ALLAN GRAY

QUARTERLY COMMENTARY 1

31 MARCH 2016

LONG-TERM THINKING IN ACTION

The cover of this Quarterly Commentary features the bamboo plantations of south-east Asia. Growing bamboo is a task that requires patience, dedication and a long-term outlook. Bamboo farmers plant seeds and tend to their crops in the hope that one day they will reap a harvest.

For five years, without seeing signs of growth, the bamboo farmers continue to water the seeds – day in and day out. Then, after years of labour and consistently doing the right things the bamboo grows and can reach 27 metres in just five weeks.

The discipline and perseverance of the bamboo farmer resonates with us at Allan Gray. We dedicate ourselves to a tried-and-tested investment process and philosophy that often only bears value over the long term.

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The paper is certified by the Forest Stewardship Council (FSC), an organisation which promotes responsible management of the world's forests.

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ROB DOWER

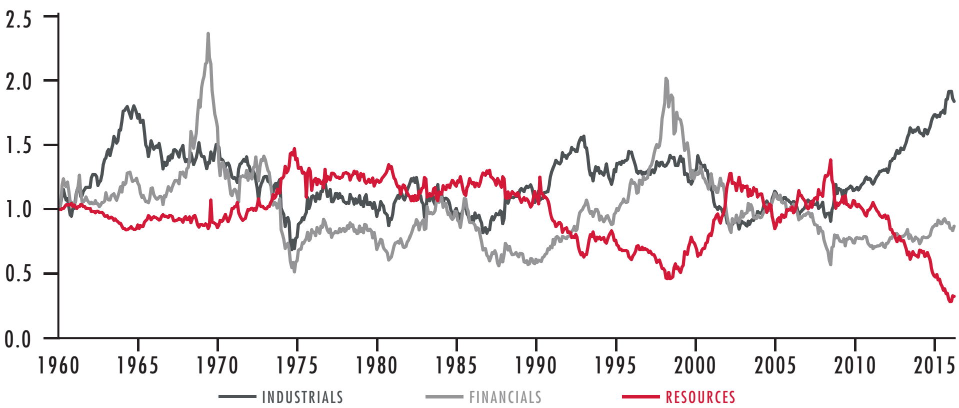
COMMENTS FROM THE CHIEF OPERATING OFFICER

With political volatility at home, uncertain economic prospects in China and potential changes to the monetary policy momentum in the US, South African share prices have been particularly up and down recently. On top of this, the rand weakened 8% in the first few weeks of January before rebounding: many large companies had moves of over 100% between their low and high rand prices for the period and even more when measured in dollars.

We have used **Graph 1** below in client presentations for as long as I have worked at Allan Gray to demonstrate headline differences – or a lack of difference – between sector valuations on the Johannesburg Stock Exchange. This is a sound long-term dataset but a very blunt measure of disparities in the market since they are shown only at sector level, and changes in value are often justified. Nevertheless, there are periods when no one or other sector is the darling or the dunce and other periods with big differences, and often this carries through to more – or less – efficiently priced individual shares as well.

Right now, you will notice that the financial sector as a whole looks cheap relative to its past, and the resources sector even more so. While fluctuation can be unnerving, it provides buying and selling opportunities for investors who have a view on companies' underlying value (like us). If a company's share price goes down and our research shows that this is not justified by changes to its fundamental prospects, we may be able to buy its shares at a bargain price. Thus, the big sector movements shown in the graph currently offer interesting ideas for research, and opportunities to buy some individual stocks and to sell others. Bear this in mind when you read this quarter's investment articles, which cover two very different sectors: banks (included in the financials sector) and luxury goods (perhaps ironically, included in the industrials sector).

GRAPH 1 **INDICES RELATIVE PERFORMANCE**



31 December 1997		
	ALSI	Allan Gray
Resources	23	32
Financials	28	0
Industrials	49	68

31 March 2016		
	ALSI	Allan Gray
Resources	17	24
Financials	23	35
Industrials	60	41

Source: INet BFA, date to 31.03.2016 (RN080416m), this chart has been adjusted for Sasol's reclassification in the indices (March '15 – December '15)

Volatility leads to opportunity

Mark Dunley-Owen examines whether or not there is opportunity in the banking sector. With Barclays exiting Africa, Old Mutual potentially offloading its stake in Nedbank and credit rating downgrades looming, the picture is not very rosy. While negativity can be self perpetuating, it doesn't last indefinitely, and it is our job to find hidden future potential. Valuations of banks are at long-term lows and with their earnings looking sustainable, we are finding selective banking shares attractive.

Usually when we talk about time it is with reference to long term; this quarter it is with reference to timepieces, as Jacques Plaut looks at the history and mechanics of watches. He does this in the context of examining the highly cyclical luxury goods sector, with a focus on Richemont, which appears to be moving out of a period of very strong performance. As discussed earlier, fluctuation can work to our benefit: we have owned Richemont in the past and will keep an eye on it to see if it presents value in the future.

While picking shares that will do well is one aspect of successful investing, avoiding shares that drop significantly is another. William Gray, from our offshore partner Orbis, explains in his latest quarterly report why avoiding losers (in the form of overpriced shares) can sometimes be a better way to win than going for risky potential winners (cheap shares that may turn out to be justifiably cheap).

Responsible investing

These examples describe the most common view of active portfolio management – actively constructing a portfolio of shares and other investments that aims to beat its benchmark and to make money for clients. However, we do not believe that our responsibility ends there. There is another aspect of active management that is often overlooked: shareholder activism. We take our role as custodian of your hard-earned capital very seriously. This includes engaging with company management and voting during shareholder meetings to protect your ownership interests. Grant Pitt and Pieter Koornhof explain.

You entrust us with your hard-earned savings, and we do our best to make your capital grow and contribute towards your future needs. Most of us know we should be saving more, but sacrificing today's wants for tomorrow's needs is very challenging. We are often asked how much of one's income is prudent to save for retirement. Of course this answer varies depending on your personal needs and lifestyle goals, but Wanita Isaacs provides a framework for you to think more strategically about this future event.

No matter your age or life stage, it is important to be aware of what happens to your investments when you die. And as uncomfortable as it is to confront your own mortality, it is important to create a plan that provides for the financial needs of your loved ones. To assist with the complexities, in this quarter's investing tutorial Thandi Ngwane offers a summary of the rules around estate planning for various kinds of investments.

Changes to the board

You may have read in the papers that the shareholders of Allan Gray's main operating company in South Africa and our group holding company recently approved the appointment of Mr Nhanhla Nene to both of these companies' boards, and that he has accepted these appointments. We are very happy to have someone of Mr Nene's experience on our board, and we are grateful that he chose to accept the appointment. At its best, our leadership culture is purposeful, humble and accountable, and we are proudly independent-minded. Mr Nene fits the bill on all of these and we are looking forward to his contributions to governance and strategy on our board.

Thank you for trusting us with your savings.

Kind regards

Rob Dower

MARK DUNLEY-OWEN

SOUTH AFRICAN BANKS: DO VALUATIONS SUPPORT THE RISKS?

There has been much volatility in the banking sector over the last few months: Barclays is exiting Africa, Old Mutual may be selling its stake in Nedbank, credit rating downgrades loom. So how does one think about banks as an investment – is there value to be found or should one approach with caution? Mark Dunley-Owen investigates.

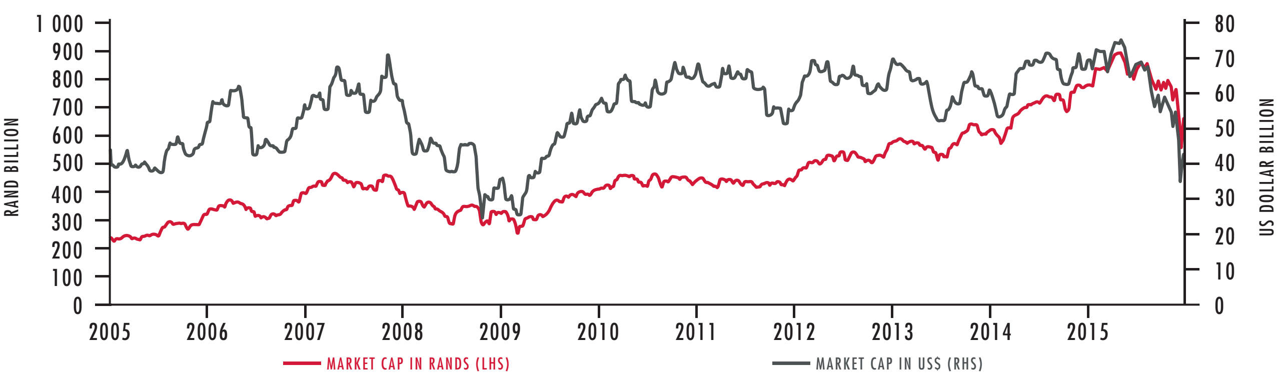
The market capitalisation of Standard Bank, FirstRand, Nedbank and Barclays Africa, South Africa's big 4 banks, peaked at just under R900bn in April 2015. As shown in **Graph 1**, it fell by R338bn or 38% in rands over the remainder of the year. In dollars, it more than halved. Macro conditions, such as low economic growth and questionable government policies, have been blamed for the fall. A better answer is to view price as equal to valuation times earnings, and to consider each of these in turn.

Valuation

The simplest explanation for the recent fall is that banks were overvalued. **Graph 2** shows the price-to-earnings (PE) multiple for the big 4 banks since 2000, the red line being the absolute PE and the grey line the banks' PE relative to the FTSE/JSE All Share Index (ALSI). In April last year the banks' absolute PE was at the top end of its range. Historically this has been a good time to sell and, in hindsight, it is unsurprising that bank share prices fell.

