ALLANGRAY

QUARTERLY COMMENTARY 2

30 JUNE 2014

LONG-TERM THINKING IN ACTION

The cover of this Quarterly Commentary features the Brooklyn Bridge in New York, USA. It was designed and built by John Roebling and his son Washington and took more than 600 workers 14 years to complete. The imposing structure of steel, wire and masonry was not only a truly remarkable feat of 19th-century engineering, but also showed vision: It connected Brooklyn and Manhattan over the East River for the first time and it is still in use today. The Brooklyn Bridge incorporated pioneering ideas and, considering the dangerous conditions under which its builders operated, was an example of what can be achieved through perseverance.

At the time of its construction, naysayers said that it would collapse into the East River. Yet, 131 years later, the Brooklyn Bridge is more than a famous landmark. It is a persistently sturdy, fully functional bridge crossed by some 120 000 vehicles, 4 000 pedestrians and 3 100 cyclists every day. We see the Brooklyn Bridge as a lasting example of what long-term thinking can achieve. It reminds us that, as contrarian investors, we should not take heed of the sceptics out there and the challenges of the day, or be afraid of going against popular beliefs. Rather, we should invest with conviction and remain steadfastly focused on creating long-term wealth for our clients.

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ROB DOWER

COMMENTS FROM THE CHIEF OPERATING OFFICER

If a company keeps doing something for many years, it eventually becomes part of its wiring. One could ascribe the modest success that Allan Gray Proprietary Limited has achieved over the last 40 years in making money for its clients almost entirely to the very strong connection that we have to our purpose and to the values that our founder set out when he established this firm in 1973. These values have been our compass ever since. A few years ago Allan Gray and his wife Gill funded a Centre for Values-based Leadership at the UCT Graduate School of Business (GSB). In our first article this quarter, republished from the GSB's magazine, Allan talks about the role of ethics and purpose in business, and the role of business in society.

Many investment managers in this country, including ourselves, are beginning to sound like stuck records when we caution investors about the high level of share prices on the JSE. Our stock market is up approximately 21% per annum over the last three years, yet even at the beginning of these three years we struggled to find South African shares that we considered to be trading at a discount to fair value. The market has ignored our scepticism and powered ahead. The market also seems to have ignored reality: since 2011 our economy has been dealing with over-indebted consumers, a labour crisis and regulatory uncertainty in mining, a slowdown in China – which is the major source of demand for the basic materials that are our main exports – and the extended impact of the global financial crisis on capital markets.

A part-explanation for the disconnect between share prices and the tough realities of doing business in South Africa may be found by looking at globally diversified companies listed on the JSE separately to the rest. The top 40 shares on the JSE currently make up about 84% of the FTSE/JSE All Share Index (ALSI) market cap. According to our estimates, 16 of these top 40 shares derive more than half of their value from outside of SA. Our calculations also show that these global firms have accounted for roughly 70% of the total gains in the Top 40 Index since the end of June 2011. Although these shares now trade at an average price-to-earnings (PE) multiple of 22, and their more local Top 40 peers trade at about 15 times earnings, we still hold substantial positions in some of them. The PE multiple that a rational investor would pay for a company must depend on the level, quality and growth prospects for its earnings; we believe some of these companies justify their higher multiples. Our investment team's jobs would be much easier if the cheaper shares were also those with a global earnings base, or even if shares with mostly local earnings were trading at or below the entire market's long-run average multiple of 12. But the current market bodes relatively well for active investors: without the benefit of fundamental research, passive index investors right now are indiscriminately buying the entire market at share prices that in most cases appear to offer poor value.

The offshore component of your investments

A small percentage of the foreign component of our Balanced and Stable Funds is invested in Africa, and some of you access African investments via our Africa ex-SA Fund.

Clients are often surprised to hear where we are finding opportunities to invest – countries such as Zimbabwe, which present obvious risks. Remember that we always use the same investment philosophy, locally in Africa, and Orbis uses it abroad, looking for opportunities where we feel the market has undervalued a company which has the potential to reach our estimate of its intrinsic value, including a margin of safety. Often these opportunities seem irrational to the outside world. Andrew Lapping discusses our approach to risk in the African region, noting that extremes in market sentiment often represent the best buying opportunities.

Our Balanced and Stable Funds and the Allan Gray-Orbis Global Fund of Funds are invested in our offshore partner Orbis' newly launched Global Balanced Fund. You can also access this Fund directly via our offshore platform. Alec Cutler, from Orbis, discusses the rationale behind the launch of this Fund, which essentially balances appreciation of capital and income generation with the risk of capital loss, as it has the flexibility to invest in a variety of asset classes.

Local shares

While good quality companies at decent prices are hard to come by these days on the local market, our research leads us to the less obvious opportunities. One such company is poultry producer Astral Foods. Leonard Krüger explains the investment case for Astral, the leader in its industry.

Time and investing

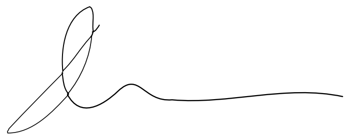
Time can work for you in the form of compounding, and against you in the form of inflation. Our perception of time changes as we get older: there is a not-so-subtle shift from feeling we have all the time in the world to save for our distant retirement, to scrambling around as this milestone nears. Time is intrinsically linked to risk. In the context of investments, market fluctuations usually smooth out over time, so if you have a lot of time on your hands, you can often afford to take on more risk. If you do not have the luxury of time, however, you will need to seek out stability – less stable investments have the potential to dip in value and, if you urgently need to cash in, you may land up locking in losses.

We talk a lot about long-term investing in our commentaries and presentations and we apply long-term thinking to your investment portfolios and to our business decisions. But 'long term' means different things to different people. In this quarter's 'Investing Tutorial', Wanita Isaacs tackles this topic.

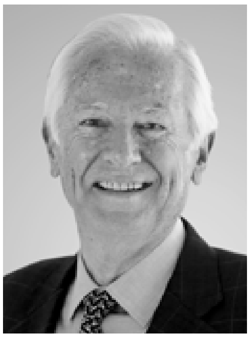
While retirement is the beginning of the next stage of your life, it is not the end of the investing process. Just because you are making withdrawals does not mean your investment cannot continue to grow. Michael Summerton looks at suitable withdrawal rates for living annuitants and discusses how to adjust your asset allocation to give your retirement savings a longer lifespan. These are complex decisions which will have an impact on the rest of your life, so if you are uncertain what to do, I encourage you to talk to a good, independent financial adviser.

Thank you for continued support.

Kind regards



Rob Dower



ALLAN GRAY

PURPOSE BEFORE PROFIT

While a corporate philosophy of first trying to make a positive difference to others may seem inconsistent with running a profitable and successful firm, nothing could be further from the truth. Acting in society's interests can be and is good business. Over 40 years ago Allan Gray was founded with this conviction and ethos, yet has managed to prosper in South Africa's intensely competitive field of asset management. In a reprint of a piece that first appeared in the UCT Graduate School of Business (GSB) magazine, Allan shares his thoughts and philosophies with guest writer Dave Marrs.

National elections invariably train the spotlight on governance. Equally predictable is that opposition parties will disapprove of what is revealed about the incumbent governing party.

It is therefore no surprise that the buildup to South Africa's Election 2014 has seen a focus on corruption, maladministration, the wastage of public resources and financial scandals, most notably the allegation that President Jacob Zuma benefited personally to the tune of more than R200m from irregular 'security upgrades' to his home at Nkandla. While at least some of this can be written off to electioneering, there is a widely held public perception that moral standards have been slipping in South Africa, not only in government but across society, including in the business sector. Far from having been suppressed by the 2008 global financial crisis and subsequent recession, the straitened times appear to have increased the amount of fraud and general unethical behaviour taking place in society. The lament that is frequently heard is that the country has lost its moral compass; that South Africans no longer share a common set of ethical values.

In the case of business, this is seen to be reflected in the widening pay differential between company executives and the average worker, and conflict between trade unions and the corporate sector over retrenchments and what should be considered an acceptable return on investment.

Violent confrontations such as the 2012 Marikana massacre, when 34 striking platinum miners were killed and 78 wounded by police gunfire, point to a complete breakdown in the relationship between some companies and their employees, despite their adherence to basic employment regulations, the existence of liberal labour laws that grant trade unions free access to the workplace, and the widespread application of corporate social investment programmes in surrounding communities.

"ACTING IN SOCIETY'S BEST INTERESTS CAN BE AND IS GOOD BUSINESS."

The government's response to such incidents has been to pass legislation covering, among others, black economic empowerment, minimum wages, employment equity and increased regulation of the extractive industries.

These ostensibly benefit employees, local communities, and the state through royalties and free carry arrangements, but tend also to make it more difficult to do business in the country. There are indications that South Africa is no longer a preferred destination for foreign capital seeking investments in emerging markets, for instance, with the mining sector in particular experiencing damaging disinvestment.

It is clear that to avoid a downward spiral of disgruntled employees, a pressurised government attempting to legislate the nation to prosperity, and capital flight, a social compact is required to achieve consensus on a way forward that benefits society as a whole. Key to this is the re-establishment of a value system that is accepted by all, and it is in the long-term interests of business that it takes the lead in this endeavour.

> **"...WE TRY TO STICK TO OUR KNITTING, WHICH IS EXCELLING ON BEHALF OF OUR CLIENTS IN PROFESSIONAL ASSET MANAGEMENT..."**

It is for this reason that the establishment of the Allan Gray Centre for Values-based Leadership at the Graduate School of Business is such an important development. The centre, which has been funded by Allan Gray, founder of Allan Gray Proprietary Limited and co-founder of the Allan Gray Orbis Foundation, and his wife Gill, will explore new ways of doing business based on purpose and sustainability, with the intention of creating dignity and belonging in the workplace.

To Gray, values-based leadership involves a fundamental questioning of the principles by which many firms have been doing business, and the chair will explore what is required for the generation of new business and economic practices that are geared towards adding more value to society.

While this corporate philosophy of first trying to make a positive difference to others may seem inconsistent with running a profitable and successful firm, Gray says that nothing could be further from the truth.

'Acting in society's interests can be and is good business. Over 40 years ago Allan Gray was founded with this conviction and ethos, yet has managed to prosper in South Africa's intensely competitive field of asset management,' he says.

The Grays' involvement with the GSB started about three decades ago, when they endowed a Chair for Strategic Management, and Allan Gray Limited contributed by managing these endowed funds.

