

# Quarterly Commentary

31 December 2004

Q4



ALLAN GRAY  
INTELLIGENT INVESTING

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Front cover: Some of the people that contributed to this issue are, from left to right: Mahesh Cooper, Delphine Govender, John Rainier.

Greg Fury

Chief Operating Officer, Allan Gray Limited

## Comments from the Chief Operating Officer



Although South African shares have appreciated markedly in value from their lows in April 2003 and are obviously nowhere near as attractive on an absolute basis, they have done so broadly in line with other domestic assets. The article by Arjen Lugtenburg in the 'Investment Perspective' section reveals that the risk in holding these South African assets has therefore increased substantially and most domestic assets now discount the sound economic conditions prevalent in the country. Offshore assets are now relatively much more attractively priced and accordingly Allan Gray has moved its offshore portfolio exposure to that of the maximum regulatory allowance.

### Investment Commentary

Retailers' earnings have recovered strongly since we built up large positions in many of these counters in 2002 and our research shows that earnings are now above normal; in fact, virtually as high as they have ever been over the past 40 years. Delphine Govender, Portfolio Manager of our relative portfolios and analyst, elaborates on why Allan Gray has been reducing our clients' holdings in certain of the retailers over the past few months and highlights the investment case of the three shares that remain attractively priced.

### Institutional Update

Allan Gray's stockpicking process is driven by a philosophy of buying good quality assets that are priced below their worth. Mahesh Cooper explains this bottom-up approach of portfolios being built from a 'clean sheet' minimising the risk of capital loss and achieving positive above average returns over time.

### Offshore Update

After the 30-year anniversary of Allan Gray in 2004, Orbis has now celebrated 15 years of operation. Craig Bodenstab's article describes the investment philosophy, which is identical to that of Allan Gray as described in Mahesh's article prior and remains as relevant and effective as it was 15 (or 30) years ago. He explains the investment process and shows how the size of the global investment universe requires a combination of an effective quantitative screening tool to identify possible opportunities and exhaustive fundamental research to select shares that offer higher prospective returns with a lower chance of permanent capital loss.

### Property Update

John Rainier is Managing Director of Allan Gray Property Trust Management Limited, which manages the listed property trust Grayprop. In this article, he provides an overview of the South African property market and the recent performance of Grayprop. He describes how demand-driven economic activity is looking more positive than it has for many years and this is impacting favourably on the property market. Against this background, the gross value of the Grayprop portfolio is 32.8% higher than last year and the market rating of the property portfolio in terms of the anticipated forward earnings yield has improved marginally from 12.7% last year to 12.2.

### Investment Performance

The trends of the third quarter of 2004 continued in the fourth quarter with strong performance from the JSE, which returned

8.1% in the quarter to bring its total return for the year to 25.4%. Other domestic asset classes have also performed well but the continued strength of the Rand (which in our view is unlikely to be sustained) meant that, measured in Rand terms, foreign assets delivered poor returns over the period. This has benefited all portfolios weighted towards domestic equities including Allan Gray's. And so, despite underperforming relative to our peers in both the most recent quarter and the year to date, Allan Gray's largest client composites, Domestic Equity and Global Balanced delivered returns of 31.2% and 21.8% respectively in 2004. Full detail of our investment performance in these and other composites appears at the end of the QC.

While we are not pleased with our short-term relative underperformance we accept that it is inevitable from time to time and we remain confident that the positioning of our portfolios will deliver superior returns over the longer term. However, given the current valuation of South African assets, we would encourage investors to be cautious and not rely on the very strong performance of the past year continuing.

I hope that you enjoy this issue of our Quarterly Commentary.

Kind regards

Greg Fury

Arjen Lugtenburg

Director, Portfolio Manager and Analyst, Allan Gray Limited

# Investment Perspective

The investment merits of the JSE



## Executive Summary

**Although South African shares have appreciated markedly in value, they have done so in line with other domestic assets and thus remain attractive on a relative basis. However, as this analysis by Arjen Lugtenburg reveals, the absolute risk in holding South African assets (including shares) has increased as most domestic asset prices now reflect the sound economic conditions prevalent in the country. Offshore assets on a relative basis are now more attractively priced. Accordingly, the Allan Gray portfolios have moved exposure to offshore assets to the maximum regulatory allowance.**

From its lows in April 2003 the FTSE/JSE All Share Index (ALSI) has appreciated by 66%. In US\$ terms the index is up 112%. After such strong appreciation, it is appropriate to re-examine the investment merits of the ALSI.

A simple analysis shows that at December 2004 the PE multiple on the ALSI stands at 14.4, up substantially from around nine times in April last year and well

above the ALSI's long-term average PE multiple of 11 times.

It is our experience that a longer term analysis of the underlying variables enhances one's perspective greatly. In order to show the long-term relationship between the share price of the average company in this index and the underlying earnings, we have graphed the index level and its underlying earnings since 1960 in Graph 1. As this period covers eras where the levels of inflation varied greatly, we have eliminated the effects of inflation from the earnings and the price series, i.e. we have shown both series in real terms. In order to relate the index to its underlying earnings, we have plotted the real ALSI on top of the real earnings series, which we have valued at its long-term average PE ratio of 11 times.

A first observation is the very cyclical nature of the earnings series, which is mainly driven by the large influence that commodity prices and our terms of trade (exchange rate) have on company earnings. In order to interpret these earnings, we have statistically fitted a trendline through the earnings series that we believe reflects the underlying normal earnings of

the index. The line through the earnings series depicts the earnings trendline, also valued at 11 times. We have also fitted two outer boundaries around the trendline, each moved by one standard deviation of the earnings variance to the trendline. These two boundaries depict trendline earnings valued at 13.8 times and 8.8 times respectively. From these graphs, it is clear that movements in the ALSI historically can be better explained by the level of trendline earnings than actual earnings, as the market, with a few exceptions has largely moved between 8.8 times trendline earnings (cheap) and 13.8 times trendline earnings (expensive). This is in line with one of our basic investment tenets that an investment in a company should be judged on normal rather than real earnings.

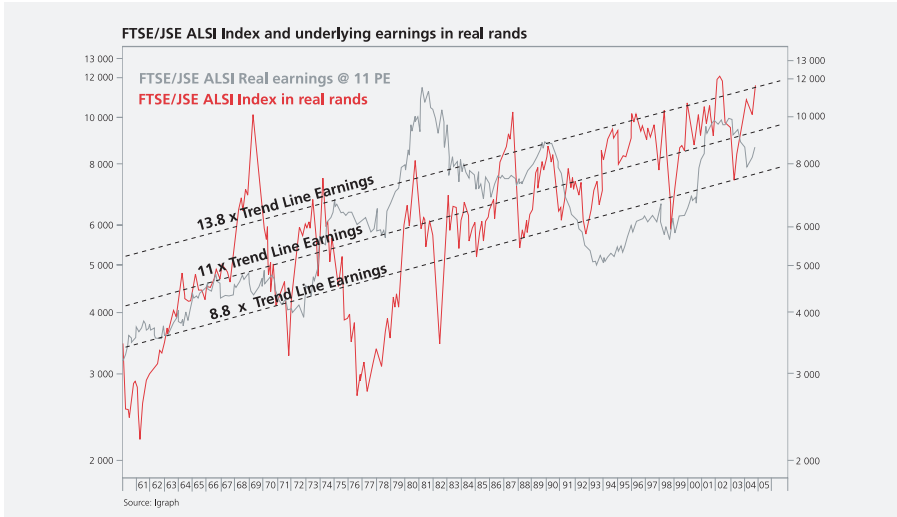
It is clear from the graph that the ALSI with its recent rally has moved from the bottom boundary (8.8 times trendline earnings, and cheap) to the upper boundary (13.8 times trendline earnings, and expensive). With South African shares appearing expensive in absolute terms, investors should be asking themselves how they compare with our investment alternatives.

In Graph 2 we compare the earnings yield of the ALSI (inverse of the PE ratio) to the yield of a long-term government bond (as a proxy for a fixed interest investment). Historically, investors have accepted a yield

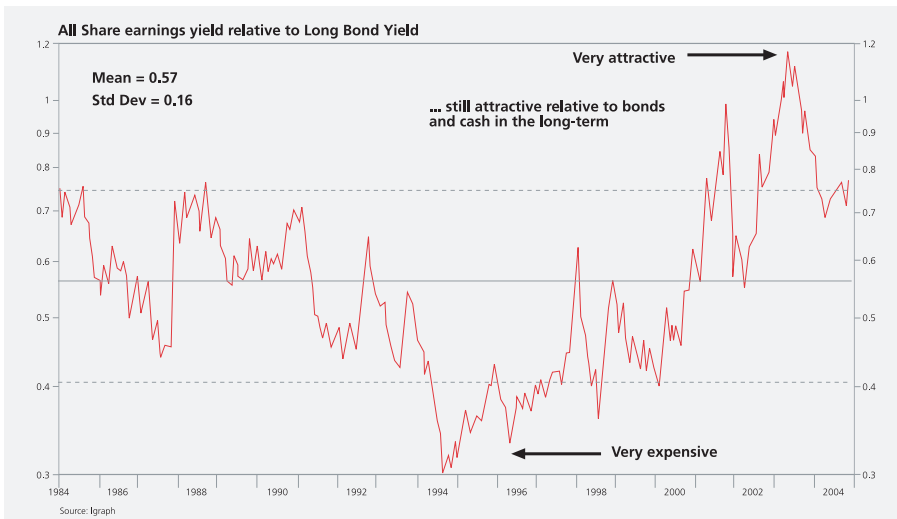
on shares of approximately 60% of that available on long-term government bonds. This is due to the growth function inherent in shares and the fact that the yield on shares is after-tax while most investors must

still pay tax on interest earnings. The recent rally in the ALSI has taken its yield differential from 120% in April 2003 (then very undervalued) to 80% currently. Although not attractive as it was, domestic shares still appear attractive relative to domestic fixed interest investments.

