



QUARTERLY COMMENTARY **1**
31 MARCH 2010

ALLAN GRAY

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Rob Dower

Comments from the Chief Operating Officer

In a recent GrayIssue, our monthly electronic newsletter, we noted that a significant portion of the Allan Gray Equity Fund's outperformance came from protecting investors' capital during downturns in the market. Since the Equity Fund's inception (as at end 2009), the market has experienced 31 'up quarters' and 14 'down quarters'. During the up quarters, the Fund beat its benchmark just less than half the time, while it outperformed the benchmark in all 14 of the down quarters. Our investment philosophy and process put a lot of emphasis on preserving capital.

Against this background, we feature in this issue the case for two shares which have attracted our analysts' attention. Andrew Lapping explains why Sasol is our preferred resource share. He points out that the oil price in rands is the most important driver of Sasol's earnings and argues that there are good reasons for this to increase. If the oil price remains close to or exceeds R600 per barrel, which is where things are as I write this, Sasol is trading at about 10 times earnings: an attractive multiple for a business like Sasol, more so in the current market. This is followed by Ruan Stander's contribution on Sanlam, where he makes sense of a very complicated business with a few critical points on performance. Ruan notes that the 'back to basics' strategy of Sanlam group chief executive Johan van Zyl is bearing fruit.

We do not often launch new unit trust funds, so the recently completed first quarter of 2010 was notable for the introduction of the Allan Gray-Orbis Global Optimal Fund of Funds. It brought our total number of unit trusts to nine and filled the 'offshore low-risk' space in our risk-profiled range of such trusts. We have been aware since the launch of the Allan Gray-Orbis Global Fund of Funds in 2004 and the Global Equity Feeder Fund a year later that we did not have a rand-denominated offshore fund that caters for investors who wish to invest offshore and do not want to have a significant exposure to equities. The persistent strength of the rand and the uncertainty in global equity markets have made the investment case for a low-risk offshore fund even stronger. Our Global Optimal Fund of Funds now meets that need.

In a further article, Jeanette Marais looks at the role of independent financial advisers in helping you to become a better long-term investor. We previously examined the role of Allan Gray and your role as an investor in improving your investment outcome. In this piece, Jeanette analyses how the best independent financial advisers have the ability and experience to help investors make choices that suit their circumstances and help them stay the course.

In the next few months we will be saying goodbye to Johan de Lange, who is leaving Allan Gray to join our Chairman, Simon Marais, at the Orbis Australia office in Sydney after nine years heading up our retail division. Under Johan's principled leadership the division has flourished, now serving more than a hundred thousand clients with a simple and sensible range of products.

Continuity in leadership is a key theme for us and the reigns of the retail business will remain firmly in the hands of Rob Formby, Jeanette Marais and Richard Carter (all of whom have contributed and are profiled in this QC). I have great confidence that they will continue Johan's legacy in leading the retail business in a way that puts our clients' needs first.

I do hope you will find these and other contributions in this first Quarterly Commentary issue of 2010 both stimulating and useful.

Kind regards

Rob Dower



Andrew Lapping

Why Sasol is our preferred resource share

EXECUTIVE SUMMARY: Sasol's share price has fared poorly over the past year compared to the 28% appreciation of the FTSE/JSE All Share Index (ALSI). Going forward, Sasol will be a good investment if the rand oil price remains close to, or exceeds R600 per barrel. Andrew Lapping explains why, at its current price, Sasol is Allan Gray's preferred resource share.

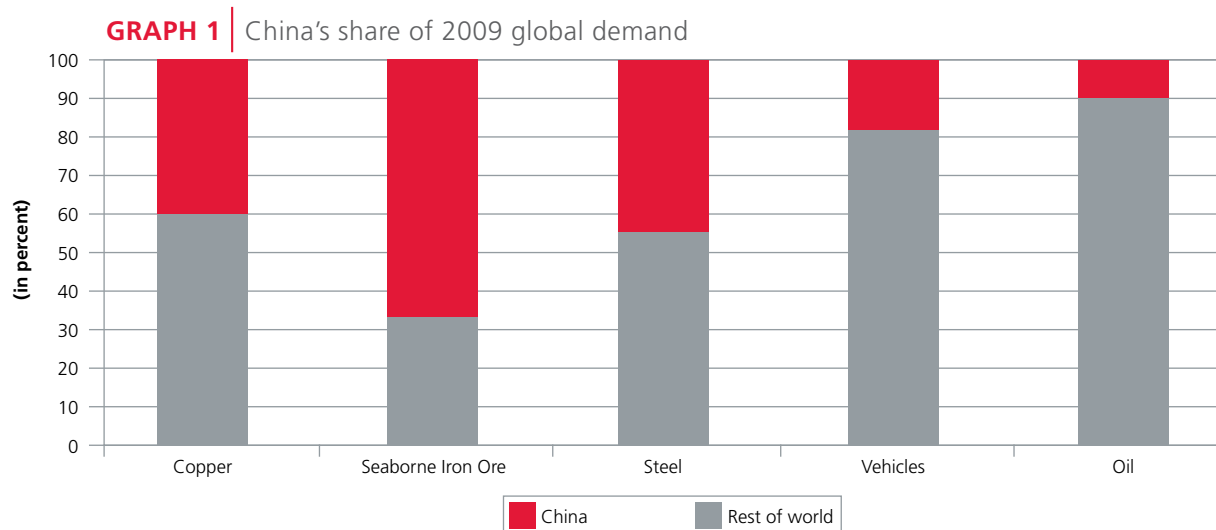
The Sasol share price disappointed over the past year, returning 6% compared to the 28% appreciation of the ALSI. Numerous factors influence a share price, but we believe that the primary reason for the underperformance was that the market priced too much positive sentiment into the share in late 2008 and early 2009. Attitudes towards Sasol are now a little different and investor sentiment is possibly too negative.

The oil price in rands is the most important driver of Sasol's earnings. Herein lay the primary disappointment, with the price falling by more than half from June 2008. While revenues declined, Sasol's costs continued to escalate at rates in excess of inflation, reducing margins. Going forward, Sasol should be a good investment if the rand oil price remains close to, or exceeds, R600 per barrel. At this oil price, Sasol is trading at about 10 times earnings.

In a normal environment where we believe the average company listed on the JSE should trade at about 11.5 times earnings, a Price to Earnings (PE) ratio of 10 for a company like Sasol is an attractive proposition. Furthermore, in the current environment where we are finding very few shares trading below 11.5 times earnings based on our normal earnings calculation, a PE of 10 for Sasol is particularly attractive.

The normal oil price

As noted above, the most important variable in calculating Sasol's normal earnings is the rand oil price. We use a normal rand oil price of R600 per barrel. Below I will discuss some of the reasons why we use R600; I will also explain why potential Chinese demand leads us to a generally positive view on the oil price, especially in relation to other industrial commodities.



Increasing production costs

A good starting point when deciding on a normal price is the 10-year average. The oil price has averaged R500 per barrel in real terms over the past ten years, 17% below our normal price of R600. One of the reasons why we use a higher normal price is that, across the world, cost escalation in extractive industries has exceeded Consumer Price Inflation (CPI) by about 6% per year over the past decade. If the rand oil price is deflated by an index representing the actual cost inflation experienced in the resource industry, the 10-year average is above R600.

Increases in costs exceeded CPI over the past decade as the 20-year commodity bear market prior to 2003 forced companies to cut costs aggressively. This led to an under-investment in skills and resource development. When the cycle finally turned and resource businesses tried to ramp up production, many found they did not have the people or the production equipment to do so. This led to a rapid escalation in staff costs and maintenance expenditure.

Production response

The oil price first exceeded US\$60 in August 2005; at the time, this was considered a high enough price to encourage rapid supply growth. However, since 2005, non-OPEC oil

supply has only grown by a cumulative 1.7%. OPEC oil supply has increased but almost all the spare capacity is in the hands of Saudi Arabia. A low oil price is not in the Saudis' best interests as oil is a finite resource and, as a sensible resource owner, they will maximise the net present value of the resource by not selling oil at what they consider a low price. Interestingly, even \$80 does not seem to be resulting in much of a supply response.

China and the commodity markets

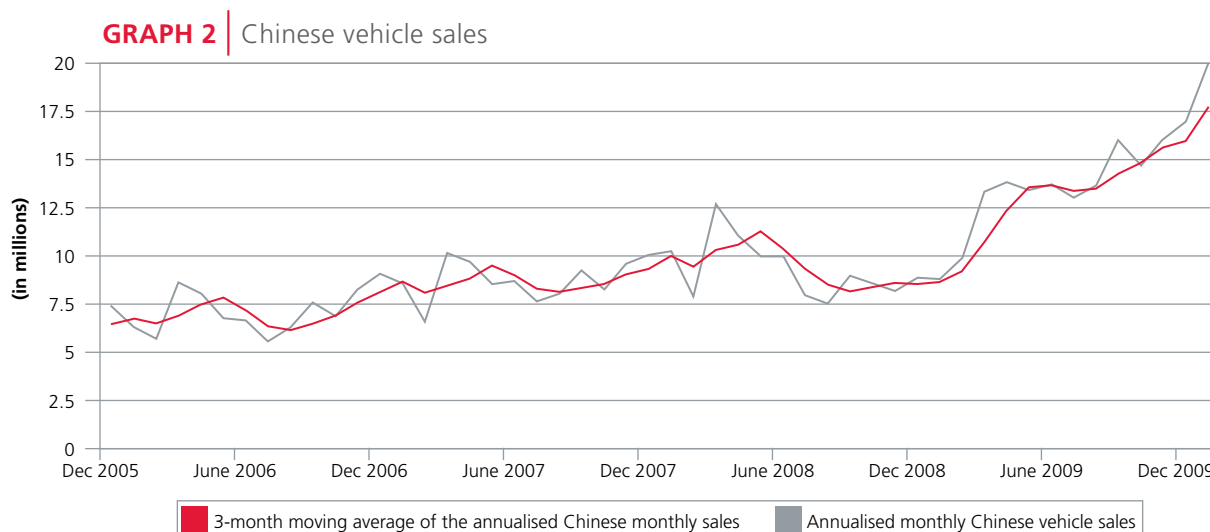
Graph 1 shows how over the past decade China was pretty much the only show in town for most industrial commodities.

Consider copper, where Chinese demand growth was 22% per year while demand in the rest of the world declined by 2% per year. The combined effect was global growth of 2.5% per year and a very tight copper market.

The story is similar in seaborne iron ore where, since 1999, Chinese demand increased from 55 million tons (mt) to 623mt while demand from the rest of the world declined from 347mt to 314mt.

Most commodity analysts expect Chinese iron ore demand to be about one billion tons by 2015. Fortunately, the strong demand and consequent high prices have led to record levels of investment in iron ore production so there should be sufficient ore available to meet the forecast Chinese demand.

