The Balanced Fund celebrates 10 years

African expansion sweetens the Illovo mix

The cost of too much choice

South African banks – not just a bad debt story

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Allan Gray

INSIDE THIS ISSUE

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Rob Dower

COMMENTS FROM THE CHIEF OPERATING OFFICER

As I write, the JSE is more than double its March low when priced in US dollars. To justify the current stock market valuation on a PE multiple hovering around 15, with in all probability some more bad news to come in the earnings numbers, one has to be pretty optimistic about a return to the high profit levels which characterised the boom years.

The risk is not just in earnings. The last three swings in South African equity prices – the peak in July last year, the trough in October and the recovery since March – have demonstrated the extent to which short-term movements in our local capital markets are driven by global rather than local investor sentiment. Although this sentiment is currently in our favour, and there is a lot more capital out there that could flow into SA, it is also extremely fickle. And the current state is not stable: based on fundamentals, SA share prices expect a strong recovery. Yet the appetite for emerging market currencies implies a continuation of low hard currency interest rates and therefore continued economic weakness. Both of these cannot easily be true – having either proved wrong would be bad news for local equities.

Simply put, share prices in South Africa have reached a point where generally we are finding more opportunities to sell shares than to buy them. This is reflected in the reduced equity exposure in our asset allocation portfolios.

Cyclical factors are only one part of the equation

This issue of our Quarterly Commentary includes two articles that demonstrate why value-based investing requires more than a simple analysis of the business cycle.

Our first example is Illovo. The world sugar market is arguably overheated, with sugar currently trading above its long-term mean of US$10.5c/lb. This favourable commercial environment is fully reflected in sugar company stock prices, so you probably would not expect to find a value-based investor like Allan Gray attracted to a sugar business like Illovo at this point in the cycle. Lonwabo Maqubela explains in his article why we believe that Illovo's African operations and favourable European market access mean that its current price is sustainable even if the global price declines, and why we favour the share despite its recent gains.

The opposite is true of the banking sector, which is experiencing depressed profits on the back of record-high bad debts. This would usually make it a good hunting ground for investors like us, as the market tends to extrapolate the bad news of today into the future. Jacques Plaut explains why, despite an expected cyclical improvement in bad debts, we believe that the outlook for South African bank earnings is even more negative than the market anticipates.

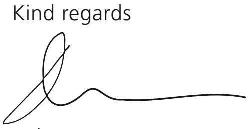
Balanced Fund's 10th anniversary

It is difficult not to be proud of the Balanced Fund. It has done a remarkable job over its history, delivering returns in line with those of equities but at a much lower level of risk. Jeanette Marais reminds us of the Allan Gray Balanced Fund's investment mandate as it celebrates its 10th anniversary. Along with the Equity Fund, which began its track record in 1998, the Balanced Fund allowed us to help many thousands of individual investors who we were not able to serve with segregated portfolios.

There are eight Allan Gray funds, and including these we have 43 local funds on our investment platform. This is an intentionally small selection when set against the 899 funds available industry-wide. Marisa Kaplan looks at how in the face of too much choice people often land up making worse decisions, or suffering from buyer's remorse – that is, if they are able to make any choice at all.

I hope you enjoy this issue and look forward to your feedback. Thank you sincerely for your continued support.

Kind regards



Rob Dower

Lonwabo Maqubela

AFRICAN EXPANSION SWEETENS THE ILLOVO MIX

EXECUTIVE SUMMARY: Despite our concerns about the current heat in the sugar market (with the world sugar price trading at 22-year highs), we are reluctant to part with our position in Illovo. We observe with interest as Illovo's management plots further expansion into Africa. Given the team's success in that region to date, we are confident that the African operations will continue to generate attractive returns for shareholders. Lonwabo Maqubela explains.

In the Middle Ages, due to its rarity, sugar was considered a romantic gift, while throughout the 18th century, it is thought, securing the sugar supply was the cause of many of the Anglo-French Caribbean wars. Although I dare not suggest that we all start sharpening our swords, another shortage in sugar is looming. As a result, the world sugar price is trading at 22-year highs (see **Point A** on **Graph 1**).

