

An opportune time to use available foreign capacity?

South African shares have continued to outperform world markets in US dollar terms during 2010. Regular readers of our investment commentary will know that we do not currently have high expectations for returns from South African shares, and that we believe the rand remains fairly strong versus most developed market currencies. Our unit trusts and institutional portfolios remain at maximum allowable offshore exposure.

For investors who agree with our view on local stock market valuations and the rand, now may be an opportune time to make use of the available offshore capacity in our local unit trusts. Inflows into these funds, as well as the relative performance of foreign assets, can lead to swings in the amount of foreign capacity that is available over time.

For example, there is no capacity available right now in our Retirement Annuity and Pension Preservation and Provident Preservation funds. There is however foreign capacity of roughly R1.7 billion available for offshore discretionary investments and R1.1 billion available for Living Annuity and Endowment investments.

Foreign investment limits

Individuals, companies and pension funds have to abide by South African exchange control regulations. Investment management companies, such as Allan Gray Unit Trust Management Limited, can invest up to 30% of their assets offshore.

Retirement funds, such as the Allan Gray Retirement Annuity Fund and the Allan Gray Pension Preservation and Provident Preservation funds, may invest up to 20% offshore. The Allan Gray Living Annuity and the Allan Gray Endowment are products provided by Allan Gray Life, which as a company may take 30% of its assets offshore. If investors buy any of these Allan Gray products, they need to select unit trusts which form the basis of their investment. They can choose

Allan Gray unit trusts or any other unit trusts offered on Allan Gray's investment platform.

Under the South African Reserve Bank (SARB) foreign exchange regulations, individuals' investments into local unit trusts (such as the Allan Gray Equity Fund) create capacity for investments into foreign unit trusts (such as the Allan Gray-Orbis Global Fund of Funds). Some, but not all, of this capacity is used up within the Allan Gray Balanced and Stable funds. Our policy is to reserve the unused additional capacity for those investors who 'created' it within each product. For example, at 31 May 2010, there was roughly R58 billion invested in the Allan Gray discretionary unit trust funds. This creates capacity for R17.4 billion (30%) to be invested offshore. Currently only R7.9 billion of this capacity is being used by the Allan Gray funds in the form of foreign investments. A further R7.8 billion is taken up by investors invested directly in one of the three Allan Gray-Orbis unit trusts, and the balance of R1.7 billion is available for investments into these funds.

Factors that affect availability of foreign capacity

Available foreign capacity is affected dramatically by offshore assets under- or outperforming local assets in rand terms. While the rand remains strong and local assets outperform their offshore equivalents, flows into offshore funds also tend to decline at exactly the point that more capacity is opened up. At the other extreme, when local assets are not doing so well and the rand has weakened, the demand for offshore capacity increases, sometimes very rapidly, at exactly the point when less capacity is available.

An optimistic view is that this mechanism unintentionally prevents some panicked behaviour that can be bad for investors. More importantly though, for offshore capacity even more than for other investment decisions, investors would be wise to act on their convictions before it is too late.

Commentary by Chris du Toit, Responsible for Orbis Client Servicing in South Africa

The Allan Gray Retirement Annuity Fund, the Allan Gray Pension Preservation Fund and the Allan Gray Provident Preservation Fund are all administered by Allan Gray Investment Services Limited, an authorised administrative financial services provider. The Allan Gray Living Annuity and Allan Gray Endowment Policy are both underwritten by Allan Gray Life Limited, an authorised financial services provider. The underlying investment options of the Allan Gray individual life and retirement products are unit trusts.

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. 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. 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). Allan Gray Limited, an authorised financial services provider, is the appointed investment manager of Allan Gray Unit Trust Management Limited.