QUARTERLY COMMENTARY 1

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ALLAN GRAY

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Rob Dower

Comments from the Chief Operating Officer

There are a few ways in which we can reduce short-term risk in a portfolio and not all of these require that there is a matching dilution in long-term return.

First, we try to buy assets for less than their fundamental value. Any estimate of fundamental value tries to forecast the future profitability and growth of a company and is thus inherently inaccurate, so we include a margin of safety in our estimates to protect against nasty surprises. A stock market works so that the best potential returns are on offer from investments that find it hardest to attract capital. Theoretically, these should also be the investments that are most risky. In practice this is not always the case, allowing an investor with the time and skill to make independent estimates of fundamental value, and the strength of conviction to own unfashionable shares, the opportunity to achieve a higher return and a lower risk of capital loss.

Our overweight position in Japan is a good example. After two decades of decline, the shares of many Japanese companies have for some time been on offer at prices that the Orbis and Allan Gray investment teams find attractive. The tragic recent events were a reminder of how much short-term impact the unpredictable natural world can have on market sentiment, even when that sentiment was depressed to begin with.

The Japanese earthquake and tsunami affected our clients' portfolios, but the impact was limited because the Japanese shares in these portfolios were already well priced. Thus, despite a 20% drop in the days following the disaster, the Topix recovered quickly to November 2010 levels, 10% off its recent highs. Some outcomes in Japan are still unfolding, but Orbis' judgement has been that even this price decline has been much greater than its current estimates of the impact on the economics of businesses in the portfolio.

Another way to reduce risk is by diversifying. If you invest in two individual shares your investment is less risky if they tend not to underperform at the same time. If you add more investments that perform well at different times it is possible to reduce risk substantially without reducing returns. The Allan Gray Balanced and Stable funds are highly diversified portfolios that include local shares (in itself a diversified portfolio), global shares, bonds, offshore hedged investments and cash.

Buying insurance, or hedging, against stock market declines is a third way to reduce risk. Since the financial crisis the rand has tended to strengthen and weaken at the same time as global stocks, both being driven by the appetite for risk and return from global investors. As a result, some of the upside you would expect to gain from potential rand weakness by investing in offshore shares is lost as losses in the shares cancel out gains from a weaker rand. Despite low interest yields this can make foreign cash, or a hedged investment like Orbis' Optimal funds, a worthwhile addition to diversified portfolios, as Chris du Toit discusses in his piece.

Finally, an investor can reduce short-term risk of loss by holding cash. This is not only a mechanism for reducing risk; cash also allows an investor to take advantage of future investment opportunities. We are currently holding substantial cash in your Balanced and Stable portfolios to take advantage of such opportunities, and we expect this strategy will allow us to deliver higher returns than if we were already fully invested. From this quarter we include asset allocation breakdowns for these two portfolios at the back of this publication.

I am pleased to inform you that Allan Gray Botswana now offers local investors access to our nine unit trusts. I would also like to share with you that two senior members of staff have changed roles. Christo Terblanche now heads up Retail Product Development, previously run by Richard Carter; Richard takes over from Christo, including overall responsibility for Allan Gray Life. Changes such as these help us promote innovative thinking among our staff who, as always, remain focused on creating long-term wealth for our clients.

Thank you for your continued confidence.

Kind regards

Rob Dower

Duncan Artus

Correlation to confidence

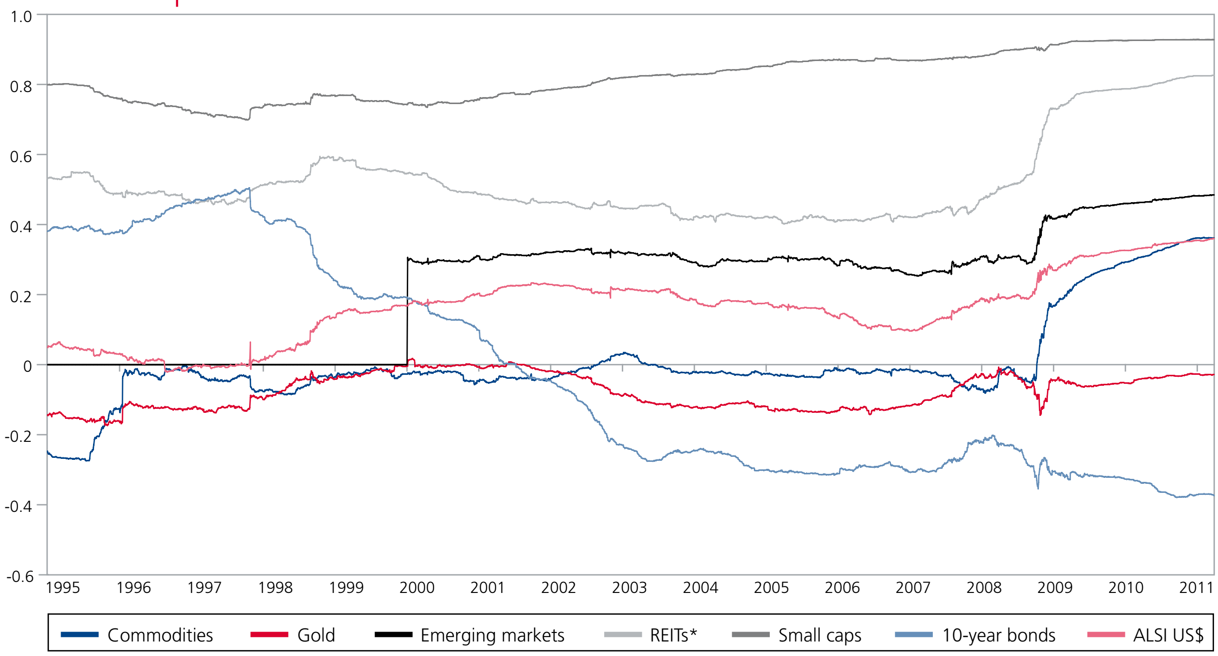
EXECUTIVE SUMMARY: There is an increasingly positive and high level of correlation between assets currently. This increase in correlations appears to have been influenced by expansive global fiscal and monetary policies. South African asset prices, as an emerging market commodity supplier, have been a major beneficiary of this trend. This is a concern for investors who are aware of the importance of minimising absolute risk of loss in long-term wealth creation and believe it can be achieved by simply holding a diversified portfolio of assets. Duncan Artus discusses how our portfolios are positioned to deal with a potential reversal of these trends should they prove unsustainable.

While recently travelling in Latin America the extent to which the current levels of asset prices in many emerging markets, including South Africa, are reliant on high commodity prices and the consumption funded from the resultant net inflows, was reinforced further in my mind.

This implies an ultimate dependence on the continuation of both the commodity intensiveness of Chinese economic growth and the perceived success of the developed world's monetary and fiscal policies. One of the consequences of this interdependent cycle has been a steady and increasingly fast rise in correlations between different asset classes and indeed within asset classes.

This is a concerning development for many investors who believe, as I do, that limiting the risk of absolute loss is one of the foundations of successful long-term wealth creation. Local investors' belief in the safety provided by diversification within their portfolios may be misplaced.

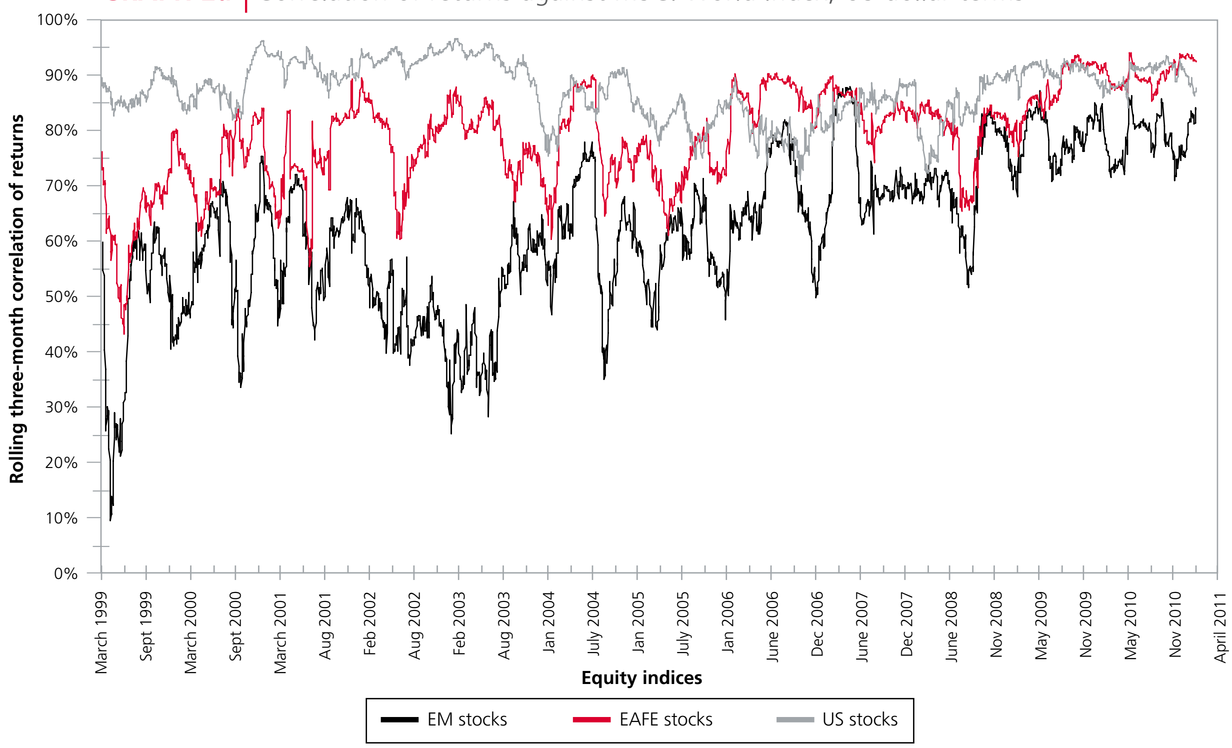
GRAPH 1 | Rolling five-year correlations to S&P 500