World market, from surplus to deficit

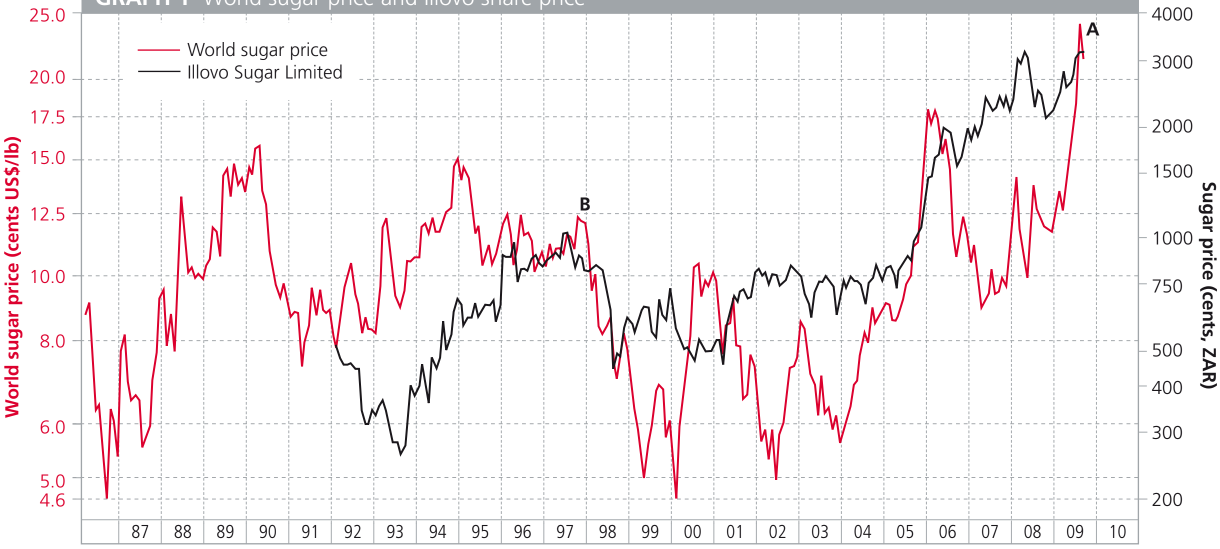
In 2008, 166 million (m) tons of sugar were produced globally, 10m tons more than what was consumed. The surplus is expected to swing into a deficit in the 2009 sugar season, primarily as a result of substantial production declines in India and the European Union (EU), which together accounted for 28% of 2008's global supply.

The 12m ton (38%) decline in Indian production can be blamed squarely on the rain – or the lack thereof. Indian rainfall this year is well below average, with the country experiencing its driest summer in 83 years.

The decline in the EU's production is one of several structural changes in the European sugar market, including:

- **Export restrictions**
  Due to subsidies and political interventions, the EU has historically produced sugar well above its consumption requirements. The surplus of 5-6m tons was effectively dumped on the world sugar market, depressing the price. In 2006, the World Trade Organisation responded by imposing an export restriction on the EU. To date, this has resulted in a 4m ton (18%) decline in the EU's sugar production.

GRAPH 1 World sugar price and Illovo share price



Source: I-Net Bridge

- **Price reduction**
  Effective from 2010, the EU will reduce the EU regulated price by 36%, which is expected to cause even more of the inefficient European sugar-beet farmers to stop producing.

Global weather patterns are also contributing to the positive sentiment in the world sugar price. Meteorologists speculate that there is a high probability that El Niño has returned. El Niño results in flooding and droughts in regions that are crucial for the global supply of sugar.

Investing in sugar

The world sugar market is highly volatile. As contrarian investors, when we observe the positive sentiment and strong momentum found in the sugar sector today, we become cautious. The world sugar price is currently trading above its long-term mean of US$10.5c/lb. In time, the high prices are likely to result in a significant supply response from the world's largest producer, Brazil, as well as India (when conditions improve). This additional supply will result in a correction of the world sugar price, which is what happened in 1997 (see **Point B** on Graph 1). During this period our clients were well-served by timely selling of Illovo shares when the world sugar price was trading above the long-term mean.

However, despite our concerns about the current heat in the sugar market, we are reluctant, at this stage, to part with our position in Illovo at current prices for the following reasons:

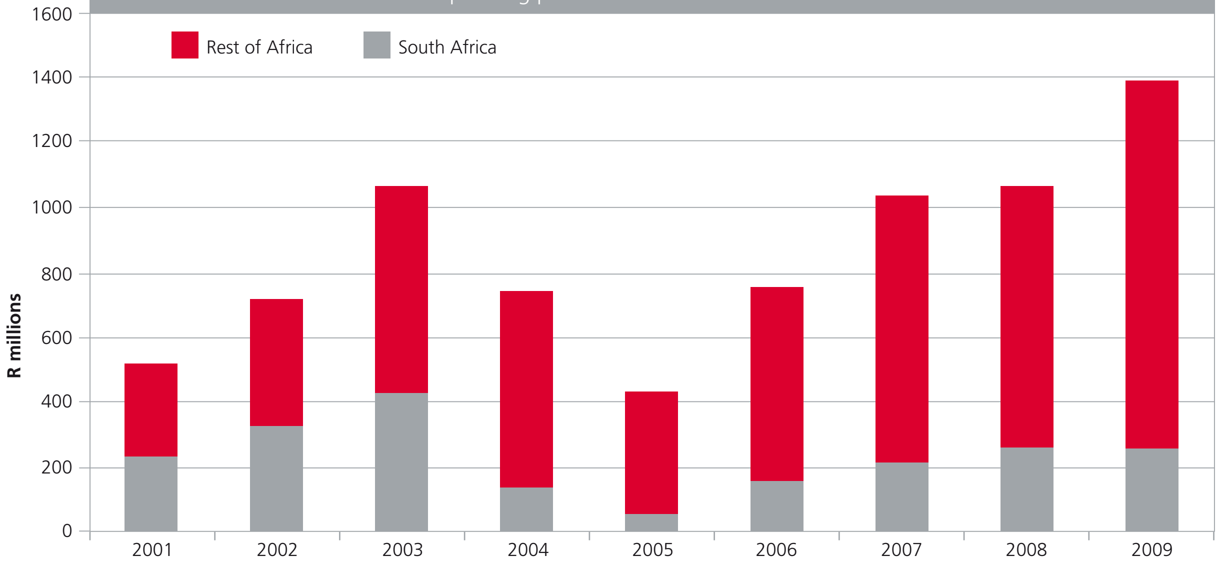
- The world sugar market is only 18% of Illovo's volumes and will become even less important as Illovo's African expansions come into fruition.
- 40% of Illovo's volumes are sold into African markets (excluding South Africa), which have historically traded at prices that are at a premium even to the current world sugar price. Africa imports one-third of its sugar consumption and is short sugar. Further, logistics for importing and retailing sugar in many countries are difficult. These factors allow for pricing power for producers in Africa. As a result, whereas the world sugar price may decline, prices in the African markets should continue to trade at current levels.
- We estimate 20% of Illovo's volumes will be sold into the EU preferential market, at prices that happen to be similar to the current world sugar price. Unlike the world sugar price, prices in the EU are fixed and despite the regulated change next year, have almost no mid-term downside risk.
- Growth potential of Illovo's African operations (discussed below).

African expansion

Besides South Africa, Illovo also operates in Zambia, Malawi, Swaziland, Mozambique, Tanzania and is expanding into Mali currently.

The 'African' operations have grown to 80% of Illovo's operating profits (see growth of the red bar in **Graph 2**).

GRAPH 2 Contribution to Illovo's operating profits



Source: Allan Gray research

Given Illovo's successes in Africa to date, it is expanding capacity in its African operations.

Earlier this year, Illovo commissioned a R1.4bn, 200 000 ton per year expansion in Zambia. In addition, Illovo recently undertook a R3bn rights issue, in order to fund its expansion plans. We followed our clients' rights on their behalf and we are optimistic about the expansions in the following regions:

- **Mali:** Greenfield sugar production expansion of 200 000 tons per year
- **Mozambique:** 75 000 ton per year sugar production expansion
- **Swaziland:** 80 000 ton per year sugar production expansion, including an increase in electricity generating capacity, which will be sold into the Swazi national grid

Besides the above-mentioned projects, which are expected to cost R4bn, Illovo is also considering further expansion opportunities of R2.8bn. As alluded to in its prospectus, the most significant opportunities include the potential substantial expansion of Illovo's Malawian operations and rehabilitation of a 150 000 ton old sugar estate near Beira, Mozambique.

If all these expansions are successful, we estimate that Illovo's production capacity could increase by 1m tons (53%) from the current 1.8m ton capacity. Given Illovo's management team's successes in its African operations, we are confident of its ability to execute the expansion plan. Further, post the rights issue, Illovo will have sufficient cash resources to take advantage of other attractive expansion opportunities that may arise.

"Sugar cane requires land, sunlight and water in order to grow and there is plenty of each in Illovo's African operations."

Why invest in Africa?

In the 2009 financial year, for each ton of sugar produced, the African operations generated a profit of R1 250, compared with R320 generated by the South African operations. We have reason to believe that the African operations will continue to generate attractive returns for shareholders:

- The African operations will effectively sell no volumes to the volatile, and at times depressed, world sugar market.
- The net effect of the above-mentioned EU reforms is that the EU will have to import 3m tons of sugar. The EU has granted Least Developed Countries (LDCs) unrestricted access to export to the EU, at fixed prices (which coincidentally are the same as the current spot world sugar price). All of Illovo's operations outside South Africa qualify for the EU's LDC programme.
- As mentioned earlier, we think that African sugar prices will continue to trade at levels which are higher than the current world sugar price.
- Sugar cane requires land, sunlight and water in order to grow and there is plenty of all three in Illovo's African operations. For example, agricultural yields (the amount of sugar cane grown per hectare of land) in Zambia are close to double South Africa's. As a result, the African operations' costs are among the lowest in the world.

Readers of our recent investment commentary will know that we think that the FTSE/JSE All Share Index (ALSI)'s levels of earnings are high. We are optimistic that Illovo's earnings should grow faster than the ALSI's. While the share price is up significantly, we believe that it is still not reflecting adequately the potential value in Illovo's African operations.