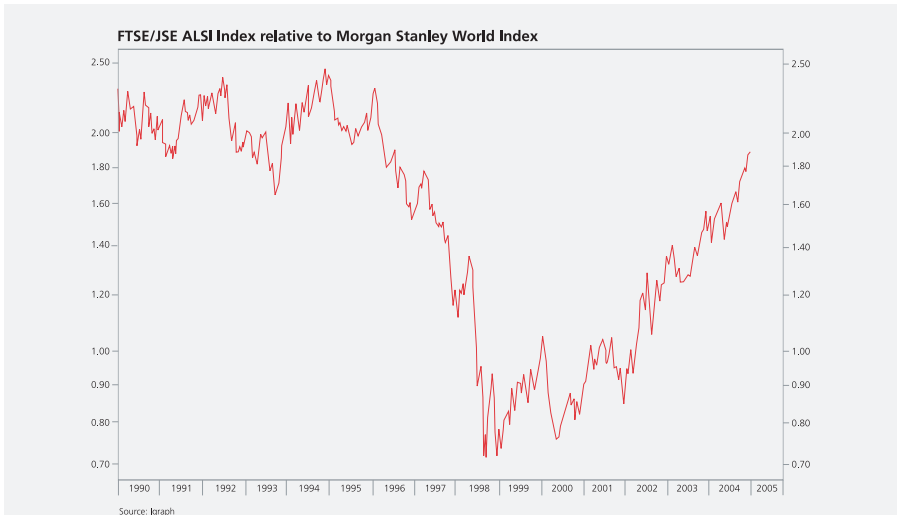
Graph 1



Graph 2



Graph 3



In Graph 3 we compare the ALSI index, in US\$ terms, to the Morgan Stanley World Index (MSWI), the latter reflecting the average price level of listed companies, in US\$ terms, from around the world. With the strong Rand and the strong performance of the ALSI, the average price of a South African company has appreciated markedly relative to that of the average listed company around the world. Where South African shares were very cheap in the latter part of the 90's, they are now approaching relatively expensive levels. Or, conversely, offshore companies are now on a relative basis much more attractively priced.

The above analysis leads me to conclude the following:

- Although South African shares have appreciated markedly in value, they have done so in line with other domestic assets and relative to other domestic assets still appear attractive. However, the risk in holding South African assets has increased in that the prices of most domestic assets now reflect the sound economic conditions currently prevailing in the country.
- Offshore assets on a relative basis are now more attractively priced and Rand returns on offshore assets are likely to be competitive going forward. However, the world is a large place and the MSWI consists of expensive and inexpensive shares. Orbis, for instance, has identified numerous attractively valued shares in countries like Japan and Korea while they struggle to find value in the USA.
- The Allan Gray portfolios remain relatively fully invested in domestic shares as this continues to be the most attractive domestic asset class. However, we have increased exposure to offshore assets to the maximum levels that regulators allow.

Delphine Govender

Portfolio Manager and Analyst, Allan Gray Limited

# Investment Commentary

## Updating our view on retailers



### Executive Summary

**Retailers' earnings have recovered strongly, both in absolute and relative terms, since Allan Gray last commented on them in September 2002. As Delphine Govender points out, the level of their earnings versus the market is as high as it has ever been over the past 40 years. The risk now exists that these earnings are above normal. Accordingly, over the past months, Allan Gray has sold or reduced clients' holdings in many of the retail shares owned in 2002. However, certain shares including Shoprite, Clicks and Woolies continue to be attractive.**

In our September 2002 Quarterly Commentary, we commented on the value we were finding at the time among several industrial shares and, in particular, retailers. One of the key reasons for our finding several retailers so attractive was the low level of earnings that these retailers were achieving both in relation to their own history and when compared to the market (Point A on Graph 1).

Graph 1 is an update to the end of November 2004 of the earnings of retailers relative to the FTSE/JSE All Share index - a graph we showed you at September 2002. Retailers' earnings have recovered strongly both in absolute and relative terms. The level of retailers' earnings now versus the market (Point B) is as high as it has ever been over the past 40 years.

This earnings recovery has been driven by a combination of company-specific and macro-economic factors.

Graph 2 reflects the price performance of retailers versus the FTSE/JSE All Share Index.

Despite the fact that the share price performance of retailers has not been as sharp as the relative earnings recovery, since September 2002 the share prices of retailers on average have more than doubled relative to the market.

Graph 3 reflects the price-earnings ratio of retailers versus the price-earnings ratio (P/E) of the market since 1962.

The graph indicates that the retailers are currently trading at parity with the market. This is below the long-term average of a premium of approximately 16% to the market. While it could therefore be argued that retailers are still cheap relative to the market based on their long-term relative P/E, it is critical to consider the level of earnings in determining the relative attractiveness of retailers.

It is clear that the current economic landscape in South Africa, fuelled predominantly by a consumer-spending boom, has provided the retailers with a strong tailwind in terms of the revenue growth they have been able to achieve. There appears to be considerable underlying

momentum to this cyclical upturn in the short- to medium-term, which will provide in turn ongoing support to retailers' profits.

Given the record Returns on Equity (ROE) generally forecast to be earned by most retailers over the next six to 12 months, the risk does exist that the earnings of these retailers is now above normal, both in relation to their own history and when compared to the market. In such an environment, investors who place even average P/E multiples on high levels of earnings run the risk of poor future returns. Accordingly, over the past several months, as share prices have risen, we have sold or reduced our clients' holdings in many of the retail shares that we had owned in 2002.

As you are aware, we are bottom-up, fundamental investors (explained in more detail in the article overleaf) and therefore while the graphs would indicate why we believe retailers are now generally fully valued or even overpriced, there are specific shares that we believe remain attractive. Three retail shares we continue to find attractive are Shoprite Holdings, New Clicks Holdings and Woolworths Holdings. Based on our expectations for the earnings potential of these businesses, the share prices of these three counters remain below our intrinsic valuations of the respective companies. We briefly highlight the basic elements of our analysis of these three companies.

## Shoprite Holdings

Shoprite Holdings (Shoprite) is South Africa's second largest food retailer in terms of measured market share. While there are several facets to the underlying investment case for Shoprite, the key points are:

### 1. Normalisation of operating margins in South Africa

Currently, the operating margin earned by Shoprite across its South African supermarkets is well below that of its main competitor, Pick 'n Pay Holdings. While there are structural reasons why this difference exists, we believe that there is considerable scope for Shoprite to narrow this operating margin gap. This will be driven by a combination of factors, including operational efficiencies

achieved by Shoprite as a result of its move to a centralised distribution platform.

### 2. Expansion into Africa

We believe that there are considerable growth prospects for companies setting up operations in selected African countries. Shoprite has invested sizeable sums into setting up operations across 14 different African countries. The majority of these operations are expected to contribute more meaningfully to group profitability in the medium- to long-term. We believe that Shoprite has established considerable first-mover advantage in Africa.

### New Clicks Holdings

New Clicks Holdings (Clicks) is a national retailer of pharmaceutical, beauty and

lifestyle products. The rate of growth in the earnings achieved by Clicks has been markedly lower than its peer retailers over the past three years. We believe that there is significant opportunity for Clicks to increase its earnings in the medium- to long-term. This will be driven by:

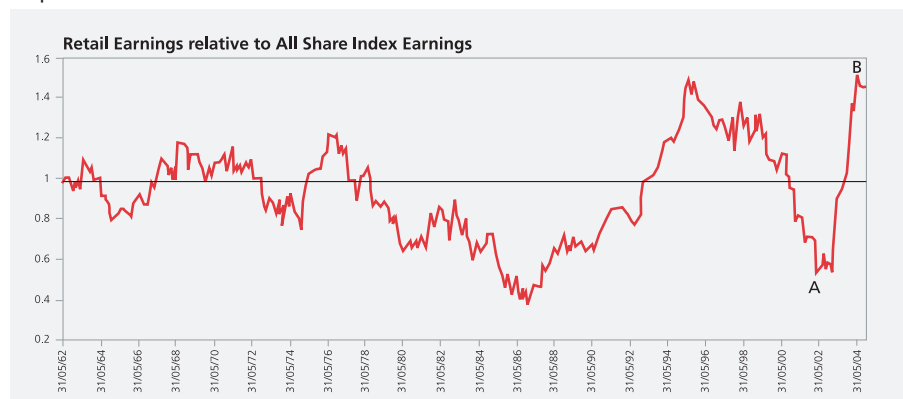
### 1. Introduction of retail pharmacy

We believe that the introduction of retail pharmacy into the Clicks business model has the potential to be a significant earnings driver for the group. While we acknowledge the ongoing fluidity and resultant uncertainty in South African legislation governing retail pharmacy and its underlying profitability, it is our view that over the longer term Clicks will be positioned as a key player in this market. While Clicks has made significant investments in establishing a retail pharmacy footprint, it has yet to enjoy a concomitant return from this investment.