*Real Estate Investment Trusts

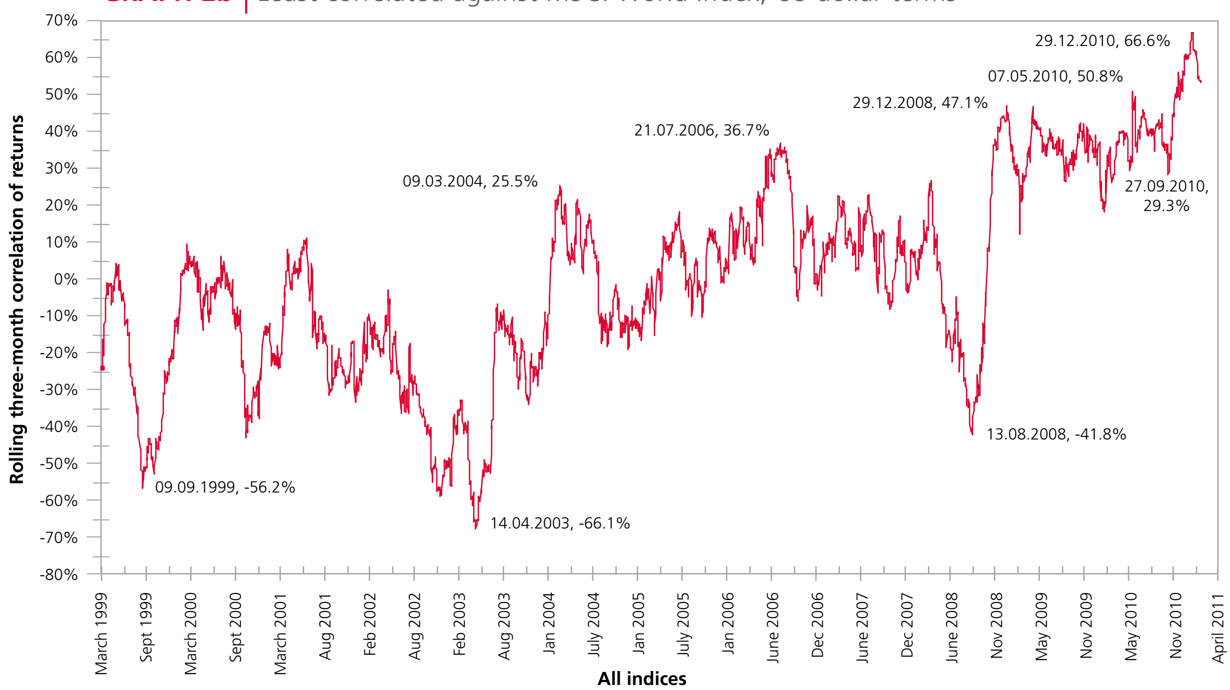
Source: Datastream, Allan Gray research

GRAPH 2a | Correlation of returns against MSCI World Index, US dollar terms



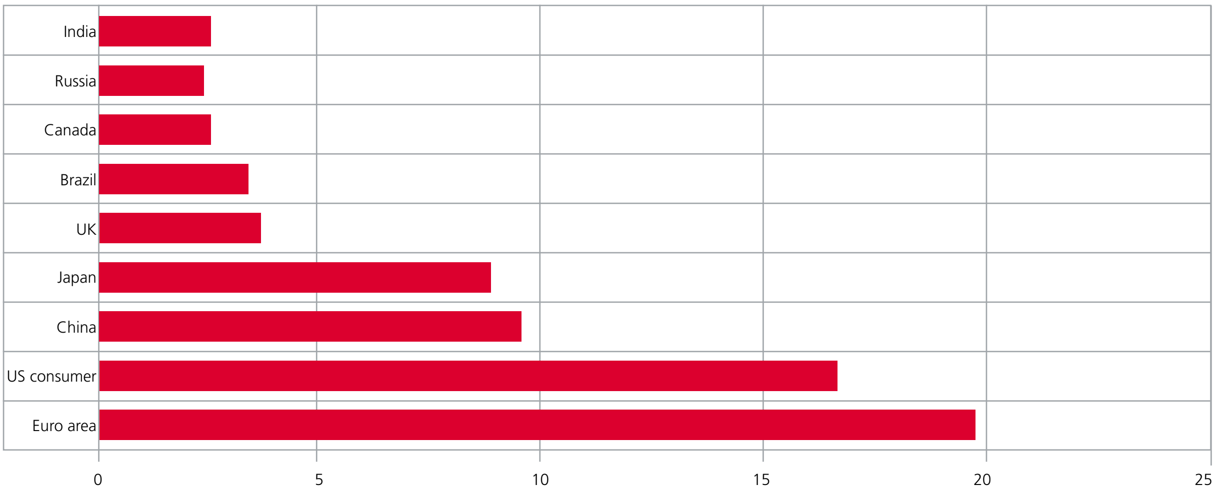
Source: Bianco Research LLC, February 2011

GRAPH 2b | Least correlated against MSCI World Index, US dollar terms



Source: Bianco Research LLC, February 2011

GRAPH 3 | Percentage of world GDP



Sources: JP Morgan

Increasing correlations

The rise in correlations globally is illustrated in **Graph 1** (on page 2), which depicts the rolling five-year correlation between various asset classes and the S&P 500 since 1995.

Correlations rose notably through the market crash in late 2008 and have continued to climb with the subsequent governments' and central banks' massively expansive fiscal and monetary policy. Of particular importance to local investors is the increasing positive correlation between commodities and equities and the absolute level of this correlation.

Over shorter periods the correlations are even higher. **Graph 2a** (on page 3) shows the three-month rolling correlation of US, emerging market (EM) and Europe Asia Far East (EAFE) equities to the World Index. The current high levels are immediately apparent. **Graph 2b** (on page 3) highlights the correlation of the least correlated items over each period among major equity, fixed income, commodity and currency indices to the World Index. There appear to be few places for cautious investors to hide.

That this important change in correlations has accelerated since the US implemented 'quantitative easing' can be explained by the often forgotten importance of the US consumer to world GDP; a consumer who is being propped up by extremely low interest rates. **Graph 3** shows the contributions of various countries to world GDP and contrasts these with the size of the US consumer.

Increasing positive correlations while assets have been rising has been a good thing for investors. However, as was so starkly demonstrated in 2008, a highly leveraged economic system is increasingly reliant on the confidence of its participants. The problem is that future levels of confidence are difficult to forecast.

> "We remain very aware of the downside risks of the remarkable increase in correlations."

The transmission mechanism of this confidence to the South African market is commodity prices, not only via the direct effect on the earnings of commodity suppliers, but indirectly as well. High commodity prices are beneficial for the local economy as a whole – net inflows, strong currency, low inflation and interest rates.

Graph 4 shows this relationship, visually highlighting the strong correlation between the ALSI measured in dollars and the copper price or 'Dr Copper', as it is known due to its sensitivity to forecast economic growth or confidence.

The relationships noted above have led to some people questioning the relevance of bottom-up investors in a world of historically extreme macro policies, where most assets seem to be rising and falling together.

GRAPH 4 | ALSI in US dollars versus copper

Source: Igraph

Positioning of our portfolios

I believe that bottom-up investing can still be relevant by harnessing the ideas generated from our research into many different businesses and industries in combination with an understanding of current valuations within their historical context.

The outcome of this process is a portfolio that should capture a reasonable portion of the positive returns generated should prices continue to rise in unison but not to the full extent. However, if these trends prove unsustainable, as I believe they ultimately will, our portfolios should exhibit a different return profile from the average as they have:

- Limited direct exposure to assets that derive a majority of their value from the assumed continued commodity intensiveness of Chinese growth, while being exposed to certain commodities such as oil (via Sasol) where Chinese consumption remains relatively low.
- A scepticism towards assets that rely on high leverage and low interest rates offshore to grow or maintain their intrinsic value.
- A full offshore weighting reducing exposure to local assets that have been significant net beneficiaries of the trends driving increased correlations.
- Exposure offshore to much unloved cash return assets, high quality businesses and depressed Japanese equities.
- A higher cash weighting than normal. The return on cash can be thought of in terms of the amount of assets it can purchase, as opposed to the quoted yield. If asset prices decline, the value of the cash in the portfolio rises. This is attractive in a world of high positive correlations.

Global fiscal and monetary policy appear to have resulted in an increase in the positive correlation between assets. South Africa as an 'emerging market commodity-based economy' has been a significant beneficiary of this. Of course, the best protection against a potential reversal of confidence is being able to invest at low prices which provide a margin of safety. In my view this is unfortunately not currently the case.

We remain very aware of the downside risks of the remarkable increase in correlations. As Howard Marks remarked: 'You don't want to be the six-foot man who drowned walking through a river that is five foot deep on average.'

Duncan is a portfolio manager. He joined Allan Gray in 2001 and is a CFA charter holder.

Andrew Lapping

The long-term outlook for the South African bond market

EXECUTIVE SUMMARY: As a bond investor you need to ask yourself two questions: are your inflation expectations reasonable, and will the potential real return be sufficient? Andrew Lapping explains why it is important to take a long-term view and consider the full life of the bond.

South African 10-year bond yields rose sharply over the past six months to 8.9%. A yield of 8.9% seems to be a fairly attractive proposition compared with cash yielding 5.4%. Unfortunately in the bond market, as in life, it is not that simple.

When buying a 10-year bond the question is not what is the pick-up on cash or inflation today, but rather what will the pick-up be over the life of the bond? The reason is, when buying a 10-year fixed rate note, the difference between the initial yield and inflation over the 10-year period determines the real return. If investors require a 3% real rate of return on their money, a 10-year interest rate of 8.9% indicates an expected inflation rate of 5.9% over the period.

> "In addition to the inflation consequences of a weaker currency, the steady increases in administered prices are putting upward pressure on inflation."

As the investor you must ask yourself two questions: firstly, is an anticipated inflation rate of 5.9% a reasonable expectation and secondly, is a 3% real return sufficient?

Inflation outlook

In a small, open economy like South Africa's, the exchange rate is a key inflation driver as imported cost inflation is quickly passed on to the consumer. Over the past 10 years the rand has strengthened 10% against the US dollar, from R7.70/US$ to R6.90, while at the same time weakening 26% against the euro. The general trend of a strengthening currency has been a substantial tailwind in keeping inflation down. From here it is hard to see this tailwind being maintained over the next decade, and the more likely scenario is a weaker currency. This is because the rand is now relatively strong in terms of purchasing power parity against a basket of currencies. If the rand weakens only gradually, in line with inflation differentials, the South African Reserve Bank (SARB) will no longer have the benefit of a strengthening currency. Considering inflation averaged 5.9% over the past 10 years, just inside the target range, the outlook for the next 10 years is less positive.

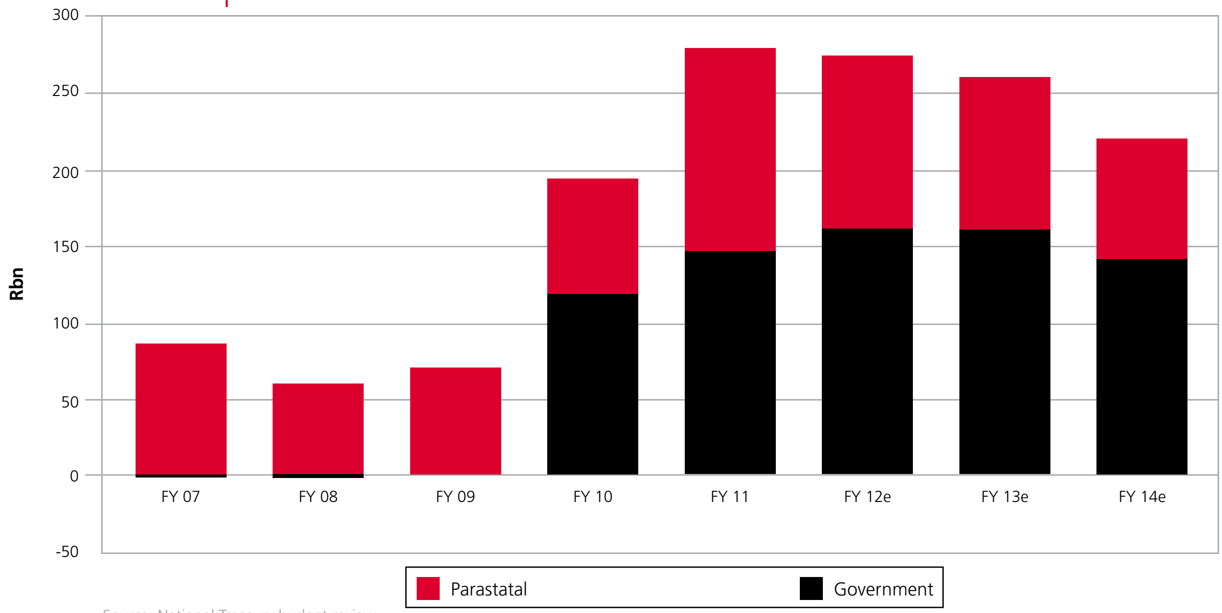
In addition to the inflation consequences of a weaker currency, the steady increases in administered prices are putting upward pressure on inflation. Administered prices, excluding fuel, are currently increasing by 9%, a level not compatible with a long-term inflation rate of below 6%. For example, many listed property companies in South Africa are reporting property occupation cost increases of over 15% due to higher rates and electricity costs. These administered price increases flow through into the cost of doing business in South Africa, which the anecdotal evidence, together with reported wage settlement data, suggest is increasing at a rate well in excess of headline CPI. Unless real wage and administered price increases can be offset by substantial productivity gains, South Africa will not be able to maintain a low and stable inflation rate.