Jacques Plaut

SOUTH AFRICAN BANKS – NOT JUST A BAD DEBT STORY

EXECUTIVE SUMMARY: Record-high bad debts are currently weighing on the banking sector. Typically, an industry experiencing depressed profits due to cyclical factors is a good hunting ground for bargains, as the market tends to extrapolate the bad news of today into the distant future. However, we have reservations about the banks – we think the future benefits of a lower bad debt charge will probably be offset by other factors. Jacques Plaut elaborates.

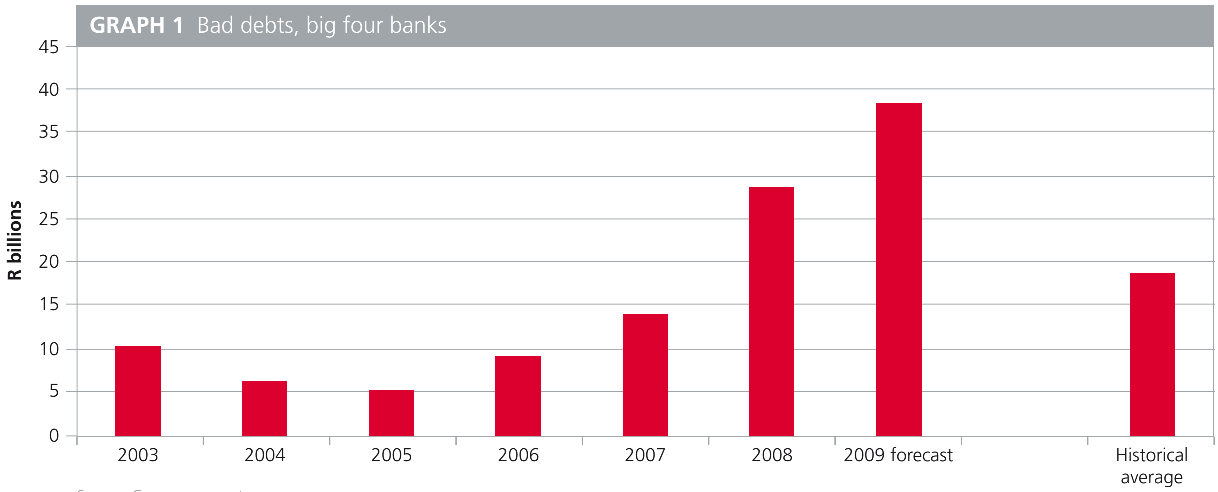
When it comes to valuing banks, bad debts are grabbing the headlines. This is understandable: in 2008 the big four South African banks reported that a total of R30bn in loans had gone bad. This is no small sum, compared with the banking profit pool of R40bn, and larger than the total amount that went bad in the three years from 2004 to 2006. This year will be worse still. (Note that all amounts and percentage increases in this article have been adjusted for the effects of inflation).

Bad debts are cyclical. Currently, they are at record highs, and we are confident that the long-term average bad debt charge will be lower than it is today (see **Graph 1**). However, we think the future benefits of a lower bad debt charge will probably be offset by other factors, such as:

- A shrinking base of 'lazy deposits' and lower returns on these funds because of lower interest rates
- Low growth in advances for some time
- Compared with the last two decades, much less opportunity to improve operational productivity and cut costs, and upward pressure on costs per rand of assets as average loan sizes fall
- Lower trading income

Deposits and the endowment effect

It has often been said that a bank's most valuable asset is its base of lazy deposits. A hundred years ago, when banks were allowed to fail, the business used to be entirely about attracting deposits. Banks competed to be the most conservative – only lending depositors' money to municipalities, large corporations and governments, and never accepting illiquid assets such as real estate or cars as collateral. The economics of lazy deposits are simple: take the R100 that customer X carelessly leaves in his 0.5% savings account, lend it to customer Y at prime, and pocket the difference.



Source: Company reports

In 2008 lazy deposits were even more profitable than usual, because interest rates were so high: banks could lend out their 'free' money at a comparatively high rate (see **Graph 2**) to comparatively low risk customers. In 2009 and beyond, this 'endowment' will be considerably less generous, and we expect profits to be impacted negatively.

Not only will banks earn less on their lazy deposits going forward, but over time we expect there will be fewer lazy deposits to lend out. For at least a decade, customers have become increasingly conscientious about where they leave their money, with new savings vehicles, such as money market funds, offering convenient alternatives to no-interest bank accounts. We expect this trend to continue over the long term. Banks will thus have fewer lazy deposits as a proportion of assets in future.

> "It has often been said that a bank's most valuable asset is its base of lazy deposits."