Then Walter Baets and his wife, Erna, published their book *Rethinking Growth: Social Intrapreneurship for Sustainable Performance*, and Gray says he was 'astounded to find an academic echoing my colleagues and my own thoughts on the matter as practised by Allan Gray Proprietary Limited ever since its formation 40 years ago. That was largely how the centre came about – a meeting of mutual minds.'

However, the search for someone to fill the chair took several years, with a selection committee 'scouring the world' to find the right person. Gray even approached Harvard Business School for advice, and was warned that filling this sort of post was particularly difficult 'because you cannot know that the person will fulfil the vision', and that it was best to appoint someone the school knew. 'That was the conclusion the selection committee eventually came to themselves. I was delighted when they suggested Walter... It was the perfect solution.'

Gray says his own philosophy of doing business started 'more as a way of thinking' when he started Allan Gray Proprietary Limited in Cape Town in 1973 with just himself and a secretary, rather than as a formal vision. 'I believed in leading by example and not in writing down a lot of guidelines and telling people how to operate. Anyway, it wasn't then necessary because we were small enough to all be in one office and the ethos could permeate the organisation almost by osmosis.'

However, this changed in 1989 when Allan Gray and his son William, along with Alan Gilbertson and Andrew Veglio, founded Orbis, the global asset management business, and launched the Orbis Mutual funds in 1990. 'We realised that with our opening up offices in other countries the ethos was not as easily perpetuated and we had to write it down, so we formalised it for both Orbis and Allan Gray Group Proprietary Limited, which now have what I suppose are their founding principles. In the case of Orbis, the focus is on a core values document, which is what we are trying to achieve.'

Gray says these core values coincide with the GSB's values-based leadership approach 'in a narrow sense', as 'we try to stick to our knitting, which is excelling on behalf of our clients in professional asset management, whereas Walter's philosophy has a much broader approach.'

Values-based investing entails finding companies that are managed by people whose driving motivation is to 'really make a positive difference', Gray says, not only for their shareholders but to society overall. 'I am very much attracted to that type of company, as a great, sustainable investment.'

However, he believes the values applied to stock-picking are more tertiary than the core values required for successful and sustainable management. 'When I decided to start my own business I sat back and asked myself: "What's important; what do you want to accomplish?" Having worked in asset management with some great firms, we were competing against other firms to excel in investment management, but I never met a client in eight years. I felt we were missing something, because our driving motivation was just to beat the market.

'The global financial crisis really showed the weaknesses of the blatant capitalist philosophy that was expounded in the business schools of the US for decades – that if the president of a company sought to maximise shareholder value everything else would fall into place, and that this would promote the well-being of society. As if it was automatic.

'The obsession with profit was what led to the excessive remuneration of executives and the culture of stock options, and of course the increasing gap between the haves and have-nots. The market crash was a very important shift, because it brought out the awareness of what was going on in society at large.

'At Allan Gray we set out to create wealth for clients and give them a sense of financial security, not only to provide the best returns, but to meet their needs. The stock market is driven by greed and fear, and we wanted to meet real needs, not wants.

'What investors need is the feeling of security that comes with a good rate of return without too much risk. That became our rationale, the sense of purpose for the business. We set out to win the trust and confidence of our clients by excelling on their behalf and being very client-centric.

'We are able to grow assets under management, which of course determine the fee, simply by getting a good alpha; if we outperform the market by five percentage points per annum our assets under management grow by 5% per annum more than the market, which is rather nice for expanding your revenue base.

'There should never be a conflict between the asset manager and clients. If the firm succeeds for the client, it will be successful. If we do something clients don't like, I would rather know about it so we can correct it.'

Gray says making a profit has never been an end in itself, but a consequence of pursuing a sense of purpose; to really want to make a difference, not only for clients but all other stakeholders, from employees to the community, the taxman and society at large. 'It is only if the client is satisfied that the firm is enabled to help more and more clients. Maximising shareholder value is a crazy philosophy because it's short term; it's not sustainable.'

Gray says he was always intrigued with Japanese philosophy, which recognises the importance of a range of stakeholders, the ecology and society as a whole. 'I think in many ways they are closer to the solution than the Western extreme. But the Japanese philosophy has not proved sustainable either. Perhaps the Chinese will get it right – they have seen the benefits of capitalism, the free market economy and the greater productivity that comes with entrepreneurship. To their credit they have adapted their system to embrace the best of the Western philosophy without ditching their own. It has been quite a good combination so far, but it remains to be seen whether they can hold it together.'

Gray believes values-based management has broader connotations than just business. 'The greatest values-based leader in Africa's history must be Nelson Mandela. If the Allan Gray Centre for Values-based Leadership helps to spread Madiba's philosophy through the wider society, that would be great.'

"IT IS ONLY IF THE CLIENT IS SATISFIED THAT YOU CAN HELP MORE AND MORE CLIENTS. MAXIMISING SHAREHOLDER VALUE IS A CRAZY PHILOSOPHY BECAUSE IT'S SHORT TERM; IT'S NOT SUSTAINABLE."

This piece was written by Dave Marrs and originally appeared in the UCT GSB Business Review. Dave Marrs is a former Business Day finance editor who now runs the publication's Cape Town bureau. He is also chief lead writer, a columnist and editor of the Bottom Line.

ANDREW LAPPING

UNDERSTANDING THE RISK OF LOSS IN AFRICA EX-SA

A small percentage of the foreign component of our Balanced and Stable Funds is invested in Africa and investors looking for greater exposure to the region can access African investments via our Africa ex-SA Equity Fund. Andrew Lapping discusses our approach to risk in the region, noting that we often invest where others fear to tread. In our view, extremes in market sentiment represent opportunities to buy and sell shares.

People often ask: 'Don't you know what is going on there?' when they see 20% of the Allan Gray Africa ex-SA Equity Fund is invested in Zimbabwean equities. The reason they ask this is that they are too polite to question my sanity.

The economic and political situation is no doubt very difficult in Zimbabwe and may stay that way for a few years yet. But the great thing for equity investors is the short term does not matter much when determining a business's value, as long as the business can survive the short term. This is particularly pertinent for a leveraged business.

Bad news creates opportunities

For an equity investor, the importance of short-term news and economic cycles is that these events create opportunities to buy companies for less than they are worth, as investors with short time horizons exit. The seemingly simple trick of long-term wealth creation is to invest consistently in assets that are trading at a discount to what they are worth and to avoid those trading at a premium. We think a few of these opportunities exist in Zimbabwe.

The Zimbabwean risks include the possibility of nationalisation, higher tax rates, a liquidity crisis, a shrinking economy, flight of skills, deteriorating infrastructure, obstructive officials and the return of the Zimbabwean dollar. The good thing is that these risks are well known, to the extent that some investors avoid Zimbabwean equities totally as they do not want to deal with the uncertainties. The obvious risks give us the opportunity to invest in high-quality businesses at valuations that are unheard of in the rest of the world, with the possible exception of Russia. Of course, there is a chance that we are wrong and these companies are in fact overpriced. This will be the case if, rather than the economy stumbling along as we expect, there is an economic collapse similar to the 2000 to 2008 period. We are willing to take this risk. A total economic collapse is unlikely as this is what led to ZANU-PF losing popularity and the election in 2008. When there is no money for the people there is also a lot less money for the politicians – something they want to avoid. In the case of an extreme downside scenario we own quality industrial businesses with little debt that should retain some value.

If, rather than collapsing, the economy defies the critics and begins to recover or even remains stable, which is the more likely path from rock bottom, our investments should perform nicely. There are a lot of things that could go right for Zimbabwe, including a continuation of the recovery in agricultural production, increasing platinum production at higher platinum prices and some kind of resumption in donor funding.

The weak economy and tight liquidity situation can actually play into the hands of well-capitalised, established businesses as the barriers to entry become very high. Dollar funding in Zimbabwe costs about 14%, so any new entrants must fund their expansions with equity and the difficult conditions deter many potential competitors from even trying.

The situation in Nigeria is very different

Corporates are generally very keen on the Nigerian consumer story and are investing capital to meet the expected demand; this can reduce returns for all players. A good example is the beer industry and Guinness Nigeria in particular. The highly rated Guinness has seen its return on capital fall from 40% in 2010 to 22% currently – still a very high number, but nonetheless a disappointment for investors. This is not to say we are not finding opportunities in Nigeria; we are. However, the risk of buying a company where earnings are unsustainably high because of temporarily weak competition is a much harder risk to identify than the plainly obvious risks in Zimbabwe. For this reason, investors sometimes overpay for companies when everything is going well and there are no clouds on the horizon. Investing in a stock that is priced for perfection can lead to a permanent capital loss as the stock is re-priced from overvalued to fair value.

I far prefer to invest in companies where things are dire and the dire scenario is expected to persist. This way time and valuation are on your side. With time, very bad economic situations usually improve: witness the US and Europe in 2009/2010. If a business is struggling, a return to normality usually results in share price appreciation.

A closer look at specific investments

Our largest Zimbabwean investment is Econet Wireless, the country's dominant mobile phone operator with a 66% subscriber share and a larger share of revenue. If Econet was a run-of-the-mill mobile operator in a fairly competitive market, the valuation of eight times historic earnings would be attractive. Fortunately for investors, the company offers much more than that. The mobile phone industry is one where scale counts and the dominant operator is usually able to generate better-than-market returns. This makes sense, as the cost of serving additional customers is marginal on an established infrastructure base. Econet has invested capital of US$900m since 2010, distancing its network from those of its two competitors. The two smaller operators have struggled to generate the cash flow required to make substantial capital investments. The very high cost of debt funding in Zimbabwe means operating cash flow is required for capital investment.

Globally, in order to increase revenue, mobile operators try to offer their customers additional products and services over and above the traditional voice service, especially those services that deter switching to competitor networks. The best example of this strategy in Africa is Safaricom in Kenya, which enjoys a 75% revenue share and almost no subscriber churn among its important high-value subscribers. Interestingly, Safaricom's churn has not increased despite the fact that it raised tariffs, a move the competitors did not follow. Safaricom has a very loyal customer base because of the superior network coverage that comes with its ability to invest capital, and M-Pesa, its very popular mobile money system. Investors have recently realised the power and potential of M-Pesa and rerated the Safaricom share price accordingly. Safaricom trades on 22 times historic earnings – a very high multiple for an established mobile operator.