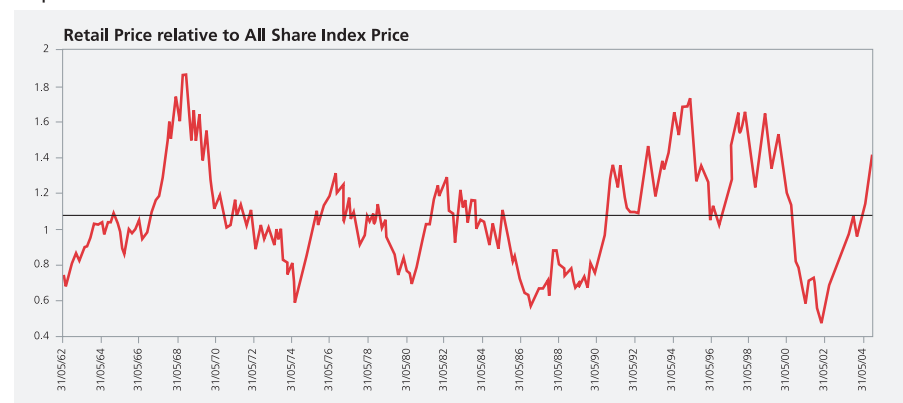
### 2. Improvement in the underlying businesses

The performance of the core businesses in Clicks has lagged on balance the performance of its peers. We believe that the turnaround strategies employed by management will result in an improvement in these businesses to more normal levels of return.

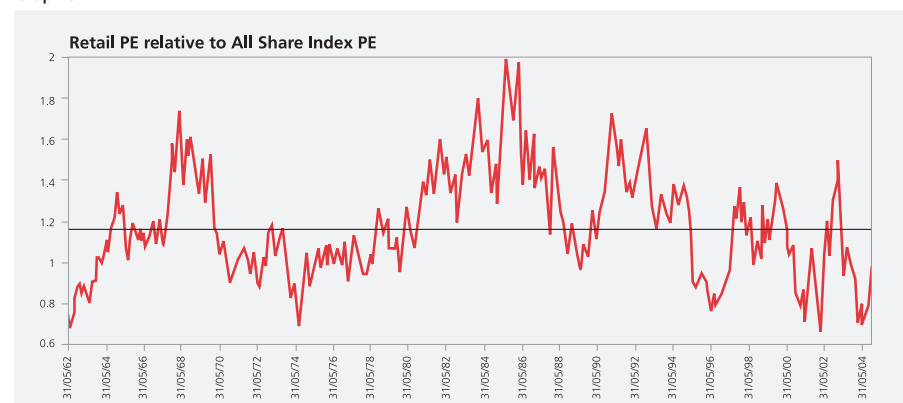
Graph 1



Graph 2



Graph 3



## Woolworths Holdings

We have outlined our investment case for Woolworths Holdings (Woolies) previously. We continue to rate the underlying businesses very highly. While Woolies too has enjoyed a good recovery in its earnings (off a low base) since 2002, we do not believe that the level of returns currently achieved is above normal for this company in relation to its history. More importantly, we believe that, given the quality and growth prospects of the operational businesses, the strength of the brand, the conservative nature of management and their value-unlocking strategies being pursued - a premium rating to the market is well justified for Woolies.

In summary, Shoprite, Clicks and Woolies are all trading at attractive prices when compared to our estimate of their intrinsic value. Therefore, unlike many other retail shares, we believe that at current levels these three companies still offer the prospect of superior long-term returns.

Mahesh Cooper

Business Analyst, Allan Gray Limited

# Institutional Update

## Looking bottom-up



### Executive Summary

Allan Gray's stockpicking and asset allocation process is driven by a philosophy of buying good quality assets that are priced below their worth. Through this bottom-up approach, as Mahesh Cooper points out, Allan Gray seeks to minimise the risk of capital loss and achieve positive above average returns over time. Portfolios are built up from a 'clean sheet' as opposed to starting with a benchmark and then selecting equity positions around that benchmark.

Allan Gray's investment philosophy and process is *absolute* in nature in that our research is focused on identifying good quality assets that are priced below their worth. It is this philosophy of buying assets below their intrinsic value that drives our bottom-up stockpicking process. The asset allocation in our balanced portfolio flows from this process. Through this approach, we seek to minimise the risk of capital loss and achieve positive above average returns over time.

*"Equities are selected if they are priced at a meaningful discount to their underlying business value."*

To the extent that we can find attractively priced equities (i.e. trading at a discount to intrinsic value), our balanced portfolio will have a higher exposure to equities. When equities are expensive and trading above their intrinsic value, our balanced portfolio 'retreats' to cash (or bonds, if appropriately priced). A specialist equity portfolio removes the portfolio manager's ability to select the most attractive assets across all asset classes and instead the portfolio manager is forced to hold the most attractive equities relative to other equities, even at times when equities might be expensive relative to bonds or cash.

Equities are selected if they are priced at a meaningful discount to their underlying business value. Their expected four-year total rate of return is compared first and foremost with the expected returns from cash and bonds before any relative comparisons with other equities. Our overall equity weighting is thus the result of the amount of shares that we find attractive in the market at a point in time. Interestingly, this process means that, at times when the market is expensive on average, our balanced portfolios may still have a high weighting in equities if we can identify sufficient shares that are still cheap. An example of this would have been in 2001/2002 when the weakening Rand drove the large Rand-hedge stocks, which

dominated the average, to very expensive levels. However, domestic industrial companies were offering exceptional value and our portfolios were full of them.

*"... (asset allocation) is thus the result of the amount of shares that we find attractive...."*

*This is very different from a top-down process."*

The bottom-up stock selection also influences our relative sector weightings. Naturally, if we are finding many attractively valued stocks in a particular sector, we will have an overweight position in that sector. We do not take an active decision to have an overweight position relative to a particular benchmark: it is the result of our bottom-up stock selection process finding attractive investment opportunities in that sector relative to others.

This is very different from a top-down process. A top-down process dissociates stock selection from asset allocation with different individuals or teams often being responsible for each. For instance, an asset allocation team may decide on whether or not a portfolio should be overweight in



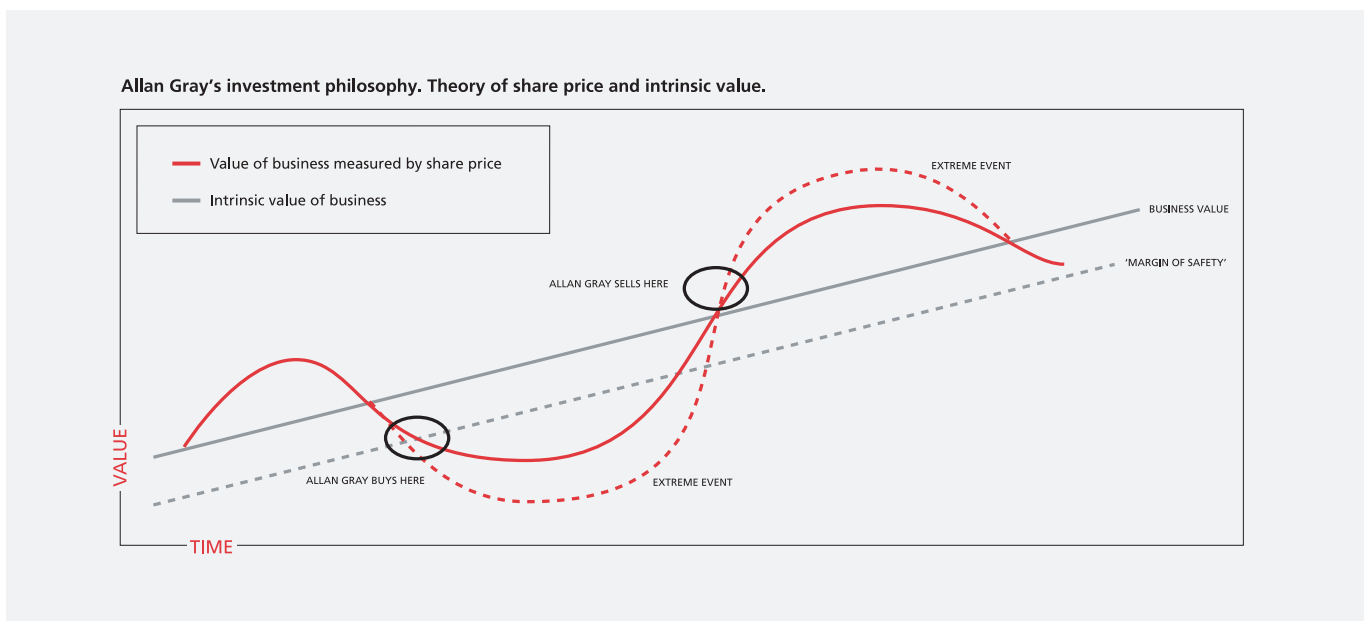
equities, whilst other portfolio managers select the shares that make up the equity allocation.

We think that it is far more practical to have a higher weighting in assets that are trading below what they are worth. The selection of assets in this manner means that very little attention is paid to a particular benchmark in building a portfolio. Portfolios are built-up from a 'clean sheet' as opposed to starting with a benchmark and tweaking an overweight or underweight position in a particular stock in relation to the benchmark.

It is this absolute bottom-up approach to investing that means that we are comfortable in allowing the client to select a reasonable benchmark. For instance, on our institutional balanced portfolios, a client can select a *peer group* benchmark (such as the average return according to a consultant survey), an *absolute* benchmark (CPI + 5%) or a *strategic* benchmark of market indices (such as 65% equities, 30% bonds, 5% cash). The choice of benchmark will not influence the way in which the portfolio is managed: balanced portfolios with each of the above benchmarks are

managed in an identical manner. This is because our balanced portfolios are built-up through bottom-up asset selection: the relative attractiveness of a particular share is compared with the return that one would achieve had the money been invested in a bond or cash.