Advances growth

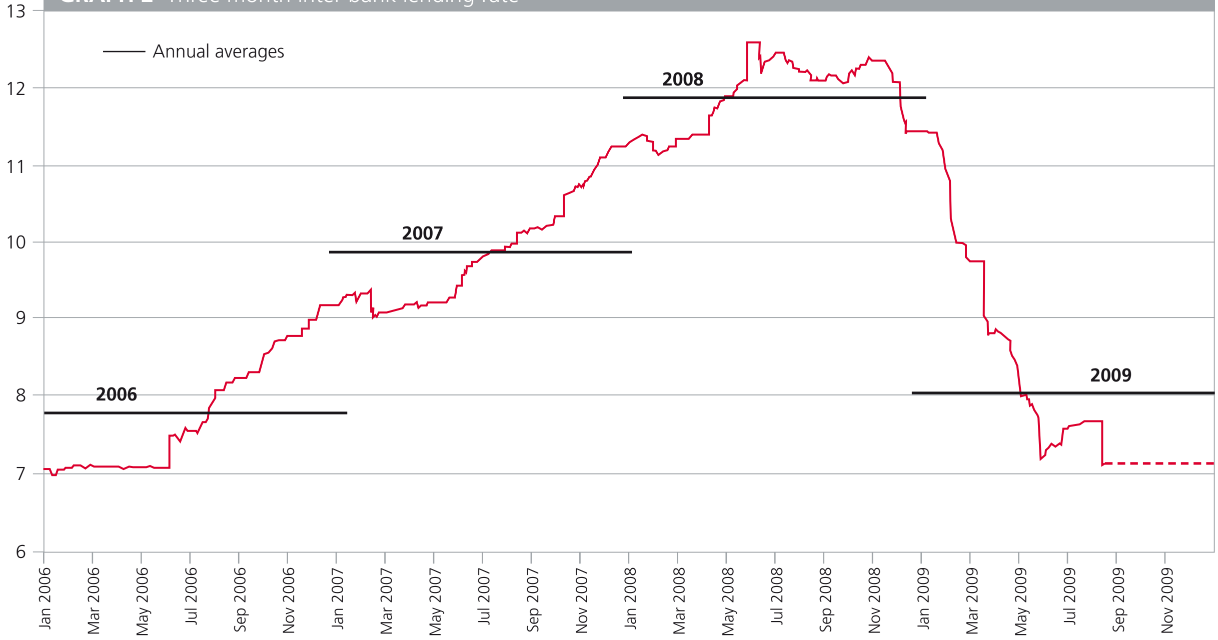
From 1966 to 2000, banks grew their loan books at a rate of 5%. The growth accelerated to 9% in the past decade, and to 12% over the past five years. This was possible thanks to large house price increases, deposits on home loans going from 20% to 0%, and an increase in the general appetite for debt.

These factors have started to reverse, and we think loan growth will be low for several years as a result. In the UK, after the recession and housing slump in the early 90s, Barclays saw its loan book shrink by 17%, with management citing weak demand for loans as one of the reasons. This happened three years after UK house prices started to fall, which means we could still see something similar playing out in South Africa.

Costs

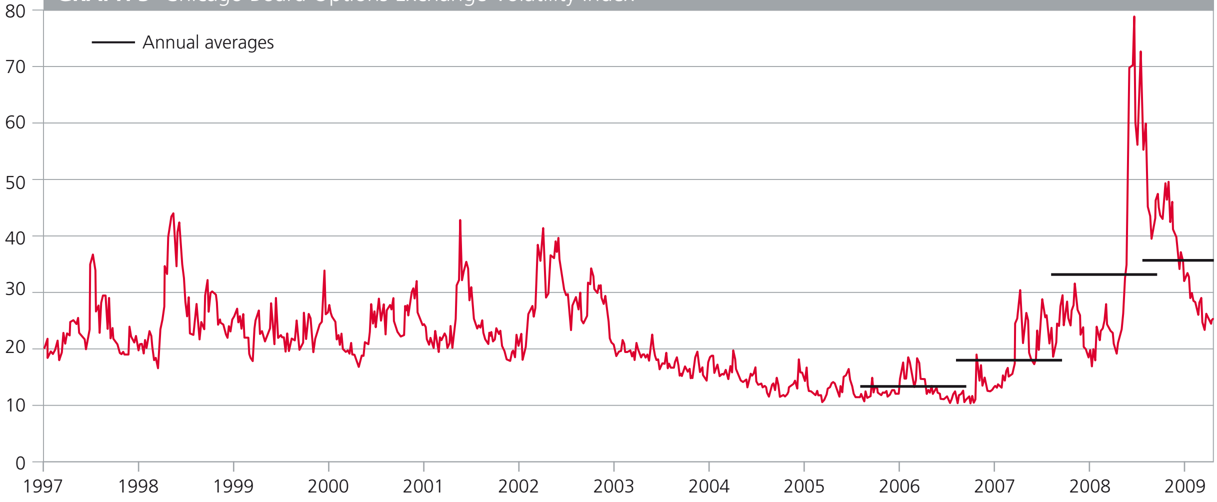
Banks have become a lot more efficient in the past 20 years. In 1988, each Standard Bank employee was responsible for administering, on average, R4m worth of loans. Today the number (net of inflation adjustment) is R13m – and the story is much the same for the other banks. We suspect that technology has played a part in improving the loan-to-employee ratio: in 1988 there was no internet banking, retailers had no point-of-sale machines, and bank employees spent their time processing cheques. Today much of this work is done by computer, which means employees are free to do more productive things.