In Econet Wireless's mobile money platform, EcoCash, we see all the ingredients of a potentially successful mobile money system. Zimbabwean banking penetration is low and the transaction costs are high. Additionally, there is a shortage of coinage in the economy so receiving change for purchases is difficult. Econet's high market share means customers are able to transfer money to two-thirds of the population. These factors should play into Econet's hands and enable EcoCash to achieve scale, generating additional revenue and driving subscriber loyalty. Econet management are very aware of the potential and are working to realise it.

What could make EcoCash a superior product to M-Pesa is that Econet owns a bank, which makes it possible to offer clients more functionality. After three years EcoCash Save has 1.5 million account holders, compared to the total clients of the Zimbabwean banking system of 0.85 million.

We think Econet's growth potential and dominant market position deserve a substantially higher multiple than the current eight. As always, we measure the obvious risks of investing in Zimbabwe against the potential of earning a good return for our clients.

Andrew joined Allan Gray in February 2001. He is a fund manager for the Allan Gray Bond and Money Market funds, as well as the African equity portfolios, and also manages a portion of client equity and balanced portfolios.

LEONARD KRÜGER

ASTRAL FOODS: UNAPPRECIATED QUALITY

Good quality companies at decent prices are hard to come by these days on the local market. Leonard Krüger explains the investment case for Astral Foods.

Readers of the financial press will no doubt be aware of the plethora of woes the South African poultry industry has experienced in recent years. This is clearly illustrated by the decline in operating margins of the largest poultry producers listed on the FTSE/JSE All Share Index (ALSI), as shown in **Graph 1**.

For some time now we have been of the opinion that the average profitability of local companies is above their long-term growth trend line. Coupled with price-to-earnings ratios above 18x, quality companies, with current profits below our estimate of normal, at a decent price, are almost as scarce as chicken teeth. However, Astral Foods fits this description and is a holding in our clients' portfolios for the reasons highlighted below.

Quality operations

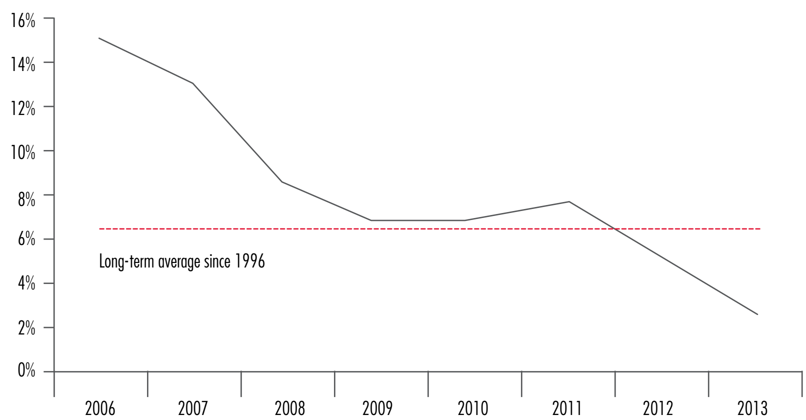
1. Scale and efficiency

   With well over four million chickens produced every week, Astral is one of SA's largest poultry producers. Rearing, feeding and processing such quantities from three production hubs results in significant benefits of scale. Higher utilisation of assets, lower per-unit fixed overhead costs and increased bargaining power and reach with suppliers and customers equates to an efficiently run operation.

2. Integration leads to lowest-cost producer

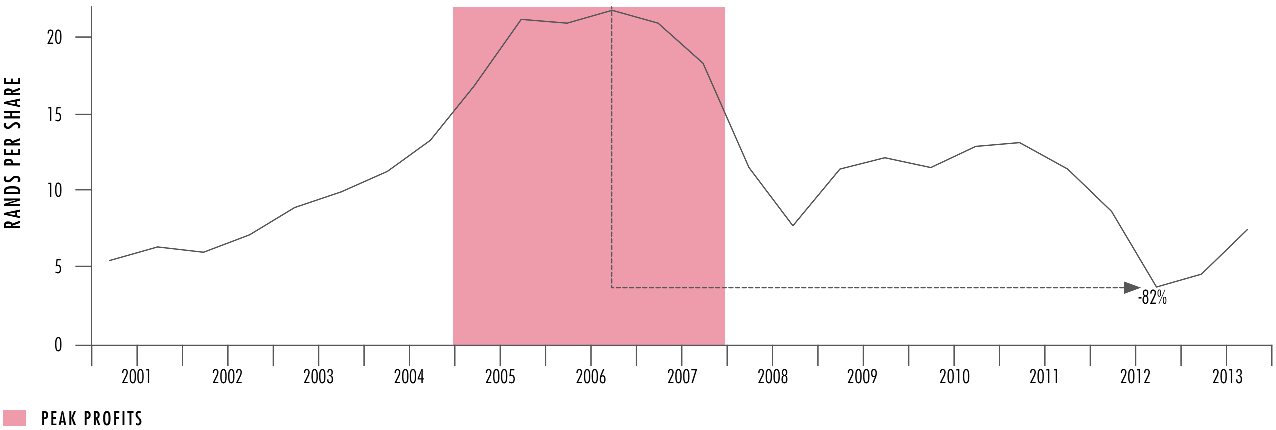
   As an integrated producer, Astral manages the full life cycle – from the laying of eggs to getting fresh chicken on supermarket shelves. This not only adds to greater efficiency and lower overall costs, but also allows Astral to make a profit by, for example, selling feed to its broiler operations. Meadow Feeds is a high-quality operation with excellent returns on capital, highly predictable customer demand and a low risk of technological obsolescence.

GRAPH 1 **JSE-LISTED POULTRY INDUSTRY OPERATING MARGINS**



Source: Allan Gray research

GRAPH 2 **ASTRAL EARNINGS PER SHARE HISTORY (REAL TERMS)**



Source: Allan Gray research

3. Free cash flow and strong financial position

Astral has a proven track record as a great generator of free cash flow (FCF). We define FCF as the cash remaining in a business after paying all interest, tax and investments in working capital and capital expenditure. Since listing in 2001, almost two-thirds of Astral's declared accounting profits have translated into FCF, while at the same time, sufficient investments have been made into the business to grow revenue per share by a compound 9% per annum. This FCF has been applied substantially to pay dividends and buy back shares over this time as acquisitions have been kept to a minimum.

The group carries minimal debt and does not speculate in commodity hedging activities.

4. Management and capital allocation

Astral's focused and stable leadership team has been instrumental in the group's ability to navigate the difficulties faced by the industry. Management has resisted the temptation to diversify away from the company's core competence and, thanks to its healthy financial position, Astral has been investing in its operations at a time when its competitors are struggling to stay afloat. These investments will further enhance Astral's long-term competitive position relative to local peers, in our opinion. We like management's rational approach to return-focused capital allocation, cost control and opportunistic expansion activities.

Below-normal profitability

Competition from imports, a weak local consumer environment and increasing input costs have materially impacted the profitability of Astral (and the industry as a whole). However, there are reasons to be optimistic.

Recent declines in the global and domestic price of inputs such as maize and soya beans bode well for poultry producers. Such inputs constitute up to 60% of Astral's total costs.

Meanwhile, a significant capital project at the group's Standerton production hub has been completed. This will result in new efficiency savings, in-sourcing of previously procured feed volumes and additional capacity at the lower end of the industry cost curve.

Added to this, it appears likely that the government will impose tariffs on imported poultry products, deemed to constitute dumping. While we have a strong preference for free markets wherever possible, this does seem to be a true case of unfair competition. Leveling the playing field for local producers is necessary to ensure a return to health for an industry that closely aligns with some of the key objectives of government, such as raw material beneficiation, rural development and large-scale employment of lower skilled employees.

Although we do not believe that the peak profits of 2005-2007 will be repeated anytime soon in real terms, we think current profits are below normal for a business that is the leader in its industry (see **Graph 2**).

Leonard joined Allan Gray in 2007 as an equity analyst. He began managing a portion of our clients' equity and balanced portfolios earmarked for associate portfolio managers from July 2014. Leonard completed his BSc (Hons) Actuarial Mathematics at the University of Pretoria and is a qualified actuary.

ALEC CUTLER

ORBIS GLOBAL BALANCED FUND: BALANCING RISK AND REWARD

Orbis has launched a new global multi-asset fund – the Orbis Global Balanced Fund. The Fund has been registered for marketing in South Africa and is now available via the Allan Gray offshore platform. Alec Cutler discusses the rationale behind the launch and explains how the Fund aims to deliver on its mandate.

At the inception of the Orbis Funds in 1990, the firm provided clients with both a long-only Global Equity Fund and two Absolute Return options, which substantially hedge their stock market exposures. This allowed clients to blend these building blocks to suit their own risk tolerance and portfolio needs, particularly regarding the level of equity exposure. Since 1990, Orbis has added to its range of strategies in response to long-term investment opportunities.

Over the past few years, clients have called for an offering where asset classes are blended to provide long-term capital appreciation, but with less volatility and risk of loss than Orbis' long-only Equity Funds. In studying the best way to accomplish this, Orbis sought to design a fund that could produce the desired balance of risk and reward for the very long term. Their analysis concluded that a balanced strategy best fits the bill, with the ability to vary exposure across asset classes.

Enter Orbis Global Balanced

In 2013, Orbis launched the Global Balanced strategy. Its mission is to balance appreciation of capital and income generation with the risk of capital loss. In addition to the flexibility to invest in the asset classes described in **Table 1**, it can also adjust its equity and currency exposures using hedging.

As with all Orbis funds, the positioning of Global Balanced – including the percentage of the portfolio that is allocated across the various asset classes – is driven from the bottom up, drawing on Orbis' fundamental research process and capital allocation capabilities.