It has been our experience that identifying and investing in assets (be they stocks or bonds) trading at a discount to their intrinsic value reduces the risk of capital loss whilst enhancing the likelihood of delivering superior returns over time.



Craig Bodenstab

Head of Global Trading, Orbis Investment Management Limited



# Offshore Update

15 years on



## Executive Summary

**The investment philosophy practiced at both Orbis and Allan Gray has essentially remained unchanged for 30 years, writes Craig Bodenstab. The overwhelming focus is on picking shares that offer higher prospective returns with a lower risk of permanent capital loss. Painsstaking research going back 30 years, if possible, is a crucial part of the process, which goes through no fewer than three phases. As a filter, approximately 9000 public companies from around the world are scrutinised and then ranked on prospective rates of return over the next five years. The most attractive opportunities thus identified are then subjected to rigorous fundamental research. As this article explains, some attractive investments have been unearthed as a result.**

It was 15 years ago this month that Orbis started offering investment management services through the launch of the Orbis Global Equity Fund, the Orbis Optimal Fund and the Orbis Leveraged Fund. While world events are certainly different today from those in 1990, the investment process currently applied at Orbis is substantially the same as it was in that first year.

Moreover, despite operating in very different markets, the investment philosophy practiced today at both Orbis and Allan Gray Limited is essentially unchanged from the time Allan W B Gray started the firm in Cape Town, more than 30 years ago. Hopefully, the following description of our investment process will provide existing and prospective investors with more information to understand better what we do.

## Our objective

The investment process of Orbis, like that of Allan Gray Limited, is focused overwhelmingly on picking shares that offer higher prospective returns with a lower chance of permanent capital loss. Not only is share selection the starting point, it also determines the eventual allocation of shares to each market. For example, Orbis Global's current overweight position in Japanese equities is driven by the extent to which we have found attractive shares in that market compared with other markets rather than a top-down view on Japan that has steered the Fund's overweight position. Conversely, the same is true of Orbis Global's underweight position in US equities.

By contrast, many global equity investment managers start with a benchmark like the FTSE World Index and then, based on macro

or top-down considerations, decide in which sectors or markets to be over- or underweight. Share selection is very often their last consideration.

## Taking a long-term view

Orbis' research includes reviewing, where possible, a company's operating history as far back as 30 years as well as financial forecasts for the next five years. We believe this longer term perspective allows us to capitalise on anomalies between the price of a share and its inherent long-term intrinsic value that may not be as readily identifiable when focusing on the short-term. The UK homebuilder, Berkeley Group, is an example of this. In our opinion, the market focused disproportionately on the short-term macro considerations facing the homebuilding sector and paid little regard to Berkeley's long-term intrinsic value. This presented Orbis' funds with the opportunity to invest in an above average company with an above average margin of safety. A great company that has fallen on temporary hard times, which the short-term focused investment community cannot see past, is often an ideal investment opportunity due to its discounted share price. Not surprisingly, we find our funds buying shares of companies when most investors are pessimistic and are selling, and vice versa.

### Identifying opportunities globally

In an effort to maximise our probability of researching shares of companies that our funds are likely to own, Orbis adopts a highly disciplined approach to filtering investment ideas. The search for attractively valued shares begins with a daily computerised quantitative screen of historical data on about 9000 public companies from around the world. Our proprietary quantitative model then ranks all of these shares based on prospective rates of return over the next five years. Despite the highest-ranking shares appearing cheap on a statistical basis, it is our in-depth analysis that determines whether the business is in trouble and priced accordingly or simply misunderstood by the market. Also, work done on existing ideas often leads to new ideas, be they competitors, suppliers or clients of the original company analysed. For example, while researching the Japanese carmaker Toyota Motor, we became aware of Toyota Industries, a supplier to Toyota Motor, and found Toyota Industries sufficiently attractive (based not only on its business but also the margin of safety afforded through its holding in Toyota Motor) for our funds now to own a stake in that company. Regardless of the original source of the idea, the profile of each stock is extracted from the quantitative database and analysed, typically on price to tangible net asset value, price to normalised long-term earnings, long-term revenue, operating profit, net profit and tangible net asset value growth. This initial review helps in the preparation of a Phase I research report.

### Rigorously analysing potential investments

A Phase I report provides a brief overview of the company, its financial history, its competitive drivers and the main pros and cons of owning the business. Phase I is not expected to take more than a day and is an attempt to distinguish between a cheap company that is genuinely interesting from a contrarian point of view and companies that are cheap for valid reasons. A Phase I report concludes with a recommendation to proceed to Phase II or not.

A Phase II report involves significantly more detailed research, focusing on a comprehensive understanding of the company and its value drivers. It is during

Phase II that an analyst's conviction is reinforced, or not. Like Phase I, the report concludes with a recommendation to continue to Phase III or not. Phase III, in turn, examines the central thesis of Phase II from a critical perspective with the analyst testing his or her conviction against various negative 'what if' scenarios. It is also at this time that management of the company is contacted to help us form an opinion as to its quality and to test the investment thesis against our understanding of the company and its environment. Assessing management's skills and motivation is also an important part of our research. We prefer management to have a meaningful proportion of their net worth invested in the company, ideally in the form of shares as opposed to stock options. This helps ensure management is exposed to the same risks and rewards as shareholders, thereby encouraging management to take prudent risks and make rational choices.

Following the completion of Phase III, analysts present their best ideas for discussion at a policy group meeting. This group consists of the analyst, the portfolio manager and other senior analysts as well as a quantitative analyst. The primary motive for the policy group is not to form a consensus, but rather to interrogate the investment idea in such a manner that the analyst benefits from the perspective and experience of others before making a final decision to recommend the share for purchase by the funds. We believe very much in individual accountability when it comes to making investment decisions. Analysts are required to monitor the fundamentals of all equities they are recommending and to provide ratings and updated reports to Orbis' portfolio manager on an ongoing basis.

As our long-standing investors will know, we prefer our funds to invest in fewer meaningful positions rather than to hold numerous insignificant positions. This permits us more research time per company introduced to the funds' portfolios and allows us to make a few high quality, lasting decisions rather than many inconsequential ones. Notwithstanding all our efforts and in-depth research, our analysis is sometimes wrong. When our ongoing research enables us to recognise this, we eliminate the position from the

fund without hesitation, regardless if there is a gain or a loss.

While the world has certainly changed since 1990, our investment philosophy has not, and we remain optimistic that this will allow us to continue to be successful for our investors over the long-term.

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In our experience, companies that historically have generated consistently superior returns on equity are more likely than other companies to generate and sustain a high growth rate in the future, hence our desire to analyse 30 years of historical fundamental data. For example, Korea-based Samsung Electronics Co. Ltd. has delivered for over 20 years a return on equity of over 25% per annum, yet investors can own the preferred shares at less than five times this year's earnings and five times our estimate of next year's earnings. In our opinion, our clients are being adequately compensated for the risks in owning shares in a great company like Samsung.

In our research, we analyse almost all published data including annual and quarterly reports and any other regulatory filings. We also review 'sell-side' research to confirm that our research has not missed any relevant issues as well as studying the company's competition to understand better the company's competitive position. Strong balance sheets are also attractive, particularly when they are the consequences of good cash flows and reflect conservative accounting.

Frequently, our contrarian approach leads us to become enthusiastic about a share some time before the share price reaches its low point and to become less enthusiastic about a share well before its price reaches its peak. Investors may recall our enthusiasm for Munich-based Bayerische Hypo-und Vereinsbank (HVB), which our funds started purchasing in earnest at under 15 euro per share in late 2002, only to see the shares drop to below six euro per share before recovering to valuations that better reflected the long-term profitability of the business. In the interim, HVB also spun-off Hypo Real Estate Holdings, which our funds acquired at attractive prices and continue to own today.

John Rainier

Managing Director, Allan Gray Property Trust Management Limited

# Property Update

## The South African Property Market



### Executive Summary

Demand-driven economic activity is looking more positive than it has for many years and this is impacting favourably on the property market. Pricing of non-residential property, which softened last year because of an oversupply of office space has improved significantly. At the present take-up rate, existing office space in decentralised nodes would be absorbed in just under two years. In part buoyed by this, over the past five years to September 2004, the pre-tax annualised total return per annum earned by Allan Gray Property Trust has been 30.7% (25.3% ahead of inflation).

Driven largely by demand, general economic activity, on which the property market depends, is looking more positive than it has for many years. An environment of low interest rates and positive business sentiment contributes greatly to this and the leading indicator is at its highest level for 10 years.

Personal consumption expenditure is strongly positive and real retail sales are growing at the fastest rate since 1990. There is also growing anecdotal evidence of the emergence in South Africa of a new middle class whose consumption expenditure has not been fully captured before in official statistics. Insolvencies and

debt summonses are diminishing to levels not seen since the late 1980's.

*“ Driven largely by demand, general economic activity, on which the property market depends, is looking more positive than it has for many years.”*

Added to this, the change in the real value of completed non-residential building plans, while off the historical lows last year, is still well below the long-term average. The only note of caution is that the real value of non-residential building plans passed is approaching the previous peak in 1999, a level that ultimately led to the recent oversupplied office market. Ameliorating this, however, is the improved take-up of office space recently reported. The latest Rode Report (2004:3) states that, in the twelve months to June 2004, a total of 471 000m<sup>2</sup> of grades A and B space was

taken up nationally in decentralised office nodes of which 58% was taken up in the last six months. This equates to 6% of existing stock. Compare this with take-up of 295 000m<sup>2</sup> for the year to June 2003. At a similar rate, existing vacancies in these nodes would be absorbed in just under two years.