“... over the past decade China was pretty much the only show in town for most industrial commodities.”



We do not know whether Chinese iron ore demand will grow by 60 to 70mt per year for the next five years. Nevertheless, an investor can be fairly sure that the 'China Effect' is priced into the iron ore producers, as both production growth and prices high enough to stimulate rapid supply growth are discounted in the share prices.

Contrast the iron ore market with the oil market where China accounts for only 10% of demand and current oil prices are not sufficient to stimulate rapid supply growth.

The outlook for oil demand in China is positive. **Graph 2** (on page 3) shows that in 2009, 13.6 million vehicles were sold in the country, which was a 48% increase on 2008 sales. Sales over the past three months increased to an annualised rate of 17.5 million units. For context, global vehicle sales were 75 million in 2009, China thus accounted for 18% of vehicle demand but only 10% of oil demand. It follows that, as the Chinese consumer becomes wealthier, more people will drive cars and oil consumption will increase. The government is spending enough money on infrastructure to ensure there are sufficient roads available for the rapidly growing fleet of cars.

Sasol relative to other commodity producers

Sasol is our preferred resource share because of relative commodity prices and the impact of Chinese demand on these commodities. The share prices of diversified mining

companies have substantially priced in the China story so the possibility for upside surprise in these stocks is limited. However, if Chinese growth does not meet expectations or if commodity prices fall once supply exceeds demand, the downside to earnings and valuations could be severe. Conversely, the oil price and oil shares have not felt the full impact of Chinese demand growth and seem to have more downside support as producers are not generating super profits and the oil price is not far above the marginal cost of production.

Normal margins check

To check if normal earnings forecasts are reasonable, it is important to look at the historic margins of the business. If the forecast margin is well above or well below the historic norm, one should question the assumptions on which the forecast is based. Excluding the Olefins and Surfactants (O&S) business, Sasol's operating margin has averaged 28% since 1997. The R600bbl forecast yields a 25% margin, which seems reasonable. (O&S has been excluded as it is a low margin, high revenue business that was only acquired in 2003 and distorts the numbers slightly.)

“The oil price in rands is the most important driver of Sasol's earnings.”

Conclusion

We believe Sasol is an attractively-priced share with good upside potential relative to a market that has priced in aggressive earnings growth assumptions.

Andrew joined Allan Gray as a fixed interest trader, later moving to the research team. He soon became a fixed interest portfolio manager and subsequently has taken on both equity and balanced portfolio responsibilities.



Ruan Stander

Sanlam justifies heavy weighting

EXECUTIVE SUMMARY: The recent financial crisis was a stark reminder of the impact that management has on the wellbeing of a financial services business. With complex products and flexible capacity, a short-term focus is more tempting than in other industries. Shareholders are easily fooled by complex dynamics reflected in aggregate numbers and the real cost of growth is often revealed only much later. The evidence of sensible long-term focused management at Sanlam, combined with an attractive margin of safety, justifies its large weighting in our clients' portfolios.

The focused 'back to basics' strategy is working and bodes well for the future

The South African life insurance industry is mature, with 12.5% of our GDP received in premiums annually¹. Only Taiwan (12.9%) and the United Kingdom (12.8%) exceed this percentage. Within this context shareholders are best served by management not pursuing aggressive growth strategies, but focusing rather on the basics:

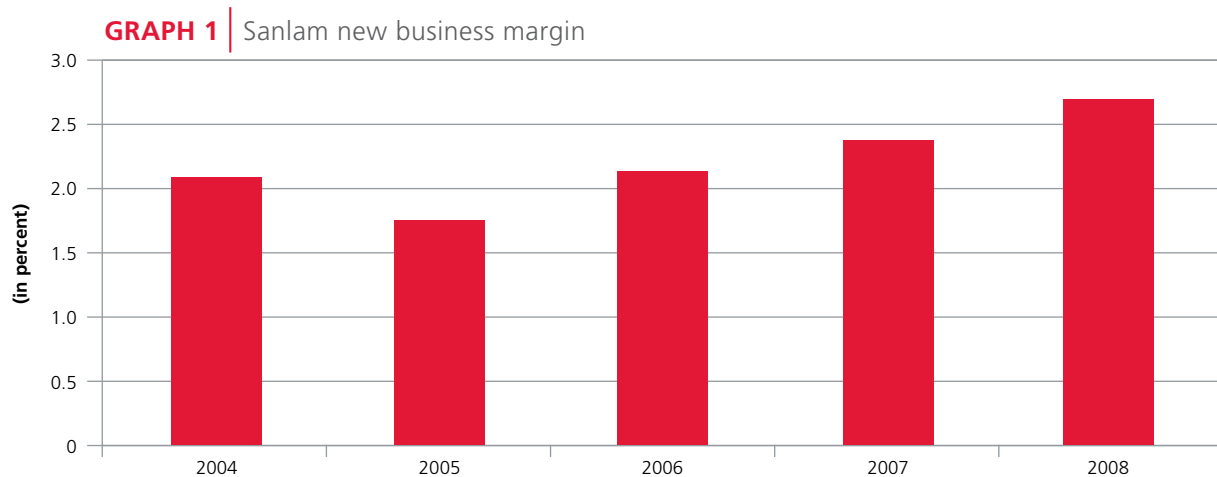
1. Careful pricing
2. Retaining clients
3. Managing costs

Sanlam group chief executive Johan van Zyl is well known for his focused 'back to basics' strategy. This strategy is now bearing fruit and bodes well for long-run shareholder returns.

1. Careful pricing

Unlike other industries, the cost of an insurance product at point of sale is not known because statistical estimates such as life expectancy and client retention influence the total cost of a policy. With prices based on uncertain future costs, in the search for growth, companies can be tempted to buy market share - finding data to justify charging less. Sanlam's focus on return on capital causes them to view any product as a project that should deliver a high enough Internal Rate of Return (IRR) on its own to justify its existence after taking distribution costs into account and adjusting for risk. This focus has created steadily increasing profitability. It should also protect the business from the temptation of chasing volume in the future. One indicator of pricing discipline is the estimated margin that the business makes at the point of sale on newly sold products. This estimated margin has been increasing in recent years as shown in **Graph 1**.

¹ Swiss Re. [sigma](#). World insurance in 2007: emerging markets leading the way, No.3/2008



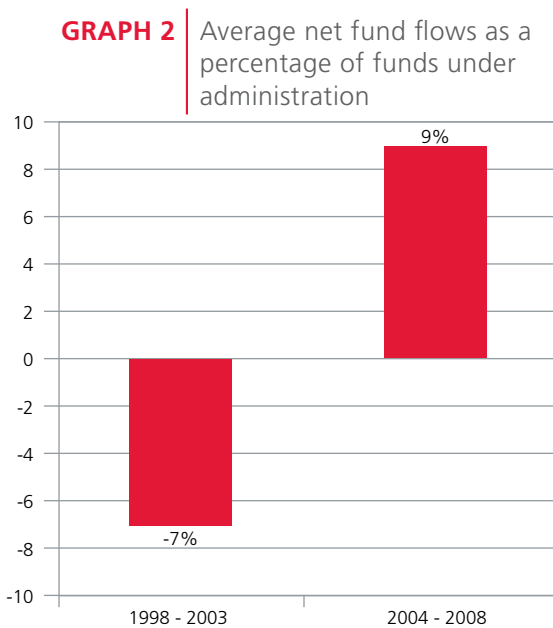
Source: Sanlam annual reports

2. Retaining clients

Life insurance is capital intensive if upfront sales commissions to financial advisers are considered as capital expenditure. For a pure life insurance policy these upfront costs can be as high as the first year's premiums received from a customer. Retaining existing customers is therefore an attractive alternative compared with acquiring new business from competitors.

A good way to retain clients is to make sure that you take on the right ones from the start. Sanlam use a statistical model to screen potential savings-policy clients for the probability that the product is suitable for them and that it justifies their upfront costs in buying the policy.

Sanlam's focus on retention has effectively turned around net fund flows, with for example, the Sanlam Personal Finance division now retaining 46% of policy maturities within the group. **Graph 2** shows how the group's net client cash flows have improved over the last five years. The graph shows the difference between inflow of funds and outflow of funds for the group as a whole as a percentage of average assets administered and excludes the effect of market movements.



Source: Allan Gray research

3. Managing costs

Until 1998, Sanlam was run as a mutual company. Within this corporate structure there was never sufficient incentive

to control costs because policyholders owned the company. After demutualisation in 1999 the strategic focus of the business was on expansion into other industries, not on costs. Corporate strategy started focusing on the cost structure when Johan van Zyl took over in 2003. Since then, the business has reduced costs in real terms with the same number of people administering more premiums.

Graph 3 reflects how administration costs have been declining relative to the value of premiums administered. These savings are even more significant in light of start-up costs (expensed in the income statement) for establishing significant new operations:

- Sanlam Developing Markets (provides insurance to the entry level market in South Africa, other parts of Africa and India)
- Sanlam Glacier (upper middle market financial services)
- MiWay (direct insurer)

Although this does not form part of our investment case, it is reasonable to expect future cost savings due to the development of synergies within the group over time. An example of this is the shared administration between Sanlam and its 57% owned subsidiary Santam.

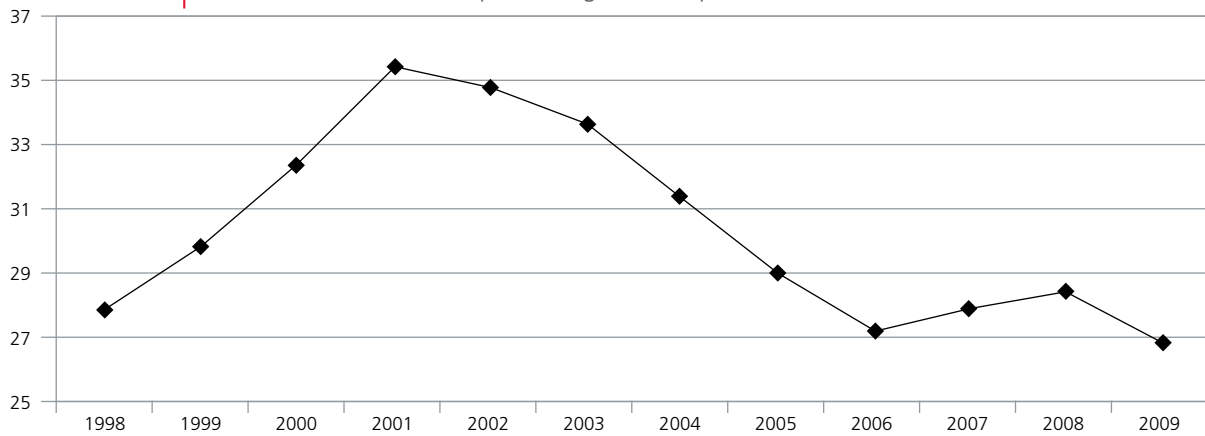
Valuation

The value of a life insurance business is made up of two parts: equity and the insurance business. Instead of buying plants and machinery, shareholders' equity is required by the regulator to back the possible fluctuation in claims on its insurance book. Insurers provide a self-evaluation of their business called Embedded Value, with Sanlam reporting a valuation called Group Equity Value (GEV). The valuation of the insurance book attempts to capture all future cash-flows including an allowance for taxes, central costs and a charge for shareholders putting their capital at risk. Although we always approach valuations from a variety of perspectives, Sanlam's stated GEV is used as a reference point in **Graph 4**.