While Orbis Global Balanced seeks to deliver more stable returns than Orbis Global Equity, capital appreciation is a core aim of both strategies. Importantly, reducing volatility at the portfolio level does not mean forgoing individually attractive investment opportunities – even ones that may appear more 'risky' in isolation. The portfolio is therefore likely to include many of the same shares that Orbis analysts recommend for the Global Equity strategy. But,

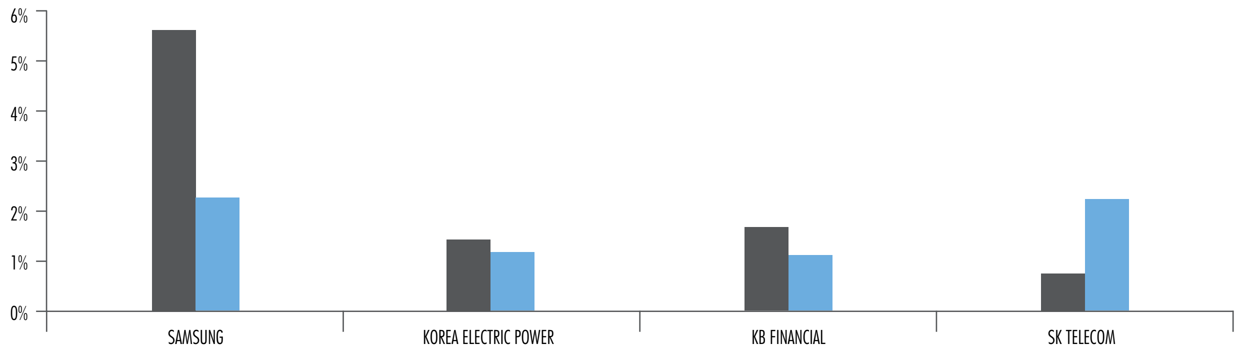
TABLE 1 **ORBIS GLOBAL BALANCED: ASSET ALLOCATION (%)***

ASSET CLASS	MAX (%)	MIN (%)	30 JUNE (%)
GROSS EQUITY	90	40	88
EQUITY HEDGING	30	0	19
NET EQUITY	75	10	69
FIXED INCOME	50	10	10
COMMODITY-RELATED	10	0	1

*Figures may not sum due to rounding and net current assets.

Source: Orbis

GRAPH 1 ORBIS GLOBAL BALANCED KOREA HOLDINGS COMPARED TO ORBIS GLOBAL EQUITY: PREFERENCE FOR YIELD AND STABILITY



	SAMSUNG	KOREA ELECTRIC POWER	KB FINANCIAL	SK TELECOM
PE*	5.5	-	8.5	8.6
YIELD**	1.1%	0.2%	1.4%	3.7%
BETA***	0.9	0.5	1.0	0.7

■ ORBIS GLOBAL EQUITY WEIGHT ■ ORBIS GLOBAL BALANCED WEIGHT

*Price-to-earnings (PE) data is based on Orbis estimates of 2014 earnings.
**Indicated dividend yield.
***Three-year Beta vs MSCI World Index. Beta reflects the sensitivity of a stock's price to stock market movements. All else being equal, for every 10% (positive or negative) move in the stock market, a stock with a beta of 1.0 would be expected to move 10% in the same direction, one with a 0.9 beta, 9% and one with a 1.1 beta, 11%.

Source: Orbis

importantly, Orbis Global Balanced also has the latitude to invest in higher-yielding and more stable shares if they appear to offer a more appropriate balance of risk and reward. A good example is the Fund's holdings in Korea, as shown in **Graph 1**.

In line with the investment approach, there is significant overlap between the Korean holdings in each Fund. While Orbis Global Equity holds higher weights in Samsung Electronics and KB Financial, which are more economically sensitive, Orbis Global Balanced also has significant positions in these shares. The Fund's approach to yield is similar. While Orbis Global Balanced holds a bigger weight in the high-yielding SK Telecom, it also holds Korea Electric Power, which offers a negligible dividend today but attractive upside potential and the capability to meaningfully increase pay-outs in the future. By applying this approach across regions and sectors, Orbis Global Balanced aims to produce an equity portfolio with a higher yield and lower market sensitivity than Orbis Global Equity – without 'sacrificing' too much in the way of returns.

> **"...ORBIS SOUGHT TO DESIGN A FUND THAT COULD PRODUCE THE DESIRED BALANCE OF RISK AND REWARD FOR THE VERY LONG TERM."**

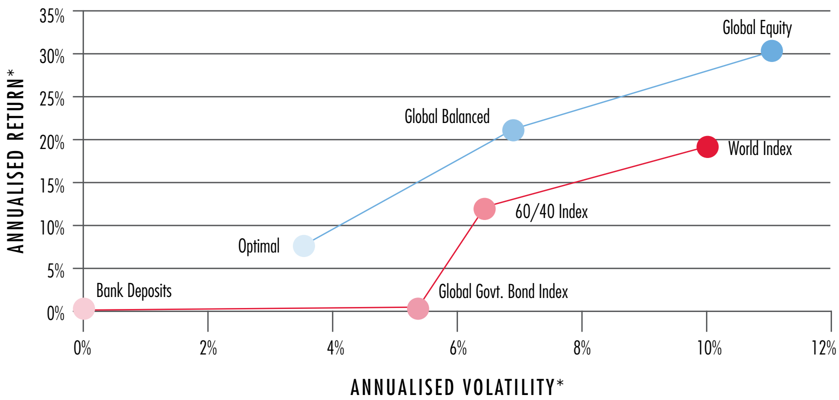
Leveraging company research to find attractive bonds

When Orbis first launched Global Balanced, the fixed income asset class had enjoyed a multi-decade bull market. Understandably, Orbis was not enthralled with the near-term potential of bonds as an asset class, and started with the minimum 10% target allocation to fixed income, with most of that in cash or short-term corporate bonds. While bonds performed poorly in 2013, Orbis continued to find better alternatives in the form of higher yielding and strongly cash generative equities, as well as in more cyclical shares whose contribution to the portfolio's risk can be reduced with stock market hedging.

That said, Orbis has found selected bonds that it is happy for the Fund to hold. To date, it has held short-term bonds from the likes of Vodafone at one end of the maturity schedule, and Thomas Cook and Alcoa bonds further out. If one recognises these names from the equity portfolios of Global Balanced or other Orbis Funds, it is no coincidence. Orbis uses the same fundamental research process that has proved capable of uncovering undervalued equities to uncover securities in other parts of a company's capital structure. Orbis has found that if the market is overly pessimistic about a company's prospects, that pessimism is typically not limited to the company's shares, but extends to its preferred shares and fixed income issues. With Orbis Global Balanced's broader mandate, Orbis has the ability to consider and purchase these securities.

An example of this approach is the Fund's holdings in the aluminium industry. In the past year, Orbis company analysts have found aluminium producers Alcoa and Norsk Hydro attractively valued, as sentiment on the industry was poor but its supply/demand balance was starting to improve. In comparing the companies' equity, Norway-based Norsk Hydro's 2.5% dividend yield, relatively solid balance sheet, and conservative management team appeared more appropriate for Orbis Global Balanced, while the greater uncertainty – and potential upside – of Alcoa's equity made it more appropriate for Orbis Global Equity. As for the companies' debt, Norsk Hydro's fiscal conservatism was reflected in relatively unremarkable yields. But Alcoa's bonds looked interesting. Moody's had downgraded Alcoa's credit rating, and as Orbis analysts compared the reasons for the downgrade against the company's fundamentals, they gained conviction that the reduced rating would likely prove temporary. Accordingly, Orbis Global Balanced bought a significant position in Alcoa's 2037 bond.

GRAPH 2 **RETURN AND VOLATILITY: ORBIS FUNDS AND THEIR BENCHMARKS**



*Since 1 January 2013. The 60/40 Index is a composite index consisting of the MSCI World Index with net dividends reinvested (60%) and the JP Morgan Global Government Bond Index (40%). Gross returns for Orbis Funds are calculated gross of all income, net of all expenses, assume reinvestment of dividends (i.e. calculated before the deduction of all management and performance fees).

Source: Orbis

Will the Fund deliver on its mandate?

With this flexible approach, Orbis believes Global Balanced can deliver on its mandate over the very long term. And while six quarters do not a track record make, the Fund's performance so far has been encouraging. Some readers will recognise **Graph 2** as an 'efficient frontier', which compares the return generated by a portfolio with the volatility of its returns. Higher and to the left is better. As you can see, Orbis Global Balanced has thus far generated a higher return than its benchmark, without much more volatility. Early indications are that it is doing its job within the Orbis Fund family, with returns and volatility sitting in the middle of Global Equity and Optimal Funds.

Of course, as with any fund, there are environments in which Orbis Global Balanced may look stupid. With its current low weighting in bonds and hedged exposure to US equities, the Fund could perform poorly if US equities strongly outperform, or if bonds resume their multi-decade bull market. Performance may also suffer if momentum darling stocks emerge and the bull market narrows into a small group of 'chosen few' stocks. On the other hand, with large weightings in selected European and Asian shares, Orbis Global Balanced may perform well if those markets outperform. With its substantial exposure to equities, the Fund may also do well if economic activity continues to accelerate.

While the macroeconomic environment may drive relative performance over the short term, Orbis is confident that the Fund's long-term success will be determined by their core skill: finding attractively-priced individual securities.

Alec joined Orbis in 2004 and is co-manager and a director of Orbis Investment Management Limited and a director of Orbis Investment Management (BVI) Limited. He has 10 years' previous experience in asset management. He has a BSc (Honours) in Naval Architecture (US Naval Academy) and an MBA (Wharton), and is a CFA charterholder.

MICHAEL SUMMERTON

HOW TO ENSURE YOUR RETIREMENT INCOME GOES THE DISTANCE

It is only a number of years into retirement that the consequences of decisions made early on begin to show. If you are nearing retirement, or you are in early retirement, it is important to be aware of the impact of your decisions. Looking at international research, and applying it in a local context, Michael Summerton gives living annuitants some perspective on the appropriate income levels to draw down (within the 2.5% to 17.5% range as currently prescribed by legislation), and offers some thoughts on asset allocation.

'The question isn't at what age I want to retire, it's at what income' - George Foreman

Only a small proportion of South Africans begin retirement with sufficient capital that will comfortably last the rest of their lives. We all need to make well-informed income and asset allocation decisions early on to give our retirement savings the best chance of going the distance. This will prevent us from being forced into making drastic lifestyle adjustments as we figure out how long we may live, and how quickly our nest eggs may diminish.

Withdrawal rates and asset allocation

Personal circumstances are unique which makes it very difficult to prescribe a 'recommended withdrawal rate'. Various studies have been carried out on the subject to try to give retirees and their financial advisers a solid basis for their decisions. In 1994, US author and financial adviser William P. Bengen conducted extensive research to identify a strategy that would allow his clients the best chance of enjoying real income for at least 30 years (30 years seemed ample for retirement from age 65). Using historical returns going back to the 1920s for equities and bonds in the US, he ran a number of different scenarios using portfolios beginning on 1 January of each year. He built up a dataset of portfolio performance and end market value around the following variables: percentage withdrawal and asset allocation. Bengen came up with a formula for withdrawals and asset allocation and concluded that if you follow his method, you will enjoy inflation-adjusted income for at least 30 years in nearly all circumstances.