What real return will South African government bond investors require?

Two metrics guide any estimate: (1) the historical real government bond yield, which has averaged 3% since the inflation targeting regime began in February 2000, and (2) the real yield on inflation linked bonds (currently 2.7%). A caveat to this is that inflation linkers have a slightly different risk profile from nominal bonds as your capital is protected in high inflation environments, while the capital losses on nominal bonds can be substantial.

A real return of 3% over the long term is an attractive proposition for non-tax paying investors like South African

GRAPH 1 | Government borrowing requirement



Source: National Treasury budget review

pension funds. Real return is determined by supply and demand: the demand for government debt comes from savers/investors and financial institutions, while the supply is determined by government borrowing. Government borrowing, including parastatals, has picked up recently because of the increasing budget deficit and the infrastructure investment programme (see **Graph 1**). In 2009 government borrowing requirements could be satisfied from the reinvestment of interest and flows into private and public pension funds. Worryingly, the personal savings rate in South Africa is close to zero so the net flows into savings products are limited. These flows are no longer sufficient to meet the government's borrowing requirement.

"… we think it is very difficult to make money out of short-term volatility in the bond market."

During 2010 the demand was met through pension funds shifting their asset allocation towards bonds and the inflow of funds from foreign investors. Foreigners invested a net R84bn into South African debt and equity markets last year. The increased borrowing requirements over the next three years will require a further asset allocation shift and foreign investment. Positive sentiment towards emerging markets from international investors has led to the substantial net flows into South African assets over the past two years. If this sentiment, and hence the flows, reverses, it will put pressure on the government bonds as a big source of demand will disappear. For context, the sum of parastatal and government bonds outstanding is R855bn. This compares with a budgeted additional borrowing requirement of R275bn from these institutions in FY2012.

It may be the case that higher real yields are required to entice investors to move capital from other asset classes into government debt. The shift in yields, if it occurs, may be gradual or take the form of a phase shift where the situation rapidly changes from one where there are sufficient buyers to one where there is a paucity of demand. The Southern European countries are a good example of this. Anyone who took a careful look at the Greek fiscal and economic data could see the situation was unsustainable, or at the very least that the quality of Greek credit was worse than Germany's, but the spread between Greek and German government bonds was very narrow until investors suddenly decided the situation was untenable (see **Graph 2** on page 8). This example is not to say the South African fiscal situation is unsustainable, but rather that the market sometimes ignores certain things until suddenly it decides not to.

The increased government issuance may also cause the term structure of interest rates to change. Historically South Africa has had an unusually flat yield curve from the middle area

GRAPH 2 | Greek and German 10-year bond yields

Source: Datastream

of the curve to the long end. This was caused by a shortage of the long-dated bonds that insurance companies use to hedge their liabilities. Now that the issuance of long bonds has increased, the term structure has begun to normalise as the supply has satisfied demand.

Logically it seems right that a 25-year bond should have a higher yield than a 10-year bond, if you just think about what can happen over 25 years, a lot can change that can affect the value of your asset. In the United States the 30-year bond has traditionally yielded about 0.6% more than the 10-year. In contrast, until very recently the yield on 10-year government bonds was higher than that on 25-year bonds in South Africa (see **Graph 3**). This favours the shorter bonds over the long-term assets, as investors are not compensated suitably for the additional risk of the long bonds.

GRAPH 3 | Difference in yield between South African 10-year and 25-year bonds

Source: Igraph

Our long-term strategy

It may seem overly cautious to focus on the inflation outlook and expected real rates over the next decade when there seem to be opportunities to make money out of short-term volatility. Yet, we believe this is the correct strategy, as we think it is very difficult to make money out of short-term volatility in the bond market. Rather we attempt to get the big trends right, and the only way to anticipate these big trends is to take a long-term view of fair value and always be cognisant of the risks.

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

Sandy McGregor

China's Malthusian challenge

EXECUTIVE SUMMARY: Two years since the global financial crisis and commodity prices are back at the record levels of June 2008. This growth has been about five years quicker than in previous recessions. What makes the present cycle so different is the impact of China, which responded to the economic crisis by accelerating capital expenditure, leading to a surge in demand for energy and raw materials. The question is, can the world keep pace with the growing demand? Sandy McGregor investigates.

The recovery from the recession triggered by the Lehman failure in September 2008 has generally followed a path typical of previous recessions. An exception has been the behaviour of commodities as can be seen in **Graph 1**. In previous cycles it typically took about seven years for prices to return to their old highs. This time, after only two years, prices are back at the record levels of June 2008. Clearly we are witnessing something unprecedented.

What makes the present cycle so different from all the previous ones, is the impact of China. We are witnessing a surge in economic growth in China similar to that experienced by Germany after World War II, Japan between 1960 and 1980 and the Asian Tigers (Korea, Taiwan, Singapore) in the 1980s. What makes China different is its scale. It is the third largest country after Russia and Canada with an area of 9.3m square kilometres. Physically, it is slightly larger than the United States. It is the country with the largest population (1.33 billion). In contrast, other regions that industrialised rapidly are much smaller. Western Europe's population is 395 million and Japan's is 127 million. China aspires to a living standard similar to that of Japan and Europe. To achieve this, it must create an economy three times the size of Western Europe or 10 times the size of Japan.

"... the question being asked is, does the world have the resources and capacity to produce food to meet the growing demand from almost one-third of the world's population?"

Surge in demand for raw materials and energy

The early stages of the development cycle are extremely material intensive. The consumption of raw materials is one of the best measures of the progress China is making in achieving its goals. For example, consider steel consumption. Since Deng Xiaping's economic reforms in 1980 created a market economy, China's steel demand has grown tremendously, as illustrated in **Table 1** (on page 12). Note the acceleration in the growth in demand over the past decade.

Another good metric is energy. China has now overtaken the US as the world's largest energy consumer. About 70% of its energy requirements are met by domestic coal production. Aggregating all energy consumption as an oil equivalent, **Table 2** (on page 12) shows how China's energy demands have more than doubled since 1999.

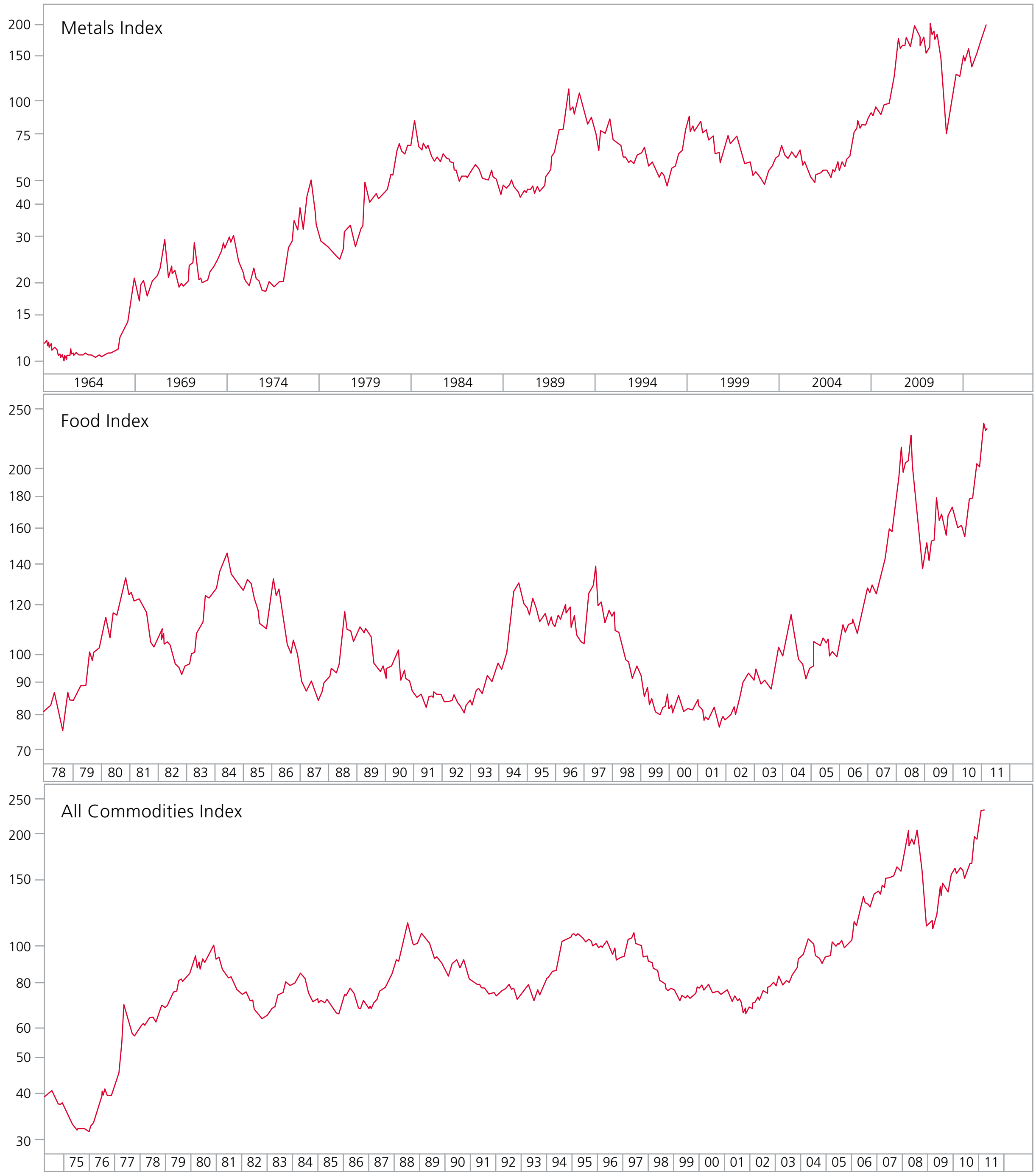
China responded to the recent world economic crisis by accelerating capital expenditure. This is why commodity prices have behaved so atypically in comparison with previous cycles. During the downturn, demand in the biggest consumer of raw materials grew rather than contracted.