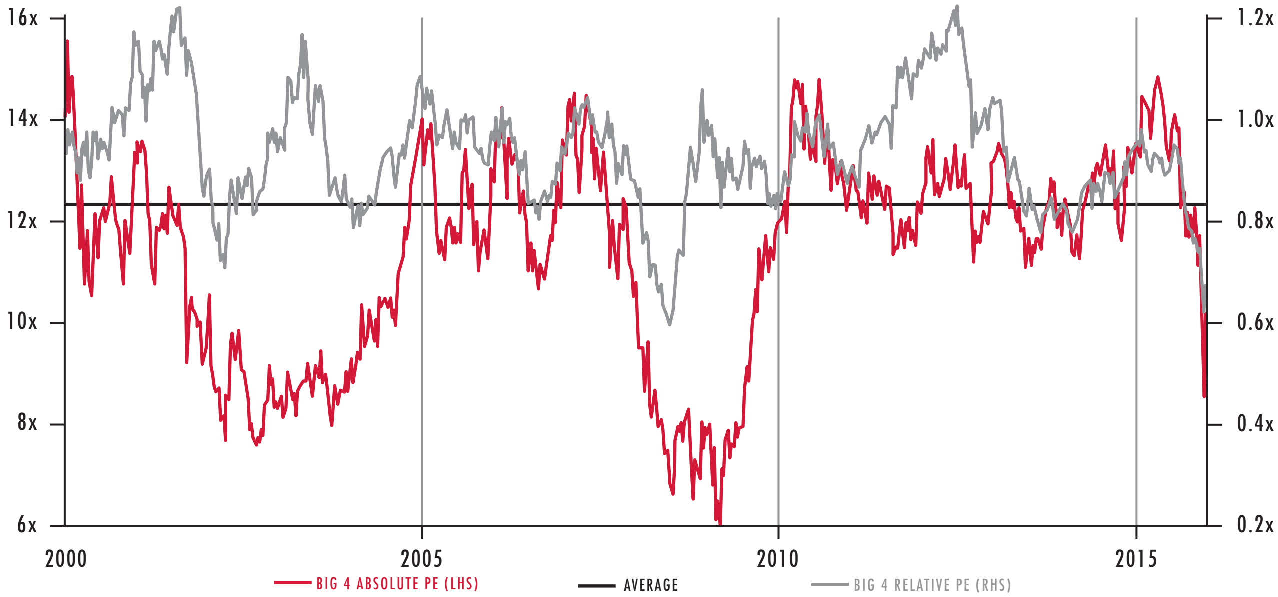
Fast forward to today, and bank valuations appear to have overreacted on the downside. In absolute terms they are approaching historic lows and relative to the ALSI they are at the global financial crisis (GFC) low. Negative sentiment linked to weakening macro conditions may have caused this overreaction, as well as uncertainty following the proposed sales of large stakes in Absa and Nedbank by their parent shareholders. We believe these are temporary headwinds and, given time, valuations

GRAPH 1 **MARKET CAPITALISATION OF SOUTH AFRICA'S BIG 4 BANKS**



Source: INet BFA

GRAPH 2 **PRICE-TO-EARNINGS (PE) MULTIPLE FOR THE BIG 4 BANKS SINCE 2000**



Source: INet BFA, Allan Gray

are likely to rise from current levels. How this will affect the prices of bank shares depends on what happens to bank earnings.

Earnings

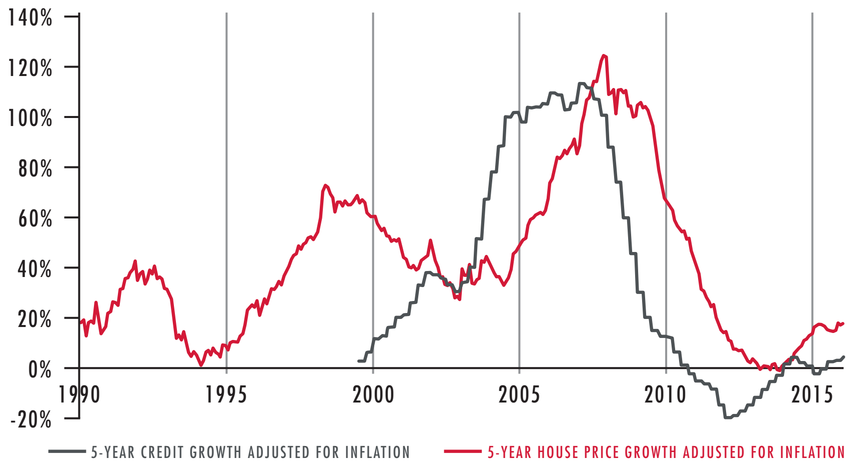
At its simplest, a bank makes money by borrowing from savers and lending to borrowers. Much of South Africa's banks' earnings thus depends on how much money they lend out, the difference between the interest rate they charge borrowers and the interest rate they pay savers, and how much of the money borrowers can't or won't repay. The first is known as their loan book, the second is the interest margin, and the third is bad debts.

It is reasonable to believe that some or all of these variables have worsened recently. But by how much? For context, during the GFC in 2009, the big 4 banks' loan book fell by 4%, their interest margin reduced by 0.55% points and their bad debts as a percentage of loans rose by 0.9%. These look like small numbers but the cumulative effect was that headline earnings of the big 4 banks fell by about a quarter in 2009.

We don't expect bank earnings to fall by the same amount as they did during the GFC: economic conditions are less extreme, and the balance sheets of South African banks are stronger today than in 2007.

History provides useful guidelines, one of which is that bank earnings fall a lot after periods of rising asset prices and debt levels. **Graph 3** shows the change in South African house prices and the change in private sector credit growth, both over five years, with inflation taken out. These graphs highlight the differences between today and the GFC. Real house prices and real private sector credit more than doubled in the five years prior to the GFC, meaning that banks entered the GFC with large loan books backed by high-priced assets. It was probable that credit growth and asset prices would revert to their long-term trend lines and, as they did, that bank earnings would fall materially.

GRAPH 3 **CHANGE IN SOUTH AFRICAN HOUSE PRICES AND THE CHANGE IN PRIVATE SECTOR CREDIT GROWTH**



Source: INet BFA, Absa, South African Reserve Bank, Allan Gray

Contrast this to today. Real house prices and private sector credit have barely grown over the last five years. Banks have made fewer loans, backed by more fairly valued assets and serviced by less indebted clients. Even if South Africa is entering another crisis, bank earnings are starting from a lower base with less downside risk.

Standard Bank's mortgage loan book illustrates this point. This doubled over the three years prior to the GFC, from R124bn to R252bn and, by 2008, the weighted average interest rate on these loans was prime minus 2.5%. From a shareholders' perspective, Standard Bank had lent out too much money too quickly at too low a margin. The subsequent poor performance of these loans confirmed this and, seven years later, this portion of Standard Bank's mortgage book is still struggling to cover its cost of funding. In contrast, Standard Bank's mortgage loan book has grown by only 30% over the seven years since the GFC, to R325bn, and the weighted average interest rate of new loans is prime *plus* 0.5%. There is more 'fat' in these recent loans, which should mean they perform better through the cycle.

"A DOWNGRADE WOULD BE NEGATIVE FOR SOUTH AFRICA, BUT WE EXPECT THE EFFECT ON SOUTH AFRICAN BANKS TO BE LIMITED."

Tail risks

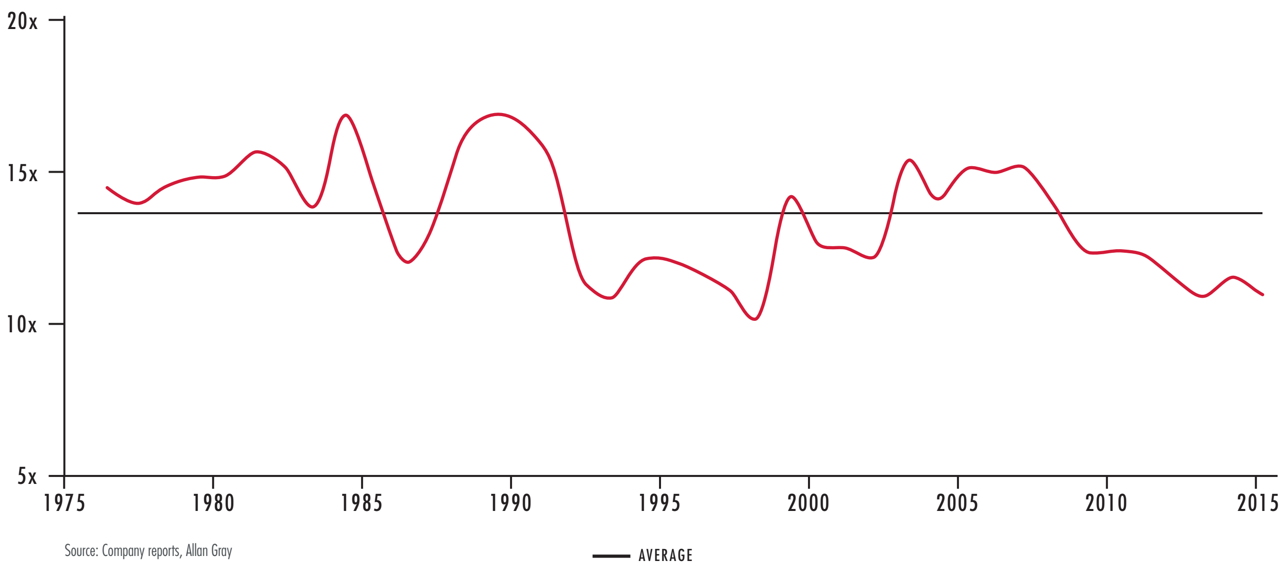
Low valuations and sustainable earnings make banks attractive investments at current prices. However, it may take some time before the market agrees with us and their share prices rise, so we also take into account tail risks, or the small chance of a big loss. Banks are geared businesses and rely on the confidence of their customers who make deposits and funders who buy their debt. This makes them particularly exposed to tail risks: the word bankruptcy is, after all, derived from the Italian 'banca rotta', meaning 'broken bank'.

The commonly mentioned tail risk is a downgrade of South Africa's sovereign rating to junk status. It seems probable that this will happen and, when it does, that less foreign money will be invested in South African assets. At best this may result in less demand and lower prices for some South African assets. At worst it could result in a loss of confidence in the South African government's ability to fund itself at reasonable rates, and a material fall in all South African asset prices.

A downgrade would be negative for South Africa, but we expect the effect on South African banks to be limited. It would not be a surprise and the banks are positioned accordingly. More importantly, our banks are more regulated today than any time in history, most notably via the international regulatory framework known as Basel III. Essentially Basel III requires banks to fund themselves with more equity and more stable debt, and invest in lower risk assets. This reduces the probability of a liquidity event (run on a bank) or insolvency (asset write-downs wipe out equity), making banks more likely to survive tail risks.