We believe Sanlam's GEV valuation is conservative relative to our market because:

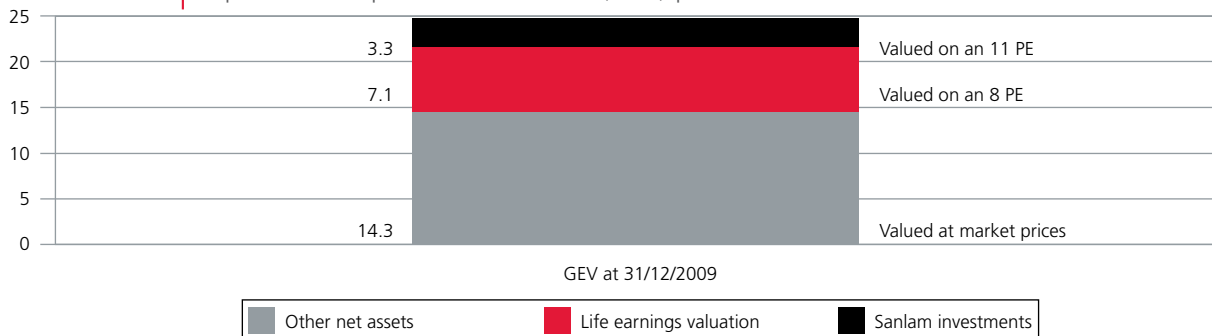
- The valuation of the life business includes only the book of existing business while Sanlam has written profitable new business for at least 10 years.
- Sanlam's insurance earnings are of a higher quality than those of its competitors since it capitalises less point of sale commissions and, in spite of this, it is effectively valued at only eight times earnings after allowing for

GRAPH 3 | Administration costs as percentage of net premiums received



Source: Allan Gray research

GRAPH 4 | Reported Group Embedded Value (GEV) per share



Source: Allan Gray research

head office costs. The FTSE/JSE All Share Index is trading on a PE of 17 times.

- Sanlam's investment division is valued at 11 times 2009 earnings while the low contribution of performance fees in this year and the cash generative nature of an asset manager should justify a higher valuation.
- Sanlam's management is incentivised by the return achieved on the GEV valuation and thus it is not in their interest to overstate historical valuations.

A significant position for Sanlam in our clients' portfolios

Although there are various risks such as further market penetration of unit trusts and a consumer-friendly regulator threatening the listed life insurers, the long-term focused management at Sanlam and an attractive margin of safety justifies a significant position for Sanlam in our clients' portfolios.

Ruan has two years experience at Allan Gray as a quantitative and equity analyst. He has an Honours degree majoring in Financial and Actuarial Mathematics.



Richard Carter

Launch of the Allan Gray-Orbis Global Optimal Fund of Funds

EXECUTIVE SUMMARY: Allan Gray introduced its third rand-denominated offshore fund on 1 March 2010 bringing the total number of unit trusts to nine. The Allan Gray-Orbis Global Optimal Fund of Funds fills the 'offshore low-risk' space in our risk-profiled range of unit trusts. While we are aware that too much choice hampers an investor's decision-making ability, it has been evident since we launched the Global Fund of Funds in 2004 and the Global Equity Feeder Fund in 2005 that we do not have a rand-denominated offshore fund that caters for investors who wish to invest offshore but do not want to have a significant exposure to equities as an asset class. The persistent strength of the rand and the uncertainty in global equity markets has made the investment case for a low-risk offshore fund even stronger.

Our risk-profiled range of rand-denominated offshore funds

The three Allan Gray-Orbis Global funds all share certain characteristics.

The funds invest in one or more of the Orbis funds registered for marketing in South Africa. Orbis is Allan Gray's global asset management partner. The two companies share a common founder, investment philosophy and ethos.

An investor who uses his or her offshore allowance can buy foreign currency and invest directly into an Orbis fund. Investors who do not want to use their offshore allowance can invest in an Allan Gray-Orbis rand-denominated fund. The three different Allan Gray-Orbis Global funds invest in different underlying Orbis funds, or into the same funds but with different levels of exposure, thus achieving quite different risk and return profiles. This article focuses on the newest addition to the range, the Global Optimal Fund of Funds, which has a typical net equity exposure of between 0 and 20%, compared to a range of 40-75% net equity exposure for the Global Fund of Funds, or near 100% for the Global Equity Feeder Fund.

Investors should note that, because of foreign exchange control regulations, the amount Allan Gray can invest into

the Orbis funds is restricted, and therefore there may be times when the rand-denominated offshore funds are closed to new investments.

Safer than equities, better than cash

The Allan Gray-Orbis Global Optimal Fund of Funds aims to achieve a higher rate of return than cash, with a high degree of capital stability in 'hard' currencies. To achieve these objectives, the Fund invests in a mix of the Orbis Optimal SA US\$ Fund and Orbis Optimal SA Euro Fund.

The Fund is managed by Ian Liddle from Allan Gray, while the underlying funds are managed by Orbis. The Orbis Optimal SA funds were launched in January 2005, based on Orbis' successful absolute return strategy in running hedged portfolios since 1990. The funds seek capital appreciation on a low-risk global portfolio by investing in a focused portfolio of selected global shares which Orbis believes should provide relative outperformance in the long term.

Orbis then uses stock market hedging to reduce the exposure to equity markets and hence the risk of loss on the portfolio.

The nature of returns

The strategy employed by the Fund is best explained by looking at the nature of the returns likely to be generated.

“(The Fund) was created for investors who wish to invest in a low-risk global portfolio,”

1. Exchange rate

The two funds are exposed to US dollars and euros respectively. The rand exchange rate relative to the dollar and the euro over time will affect the returns of the Fund. The euro versus dollar exposure will be defined largely by the benchmark.

Graph 1 shows the rand against the US dollar for the last 30 years.

2. Bank deposit returns in euros / dollars

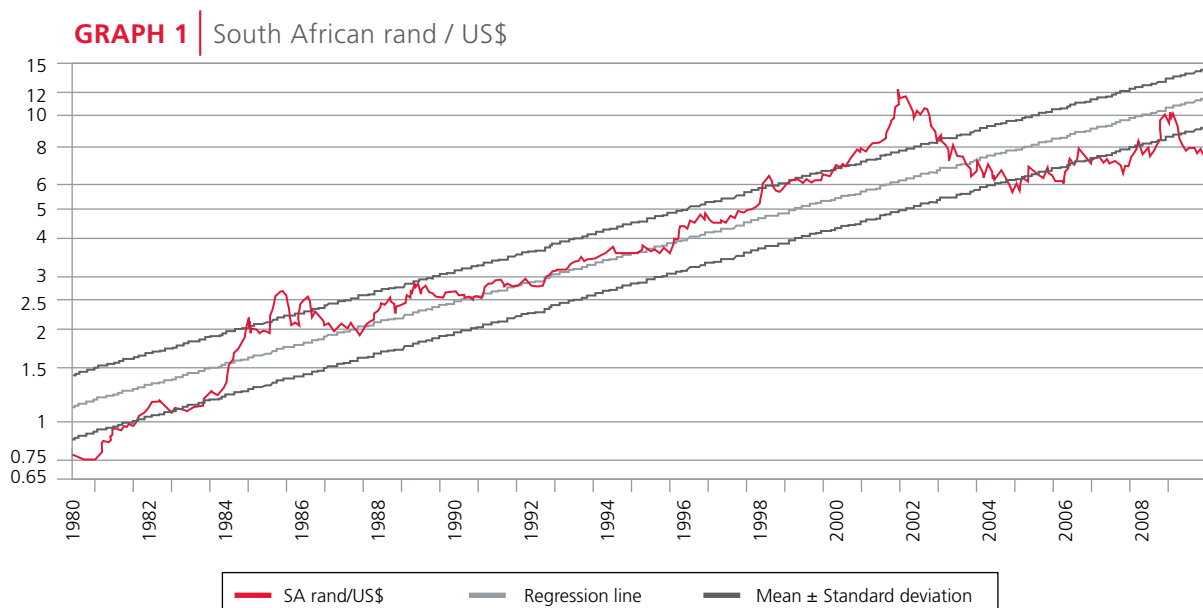
Selling stock market index futures contracts yields a return that is approximately the same as the prevailing return on cash. The underlying Optimal funds' expected returns are largely the return on cash, plus whatever value Orbis can add from stock picking (see point 3). Global interest rates are presently close to zero; historically, this has not been the case. For the 10-year period ending February 2010, US dollar bank deposits have been as high as 6.7% and have averaged 3% per annum. In the current near-zero interest rate environment, investors in the underlying funds rely almost entirely on Orbis' stock picking skill as the source of returns. The implication is two fold: absolute returns are likely to be lower than during periods of higher interest rates and there could be periods in which the Fund produces negative returns. The likelihood of negative absolute returns diminishes as global interest rates rise.

When thinking about absolute returns what is really important is the extent to which the Fund's returns are higher than inflation. The low level of interest rates reflects, to a large extent, low global inflation rates. So while nominal returns might be lower, real returns might not be.