Prior to 2003 the mining industry was structured to expand at about 3% annually to meet the growth in global requirements. The sudden addition of China to the equation has roughly doubled demand growth. Commodity producers are struggling to meet these demands and prices have appreciated accordingly.

Can the world keep pace with the growing demand?

The concept of a resource constraint to growth is not new. The most famous proponent of the idea that food would ultimately act as a limit to growth, was Thomas Malthus (1766-1834). He argued that the population would grow inexorably, but there was a limit to potential food production because arable land is finite. Ultimately the competition for

GRAPH 1 | Commodity prices back at 2008 levels



Source: Igraph

food would make the world a miserable place, subject to famines and wars. Malthus's views were rapidly discredited. The world has been able to produce as much food as it needs, due to technology.

Malthus's ideas had a revival in 1972 when the Club of Rome – a think tank of economists and experts founded by the Italian Aurelio Peccei in 1968 – warned that there were limits to growth due to a shortage of energy and raw materials.

Its report entitled 'Limits to Growth' made the institution famous and for some years, during the 1970s, high prices of oil, metals and grains suggested that it might have a case. However, in time the market economy made adjustments which eliminated shortages and set the world on a growth path that lasted over 25 years. There is an old adage that high prices fix high prices and low prices fix low prices. High prices encourage production and discourage consumption by making people more efficient. Certainly in the aftermath of the 1970s this proved to be the case and the Club of Rome's predictions were discredited. However, with the advent of China and increasingly also India as the principal consumers of resources, the question being asked is, does the world have the resources and capacity to produce food to meet the growing demand from almost one-third of the world's population? The Malthusian argument is back.

TABLE 1 | Growth in steel demand in China

Million tons	China	World	China as % of world
1980	45	514	8.8
1990	53	623	8.5
2000	141	870	16.2
2010	630	1393	45.2

Source: UBS

One particular concern is strained water resources, especially in China. To sustain economic growth China will have to greatly expand desalination of sea water so that it can supply its major northern cities such as Beijing and Shanghai with fresh water. Fortunately desalination technology is improving all the time. As long as water is priced to make desalination viable there should be adequate water over time to support large conurbations. However, the investment required will be huge. Agricultural water resource may be a bigger challenge and strikes at the heart of the issue of food security. These problems can be solved but will require considerable commitment and take time.

The world has sufficient energy resources should it choose to develop coal and nuclear power to their full potential. The advent of shale gas may have brought some respite creating a temporary energy surplus. Shale gas is a good example of how a change in technology can profoundly affect prices. However, in the long run coal and nuclear are the only viable options. If one does the mathematics, it soon becomes obvious that renewable energy resources can provide only a small part of global needs and are vulnerable to erratic weather patterns. But both nuclear energy and coal face serious environmental challenges. Regardless of their merits, they are subject to political objections, which may be unfounded, but certainly are prevalent. The political debate about these issues could prevent the energy sector from responding to growing energy demands and precipitate a Malthusian crisis, with energy becoming very expensive and with adverse consequences for economic growth.

Some raw materials have less severe long-term supply constraints and the situation here is not so dire. Mining companies are making big investments in commodities such as iron ore, which currently enjoys an extremely high price. Copper supplies might be more challenging, but consumers will respond by redesigning products to use less copper. The old adage that high prices will cure high prices will prevail.

TABLE 2 | Energy consumption in China

Million tons oil equivalent	China	World	China's share %
1999	935	9 030	10.6
2009	2 177	11 164	19.5

Source: BP

Malthusian pessimists argue that for certain commodities, such as oil and copper, we are reaching the limit of what can be produced and it will not be possible for emerging markets to grow their economies substantially from current levels. Given time, we should not underestimate the ability of a market economy to adapt to new circumstances. The challenge is that the huge economies of China and India may now be growing too fast for the mining, energy and food sectors to keep pace. Shortages are driving up prices, causing inflation and forcing consumers to reallocate their budgets toward food and energy at the expense of other potential purchases. World economic growth may be unsustainably high.

Sandy joined Allan Gray in October 1991. His current responsibilities include the management of fixed interest and individual client portfolios. Previously he was employed by Gold Fields of South Africa Limited for 22 years where much of his experience was focused on investment-related activities.

Chris du Toit

The offshore conundrum

EXECUTIVE SUMMARY: A question often asked of us is: 'How much should I invest offshore?' This question has a different answer for each person. Another, perhaps more important, question to ask is: 'Why am I investing offshore in the first place, and what should I be investing in?' Chris du Toit examines some of the options.

Why invest offshore?

Returns of developed market equities have continued to lag behind the returns of emerging market equities. Emerging markets, including South Africa, have enjoyed strong inflows of capital from abroad, supporting valuations on our stock markets and helping the rand to strengthen by nearly 25% versus the US dollar in 2009 and 2010. This strong rand has been one reason why inflation has remained subdued over the last year, as approximately one-third of the items in our inflation basket are imported.

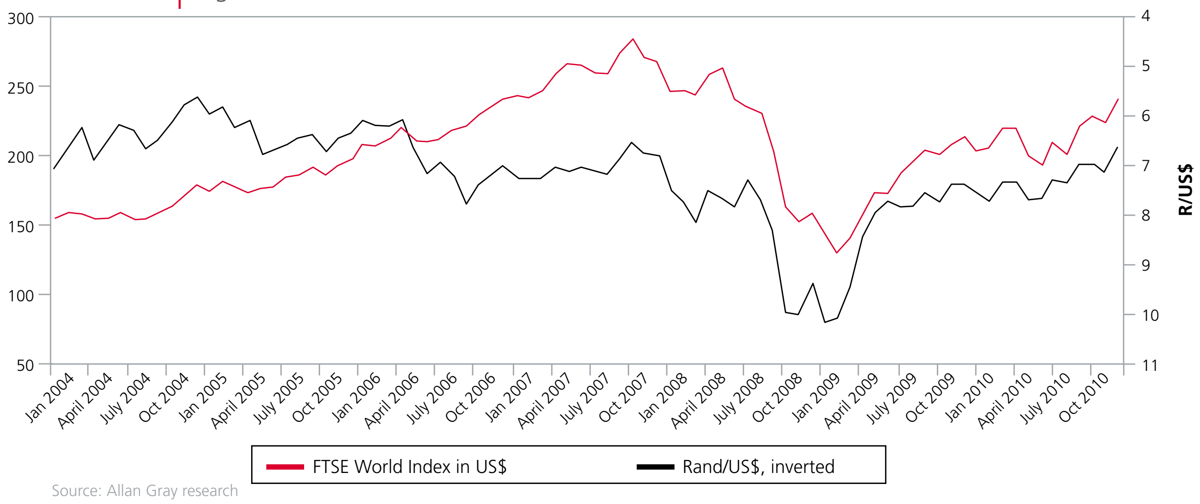
For long-term saving to be successful, the value of your investments must keep pace with inflation, and preferably beat it over the long term. A strong rand tends to drive inflation down; a weakening rand typically leads to higher inflation. To be protected against higher inflation from a weak rand, it may help to be invested offshore as the value of your assets in rand terms should grow as the currency weakens. We think there is a real risk that the rand may weaken from current levels, and therefore believe that foreign exposure is an appropriate addition to clients' portfolios.

What are the options?

There are many options for investors offshore. Shares are an obvious place to start for people with a long time horizon. It is also important to consider other options when looking abroad. An interesting dynamic is the growing link, or correlation, between share prices globally and the value of emerging market currencies. This link can work against you if you are investing in offshore equities in order to enjoy the benefits of rand weakness.

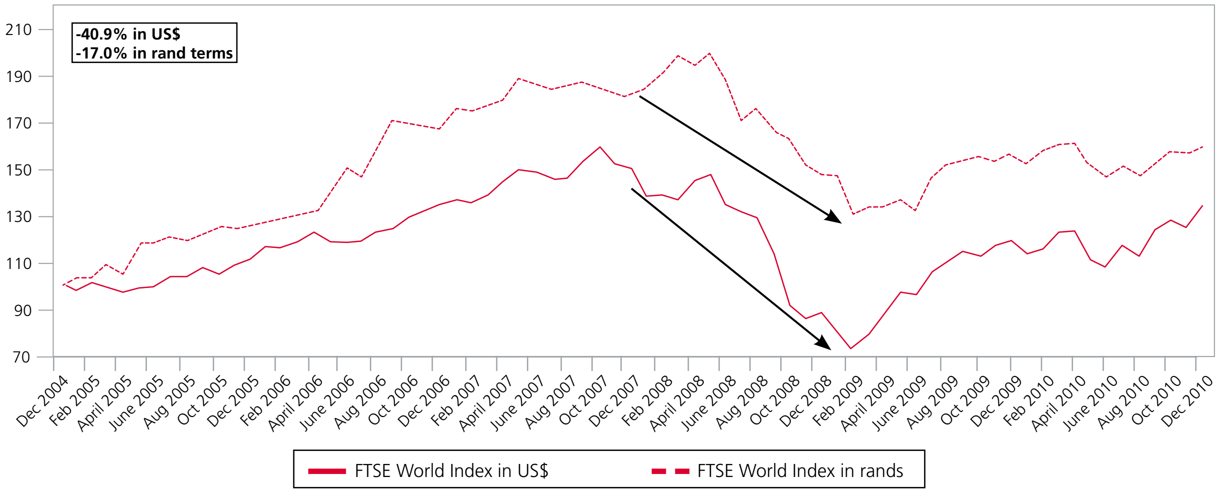
With emerging markets currently the destination of choice for global investors, there has been an increasing correlation between the performance of shares and the movement in emerging market currencies. Emerging markets are widely

GRAPH 1 | High recent correlation between world stock markets and the rand



Source: Allan Gray research

GRAPH 2 | FTSE World Index in US dollars and rands



Source: Allan Gray research

perceived to offer investors better prospects for growth at higher levels of risk than developed markets. When investors are in the mood to take on risk, the resulting capital inflows in these markets have caused their currencies to strengthen and their share prices to rise at the same time. South Africa recorded net inflows of R186 billion from foreigners into our stock and bond markets during 2009 and 2010.

When investors become risk averse they sell shares – in their own markets and indeed in emerging markets. As money flows back to developed markets, the currencies of emerging markets weaken. This is illustrated in **Graph 1** (on page 13), which shows the FTSE World Index and the rand/US dollar exchange rate, with the exchange rate inverted on the right hand y-axis, in order to better illustrate the correlation. As markets rise, the rand strengthens versus the US dollar, and vice versa.

"We think there is a real risk that the rand may weaken from current levels..."

Being invested offshore should protect you from rand weakness. However, if the losses on equities abroad exceed the extent to which the currency weakens you could still end up with fewer rands in your pocket. **Graph 2** illustrates the point. During 2008 the rand weakened by 40% as foreigners sold our shares and bonds. The problem was that they also sold shares elsewhere, leading the FTSE World Index to fall by 40.9% in 2008. Despite the rand weakness, an investment in global equities measured in rand terms returned -17%.