Surveys show that the pricing of direct property, as measured by capitalisation rates, has improved significantly. Pricing softened last year largely because of the prevailing oversupply of non-residential property that led to poor earnings growth prospects. The latest Rode Time Series (2004:3) shows the following percentage decreases in capitalisation rates over the past year to June 2004, which, everything else being equal, implies a comparable increase in price of that amount: see Table A.

*“ Our purpose is to create long-term wealth for our unitholders.”*

Table A

A Grade Multi Offices		Prime Industrial Parks		Regional Shopping Centres	
Sandton CBD	3.2	Central Witwatersrand	4.7	Witwatersrand	12.1
Brooklyn/Waterkloof	0.0	East Rand	3.1	Pretoria	15.7
La Lucia Ridge	5.6	Cape Peninsula	7.9	Durban	8.1
Tyger Valley	6.6	Durban Metro	7.4	Cape Town	17.9
		Pretoria Metro	3.8		

While vacancy rates in decentralised office markets continue to be at relatively high levels - for example, Sandton and environs at 13% (15% last year) - the situation has improved from a year ago. In the industrial market, vacancies have remained low, and at similar levels to a year ago. Manufacturing production has recovered from its declines during 2003 and is currently growing at an annual rate of more than 5%. Added to this, while imports are still growing at a faster rate than exports, the aggregate increase in both of these bodes well for a growing demand for warehouse space.

In the retail market, sales in September grew 11.8% in real terms over the previous year. Based on historical trends, one would expect the buoyant retail market to continue well into 2005, which again is positive for our portfolio. However,

retail rentals in regional shopping centres have not risen much, with the latest Rode Retail Report showing Gauteng and Durban flat and Cape Town up 4% over last year.

#### Initiatives during 2004

We continued with our programme of selling buildings that have growth prospects lower than our portfolio goals. On the other hand, the redevelopment of certain properties continued and two major properties were purchased.

*“ The gross value of the property portfolio is 32.8% higher than that of last year, ... ”*

#### Performance and financial results

Our purpose is to create long-term wealth

for our unitholders. **Table B** highlights the pre-tax annualised total return per annum earned by Allan Gray Property Trust over the five years to September 2004 and compares this with inflation.

Total distributions for the year to 30 September 2004 were R320.7 million, equivalent to 32.2 cents per unit (2003: 30.9 cents). The total distribution comprised an interim distribution of 15.6 cents (2003: 15.0 cents) and a final distribution of 16.6 cents (2003: 15.9 cents) paid on 29 November 2004. This was achieved notwithstanding the income foregone by not capitalising loss of interest.

#### Vacancy levels

Vacancy levels in terms of rentable area (%) at 30 September are highlighted in **Table C**.

By area, vacancies were 7% at half-year. By value, the vacancies equated to 6% of potential rental income, the same percentage as at half-year. The composition of Allan Gray Property Trust's portfolio, as valued by independent valuers is shown in **Table D**.

The gross value of the property portfolio is 32.8% higher than that of last year, largely as a result of the acquisition of The Boulders Shopping Centre and Mifa Industrial Park, the redevelopment of Centurion Mall and improved retail and industrial valuations. The market rating of the property portfolio in terms of the anticipated forward earnings yield has improved marginally from 12.7% last year to 12.2%.

At year-end the number of units in issue was 996 043 081 (930 857 925 last year). Based on the current property portfolio and market conditions, it is anticipated that the distribution per unit for the 2005 financial year could grow by approximately 8%.

**Table B**

	2000	2001	2002	2003	2004	5-Year compound % p.a.
Allan Gray Property Trust	41.2	39.3	1.3	36.9	39.9	30.7
Inflation	6.9	4.4	11.2	3.7	1.3	5.4
Real Return	34.3	34.9	-9.9	33.2	28.6	25.3

(Source: I-Net Bridge)

**Table C**

Sector	2004	2003
Offices	11	10
Industrial	5	9
Other	0	0
Total	6	7

**Table D**

Sector	Value (Rm)	Cents/unit	Forward EY (%)	% of portfolio	
				2004	2003
Retail	2 256	227	11.7	72	67
Office blocks	409	41	13.7	13	16
Industrial	305	31	14.4	10	10
Other	163	16	11.7	5	7
Total property	3 133	315	12.2	100	100

# Performance

## ALLAN GRAY LIMITED SHARE RETURNS vs FTSE/JSE ALL SHARE INDEX

Period	Allan Gray *	FTSE/JSE All Share Index	Out/(Under) Performance
1974 (from 15.6)	-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
Annualised to 31.12.2004			
From 1.1.2002 (3 years)	28.9	10.2	18.7
From 1.1.2000 (5 years)	27.3	11.6	15.7
From 1.1.1995 (10 years)	24.0	11.1	12.9
Since 1.1.78	30.6	20.8	9.8
Since 15.6.74	29.0	17.6	11.4
Average outperformance			11.4
No. of calendar years outperformed			24
No. of calendar years underperformed			6

\*Note: Allan Gray commenced managing pension funds on 1.1.78. The returns prior to 1.1.78 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 to R23 714 804 by 31 December 2004. By comparison, the returns generated by the JSE All Share Index over the same period would have grown a similar investment to R1 420 305.

## ALLAN GRAY LIMITED GLOBAL MANDATE RETURNS vs AVERAGE OF THE CONSULTING ACTUARIES SURVEY (CAS)

Period	Allan Gray	CAS*	Out/(Under) Performance
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	-0.6	7.5
1999	79.7	41.2	38.5
2000	21.6	6.6	15.0
2001	43.9	22.3	21.6
2002	13.4	-2.2	15.6
2003	21.5	16.6	4.9
2004	21.8	25.1	-3.3
Annualised to 31.12.2004			
From 1.1.2002 (3 years)	18.9	12.6	6.3
From 1.1.2000 (5 years)	24.0	13.2	10.8
From 1.1.1995 (10 years)	22.2	13.9	8.3
Since 1.1.78	24.3	18.1	6.2
Average outperformance			6.2
No. of calendar years outperformed			22
No. of calendar years underperformed			5

\* The return from 1 October 2004 is an estimate.

An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R3 518 144 by 31 December 2004. The returns generated by the average of the Consulting Actuaries Survey over the same period would have grown a similar investment to R903 147.

**ALLAN GRAY LIMITED PERFORMANCE PROFILE**  
Annualised performance in percent per annum to 31 December 2004

	Fourth Quarter (unannualised)	1 year	3 years	5 years	Since inception	Assets under management R millions	Inception date
<b>SEGREGATED RETIREMENT FUNDS</b>							
<b>Global Balanced Mandate</b> Mean of Consulting Actuaries Fund Survey*	9.1 11.6	21.8 25.1	18.9 12.6	24.0 13.2	24.3 18.1	20,972.4	01.01.78
<b>Domestic Balanced Mandate</b> Mean of Alexander Forbes Domestic Manager Watch*	11.8 13.8	27.7 32.6	25.0 18.6	23.9 15.6	24.8 18.8	12,416.9	01.01.78
<b>Equity-only Mandate</b> FTSE/JSE All Share Index	13.6 8.1	31.2 25.4	27.7 10.2	25.9 11.6	22.0 13.4	23,600.3	01.01.90
<b>Global Namibia Balanced Mandate</b> Mean of Alexander Forbes Namibia Average Manager*	9.2 11.6	21.7 27.7	18.7 13.5	23.9 13.9	21.5 14.1	2,407.6	01.01.94
<b>Equity-only Relative Mandate</b> Resource adjusted FTSE/JSE All Share Index	11.4 11.9	30.6 32.2	18.6 12.4	- -	24.3 14.3	3,199.7	19.04.00
<b>POOLED RETIREMENT FUNDS</b>							
<b>Allan Gray Life Global Balanced Portfolio</b> Mean of Alexander Forbes Large Manager Watch*	8.6 11.6	21.6 27.6	19.0 13.2	- -	24.8 14.8	5,493.5	01.09.00
<b>Allan Gray Life Domestic Balanced Portfolio</b> Mean of Alexander Forbes Domestic Manager Watch*	11.8 13.8	28.6 32.6	24.8 18.6	- -	24.7 18.8	4,082.2	01.09.01
<b>Allan Gray Life Domestic Equity Portfolio</b> FTSE/JSE All Share Index	13.4 8.1	31.9 25.4	27.8 10.2	- -	28.8 12.5	1,881.9	01.02.01
<b>Allan Gray Life Domestic Absolute Portfolio</b> Mean of Alexander Forbes Domestic Manager Watch*	10.4 13.8	18.9 32.6	31.0 18.6	- -	30.7 17.7	549.2	06.07.01
<b>Allan Gray Life Domestic Stable Portfolio</b> Alexander Forbes Three-Month Deposit Index plus 2%	6.5 2.3	19.9 9.9	18.7 12.8	- -	18.7 12.7	214.8	01.12.01
<b>Allan Gray Life Foreign Portfolio</b> 60% of the MSCI Index and 40% of the JP Morgan Global Government Bond Index	-5.2 -3.8	-5.3 -3.4	- -	- -	-7.8 -12.6	329.3	23.01.02
<b>Allan Gray Life Domestic Optimal Portfolio</b> Daily call rate of Nedcor Bank Limited	0.7 1.5	4.6 6.5	- -	- -	9.5 8.7	68.3	04.12.02
<b>FOREIGN-ONLY (RANDS)</b>							
<b>Orbis Global Equity Fund (Rands)</b> FTSE World Index (Rands)	-2.6 -2.3	-0.8 -1.2	-10.7 -16.3	12.1 -3.0	20.8 12.8	2,208.7	01.01.90
<b>Orbis Japan Equity (US\$) Fund (Rands)</b> Tokyo Stock Price Index (Rands)	-8.0 -8.7	-3.5 -3.8	-13.1 -17.4	8.9 -5.5	13.5 5.1	343.4	12.06.98
<b>Global Balanced Mandate (Rands) - Foreign Component</b> 60% of the MSCI and 40% of the JP Morgan Government Bond Index Global (Rands)	-4.8 -3.8	-4.9 -3.4	-8.1 -13.9	22.2 0.9	16.3 10.5	2,594.5	23.05.96
<b>UNIT TRUSTS **</b>							
<b>Equity Fund (AGEF)</b> FTSE/JSE All Share Index	***	26.5 25.4	25.6 10.2	23.4 11.6	696.2 199.9	6,776.0	01.10.98
<b>Balanced Fund (AGBF)</b> Average Prudential Fund (excl. AGBF)	***	23.4 28.5	21.4 14.2	22.4 12.0	233.7 108.6	6,881.1	01.10.99
<b>Stable Fund (AGSF)</b> After-tax return of call deposits plus two percentage points	***	13.7 6.3	14.2 8.5	- -	91.2 44.3	3,238.5	01.07.00
<b>Money Market Fund (AGMF)</b> Domestic fixed interest money market unit trust sector (excl. AGMF)	***	7.7 7.6	10.2 10.4	- -	40.3 41.1	564.1	03.07.01
<b>Global Fund of Funds (AGGF)****</b> 60% of the FTSE World Index and 40% of the JP Morgan Government Bond Index Global (Rands)	***	- -	- -	- -	- -	488.6	03.02.04
<b>Optimal Fund (AGOF)</b> Daily call rate of FirstRand Bank Ltd	***	4.3 6.4	- -	- -	26.8 21.2	1,496.6	01.10.02

