthly return of 1.5%. The Fund was able to deliver an average monthly return of 1.0% – with significantly lower annualised volatility in monthly returns.

Try not to be swayed by emotion

Investors are often swayed by sentiment and make rash investment decisions on the back of short-term noise in the markets. A major risk to unit trust investors is that they personally do not enjoy the same returns as their Fund. As we have discussed previously (see Rob Dower's column on page 1 and his column in Quarterly Commentary 2, 2012), investment returns are the result of both a client's behaviour and a fund's performance. Unit trust investors who adopt a long-term approach are usually more successful than those who attempt to time the market.

The nature of our investment philosophy often finds us in short-term positions of discomfort. It is up to investors to remain true to the objective they signed up for when investing in the Fund, and give the manager the time required to generate superior returns over the long term.

As South Africans we have become very used to the exceptional level of absolute returns from almost all asset classes since the turn of the century. Given the current level of local and global capital markets, it is highly unlikely that this pattern will continue in the next 13 years. Asset allocation and stock selection become even more critical in an environment where returns may be scarce. It is important to pick a fund manager that you trust to protect your capital, first and foremost, and a fund whose objectives match your own. Then allow your fund manager the time required to provide a good return for you over the long term.

Claudia is a business analyst in the Manco Distribution team. She joined Allan Gray in 2010 after completing her Bachelor of Business Science Finance Honours Degree at UCT.

Lise-Mari is a business analyst in the Manco Distribution team. She joined Allan Gray in 2008 after completing her Honours Degree in Financial Risk Management at Stellenbosch University. Lise-Mari is a certified financial planner.

WANITA ISAACS

WHAT COMPOUNDING CAN DO FOR YOU

'Compound interest is the eighth wonder of the world. Those who understand it, earn it... those who don't, pay it.' Albert Einstein

Compounding is when the interest on a sum of money, either a deposit or loan, is added to the original amount so that the interest also earns interest. Albert Einstein's popular quote highlights the impact compounding can have over time, and also cautions that it can work either for or against you. Wanita Isaacs explains.

When you invest, time allows your invested money to grow and compounding makes your money work harder for you. Given a long enough period to work, compounding can dramatically multiply the value of your investment so that less of your total investment will be from your contributions and more from growth.

On the other hand, while compounding can be seen as the magic ingredient for successful investing, the same mechanism works against you when you borrow money, for example, through credit cards or a personal loan. The amount you owe earns interest over time and through the effect of compounding, the cost of credit can work out to substantially more than the cash amount you borrowed, depending on the interest you are charged and the length of time you will be paying the loan back.

How does compounding actually work?

The impact compounding will have on either an investment or a loan depends on:

- The amount invested or borrowed
- The time period
- The growth rate (The rate of return on an investment or the interest charged on a loan)
- The compounding frequency (The more frequently interest is added to the original amount, the greater the impact of compounding. For example, daily compounding means that you earn returns today on the amount you invested, as well as the returns you earned yesterday on the returns you earned the day before. This has a greater impact than compounding monthly, which has a greater impact than compounding annually.)

Table 1 uses an investment of R10 000 and annual compounding to illustrate how compounding works.
After 20 years, your R10 000 investment would have grown to R67 275 – a gain of R57 275. If your returns had not been added to the original amount and left to grow; if you had spent them instead, the total gain from your investment would be only R20 000. And since you would have spent this R20 000, you would only have the original R10 000 still invested.

How do you ensure compounding works for you?

To benefit from compounding, you first have to start saving and the sooner you start the better. You also have to be disciplined and not spend the money your investment makes before you reach your savings goal.

The cliché that good things come to those who wait is especially true when it comes to compounding. Both the decision to invest and the decision whether or not to use credit are essentially choices between instant and delayed gratification. If you choose to use credit you will have to pay for the benefit of instant gratification whereas, if you choose to save, you will be rewarded for delaying gratification.

TABLE 1 **HOW COMPOUNDING WORKS**

	AMOUNT OF YOUR INVESTMENT	RETURN RATE	TOTAL AMOUNT WITH RETURN EARNED
Year one	R10 000	10% annually = R1 000	R11 000
Year two	R11 000	10% annually = R1 100	R12 100
Year three	R12 100	10% annually = R1 210	R13 310

Wanita was appointed as head of investor education at the start of 2013. Prior to that she was a business analyst in the Product Development team. She is a medical doctor and a UCT graduate and has been with Allan Gray since 2008.

ANTHONY FARR

LIVING A LIFE OF PURPOSE

While a key intention of the Allan Gray Orbis Foundation is finding great talent and transforming it into exceptional accomplishment, it is essential that members of the Fellowship community are motivated by making a difference, rather than by making money. Anthony Farr discusses how the Foundation seeks out individuals likely to pursue a life of purpose; qualities personified by Founding Patron Allan Gray and the late Professor Jakes Gerwel, first chairman of the Foundation's Board of Trustees.