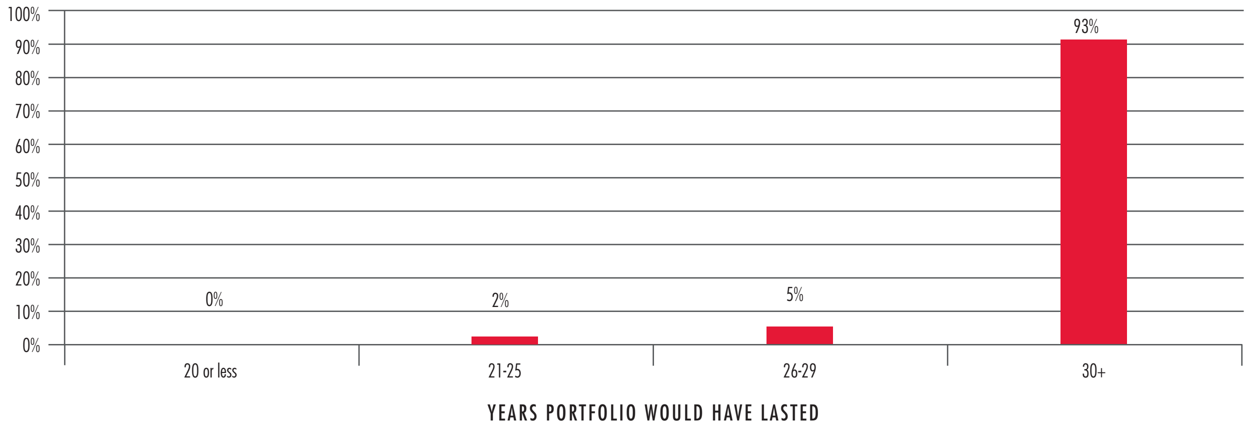
"INCREASING ANNUAL WITHDRAWALS BY INFLATION ALONE, AND REBALANCING ANNUALLY, IS ESSENTIAL FOR THE 4% RULE TO HOLD."

This theory has held through several stock market booms and busts of varying magnitudes.

Bengen suggests:

- Withdraw 4% of your capital, starting at the end of the first year of retirement (for ease of calculation purposes, Bengen used income withdrawals in arrears)
- Increase (or decrease) the absolute cash value of your withdrawal only by inflation each year
- Maintain at least a 50% allocation to equities (if the weightings in your portfolio have changed, but your investment objectives have not, you may need to

GRAPH 1 **4% INITIAL WITHDRAWAL, INCREASE BY INFLATION, 55% EQUITY EXPOSURE**



Source: Allan Gray research

'rebalance' annually to restore your original asset allocation)

Bengen's assertion that 4% is an appropriate drawdown rate has since turned into a 'rule of thumb' for many financial advisers planning their clients' post-retirement income. Increasing annual withdrawals by inflation alone, and rebalancing annually, is essential for the 4% rule to hold.

Will this work in the South African context?

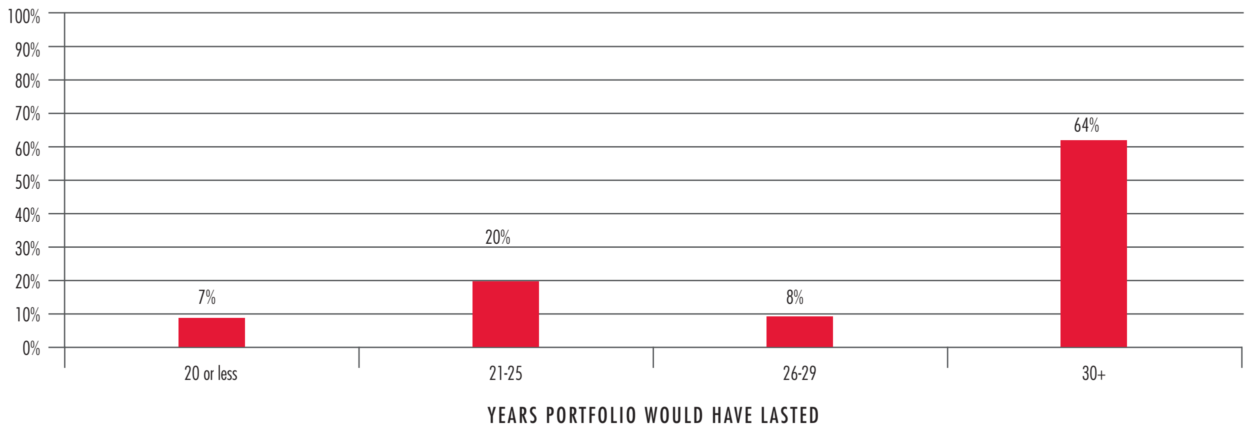
Using South African equity and bond data, and similar assumptions to Bengen, we created 84 30-year periods beginning on 1 January 1900. We concluded that if you had used 55% equity exposure, started your annual withdrawal at 4% and only increased by inflation each year, your income would have lasted for at least 30 years, 93% of the time, as shown in **Graph 1**.

The impact of your drawdown decisions

Graph 2 illustrates what would have happened had you selected an initial drawdown rate of 5%. The change from 4% to 5% may seem like a small increase, but it is in fact a 25% increase in income. While 4% proved sustainable in almost all scenarios, 5% would have run out before 30 years one-third of the time. Note how under the 4% assumption shown in Graph 1, all portfolios lasted more than 20 years, while under the 5% assumption, 7% of portfolios lasted less than 20 years. This illustrates how important the initial level of income is to the long-term sustainability of your portfolio. An initial drawdown rate of 6% would have run out before 30 years nearly two-thirds of the time.

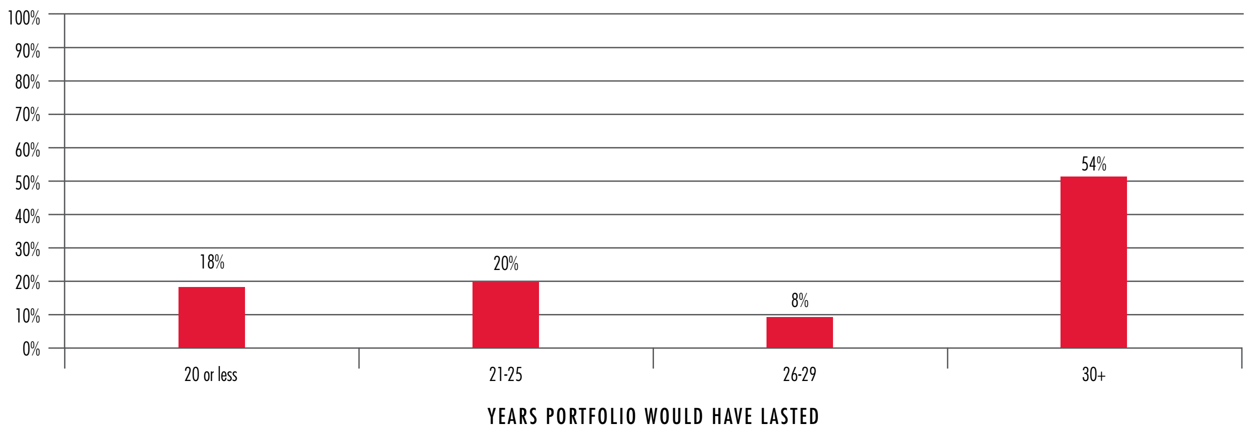
Graph 3 illustrates the impact of selecting 4% at the beginning of retirement and keeping this percentage constant for as long as possible. This shows that it isn't only the initial income level that is important; it is just as important to be disciplined

GRAPH 2 **5% INITIAL WITHDRAWAL, INCREASE BY INFLATION, 55% EQUITY EXPOSURE**



Source: Allan Gray research

GRAPH 3 **4% INITIAL WITHDRAWAL, ANNUAL INCREASE AHEAD OF INFLATION, 55% EQUITY EXPOSURE**



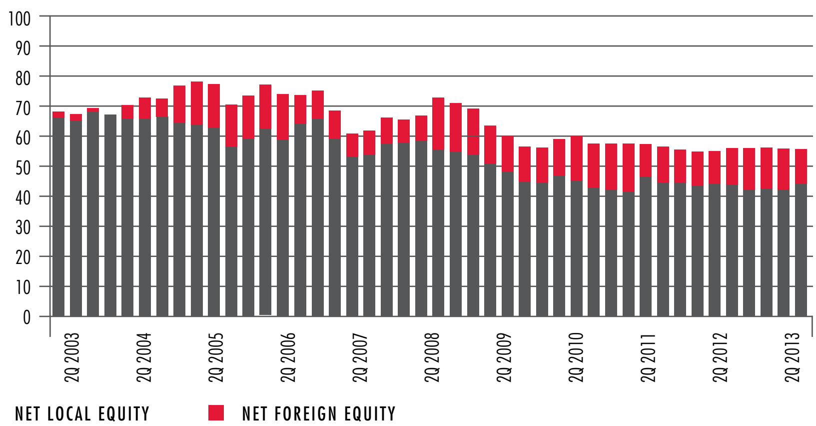
Source: Allan Gray research

about the increases you allow yourself to take. When bumper returns come along it is advisable to contain your income growth, so that your portfolio can build up a buffer for disappointing returns, which inevitably lie ahead. In this scenario, even though the initial withdrawal percentage was 4%, by then allowing annual withdrawal escalations ahead of inflation, the number of instances the portfolios lasted beyond 30 years reduced to only 54% of the time (which is nearly akin to flipping a coin).

The impact of your asset allocation decisions

Maintaining an appropriate asset allocation throughout retirement is essential. Both Bengen's research and the examples above use total return market data and both assume that annuitants build and rebalance their own portfolios. Another way to achieve appropriate asset allocation is to use a balanced fund, where the professional fund manager is mandated to vary the asset allocation and invest in shares, bonds, money markets and offshore, depending on where they are finding value at the time. Note that the maximum equity exposure limits of these funds vary, so if you are in retirement and keen to follow Bengen's advice and take on at least 50% equity exposure, it is worthwhile looking at the average exposure to equities of your chosen fund over time. **Graph 4** below and **Graph 5** on page 16 reflect the net equity exposure of the Allan Gray Balanced and Stable funds since inception.