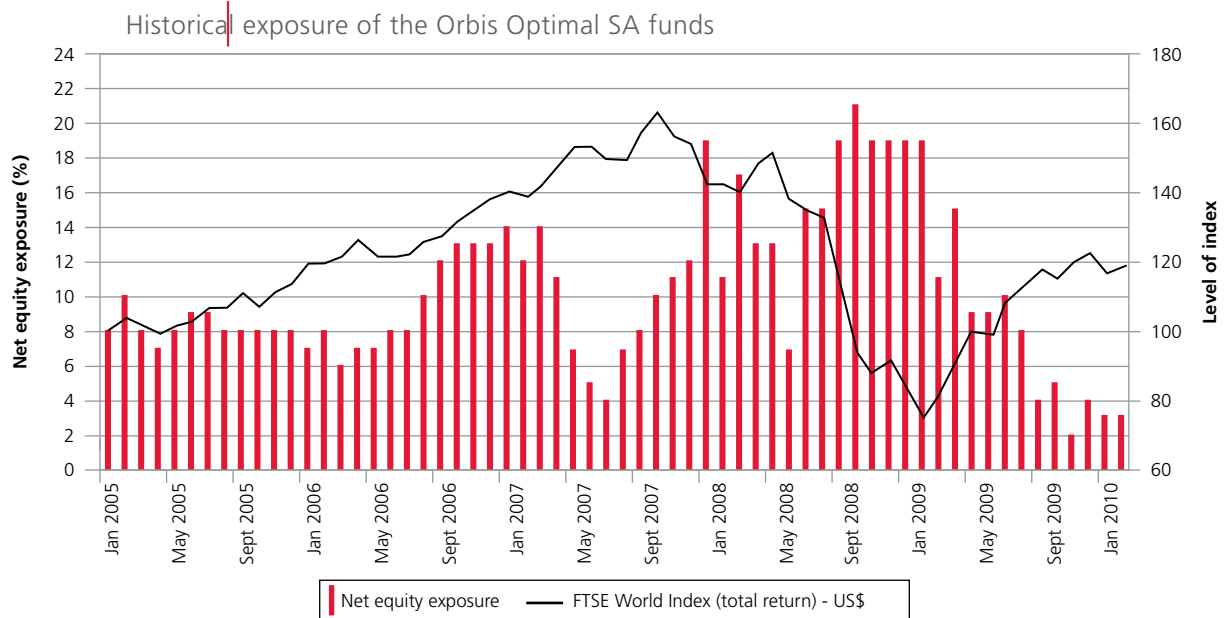
3. Value added (or subtracted) by Orbis' stock picking ability

Exchange rates and interest rates may be beyond Orbis or Allan Gray's control but our commitment to produce pleasing long-term returns on behalf of investors will never waiver. Like Allan Gray, Orbis looks for shares considered to offer superior fundamental value. Since the global universe is much larger than the 318 listed shares on the main board of the JSE, Orbis maintains a database of 13 000 of the world's most marketable stocks. Quantitative techniques are applied to this information, some extending back over 35 years, to identify promising equities. From there, intensive qualitative research is done from a 'bottom-up' basis, considering a three- to five-year time horizon. Fundamentally attractive shares are then combined into a focused portfolio for the Fund.

The Fund maintains a substantial core level of hedging to reduce the risk of the prices of its equities declining as a result of a fall in stock markets. Orbis carefully selects stock market based derivatives that are expected to make the Fund's returns



Source: I-Net Bridge and Allan Gray research



Source: Morningstar and Orbis

largely independent of the direction of global stock markets. When their research suggests that markets are overvalued and vulnerable, Orbis increases this hedging (i.e. decreases the net equity exposure). When markets present good value, Orbis lowers the hedging. At such opportunistic times, net equity exposure could be as high as 20% of the total Fund.

How the Fund is currently positioned

The latest asset allocation of the underlying funds has 88% invested in equities, with the remaining 12% in cash. The majority of the equity holding is hedged out, leaving a net equity exposure of only 3%. This is low relative to historical exposure of the Orbis Optimal SA funds (see **Graph 2**). During the recent market crash (September 2008 - February 2009) the Fund increased net exposure to around 20%, which

placed it in a good position to participate in the market rally in the last three quarters.

Conclusion

The Allan Gray-Orbis Global Optimal Fund of Funds was created for investors who wish to invest in a low-risk global portfolio, with lower net equity exposure compared to that of the existing two Allan Gray-Orbis rand-denominated offshore funds.

If you are uncertain about the direction of global markets, but believe in Orbis' stock picking ability, seek the diversification benefits of uncorrelated returns relative to shares or bonds and want to take advantage of a possible future weaker rand, you may find our new fund a suitable investment.

Richard heads up product development within the retail business unit, which includes responsibility for retail legal and compliance. He is a qualified actuary and joined Allan Gray in 2007 after working for several years in financial services in the UK.



Jeanette Marais

The role of financial advice in helping you become a better long-term investor

EXECUTIVE SUMMARY: In the Quarterly Commentary 3 of 2008, Richard Carter explained the difference between fund and investor returns. He outlined both our role at Allan Gray and your role as an investor in closing this gap and improving your investment outcome. Jonathan Brodie and Trevor Black of Orbis also recently wrote about the partnership required between the investor and the manager for success in investment management. This article considers the role of independent advice in this partnership. Jeanette Marais argues that competent, independent advisers have the ability and experience often needed by investors to make the right choices and to manage their choices over time.

For a unit trust investor, success can be as much about sticking with your choices as it is about making the right ones

Simplistically, market participants have one of two broad mindsets. Both are completely valid of course.

- Speculators hope to sell their stock on for a higher price, preferably as quickly as possible, in order to put their capital to use in the next trade. They are focused on the marketability of what they buy.
- Investors hope for long-term returns, in both income and price gains. They are focused on the risk of loss and return on capital of their underlying investments.

If you are an investor (not a speculator), once you have made a fund choice, your ability to make the most of it is dependent on whether you remain committed to the investment for long enough to benefit from the potential returns, smooth out the inevitable short-term ups and downs and let the power of compound interest increase the value of your money and compensate you for the costs of investing. These steps sound simple enough but the gap between fund returns and investor returns shows that most of us fail dismally at putting them into action.

The value-oriented investment manager's challenge is to educate clients to remain invested for long enough to generate real long-term wealth

When inevitable market corrections occur, many investors forget their commitment to their goals and the characteristics of their chosen investment. Unless investors remain invested for long enough to benefit from our approach, we cannot help them achieve their goals of long-term wealth creation.

Our contrarian investment philosophy has the potential to make this even harder. Allan Gray is a value-oriented investment house. This means that often we are invested in shares that are not fashionable. Frequently, our search for value has us sell stocks that keep going up, and buy stocks that keep going down, resulting in short-term underperformance. At extremes of these times we have lost the most investors, and yet these have also been the times after which those who stayed the course have outperformed by the greatest margin.

The role of financial advice in the partnership between investment manager and investor

Financial advisers are not all independent, ethical, wise or diligent. But then neither are lawyers, doctors or, sad to say, investment managers. A third of our individual investors do not have an adviser linked to their investment and our fee model means that they are not charged for the advice they do not receive. However, it is clear that a good and independent adviser can make a significant difference to most individuals' investment success.

1. Making sense of the wide range of products and underlying investments available

Most people do not make the time to research even the most well-known investment managers in their home countries. South Africa now has 39 distinct unit trust management companies offering 765 funds for individuals to choose from. Internationally, the numbers are much higher. Logically, the more of these funds and managers you know of and the better you understand their methods and track records, the better your chance of picking the best. But making sense of that much choice is hard. Using an independent

(this is critical) adviser to research and propose funds is a good way for investors to access a broad range of possibilities while avoiding complexity. Maintaining a relationship with him or her over time should also help to make sure that your choices are reviewed appropriately.

2. Choosing the right investment vehicle

Over the years, successive governments have encouraged individual savings in South Africa by allowing investors who put money away for a long time to pay less tax on their savings. Investment 'products' like retirement annuities, preservation funds and endowment policies all have built-in tax breaks in return for a lock-in. These examples are easy to understand if you have the time, but some of the consequences of your choice of investment vehicle are not always obvious and with regular changes in legislation this is an area in which even the most sophisticated investors tend to seek professional advice. On top of fund choice, good advisers therefore add value for their clients in choosing the right product for a particular set of circumstances.

3. Resisting behavioural biases and emotional responses

Ben Graham wrote: *'The investor's chief problem – and even his worst enemy – is likely to be himself.'* Although it may not sound like it, the academic understanding, expertise and experience investors need to make sound financial decisions is the easy part. It is the behavioural biases that we are all subject to that the majority of investors struggle to identify and manage.

In previous articles we showed that the average investor in each of the Allan Gray funds that include equities, has not achieved the return of the funds themselves; in other words they have bought and sold our funds at the wrong times. Some investors would have had logical reasons to disinvest, but these would not have explained the systemic underperformance of investors relative to the funds – the effect would have been mixed, with the average investor achieving the same return

as that of the fund. The only explanation we can find for the underperformance of investors relative to our funds is that behavioural biases (e.g. favouring recent performance over long-term performance, or reacting fearfully after a big decline) persuade them to buy and sell at the wrong times.

An independent adviser is subject to the same biases as anyone else, but a good adviser is aware of his or her biases and is able to coach a client through dangerous times.

4. Applying a disciplined savings and investment process

In order to ensure the combination of action and rigour in decision-making, successful investment requires a process of some kind and for this process to be followed with discipline over time. This is true for large professional investment firms and for individual investors saving for retirement.

In truth, people should not need an adviser to consider returns, risk, time horizon and cost before making a decision. But many advisers will admit that they add a large part of their value in simply helping their clients

to be disciplined about managing their finances and about making, and acting on, savings and investment decisions.

In summary: the characteristics of a good financial adviser

The best financial advisers are independent of any product provider. They have the objectivity and experience to help investors meet the full range of challenges they might face. They help investors make sense of complexity and products available and in so doing, better equip investors to match an investment to their needs and to react (or not) when things change. Most importantly, they help investors to manage themselves with discipline, identifying and understanding how their emotions can lead them astray in the investing process.

“(Financial advisers) help investors to manage themselves with discipline, identifying and understanding how their emotions can lead them astray in the investing process.”

Jeanette has spent her career in the financial services industry, heading up distribution operations in life offices and investment companies. Her responsibilities include managing the different channels through which all of our clients access Allan Gray's retail products.



Rob Formby

Capital Gains Tax and how it affects unit trust investors

EXECUTIVE SUMMARY: At Allan Gray, we focus on managing your investments. We acknowledge that there are important aspects of investing - such as tax on your investments - that are not directly related to portfolio management but which can and do affect your investment behaviour and therefore long-term returns. In this article, Rob Formby provides unit trust investors with a simple overview of Capital Gains Tax (CGT) and how this is calculated.

CGT was introduced into the Income Tax Act, 1962 ('the Act') in South Africa from 1 October 2001 and is applicable to capital gains made after that date. The Act sets out the basis on which you are taxed on capital gains arising from the disposal of an asset. Understanding the treatment of various types of capital gains that you may enjoy in your lifetime is important. In this article, we aim to equip you with some background to CGT and an understanding of the importance of the CGT tax certificates that we send you annually around this time of the year.

This summary contains insufficient detail to enable you to determine your CGT liability accurately in most practical situations. You should therefore not use this as a tax guide or for legal reference. If you require more information about any CGT aspect, you should contact your financial adviser, a qualified tax practitioner or your local South African Revenue Service (SARS) office.