Most metrics confirm that SA banks today are less risky than they were prior to the GFC. One of the simpler risk metrics is the assets-to-equity ratio, defined as total assets divided by total equity. A high number means the bank is highly geared, with a lot of debt

GRAPH 4 **STANDARD BANK'S ASSET-TO-EQUITY GEARING**



Source: Company reports, Allan Gray

being used to fund its assets. A small drop in asset value results in a large drop in equity value. Deutsche Bank, for example, has an asset-to-equity ratio of roughly 25x. Each EUR100 of assets is funded by EUR4 of equity and EUR96 of debt. Since equity bears the first loss, a 4% loss in the value of Deutsche Bank's assets would wipe out all of its equity and result in technical insolvency.

In contrast, the asset-to-equity ratio of South Africa's big 4 banks is 11.5x, having steadily fallen since the GFC as regulation and reality has reduced risk tolerance. **Graph 4** provides a long-term perspective, showing Standard Bank's asset-to-equity ratio since 1975. Standard Bank is less geared and thus more able to absorb tail risks now than almost any time in history.

The investment case for banks

The best time to buy shares is normally when valuations and earnings are at historical lows, typically following a crisis such as the GFC. Political and economic events caused a mini crisis in the second half of 2015 and, as a result, South African bank valuations have fallen to historic lows. Earnings have not fallen, and there is a risk they may do so should conditions worsen. Despite this, South African banks are well positioned to withstand negative events and their earnings should prove resilient. This combination of low valuations and sustainable earnings makes them attractive long-term investments for our clients.

Mark joined Allan Gray in 2009 having worked at a number of international investment banks. He is one of the portfolio managers of the Allan Gray Stable Fund, the portfolio manager of the Allan Gray Bond Fund and also manages Africa ex-SA bonds.

JACQUES PLAUT

TOP QUALITY?

Richemont is one of the world's top luxury goods companies. It sells watches, jewellery, pens, clothes, and even guns. Its most well-known brand is Cartier. Jacques Plaut discusses luxury watches, brands, the luxury cycle, and the economics of Richemont.

Luxury goods

"The best things in life are free. The second best are very expensive."
– Coco Chanel

The mechanical watch industry is one of life's great mysteries. At this very moment, thousands of craftsmen are busy assembling a product that became obsolete 35 years ago. Esteemed Swiss watchmakers are dreaming up innovations like the co-axial escapement and the anti-magnetic watch, but really they might as well be building sundials and water clocks. A standard quartz watch is a hundred times more accurate than the best mechanical watch.

For a while, in the early 1980s, it looked like quartz would replace mechanical just as surely as the wristwatch had replaced the pocket watch 70 years previously. During this period, known as the quartz crisis, production moved from Switzerland to Asia and the number of Swiss watchmakers fell by 66%. Yet the mechanical watch survived, and by 1989 there were waiting lists to buy them. Today only 7% of watches are made in Switzerland – almost all mechanical – but they account for 65% of global revenues. People are willing to pay a very large premium for a technically inferior product, because it is handmade in Switzerland. In a move that seems to be pushing the bounds of irony, Swatch unveiled a low-cost, robotically produced mechanical watch in 2013. This reminds me of modern art produced in factories.

Richemont makes half its revenue from watches, and the rest mostly from jewellery. Measured in US dollars, its share price is down nearly 40% from the 2014 peak. Does this make it an attractive opportunity for our clients?

Valuing Richemont

When evaluating the business, we take into account the following factors, amongst others:

Brands

Richemont owns some very valuable brands, and faces little risk of technical obsolescence (as the quartz crisis demonstrated). Like Coke and Colgate, companies that sell branded goods often earn attractive returns on equity, and Richemont is no exception.

But luxury brands are not immune to competition, and are not guaranteed immortality. Browsing through back issues of *The Economist*, I recognise only

UNDERSTANDING TERMINOLOGY

Mechanical mechanism: a wound-up spring gradually releases energy through a series of gears.

Quartz mechanism: works with a battery and an oscillating quartz crystal.

four out of the thirteen watch companies that advertised in 1952. As recently as 1985, Watches of Switzerland ran an advert saying: "*We are one of the largest stockists of all the leading watch names, including Cartier, Ebel, Omega, and Rolex.*" Hands up if you have heard of Ebel. Or consider Aquascutum, a luxury clothing brand established in 1841, that had a royal warrant, opened a store on 5th Avenue in 1984, was mentioned alongside Burberry in 1996, and filed for Bankruptcy in 2012.

The problem with looking at the brands that exist today is 'survivorship bias': you don't see all the brands that have disappeared over the years. What's more, Cartier might be 160 years old, but for the vast majority of that history it was run as a medium-sized family business. Its history as a global mega-brand covers only about 30 years. The same is true for most luxury brands. The perfume industry in the 1990s is a classic example of competition in luxury: a proliferation of brands saw prices fall and incumbents' market share reduced. The same could happen in watches. Richard Mille is a watchmaker founded in 1999 that now makes about 4 000 watches per year and generates US$147m of revenue – no doubt some of this revenue would have gone to Cartier.

Since they meet similar needs like status and indulgence, different luxury categories compete with each other for spending. There is a risk that watches become less fashionable and the rich simply spend their luxury dollars on something else. After all, 100 years ago elaborate dance cards were luxury items. Spending on Chinese ceramics and calligraphy, stamps, art, wine, and classic cars are all growing rapidly as these categories compete for luxury spend. Not to mention smart watches, which are currently growing much faster than luxury watches.

The luxury cycle

"The Swiss watch-making industry suffers from constant crises."
The Economist, 17 April 1948.

Some businesses, such as British American Tobacco or SABMiller, have very stable revenue and margins. Luxury is not like that: it is cyclical. Cartier's margins have fluctuated over a wide range since the 1980s. It is easy to forget this and extrapolate the recent past into the future. But falling into this trap typically leads to overpaying at the top of the cycle, or selling the share too cheaply at the bottom of the cycle. At the moment, the cycle seems to be turning from strong to weak. Swiss watch exports fell by 8% in January, the weakest number since 2009. Exports to Hong Kong, one of Richemont's most important markets, were growing at a rate of 50% in 2010 but fell by 33% in January 2016. Retailers in China, like Emperor Watch & Jewellery, are rapidly building up inventory as they struggle to move stock. Luxury brands in watches, jewellery, and leather have gone for two quarters without a price increase in any region.

None of this has yet translated into a weaker profit margin in Richemont's reported results. When we calculate the normal earnings power of Richemont, we use a margin closer to what the company has been able to achieve through the cycle, not the latest, higher-than-normal reported number.

Luxury economics

At first glance, selling US$1 000 handbags and US$20 000 watches seems like the ideal business. But despite making high gross margins, Richemont has some characteristics which are not so attractive to shareholders:

- **Poor cash flow:** On average, Richemont has produced only 50c of free cash flow for every R1 of earnings the company reports. This is because it carries a large amount of very expensive inventory, which tends to be a drain on cash as volumes grow.
- **Poor capital allocation:** Richemont has been better than its luxury peers in allocating capital, and there haven't been any major disasters, but nevertheless the company has continued to support loss-making clothing and leather brands for more than a decade, sits on a very large pile of cash, and has large overhead costs.
- **A control structure:** Johann Rupert has a 9% economic interest in Richemont, but a 50% voting interest. This means management is effectively accountable to a single minority shareholder. If it should become necessary, it would be very difficult for other shareholders to bring about change at the company despite contributing 91% of the equity interest.

When we evaluate the quality of the business, we weigh these negative factors against the high margins and the low risk of technical obsolescence mentioned before.

Can you expect to see Richemont in the portfolio?

I may be a cynic about mechanical watches, but liking the product is not a requirement for owning the share: British American Tobacco, one of our clients' largest holdings, is a case in point. We have owned Richemont in the past, when we thought the price was justified by the prospects and quality of the business. If the share continues to fall, it might present us with an attractive buying opportunity.

Jacques joined Allan Gray in 2008 as an equity analyst after working as a management consultant. He began managing a portion of client equity and balanced portfolios earmarked for associate portfolio managers from March 2013 and was appointed portfolio manager in November 2015. Jacques completed his BSc degree in Mathematics at UCT.

GRANT PITT AND PIETER KOORNHOF

ACTIVELY ADDING VALUE

The trend towards passive management – where investment managers track market indices rather than pick individual stocks – has caused some to question the merits of active management. A comparison of these strategies is usually confined to portfolio construction and cost; but there is another aspect of active management that is often overlooked: shareholder activism, which includes engaging with company management and voting during shareholder meetings. Grant Pitt and Pieter Koornhof explain.

Active versus passive: beyond portfolio construction

Passive management is an investing strategy that tracks an index or portfolio. Active management is the opposite: active managers dedicate research efforts to analysing the intrinsic value of listed securities, buying those they believe are relatively cheap and avoiding those they believe are expensive, actively constructing their portfolios. But for us at Allan Gray, active management does not end there. We take our role as stewards of our clients' hard-earned savings seriously and think that proactive engagement with the board and executives of companies whose securities we have bought for our clients can result in better investment performance. These engagements can potentially shape a company into a better and more sustainable long-term financial prospect, which is likely to increase its valuation. Passive managers, on the other hand, very rarely engage with the companies in which they invest.

Engagements with companies

To give you a sense of our involvement as active managers of our clients' capital: during 2015, our analysts and portfolio managers formally engaged with company representatives on 464 occasions. These engagements typically took the form of meetings with both executives and non-executives, site visits to companies' operations, formal written correspondence and other forms of engagement such as conferences, road shows and analyst days.

During these engagements various issues were discussed, including environmental, social and governance (ESG) and sustainability issues, which we believe, if neglected, may impact a company's long-term economic success. This is because, over time, irresponsible and unsustainable conduct will weigh down on a company's earnings and therefore its valuation.

Although we always strive to engage with companies in a constructive manner, we are not afraid to challenge management if we think the circumstances warrant a more forceful approach.

To provide insight into how our engagements work in practice and how they are incorporated into our active investment process, below is an example of a stewardship activity that we have undertaken. You can also read more about our approach to responsible investing and our policy on ownership responsibilities via the 'Institutional investors' homepage of our website.