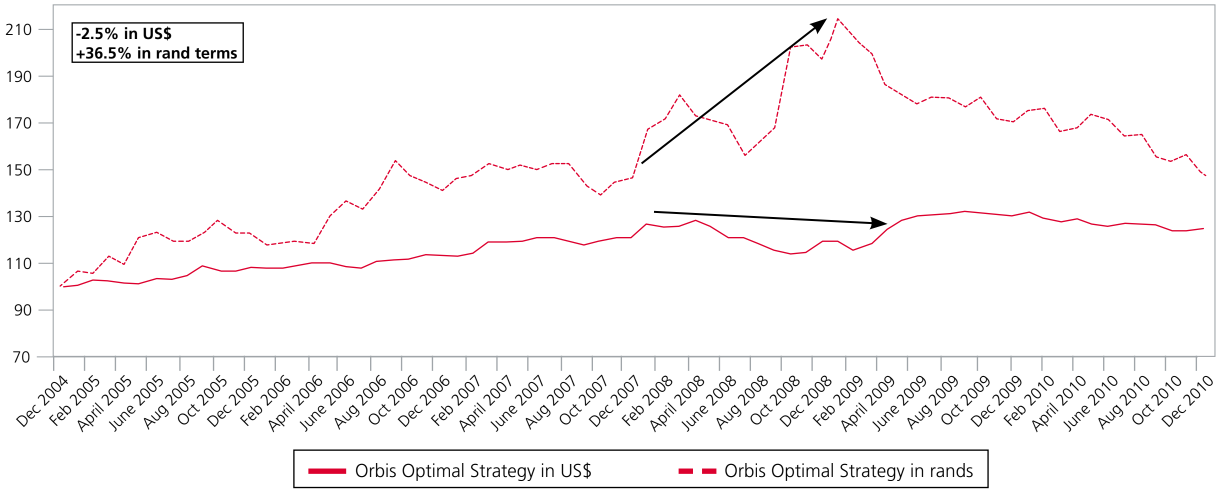
Alternatives to equities

By investing in assets that are not exposed to these market forces, investors can potentially benefit more from rand weakness.

Allan Gray uses the Orbis Optimal SA funds as uncorrelated assets offshore, being alternatives to cash and bonds. The Optimal funds invest in Orbis's underlying shares and remove the exposure to stock markets by selling futures contracts. The returns generated by these funds therefore depend on interest rates (through the way the futures contracts are priced), and the relative out- or underperformance of Orbis's shares compared to world markets. An important characteristic of the Optimal funds, is that their returns are not correlated to major asset classes. Over the last 20 years the correlation of the Optimal funds to global stock markets has been 0, and to bond funds it has been 0.2. Since Orbis's outperformance is unpredictable and not dependent on specific market conditions, the Optimal funds are able to produce positive returns independent of bull or bear markets.

An example of this was in 2008, when the Orbis Optimal strategy denominated in US dollars returned -2.5% in US dollar terms (see **Graph 3**). This allowed investors to benefit from the rand weakening, resulting in a positive 36.5%

GRAPH 3 Orbis Optimal Strategy in US dollars and rands



Source: Allan Gray research

return in rands. This illustrates how useful an uncorrelated investment can be as part of a broader portfolio, as it can provide positive returns in conditions where most other asset classes experience losses.

Benefiting from currency weakness is always an objective for investors heading offshore. If correlations between the rand exchange rate and global markets remain as high as they have been recently, an uncorrelated offshore asset, such as one of the Orbis Optimal SA funds, may prove to be a useful addition to a portfolio.

Chris is a qualified actuary and has been a member of the institutional client servicing team since 2004. He is responsible for Orbis client service in South Africa.

Richard Carter

Living annuities for life

EXECUTIVE SUMMARY: Living annuities need to provide an income stream for life. This means that the asset allocation in your living annuity investment should be aimed both at maintaining your income level and providing long-term growth. Richard Carter discusses some of the factors that you should consider when making your asset allocation decisions.

It is well known that intelligent diversification between different asset classes can have a significant impact on an investor's returns. Careful asset allocation is particularly important in a living annuity, because the decisions you make will influence how long your investment will last and what standard of living you will be able to afford. Investment decisions are complex and, if you don't have the time or the expertise to research the options yourself, you may wish to consult an independent financial adviser.

Where to start with asset allocation decisions

Getting the balance right on an ongoing basis is difficult. Before you begin, you should consider how much growth you need to sustain your investment and how much risk you can afford to take.

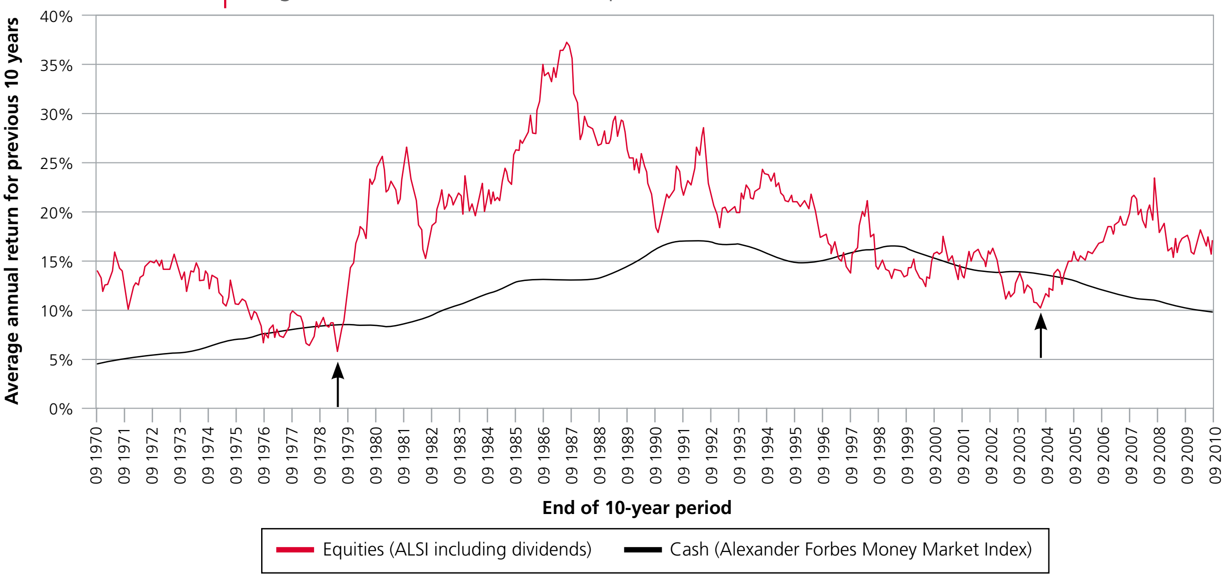
Based on this you should:

1. Look for assets that offer long-term growth potential.
2. Allocate capital to these assets based on your risk appetite and ability to handle decreases in income.

1. Look for assets that offer long-term growth potential
A key step in the investment planning process is to decide which asset classes currently offer value for money. Try not to make the mistake of investing in assets based on recent outperformance.

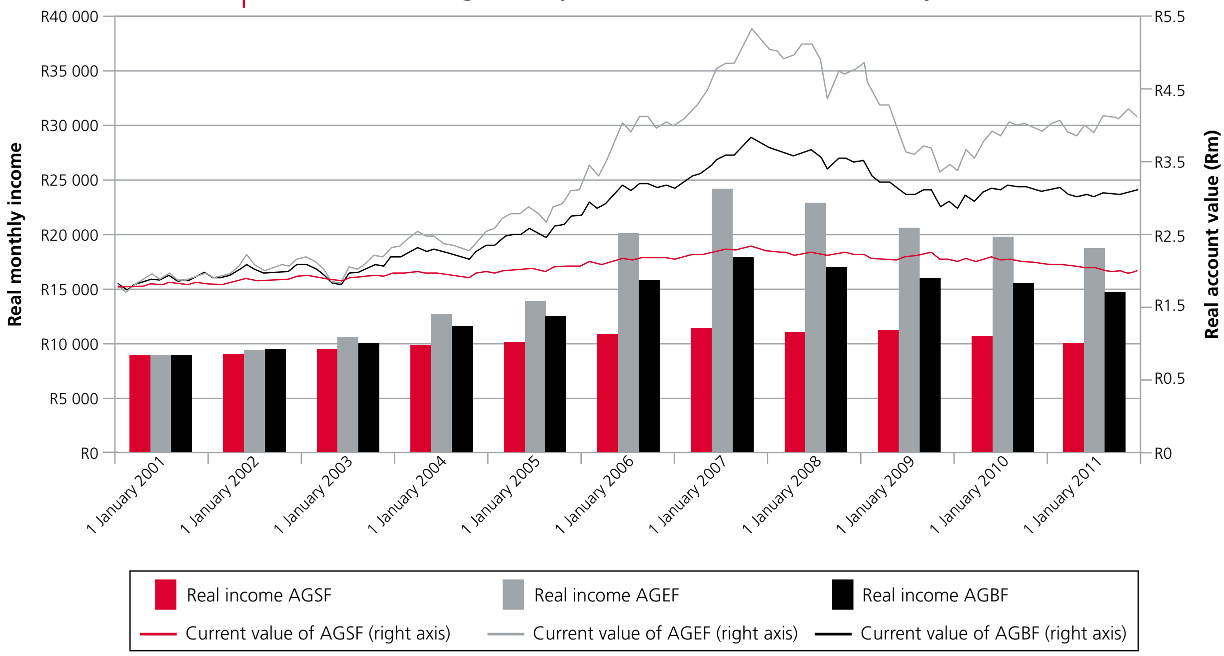
Graph 1 shows the long-term historic returns of equities and cash in South Africa. Each point represents the average performance over the previous 10 years. Investors looking at

GRAPH 1 | Long-term historic returns of equities and cash in South Africa



Source: Allan Gray research

GRAPH 2 | Real value of living annuity with 6% drawdown over 10 years



Source: Allan Gray research

the 10-year performance up to either of the points indicated by the arrows, may have chosen to allocate a higher proportion of their investment to fixed interest rather than equities. These investors would then have missed out on the next 10 years of growth. The graph illustrates that past performance is a misleading indicator of future performance. Instead of looking at past performance, you should base your initial asset allocation on whether or not the asset is undervalued and likely to increase in value over the long term.

Graph 1 also shows that over the past 50 years equities have outperformed cash in 83% of the 10-year periods shown, making them the traditional asset choice for providing investment growth. However, domestic equities have just had a great 10-year run and we do not believe that they are currently undervalued. It is unlikely that this level of outperformance will be repeated in the next 10 years.

2. Allocate capital to assets based on your risk appetite and ability to handle decreases in income

Asset classes with the potential for greater returns come at the expense of increased risk of capital loss as well as increased short-term volatility. Therefore, if you want to enjoy the benefit of greater lifetime income, you must be prepared to tolerate both these risks. In a living annuity your ability to handle volatility is especially important as it affects both your investment growth and the income you receive. Specifically, you should be able to restrict your income if growth disappoints and is low or negative.