GRAPH 4 **ALLAN GRAY BALANCED FUND NET EQUITY EXPOSURE (2003 TO DATE)**



Source: Allan Gray research

Put the theory into practice

There are various factors that influence the level of income you can draw in retirement, as well as how long your capital will last.

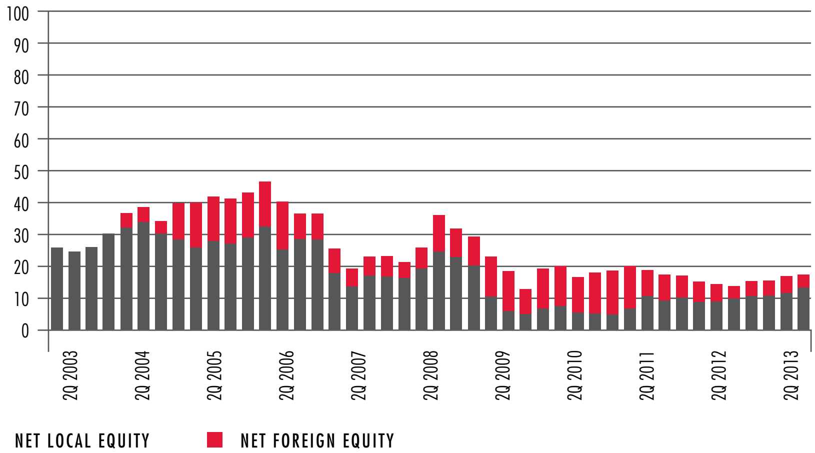
1. Level of initial capital

   A consistent level of savings over a long enough time horizon, further enhanced by a sensible asset allocation and resisting the temptation to make early withdrawals, provides the best chance of arriving at retirement with a decent capital sum. By the time you reach retirement, there is unfortunately very little that can be done about the value of capital that you have; but you can be smart about making it work for you.

2. Inflation

   Inflation eats away at your spending power. It is the antithesis to the wonder of compound interest. Even over the medium term, if your investment does not keep up with inflation, it will quickly erode your retirement capital. In addition to the

GRAPH 5 **ALLAN GRAY STABLE FUND NET EQUITY EXPOSURE (2003 TO DATE)**



Source: Allan Gray research

'headline' inflation rate published by the government, you should also consider your personal inflation rate, as some specific costs that retirees face (like medical care) may increase at a higher rate.

3. Withdrawal rate

Your withdrawal rate will affect how long your capital lasts. The more income you draw each year, the quicker your capital will erode. Instead of drawing the same percentage in your living annuity each year, you should rather calculate what a reasonable increase would be in absolute rand terms, taking inflation into account and amending your percentage accordingly. Some successful living annuitants have reduced their percentage drawdown over time, which extends the time their capital will last.

4. Investment returns

Depending on your appetite for risk and thus your investment's level of exposure to equities, your returns may vary. Over the long term, a higher equity weighting generally leads to higher returns, but with increased volatility and an increased probability of a worse outcome. A lower equity weighting generally leads to lower returns on average, with lower volatility, but a lower chance of a very bad outcome.

If you can manage by initially drawing 4% of your retirement capital without suffering major lifestyle adjustment, increase the rand value of your withdrawals only by inflation, and maintain a suitable asset allocation over time, your money has an excellent chance of outliving you.

Retirement is the beginning of the next stage of your investing life. Careful planning and understanding the impact of your early decisions can increase the longevity of your investment. It is possible to grow your capital at an appropriate rate, while also providing a real, sustainable income. If you are uncertain of the best course of action, you may wish to consider speaking to an independent financial adviser.

Michael joined Allan Gray in May 2008 and is a manager in product development. He was previously a senior audit manager with Ernst & Young in Cape Town and New York where he specialised in the Financial Services and Oil & Gas industries respectively. Michael qualified as a Chartered Accountant (SA) in 2004.

WANITA ISAACS

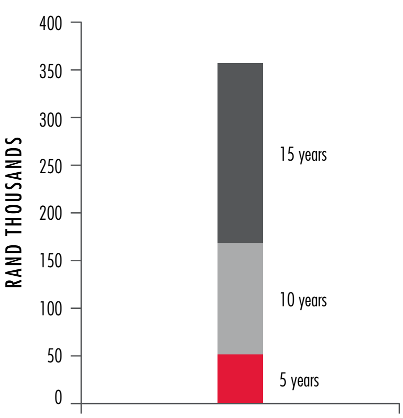
THINKING LONG TERM

We encourage people to invest for the long term. But how long is long term and what does this mean for investment decision-making? Wanita Isaacs offers some thoughts on this topic.

What do we consider long term?

At Allan Gray we take a four-year view when selecting shares to invest in. This typically allows enough time for our value investing approach to pay off. If you are considering investing in the Allan Gray Equity Fund, having four or five years to invest means that you are less likely to be disappointed. However, your return increases exponentially the longer you invest. **Graph 1** shows the growth of an investment in the Allan Gray Equity Fund after 5, 10 and 15 years, if you had invested R10 000 since inception in 1998.

GRAPH 1 **EQUITY FUND GROWTH***



*R10 000 invested since inception (1998)

Source: Allan Gray research

What are your other options?

If you have a shorter time horizon, more stable investments present less of a risk, but may have lower potential returns. For example, asset allocation unit trusts, which invest in asset classes such as shares, bonds, money markets and offshore, generally fluctuate less than equity-only unit trusts, and may be more suitable if you have a medium-term time horizon.

A money market unit trust, which aims to preserve capital while delivering higher return than you might get from a bank account, might be suitable if you need to access your money in the very short term. However, very stable investments usually do not keep up with inflation over time and are therefore best suited for investments of a year or less.

Once you have selected a unit trust to match your needs, it is important to stay invested in that unit trust without withdrawing or switching prematurely (see 'What is switching?' in Quarterly Commentary 1, 2014).

Key actions

Thinking long term means planning for the future by making appropriate investment decisions based on how long you have to invest for each of your goals, and how much risk you are prepared to stomach over your investment period.

Successful long-term investing involves:

- Identifying your goals
- Selecting appropriate investments based on your time frames
- Making sure you do not delay starting to save and that you contribute enough

Why are goals important?

Identifying your specific goals allows you to determine your investment time frame. While your short-term goals will naturally feel more urgent, giving priority to goals which are further away (such as saving for retirement) will, through compound return, give you a better chance of reaching them, while making the lowest contributions.

How to select appropriately

Your time frame, and your ability to tolerate investment fluctuation, determine the type of investments you choose. For example, investments such as shares, which have the potential for high returns, tend to fluctuate more. Drops in value are on paper only, unless you sell your investment when it has lost value. This means that these investments are suitable if you know you will not need to access your money, and you are able to stomach some significant ups and downs, with periods of underperformance that may last for years.

The sooner, the better

Each month that you put off saving, in favour of spending, increases the amount that you will have to save in the remaining months. For example, if investments are returning 9% per year and you need to meet your objective in 10 years' time, delaying saving for just 18 months increases the amount you need to save per month by more than 25%. If your time frame is five years, an 18-month delay means you need to increase your monthly amount by more than 50%.

To give yourself the best chance of reaching your goals, start investing as soon as you can, and take a long-term approach.

Wanita was appointed as head of investor education at the start of 2013. Prior to that she was a business analyst in the Product Development team. She is a medical doctor and a UCT graduate and has been with Allan Gray since 2008.

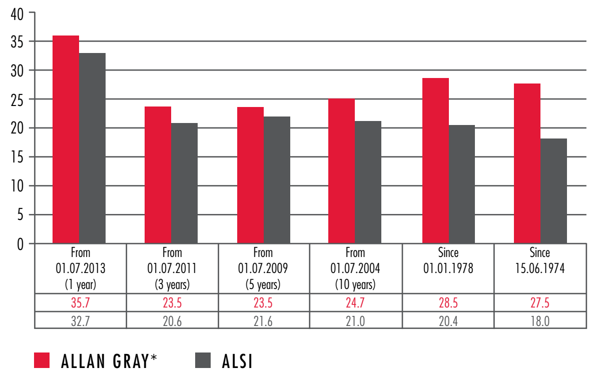
NOTES

INVESTMENT TRACK RECORD – SHARE RETURNS

ALLAN GRAY PROPRIETARY LIMITED GLOBAL MANDATE SHARE RETURNS VS FTSE/JSE ALL SHARE INDEX

PERIOD	ALLAN GRAY*	FTSE/JSE ALL SHARE INDEX	OUT/UNDER-PERFORMANCE
1974 (from 15.06)	-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
2005	56.5	47.3	9.2
2006	49.7	41.2	8.5
2007	17.6	19.2	-1.6
2008	-13.7	-23.2	9.5
2009	27.0	32.1	-5.1
2010	20.3	19.0	1.3
2011	9.9	2.6	7.3
2012	20.6	26.7	-6.1
2013	24.3	21.4	2.9
2014 (to 30.06)	16.4	11.8	4.6

RETURNS ANNUALISED TO 30.06.2014



* Allan Gray commenced managing pension funds on 1 January 1978. The returns prior to 1 January 1978 are of individuals managed by Allan Gray, and these returns exclude income. Returns are before fees.

Note: Listed property included from 1 July 2002. Inward listed included from November 2008.

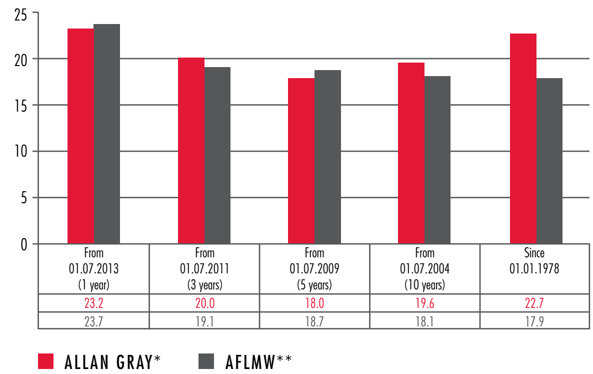
An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R165 443 009 by 30 June 2014. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R7 493 629.