Improving executive remuneration at Sasol

We acquired a significant position in Sasol for our clients over the course of 2010 and 2011. While we considered Sasol to be an attractive investment opportunity at the time (and still do today), we thought that Sasol's executive remuneration scheme was poor and accordingly recommended that our clients vote their shares against the scheme at the 2011 annual general meeting. We had a number of concerns with the scheme at the time: the disclosure was minimal, many of the performance targets were low, the majority of the long-term incentives (LTIs) were not subject to performance conditions and simply vested over time, executives did not own shares in the company and most of the LTIs were delivered through share appreciation rights. These instruments do not provide suitable alignment with shareholders as they result in executives not sharing in downside risks if performance is disappointing and, as they are delivered in cash, it is the default outcome that executives do not own shares in the company. This lack of alignment with shareholders was especially concerning in light of the large capital projects that the company was undertaking.

We subsequently started working with Sasol's Remuneration Committee (Remco) to improve the scheme. This included detailed analysis and benchmarking of the remuneration scheme, meeting with the Remco in person on a number of occasions and further formal correspondence through letters to Sasol's board. While the scheme was still short of best practice, we recommended to our clients that they vote their shares in favour of Sasol's remuneration scheme in 2012, 2013 and 2014. We did so to recognise the progress that was being made and to give Remco a clear mandate to make further improvements to the scheme. Though it took some time for our efforts to bear fruit, the scheme has transformed dramatically over the last four years and is now close to being best in class: disclosure has been enhanced; performance targets required for incentives to vest have been made more challenging; all the LTIs are subject to stringent performance conditions and executives are formally required to build substantial shareholdings in the company. These changes go a long way towards ensuring that executives act in the long-term best interests of shareholders.

Despite the progress, we believe there is still some room left for improvement and we continue to engage with Sasol's Remco on a regular basis to ensure that the scheme keeps evolving to the benefit of shareholders. In particular, even higher shareholding requirements for executives and the use of equity-settled incentives would further improve alignment with shareholders. We also consider changes to the macro environment, such as the collapse of oil prices over the last 18 months, when thinking about appropriateness of the performance factors and targets that are used to incentivise executives.

Proxy voting

Actively engaging with management and also assisting our clients to exercise their right to vote are important components of the overall service we provide to our clients.

We provide voting recommendations for general meetings of companies which have a material weight in your portfolio and for smaller companies in which our clients collectively hold a significant percent of the company. We will always make voting recommendations which we believe at the time to be in the best interests of our clients. Over the 12 months to 31 December 2015, we made voting recommendations on 1 476 resolutions tabled at shareholder meetings of South African listed companies. We disclose these voting recommendations, together with the outcome of the shareholders' vote on each relevant resolution, quarterly on our website.

Responsible investing needs active management

Responsible investing is receiving increasing attention: globally, through the United Nations-supported Principles for Responsible Investment (PRI) Initiative, and in South Africa through the Code for Responsible Investing in South Africa (CRISA). This is positive for investment managers like us and our clients: there is no doubt that long-term sustainable returns are dependent on stable, well-functioning and well-governed social, environmental and economic systems.

Effective responsible investing depends on active investment research – to identify issues to engage management upon and to do so intelligently – and on active investment management, which allows a manager not to own companies which don't deal with their ESG challenges or which don't respond on these issues. Since they rarely address these issues and are poorly resourced to do so, passive investment managers weaken shareholders' ability to drive ESG issues with company managers, to their clients' long-term detriment.

Grant is joint head of institutional client services. He joined Allan Gray in 2009 as an investment analyst after working for several years in financial services in the UK. Grant completed his BBusSc degree at UCT and is a qualified CA (SA) and Chartered Financial Analyst.

Pieter is an analyst in the investment team and joined Allan Gray in 2013. He holds a Bachelors in Accounting from the University of Stellenbosch, an MSc in African Studies and an MBA from the University of Oxford, where he studied as a Rhodes Scholar. Pieter qualified as a CA (SA) after completing his articles at Allan Gray.

WILLIAM GRAY

PLAYING A LOSER'S GAME

The loser's game isn't especially fun to play, but it is a winning strategy for those who have the discipline and the patience for it. William Gray, from our offshore partner Orbis, explains why the same goes for investing.

Many think of investing as the pursuit of winning investments. I prefer to think of it as controlled aggression: acting with conviction while trying to avoid big mistakes, much as Charles Ellis explained more than 40 years ago in a Financial Analysts' Journal article entitled 'The Loser's Game'. He cited the work of Dr. Simon Ramo, an engineer who examined the game of amateur tennis and found that about 80% of points are decided by mistakes rather than skilled shot-making. As a result, a player's best strategy is not to try to win by hitting winners but instead to avoid mistakes and let their opponents lose by making more of them.

A sobering pattern

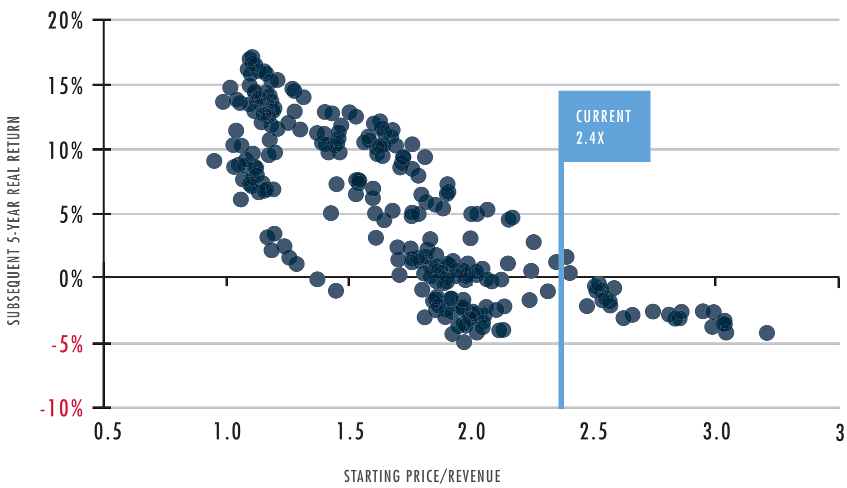
Moving beyond the analogy, the ability to avoid losers is particularly important when investors seek to produce positive inflation-adjusted returns amid high starting valuations. That is illustrated well in **Graph 1**. Each dot shows the subsequent five-year real return that investors realised when the FTSE World Index began at the starting valuation shown in the horizontal axis.

The pattern is sobering: whenever the index has started at a valuation higher than 2.4 times revenue — its current level — it has only rarely produced positive real returns over the ensuing five-year period. Of course, it could be different this time or prices could simply go higher — indeed there are some points to the right of the light blue line — but it is unlikely that a passive strategy which simply captures the average stock at the average valuation can provide investors with a fighting chance to overcome this headwind.

In recent years, as some sectors of the market have trended higher and higher, our efforts to avoid making mistakes

GRAPH 1 **HIGH STARTING VALUATIONS SELDOM LEAD TO PLEASING SUBSEQUENT RETURNS**

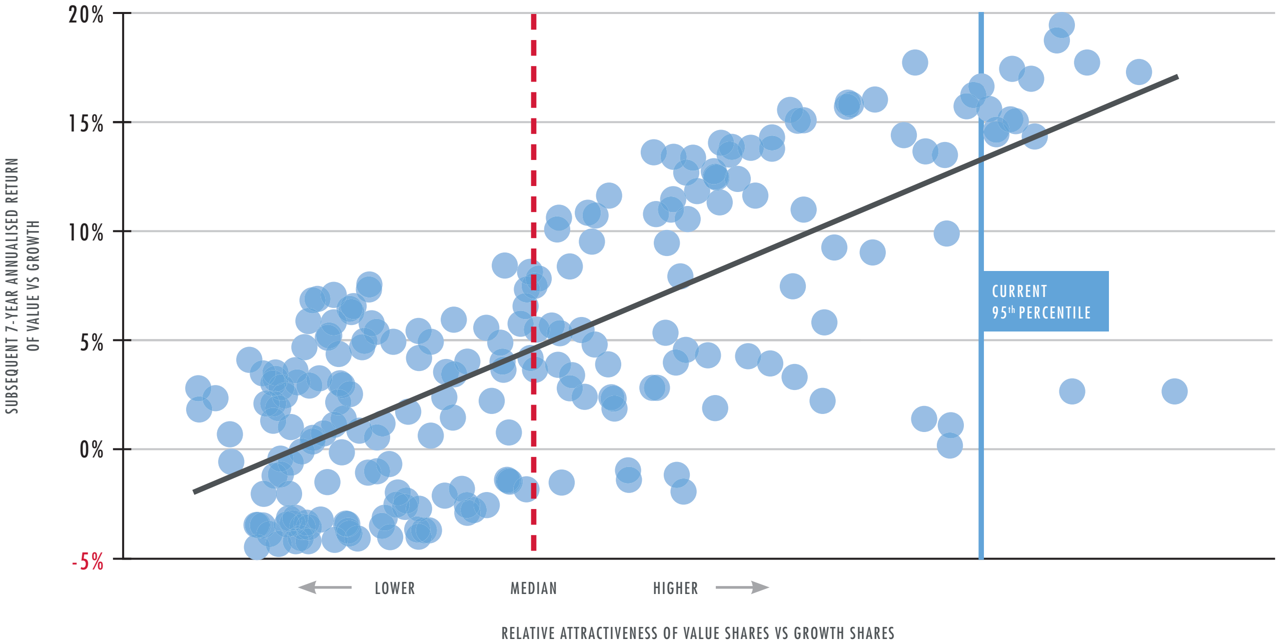
PRICE/REVENUE AND SUBSEQUENT 5-YEAR REAL RETURN OF STOCKS IN THE FTSE WORLD INDEX, MONTHLY DATA FROM 1990



Source: Orbis

GRAPH 2 **THE GULF IN ATTRACTIVENESS BETWEEN VALUE AND GROWTH SHARES IS UNUSUALLY WIDE**

RELATIVE ATTRACTIVENESS OF VALUE SHARES VS GROWTH SHARES IN THE FTSE WORLD INDEX AND SUBSEQUENT 7-YEAR ANNUALISED RELATIVE RETURN OF VALUE VS GROWTH SHARES, MONTHLY DATA SINCE 1990



Source: Orbis

have created a meaningful drag on our performance, as we have discussed in previous commentaries. This has been true, for example, of companies with stable earnings in developed markets, which are at a relative peak. From this point we are especially enthusiastic about the ability of the Orbis Global Equity Fund (the Fund) to outperform in future as a result of the larger-than-normal disparity in valuations within global stock markets. Put another way, we believe the reward for skillfully avoiding losers has increased as the dispersion of likely future returns has widened.