At the Foundation our *raison d'etre* or fundamental purpose is to foster entrepreneurship for the common good. 'Common good' is defined in numerous ways; however, American political philosopher Michael Sandel provides an understanding which particularly resonates with the Foundation, when he states: 'The common good means to do what is best for the community as a whole.' For the Foundation this specifically means that the Allan Gray Fellowship community is a community of purpose-driven responsible entrepreneurs, who focus on the long-term goals of creating employment opportunities, improving living standards, making strides to eliminate abject poverty and achieving a more equitable society for all. In practical terms, this means, in the first instance, they should be motivated by making a difference rather than making money. It is essential that a business makes a profit, but profit is secondary to purpose.

What then is purpose?

Purpose is the reason for which something is done or created or for which something exists. The definition and pursuit of purpose has lent itself to numerous books and articles describing individuals who personify purpose. For us at the Foundation, examples of these individuals can be found very close to home.

In 2014, South Africa celebrates the 20th year of becoming a democracy. While this feat was achieved through the collective efforts of a number of individuals, most notably our recently departed Nelson Mandela, we would like to pay respect to the legacy of the late Professor Jakes Gerwel. The founding chairman of the Foundation's Board of Trustees who, through his life's work and achievements in academia, politics and business, personified a sense of purpose which served the betterment of society, creating greater equality of opportunity and access for all South Africans. At the outset of his journey, he had a clear vision for the South Africa of the future. Regardless of the many challenges and obstacles he faced, he remained resolved and determined to fulfil his purpose.

"THE FOUNDATION'S SELECTION PROCESS IS GEARED TOWARDS UNCOVERING THOSE OF 'GREATEST POTENTIAL', RATHER THAN EXCLUSIVELY ON 'MERIT'..."

And even closer to home, a key example for us at the Foundation is that of our founding patron, Allan Gray. Regardless of market sentiment or herd mentality, he has remained resolute in fulfilling his purpose. With a firm resolve to create wealth for his clients, and through that having built two successful investment management firms and achieved some financial success of his own, his purpose then extended to creating societal wealth through the Foundation.

Management thought leader Gary Hamel succinctly describes the effect of purpose as follows: 'A noble purpose inspires sacrifice, stimulates innovation and encourages resilience. In so doing it transforms great talent into exceptional accomplishment.' There can be few better descriptions of the intention of the Foundation than transforming great talent into exceptional accomplishment.

How do we define talent?

The challenge, though, may lie more with our initial construct of this word 'talent'. The Foundation's selection approach is geared towards uncovering those of 'greatest potential', rather than exclusively on 'merit' as a means of more truly reflecting our understanding of talent. Potential is more forward looking than merit alone, which is based largely on past achievement. In his 2013 commencement speech at Princeton University, Ben Bernanke observed the following: 'A meritocracy is a system in which the people who are the luckiest in their health and genetic endowment; luckiest in terms of family support, encouragement, and, probably, income; luckiest in their educational and career opportunities; and luckiest in so many other ways difficult to enumerate – these are the folks who reap the largest rewards.' Similarly to the age-old investment adage that past performance is not an indicator of future performance, and however challenging it might prove to be in practice, we therefore look at the underlying potential of the individual as a better indicator of individuals likely to achieve their future purpose.

In reflecting on 2013, the following provides some insights into the Foundation community's progress towards our long-term purpose.

Association of Allan Gray Fellows

This year signalled the end of term for the first Executive team of the Association of Allan Gray Fellows. As the pioneers who assisted in setting up the initial structures for the Association, the outgoing team laid a strong foundation from which the new Executive can only go from strength to strength. We thank the outgoing team and wish the new Executive well as they carry the Foundation's vision forward among the Association members.

In 2014, 48 Year Experience Fellows are expected join the current 151, making the Association membership 199 strong.

"...PURPOSE CAN BE SEEN AS SOMETHING WHICH TRANSCENDS THE PAST MERITS YOU HAVE ACHIEVED..."

Allan Gray Fellowship

Candidate Allan Gray Fellows, in addition to their academic performance at university, participated in international learning opportunities in London and Germany, the Brightest Young Minds Summit and were invited to present at the 6th SA Innovation Summit.

The National Fellowship Jamboree took place in July with some 240 Candidate Fellows converging in Cape Town, with the sole purpose of engaging with experiential entrepreneurial learning and forging strong ties within the community across the various geographic hubs. The guest speaker this year was outgoing FNB CEO Michael Jordaan, who provided some key insights from his own entrepreneurial journey.

The Selection efforts for 2013 have resulted in 85 individuals being offered the opportunity to join the Fellowship community in 2014. This means the Fellowship community will be 250 strong.