GRAPH 2 Three month inter-bank lending rate



Source: I-Net Bridge

GRAPH 3 Chicago Board Options Exchange Volatility Index



Source: Bloomberg

But banks are also more efficient today because house prices and corporate profits have doubled since 1988. We expect this means that the average loan size has also doubled, helping the banks. Lower corporate profits and house prices going forward will put pressure on the average loan size and hence the loan-per-employee ratio. We also expect that a retail bank where 10% of customers are not paying their loans – compared with a long-term average closer to 3% – will be more expensive to run per rand of assets, pushing up costs in the medium term.

Trading income

One of the things we like about banks is that they are able to generate revenue almost everywhere that money is flowing. For example, when a corporation wants to move money offshore, or hedge its exposure to the copper price, it does so through a bank. As a rule of thumb, the more volatile the price of the commodity or currency, the more profit the bank makes on the transaction. In 2008, volatilities across all traded instruments were at record highs, and banks made record trading profits. We expect this number to be lower in the future as the level of volatility returns to its long-term average (see **Graph 3**).

Even if one believes in an imminent recovery in bad debts, there are other reasons why banking profits will be under pressure in the future. But then, the recovery might not be so imminent. The evidence about where we are in the bad debt cycle is mixed. And bad debts have a tendency to go higher than people expect.

Jeanette Marais

THE BALANCED FUND CELEBRATES 10 YEARS

EXECUTIVE SUMMARY: On 1 October 2009 Allan Gray celebrated the 10-year anniversary of the Balanced Fund. Excluding the money market funds, at just over R29bn it is now the largest single unit trust in any South African sector. Jeanette Marais reminds us how the Fund's broad investment mandate allows the portfolio managers to reduce the volatility of the portfolio over the medium to long term, making the Balanced Fund a popular choice for retirement products.

The Allan Gray Balanced Fund proudly celebrates its 10-year anniversary this month, having achieved an annualised return of 21.8% since its inception on 1 October 1999. This means that an investment of R10 000 on 1 October 1999 at the opening unit price of R10 would have grown to R71 598 after fees and with distributions re-invested at the closing price of R49.19 on 30 September 2009. As shown in **Graph 1** on page 9, the average fund in its sector (Domestic Prudential – Variable Equity) achieved an annualised return of 16.1% over the same period, with a R10 000 investment growing to R44 579. The same investment in the FTSE/JSE All Share Index (ALSI) would have achieved an annualised return of 17.7%, growing to R50 819 (before fees but with dividends re-invested).

"Excluding the money market funds, at just over R29bn, [the Balanced Fund] is now the largest single unit trust in any South African sector."

Why a balanced fund may be the right investment choice for you

If you are looking to diversify your investment portfolio, you are probably aware that you should include a spread of assets such as cash, shares, offshore investments, property and bonds. But what percentage of each would work best to deliver returns? And will you know exactly the right time to ease out of equities and increase, for example, your cash component? Allocation between different classes of assets in an investment portfolio can be very challenging. A better bet for many investors who wish to invest in a range of asset classes, and are happy to delegate their asset allocation decisions, may be to invest in a balanced fund.