The value-growth gap

The horizontal axis on **Graph 2** shows a measure of the spread between the prospective return of so-called 'growth' and 'value' shares as measured by a relatively simple proprietary model. The vertical axis shows the subsequent seven-year annualised total return of value versus growth shares. The regular dispersion of the dataset around the straight diagonal line shows that there is a pretty strong, albeit imperfect, relationship between prospective return dispersions and subsequent realised returns. It also shows that at today's current value-growth gap, the opportunity to add value by avoiding some shares in favour of others is meaningfully higher than average, low prospective returns, but also playing a winner's game by investing very heavily in shares of excellent businesses with extremely compelling prospective returns and very little risk of permanent capital loss. The results produced were extraordinary, though

"THE ABILITY TO AVOID LOSERS IS PARTICULARLY IMPORTANT WHEN INVESTORS SEEK TO PRODUCE POSITIVE INFLATION-ADJUSTED RETURNS AMID HIGH STARTING VALUATIONS."

although by no means certain.

On very rare occasions the market presents investors with an opportunity to play both a 'loser's game' and a 'winner's game' at the same time, thereby presenting extraordinary opportunity. The best example of this in the Fund's history was in the year 2000 at the peak of the technology, media and telecommunications (TMT) boom. We were presented not only with the opportunity to play a loser's game by avoiding the mistake of owning technology shares with extraordinarily not before we looked foolish for a painfully long period of time leading up to that peak in 2000.

No winner's game in sight

Today we find ourselves in a similarly embarrassing position of looking foolish for a painfully long time as a result of not owning an increasingly narrow group of market leaders. But unlike the late 1990s, we do not see the opportunity to invest in a group of attractive laggards with high prospective returns and low risk of permanent capital loss. Some areas of the market such as precious metals, energy and other commodity-related shares have indeed fallen sharply and are deeply out of favour. As such, these areas are more likely than not to produce attractive returns, but in our opinion, the risk of a permanent loss of capital in those shares is also meaningful, even at today's valuations. That's because their intrinsic value is ultimately determined by a single variable — the commodity price — that is outside the control of management and inherently unpredictable. In addition, management incentives often lead to value-destructive behaviour through the cycle. In our view, these shares' prices are mostly driven by speculative rather than fundamental forces and their aggregate position size should therefore be constrained within the portfolio. Make no mistake, if we again see the opportunity to hit a winner, we would take it just as we did during the TMT boom. We just don't see it now.

Playing aggressively for winners today would involve taking much larger positions in the commodity/energy areas of the market mentioned above. For an investment management business that may well be the right thing to do given the financial incentives. But we see ourselves as pursuing a profession, and as stewards of your capital, and, for now, we prefer to focus on avoiding losers. While the opportunity set today is not as extreme as it was in the TMT era, the rewards available for simply avoiding losers appear to be well above average, and that's a distinct and refreshing change from the situation over the past five years.

William Gray is the President and a Director of the Orbis funds and Orbis Investment Management Limited. He is Orbis' Chief Investment Officer. Prior to joining Orbis Investment Management Limited in 1993, he had been an analyst with Orbis Investment Advisory Limited and with the Orbis predecessor company in Hong Kong.

WANITA ISAACS

SAVING FOR A COMFORTABLE RETIREMENT

How much is enough to save for a comfortable retirement? Wanita Isaacs unpacks the concepts of 'enough' and 'comfortable' in the context of this distant, unpredictable goal.

Rules of thumb for a comfortable versus sustainable retirement income

Behavioural scientists explain that we base most of our actions on mental shortcuts, learned through our own past experience or through commonly held beliefs: we use 'rules of thumb'.

A well-researched rule of thumb is that a retirement income equal to 75% of your final salary just before you retire will allow you to live comfortably in retirement. This figure accounts for the adjustments many people make as they age, for example, lower housing and higher medical costs.

We have written previously about a rule of thumb for ensuring a sustainable income during retirement. Based on the findings of US author and financial adviser William Bengen, and our own research, we found that if you structure your portfolio appropriately and draw a rand-based (rather than percentage-based) income that amounts to 4% of your savings at retirement, and only increase your rand amount in line with inflation each year, there is a high likelihood that your income could last for at least 30 years (see Michael Summerton's piece in Quarterly Commentary 2, 2014).

Not all widely held beliefs are good rules of thumb

The government incentivises us to save for retirement in approved retirement funds, rewarding us with tax breaks. An example of an unintended rule of thumb is using the tax-break maximum as a guide for how much is an appropriate amount to save. For years many people have used the previous maximum tax-break of 15% as a savings benchmark, which is too low to reach the recommended 75% income replacement.

This might explain why many of our living annuitants, and their financial advisers, report that 4% of their investment is not enough to fund their lifestyles. Our client research indicates that the majority of retirees already take a conservative approach to their spending, which suggests that they simply have not saved enough.

TABLE 1 **RETIREMENT SAVINGS RATES NEEDED TO ENSURE 75% REPLACE RATIO***

4% income = 75% replacement ratio if you save at:		
Age	**Percentage of salary needed (if you are starting saving for the first time)**	**Increased percentage of salary needed (if you started on 15% at age 25)**
25	17%	n/a
30	22%	17%
35	30%	18%
40	42%	21%
45	59%	22%

*Assuming retirement age of 65 years, investment return of CPI + 5% and inflation-related salary increases annually

Source: Allan Gray research

How much do you need to save for 4% to be a comfortable retirement income?

Assuming that you will be comfortable living off 75% of your pre-retirement salary, the first column in **Table 1** on page 14 shows the percentage of current salary that individuals at different ages would need to invest when starting to save for retirement for the first time. The table shows that even for a 25-year old, investing 15% of taxable income is not enough to ensure a sustainable and comfortable retirement. A safer rule of thumb is to invest *at least* 17%.

For those of us who started saving for retirement early and have been resting in the false security of investing the previous 'maximum' of 15% of our salaries, the second column shows the level to which we would need to increase our percentage of salary in order to catch up.

The new maximum tax-break of 27.5%, which came into force on 1 March 2016, is a much better benchmark, but it is still important to look at your personal needs to assess how much you should save.

Rules of thumb do not account for personal circumstances

The numbers in Table 1 are simply averages and it is important that you take your personal circumstances into account. This percentage of salary rule of thumb assumes a consistent, inflationary salary increase each year. This won't work for you if your personal inflation rate is higher than the published inflation rate (which reflects the general rise in the cost of goods and services). Your personal inflation rate rises each time you improve your lifestyle, for example moving to a bigger, more expensive house.

A spike in salary affords you those lifestyle improvements, but may set you back in your provision for retirement if you don't shift your retirement savings goalposts appropriately and allocate some of the extra cash to the future. Continuing to invest at the same percentage of your new salary won't be enough. This is because everything you invested before your salary increase accounted for your previous lifestyle; you will need to make up for the shortfall if you want your retirement income to fund your current lifestyle at that time.

"MOST OF US HAVE CONFLICTING PRIORITIES WHEN IT COMES TO AFFORDING OUR CURRENT LIFESTYLE AND SAVING FOR OUR FUTURE"

Three levers to pull to increase your retirement savings pot

Most of us have conflicting priorities when it comes to affording our current lifestyle and saving for our future. If you can't currently afford to increase your retirement savings, there are three levers to pull:

1. Prioritise your retirement savings when you get additional income. Consider either splitting each individual income boost, or alternate between improving your current lifestyle and increasing your retirement savings.

2. Delay retirement to give your investment more time to grow, both through your contributions and return on your investment.

3. Decrease your income needs in retirement by re-thinking your lifestyle priorities.

Also, remember that there are various ways you can supplement your retirement savings. It makes sense to use the tax break the government provides in approved retirement funds, such as your employer's retirement fund or an RA, but thinking this is the *only* way you can save for your retirement is another unintended, and potentially disadvantageous, rule of thumb.

You may want to consider saving in other products, such as a tax-free investment account or a basic unit trust, which give you more flexibility in terms of investment choice and access to your investment. And any paid-off assets you own, such as your house, contribute towards your retirement by decreasing your financial needs, or increasing your income in retirement.

A comfortable retirement takes careful planning

While we inherently look for mental shortcuts to make sense of the complexity of life, problems arise when we follow rules of thumb blindly. It often feels easy to take a mental shortcut when it comes to your income at retirement, but it may be better to get advice from a good, independent financial adviser. At the very least, thoroughly research and plan your next steps making sure that the shortcuts you choose to take are prudent.

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.

THANDI NGWANE

WHAT HAPPENS WHEN I DIE?

Thinking about death is uncomfortable. But, trying to rebuild your life after the death of a loved one and dealing with questions of money is a stress that nobody should have to bear. As uncomfortable as it is to confront your own mortality, it is important to create a plan that provides for the financial needs of your loved ones. Thandi Ngwane explains.

Where to begin?

A good place to start is by writing your Will, if you haven't already done so. You can do this yourself by downloading a standard template or with the help of your bank, attorney or financial adviser. Then make sure you understand the rules around estate planning and the claims process for your existing investments. There are some products that are specifically geared towards estate planning: familiarise yourself with what is available.

Products with estate planning advantages

Tax-free investments

Tax-free investments, which allow you to save up to R30 000 per year and pay no tax on interest, capital gains and dividends have estate planning advantages if they are structured as a life policy, as is the case with the Allan Gray Tax-Free Investment (TFI). You may nominate beneficiaries when you open your account. Your chosen beneficiaries will receive the proceeds of your TFI once Allan Gray is notified of your death. TFIs form part of your estate duty calculation, but there are no executor's fees and your beneficiaries get the money immediately.

Endowments

An endowment is an investment policy that caters for investors with a marginal income tax rate higher than 30%, and it is also a useful estate planning tool. This is quite a complex product in that it doesn't have to come to an end when you die and it allows you to make various nominations:

As the person investing in the Allan Gray Endowment, you will be known as the *policyholder*, or the owner of the investment. You can then make nominations, depending on your estate planning needs.

