

Portfolio objective and benchmark

This Portfolio is for institutional investors requiring management of a specific equity portfolio. It aims to offer superior returns to that of the FTSE/JSE All Share Index including dividends but with a lower risk of capital loss. The benchmark is the FTSE/JSE All Share Index including dividends.

Product profile

- Actively managed pooled portfolio.
- Represents Allan Gray's 'houseview' for a specialist equity-only mandate.
- Portfolio risk is controlled by limiting the exposure to individual counters.

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.

Fund manager quarterly commentary as at 30 June 2019

The Portfolio had a poor quarter, returning -3.2% while the FTSE/JSE All share Index returned 3.9%. The major detractors have been our overweight positions in British American Tobacco and Sasol. Sasol is currently trading on eight times earnings. The long-term average is 10.5 times. A simple multiple re-rating from eight to 10.5 would give a return of 31%.

Then in 2022, if all goes to plan, earnings should grow by 45% when its large project in the US (the Lake Charles Chemicals Project or LCCP) is fully up and running. This is not the whole story. Investors in Sasol have to carefully consider all of the following:

- Much depends on the oil price, which is difficult to forecast. On the supply side, US production has grown rapidly over the past few years, and the US is now the world's largest producer. Demand growth has historically been very consistent but, in the long term, the impact of electric cars will be negative for oil.

- Sasol is a very large emitter of carbon dioxide and sulphur dioxide.
- The company has incurred a huge amount of debt in order to build their ethane cracker in the US. The balance sheet is currently stretched.
- Capital allocation has been poor historically. One barrel of oil currently trades for about R1 000. For the same price, you can buy 2.7 Sasol shares. This ratio was similar 20 years ago: In 1999, you could buy 2.7 Sasol shares for the price of one barrel of oil. One would have expected Sasol to become more valuable relative to oil, given the billions of rands that have been spent on expansion projects in the past 20 years.
- Management has lost a lot of credibility in recent years. Shareholders were short-changed in the company's recent BEE deal. Costs have been disappointingly high. The ethane cracker has had multiple cost overruns.

These points seem (and are) alarming, but in fact, almost every company has a similar list. It is our job to worry about these things, to incorporate them into our valuations and, where we can, to encourage companies to pollute less and act in shareholders' best interests. We do not sell shares on bad news or buy them on good news. Rather, we buy when we think we are getting a bargain for our clients. Sometimes, negative sentiment can create a good buying opportunity.

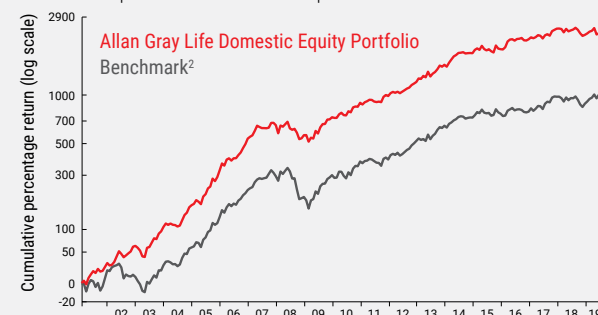
It is interesting to compare the valuation of Sasol with that of Anglo American Platinum or Amplats (which we don't own). Everything has gone right for Amplats in recent years, and sentiment is extremely positive towards the company. Both companies have a similar market cap: around R220bn. Over the past 10 years, Amplats has made cumulative profits of R6.2bn. Sasol has made R210bn. One should see the issues at Sasol in the context of this very attractive valuation.

Portfolio information on 31 August 2019

Assets under management	R4 535m
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Performance gross of fees

Cumulative performance since inception³



% Returns ¹	Portfolio	Benchmark ²
Since inception ³	18.4	13.5
Latest 10 years	11.8	11.5
Latest 5 years	4.0	4.7
Latest 3 years	0.8	4.7
Latest 2 years	-1.7	2.0
Latest 1 year	-10.9	-2.6
Latest 3 months	-3.0	-0.2

Sector allocation on 30 June 2019 (updated quarterly)

Asset Class	% of portfolio	% of benchmark
Basic materials	20.9	27.0
Industrials	11.1	3.7
Consumer goods	8.0	11.9
Healthcare	5.0	1.6
Consumer services	8.6	8.1
Telecommunications	0.3	3.9
Financials	30.4	24.2
Technology	9.9	19.5
Commodity-linked	0.8	0.0
Other	0.8	0.0
Money market and bank deposits	4.2	0.0
Total	100.0	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. FTSE/JSE All Share Index including dividends.
 3. Since alignment date (1 February 2001).
 Note: There may be slight discrepancies in the totals due to rounding.

Disclaimer

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