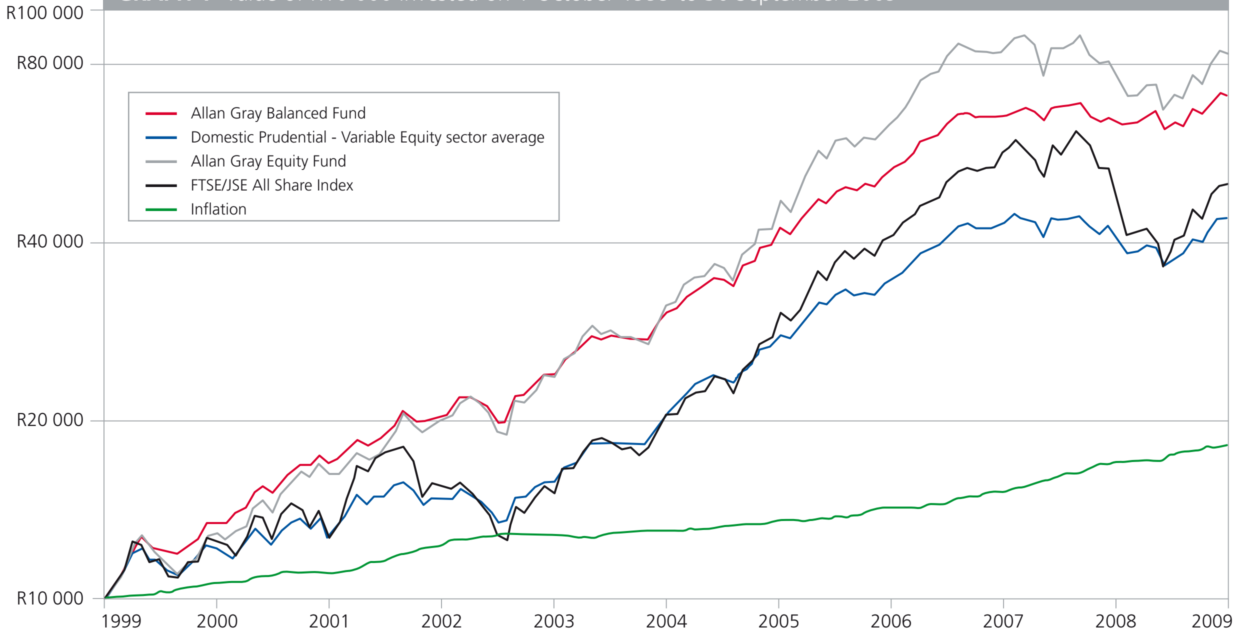
Balanced funds, like equity funds, have the capacity to create wealth over time and not just to preserve wealth. But they are not as high risk as equity-only funds, as their broader investment mandate allows other asset classes to be included in the portfolio, enabling the portfolio managers to reduce volatility. The Allan Gray Balanced Fund is limited to a maximum equity exposure of 75%, and although it has never had less than 48% exposure to equities, its mandate allows it to have no exposure to equities at all. Although pure equity mandates should produce higher returns over the long term, the Allan Gray Balanced Fund has outperformed the Domestic General Equity Sector over its full history, but with considerably lower volatility and risk.

Approaches to asset allocation

There are two different schools of thought when it comes to asset allocation – managers either use a top-down, or bottom-up philosophy. The top-down school of thought starts with a macro view of the economy. Economists forecast views on the economy, sectors, currencies and interest rates. Then they make a call on which sectors should be overweight or underweight the ALSI. From there analysts seek out appropriate shares.

The bottom-up school of thought manages investments the opposite way around – and this is the school of thought we subscribe to. It is our experience that understanding companies, and investing in them when their fundamental value is less than their market value, is more rewarding than trying to predict economic, political or share-market trends. Fundamental value is the value a prudent businessman would place on a business. This involves detailed analysis of the business, its income, expenses, outlook and positioning within its industry. Our research results in portfolio manager

GRAPH 1 Value of R10 000 invested on 1 October 1999 to 30 September 2009



Source: Allan Gray research, MoneyMate

decisions to hold individual companies, or to keep funds in bonds, property or cash. And the sum of all of these individual, bottom-up investment decisions is the asset allocation of the Fund. Our company research – including many conversations with senior management – also ultimately gives us a rounded view of the state of the economy, which we can use as a check on the bottom-up allocation.

The Balanced Fund's asset allocation varies over time

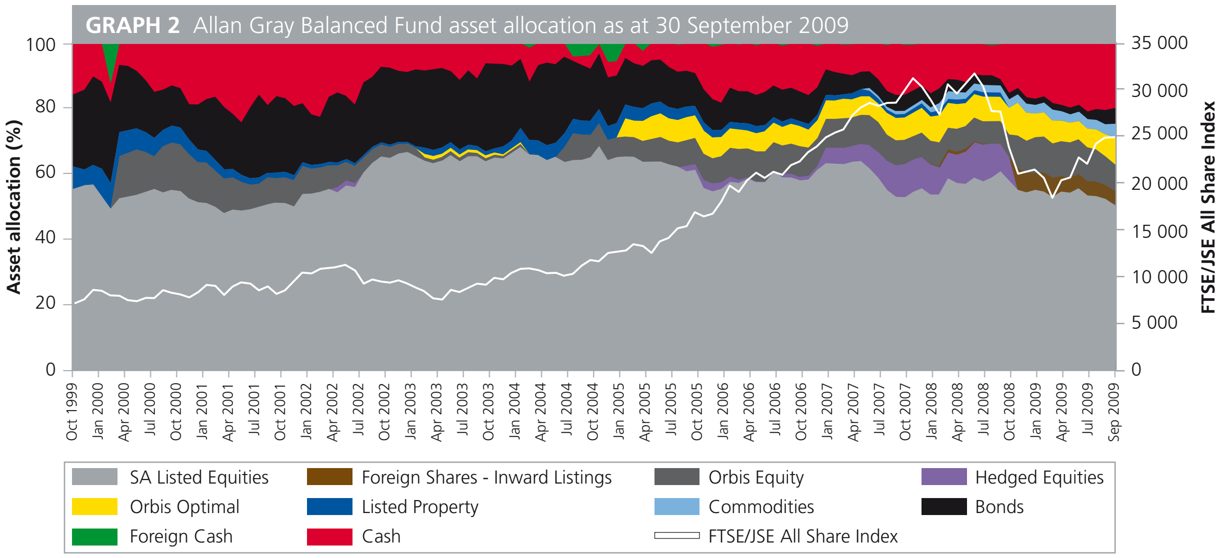
Graph 2, on page 10, shows how the Fund's asset allocation has changed over the years. By examining the asset allocation over the last year, you can see how we have responded to the global financial crisis. Between January 2007 and September 2008 the Fund reduced equity exposure, taking advantage of the strong performance of the ALSI. The Fund used stock market hedging to achieve this. This trend continued until October 2008, a month characterised by extreme volatility in asset prices as investors tried to adjust to the concept of a world recession. During this month, the Fund took advantage of the weakness in the equity market to close out its hedge against stock market declines. This had the effect of increasing the net equity exposure of the Fund.

