

Portfolio objective and benchmark

This is a long-term absolute return portfolio for the institutional investor who wishes to diversify the volatility generally associated with stock and bond markets, but still wants exposure to specialist stock-picking skills and to target a positive rate of return which is higher than that of cash. The benchmark is the Nedbank Call Deposit Rate.

Product profile

- Actively managed pooled portfolio, seeking absolute returns.
- Little correlation to stock or bond markets, with a low level of risk of capital loss.
- Investments consist of shares offering superior fundamental value, carefully managed to reduce the risk of underperforming the market, and short index derivatives to reduce stock market risk.

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 stock market returned 3.9% during the second quarter with the Portfolio returning -2.5%. The Portfolio's overall net equity position was reduced by almost 10% over the quarter on the back of a strong equity market.

The second quarter was good for investors that owned resource shares, but unfortunately the Portfolio was underweight these – on top of this, a significant proportion of our resource exposure underperformed. The Portfolio was overweight British American Tobacco, Glencore and KAP during this period.

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.

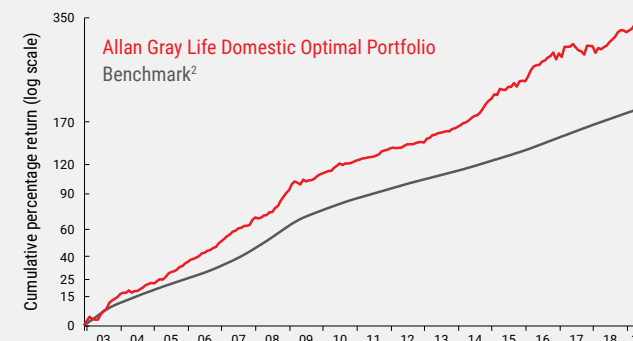
Short-term changes in commodity prices have, however, gone in the opposite direction to our long-term expectations, with weaker coal/copper/paper prices hurting Glencore/Sappi, while a stronger iron ore price, as a result of the January tailings dam failure in Brazil and cyclones in Australia between September 2018 and May 2019, helped Anglo American and BHP Group. 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	R381m
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Performance gross of fees

Cumulative performance since inception



% Returns ¹	Portfolio	Benchmark ²
Since inception	9.2	6.6
Latest 10 years	8.0	5.4
Latest 5 years	9.1	5.9
Latest 3 years	5.7	6.1
Latest 2 years	7.1	6.0
Latest 1 year	6.8	5.9
Latest 3 months	1.4	1.5

Asset allocation on 31 August 2019

Asset Class	Total
Net SA equity	5.7
Hedged SA equity	72.9
Property	0.0
Money market and bank deposits	21.4
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. Nedbank Call Deposit Rate.

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

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