Allan Gray Scholarship

At the beginning of 2013, an auspicious milestone was achieved with the first cohort of Allan Gray Scholars entering Matric. At the end of 2013, the Matric class was 17 strong, with nine of them having secured the Allan Gray Fellowship for 2014 during the highly competitive selection process.

In addition to this, during 2013 Scholars in varying grades achieved some of the following accolades at their respective high schools: head of house, prefect, leadership awards and full academic colours. Along with academic performance, three of our scholars have already started exercising their social entrepreneurial muscles through their individual Community Action Projects and received funding from the Enke Incubator Fund.

As reported in Quarterly Commentary 2, 2013, the 2012 Scholars Selection campaign culminated in an additional 30 Scholars qualifying to start high school in 2014. They join the current 155 Scholars at schools across the country, bringing the total number of Allan Gray Scholars on their own journeys toward purpose to 185 for 2014.

Discover your pathway to purpose

In closing, purpose can be seen as something which transcends the past merits you have achieved, the title you hold or the career you pursue. The achievement of purpose for us at the Foundation is guided by one of the Foundation's five Pillars, the Spirit of Significance, which is defined as a weight of personality that comes from living a life personified by passion and integrity. Recognition that ultimate personal satisfaction comes from empowering oneself in order that one might be able to serve others.

It is through the serving of others, seldom better illustrated than in the life of Jakes Gerwel, that one ultimately discovers one's own pathway towards purpose.

To view our 'Year in Review 2013', visit the Foundation's YouTube channel at www.youtube.com/user/AGOFoundation

Coming together of all Candidate Allan Gray Fellows at the annual Jamboree.

Allan Gray Orbis Foundation

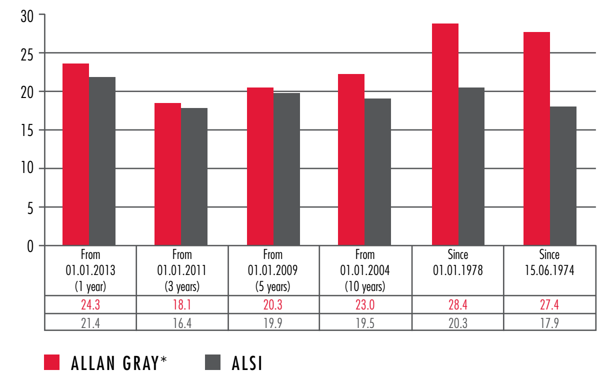
Anthony is a qualified chartered accountant. Prior to joining the Allan Gray Orbis Foundation in 2005 he worked at the Starfish Greathearts Foundation.

INVESTMENT TRACK RECORD – SHARE RETURNS

ALLAN GRAY PROPRIETARY LIMITED GLOBAL MANDATE SHARE RETURNS VS FTSE/JSE ALL SHARE INDEX

PERIOD	ALLAN GRAY*	FTSE/JSE ALL SHARE INDEX	OUT/UNDER-PERFORMANCE
1974 (from 15.06)	-0.8	-0.8	0.0
1975	23.7	-18.9	42.6
1976	2.7	-10.9	13.6
1977	38.2	20.6	17.6
1978	36.9	37.2	-0.3
1979	86.9	94.4	-7.5
1980	53.7	40.9	12.8
1981	23.2	0.8	22.4
1982	34.0	38.4	-4.4
1983	41.0	14.4	26.6
1984	10.9	9.4	1.5
1985	59.2	42.0	17.2
1986	59.5	55.9	3.6
1987	9.1	-4.3	13.4
1988	36.2	14.8	21.4
1989	58.1	55.7	2.4
1990	4.5	-5.1	9.6
1991	30.0	31.1	-1.1
1992	-13.0	-2.0	-11.0
1993	57.5	54.7	2.8
1994	40.8	22.7	18.1
1995	16.2	8.8	7.4
1996	18.1	9.4	8.7
1997	-17.4	-4.5	-12.9
1998	1.5	-10.0	11.5
1999	122.4	61.4	61.0
2000	13.2	0.0	13.2
2001	38.1	29.3	8.8
2002	25.6	-8.1	33.7
2003	29.4	16.1	13.3
2004	31.8	25.4	6.4
2005	56.5	47.3	9.2
2006	49.7	41.2	8.5
2007	17.6	19.2	-1.6
2008	-13.7	-23.2	9.5
2009	27.0	32.1	-5.1
2010	20.3	19.0	1.3
2011	9.9	2.6	7.3
2012	20.6	26.7	-6.1
2013	24.3	21.4	2.9

RETURNS ANNUALISED TO 31.12.2013



* Allan Gray commenced managing pension funds on 1 January 1978. The returns prior to 1 January 1978 are of individuals managed by Allan Gray, and these returns exclude income. Returns are before fees.

Note: Listed property included from 1 July 2002. Inward listed included from November 2008.