\* The returns from 1 October 2004 are estimated from various indices as the relevant survey results have not yet been released.

\*\* The returns for the unit trusts and their respective benchmarks are net of investment management fees.

\*\*\* Unavailable due to ACI Regulations.

\*\*\*\* As of 3 February 2004, the benchmark is as displayed. The benchmark was the Morgan Stanley Capital International Index (in Rands) prior to this date.

Unit trust performance data is based on a lump sum investment calculated on a sell-to-sell basis with distributions reinvested for the Class A units. The source of the figures quoted is the Pretoria's Unit Trust Survey for the period ending 31 December 2004.

# Products

## SEGREGATED PORTFOLIOS

**RETIREMENT FUND INVESTMENT MANAGEMENT IN SOUTH AFRICA**  
Allan Gray manages large retirement funds on a segregated basis where the minimum portfolio size is R200 million. These mandates are of a balanced or asset class specific nature. Portfolios can be managed on an absolute or relative risk basis.

**RETIREMENT FUND INVESTMENT MANAGEMENT IN NAMIBIA**  
Allan Gray Namibia manages large retirement funds on a segregated basis.

**PRIVATE CLIENTS**  
Allan Gray manages segregated portfolios for individuals where the minimum portfolio size is R20 million.

## NAMIBIAN POOLED PORTFOLIO - ALLAN GRAY NAMIBIA INVESTMENT TRUST

This fund provides investment management for Namibian retirement funds in a pooled vehicle that is similar to that for segregated Namibian retirement fund portfolios. The minimum investment requirement is N\$5 million.

## ORBIS MUTUAL FUNDS

### ORBIS GLOBAL EQUITY FUND

### ORBIS JAPAN FUNDS (YEN, EURO AND US\$ FUND CLASSES)

Type of Fund	ORBIS GLOBAL EQUITY FUND	ORBIS JAPAN FUNDS (YEN, EURO AND US\$ FUND CLASSES)
Type of Fund	US\$ denominated Equity Fund which remains fully invested in global equities.	Orbis Japan Equity (Yen) Fund - invests in a relatively focused portfolio of Japanese equities.  Orbis Japan Equity (Euro) Fund - invests in the same Japanese equities as the Orbis Japan Equity (Yen) and hedges the resulting Japanese yen exposure into euro with the result that the Fund's returns are managed in euro.  Orbis Japan Equity (US\$) Fund - invests substantially all of its assets in the Orbis Japan Equity (Yen) and hedges the resulting Japanese yen exposure into US\$, with the result that the Fund's returns are managed in US\$.  Orbis Japan Equity (Yen) Fund – seeks higher returns in yen than the Japanese stockmarkets, without greater risk of loss.
Investment objective	Aims to earn higher returns than world stockmarkets. Its benchmark is the FTSE World Index, including income. The Fund's currency exposure is managed relative to that of the benchmark.	Orbis Japan Equity (Euro) Fund - seeks higher returns in euro than the Japanese stockmarkets hedged into euro, without greater risk of loss.  Orbis Japan Equity (US\$) Fund - seeks higher returns in US\$ than the Japanese stockmarkets hedged into US\$, without greater risk of loss.
Structure	Open-ended Bermuda mutual fund company (similar to unit trusts in South Africa).	Open-ended collective investment schemes.
Dealing costs	None. No front-end fee (initial charge) or transaction charges (compulsory charge). Please note that this is not a Rand-denominated unit trust so a prospective investor is required to have funds offshore.	None. No front- or back-end load. No bid-to-offer spread.
Manager's fee	0.5% - 2.5% per annum depending on performance.	0.5% - 2.5% per annum depending on performance.
Subscriptions/redemptions	Weekly each Thursday.	Weekly each Thursday.
Reporting	Comprehensive reports are distributed to members each quarter.	Comprehensive reports are distributed to members each quarter.
Client Service Centre	Allan Gray Client Services on 0860 000 654.	Allan Gray Client Services on 0860 000 654.



## SOUTH AFRICAN POOLED PORTFOLIOS - ALLAN GRAY LIFE LIMITED

(The minimum investment per Life Company client is R20 million.  
Institutional clients below R20 million are accommodated by our Regulation 28 Compliant Unit Trusts.)

### RISK-PROFILED POOLED PORTFOLIOS

	STABLE PORTFOLIO	BALANCED PORTFOLIO	ABSOLUTE PORTFOLIO
<b>Investor Profile</b>	<ul style="list-style-type: none"> <li>Highly risk-averse institutional investors, e.g. investors in money market funds.</li> </ul>	<ul style="list-style-type: none"> <li>Institutional investors with an average risk tolerance.</li> </ul>	<ul style="list-style-type: none"> <li>Institutional investors seeking superior absolute returns (in excess of inflation) over the long-term with a higher than average short-term risk tolerance.</li> </ul>
<b>Product Profile</b>	<ul style="list-style-type: none"> <li>Conservatively managed pooled portfolio.</li> <li>Investments selected from all asset classes.</li> <li>Shares selected with limited downside and a low correlation to the stockmarket.</li> <li>Modified duration of the bond portfolio will be conservative.</li> <li>Choice of global or domestic-only mandate.</li> </ul>	<ul style="list-style-type: none"> <li>Actively managed pooled portfolio.</li> <li>Investments selected from all asset classes.</li> <li>Represents Allan Gray's houseview for a balanced mandate.</li> <li>Choice of global or domestic-only mandate.</li> </ul>	<ul style="list-style-type: none"> <li>Aggressively managed pooled portfolio.</li> <li>Investments selected from all asset classes.</li> <li>Will fully reflect the manager's strong investment convictions and could deviate considerably in both asset allocation and stock selection from the average retirement portfolio.</li> <li>Choice of global or domestic-only mandate.</li> </ul>
<b>Return Characteristics/ Risk of Monetary Loss</b>	<ul style="list-style-type: none"> <li>Superior returns to money market investments.</li> <li>Limited capital volatility.</li> <li>Strives for capital preservation over any two-year period.</li> </ul>	<ul style="list-style-type: none"> <li>Superior long-term returns.</li> <li>Risk will be higher than Stable Portfolio but less than the Absolute Portfolio.</li> </ul>	<ul style="list-style-type: none"> <li>Superior absolute returns (in excess of inflation) over the long-term.</li> <li>Risk of higher short-term volatility than the Balanced Portfolio.</li> </ul>
<b>Benchmark</b>	<ul style="list-style-type: none"> <li>Alexander Forbes three-month Deposit Index plus 2%.</li> </ul>	<ul style="list-style-type: none"> <li>Mean performance of the large managers as surveyed by consulting actuaries.</li> </ul>	<ul style="list-style-type: none"> <li>Mean performance of the large managers as surveyed by consulting actuaries.</li> </ul>
<b>Fee Principles</b>	<ul style="list-style-type: none"> <li>Fixed fee, or performance fee based on outperformance of the benchmark.</li> </ul>	<ul style="list-style-type: none"> <li>Fixed fee, or performance fee based on outperformance of the benchmark.</li> </ul>	<ul style="list-style-type: none"> <li>Performance fee based on outperformance of the benchmark, 0.5% p.a. plus (or minus) 25% of the out/underperformance of the portfolio relative to the benchmark, subject to an overall minimum of 0% p.a.</li> </ul>