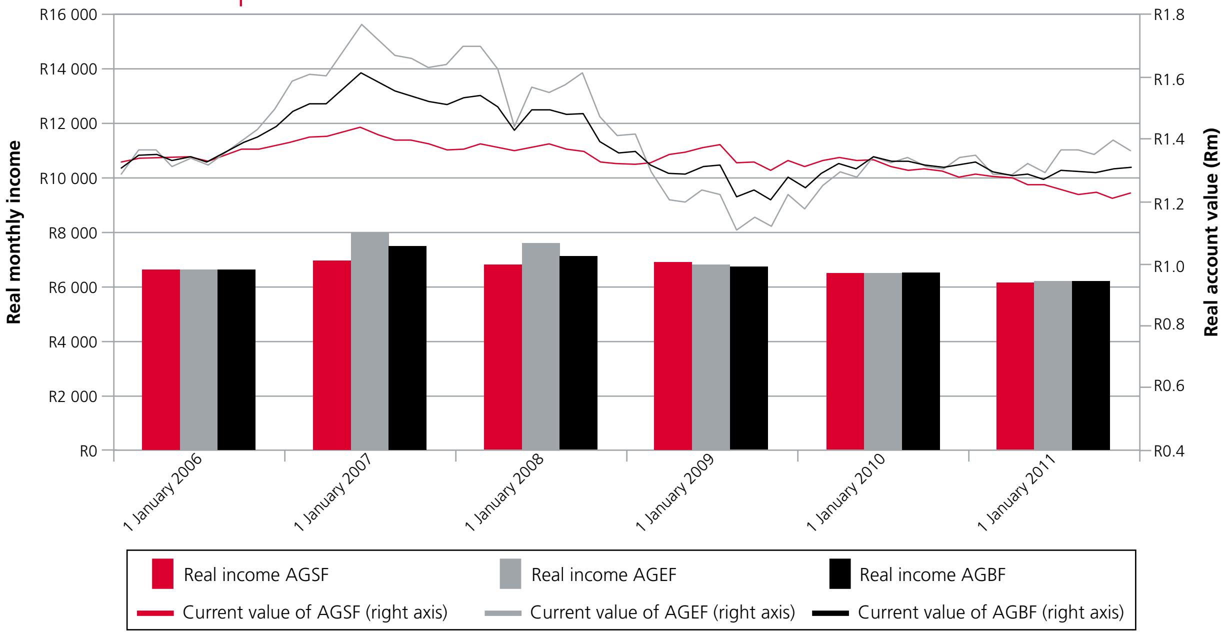
There are many unit trusts available that allow you to hand over your asset allocation decisions to the investment manager. These are called asset allocation or solution funds. Even if you invest in these funds, it is important to ensure that the fund you choose matches your risk appetite.

Investors who are able to stomach some risk and can remain disciplined throughout the investment may benefit from a balanced asset allocation, such as the Allan Gray Balanced Fund. This Fund has a diversified portfolio with exposure to a mix of assets with potential for growth and capital stability. Investors who are more conservative and unable to tolerate lower income during down times may find that an investment with more focus on capital stability is more suitable, such as the Allan Gray Stable Fund.

How does volatility impact on your investment?

Graph 2 compares an investment in the Allan Gray Equity Fund (AGEF), Balanced Fund (AGBF) and Stable Fund (AGSF). The bars show the real monthly income drawn from each investment, every year for the past 10 years, as well as the income that would be drawn for the current year. The line graphs show the value held in the investment account over

GRAPH 3 | Real value of living annuity with 6% drawdown over five years



Source: Allan Gray research

the period expressed in today's prices. As one would expect, due to the outperformance of equities over the last 10 years, the Equity Fund clearly outperformed the Balanced and Stable funds in terms of both increased capital growth and greater income.

If you consider Graph 2, you could conclude that a living annuity should be 100% invested into equities instead of into an asset allocation fund. Not only would you be banking on equities outperforming in the future, as they have over the past 10 years, you would also run an increased risk of capital loss and increased short-term volatility. This is demonstrated in **Graph 3**. Three living annuity investments are shown over a shorter five-year term, in which the Equity Fund experienced a sharp drop in value of about 37% from 2007 to 2009. Over the five years, the three investments produced similar real monthly income levels and final capital values, although this is due to the very strong recovery in the Equity Fund over the last two years. Looking at the situation in early 2009, the investment in the Equity Fund was 16% below the Stable Fund, and many investors jumped ship, locking in the drop in value of the previous two years.

The investments illustrated in Graphs 2 and 3 assume a constant income level of 6% drawn throughout the investment. While the percentage income remained the same, in the volatile equity investment, the rand amount the investor withdrew would have changed depending on the performance of the Fund. During up times, the investor would have enjoyed increased income in rand terms, while in the down times income would have been lower.

To cope with this volatility, instead of drawing an income set at a constant percentage, you should consider setting your income in rands and then increasing it yearly with inflation. Returns not withdrawn during the up times help to cope with periods of low or negative returns. During periods of negative growth, you may need to decrease the amount withdrawn to protect capital, as drawing too high an income can erode capital quickly.

Asset allocation decisions should always be based on value and be influenced by your ability to stomach risk. The two common pitfalls of choosing asset classes based on recent past performance, and ignoring the effects of volatility, could mean that your living annuity runs out too soon.

Richard is part of the institutional client servicing team. He joined Allan Gray in 2007 after working for several years in financial services in the UK. Richard completed his B Bus Sc degree at UCT and is a qualified actuary.

Rob Formby

Questions for personal investing

EXECUTIVE SUMMARY: Rob Formby suggests five questions you may want to ask regarding your personal investments. Every person's situation is unique, so the list is not exhaustive. It is more a starting point to get you thinking about current and future investments.

1. Do you know what you want to achieve?

The purpose of an investment is very specific to individuals and their particular circumstances. Perhaps you wish to build up investments for a future date, or live off your investments, or a combination of both. Alternatively, you may be investing for specific needs such as your child's education, building up capital to buy a business, or developing an inheritance for future generations. If you are clear about your purpose, it is easier to decide on your time horizon, return objectives and your ability to tolerate uncertainty. Ultimately, having an objective allows you to plan; without a plan it is less likely that your long-term purpose will be achieved.

If you need to draw an income from your investment the question that arises is how much can you comfortably draw in a sustainable way.

Sustainability is related to the amount of income drawn (as a percentage of the investment) and the growth of the investment. The higher the income drawn, the shorter the time that the investment will sustain this income. And the higher the return, the longer the investment will sustain the income. However, the potential for higher returns leads to more risk, which could negatively affect the investment. (You can read more about asset allocation in living annuities in Richard Carter's piece on page 16).

"... disciplined adherence to an investment strategy is the single most important factor in generating superior returns over the long term."

2. Are you using the right investment manager(s)?

If you choose to invest in unit trusts instead of, for example, directly into shares, you need to be comfortable with the investment manager's philosophy and fees and trust that your manager will accomplish what you want. Different investment managers have different ways of investing (philosophies) and they follow these with different resolve. If you understand and buy into a certain approach to managing money, the likelihood is that your investing behaviour will be aligned with the investment manager's, improving your chances of achieving investment success.

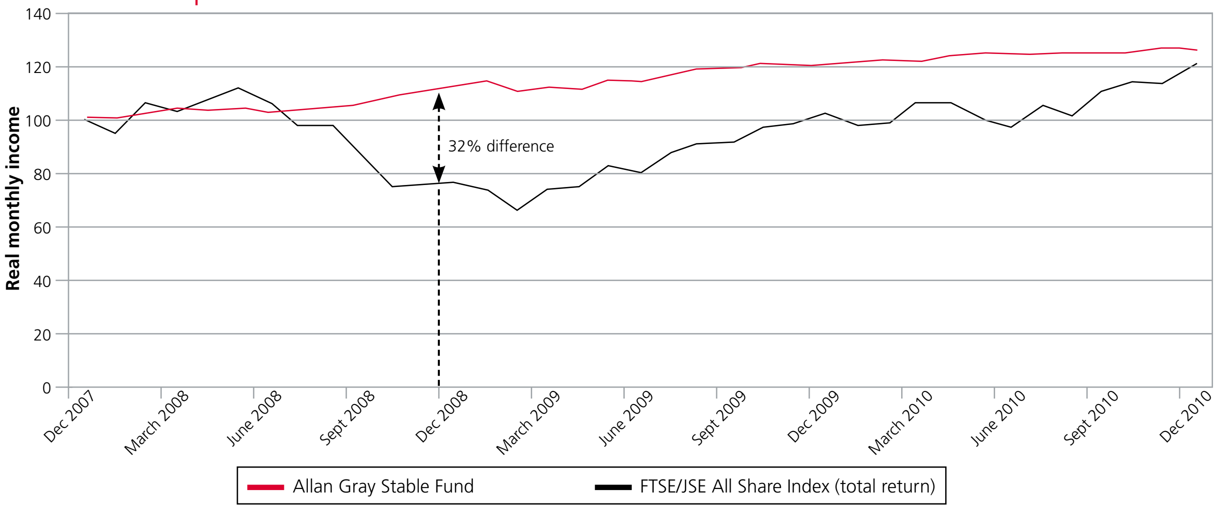
Investment managers charge fees for managing your investment. You need to understand these and be comfortable with them. Allan Gray adheres to the principle that fees should be transparent and that, where possible, fees should be linked to performance.

Allan Gray's range of unit trusts

At Allan Gray we offer a simple range of unit trusts as personal investments, as we believe they allow easy and affordable access to financial markets. For a relatively small amount of money, our nine unit trusts provide access to experts, skilled in managing money and backed by a highly experienced research team.

There are broadly two types of unit trusts at Allan Gray – solution unit trusts and building block unit trusts. Solution unit trusts offer investors exposure to a variety of assets normally including equities, bonds, cash and property. Because you invest in a single unit trust, you don't have to worry about how to divide your exposure to different asset classes; the unit trust manager does it for you. Building blocks contain individual asset classes, such as equities or bonds. You can use these as building blocks to create your own portfolio.

GRAPH 1 | Performance of the Allan Gray Stable Fund and the FTSE/JSE All Share Index



Source: Allan Gray research

You need to trust your investment manager. Trust has a number of facets – you need to trust (1) in the competence of the manager to deliver returns, (2) the manager's ethics and (3) that the manager will stay in business.

3. Does your investment adequately balance risk vs. return?

Higher returns are generally associated with more risk. If risk was not a consideration, every person would opt for the higher returns. However, risk is a real issue and manifests itself as follows:

1. If your investment is ill-conceived or if you pay too much for an investment you could suffer a permanent loss of capital.

2. Performance could be volatile which, depending on your switching behaviour, may cause you to underperform the funds that you are invested in.

