ALLANGRAY

Inception date: 1 September 2001

Allan Gray Life Domestic Balanced Portfolio

31 August 2019

Portfolio objective and benchmark

This Portfolio is for institutional investors with an average risk tolerance. It aims to offer long-term returns superior to the benchmark, but at lower risk of capital loss. In terms of Allan Gray's risk-profiled range, this Portfolio has a higher risk of capital loss than the Stable Portfolio, but less than the Absolute Portfolio. The benchmark is the mean performance of the large managers as surveyed by consulting actuaries.

Product profile

- Actively managed pooled portfolio.
- Investments selected from all local asset classes.
- Represents Allan Gray's 'houseview' for a domestic balanced mandate.

Investment specifics

- This Portfolio is available as a linked policy issued by Allan Gray Life Limited available only to retirement funds and medical schemes.
- Minimum investment: R20m.
- Performance based fee.

Compliance with Prudential Investment Guidelines

The Portfolio is managed to comply with Regulation 28 of the Pension Funds Act. Exposures in excess of the limits will be corrected immediately, except where due to a change in the fair value or characteristic of an asset, e.g. market value fluctuations, in which case they will be corrected within a reasonable time period. Allan Gray Life Limited does not monitor compliance with section 19(4) of the Pension Funds Act (item 6 of Table 1 to Regulation 28) on behalf of retirement funds invested in the pool.

Fund manager quarterly commentary as at 30 June 2019

The Portfolio returned -1.5% over the second quarter. Overweight positions in British American Tobacco and Glencore accounted for the majority of the equity component of the Portfolio's underperformance relative to the market.

The second quarter was good for investors that owned resource shares, with Anglo American and BHP Group gaining 4% as a result of an almost 40% spike in the iron ore price over this period. These two shares contributed to 0.7% of the FTSE/JSE All Share Index's performance. Unfortunately, the Portfolio was underweight these shares – on top of this, a significant proportion of our resource exposure underperformed.

Investing in resource companies can be a wild ride for investors since almost all of the variables required to value a company are in flux: Commodity prices respond to short-term changes in supply and demand, natural disasters or labour commotions can disrupt mines, and company management needs to respond to all these factors by allocating capital. It does not help that the geology of a mine is hard to understand from the outside, and this can have a significant impact on unit costs.

Our approach to valuing resource companies is to focus on long-term expectations for commodity prices, normalised unit costs, as well as the skill of management in deploying the cash generated. This approach has led us to own multinational miner Glencore and pulp and paper producer Sappi, and avoid BHP Group and Anglo American. This is because a normal commodity price assumption leads to a more attractive free cash flow yield for Glencore and Sappi and at the margin, capital at these companies is being deployed sensibly.

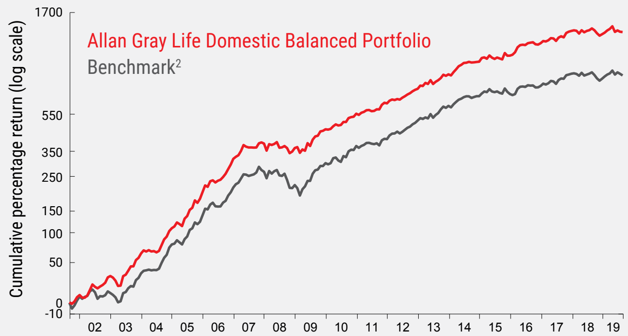
Short-term changes in commodity prices have, however, gone in the opposite direction to our long-term expectations, with weaker coal/copper/paper prices hurting Glencore and Sappi, while a stronger iron ore price, as a result of the January tailings dam failure in Brazil and cyclones in Australia between September 2018 and May 2019, helped Anglo American and BHP Group. The iron ore price is up to US$118 per tonne relative to our normal estimate of US$55. Risks to an iron ore price from this level include increased supply (the return on a new iron ore mine is very attractive), capacity coming back in Brazil and Australia, and a decrease in demand from China (steel demand seems high compared to other countries, and iron ore is likely to be substituted by scrap steel over time). Glencore and Sappi appear more attractive in our view considering current valuations and that their commodity prices are lower than our long-term assumptions.

Portfolio information on 31 August 2019

Assets under management	R3 170m

Performance gross of fees

Cumulative performance since inception



% Returns[1]	Portfolio	Benchmark[2]
Since inception	16.1	13.3
Latest 10 years	10.9	9.8
Latest 5 years	6.1	4.2
Latest 3 years	3.6	3.4
Latest 2 years	2.1	1.5
Latest 1 year	-3.6	-3.1
Latest 3 months	-0.1	-0.8

Asset allocation on 31 August 2019

Asset Class	Total
Net SA equity	62.4
Hedged SA equity	2.2
Property	1.6
Commodity-linked	4.1
Bonds	17.6
Money market and bank deposits	12.1
Total (%)	**100.0**

1. Investment returns are annualised (unless stated otherwise), except for periods less than one year. Performance as calculated by Allan Gray as at 31 August 2019.
2. Mean of Alexander Forbes Domestic Large Manager Watch. The return for August 2019 is an estimate.

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

Disclaimer

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