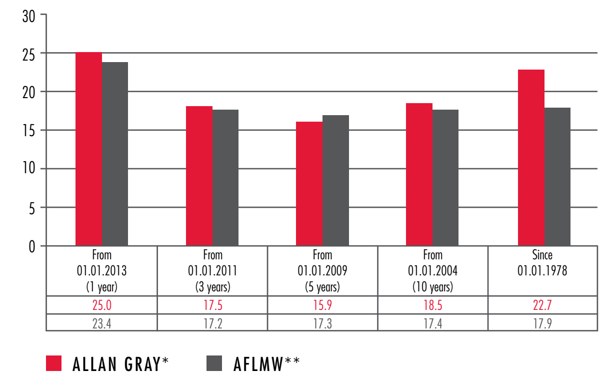
An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown (before fees) to R142 111 981 by 31 December 2013. By comparison, the returns generated by the FTSE/JSE All Share Index (before any fees) over the same period would have grown a similar investment to R6 704 663.

INVESTMENT TRACK RECORD – BALANCED RETURNS

ALLAN GRAY PROPRIETARY LIMITED GLOBAL MANDATE TOTAL RETURNS VS ALEXANDER FORBES GLOBAL MANAGER WATCH

PERIOD	ALLAN GRAY*	AFLMW**	OUT/UNDER-PERFORMANCE
1974	-	-	-
1975	-	-	-
1976	-	-	-
1977	-	-	-
1978	34.5	28.0	6.5
1979	40.4	35.7	4.7
1980	36.2	15.4	20.8
1981	15.7	9.5	6.2
1982	25.3	26.2	-0.9
1983	24.1	10.6	13.5
1984	9.9	6.3	3.6
1985	38.2	28.4	9.8
1986	40.3	39.9	0.4
1987	11.9	6.6	5.3
1988	22.7	19.4	3.3
1989	39.2	38.2	1.0
1990	11.6	8.0	3.6
1991	22.8	28.3	-5.5
1992	1.2	7.6	-6.4
1993	41.9	34.3	7.6
1994	27.5	18.8	8.7
1995	18.2	16.9	1.3
1996	13.5	10.3	3.2
1997	-1.8	9.5	-11.3
1998	6.9	-1.0	7.9
1999	80.0	46.8	33.1
2000	21.7	7.6	14.1
2001	44.0	23.5	20.5
2002	13.4	-3.6	17.1
2003	21.5	17.8	3.7
2004	21.8	28.1	-6.3
2005	40.0	31.9	8.1
2006	35.6	31.7	3.9
2007	14.5	15.1	-0.6
2008	-1.1	-12.3	11.2
2009	15.6	20.3	-4.7
2010	11.7	14.5	-2.8
2011	12.6	8.8	3.8
2012	15.1	20.0	-4.9
2013	25.0	23.4	1.6

RETURNS ANNUALISED TO 31.12.2013



** Consulting Actuaries Survey returns used up to December 1997. The return from 1 April 2010 is the average of the non-investable Alexander Forbes Large Manager Watch. The return for December 2013 is an estimate.

An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown (before fees) to R15 879 577 by 31 December 2013. The average total performance (before fees) of global mandates of Large Managers over the same period would have grown a similar investment to R3 775 028.

ALLAN GRAY BALANCED AND STABLE FUND ASSET ALLOCATION AS AT 31 DECEMBER 2013

	BALANCED FUND % OF PORTFOLIO			STABLE FUND % OF PORTFOLIO		
	TOTAL	SA	FOREIGN**	TOTAL	SA	FOREIGN
Net equities	55.6	42.0	13.6	16.8	11.6	5.2
Hedged equities	12.8	2.6	10.2	32.8	15.4	17.4
Property	1.1	0.6	0.4	1.9	1.5	0.3
Commodities	3.6	3.6	0.0	4.5	4.5	0.0
Bonds	9.6	9.5	0.1	7.5	7.5	0.0
Money market and bank deposits	17.4	15.6	1.8	36.5	33.9	2.6
TOTAL	**100.0**	**74.0**	**26.0***	**100.0**	**74.4**	**25.6***

Note: There might be slight discrepancies in the totals due to rounding.

* The Fund is above its foreign exposure limit due to market value movements.
** This includes African ex-SA assets.