Key facts about CGT for investors

Investors do not pay CGT when the portfolio manager trades shares

A key difference and benefit for investors in South African unit trusts is that you only incur CGT when you sell your units in a unit trust. The buying and selling of the underlying assets held by the portfolio manager are not seen as CGT events for either unit trust company or investor. Portfolio managers can therefore focus on their core business of managing the portfolio according to their mandate, without having to concern themselves with tax issues. The unit trust investor receives the advantage of asset allocations changing without CGT being triggered, which would be the case if

the investments were held in a segregated share or property portfolio.

You decide when to become liable for CGT

A CGT event is triggered whenever an investor sells units.

Therefore, you decide when to become liable for CGT, allowing you to defer tax and to plan your investments appropriately. In this sense, your role in managing your exposure to this tax is important.

In other words, you are not liable to pay CGT simply because your investments grew in a particular tax year. You realise a capital gain or loss on unit trust investments only once you sell the units (known in the industry as a 'withdrawal' or 'repurchase'). This includes:

- Regular and once-off withdrawals
- Switches between funds
- Transfer of an investment (or part thereof) to another investor (referred to as a 'change of beneficial ownership')
- The divorce of an investor married in community of property as assets jointly owned are sold to divide the proceeds between the two parties
- Sequestration, emigration or death of an investor (unless you have made provision for your units to be transferred to your surviving spouse; or you transfer them to a registered public benefit organisation)

If you remain invested in the same unit trust, you could avoid paying CGT for as long as you remain in that fund. Investors should be careful, however, not to lose sight of their overall investment goals and objectives when considering 'deferring' CGT. CGT is merely one aspect to consider as part of your investment decisions.

"... you are not liable to pay CGT simply because your investments grew in a particular tax year."

Calculating your capital gains and losses

The Act provides that a taxable capital gain or loss must be included in the taxable income of a taxpayer for the year of assessment. The taxable capital gain is calculated in terms of the rules contained in the Eighth Schedule to the Act and will be determined by calculating the difference between the original cost ('base cost') and the market value of the units at the date of sale.

At the end of the tax year Allan Gray will send you a tax certificate (IT3c) reflecting any capital gains or losses you may have incurred during the tax year. You will have to declare any net gains or losses in your annual income tax return. Allan Gray is required to send copies of the tax information to SARS.

Determining the base cost of your units

The base cost of an asset is the cost of acquiring it. A capital gain or loss is determined by deducting the base cost from the market value of the units at date of sale.

- **Base cost of investments acquired before 1 October 2001**

For investments made before 1 October 2001, unit trust management companies publish a price to be used for this calculation, which is effectively the price on that date.

- **Base cost of investments acquired on or after 1 October 2001**

For investments made on or after 1 October 2001, the actual cost incurred in acquiring the units is used to

TABLE 1 | Your CGT liability will vary depending on which product you are invested in

Investment product	Principle applied	Calculation of CGT																				
South African and foreign unit trusts	All local and foreign unit trusts are subject to CGT except for money market funds, which have a fixed price and which generate income rather than capital gains or losses.	<p>If the taxpayer is a natural person who is resident in South Africa, the first R17 500 of the capital gain for the 2010/2011 tax year is exempt from CGT. Thereafter, 25% of the net capital gain (after exclusions and capital losses) is included in taxable income and taxed at the taxpayer's marginal tax rate.</p> <p>If the taxpayer is a company, close corporation or trust, 50% of the net capital gain is included in its taxable income and taxed at the applicable tax rate.</p>																				
Allan Gray Retirement funds	Capital gains realised on an investment in a retirement fund are not taxable for CGT purposes.	N/A																				
Allan Gray Living Annuity	Capital gains realised within a Living Annuity are not taxable for CGT purposes.	N/A																				
Allan Gray Endowment	Unlike unit trusts, endowment policyholders are not required to account for their investment income and capital growth in their tax return. Policyholders are not taxed directly; the fund that pools their contributions with those of other policyholders will pay the tax to SARS on their behalf.	<p>In terms of Section 29A of the Income Tax Act, insurers are required to maintain four separate funds for each category of policyholder. This is referred to as the Four Fund Approach and each fund is taxed as a separate taxpayer. The applicable tax rate will be determined by the table below:</p> <table border="1"> <thead> <tr> <th>Type of taxpayer</th> <th>Tax on income</th> <th>CGT inclusion rate</th> <th>Effective tax rate</th> </tr> </thead> <tbody> <tr> <td>Untaxed</td> <td>N/A</td> <td>0%</td> <td>N/A</td> </tr> <tr> <td>Individual</td> <td>30%</td> <td>25%</td> <td>7.5%</td> </tr> <tr> <td>Company</td> <td>28%</td> <td>50%</td> <td>14%</td> </tr> <tr> <td>Corporate</td> <td>28%</td> <td>50%</td> <td>14%</td> </tr> </tbody> </table>	Type of taxpayer	Tax on income	CGT inclusion rate	Effective tax rate	Untaxed	N/A	0%	N/A	Individual	30%	25%	7.5%	Company	28%	50%	14%	Corporate	28%	50%	14%
Type of taxpayer	Tax on income	CGT inclusion rate	Effective tax rate																			
Untaxed	N/A	0%	N/A																			
Individual	30%	25%	7.5%																			
Company	28%	50%	14%																			
Corporate	28%	50%	14%																			

calculate the base cost. Industry practice is to make use of the Weighted Average Unit Cost (WAUC) method for the calculation of the base cost.

In determining the base cost of your units, there are certain costs that may be added to the original cost. These amounts were incurred as expenditure directly related to the acquisition of the assets, one of which is initial financial adviser fees. If you make use of a financial adviser, Allan Gray automatically includes any initial fees you paid to them in the base cost of your investment. This reduces your CGT liability when you eventually sell the units. Ongoing financial adviser fees may not be added to the base cost of an investment.

A new WAUC is determined every time you buy units, taking into account the number of units you hold, the number of units you buy, the price paid for the units and the previous base cost. Allan Gray calculates and supplies investors with a WAUC.

CGT is applicable to offshore investments

Capital gains on offshore investments need to be calculated and declared in rands. To make this work, taxpayers are asked to translate each leg of the underlying transactions (each

purchase and sale) into rands. SARS allows you to choose between using the average exchange rate over the year to do this, or to use the rate on the day of the purchase or sale. Fluctuations in the exchange rate can therefore also give rise to (or eliminate) capital gains or losses.

Planning is critical

In conclusion, it is important to plan your investment properly and understand the tax implications of your decisions (see **Table 1**). Make adequate provision for your tax liabilities and consider taking advantage of any concessions provided by SARS in your investment plan.

Although we have tried to set out the key things to consider in CGT, we are not tax professionals and we suggest you seek the help of an adviser if you need it.

Rob has joint responsibility for the retail business, specifically operations, technology and financial management. Prior to joining Allan Gray, he headed up a services company within the Mvelaphanda Group and was a strategy consultant with McKinsey.



Chris du Toit

The role dividends play in generating returns

EXECUTIVE SUMMARY: In the previous edition of the Quarterly Commentary, Richard Carter and Roenica Botha demonstrated the importance of reinvesting income distributions from unit trusts for successful long-term wealth creation. Chris du Toit has revisited the history of South African stock market returns and come to the same conclusion. Over the last 50 years of equity investing, dividends have contributed more than half of the total real return earned on the JSE.

The total return from shares can be explained by the amount of dividends reinvested over time, the growth of companies' earnings and changes in the overall valuation of these earnings in the stock market.

The market returned 8.3% in real terms per year over the 50 years from 1960 to 2009

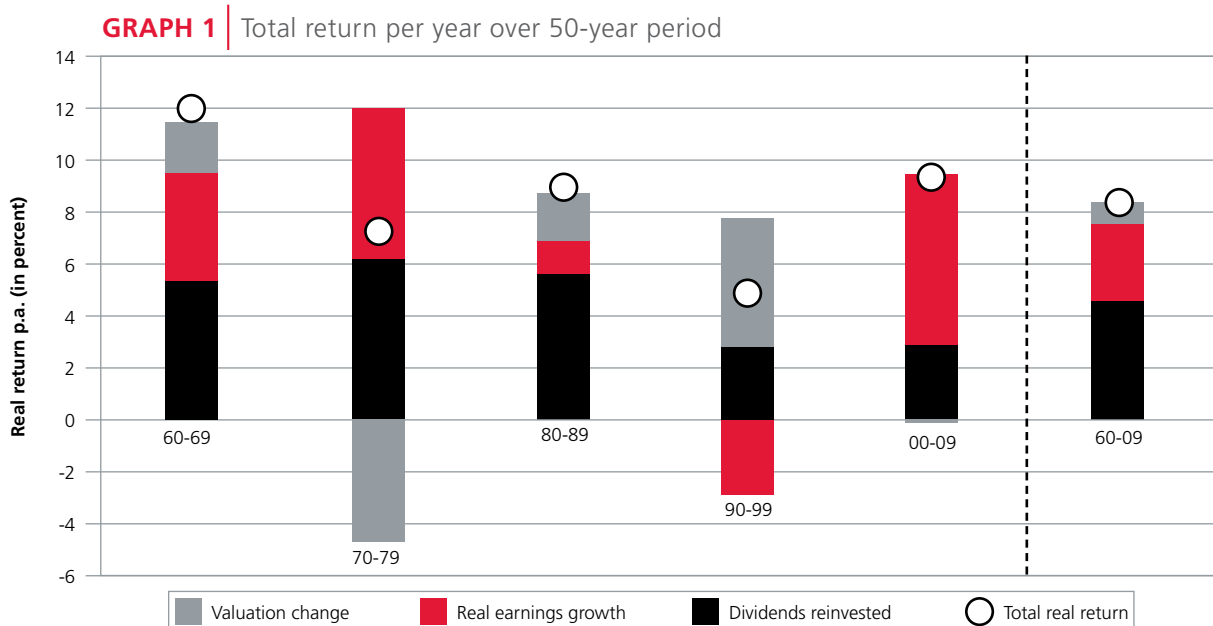
We analysed the total return of shares listed on the South African stock market, as represented by the FTSE/JSE All Share Index (ALSI) over the 50-year period from 1960 to 2009. The total return in nominal terms from the ALSI has been

17.4% per year. Inflation averaged 8.4% per year over the period, giving a real return of 8.3% per year from a passive investment in the market*. Of this return, 4.6% was from reinvested dividends and 3% was from real earnings growth. The Price to Earnings (PE) ratio increased from 11.8 to 17.2 times, contributing 0.8% per year to real returns.