3. The higher returns that you envisage may not materialise.

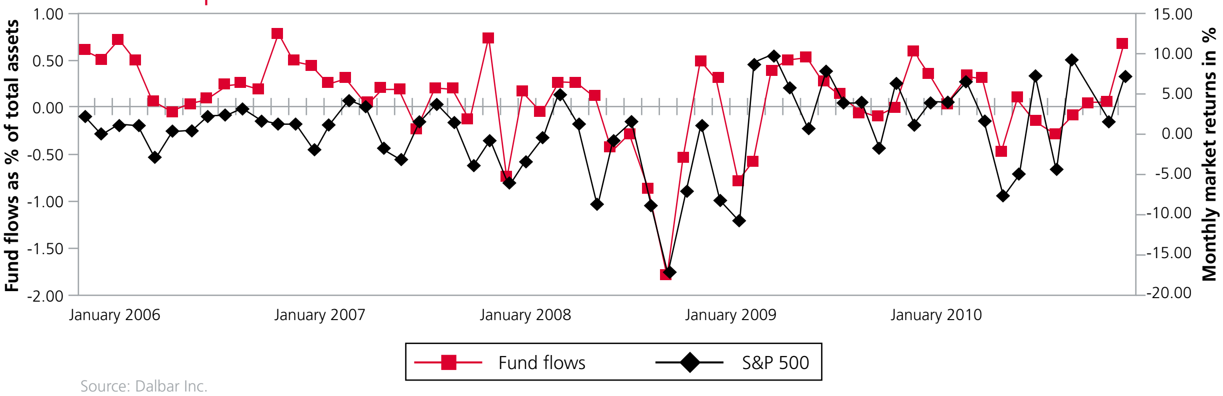
You can assess the sensitivity that you have for each of these factors by answering these questions:

- **Would short-term price movement affect your discipline as a long-term investor?** If you had an investment into equities (as represented by the JSE All Share Total Return Index) the market crash in 2008 would have seen the value of this investment drop by 45%. Even for those equity investors who were fully prepared for this level of risk, it was an extremely uncomfortable and uncertain time with a high risk of losing nerve – and yet also a very bad time to sell.

- **Will you need to withdraw money in the short term? Graph 1** shows the performance of the Allan Gray Stable Fund and the FTSE/JSE All Share Index (ALSI). If you needed to sell your investment after year one (end 2008) the volatility gives rise to a large difference between the Stable Fund and the ALSI. In addition, the three-year return of the ALSI to the end of February is 4.6% annualised, which is comparable to the 7.2% annualised for the Allan Gray Stable Fund. While the example is extreme, the effects of volatility associated with the timing of the buy and sell, can be large and long lasting. One thing to consider is emergency funding. Investments take a long time to build up and may not be sufficient to cover the unforeseen. If catastrophe strikes (e.g. you have a medical emergency, your house burns down etc.) and you are inadequately insured against this, the effects can tear a hole in your investment objectives.

- **How certain do you need to be of achieving your desired returns?** Although more risky instruments have a higher potential for returns, these returns are not guaranteed. For example, although the US equity market generally has higher potential for returns than the bond market, an investor in the US equity market from 2000 to 2010 would have earned less than an investor in the US bond market. If you need to be certain of your investment growth you should potentially

GRAPH 2 | Investor fund flows and market performance for the five years ended 31.12.2010



Source: Dalbar Inc.

look at less risky, more predictable options. In addition, the South African equity market has had a fantastic decade, outperforming most indices. There is a risk that investors are basing their current expectations on past information.

4. Is your own behaviour undermining your investment return?

In most studies comparing unit trust returns to returns achieved by the average investor within the unit trust, investor return is lower. The difference is generated when investors make poor decisions on when to buy and sell.

Graph 2, courtesy of Dalbar Inc. and based on a US study, shows how flows out of a unit trust are at their greatest when the performance is lowest. Since this is actually the worst time to sell, and therefore locks in the loss, this is a good example of how investment decisions based on emotion, rather than reason, negatively impact an investor's return. The effects of this were estimated to give rise to a difference in returns in excess of 5%.

Because markets can be volatile over the short term, investors are strongly encouraged to invest for the long term. At Allan Gray we believe that the disciplined adherence to an investment strategy is the single most important factor in generating superior returns over the long term.

5. Are you invested in the right product?

When deciding which product best suits your needs, you should consider factors such as when you will need to access your investment, how your investment will be taxed and what happens to your investment in the event of your death. The product (sometimes referred to as the product wrapper) is essentially an overlay on the unit trusts that you choose for investments. For example, you can invest in a retirement annuity and within this product the investments are in unit trusts.

Different products fulfill different needs:

- **A unit trust:** Allows you to use a relatively small amount of money to buy 'units' of a fund that invests in a wide range of shares, bonds and other assets. You can access your money at any time.
- **A retirement annuity fund:** Allows you to save for retirement in a tax-efficient manner, but does not generally allow withdrawals before you retire.
- **A preservation fund:** Allows you to preserve and grow your existing retirement benefits.
- **A living annuity:** Allows you to draw an income from your investment after you retire.
- **An endowment policy:** Allows you to grow your money and benefit from an estate-planning tool, but restricts withdrawals and additional contributions (suitable for higher income earners).

Often legislation limits your choice of products. For example, if you want to preserve your retirement savings when leaving your employer, you can only transfer your money to either a retirement annuity or a preservation fund. And your choice of products can make quite a big difference to what will happen when you die, especially if you have dependants:

- Unit trusts are like any other asset and should be included in your comprehensive will. Remember that joint accounts are frozen by South African law upon your death until your estate is wound up.
- Living annuities and endowments are technically forms of life insurance, and as such, they are passed on

to your nominated beneficiaries. Living annuities do not attract estate duty and do not need to wait for your estate to be wound up. Endowments will form part of your estate.

- Your retirement annuity investments are technically a type of pension fund. When you die, the trustees of all of your pension fund investments are not bound by your will and they have to consider the needs of your dependants before nominated beneficiaries. This can take some time.

If you are unclear about any of the questions above, if you lack the knowledge or confidence to manage your investments, if you lack the discipline to save, if you are worried about your investments in the event of your death or if you would like to explore alternatives to the way you currently invest, then it would be worthwhile seeking independent financial advice. Independent advisers can assist you not only in making investment decisions, but with planning your investments and making some of the choices that have been mentioned above.

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.

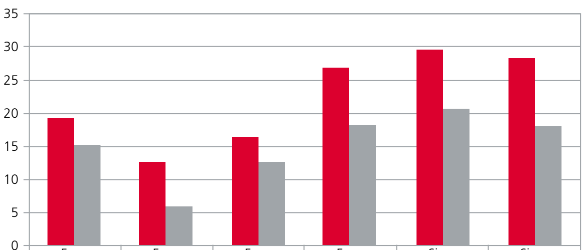
Unit trusts	A unit trust is a savings vehicle for investors who want to grow their money and may want to access it before they retire. Unit trusts allow investors to pool their money with other investors who have similar investment objectives. Unit trusts are also known as 'portfolios of collective investment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

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

Investment track record - share returns

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	20.9	19.0	1.9
2011 (to 31.03)	1.7	1.1	0.6

Returns annualised to 31.03.2011



	From 01.04.2010 (1 year)	From 01.04.2008 (3 years)	From 01.04.2006 (5 years)	From 01.04.2001 (10 years)	Since 01.01.1978	Since 15.06.1974
Allan Gray*	19.2	12.6	16.3	26.6	29.4	28.1
ALSI	15.2	5.8	12.6	18.2	20.5	17.9

* 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.

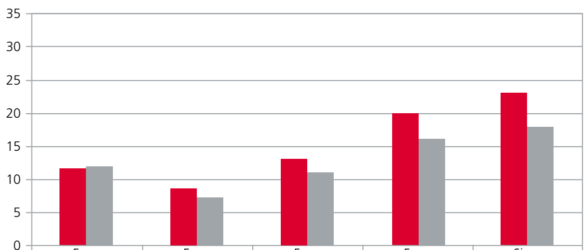
Note: Listed property included from 1 July 2002.

An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown, before the impact of fees, to **R90 516 881** by 31 March 2011. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to **R4 296 332**.

Investment track record - balanced returns

Allan Gray Limited global mandate total returns			
	vs. Alexander Forbes Large Manager Watch		
Period	Allan Gray*	AFLMW**	Out/ underperformance
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 (to 31.03)	2.4	2.0	0.4

Returns annualised to 31.03.2011



	From 01.04.2010 (1 year)	From 01.04.2008 (3 years)	From 01.04.2006 (5 years)	From 01.04.2001 (10 years)	Since 01.01.1978
Allan Gray	11.7	8.6	13.1	20.0	23.1
AFLMW**	11.9	7.2	11.1	16.1	17.9

** 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 2011 is an estimate.

An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown, before the impact of fees, to **R10 031 902** by 31 March 2011. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to **R2 389 526**.

Allan Gray Balanced and Stable Fund asset allocation as at 31 March 2011

	Balanced Fund % of portfolio			Stable Fund % of portfolio		
	Total	**SA**	**Foreign**	**Total**	**SA**	**Foreign**
Net equities	57.3	42.7	14.7	17.9	5.1	12.8
Hedged equities	10.6	3.0	7.6	28.8	18.5	10.3
Property	0.3	0.3	-	0.1	0.1	-
Commodities (gold)	3.2	3.2	-	4.8	4.8	-
Bonds	9.8	9.8	-	9.4	9.4	-
Money market and bank deposits	18.7	16.3	2.4	39.0	37.2	1.8
Total	**100.0**	**75.3**	**24.7**	**100.0**	**75.2**	**24.8**

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

Allan Gray Equity Fund net assets as at 31 March 2011

Security (ranked by sector)	Market value (R million)	% of fund	JSE ALSI weight (%)
Resources	**7 446**	**28.1**	**44.1**
Sasol	3 109	11.7	
Anglogold Ashanti	1 434	5.4	
Harmony Gold Mining	744	2.8	
Impala Platinum	556	2.1	
Gold Fields	374	1.4	
Anglo American	283	1.1	
Positions less than 1%	945	3.6	
Financials	**3 546**	**13.4**	**18.7**
Sanlam	1 181	4.5	
Standard Bank	955	3.6	
Positions less than 1%	1 409	5.3	
Industrials	**14 262**	**53.8**	**37.2**
British American Tobacco	2 759	10.4	
SABMiller	2 711	10.2	
Remgro	1 896	7.2	
MTN	1 076	4.1	
Mondi	896	3.4	
Sappi	632	2.4	
Nampak	502	1.9	
Tongaat-Hulett	430	1.6	
Netcare	326	1.2	
Illovo Sugar	320	1.2	
Datatec	292	1.1	
Positions less than 1%	2 421	9.1	
Other securities	**605**	**2.3**	
New Gold ETF	394	1.5	
Positions less than 1%	211	0.8	
Money market and call deposits	**638**	**2.4**	
Totals	**26 496**	**100.0**	

Allan Gray Unit Trusts annualised performance in percentage per annum to 31 March 2011