ALLAN GRAY EQUITY FUND NET ASSETS AS AT 31 DECEMBER 2013

SECURITY (RANKED BY SECTOR)	MARKET VALUE (R MILLION)	% OF FUND	FTSE/JSE ALSI WEIGHT (%)
EQUITIES	**36 479**	**98.6**	
RESOURCES	**8 741**	**23.6**	**25.4**
Sasol	4 531	12.2	
Anglo American*	1 468	4.0	
BHP Billiton	1 035	2.8	
Impala Platinum	548	1.5	
Positions less than 1%	1 159	3.1	
FINANCIALS	**10 064**	**27.2**	**19.0**
Standard Bank	2 805	7.6	
Reinet Investments SA	1 413	3.8	
Old Mutual	1 229	3.3	
Investec	1 199	3.2	
Sanlam	915	2.5	
Rand Merchant Insurance	441	1.2	
Positions less than 1%	2 063	5.6	
INDUSTRIALS	**17 381**	**47.0**	**55.6**
British American Tobacco	4 114	11.1	
SABMiller	3 216	8.7	
Remgro	2 089	5.6	
Netcare	663	1.8	
Nampak	659	1.8	
Mondi	604	1.6	
Sappi	551	1.5	
Tongaat Hulett	470	1.3	
Aspen Pharmacare	436	1.2	
Positions less than 1%	4 579	12.4	
OTHER SECURITIES	**293**	**0.8**	
COMMODITIES	**68**	**0.2**	
MONEY MARKET AND CALL DEPOSITS	**446**	**1.2**	
TOTALS	**36 993**	**100.0**	

* Including positions in Anglo American stub certificates.

ALLAN GRAY UNIT TRUSTS ANNUALISED PERFORMANCE IN PERCENTAGE PER ANNUM TO 31 DECEMBER 2013

UNIT TRUSTS[1]	QTR[3] (UNANNUALISED)	1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R MILLION)	INCEPTION DATE
HIGH NET EQUITY EXPOSURE (100%)								
Allan Gray Equity Fund (AGEF)	-	**21.3**	**16.2**	**17.4**	**19.6**	**26.9**	**36 993.2**	**01.10.98**
FTSE/JSE All Share Index		21.4	16.4	19.9	19.5	19.0		
Allan Gray-Orbis Global Equity Feeder Fund (AGOE)	-	**78.2**	**33.2**	**20.3**	**-**	**16.7**	**13 090.3**	**01.04.05**
FTSE World Index (Rands)		54.2	29.1	18.3	-	13.9		
MEDIUM NET EQUITY EXPOSURE (40% - 75%)								
Allan Gray Balanced Fund (AGBF)	-	**23.7**	**16.2**	**14.6**	**17.0**	**19.7**	**83 453.3**	**01.10.99**
Average of South African - Multi Asset - High Equity category (excl. AGBF)[10]		20.0	14.4	14.4	15.3	14.4		
Allan Gray-Orbis Global Fund of Funds (AGGF)	-	**55.6**	**27.0**	**12.3**	**-**	**11.7**	**11 316.9**	**03.02.04**
60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index (Rands)		38.8	24.8	13.0	-	11.1		
LOW NET EQUITY EXPOSURE (20% - 40%)								
Allan Gray Stable Fund (AGSF)	-	**15.3**	**11.4**	**9.1**	**12.0**	**13.5**	**32 982.3**	**01.07.00**
Daily interest rate of FirstRand Bank Limited plus 2%		6.2	6.4	7.4	8.5	9.5		
VERY LOW NET EQUITY EXPOSURE (0% - 20%)								
Allan Gray Optimal Fund (AGOF)	-	**6.5**	**4.2**	**4.9**	**6.8**	**7.8**	**848.9**	**01.10.02**
Daily interest rate of FirstRand Bank Limited		4.1	4.4	5.2	6.4	6.9		
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO)	-	**39.6**	**21.7**	**-**	**-**	**12.3**	**1 294.7**	**02.03.10**
Average of US$ Bank Deposits and Euro Bank deposits		26.6	17.6	-	-	9.3		
NO EQUITY EXPOSURE								
Allan Gray Bond Fund (AGBD)	-	**2.2**	**8.3**	**8.9**	**-**	**9.3**	**631.4**	**01.10.04**
BEASSA All Bond Index (total return)		0.6	8.3	7.7	-	9.0		
Allan Gray Money Market Fund (AGMF)	-	**5.2**	**5.4**	**6.5**	**7.6**	**8.3**	**7 852.6**	**03.07.01**
Alexander Forbes Short Term Fixed Interest (STeFI) Composite Index[9]		5.2	5.4	6.4	7.5	8.3		

ALLAN GRAY TOTAL EXPENSE RATIOS (TERS)

	EQUITY FUND	GLOBAL EQUITY FEEDER FUND	BALANCED FUND	GLOBAL FUND OF FUNDS	STABLE FUND	OPTIMAL FUND	GLOBAL OPTIMAL FUND OF FUNDS	BOND FUND	MONEY MARKET FUND
Performance fees	0.64%	0.20%	0.48%	1.09%	0.76%	0.00%	1.69%	0.12%	N/A
Fee for benchmark performance	1.50%	1.49%	1.06%	1.21%	1.02%	1.00%	0.99%	0.25%	0.25%
Other costs including trading costs	0.07%	0.19%	0.10%	0.24%	0.09%	0.09%	0.25%	0.02%	0.01%
VAT	0.30%	0.00%	0.14%	0.00%	0.16%	0.15%	0.00%	0.05%	0.04%
TOTAL EXPENSE RATIO (TER)	2.51%	1.88%	1.78%	2.54%	2.03%	1.24%	2.93%	0.44%	0.30%