Changes in real earnings and valuations have been shown to be either a head- or tailwind to returns

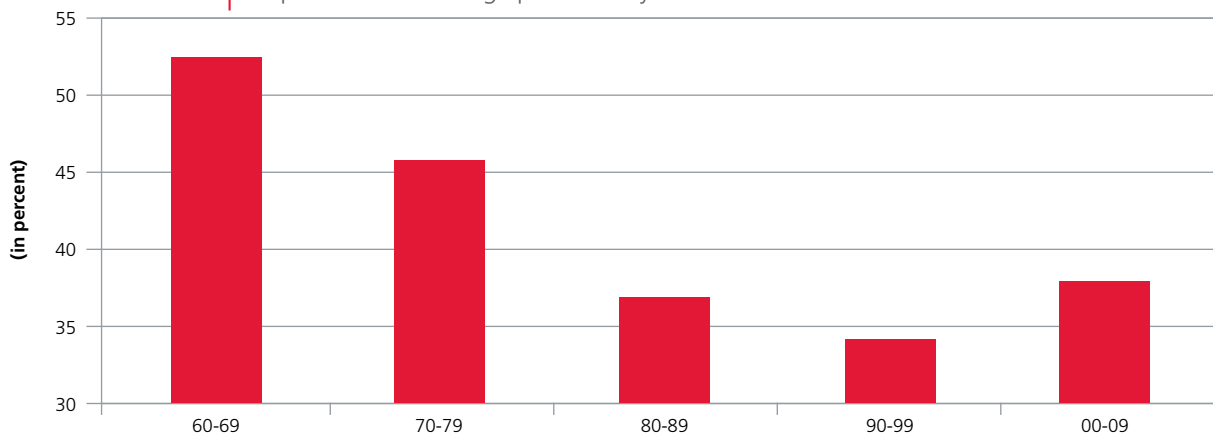
We also analysed the contribution to total real returns over the five 10-year periods from 1960 to 2009. In each of these

* Measured geometrically, not additively.



Source: I-Net Bridge and Allan Gray research

GRAPH 2 | Proportion of earnings paid out by the market as dividends



Source: I-Net Bridge and Allan Gray research

10-year periods, dividends made a significant contribution to the total return. From 1970 to 1979, dividends accounted for almost the entire return. Over different periods, changes in real earnings and changes in valuations have either been a headwind or tailwind to returns. For example, between 1970 and 1979, the PE ratio of the market fell from 14.3 to 8.5, leading to lower returns from the market. During the decade from 1990 to 1999, investors benefited from expanding valuations as the PE multiple of the market grew from 10.3 to 17.8 times earnings. The effect of earnings can be just as significant, and has played a larger and much more consistent role than valuation changes over the long term. The 70s saw strong earnings growth leading to a real return of 5.8%. The 90s saw earnings fall in real terms by 3% per year.

Your starting point is important

Depending on your starting point - in other words, how high or low earnings, dividends and valuations are when you invest - each of the three factors may have a positive or negative impact on the total return from the market.

Graph 1 shows a breakdown of the total return per year over the 50-year period. It is interesting to note that dividends have become a smaller portion of returns over time. Share prices have risen faster than dividends over the 50-year period, leading to lower dividend yields. The dividend

yield in 1960 was 5.2% and it is currently 2.2%. In addition, companies over time have returned a smaller proportion of their earnings to shareholders through dividends. The dividend payout ratio is the proportion of company profits that are paid out as dividends each year.

The dividend payout ratio has declined significantly since 1960

Graph 2 illustrates the average dividend payout ratio for the ALSI over the last 50 years, according to the same 10-year periods as before. The dividend payout ratio has declined from an average of 57% in the 1960s to 38% during the last decade.

There are many possible explanations for companies paying a declining proportion of their earnings as dividends. An alternative method of returning capital to shareholders through share buy-back programmes was

allowed in South Africa from 1999. The last decade has seen the introduction of both secondary dividend and capital gains taxes, both of which impact on a company's optimal dividend policy. There are also many alternative uses of cash for companies, including growth, funding new businesses, merger and acquisition activity, capital expansion and reducing existing debt. The potential returns available from each of these alternatives at the time may also influence the decision to maintain or increase dividends.

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Shareholders enjoy returns through dividends, earnings growth and valuation changes. In the past, each of these three factors have either contributed to or detracted from the total returns of the stock market. We believe that changes in valuations and real earnings growth may not continue to

provide the same tailwinds to total returns in the next 10 years. In fact a reversion to the long-term average would result in a headwind from valuations changes.

In this context, the most attractive shares for the next decade are likely to be those of companies that are able to sustainably distribute healthy dividends and yet still grow earnings in real terms. In our view, large holdings in our portfolios such as SABMiller, Remgro and BAT fall into this category.

Chris is a qualified actuary and has been a member of the institutional client servicing team since 2004.



Christo Terblanche

Retirement fund reform – still debated

EXECUTIVE SUMMARY: In previous articles covering retirement fund reform, we have shared our views on some of the choices being debated between stakeholders (see Quarterly Commentary 3 and 4 of 2008). In this issue Christo Terblanche considers how national pension benefits should be determined, i.e. whether a future state system should be defined benefit or defined contribution in nature. Both these options can be fully funded (where current accumulation goes towards the current workforce's retirement one day), or pay-as-you-go (where current accumulation pays the pensions to the current non-contributing pensioner community). We are strong pundits of a funded system and have considered the alternatives within the context only of a fully funded environment.

As a reminder: the headline objectives of retirement fund reform are to encourage adequate provision for retirement; to ensure retirement arrangements are cost-efficient, fair, prudent and transparent; to improve fund governance and to provide a basic safety net for those in old age. It is important to keep up to date with the major design choices to be made in the new system, as the end result will have an impact on every South African.

It is not yet clear whether the new National Savings Fund (NSF) will be a defined benefit (DB) or a defined contribution (DC) fund – this is an area of some disagreement between stakeholders, including those within government. The key differentiator between the two types of schemes is the allocation of risk and reward between the individual and the scheme provider. In our view, for a national retirement fund of the kind being proposed in this country, and especially where there is an old age grant 'safety net' already in place, a DC scheme is preferable.

Transparency and ease of understanding

Being able to understand a scheme and monitor the growth in benefits is very important as it builds trust in the system and thus increases support.

In a DC scheme, the value of a member's benefit is simply the market value of the accumulated and invested contributions in the investment account. This is much akin to a bank account. With a moderate investment in education, a national DC scheme could have as a side benefit that South Africans gain a better understanding of the benefits of savings and the power of investment compounding.

In a DB scheme, the level of benefit is also easy to understand, and often based on a simple percentage of earnings in the final years of employment. However, the formula used to derive this benefit relies on actuarial calculations, taking into account discounted future income streams and including assumptions about future investment returns, mortality, etc. Changes in the benefit formula can therefore be very difficult to explain or justify, whether they are based on unexpected changes in individual earnings or on unexpected investment returns. Even leaving aside the impact of the world economy, South Africa faces considerable uncertainty in both our capital and labour markets and formula changes would undoubtedly be required. A DB scheme would ultimately be hard to trust and do little to improve financial literacy among South Africans.

Choice and flexibility

Generally, as explained in **Table 1** (on page 20), DC schemes allow members some level of control over choice of investment manager and asset allocation. In a DB scheme, the investment aspects of the funds would be pooled and managed for all members collectively.

This is a common argument for why a DB scheme is desirable, because the government as sponsor should provide a 'fixed' benefit to members, since the average member does not have the necessary skill to select investment portfolios in a DC environment.

But a DC scheme does not have to require members to make choices. All members in a particular category (e.g. based on age bands) can be pooled in a default portfolio.

TABLE 1 | Defined benefit versus defined contribution – how alternative national systems might work

	Defined benefit	Defined contribution
Contributions	Contributions are deducted from salaries and/or made by employers as a social security tax. All contributions would probably go into a single national pool to be invested together.	Contributions are deducted from salaries and/or made by employers on behalf of employees. These contributions go into individual accounts, and accumulate with investment returns over the person's life up to retirement.
Choice and flexibility	Members have no choice in the investment selection.	Because a DC system has individual accounts, it is possible to allow people to choose their own investments, typically in the form of unit trusts. Most DC systems have default investments and a limited range of choices, and many only allow switching at particular points in time. In a scheme with choice, individuals can tailor their portfolios to suit their appetite for risk and their own unique set of circumstances.
Amount the member will receive at retirement	The benefit is pre-defined based on a formula such as a percentage of salary for each year of service, or in some simplistic cases, a fixed monetary amount.	The benefit at retirement is not known in advance and depends on the extent of contributions paid and the investment returns earned on those contributions.
Payout structure	The benefit payout structure is pre-determined, e.g. either as a lump sum, or more often (and appropriately) as a regular income.	Most national DC systems allow retirees to use their retirement savings to buy a regular income from a life insurance company, and to take a portion as a lump sum.
Who bears the risks?	The government bears the risk that contributions over time may not be sufficient to meet the benefits paid. However, members face the risk of reduced benefits or indirectly higher cost through increased taxes over time.	Each member bears their own investment risk and 'lifetime earnings' risk.

The point is that in a DC scheme, those who are comfortable making a selection of their own could be given a limited set of alternatives to choose from. Too much choice generally causes confusion (see Marisa Kaplan's article in the Quarterly Commentary 3 of 2009, 'The cost of too much choice'), but it would not be hard to provide the right amount of choice under even a very basic DC system. Marketing regulations are already effective in the unit trust environment and these could be used to regulate providers of the limited additional investment choices. South Africa has a strong community of financial planning experts who could assist members who decide to select their own portfolios in the selection process.

“Being able to understand a scheme and monitor the growth benefits... builds trust in the system and thus increases support.”

The combination of a good and cost-effective default, a limited range of additional investment portfolios and informed decision-making (members on their own or with the assistance of financial experts), would naturally lead to healthy competition among investment managers.

A healthy competitive environment in turn should lead to value-for-money fees and attractive investment performance.

Risks in DC schemes are easier to manage over long periods

Both DB and DC schemes have investment risk. In a DC scheme, sensible scheme design can help members to manage this risk. In a national DB scheme the investment risk is pooled between individuals, so that there is no disparity in individual investment outcome. But the investment risk in the pool itself is carried by the state. DB scheme contributions are expected to accumulate to the benefit value in future, based on assumptions of future mortality and investment returns. If investment returns

end up being worse than expected, the cost of the scheme increases. The state may not be in a position to fund increased contributions, and the scheme may either run into a deficit (which means there are insufficient assets to meet all the

benefit promises), or the government may have to reduce the benefits.

South Africa has a safety net for pensioners in the form of an old age grant, funded by taxes, currently set at R1 010 per month. The government has avoided calling this a state pension because a grant is not a permanent commitment. Rather than taking on the funding risk in a national DB scheme, policymakers should make a long-term commitment to providing this basic state pension.