INVESTMENT TRACK RECORD – BALANCED RETURNS

ALLAN GRAY PROPRIETARY LIMITED GLOBAL MANDATE TOTAL RETURNS VS ALEXANDER FORBES GLOBAL MANAGER WATCH

PERIOD	ALLAN GRAY*	AFLMW**	OUT/UNDER-PERFORMANCE
1974	-	-	-
1975	-	-	-
1976	-	-	-
1977	-	-	-
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	-1.0	7.9
1999	80.0	46.8	33.1
2000	21.7	7.6	14.1
2001	44.0	23.5	20.5
2002	13.4	-3.6	17.1
2003	21.5	17.8	3.7
2004	21.8	28.1	-6.3
2005	40.0	31.9	8.1
2006	35.6	31.7	3.9
2007	14.5	15.1	-0.6
2008	-1.1	-12.3	11.2
2009	15.6	20.3	-4.7
2010	11.7	14.5	-2.8
2011	12.6	8.8	3.8
2012	15.1	20.0	-4.9
2013	25.0	23.3	1.7
2014 (to 30.06)	9.8	8.3	1.5

RETURNS ANNUALISED TO 30.06.2014



** Consulting Actuaries Survey returns used up to December 1997. The return from 1 April 2010 is the average of the non-investable Alexander Forbes Large Manager Watch. The return for December 2013 is an estimate.

An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R17 439 257 by 30 June 2014. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R4 084 604.

ALLAN GRAY BALANCED AND STABLE FUND ASSET ALLOCATION AS AT 30 JUNE 2014

	BALANCED FUND % OF PORTFOLIO			STABLE FUND % OF PORTFOLIO		
	TOTAL	SA	FOREIGN*	TOTAL	SA	FOREIGN*
Net equities	56.3	44.2	12.1	18.4	13.4	5.0
Hedged equities	12.9	2.5	10.4	31.6	15.2	16.5
Property	1.6	1.2	0.4	3.1	2.7	0.4
Commodities	3.8	3.7	0.0	4.7	4.7	0.0
Bonds	11.6	11.2	0.4	9.8	9.5	0.3
Money market and bank deposits	13.9	11.4	2.5	32.3	29.2	3.2
TOTAL	**100.0**	**74.2**	**25.8**	**100.0**	**74.7**	**25.3**

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

* This includes African ex-SA assets.

ALLAN GRAY EQUITY FUND NET ASSETS AS AT 30 JUNE 2014

SECURITY (RANKED BY SECTOR)	MARKET VALUE (R MILLION)	% OF FUND	FTSE/JSE ALSI WEIGHT (%)
EQUITIES	**40 479**	**97.9**	
RESOURCES	**9 302**	**22.5**	**25.7**
Sasol	5 141	12.4	
Anglo American*	1 439	3.5	
BHP Billiton	461	1.1	
Sibanye Gold	425	1.0	
Positions less than 1%	1 836	4.4	
FINANCIALS	**11 364**	**27.5**	**19.7**
Standard Bank	3 156	7.6	
Reinet Investments SA	1 766	4.3	
Old Mutual	1 382	3.3	
Investec	1 268	3.1	
Sanlam	697	1.7	
Rand Merchant Insurance	553	1.3	
Barclays Africa	516	1.2	
Positions less than 1%	2 027	4.9	
INDUSTRIALS	**19 698**	**47.6**	**54.6**
British American Tobacco	4 640	11.2	
SABMiller	3 591	8.7	
Remgro	2 300	5.6	
Netcare	731	1.8	
Tongaat Hulett	627	1.5	
Nampak	587	1.4	
Sappi	525	1.3	
Mondi	523	1.3	
Aspen Pharmacare	485	1.2	
Naspers	478	1.2	
Positions less than 1%	5 212	12.6	
OTHER SECURITIES	**115**	**0.3**	
COMMODITIES	**181**	**0.4**	
MONEY MARKET AND CALL DEPOSITS	**708**	**1.7**	
TOTALS	**41 368**	**100.0**	

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

* Including positions in Anglo American stub certificates.

ALLAN GRAY SOUTH AFRICAN UNIT TRUSTS ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 30 JUNE 2014 (AFTER FEES)

	ASSETS UNDER MANAGEMENT (R MILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR
HIGH NET EQUITY EXPOSURE (100%)							
Allan Gray Equity Fund (AGEF) FTSE/JSE All Share Index	41 367.9	01.10.98	**27.0** 19.2	**21.4** 21.0	**20.5** 21.6	**20.9** 20.6	**34.0** 32.7
Allan Gray-Orbis Global Equity Feeder Fund (AGOE) FTSE World Index	13 816.9	01.04.05	**16.5** 14.0	- -	**21.9** 22.8	**33.7** 29.3	**31.9** 31.4
MEDIUM NET EQUITY EXPOSURE (40% - 75%)							
Allan Gray Balanced Fund (AGBF) Average of South African - Multi Asset - High Equity category (excl. AGBF)[1]	97 012.1	01.10.99	**19.7** 14.3	**17.8** 15.8	**16.4** 15.6	**18.4** 16.3	**21.9** 19.9
Allan Gray-Orbis Global Fund of Funds (AGGF) 60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index	11 779.3	03.02.04	**11.5** 11.3	**13.2** 13.1	**14.1** 18.1	**26.4** 25.0	**18.9** 23.8
LOW NET EQUITY EXPOSURE (0% - 40%)							
Allan Gray Stable Fund (AGSF) Daily interest rate of FirstRand Bank Limited plus 2%	36 876.3	01.07.00	**13.4** 9.4	**12.2** 8.4	**9.9** 6.9	**12.0** 6.4	**10.5** 6.4
VERY LOW NET EQUITY EXPOSURE (0% - 20%)							
Allan Gray Optimal Fund (AGOF) Daily interest rate of FirstRand Bank Limited	839.5	01.10.02	**7.9** 6.8	**7.1** 6.3	**5.1** 4.8	**5.5** 4.3	**7.2** 4.3
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO) Average of US$ Bank Deposits and Euro Bank deposits	1 570.3	02.03.10	**10.9** 8.4	- -	- -	**19.7** 15.5	**10.4** 8.7
NO EQUITY EXPOSURE							
Allan Gray Bond Fund (AGBD) JSE All Bond Index	531.3	01.10.04	**9.2** 8.9	- -	**9.3** 9.5	**8.4** 8.7	**5.5** 5.4
Allan Gray Money Market Fund (AGMF) Alexander Forbes Short-Term Fixed Interest (STeFI) Composite Index[2]	8 194.3	03.07.01	**8.2** 8.2	**7.5** 7.4	**6.1** 5.9	**5.4** 5.4	**5.5** 5.4

[1] The benchmark was the daily weighted average of the Domestic Prudential Medium Equity Unit Trust sector excluding Allan Gray Balanced Fund from inception until 31 December 2007. With effect from 1 January 2008 it was changed to the daily weighted average (based on assets under management) of the Domestic Prudential Medium Equity Unit Trust Sector and the Prudential Variable Equity Sector excluding Allan Gray Balanced Fund. The change was as a result of the Allan Gray Balanced Fund being reclassified from the Domestic Prudential Medium Equity Sector to the new Prudential Variable Equity Sector. The benchmark from 1 February 2013 is the daily weighted average return of funds in the South African - Multi Asset - High Equity category (excluding the Allan Gray Balanced Fund)

[2] Alexander Forbes Three-Month Deposit Index from 3 July 2001 to 31 March 2003. As from 1 April 2003, the benchmark is the simple average of the Domestic Fixed Interest Money Market Unit Trust Sector excluding the Allan Gray Money Market Fund. The benchmark from 1 November 2011 is the Alexander Forbes Short Term Fixed Interest (STeFI) Composite Index

ALLAN GRAY TOTAL EXPENSE RATIOS (TERS) FOR THE YEAR ENDING 31 MARCH 2014

	EQUITY FUND	GLOBAL EQUITY FEEDER FUND	BALANCED FUND	GLOBAL FUND OF FUNDS	STABLE FUND	OPTIMAL FUND	GLOBAL OPTIMAL FUND OF FUNDS	BOND FUND	MONEY MARKET FUND
Performance fees	0.24%	0.66%	0.49%	1.40%	0.84%	0.00%	2.04%	0.35%	N/A
Fee for benchmark performance	1.50%	1.49%	1.06%	1.23%	1.02%	1.00%	1.00%	0.25%	0.25%
Other costs including trading costs	0.08%	0.22%	0.10%	0.24%	0.10%	0.09%	0.25%	0.02%	0.01%
VAT	0.25%	0.01%	0.13%	0.00%	0.16%	0.15%	0.00%	0.09%	0.04%
TOTAL EXPENSE RATIO (TER)	2.07%	2.38%	1.78%	2.87%	2.12%	1.24%	3.29%	0.71%	0.30%

A Total Expense Ratio (TER) of a portfolio is a measure of the portfolio's assets that were relinquished as a payment of services rendered in the management of the portfolio. The total operating expenses are expressed as a percentage of the average value of the portfolio, calculated for the year to 31 March 2014. Included in the TER is the proportion of costs incurred by the performance component, fee at benchmark and other expenses. These are disclosed separately as percentages of the net asset value. Trading costs (including brokerage, VAT, STT, STRATE, levy and insider trading levy) are included in the TER. A high TER will not necessarily imply a poor return nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs.