A Total Expense Ratio (TER) of a portfolio is a measure of the portfolio's assets that were relinquished as a payment of services rendered in the management of the portfolio. The total operating expenses are expressed as a percentage of the average value of the portfolio, calculated for the year to 30 September 2013. Included in the TER is the proportion of costs incurred by the performance component, fee at benchmark and other expenses. These are disclosed separately as percentages of the net asset value. Trading costs (including brokerage, VAT, STT, STRATE, levy and insider trading levy) are included in the TER.
A high TER will not necessarily imply a poor return nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs.

ORBIS FUNDS ANNUALISED PERFORMANCE IN PERCENTAGE PER ANNUM TO 31 DECEMBER 2013

	QTR (UNANNUALISED)	1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	INCEPTION DATE
ORBIS FUNDS (RANDS) REGISTERED FOR MARKETING IN SOUTH AFRICA[1, 6]							
Orbis Global Equity Fund (Rands)	**11.6**	**77.1**	**33.5**	**20.4**	**15.9**	**19.8**	**01.01.90**
FTSE World Index (Rands)	12.3	54.2	29.1	18.3	13.0	13.5	
Orbis SICAV Japan Equity (Yen) Fund (Rands)	**2.6**	**59.2**	**29.5**	**13.7**	**11.8**	**15.7**	**01.01.98**
Tokyo Stock Price Index (Rands)	6.6	56.6	23.8	10.2	9.1	8.6	
Orbis SICAV Asia Ex-Japan Equity Fund (Rands)	**10.7**	**48.6**	**27.1**	**24.8**	**-**	**18.9**	**01.01.06**
MSCI Asia Ex-Japan (Rands)	7.9	27.5	18.0	19.2	-	15.4	
Orbis Optimal SA Fund-US$ Class (Rands)	**4.9**	**39.2**	**21.8**	**6.7**	**-**	**12.0**	**01.01.05**
US$ Bank Deposits (Rands)	4.4	23.9	16.6	2.6	-	9.3	
Orbis Optimal SA Fund-Euro Class (Rands)	**6.6**	**44.1**	**22.8**	**6.0**	**-**	**11.6**	**01.01.05**
Euro Bank Deposits (Rands)	6.2	29.2	18.3	2.4	-	9.2	