You must decide who should be the '*life assured*'. The life assured is the person on whose life the endowment is issued. You can be the life assured, or you can nominate other people. The endowment comes to an end when the last life assured dies.

You can also nominate *beneficiaries* to receive the investment. The beneficiary (or beneficiaries) for proceeds will receive the money from the investment when the last life assured dies. Your money will be paid out directly – i.e. the beneficiaries do not need to wait for the estate to be wound up. No executor's fees will be paid on this amount, but it will form part of the estate for the calculation of estate duty.

If no beneficiaries are nominated, your investment will be paid out to the estate and executor's fees may apply.

Retirement products

A key difference between pre-retirement products (like pension, provident, preservation and retirement annuity funds) and post-retirement products (like living annuities) is in how the death benefit is distributed: in pre-retirement products, the final decision rests with the trustees of the retirement fund, whereas in a living annuity you decide who receives the payout.

Pension funds, provident funds, preservation funds and retirement annuity funds

The Pension Funds Act applies to all retirement funds and it states that the trustees of a retirement fund are responsible for allocating your benefits if you die before you retire. Trustees are required to perform the following three duties:

1. **Identify and find all of your dependants.** Dependants are defined as spouses, children, anyone proven to be financially dependent on you at the time of death, anyone entitled to maintenance, as well as anyone who may in future become financially dependent on you.

2. **Decide how to divide the benefit based on an investigation.** Your chosen 'nominees' will also be taken into account. A nominee is any party whose details you provided to your retirement fund in writing indicating that they should be considered by the trustees along with all the other qualifying dependants, for example, a dependant, or a person who is not a dependant, such as a friend. A nomination does not guarantee that the person will receive all, or a part, of the benefit.

3. **Decide how the benefit will be paid,** for example, whether payment will be made directly to a dependant, to a legal guardian of a minor dependant, or a trust for the benefit for such dependant.

Although trustees aim to complete the process as quickly as possible, the Act gives them at least a year to search for dependants, and the process may take longer to finalise, for example when the deceased member left behind more than one family unit. During this time the benefit is held in a money market fund.

There are various options available to dependants and nominees in terms of how they can receive their benefit. They can 1) transfer their benefit to a living or guaranteed life annuity, 2) take a cash lump sum (from which tax may be deducted) or 3) take a combination of a cash lump sum (from which tax may be deducted) and a living or guaranteed life annuity.

Living annuity

When you retire from your retirement fund you have the option of transferring your investment to a product that can provide you with an income in retirement, such as a living or guaranteed life annuity. One of the key features of a living annuity is that your investment can be left to your beneficiaries. This contrasts to guaranteed life annuities that usually end when you die.

The death benefit from a living annuity is paid out to your nominated beneficiary(ies) and can be taken as a lump sum payment, transferred to another living annuity or a combination of both. A cash payment triggers tax, although the first R500 000 may be tax free.

Other products

Unit trusts

Unit trust investments do not require a beneficiary and the proceeds of your investment go to your estate when you die, which may mean that it is subject to estate duty. The South African Revenue Service charges a duty of 20% on estates valued above R3.5 million (after allowable deductions), which is subject to change from time to time according to legislation. The executor of your estate will distribute all your assets, including your unit trust investment, according to the provisions of your Will.

Offshore investments

Foreign-currency investments via the Allan Gray offshore platform can be dealt with locally in the estate under a South African executorship. Your investment will not be subject to the administrative complications of estates law in offshore jurisdictions or require the appointment of an offshore executor, as is the case with many offshore-domiciled investments.

Top tips for estate planning

1. **Keep your Will up to date.** Your Will gives you the opportunity to decide what should happen to your estate assets after your death. If you die without a Will, the laws of intestate succession will apply.
2. **Keep the beneficiaries of your endowments, TFI and living annuities up to date.** This will ensure that the intended beneficiaries receive speedy payment of their benefits.
3. **Keep your nominees' details on your retirement funds up to date.** This will enable the trustees to consider your wishes during their investigation into your circle of dependants at the time of your death.
4. **Plan for immediate needs.** Immediate needs, like funeral costs, may need money that your loved ones will not be able to access from your investments in time.
5. **Talk to your beneficiaries, dependants and nominees.** Half the task is preparing a plan, but it is just as important that you share your plan with the people who need to know. Make sure that they know the documents they will have to produce and complete after your death to make the process as seamless as it can be. You can find details about the required documents for our products on allangray.co.za

Investments are only one part of your estate planning. You might have other assets (such as property), as well as debt that also need to be accounted for in a holistic plan. A financial adviser can help you create a plan that works for you.

TABLE 1 **AN OVERVIEW OF WHAT HAPPENS WITH DIFFERENT INVESTMENT PRODUCTS WHEN YOU DIE**

Investment	Who gets the payout?	Does it form part of the estate duty calculation?	Is it subject to executor's fees?
Endowment	Your beneficiary for proceeds receives payment after the death of the last life assured.	Yes	No
Living annuity	Your nominated beneficiary receives the payment.	No	No
Retirement funds	The trustees of your retirement fund decide on how your benefit will be paid to your dependants / nominees.	No	No
Tax-free investment	Your nominated beneficiary receives the payout.	Yes	No
Unit trusts	Unit trusts pay out to your estate.	Yes	Yes
Offshore platform	Pays out to your estate.	Yes	Yes

Source: Allan Gray

Thandi joined Allan Gray in 2008. She is a senior member of the distribution team having previously worked in legal and compliance and marketing in the financial services sector. Thandi completed her Masters of Business Law at the University of KwaZulu-Natal, has an advanced CFP from the University of the Free State and is an admitted attorney.

NOTES

ALLAN GRAY BALANCED AND STABLE FUND ASSET ALLOCATION AS AT 31 MARCH 2016

	BALANCED FUND % OF PORTFOLIO			STABLE FUND % OF PORTFOLIO		
	TOTAL	SA	FOREIGN*	TOTAL	SA	FOREIGN*
Net equities	60.1	47.2	12.9	27.2	20.6	6.7
Hedged equities	9.9	1.4	8.5	22.1	8.4	13.8
Property	1.4	0.8	0.6	2.6	2.0	0.6
Commodity-linked	5.1	5.0	0.1	4.2	4.1	0.1
Bonds	12.4	10.8	1.6	13.2	11.4	1.7
Money market and bank deposits	11.2	9.2	2.0	30.7	28.6	2.0
TOTAL	**100.0**	**74.3**	**25.7**	**100.0**	**75.1**	**24.9**

Note: There might be slight discrepancies in the totals due to rounding.
* This includes African ex-SA assets.

ALLAN GRAY EQUITY FUND NET ASSETS AS AT 31 MARCH 2016

SECURITY (RANKED BY SECTOR)	MARKET VALUE (R MILLION)	% OF FUND	FTSE/JSE ALSI WEIGHT (%)
SOUTH AFRICA	**34 750**	**87.6**	
SOUTH AFRICAN EQUITIES	**33 658**	**84.8**	
RESOURCES	**8 172**	**20.6**	**17.2**
Sasol	3 459	8.7	
Sappi	653	1.6	
Goldfields	536	1.4	
African Rainbow Minerals	440	1.1	
Glencore	429	1.1	
Harmony	419	1.1	
Impala Platinum	406	1.0	
Positions less than 1%	1 830	4.6	
FINANCIALS	**11 645**	**29.4**	**22.6**
Standard Bank	2 794	7.0	
Old Mutual	2 146	5.4	
Reinet SCA	1 301	3.3	
Investec	870	2.2	
Rand Merchant Investment[1]	806	2.0	
Capitec	597	1.5	
Nedbank	584	1.5	
Barclays Africa	465	1.2	
FirstRand	415	1.0	
MMI	358	0.9	
Positions less than 1%	1 310	3.3	
INDUSTRIALS	**13 645**	**34.4**	**60.2**
British American Tobacco	2 621	6.6	
Naspers[2]	2 158	5.4	
Remgro	1 301	3.3	
SABMiller	1 088	2.7	
Super Group	570	1.4	
KAP Industrial	515	1.3	
Netcare	392	1.0	
Life Healthcare	361	0.9	
Blue Label Telecoms	359	0.9	
Aspen	348	0.9	
Positions less than 1%	3 933	9.9	
OTHER SECURITIES	**196**	**0.5**	
Positions less than 1%	196	0.5	
COMMODITY-LINKED SECURITIES	**546**	**1.4**	
Positions less than 1%	546	1.4	
MONEY MARKET AND BANK DEPOSITS	**546**	**1.4**	
FOREIGN EX-AFRICA	**4 656**	**11.7**	
EQUITY FUNDS	**3 542**	**8.9**	
Orbis Global Equity Fund	3 542	8.9	
MONEY MARKET AND BANK DEPOSITS	**1 114**	**2.8**	
AFRICA EX-SA	**267**	**0.7**	
EQUITY FUNDS	**267**	**0.7**	
ALLAN GRAY AFRICA EX-SA FUND	267	0.7	
TOTALS	**39 672**	**100.0**	

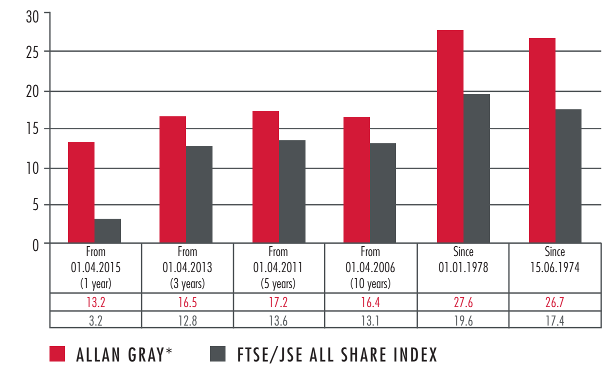
Note: There might be slight discrepancies in the totals due to rounding. Positions less than 1% include positions that are individually less than 1% of total JSE-listed equities, property and commodity-linked instruments held by the Fund.
[1] Including positions in Rand Merchant Investment stub certificates.
[2] Including positions in Naspers stub certificates.