**Note** The above risk-profiled portfolios comply with Regulation 28 of the Pension Funds Act.

### ASSET CLASS POOLED PORTFOLIOS

	MONEY MARKET	BOND MARKET	LISTED PROPERTY	EQUITY	FOREIGN
<b>Investor Profile</b>	<ul style="list-style-type: none"> <li>Institutional investors requiring management of a specific money market portfolio.</li> </ul>	<ul style="list-style-type: none"> <li>Institutional investors requiring management of a specific bond market portfolio.</li> </ul>	<ul style="list-style-type: none"> <li>Institutional investors requiring management of a specific listed property portfolio.</li> </ul>	<ul style="list-style-type: none"> <li>Institutional investors requiring management of a specific equity portfolio.</li> </ul>	<ul style="list-style-type: none"> <li>Institutional investors requiring management of a specific foreign portfolio.</li> </ul>
<b>Product Profile</b>	<ul style="list-style-type: none"> <li>Actively managed pooled portfolio.</li> <li>Investment risk is managed using modified duration and term to maturity of the instruments in the portfolio.</li> <li>Credit risk is controlled by limiting the exposure to individual institutions and investments.</li> </ul>	<ul style="list-style-type: none"> <li>Actively managed pooled portfolio.</li> <li>Modified duration will vary according to interest rate outlook and is not restricted.</li> <li>Credit risk is controlled by limiting the exposure to individual institutions and investments.</li> </ul>	<ul style="list-style-type: none"> <li>Actively managed pooled portfolio.</li> <li>Portfolio risk is controlled by limiting the exposure to individual counters.</li> </ul>	<ul style="list-style-type: none"> <li>Actively managed pooled portfolio.</li> <li>Represents Allan Gray's houseview for a specialist equity-only mandate.</li> <li>Portfolio risk is controlled by limiting the exposure to individual counters.</li> </ul>	<ul style="list-style-type: none"> <li>Actively managed pooled portfolio.</li> <li>Investments are made in equity and absolute return foreign mutual funds managed by Orbis.</li> <li>Represents Allan Gray's houseview for a foreign balanced mandate.</li> </ul>
<b>Return Characteristics/ Risk of Monetary Loss</b>	<ul style="list-style-type: none"> <li>Superior returns to the Alexander Forbes three-month Deposit Index.</li> <li>Low capital risk.</li> <li>High flexibility.</li> <li>Capital preservation.</li> <li>High level of income.</li> </ul>	<ul style="list-style-type: none"> <li>Superior returns to that of the FTSE/JSE All Bond Index plus coupon payments.</li> <li>Risk will be higher than the Money Market Portfolio but less than the Equity Portfolio.</li> <li>High level of income.</li> </ul>	<ul style="list-style-type: none"> <li>Superior returns to that of the Alexander Forbes Listed Property Index (adjusted).</li> <li>Risk will be no greater than that of the benchmark and will be lower than the Equity Portfolio.</li> <li>High level of income.</li> </ul>	<ul style="list-style-type: none"> <li>Superior returns to that of the FTSE/JSE All Share Index including dividends.</li> <li>Risk will be no greater than that of the benchmark.</li> <li>Higher than average returns at no greater than average risk for an equity portfolio.</li> </ul>	<ul style="list-style-type: none"> <li>Superior returns to that of the benchmark at no greater than average absolute risk of loss.</li> </ul>
<b>Benchmark</b>	<ul style="list-style-type: none"> <li>Alexander Forbes three-month Deposit Index.</li> </ul>	<ul style="list-style-type: none"> <li>FTSE/JSE All Bond Index plus coupon payments.</li> </ul>	<ul style="list-style-type: none"> <li>Alexander Forbes Listed Property Index (adjusted).</li> </ul>	<ul style="list-style-type: none"> <li>FTSE/JSE All Share Index including dividends.</li> </ul>	<ul style="list-style-type: none"> <li>60% Morgan Stanley Capital International Index, 40% JP Morgan Global Government Bond Index.</li> </ul>
<b>Fee Principles</b>	<ul style="list-style-type: none"> <li>Fixed fee of 0.2% p.a.</li> </ul>	<ul style="list-style-type: none"> <li>Fixed fee of 0.35% p.a.</li> </ul>	<ul style="list-style-type: none"> <li>Fixed fee of 0.75% p.a.</li> </ul>	<ul style="list-style-type: none"> <li>Performance fee based on outperformance of the benchmark.</li> </ul>	<ul style="list-style-type: none"> <li>No fee charged by Allan Gray. Unit prices of underlying mutual funds reflected net of performance fees charged by Orbis.</li> </ul>

**Note** The above asset class portfolios comply with the asset class requirements of Regulation 28 of the Pension Funds Act.

### OTHER POOLED PORTFOLIO

#### OPTIMAL PORTFOLIO

<b>Investor Profile</b>	<ul style="list-style-type: none"> <li>Institutional investors wishing to diversify their existing investments with a portfolio that not only has no/low correlation to stock or bond market movements, but also strives to provide a return in excess of that offered by money market investments.</li> <li>Institutional investors with a high aversion to the risk of capital loss.</li> </ul>
<b>Product Profile</b>	<ul style="list-style-type: none"> <li>Seeks absolute returns.</li> <li>Actively managed pooled portfolio consisting of shares and derivative instruments.</li> <li>Shares selected that offer fundamental value.</li> <li>Risk of shares underperforming the market is carefully managed.</li> <li>Stockmarket risk reduced by using derivative instruments.</li> </ul>
<b>Return Characteristics/ Risk of Monetary Loss</b>	<ul style="list-style-type: none"> <li>Superior returns to bank deposits.</li> <li>Little or no correlation to stock or bond markets.</li> <li>Low risk of capital loss.</li> <li>Low level of income.</li> </ul>
<b>Benchmark</b>	<ul style="list-style-type: none"> <li>Daily call rate of Nedcor Bank Limited.</li> </ul>
<b>Fee Principles</b>	<ul style="list-style-type: none"> <li>Fixed fee of 0.5% plus 20% of the outperformance of the benchmark.</li> </ul>

## COMPULSORY PRODUCTS - RETAIL

## INDIVIDUAL RETIREMENT PRODUCTS

	RETIREMENT ANNUITY	PENSION OR PROVIDENT PRESERVATION FUND	LIVING ANNUITY*
<b>Description</b>	<ul style="list-style-type: none"> <li>Enables saving for retirement with pre-tax money.</li> <li>Contributions can be at regular intervals or as single lump sums.</li> <li>Ideal for the self-employed or employees who want to make additional contributions to an approved retirement vehicle.</li> </ul>	<ul style="list-style-type: none"> <li>Preserves the pre-tax status of a cash lump sum that becomes payable from a pension (or provident) fund at termination of employment.</li> <li>A single cash withdrawal can be made from the Preservation Fund prior to retirement.</li> </ul>	<ul style="list-style-type: none"> <li>Provides a regular income from the investment proceeds of a cash lump sum that becomes available as a pension benefit at retirement.</li> <li>A regular income of between 5% and 20% per year of the value of the lump sum can be selected.</li> <li>Ownership of the annuity goes to the investor's beneficiaries on his/her death.</li> </ul>
<b>Investment Options</b> The contribution(s) to any one of these products can be invested in any combination of Allan Gray unit trust funds as indicated.	<ul style="list-style-type: none"> <li>Allan Gray Equity Fund</li> <li>Allan Gray Balanced Fund</li> <li>Allan Gray Stable Fund</li> <li>Allan Gray Bond Fund</li> <li>Allan Gray Optimal Fund</li> <li>Allan Gray Money Market Fund</li> <li>Allan Gray Global Fund of Funds</li> </ul>	<ul style="list-style-type: none"> <li>Allan Gray Equity Fund</li> <li>Allan Gray Balanced Fund</li> <li>Allan Gray Stable Fund</li> <li>Allan Gray Bond Fund</li> <li>Allan Gray Optimal Fund</li> <li>Allan Gray Money Market Fund</li> <li>Allan Gray Global Fund of Funds</li> </ul>	<ul style="list-style-type: none"> <li>Allan Gray Equity Fund</li> <li>Allan Gray Balanced Fund</li> <li>Allan Gray Stable Fund</li> <li>Allan Gray Bond Fund</li> <li>Allan Gray Optimal Fund</li> <li>Allan Gray Money Market Fund</li> <li>Allan Gray Global Fund of Funds</li> </ul>
<b>Minimum Investment Size</b>	R 20 000 lump sum R 1 000 monthly	R 50 000	R 100 000
<b>Initial Fee</b>	None	None	None
<b>Annual Administration Fee</b>	0.4% (VAT included)	0.4% (VAT included)	0.4% (VAT included)
<b>Investment Management Fee**</b>	Depends on the combination of unit trusts selected as investment options.	Depends on the combination of unit trusts selected as investment options.	Depends on the combination of unit trusts selected as investment options.
<b>Switching Fee</b>	None	None	None
<b>Financial Adviser Fees (if applicable)</b>	Option A: Initial Fee 0.0% - 3.0% Annual Fee 0.0% - 0.5% OR Option B: Initial Fee 0.0% - 1.5% Annual Fee 0.0% - 1.0%	Option A: Initial Fee 0.0% - 3.0% Annual Fee 0.0% - 0.5% OR Option B: Initial Fee 0.0% - 1.5% Annual Fee 0.0% - 1.0%	Initial Fee 0.0% - 1.5% Annual Fee 0.0% - 1.0%

\* Allan Gray Living Annuity is underwritten by Allan Gray Life Limited.

\*\* For annual investment management fees of Allan Gray unit trusts, please refer to page 7 of the unit trust application form, which can be downloaded from the website [www.allangray.co.za](http://www.allangray.co.za) or see section on Unit Trusts.