SEGREGATED AND LIFE POOLED PORTFOLIOS ANNUALISED PERFORMANCE IN PERCENTAGE PER ANNUM TO 31 DECEMBER 2013

	QTR[3] (UNANNUALISED)	1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R MILLION)	INCEPTION DATE
SEGREGATED PORTFOLIOS[5] (BEFORE FEES, EXCEPT FOR FUNDS INDICATED BY FOOTNOTE 1)								
Domestic Equity Composite	**5.5**	**22.9**	**16.7**	**19.1**	**22.7**	**21.9**	60 600.2	01.01.90
FTSE/JSE All Share Index	5.5	21.4	16.4	19.9	19.5	15.4		
Domestic Balanced Composite	**3.7**	**15.3**	**13.5**	**15.4**	**19.2**	**23.0**	22 177.7	01.01.78
Mean of Alexander Forbes Domestic Manager Watch[2,7]	4.0	16.0	14.3	17.1	18.1	18.3		
Global Balanced Composite	**4.8**	**25.0**	**17.5**	**15.9**	**18.5**	**22.7**	58 094.7	01.01.78
Mean of Alexander Forbes Global Large Manager Watch[2,4]	5.4	23.4	17.2	17.3	17.4	17.9		
Global Balanced Namibian High Foreign Composite	**5.1**	**26.3**	**18.3**	**14.8**	**18.2**	**19.8**	8 431.8	01.01.94
Mean of Alexander Forbes Namibia Average Manager[2]	5.6	22.8	16.5	16.4	17.2	15.0		
Foreign Best View (Rands) Composite[1,8]	**7.3**	**53.8**	**26.9**	**12.0**	**12.6**	**15.4**	6 462.4	23.05.96
60% of the MSCI World Index[11] and 40% of the JP Morgan Global Government Bond Index (Rands)	8.4	38.0	24.4	13.0	11.7	12.0		
Relative Domestic Equity Composite	**6.8**	**25.0**	**17.1**	**19.9**	**21.2**	**21.6**	3 607.3	19.04.00
Weighted average of client specific benchmarks[2]	6.0	20.9	16.8	20.2	19.8	17.1		
LIFE POOLED PORTFOLIOS (BEFORE FEES, EXCEPT FOR FUNDS INDICATED BY FOOTNOTE 1)								
Domestic Equity Portfolio	**5.9**	**24.5**	**17.5**	**19.6**	**22.9**	**24.0**	7 562.6	01.02.01
FTSE/JSE All Share Index	5.5	21.4	16.4	19.9	19.5	16.8		
Domestic Balanced Portfolio	**3.8**	**15.5**	**13.9**	**15.8**	**19.5**	**20.2**	4 989.3	01.09.01
Mean of Alexander Forbes Domestic Manager Watch[2,7]	4.0	16.0	14.3	17.1	18.1	17.2		
Global Balanced Portfolio	**4.9**	**25.3**	**17.8**	**16.2**	**18.7**	**20.4**	29 613.4	01.09.00
Mean of Alexander Forbes Global Large Manager Watch[2,7]	5.4	23.4	17.2	17.3	17.4	15.8		
Domestic Stable Portfolio	**2.2**	**8.0**	**7.9**	**9.5**	**13.6**	**14.3**	2 081.0	01.12.01
Alexander Forbes Three-Month Deposit Index plus 2%	1.8	7.1	7.4	8.3	9.6	10.3		
Global Stable Portfolio	**2.7**	**16.3**	**12.5**	**10.1**	**-**	**13.9**	4 830.5	15.07.04
Alexander Forbes Three-Month Deposit Index plus 2%	1.8	7.1	7.4	8.3	-	9.5		
Domestic Absolute Portfolio	**1.5**	**7.1**	**7.5**	**10.7**	**17.1**	**20.6**	644.3	06.07.01
Mean of Alexander Forbes Domestic Manager Watch[7]	4.0	16.0	14.3	17.1	18.1	16.9		
Global Absolute Portfolio	**2.7**	**16.8**	**12.3**	**11.8**	**-**	**17.7**	3 466.4	01.03.04
Mean of Alexander Forbes Global Large Manager Watch[2,7]	5.4	23.4	17.2	17.3	-	17.4		
Orbis Global Equity Portfolio[1]	**11.5**	**77.0**	**33.4**	**20.4**	**-**	**16.3**	5 740.2	18.05.04
FTSE World Index (Rands)	12.3	54.2	29.1	18.3	-	13.6		
Foreign Portfolio[1]	**7.3**	**53.5**	**26.7**	**11.9**	**12.6**	**8.7**	1 268.0	23.01.02
60% of the MSCI World Index[11] and 40% of the JP Morgan Global Government Bond Index (Rands)	8.4	38.0	24.4	13.0	11.7	6.5		
Hedged Domestic Equity Portfolio	**5.3**	**22.0**	**16.4**	**18.4**	**-**	**13.3**	1 163.2	01.06.08
FTSE/JSE CAPI Index	5.5	21.6	16.6	20.2	-	11.1		
Relative Domestic Equity Portfolio	**6.1**	**25.0**	**16.2**	**19.4**	**20.8**	**23.5**	276.7	05.05.03
FTSE/JSE CAPI Index	5.5	21.6	16.6	20.2	20.0	22.3		
Domestic Optimal Portfolio[1]	**2.1**	**7.5**	**5.1**	**5.8**	**7.7**	**8.3**	385.0	04.12.02
Daily Call Rate of Nedcor Bank Limited	1.1	4.3	4.6	5.5	6.6	7.0		
Domestic Medical Scheme Portfolio	**2.1**	**7.6**	**7.9**	**9.3**	**-**	**12.8**	1 414.4	01.05.04
Consumer Price Index plus 3% p.a.[2]	1.1	8.4	8.9	8.5	-	9.0		
Money Market Portfolio[1]	**1.3**	**5.4**	**5.6**	**6.8**	**7.8**	**8.7**	167.6	21.09.00
Alexander Forbes Three-Month Deposit Index	1.3	5.0	5.3	6.2	7.4	8.4		

PERFORMANCE AS CALCULATED BY ALLAN GRAY

1 The fund returns are net of investment management fees

2 The return for the period ending 31 December 2013 is an estimate as the relevant survey results have not yet been released

3 Unable to disclose due to ASISA regulations

4 Consulting Actuaries Survey returns used to 31 December 1997. Alexander Forbes Global Large Manager Watch used from 1 January 1998. Alexander Forbes Non-Investable Global Large Manager Watch used from 1 April 2010

5 The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate

6 Amounts invested by the Allan Gray client portfolios in the Orbis funds are included in the assets under management figures in the table above

7 The mean returns of the Alexander Forbes Non-Investable Large Manager Watch used from 1 April 2010

8 The foreign carve-out returns of the Global Balanced Composite used from 23 May 1996 to 31 August 2001. The Foreign Balanced Composite returns are used from 1 September 2001

9 Alexander Forbes Three-Month Deposit Index from 3 July 2001 to 31 March 2003. As from 1 April 2003, the benchmark is the simple average of the Domestic Fixed Interest Money Market Unit Trust Sector excluding the Allan Gray Money Market Fund. The benchmark from 1 November 2011 is the Alexander Forbes Short Term Fixed Interest (STeFI) Composite Index