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 15.6)	- 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
2014	16.2	10.9	5.3
2015	7.8	5.1	2.7
2016 (to 31.03)	9.5	3.9	5.6

RETURNS ANNUALISED TO 31.03.2016



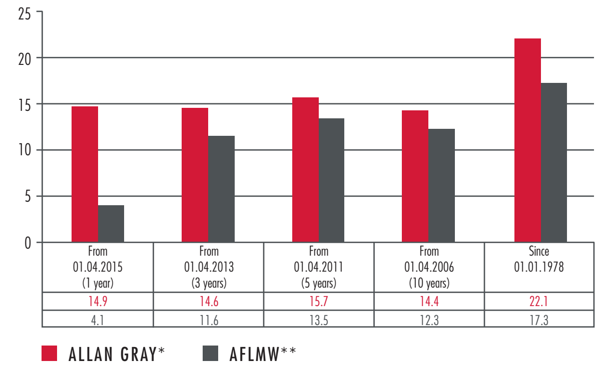
An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R194 964 771 by 31 March 2016. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R8 117 280. Returns are before fees.

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	23.3	1.7
2014	10.3	10.3	0.0
2015	12.8	6.9	5.9
2016 (to 31.03)	5.2	1.5	3.7

RETURNS ANNUALISED TO 31.03.2016



An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R20 776 023 by 31 March 2016. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R4 512 869. Returns are before fees.

* 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.
** 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 March 2016 is an estimate.
Note: Listed property included from 1 July 2002. Inward listed included from November 2008 to November 2011.

ALLAN GRAY SOUTH AFRICAN UNIT TRUSTS ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 31 MARCH 2016 (NET OF FEES)

	ASSETS UNDER MANAGEMENT (R BILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR	HIGHEST ANNUAL RETURN[4]	LOWEST ANNUAL RETURN[4]
HIGH NET EQUITY EXPOSURE (100%)									
Allan Gray Equity Fund (AGEF) Average of South African - Equity - General category (excl. Allan Gray Funds)[1]	**39.7**	**01.10.1998**	**24.9** 17.5	**13.6** 12.9	**14.5** 13.2	**13.5** 12.2	**9.4** 1.3	**125.8** 73.0	**– 20.7** – 37.6
Allan Gray-Orbis Global Equity Feeder Fund (AGOE) FTSE World Index	**15.6**	**01.04.2005**	**16.0** 14.8	**15.0** 14.3	**23.7** 24.0	**24.3** 24.6	**19.2** 17.1	**78.2** 54.2	**– 29.7** – 32.7
MEDIUM NET EQUITY EXPOSURE (40% - 75%)									
Allan Gray Balanced Fund (AGBF) Average of South African - Multi Asset - High Equity category (excl. AGBF)[2]	**115.4**	**01.10.1999**	**18.6** 13.6	**13.0** 10.8	**14.4** 12.3	**13.6** 11.2	**14.0** 5.7	**46.1** 41.9	**– 8.3** – 16.7
Allan Gray-Orbis Global Fund of Funds (AGGF) 60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index	**12.7**	**03.02.2004**	**12.2** 12.4	**14.0** 14.6	**21.3** 22.1	**21.5** 22.1	**24.8** 21.7	**55.6** 38.8	**– 13.7** – 17.0
LOW NET EQUITY EXPOSURE (0% - 40%)									
Allan Gray Stable Fund (AGSF) Daily interest rate of FirstRand Bank Limited plus 2%	**38.1**	**01.07.2000**	**13.1** 9.1	**10.5** 8.3	**11.1** 6.7	**10.6** 6.8	**14.9** 7.4	**23.3** 14.6	**3.3** 6.2
VERY LOW NET EQUITY EXPOSURE (0% - 20%)									
Allan Gray Optimal Fund (AGOF) Daily interest rate of FirstRand Bank Limited	**1.2**	**01.10.2002**	**8.5** 6.5	**7.9** 6.1	**7.6** 4.6	**9.7** 4.7	**9.9** 5.3	**18.1** 11.9	**1.6** 4.1
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO) Average of US$ bank deposits and euro bank deposits	**1.4**	**02.03.2010**	**12.5** 10.2	**–** –	**17.5** 14.6	**17.9** 14.9	**30.0** 24.9	**39.6** 35.6	**– 8.4** – 7.8
NO EQUITY EXPOSURE									
Allan Gray Bond Fund (AGBD) JSE All Bond Index (total return)	**0.5**	**01.10.2004**	**8.7** 8.3	**8.0** 7.5	**7.8** 7.8	**5.1** 4.0	**2.0** – 0.6	**18.0** 21.2	**– 2.6** – 5.6
Allan Gray Money Market Fund (AGMF) Alexander Forbes Short-term Fixed Interest (STeFI) Composite Index[3]	**12.6**	**03.07.2001**	**8.0** 8.0	**7.4** 7.3	**5.9** 5.8	**6.1** 6.0	**6.8** 6.6	**12.8** 13.3	**5.2** 5.2

[1] Since inception to 28 February 2015 the benchmark was the FTSE/JSE All Share Index including income.
[2] Since inception to 31 January 2013 the benchmark was the market value-weighted average return of the funds in both the Domestic Asset Allocation Medium Equity and Domestic Asset Allocation Variable Equity sectors of the previous ASISA Fund Classification Standard, excluding the Allan Gray Balanced Fund.
[3] Since inception to 31 March 2003, the benchmark was the Alexander Forbes 3-Month Deposit Index. From 1 April 2003 to 31 October 2011 the benchmark was the Domestic Fixed Interest Money Market Collective Investment Scheme sector excluding the Allan Gray Money Market Fund.
[4] This is the highest or lowest consecutive 12-month return since inception. All rolling 12-month figures for the Fund and the benchmark are available from our Client Service Centre on request.

ALLAN GRAY TOTAL EXPENSE RATIOS AND TRANSACTION COSTS FOR THE 3-YEAR PERIOD ENDING 31 MARCH 2016

	FEE FOR BENCHMARK PERFORMANCE	PERFORMANCE FEES	OTHER COSTS EXCLUDING TRANSACTION COSTS	VAT	TOTAL EXPENSE RATIO	TRANSACTION COSTS (INCL. VAT)	TOTAL INVESTMENT CHARGE
Allan Gray Equity Fund	1.36%	0.74%	0.01%	0.29%	2.40%	0.05%	2.45%
Allan Gray-Orbis Global Equity Feeder Fund	1.49%	0.60%	0.06%	0.00%	2.15%	0.15%	2.30%
Allan Gray Balanced Fund	1.07%	0.34%	0.02%	0.13%	1.56%	0.07%	1.63%
Allan Gray-Orbis Global Fund of Funds	1.28%	0.57%	0.07%	0.00%	1.92%	0.18%	2.10%
Allan Gray Stable Fund	1.03%	0.51%	0.02%	0.15%	1.71%	0.07%	1.78%
Allan Gray Optimal Fund	1.00%	0.72%	0.02%	0.24%	1.98%	0.14%	2.12%
Allan Gray-Orbis Global Optimal Fund of Funds	1.00%	0.68%	0.07%	0.00%	1.75%	0.16%	1.91%
Allan Gray Bond Fund	0.25%	0.27%	0.02%	0.07%	0.61%	0.00%	0.61%
Allan Gray Money Market Fund	0.25%	N/A	0.00%	0.04%	0.29%	0.00%	0.29%

The total expense ratio (TER) is the annualised percentage of the Fund's average assets under management that has been used to pay the Fund's actual expenses over the past three years. The TER includes the annual management fees that have been charged (both the fee at benchmark and any performance component charged), VAT and other expenses like audit and trustee fees. Transaction costs (including brokerage, Securities Transfer Tax [STT], STRATE and FSB Investor Protection Levy and VAT thereon) are shown separately. Transaction costs are a necessary cost in administering the Fund and impact Fund returns. They should not be considered in isolation as returns may be impacted by many other factors over time including market returns, the type of financial product, the investment decisions of the investment manager and the TER. Since Fund returns are quoted after the deduction of these expenses, the TER and transaction costs should not be deducted again from published returns. As unit trust expenses vary, the current TER cannot be used as an indication of future TERs. A higher TER ratio does not necessarily imply a poor return, nor does a low TER imply a good return. Instead, when investing, the investment objective of the Fund should be aligned with the investor's objective and compared against the performance of the Fund. The TER and other funds' TERs should then be used to evaluate whether the Fund performance offers value for money. The sum of the TER and transaction costs is shown as the total investment charge.

FOREIGN DOMICILED FUNDS ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 31 MARCH 2016 (NET OF FEES)

	ASSETS UNDER MANAGEMENT (R BILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR	HIGHEST ANNUAL RETURN[4]	LOWEST ANNUAL RETURN[4]
HIGH NET EQUITY EXPOSURE									
Orbis Global Equity Fund	**100.1**	**01.01.1990**	**19.1**	**15.2**	**23.7**	**24.1**	**19.2**	**87.6**	**– 47.5**
FTSE World Index			14.0	14.3	24.1	24.6	17.6	54.2	– 46.2
Orbis SICAV Japan Equity (Yen) Fund	**22.4**	**01.01.1998**	**15.6**	**11.4**	**24.3**	**21.4**	**18.7**	**94.9**	**– 40.1**
Tokyo Stock Price Index			9.6	8.9	22.5	22.8	15.6	91.0	– 46.4
Orbis SICAV Asia Ex-Japan Equity Fund	**41.2**	**01.01.2006**	**17.2**	**17.0**	**19.5**	**19.0**	**13.1**	**58.6**	**– 34.2**
MSCI Asia Ex-Japan Index			15.3	15.0	16.8	17.0	7.0	60.1	– 39.7
Allan Gray Africa ex-SA Equity Fund	**3.1**	**01.01.2012**	**14.4**	-	-	**0.7**	**– 14.2**	**65.7**	**– 24.3**
Standard Bank Africa Total Return Index			6.6	-	-	– 2.0	– 7.3	33.5	– 29.4
Allan Gray Australia Equity Fund	**10.4**	**04.05.2006**	**16.1**	-	**18.2**	**11.5**	**20.2**	**99.5**	**– 55.4**
S&P/ASX 300 Accumulation Index			14.0	-	16.2	11.2	10.9	55.6	– 45.1
MEDIUM NET EQUITY EXPOSURE									
Orbis SICAV Global Balanced Fund	**27.5**	**01.01.2013**	**26.1**	-	-	**22.5**	**21.4**	**54.4**	**2.3**
60% MSCI World Index with net dividends reinvested and 40% JP Morgan Global Government Bond Index			24.7	-	-	22.3	22.1	40.2	7.1
LOW NET EQUITY EXPOSURE									
Allan Gray Australia Opportunity Fund	**1.1**	**01.07.2011**	**17.3**	-	-	**11.1**	**28.4**	**32.7**	**– 6.1**
Reserve Bank of Australia cash rate			13.2	-	-	8.1	24.9	28.8	– 5.3
VERY LOW NET EQUITY EXPOSURE									
Orbis Optimal SA Fund-US$ Class	**14.2**	**01.01.2005**	**12.6**	**12.5**	**18.9**	**19.1**	**28.1**	**48.6**	**– 15.7**
US$ Bank Deposits			10.8	10.6	17.0	17.3	22.0	57.9	– 25.6
Orbis Optimal SA Fund-Euro Class	**8.7**	**01.01.2005**	**10.7**	**11.5**	**14.4**	**15.1**	**34.3**	**44.1**	**– 19.2**
Euro Bank Deposits			8.8	9.9	12.1	12.4	28.8	40.2	– 20.9

[4] This is the highest or lowest consecutive 12-month return the Fund has experienced since inception, along with the benchmark performance for the corresponding period. All rolling 12-month figures for the Fund and the benchmark are available from our Client Service Centre on request.