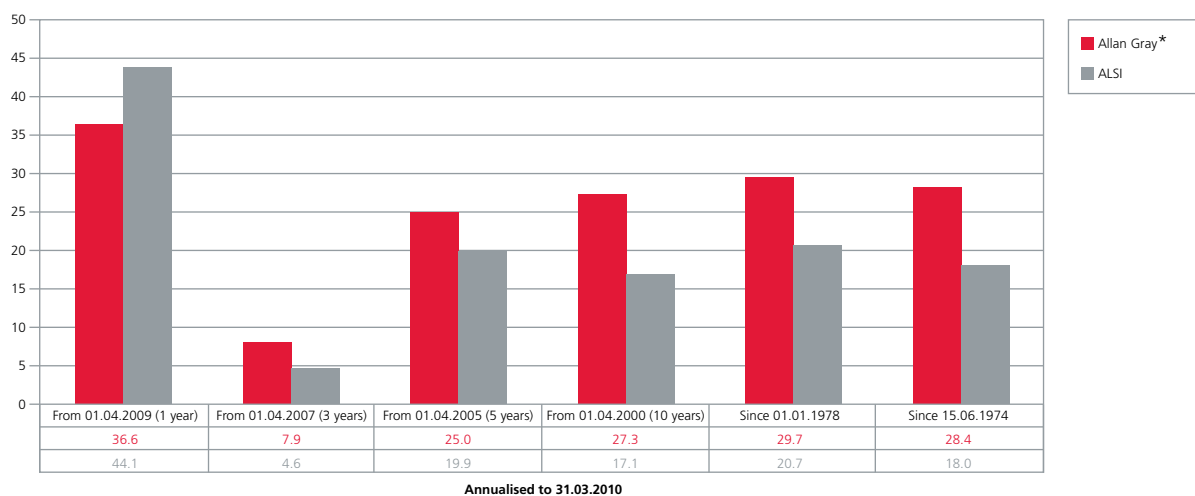
Risk and reward

In summary, in a DB scenario provided by government, the member faces the risk of reduced benefits or indirectly higher cost through increased taxes over time. On the other hand, in a DC environment the member has the potential to understand, monitor and to a large extent control the funding of his or her own pension, and in doing so to optimise his or her own trade-off between risk and reward.

Christo joined Allan Gray in 2000 after spending four years in the employee benefits consulting environment. His responsibilities include overseeing the affairs of Allan Gray Life, the development of pooled investment products for institutions and the servicing of institutional clients within pooled vehicles.

Allan Gray Limited global mandate share returns vs. FTSE/JSE All Share Index

Period	Allan Gray*	FTSE/JSE All Share Index	Out/Underperformance
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	-12.6	-23.2	10.6
2009	28.8	32.1	-3.3
2010 (to 31.03)	3.2	4.5	-1.3
Annualised to 31.03.2010			
From 01.04.2009 (1 year)	36.6	44.1	-7.5
From 01.04.2007 (3 years)	7.9	4.6	3.3
From 01.04.2005 (5 years)	25.0	19.9	5.1
From 01.04.2000 (10 years)	27.3	17.1	10.2
Since 01.01.1978	29.7	20.7	9.0
Since 15.06.1974	28.4	18.0	10.4
Average outperformance			10.4
Number of calendar years outperformed			27
Number of calendar years underperformed			8



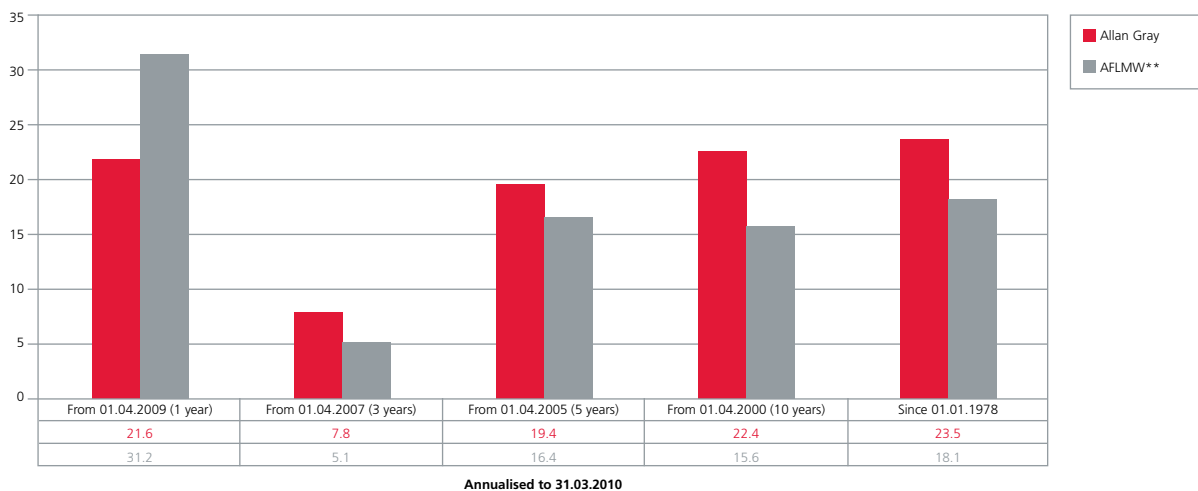
* Allan Gray commenced managing pension funds on 1 January 1978. The returns prior to 1 January 1978 are of individuals managed by Allan Gray, and these returns exclude income.

Note: Listed property included from 1 July 2002.

An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to **R75 961 590** by 31 March 2010. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to **R3 730 400**.

Allan Gray Limited global mandate total returns vs. Alexander Forbes Large Manager Watch

Period	Allan Gray	AFLMW**	Out/Underperformance
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 (to 31.03)	2.5	4.1	-1.6
Annualised to 31.03.2010			
From 01.04.2009 (1 year)	21.6	31.2	-9.6
From 01.04.2007 (3 years)	7.8	5.1	2.7
From 01.04.2005 (5 years)	19.4	16.4	3.0
From 01.04.2000 (10 years)	22.4	15.6	6.8
Since 01.01.1978	23.5	18.1	5.4
Average outperformance			5.4
Number of calendar years outperformed			25
Number of calendar years underperformed			7



** Consulting Actuaries Survey returns used up to December 1997. The return for March 2010 is an estimate.

An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to **R8 983 317** by 31 March 2010. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to **R2 114 223**.

Allan Gray annualised performance in percentage per annum to 31 March 2010

	FIRST QUARTER (unannualised)
UNIT TRUSTS¹	
EQUITY FUND (AGEF)	3
FTSE/JSE All Share Index	
BALANCED FUND (AGBF)	3
Average of both Prudential Medium Equity category and Prudential Variable Equity category (excl. AGBF)	
STABLE FUND (AGSF) - (NET OF TAX)	3
Call deposits plus two percentage points (Net of tax)	
STABLE FUND (AGSF) - (GROSS OF TAX)	3
Call deposits plus two percentage points (Gross of tax)	
MONEY MARKET FUND (AGMF)	3
Domestic fixed interest money market unit trust sector (excl. AGMF) ²	
OPTIMAL FUND (AGOF)	3
Daily call rate of FirstRand Bank Ltd	
BOND FUND (AGBD)	3
BEASSA All Bond Index (total return)	
GLOBAL FUND OF FUNDS (AGGF)	3
60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index (Rands)	
GLOBAL EQUITY FEEDER FUND (AGOE)	3
FTSE World Index (Rands)	
LIFE POOLED PORTFOLIOS	
GLOBAL BALANCED PORTFOLIO	2.5
Mean of Alexander Forbes Global Large Manager Watch ²	4.1
DOMESTIC BALANCED PORTFOLIO	3.0
Mean of Alexander Forbes Domestic Manager Watch ²	5.2
DOMESTIC EQUITY PORTFOLIO	3.7
FTSE/JSE All Share Index	4.5
DOMESTIC ABSOLUTE PORTFOLIO	2.2
Mean of Alexander Forbes Domestic Manager Watch ²	5.2
DOMESTIC STABLE PORTFOLIO	2.0
Alexander Forbes Three-Month Deposit Index plus 2%	2.2
DOMESTIC OPTIMAL PORTFOLIO¹	1.1
Daily Call Rate of Nedcor Bank Limited	1.5
GLOBAL ABSOLUTE PORTFOLIO	2.2
Mean of Alexander Forbes Global Large Manager Watch ²	4.1
DOMESTIC MEDICAL SCHEME PORTFOLIO	1.9
Consumer Price Index plus 3% p.a. ²	2.3
GLOBAL STABLE PORTFOLIO	1.3
Alexander Forbes Three-Month Deposit Index plus 2%	2.2
RELATIVE DOMESTIC EQUITY PORTFOLIO	3.6
FTSE/JSE CAPI Index	4.5
MONEY MARKET PORTFOLIO¹	2.0
Alexander Forbes Three-Month Deposit Index	1.7
FOREIGN PORTFOLIO¹	-0.4
60% of the MSCI Index and 40% JP Morgan Global Government Bond Index (Rands)	1.1
ORBIS GLOBAL EQUITY PORTFOLIO¹	0.3
FTSE World Index (Rands)	2.7
SEGREGATED PORTFOLIOS⁵	
GLOBAL BALANCED COMPOSITE	2.5
Mean of Alexander Forbes Global Large Manager Watch ^{2,4}	4.1
DOMESTIC BALANCED COMPOSITE	3.1
Mean of Alexander Forbes Domestic Manager Watch ²	5.2
DOMESTIC EQUITY COMPOSITE	3.7
FTSE/JSE All Share Index	4.5
GLOBAL BALANCED NAMIBIAN HIGH FOREIGN COMPOSITE	2.1
Mean of Alexander Forbes Namibia Average Manager ²	4.1
RELATIVE DOMESTIC COMPOSITE	4.0
Weighted average of client specific benchmarks ²	4.7
FOREIGN BEST VIEW (RANDS) COMPOSITE	1.1
60% of the MSCI and 40% of the JP Morgan Global Government Bond Index (Rands)	1.1
ORBIS FUNDS (RANDS)^{1,6}	
ORBIS GLOBAL EQUITY FUND (RANDS)	0.2
FTSE World Index (Rands)	2.7
ORBIS JAPAN EQUITY (YEN) FUND (RANDS)	8.5
Tokyo Stock Price Index (Rands)	7.2
ORBIS OPTIMAL SA FUND-US\$ CLASS (RANDS)	-2.1
US\$ Bank Deposits (Rands)	-0.4
ORBIS OPTIMAL SA FUND-EURO CLASS (RANDS)	-7.4
Euro Bank Deposits (Rands)	-6.5
ORBIS ASIA EX-JAPAN EQUITY FUND (RANDS)	-2.6
MSCI Asia Ex-Japan (Rands)	0.8