## DISCRETIONARY PRODUCTS - RETAIL

## ENDOWMENT POLICY\*

<b>Description</b>	<ul style="list-style-type: none"> <li>An investment policy ideally suited to investors with medium- to long-term investment objectives who want capital growth with after-tax returns.</li> <li>Ideal for investors interested in a 5-year savings plan.</li> </ul>
<b>Investment Options</b>	<ul style="list-style-type: none"> <li>Allan Gray Equity Fund</li> <li>Allan Gray Balanced Fund</li> <li>Allan Gray Stable Fund</li> <li>Allan Gray Bond Fund</li> <li>Allan Gray Optimal Fund</li> <li>Allan Gray Money Market Fund</li> <li>Allan Gray Global Fund of Funds</li> </ul>
<b>Minimum Investment Size</b>	R 20 000 lump sum R 1 000 monthly recurring investment
<b>Initial Fee</b>	None
<b>Annual Administration Fee</b>	0.4% (VAT Included)
<b>Investment Management Fee</b>	Depends on the combination of unit trusts selected as investment options.
<b>Switching Fee</b>	None
<b>Financial Adviser Fees (if applicable)</b>	Option A:                      Option B: Initial Fee 0.0% - 3.0%      Initial Fee 0.0% - 1.5% Annual Fee 0.0% - 0.5%      Annual Fee 0.0% - 1.0%

\* The Endowment Policy is underwritten by Allan Gray Life Limited.

## UNIT TRUSTS

	EQUITY FUND	BALANCED FUND	STABLE FUND	BOND FUND	OPTIMAL FUND	MONEY MARKET FUND	GLOBAL FUND OF FUNDS
<b>Benchmark</b>	FTSE/JSE All Share Index including income.	The average (market value-weighted) of the Domestic Prudential Medium Equity Sector excluding the Allan Gray Balanced Fund.	After-tax return of call deposits (for amounts in excess of R1m) with FirstRand Bank Limited plus two percentage points.	All Bond Index.	The daily call rate of FirstRand Bank Limited. (for amounts in excess of R1m).	The simple average of the Domestic Fixed Interest Money Market Unit Trust Sector excluding Allan Gray Money Market Fund.	60% of the FTSE World Index and 40% of the JP Morgan Government Bond Index Global.
<b>Maximum net equity exposure</b>	100%	75%	60%	0%	15%	0%	100%
<b>Portfolio orientation</b>	A share portfolio selected for superior long-term returns.	A share portfolio which can include all asset classes selected for superior long-term returns.	A portfolio which can include all asset classes chosen for its high income yielding potential. The intention is to keep the equity portion significantly below 60%.	Invested in a combination of South African interest-bearing securities including bonds, loan stock, debentures, fixed deposits, money market instruments and cash.	A portfolio of carefully selected equities. The stockmarket risk inherent in these share investments will be substantially reduced by using equity derivatives.	Invested in selected money market instruments providing a high income yield.	Invested in the Orbis funds and the Allan Gray Money Market Fund. The Fund will always hold 85% offshore.
<b>Return objectives</b>	Superior long-term returns.	Superior long-term returns.	Superior after-tax returns to bank deposits.	Superior returns to the All Bond Index.	Superior returns to bank deposits.	Superior money market returns.	Superior long-term returns.
<b>Risk of monetary loss</b>	Risk higher than the Balanced Fund but less than average general equity fund due to Allan Gray's investment style.	Risk will be higher than the Stable Fund but less than the Equity Fund. This is a medium risk fund.	<ul style="list-style-type: none"> <li>Low risk.</li> <li>Limited capital volatility.</li> <li>Seeks to preserve capital over any two-year period.</li> </ul>	Low risk, higher than the Money Market Fund, but lower than the Balanced Fund.	<ul style="list-style-type: none"> <li>Low risk.</li> <li>Little or no correlation to stock or bond markets.</li> </ul>	<ul style="list-style-type: none"> <li>Low risk.</li> <li>High degree of capital stability.</li> </ul>	Risk higher than Balanced Fund but less than average foreign fund.
<b>Target market</b>	<ul style="list-style-type: none"> <li>Investors seeking long-term wealth creation who have delegated the equity selection function to Allan Gray.</li> <li>Investors should be comfortable with market fluctuations i.e. short-term volatility.</li> <li>Typically the investment horizon is five-year plus.</li> </ul>	<ul style="list-style-type: none"> <li>Investors seeking long-term wealth creation who have delegated the asset allocation decision to Allan Gray.</li> <li>Investors seeking a three-year plus investment.</li> <li>Investors who wish to substantially comply with the Prudential Investment Guidelines of the Pension Funds Act (Reg. 28).</li> </ul>	<ul style="list-style-type: none"> <li>Risk-averse investors e.g. investors in bank deposits or money market funds.</li> <li>Investors who wish to substantially comply with the Prudential Investment Guidelines of the Pension Funds Act (Reg. 28).</li> <li>Those investors who require a regular income.</li> </ul>	<ul style="list-style-type: none"> <li>Investors seeking returns in excess of that provided by income funds, the money market or cash.</li> <li>Investors who are prepared to accept some risk of capital loss in exchange for the prospect of increased returns.</li> <li>Investors who want to draw a regular income stream without consuming capital.</li> </ul>	<ul style="list-style-type: none"> <li>Risk-averse investors.</li> <li>Retired investors.</li> <li>Investors who wish to diversify a portfolio of equities or bonds.</li> <li>Retirement schemes and Multi-Managers who wish to add a product with an alternative investment strategy to their overall portfolio.</li> <li>Individuals who have lump sum contractual savings (like Living Annuities, Preservation Funds, and Retirement Annuities).</li> </ul>	<ul style="list-style-type: none"> <li>Highly risk-averse investors.</li> <li>Investors seeking a short-term parking place for their funds.</li> </ul>	Investors: <ul style="list-style-type: none"> <li>seeking to invest locally in Rands and benefit from offshore exposure.</li> <li>wanting to gain exposure to markets and industries that are not available locally.</li> <li>who desire to hedge their investments against any Rand depreciation.</li> </ul>
<b>Income</b>	Low income yield.	Average income yield.	High income yield.	High income yield.	Low income yield.	Highest income yield in the Allan Gray suite of funds.	Low income yield.
<b>Income distribution</b>	Distributed bi-annually.	Distributed bi-annually.	Distributed quarterly.	Distributed quarterly.	Distributed bi-annually.	Distributed monthly.	None.
<b>Compliance with Reg. 28 of the Pension Funds Prudential Investment Guidelines</b>	Does not comply.	Complies.	Complies.	Complies.	Does not comply.	Complies.	Does not comply.
<b>Pricing</b>	Prices are calculated on a net asset value basis.	Prices are calculated on a net asset value basis.	Prices are calculated on a net asset value basis.	Prices are calculated on a net asset value basis.	Prices are calculated on a net asset value basis.	Prices are calculated on a net asset value basis.	Prices are calculated on a net asset value basis.
<b>Fee principles</b>	Performance fee orientated to outperformance of the FTSE/JSE All Share Index over a two-year rolling period.	Performance fee orientated to outperformance of the average Domestic Prudential Medium Equity Sector Fund over a two-year rolling period.	Performance fee orientated to outperformance of taxed bank deposits. No fees if there is a negative return experienced over a two-year rolling period.	Performance fee orientated to outperformance of the All Bond Index over a one-year rolling period.	Fixed fee of 1.0% (excl. VAT) per annum. Performance fee of 20% of the daily outperformance of the benchmark. In times of underperformance no performance fees are charged until the underperformance is recovered.	Fixed fee of 0.25% (excluding VAT) per annum.	No fixed fee. The underlying funds, however, have their own fee structure.
<b>Minimum lump sum investment requirement</b>	R10 000 lump sum and/or R500 per month debit order.	R5 000 lump sum and/or R500 per month debit order.	R5 000 lump sum and/or R500 per month debit order.	R25 000 lump sum and/or R2 500 per month debit order.	R25 000 lump sum and/or R2 500 per month debit order.	R50 000 lump sum and/or R5 000 per month debit order.	R25 000 lump sum. No debit orders are permitted.
<b>Portfolio Manager</b>	Stephen Mildenhall	Arjen Lugtenburg	Stephen Mildenhall	Jack Mitchell and Sandy McGregor	Stephen Mildenhall	Michael Moyle	Stephen Mildenhall

#### ALLAN GRAY LIMITED

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#### DIRECTORS

G W Fury LLB MA CFA A W B Gray B Com CA (SA) MBA CFA Hon LLD (Non-Executive) W B Gray B Com MBA CFA (Non-Executive) (Irish)  
E D Loxton B Com (Hons) MBA J A Lugtenburg M Com CA (SA) CFA S C Marais PhD CFA (Non-Executive)  
A A McGregor B Sc BA (Hons) S C Mildenhall B Com (Hons) CA (SA) CFA W J C Mitchell B Com  
S Moodley-Moore BA (Hons) MA PhD F J van der Merwe LLB MA (Non-Executive)  
**Company Secretary:** C J Hetherington B Com CA (SA)

#### ALLAN GRAY UNIT TRUST MANAGEMENT LIMITED

Client Service Line 0860 000 654 Client Service Facsimile 0860 000 655

Collective Investment Schemes in Securities (unit trusts) are generally medium- to long-term investments. The value of participatory interests (units) may go down as well as up and past performance is not necessarily a guide to the future. Unit trust prices are calculated on a net asset value basis, which is the total value of all assets in the portfolio including any income accrual and less any permissible deductions from the portfolio. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees and charges and maximum commissions is available on request from Allan Gray Unit Trust Management Limited. Commission and incentives may be paid and if so, would be included in the overall costs. Forward pricing is used. Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. A fund of funds unit trust only invests in other unit trusts, which levy their own charges, which could result in a higher fee structure for these portfolios. All of the unit trusts 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 of Collective Investments (ACI).

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