SOUTH AFRICAN INSTITUTIONAL PORTFOLIOS[5] ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 31 MARCH 2016

	ASSETS UNDER MANAGEMENT (R BILLION)[6]	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR
LOCAL PORTFOLIOS[7] (BEFORE LOCAL FEES)							
Domestic Equity Composite (minimum net equity 75% - 95%)	62.1	01.01.1990	21.2	16.0	15.8	15.1	10.9
Domestic Equity Pooled Portfolio (minimum net equity 95%)	6.2	01.02.2001	22.5	16.2	16.4	15.7	11.3
FTSE/JSE All Share Index			14.8/15.6	13.1	13.6	12.8	3.2
Domestic Balanced Composite	16.4	01.01.1978	22.3	14.1	13.5	12.6	12.1
Domestic Balanced Pooled Portfolio	2.7	01.09.2001	19.0	14.3	13.7	12.5	12.1
Mean of Alexander Forbes SA Large Manager Watch (Non-Investable)[8]			17.6/15.6	12.1	11.7	9.8	3.0
Domestic Stable Composite	5.5	01.12.2001	13.5	10.8	9.3	9.6	12.0
Domestic Stable Pooled Portfolio	1.3	01.12.2001	13.8	10.9	9.3	9.7	12.3
Alexander Forbes Three-Month Deposit Index plus 2%			10.0	9.2	7.7	7.8	8.4
GLOBAL PORTFOLIOS[7], LIMITED TO 25% FOREIGN EXPOSURE (BEFORE LOCAL, BUT AFTER FOREIGN FEES)							
Global Balanced Composite	80.3	01.01.1978	22.1	14.4	15.7	14.6	14.9
Global Balanced Pooled Portfolio	13.9	01.09.2000	19.3	14.5	15.8	14.7	15.1
Global Balanced (RRF) Portfolio[13]	24.4	01.09.2000	19.3	14.5	15.8	14.7	14.9
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[8,9]			17.3/14.7	12.3	13.5	11.6	4.1
Global Stable Composite	6.8	15.07.2004	13.4	11.5	12.1	11.8	16.1
Global Stable Pooled Portfolio	6.0	15.07.2004	13.4	11.6	12.2	11.8	16.0
Alexander Forbes Three-Month Deposit Index plus 2%			9.2	9.2	7.7	7.8	8.4
Global Absolute Composite	10.4	01.03.2004	16.6	13.7	12.7	12.6	16.5
Global Absolute Pooled Portfolio	3.4	01.03.2004	16.8	14.0	12.6	12.5	16.2
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[8]			15.6	12.3	13.5	11.6	4.1
FOREIGN ONLY PORTFOLIOS[7] (AFTER FEES)							
Orbis Global Equity Fund[10]	100.1	01.01.1990	19.1	15.2	23.7	24.1	19.2
Orbis Global Equity Pooled Portfolio	0.7	18.05.2004	15.6	15.2	23.7	24.1	19.0
FTSE World Index			14.0/14.4	14.3	24.1	24.6	17.6
Foreign Balanced Composite[11]	5.7	23.05.1996	15.0	13.3	20.3	19.5	23.2
Foreign Balanced Pooled Portfolio	0.5	23.01.2002	9.3	13.3	20.2	19.6	23.7
60% of the MSCI World Index[12] and 40% of the JP Morgan Global Government Bond Index			12.7/8.3	14.5	21.9	21.8	21.8

PERFORMANCE AS CALCULATED BY ALLAN GRAY

[5] The composites not listed here include: Domestic Balanced Absolute, Domestic Balanced Low Equity, Domestic Balanced Stable Namibia, Domestic Equity MSCI SA, Domestic Equity Namibia, Domestic Money Market, Domestic Optimal, Domestic Equity (Restricted), Domestic Equity Unit Trust, Domestic Tax Paying, Global Balanced High Foreign, Global Balanced Namibia 35% High Foreign, Global Tax Paying, Non Discretionary Foreign.

[6] The assets under management for institutional portfolios not listed here amount to R74.6bn.

[7] The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate.

[8] The return for the period ending March 2016 is an estimate as the relevant survey results have not yet been released.

[9] Since inception to 31 December 1997 the Consulting Actuaries Survey returns were used.

[10] The total assets under management for the Fund is shown, which includes institutional and retail clients that invest directly with Orbis.

[11] Since inception to 31 August 2001 the foreign carve-out returns of the Global Balanced Composite were used.

[12] Morgan Stanley Capital International All Country World Index.

[13] The returns prior to 1 August 2015 are those of the Allan Gray Life Global Balanced Portfolio.

IMPORTANT INFORMATION FOR INVESTORS

Allan Gray Unit Trust Management (RF) Proprietary Limited (the 'Management Company') is registered as a management company under the Collective Investment Schemes Control Act 45 of 2002, in terms of which it operates unit trust portfolios under the Allan Gray Unit Trust Scheme, and is supervised by the Financial Services Board ('FSB'). Allan Gray Proprietary Limited (the 'Investment Manager'), an authorised financial services provider, is the appointed investment manager of the Management Company and is a member of the Association for Savings & Investment South Africa (ASISA). Collective Investment Schemes in Securities (unit trusts or funds) are generally medium- to long-term investments. Except for the Allan Gray Money Market Fund, where the Investment Manager aims to maintain a constant unit price, the value of units may go down as well as up. Past performance is not necessarily a guide to future performance. The Management Company does not provide any guarantee regarding the capital or the performance of its unit trusts. Funds may be closed to new investments at any time in order for them to be managed according to their mandates. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending.

PERFORMANCE

Performance figures are for lump sum investments with income distributions reinvested. Where annualised performance is mentioned, this refers to the average return per year over the period. Actual investor performance may differ as a result of the investment date, the date of reinvestment and dividend withholding tax. Movements in exchange rates may also be the cause of the value of underlying international investments going up or down. The Equity, Balanced, Stable and Optimal funds each have more than one class of units and these are subject to different fees and charges. Unit trust prices are calculated on a net asset value basis, which is the total market value of all assets in the Fund including any income accruals and less any permissible deductions from the Fund, divided by the number of units in issue. Forward pricing is used and fund valuations take place at approximately 16:00 each business day. Purchase and redemption requests must be received by 14:00 each business day to receive that day's price. Unit trust prices are available daily on www.allangray.co.za. Permissible deductions include management fees, brokerage, Securities Transfer Tax (STT), auditor's fees, bank charges and trustee fees. A schedule of fees, charges and maximum commissions is available on request from the Management Company.

BENCHMARKS

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UNDERSTANDING THE FUNDS

Investors must make sure that they understand the nature of their choice of funds and that their investment objectives are aligned with those of the Fund/s they select.

The Allan Gray Equity, Balanced, Stable and rand-denominated offshore funds may invest in foreign funds managed by Orbis Investment Management Limited, our offshore investment partner.

A feeder fund is a unit trust that invests in another single unit trust which charges its own fees. A fund of funds is a unit trust that invests in other unit trusts, which charge their own fees. Allan Gray does not charge any additional fees in its feeder fund or funds of funds.

The Allan Gray Money Market Fund is not a bank deposit account. The Fund aims to maintain a constant price of 100 cents per unit. The total return an investor receives is made up of interest received and any gain or loss made on instruments held by the Fund. While capital losses are unlikely, they can occur if, for example, one of the issuers of an instrument defaults. In this event investors may lose some of their capital. To maintain a constant price of 100 cents per unit, investors' unit holdings will be reduced to the extent of such losses. The yield is calculated according to the applicable ASISA Standards. Excessive withdrawals from the Fund may place it under liquidity pressure; if this happens withdrawals may be ring-fenced and managed over a period of time.

ADDITIONAL INFORMATION FOR RETIREMENT FUND MEMBERS AND INVESTORS IN THE TAX-FREE INVESTMENT ACCOUNT, LIVING ANNUITY AND ENDOWMENT

The Allan Gray Retirement Annuity Fund, the Allan Gray Pension Preservation Fund and the Allan Gray Provident Preservation Fund are all administered by Allan Gray Investment Services Proprietary Limited, an authorised administrative financial services provider and approved under s13B of the Pension Funds Act as a benefits administrator. The Allan Gray Tax-Free Investment Account, Allan Gray Living Annuity and the Allan Gray Endowment are underwritten by Allan Gray Life Limited, also an authorised financial services provider and licensed under the Long-Term Insurance Act 52 of 1998. The underlying investment options of the Allan Gray individual life and retirement products are portfolios of Collective Investment Schemes in Securities (unit trusts or funds).

NOTES

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Directors

Executive

M Cooper	BBusSc FIA FASSA
R W Dower	BSc (Eng) MBA
I S Liddle	BBusSc (Hons) CFA
T Mhlambiso	AB MBA JD

Non-Executive

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T J Mahuma	BA (Hons) MPhil
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