10 The benchmark was the daily weighted average of the Domestic Prudential Medium Equity Unit Trust sector excluding Allan Gray Balanced Fund from inception until 31 December 2007. With effect from 1 January 2008 it was changed to the daily weighted average (based on assets under management) of the Domestic Prudential Medium Equity Unit Trust Sector and the Prudential Variable Equity Sector excluding Allan Gray Balanced Fund. The change was as a result of the Allan Gray Balanced Fund being reclassified from the Domestic Prudential Medium Equity Sector to the new Prudential Variable Equity Sector. The benchmark from 1 February 2013 is the daily weighted average return of funds in the South African - Multi Asset - High Equity category (excluding the Allan Gray Balanced Fund)

11 Morgan Stanley Capital International All Country World Index

THE ALLAN GRAY GROUP	
UNIT TRUSTS	A unit trust is a savings vehicle for investors who want to grow their money and may want to access it before they retire. Unit trusts allow investors to pool their money with other investors who have similar investment objectives. Unit trusts are also known as 'portfolios of collective investment schemes' or 'funds'. Allan Gray has nine funds in its stable: Equity, Balanced, Stable, Optimal, Money Market, Bond, Global Equity Feeder, Global Fund of Funds and Global Optimal Fund of Funds.
RETIREMENT ANNUITY*	The Allan Gray Retirement Annuity Fund (RA) is a savings vehicle for investors looking for a flexible, tax-efficient way to save for retirement. Investors can only access their money when they retire. Individually owned RAs can be managed on a group basis, offering employers a flexible solution to the challenge of retirement funding for their staff.
PRESERVATION FUNDS*	The Allan Gray Pension Preservation and Provident Preservation funds are savings vehicles for investors looking for a tax-efficient way to preserve existing retirement benefits when they leave a pension or provident fund, either as a result of a change in employment (e.g. retrenchment or resignation), or when they transfer from another preservation fund.
ENDOWMENT*	The Allan Gray Endowment Policy is a savings policy for investors who want a tax-efficient way to save and wish to create liquidity in their estate.
LIVING ANNUITY*	The Allan Gray Living Annuity gives investors flexibility, within certain regulatory limits, to select an annuity best suited to their income needs after retirement. A living annuity provides investors with a regular income which is not guaranteed, and which is funded by growth on capital and income from interest and dividends.
OFFSHORE FUNDS	Through our partnership with Orbis we offer you a cost-effective way to diversify your portfolio by investing offshore. There are two options for investing offshore through Allan Gray: invest in rand-denominated offshore funds without the need to use your offshore investment allowance, or use your offshore investment allowance to invest in foreign funds.
PLATFORM – LOCAL AND OFFSHORE	Our investment platform provides you with access to all of our products, as well as a focused range of unit trusts from other fund providers. The platform enables you to buy, sell and switch – usually at no charge – between the funds as your needs and objectives change. South African investors who wish to diversify their portfolios can also access funds from certain other offshore fund providers via the same platform.
LIFE POOLED PORTFOLIOS	The minimum investment per client is R20 million. Mandates include risk-profiled pooled portfolios: Stable Portfolio, Balanced Portfolio and Absolute Portfolio; asset class pooled portfolios: Money Market, Equity and Foreign, and finally an Optimal Portfolio.
SEGREGATED PORTFOLIOS	The minimum portfolio size is R500 million. Mandates are of a balanced or asset class specific nature. Portfolios can be managed on an absolute or relative risk basis.
BOTSWANA	Allan Gray Botswana manages institutional portfolios on a segregated basis and offers our range of nine South African unit trusts to individual investors.
NAMIBIA	Allan Gray Namibia manages institutional portfolios on a segregated basis and the Allan Gray Namibia Investment Trust provides investment management for Namibian retirement funds in a pooled vehicle.
SWAZILAND	Allan Gray Swaziland manages institutional portfolios on a segregated basis.
ALLAN GRAY ORBIS FOUNDATION	Allan Gray Orbis Foundation is a non-profit organisation that was established in 2005 as an education and development catalyst. It seeks to foster a next generation of high-impact leaders and entrepreneurs for the ultimate purpose of increased job creation in Southern Africa. The Foundation focuses on educational and experiential methods at the secondary and tertiary levels to realise the potential of bright young minds. Through its highly-researched learning programmes, it intends to equip talented young individuals with the skills, attitudes and motivation to have a significant future impact.
E^2	E^2 stands for 'excellence in entrepreneurship' and as a long-term capital fund its purpose is to provide substantial financing to entrepreneurs who are graduates of the Allan Gray Fellowship Programme. In addition, E^2 provides financing for social entrepreneurs who demonstrate exceptional leadership and creative initiative in the not-for-profit sectors.

* This product has unit trusts as its underlying investment option.

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