	3 MONTHS (unannualised)	1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R million)	INCEPTION DATE
High net equity exposure (100%)								
ALLAN GRAY EQUITY FUND (AGEF)	[3]	16.8	8.5	12.8	22.7	29.2	26 496.1	01.10.98
FTSE/JSE All Share Index		15.2	5.8	12.6	18.2	19.3		
ALLAN GRAY-ORBIS GLOBAL EQUITY FEEDER FUND (AGOE)	[3]	2.7	-3.8	6.8	-	10.0	4 959.0	01.04.05
FTSE World Index (Rands)		5.6	-5.1	5.3	-	7.6		
Medium net equity exposure (40% - 75%)								
ALLAN GRAY BALANCED FUND (AGBF)	[3]	11.0	7.5	11.6	18.8	20.5	42 431.3	01.10.99
Average of both Prudential Medium Equity category and Prudential Variable Equity category (excl. AGBF)		10.0	6.1	9.3	14.5	14.1		
ALLAN GRAY-ORBIS GLOBAL FUND OF FUNDS (AGGF)	[3]	-4.3	-3.7	7.1	-	6.3	6 538.2	03.02.04
60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index (Rands)		3.6	-3.4	7.5	-	6.2		
Low net equity exposure (20% - 40%)								
ALLAN GRAY STABLE FUND (AGSF) - (NET OF TAX)	[3]	4.8	6.2	9.0	12.1	12.8	27 266.8	01.07.00
Call deposits plus two percentage points (Net of tax)		5.4	7.2	7.3	7.5	7.6		
ALLAN GRAY STABLE FUND (AGSF) - (GROSS OF TAX)	[3]	5.5	7.2	10.0	13.3	14.0	27 266.8	01.07.00
Call deposits plus two percentage points (Gross of tax)		7.3	9.8	9.9	10.2	10.3		
Very low net equity exposure (0% - 20%)								
ALLAN GRAY OPTIMAL FUND (AGOF)	[3]	5.1	7.9	8.2	-	9.0	2 851.0	01.10.02
Daily call rate of FirstRand Bank Ltd		5.1	7.6	7.7	-	7.7		
ALLAN GRAY-ORBIS GLOBAL OPTIMAL FUND OF FUNDS (AGOO)	[3]	-6.0	-	-	-	-7.7	486.5	02.03.10
Average of US$ bank deposits and Euro bank deposits		-4.7	-	-	-	-8.3		
No equity exposure								
ALLAN GRAY BOND FUND (AGBD)	[3]	9.1	10.6	8.2	-	9.3	290.2	01.10.04
BEASSA All Bond Index (total return)		8.3	10.1	7.3	-	8.7		
ALLAN GRAY MONEY MARKET FUND (AGMF)	[3]	6.7	9.0	9.0	-	9.2	8 300.1	03.07.01
Domestic fixed interest money market unit trust sector (excl. AGMF) [2]		6.4	8.8	8.8	-	9.1		

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	Global Optimal Fund of Funds
Performance component	0.94%	0.31%	0.06%	0.00%	0.20%	0.00%	0.34%	0.60%	0.06%
Fee at benchmark	1.71%	1.17%	1.15%	1.14%	0.29%	0.29%	1.24%	1.49%	0.96%
Total fees*	2.65%	1.48%	1.21%	1.14%	0.49%	0.29%	1.58%	2.09%	1.02%
Trading costs	0.10%	0.09%	0.06%	0.14%	0.00%	0.00%	0.16%	0.13%	0.18%
Other expenses	0.01%	0.02%	0.02%	0.01%	0.04%	0.01%	0.07%	0.05%	0.08%
Total Expense Ratio (TER)	2.76%	1.59%	1.29%	1.29%	0.53%	0.30%	1.81%	2.27%	1.28%
Annualised fee* rate for latest quarter	0.56%	0.80%	1.17%	1.14%	0.38%	0.29%	1.67%	2.31%	0.94%

** Including underlying Orbis Fund fees.*

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 31 December 2010. Included in the TER is the proportion of costs incurred by the performance component, fee at benchmark and other expenses. These are disclosed separately as percentages of the net asset value. Trading costs (including brokerage, VAT, STT, STRATE, levy and insider trading levy) are included in the TER. A high TER will not necessarily imply a poor return nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs.

Orbis Funds annualised performance in percentage per annum to 31 March 2011

	3 MONTHS (unannualised)	1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R million)	INCEPTION DATE
ORBIS FUNDS (RANDS) REGISTERED FOR MARKETING IN SOUTH AFRICA [1, 6]								
ORBIS GLOBAL EQUITY FUND (RANDS)	7.7	2.8	-3.7	7.2	8.9	18.1	-	01.01.90
FTSE World Index (Rands)	6.3	5.2	-5.1	5.4	3.7	11.6		
ORBIS JAPAN EQUITY (YEN) FUND (RANDS)	-0.4	-5.1	-4.9	-0.3	4.1	12.5	-	01.01.98
Tokyo Stock Price Index (Rands)	-2.4	-5.9	-8.8	-3.1	0.0	5.0		
ORBIS ASIA EX-JAPAN EQUITY FUND (RANDS)	6.9	4.3	0.2	14.5	-	14.9	-	01.01.06
MSCI Asia Ex-Japan (Rands)	2.8	10.1	-1.3	13.2	-	13.9		
ORBIS OPTIMAL SA FUND – US$ CLASS (RANDS)	4.4	-7.6	-4.4	6.5	-	7.9	-	01.01.05
US$ Bank Deposits (Rands)	1.7	-7.6	-5.1	4.7	-	5.9		
ORBIS OPTIMAL SA FUND – EURO CLASS (RANDS)	10.1	-3.8	-6.6	8.7	-	7.7	-	01.01.05
Euro Bank Deposits (Rands)	8.2	-2.8	-7.9	7.7	-	6.2		

Segregated and life pooled portfolios annualised performance in percentage per annum to 31 March 2011

	3 MONTHS (unannualised)	1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R million)	INCEPTION DATE
SEGREGATED PORTFOLIOS [5]								
GLOBAL BALANCED COMPOSITE	2.4	11.7	8.6	13.1	20.0	23.1	28 234.5	01.01.78
Mean of Alexander Forbes Global Large Manager Watch [2, 4]	2.0	11.9	7.2	11.1	16.1	17.9		
DOMESTIC BALANCED COMPOSITE	1.7	14.9	11.4	14.6	22.3	23.7	25 126.0	01.01.78
Mean of Alexander Forbes Domestic Manager Watch [2,7]	1.1	14.1	10.0	12.5	18.3	18.5		
DOMESTIC EQUITY COMPOSITE	1.9	17.6	11.4	16.1	26.0	22.5	51 938.7	01.01.90
FTSE/JSE All Share Index	1.1	15.2	5.8	12.6	18.2	15.1		
GLOBAL BALANCED NAMIBIAN HIGH FOREIGN COMPOSITE	3.0	9.7	7.3	12.8	19.3	20.0	5 964.1	01.01.94
Mean of Alexander Forbes Namibia Average Manager [2]	2.0	11.3	7.4	11.6	16.0	14.6		
RELATIVE DOMESTIC COMPOSITE	1.1	16.5	9.6	14.3	22.0	22.4	12 366.3	19.04.00
Weighted average of client specific benchmarks [2]	0.8	15.1	7.1	12.3	17.6	16.9		
FOREIGN BEST VIEW (RANDS) COMPOSITE	5.8	-1.3	-3.3	7.1	8.9	13.6	7 028.5	23.05.96
60% of the MSCI and 40% of the JP Morgan Global Government Bond Index (Rands)	4.5	3.4	-3.5	7.6	4.9	9.8		
LIFE POOLED PORTFOLIOS								
GLOBAL BALANCED PORTFOLIO	2.7	12.0	8.8	13.2	19.8	20.9	17 572.3	01.09.00
Mean of Alexander Forbes Global Large Manager Watch [2,7]	2.0	11.9	7.2	11.1	16.1	15.3		
DOMESTIC BALANCED PORTFOLIO	1.8	15.4	11.6	14.8	-	21.9	6 710.0	01.09.01
Mean of Alexander Forbes Domestic Manager Watch [2,7]	1.1	14.1	10.0	12.5	-	17.7		
DOMESTIC EQUITY PORTFOLIO	2.1	18.3	11.5	16.0	26.3	25.6	6 673.0	01.02.01
FTSE/JSE All Share Index	1.1	15.2	5.8	12.6	18.2	16.7		
DOMESTIC ABSOLUTE PORTFOLIO	2.1	12.1	13.6	16.7	-	24.7	1 071.6	06.07.01
Mean of Alexander Forbes Domestic Manager Watch [2,7]	1.1	14.1	10.0	12.5	-	17.4		
DOMESTIC STABLE PORTFOLIO	1.6	9.7	11.2	12.5	-	16.3	1 760.3	01.12.01
Alexander Forbes Three-Month Deposit Index plus 2%	1.8	8.3	10.6	10.8	-	11.2		
DOMESTIC OPTIMAL PORTFOLIO [1]	1.0	5.9	9.0	9.2	-	9.3	608.1	04.12.02
Daily Call Rate of Nedcor Bank Limited	1.2	5.4	7.9	8.0	-	7.9		
GLOBAL ABSOLUTE PORTFOLIO	2.3	8.7	10.8	15.4	-	19.8	1 770.0	01.03.04
Mean of Alexander Forbes Global Large Manager Watch [2,7]	2.0	11.9	7.2	11.1	-	17.1		
DOMESTIC MEDICAL SCHEME PORTFOLIO	1.6	9.6	10.8	12.2	-	14.8	1 472.9	01.05.04
Consumer Price Index plus 3% p.a. [2]	2.6	6.7	9.2	10.1	-	9.1		
GLOBAL STABLE PORTFOLIO	2.1	6.6	8.0	11.0	-	14.4	2 805.3	15.07.04
Alexander Forbes Three-Month Deposit Index plus 2%	1.8	8.3	10.6	10.8	-	10.4		
RELATIVE DOMESTIC EQUITY PORTFOLIO	1.2	15.9	9.1	14.8	-	25.7	484.1	05.05.03
FTSE/JSE CAPI Index	1.0	15.6	7.2	13.1	-	23.9		
MONEY MARKET PORTFOLIO [1]	1.5	6.9	9.3	9.2	9.5	9.6	312.0	21.09.00
Alexander Forbes Three-Month Deposit Index	1.3	6.2	8.5	8.7	9.1	9.2		
FOREIGN PORTFOLIO [1]	4.9	-4.3	-4.0	6.8	-	3.7	2 396.2	23.01.02
60% of the MSCI Index and 40% JP Morgan Global Government Bond Index (Rands)	4.5	3.4	-3.5	7.6	-	1.5		
ORBIS GLOBAL EQUITY PORTFOLIO [1]	7.7	2.5	-3.4	7.3	-	10.1	3 406.6	18.05.04
FTSE World Index (Rands)	6.3	5.2	-5.1	5.4	-	7.9		
HEDGED DOMESTIC EQUITY PORTFOLIO [1]	2.2	17.3	-	-	-	9.7	1 132.8	01.06.08
JSE/FTSE All Share Index (Rands)	1.1	15.2	-	-	-	3.3		

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 2011 is an estimate as the relevant survey results have not yet been released
3 Unable to disclose due to ASISA regulations
4 Consulting Actuaries Survey returns used to 31 December 1997. Alexander Forbes Global Large Manager Watch used from 1 January 1998. Alexander Forbes Non-Investable Large Manager Watch used from 1 April 2010
5 The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate
6 Amounts invested by the Allan Gray client portfolios in the Orbis funds are included in the assets under management figures in the table above
7 The mean returns of the Alexander Forbes Non-Investable Large Manager Watch used from 1 April 2010

Notes

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