FOREIGN DOMICILED FUNDS ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 30 JUNE 2014 (AFTER FEES)

	ASSETS UNDER MANAGEMENT (R MILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR
HIGH NET EQUITY EXPOSURE							
Orbis Global Equity Fund FTSE World Index	161 697.6	01.01.90	**19.6** 13.6	**16.6** 14.0	**22.3** 22.8	**33.7** 29.4	**33.9** 32.9
Orbis SICAV Japan Equity (Yen) Fund Tokyo Stock Price Index	17 853.4	01.01.98	**15.4** 8.5	**11.7** 8.9	**16.8** 14.7	**30.5** 25.7	**19.9** 19.4
Orbis SICAV Asia Ex-Japan Equity Fund MSCI Asia Ex-Japan	30 658.7	01.01.06	**18.5** 15.5	**-** -	**21.3** 18.3	**27.4** 19.8	**33.5** 24.8
Allan Gray Africa ex-SA Equity Fund Standard Bank Africa Total Return Index	2 180.8	01.01.12	**41.5** 23.0	**-** -	**-** -	**-** -	**35.0** 33.6
Allan Gray Australia Equity Fund S&P/ASX 300 Accumulation Index	8 113.3	04.05.06	**17.7** 15.2	**-** -	**25.7** 21.9	**25.0** 22.4	**37.4** 29.6
MEDIUM NET EQUITY EXPOSURE							
Orbis SICAV Global Balanced Fund 60% MSCI World Index with net dividends reinvested and 40% JP Morgan Global Government Bond Index	5 457.3	01.01.13	**39.0** 31.3	**-** -	**-** -	**-** -	**25.4** 25.2
LOW NET EQUITY EXPOSURE							
Allan Gray Australia Opportunity Fund Reserve Bank of Australia cash rate	519.1	01.07.11	**20.3** 15.2	**-** -	**-** -	**20.3** 15.2	**20.6** 13.4
VERY LOW NET EQUITY EXPOSURE							
Orbis Optimal SA Fund-US$ Class US$ Bank Deposits	23 573.8	01.01.05	**11.4** 8.9	**-** -	**8.7** 6.8	**20.7** 16.4	**10.3** 7.4
Orbis Optimal SA Fund-Euro Class Euro Bank Deposits	3 816.3	01.01.05	**11.1** 8.9	**-** -	**8.2** 6.6	**18.4** 14.5	**15.4** 13.2

SOUTH AFRICAN INSTITUTIONAL PORTFOLIOS ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM[3] TO 30 JUNE 2014

	ASSETS UNDER MANAGEMENT (R MILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR
LOCAL PORTFOLIOS[4] (BEFORE LOCAL FEES)							
Domestic Equity Composite (minimum net equity 75%-95%)	**66 169.0**	**01.01.90**	**22.2**	**24.4**	**22.1**	**22.1**	**33.6**
Domestic Equity Pooled Portfolio (minimum net equity 95%)	**8 232.3**	**01.02.01**	**24.4**	**24.8**	**22.8**	**22.9**	**35.0**
FTSE/JSE All Share Index		01.01.90/01.02.01	15.6/17.1	21.0	21.6	20.6	32.7
Domestic Balanced Composite	**23 415.1**	**01.01.78**	**23.0**	**20.4**	**17.6**	**16.9**	**23.4**
Domestic Balanced Pooled Portfolio	**4 857.5**	**01.09.01**	**20.4**	**20.7**	**18.0**	**17.4**	**23.3**
Mean of Alexander Forbes SA Large Manager Watch (Non-Investable)[5]		01.01.78/01.09.01	18.3/17.2	18.7	18.1	16.8	23.2
Domestic Stable Composite	**5 998.7**	**01.12.01**	**14.1**	**13.6**	**10.2**	**9.5**	**12.3**
Domestic Stable Pooled Portfolio	**2 069.7**	**01.12.01**	**14.4**	**13.9**	**10.2**	**9.4**	**12.4**
Alexander Forbes Three-Month Deposit Index plus 2%			10.2	9.4	7.9	7.4	7.3
GLOBAL PORTFOLIOS[4], LIMITED TO 25% FOREIGN EXPOSURE (BEFORE LOCAL, BUT AFTER FOREIGN FEES)							
Global Balanced Composite	**63 460.0**	**01.01.78**	**22.7**	**19.6**	**18.0**	**20.0**	**23.2**
Global Balanced Pooled Portfolio	**31 642.3**	**01.09.00**	**20.4**	**19.7**	**18.3**	**20.3**	**23.3**
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[5,6]		01.01.78/01.09.00	17.9/15.9	18.1	18.7	19.1	23.7
Global Stable Composite	**5 482.9**	**15.07.04**	**13.8**	**-**	**11.1**	**13.3**	**12.6**
Global Stable Pooled Portfolio	**4 767.1**	**15.07.04**	**13.9**	**-**	**11.2**	**13.5**	**12.7**
Alexander Forbes Three-Month Deposit Index plus 2%			9.4	-	7.9	7.4	7.3
Global Absolute Composite	**10 417.3**	**01.03.04**	**17.4**	**18.4**	**13.1**	**13.9**	**14.3**
Global Absolute Pooled Portfolio	**3 745.0**	**01.03.04**	**17.7**	**18.7**	**13.2**	**13.9**	**14.5**
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[5]			17.4	18.1	18.7	19.1	23.7
FOREIGN ONLY PORTFOLIOS[4] (AFTER FEES)							
Orbis Global Equity Pooled Portfolio	**5 680.0**	**18.05.04**	**16.2**	**16.5**	**22.2**	**33.6**	**33.7**
FTSE World Index			13.7	14.1	22.8	29.4	32.9
Foreign Balanced Composite[7]	**5 149.5**	**23.05.96**	**15.2**	**13.2**	**14.1**	**26.6**	**20.4**
Foreign Balanced Pooled Portfolio	**931.5**	**23.01.02**	**8.7**	**13.1**	**13.9**	**26.3**	**20.4**
60% MSCI World Index[8] and 40% JP Morgan Global Government Bond Index		23.05.96/23.01.02	12.1/6.8	13.1	17.9	24.7	24.9

PERFORMANCE AS CALCULATED BY ALLAN GRAY

[3] The composites not listed here are: Global Balanced High Foreign, Global Balanced Namibia 35% High Foreign, Global Tax Paying, Domestic Absolute, Domestic Balanced Low Equity, Domestic Balanced Stable Namibia, Domestic Equity MSCI SA, Domestic Equity Namibia, Domestic Equity Relative, Africa ex-SA Bond, Pan Africa Equity, Domestic Bond, Domestic Money Market, Domestic Optimal, Domestic Tax Paying

[4] The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate

[5] The return for the period ending 30 June2014 is an estimate as the relevant survey results have not yet been released

[6] Alexander Forbes Global Large Manager Watch (Non-Investable) used from 1 January 1998. Consulting Actuaries Survey returns used to 31 December 1997

[7] The Foreign Balanced Composite returns are used from 1 September 2001. The foreign carve-out returns of the Global Balanced Composite were used from 23 May 1996 to 31 August 2001

[8] Morgan Stanley Capital International All Country World Index

THE ALLAN GRAY GROUP	
UNIT TRUSTS	A unit trust is a savings vehicle for investors who want to grow their money and may want to access it before they retire. Unit trusts allow investors to pool their money with other investors who have similar investment objectives. Unit trusts are also known as 'portfolios of collective investment schemes' or 'funds'. Allan Gray has nine funds in its stable: Equity, Balanced, Stable, Optimal, Money Market, Bond, Global Equity Feeder, Global Fund of Funds and Global Optimal Fund of Funds.
RETIREMENT ANNUITY*	The Allan Gray Retirement Annuity Fund (RA) is a savings vehicle for investors looking for a flexible, tax-efficient way to save for retirement. Investors can only access their money when they retire. Individually owned RAs can be managed on a group basis, offering employers a flexible solution to the challenge of retirement funding for their staff.
PRESERVATION FUNDS*	The Allan Gray Pension Preservation and Provident Preservation funds are savings vehicles for investors looking for a tax-efficient way to preserve existing retirement benefits when they leave a pension or provident fund, either as a result of a change in employment (e.g. retrenchment or resignation), or when they transfer from another preservation fund.
ENDOWMENT*	The Allan Gray Endowment Policy is a savings policy for investors who want a tax-efficient way to save and wish to create liquidity in their estate.
LIVING ANNUITY*	The Allan Gray Living Annuity gives investors flexibility, within certain regulatory limits, to select an annuity best suited to their income needs after retirement. A living annuity provides investors with a regular income which is not guaranteed, and which is funded by growth on capital and income from interest and dividends.
OFFSHORE FUNDS	Through our partnership with Orbis we offer you a cost-effective way to diversify your portfolio by investing offshore. There are two options for investing offshore through Allan Gray: invest in rand-denominated offshore funds without the need to use your offshore investment allowance, or use your offshore investment allowance to invest in foreign funds.
PLATFORM – LOCAL AND OFFSHORE	Our investment platform provides you with access to all of our products, as well as a focused range of unit trusts from other fund providers. The platform enables you to buy, sell and switch – usually at no charge – between the funds as your needs and objectives change. South African investors who wish to diversify their portfolios can also access funds from certain other offshore fund providers via the same platform.
LIFE POOLED PORTFOLIOS	The minimum investment per client is R20 million. Mandates include risk-profiled pooled portfolios: Stable Portfolio, Balanced Portfolio and Absolute Portfolio; asset class pooled portfolios: Money Market, Equity and Foreign, and finally an Optimal Portfolio.
SEGREGATED PORTFOLIOS	The minimum portfolio size is R500 million. Mandates are of a balanced or asset class specific nature. Portfolios can be managed on an absolute or relative risk basis.
BOTSWANA	Allan Gray Botswana manages institutional portfolios on a segregated basis and offers our range of nine South African unit trusts to individual investors.
NAMIBIA	Allan Gray Namibia manages institutional portfolios on a segregated basis and the Allan Gray Namibia Investment Trust provides investment management for Namibian retirement funds in a pooled vehicle.
SWAZILAND	Allan Gray Swaziland manages institutional portfolios on a segregated basis.
ALLAN GRAY ORBIS FOUNDATION	Allan Gray Orbis Foundation is a non-profit organisation that was established in 2005 as an education and development catalyst. It seeks to foster a next generation of high-impact leaders and entrepreneurs for the ultimate purpose of increased job creation in Southern Africa. The Foundation focuses on educational and experiential methods at the secondary and tertiary levels to realise the potential of bright young minds. Through its highly-researched learning programmes, it intends to equip talented young individuals with the skills, attitudes and motivation to have a significant future impact.
E^2	E^2 stands for 'excellence in entrepreneurship' and as a long-term capital fund its purpose is to provide substantial financing to entrepreneurs who are graduates of the Allan Gray Fellowship Programme. In addition, E^2 provides financing for social entrepreneurs who demonstrate exceptional leadership and creative initiative in the not-for-profit sectors.

* This product has unit trusts as its underlying investment option.

Directors

Executive

M Cooper	BBusSc FIA FASSA
R W Dower	BSc (Eng) MBA
I S Liddle	BBusSc (Hons) CFA
T Mhlambiso	AB MBA JD

Non-Executive

W B Gray	BCom MBA CFA (Irish)
T J Mahuma	BA (Hons) MPhil
S C Marais	PhD CFA
K C Morolo	BSc (Eng) MEng

Company Secretary

C E Solomon BBusSc (Hons) CA (SA)

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