PERFORMANCE AS CALCULATED BY ALLAN GRAY

¹ The fund returns are net of investment management fees

² The return for the quarter ending 31 March 2010 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

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

1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R million)	INCEPTION DATE
30.7	4.0	20.8	23.0	30.4	22 238.2	01.10.98
44.1	4.6	19.9	17.1	19.7		
19.8	6.1	17.1	20.2	21.4	34 702.5	01.10.99
24.2	4.5	14.3	13.8	14.5		
7.5	7.5	12.0	-	13.6	30 911.9	01.07.00
6.5	8.2	7.4	-	7.8		
8.5	8.6	13.0	-	14.9	30 911.9	01.07.00
8.8	11.1	9.9	-	10.6		
8.3	10.2	9.1	-	9.5	8 262.5	03.07.01
8.1	10.0	8.9	-	9.4		
4.0	8.8	9.0	-	9.5	3 108.1	01.10.02
6.6	8.9	7.8	-	8.0		
9.9	8.9	8.9	-	9.3	166.4	01.10.04
9.0	7.5	8.2	-	8.8		
4.4	4.7	11.0	-	8.1	6 618.9	03.02.04
3.6	1.6	8.6	-	6.5		
23.5	-0.3	11.5	-	11.5	3 924.1	01.04.05
20.4	-3.4	8.0	-	8.0		
21.9	7.9	19.5	-	21.9	14 833.6	01.09.00
31.2	5.1	16.4	-	15.6		
25.9	8.5	21.5	-	22.6	5 659.0	01.09.01
36.2	7.0	18.2	-	18.2		
34.5	7.2	24.9	-	26.4	6 431.7	01.02.01
44.1	4.6	19.9	-	16.8		
22.5	13.5	24.0	-	26.2	917.1	06.07.01
36.2	7.0	18.2	-	17.8		
14.5	10.9	16.2	-	17.1	1 183.2	01.12.01
9.8	12.0	11.0	-	11.6		
5.5	9.9	10.1	-	9.8	740.3	04.12.02
6.9	9.3	8.1	-	8.2		
18.7	12.6	22.8	-	21.8	1 488.6	01.03.04
31.2	5.1	16.4	-	17.9		
14.1	10.7	15.0	-	15.7	1 108.6	01.05.04
8.1	11.5	10.1	-	9.5		
9.4	9.8	14.6	-	15.8	2 829.9	15.07.04
9.8	12.0	11.0	-	10.8		
38.4	7.3	22.8	-	27.2	391.3	05.05.03
44.9	5.4	20.3	-	25.2		
8.6	10.4	9.2	-	9.8	284.4	21.09.00
7.6	9.8	8.8	-	9.5		
2.5	4.0	10.7	-	4.8	1 657.0	23.01.02
3.8	1.6	8.7	-	1.3		
22.9	0.0	11.3	-	11.5	2 372.5	18.05.04
20.2	-3.4	8.0	-	8.3		
21.6	7.8	19.4	22.4	23.5	25 787.0	01.01.78
31.2	5.1	16.4	15.6	18.1		
26.0	8.6	21.4	23.3	24.0	21 685.9	01.01.78
36.2	7.0	18.2	17.5	18.7		
34.9	7.7	25.1	26.5	22.7	48 690.6	01.01.90
44.1	4.6	19.9	17.1	15.1		
16.7	8.3	18.9	22.0	20.6	5 418.5	01.01.94
29.5	6.4	16.7	15.7	14.8		
38.6	6.2	22.1	-	23.0	11 416.8	19.04.00
44.2	4.3	19.6	-	17.0		
6.1	3.5	10.4	17.1	14.7	5 289.5	23.05.96
3.8	1.6	8.7	4.8	10.3		
22.7	-0.4	11.5	12.5	18.9	-	01.01.90
20.2	-3.4	8.0	2.5	12.0		
11.1	-2.1	6.1	5.8	14.0	-	01.01.98
4.9	-8.1	4.0	-2.2	6.0		
-13.8	4.5	9.2	-	11.1	-	01.01.05
-22.5	3.0	6.9	-	8.7		
-13.4	4.9	9.1	-	10.1	-	01.01.05
-20.8	3.9	7.2	-	7.9		
46.1	10.8	-	-	17.5	-	01.01.06
33.8	5.2	-	-	14.8		

Allan Gray Balanced Fund quarterly disclosure as at 31 March 2010

	% of Fund
South African equities	45.9
Resources	10.8
Sasol	5.0
Anglogold Ashanti	3.4
Harmony Gold Mining Co.	1.4
African Rainbow Minerals	0.8
Positions individually less than 1% of total JSE-listed securities held by the Fund	0.2
Financials	7.3
Sanlam	2.9
Standard Bank Group	1.4
Reinet Investments SA	0.9
Firststrand	0.6
Positions individually less than 1% of total JSE-listed securities held by the Fund	1.5
Industrials	27.4
SABMiller	6.6
Remgro	3.9
MTN Group	2.4
Sappi	1.7
Dimension Data Holdings	1.5
Nampak	1.4
Illovo Sugar	1.1
Sun International	0.9
Compagnie Fin Richemont SA	0.8
Tonga-Hulett	0.8
Mondi	0.7
Netcare	0.6
Positions individually less than 1% of total JSE-listed securities held by the Fund	5.0
Other securities	0.5
Positions individually less than 1% of total JSE-listed securities held by the Fund	0.5
Derivatives	-1.3
ALSI 40 0610-RMB	-1.3
---- Net South African equities ----	44.7
Hedged South African Equities	1.3
Commodities	3.3
New Gold ETF	3.3
Bonds	8.0
RSA Bonds	4.0
Parastatal Bonds	0.2
Corporate Bonds	3.8
Money market and call deposits	22.8
Foreign - JSE inward listed shares	3.8
British American Tobacco Plc	3.8
Foreign - Orbis absolute return funds	8.3
Orbis Optimal SA Fund (US\$)	5.6
Orbis Optimal SA Fund (Euro)	2.7
Foreign - Orbis equity funds	7.8
Orbis Japan Equity Fund	4.4
Orbis Global Equity Fund (Yen)	2.2
Orbis Japan Equity Fund (US\$)	1.2
Totals:	100.0

Note: There may be slight discrepancies in the totals due to rounding.
The quarterly disclosures of our complete fund range are available at www.allangray.co.za

Total Expense Ratios (TERs)

	Equity Fund	Balanced Fund	Stable Fund	Optimal Fund	Bond Fund	Money Market Fund	Global Fund of Funds	Global Equity Feeder Fund
Performance component	1.24%	0.60%	0.09%	0.06%	0.25%	0.00%	0.73%	0.78%
Fee at benchmark	1.71%	1.16%	1.14%	1.14%	0.29%	0.29%	1.28%	1.49%
Trading costs	0.13%	0.08%	0.05%	0.29%	0.00%	0.00%	0.15%	0.16%
Other expenses	0.01%	0.02%	0.02%	0.01%	0.08%	0.01%	0.07%	0.05%
Total Expense Ratio (TER)	3.09%	1.86%	1.30%	1.50%	0.62%	0.30%	2.23%	2.48%

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 the end of December 2009. 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.

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' or 'funds'. Investors hold a participatory interest in a portfolio of a collective investment scheme also referred to as 'units'. 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. The RA is also available on an employer basis.
Preservation Funds*	The Allan Gray Pension 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 at resignation from employment or when transferring from another preservation fund.
Endowment*	The Allan Gray Endowment Policy is a savings policy for investors who want to grow their money and benefit from an estate planning tool.
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, enabling you to reap the benefits of diversification and rand hedging. There are two options for investing offshore through Allan Gray: invest without the need to use your offshore investment allowance or use your offshore investment allowance.
Platform – Local and Offshore	Our investment platform provides you with access to all our products, as well as a focused range of unit trusts from other fund providers. The platform enables you to buy, sell and switch at no charge between the funds as your needs and objectives change. South African investors who wish to diversify their portfolios have the additional choice of 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; Other pooled portfolios: Optimal Portfolio. Please note that, except for foreign mandates, institutional investments are currently restricted to existing investors only.
Segregated Portfolios	Allan Gray manages portfolios on a segregated basis where the minimum portfolio size is R500 million. These mandates are of a balanced or asset class specific nature. Portfolios can be managed on an absolute or relative risk basis. Please note that, except for foreign mandates, institutional investments are currently restricted to existing investors only.
Botswana	Allan Gray Botswana manages institutional portfolios on a segregated basis.
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.
Allan Gray Orbis Foundation	The Allan Gray Orbis Foundation is a non-profit organisation that was established in 2005 as an education and development catalyst to assist a generation of high growth entrepreneurial change agents to bring about job creation in Southern Africa. The Foundation focuses on educational and experiential methods to harness the potential of bright young minds. Through its highly researched learning programmes, it seeks to equip talented young individuals with the skills, attitudes and motivation to become successful high growth entrepreneurs.
E ²	The provision of financial assistance, upon favourable terms, to facilitate new enterprises. Its purpose is job creation, meeting a long-term need in South Africa.

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

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ALLAN GRAY

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COMPANY SECRETARY

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Collective Investment Schemes (unit trusts) are generally medium- to long-term investments. The value of participatory interest (units) may go down as well as up. Past performance is not necessarily a guide to the future. Unit trust prices are calculated on a net asset value basis, which, for money market funds, is the total book value of all assets in the portfolio divided by the number of units in issue. The Allan Gray Money Market Fund aims to maintain a constant price of 100 cents per unit. The total return to the investor is primarily made up of interest received but may also include any gain or loss made on any particular instrument held. In most cases this will have the effect of increasing or decreasing the daily yield, but in some cases, for example in the event of a default on the part of an issuer of any instrument held by the Fund, it can have the effect of a capital loss. Such losses will be borne by the Allan Gray Money Market Fund and its investors and in order to maintain a constant price of 100 cents per unit, investors' unit holdings will be reduced to the extent of such losses. Fluctuations or movements in exchange rates may also be the cause of the value of underlying international investments going up or down. Unit trusts are traded at ruling prices. Commissions and incentives may be paid and if so, would be included in the overall costs. Different classes of units apply to the Allan Gray Equity, Balanced, Stable and Optimal Funds only and are subject to different fees and charges. A detailed schedule of fees and charges and maximum commissions is available on request from the company. Forward pricing is used. A fund of funds unit trust may only invest in other unit trusts, which levy their own charges that could result in a higher fee structure for these portfolios. A feeder fund is a unit trust fund that, apart from assets in liquid form, consists solely of units in a single portfolio of a collective investment scheme. All of the unit trusts except the Allan Gray Money Market Fund may be capped at any time in order for them to be managed in accordance with their mandates. Allan Gray Unit Trust Management Limited is a member of the Association for Savings & Investment SA (ASISA).

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