Under normal circumstances we would reduce exposure to shares by selling shares, not by stock market hedging. However in the middle of 2008 we were faced with the unusual combination of A: very demanding valuations in many of the largest shares in the ALSI, and B: relatively attractive prices in the defensive shares that we held. Keen to take advantage of this valuation difference, yet pessimistic about the market as a whole, our portfolio managers unusually decided to reduce exposure through hedging.

Many of you will be aware that for some time now we have used our full offshore exposure limit. On average, South Africans spend about 40% of their income on imported goods, but legal restrictions limit us to a maximum 20% offshore exposure. We are currently taking full advantage of this holding through the Orbis funds and foreign shares that are inward listed (classified as foreign but listed on the JSE, such as Mondi and British American Tobacco).

The Balanced Fund showcases our best ideas

Regular readers of our investment commentary will know that we generally do not broadcast a 'house view' and we shy away from making economic predictions. However, those curious about our view of the world need not look much further than the Balanced Fund's asset allocation to get a few clues. For example, keeping an eye on the Fund's allocation to local shares relative to a neutral point of about



Source: Allan Gray research, I-Net Bridge

60% will tell you when we find South African equities attractive, and when we do not.

Note that when there is not a significant difference in the value of the different asset classes, the Balanced Fund will tend to be overweight in equities, as this asset class allows us to add more value to the portfolio. (More detail on the Fund's quarterly disclosures can be found on page 24 of the QC).

Recently, the Fund has been steadily reducing its net equity exposure after the rapid rebound of global stock markets off their lows. The Fund's net equity exposure is currently down to 63.2% and its net exposure to SA equities is down to 50.6%.

Conclusion

More confident investors may decide to do their own asset allocation. You can do this by choosing individual building blocks – a bond fund, an equity fund, etc. – in varying proportions, depending on how you view the overall market. A balanced fund can do this for you, but with more peace of mind.

Marisa Kaplan

THE COST OF TOO MUCH CHOICE

EXECUTIVE SUMMARY: People are attracted to choice, but that does not mean that having more choice will lead to better decisions, or a better decision-making process. Research has shown that, in the face of too much choice, people often land up making worse decisions, or suffering from buyer's remorse – that is, if they are able to make any choice at all, with many suffering from 'analysis paralysis'. Marisa Kaplan elaborates.

'When you have to make a choice and do not make it, that in itself is a choice.' (William James, US philosopher)
'Life is a sum of all your choices.' (Albert Camus, French novelist)

Over the last 10 years the unit trust industry in South Africa has enjoyed substantial growth both in assets under management and in the number of funds available. At the end of June 1999, the industry managed R96 billion in assets and had a total of 225 funds. By the end of June this year, investors could choose from a staggering total of 899 funds, and assets under management totalled R703 billion. To put this in context, our stock market consists only of some 370 shares.

But has this dramatic increase in choice benefited investors?

On the surface, most people are attracted to choice, with more options being more enticing than a limited selection. However, research has shown that, in the face of too much choice, people may:

- Suffer from 'analysis paralysis' preventing them from making any decisions at all
- Make worse decisions
- End up suffering from buyer's remorse

Analysis paralysis

Evaluating and comparing options takes time and brain power. The more choices that are available, the more likely it is that people will delay, or even ultimately avoid, making a decision.

The findings of an experiment involving jam purchasing behaviour illustrate this tendency. Grocery store shoppers were given the opportunity to taste-test jam. Some shoppers encountered a display of six varieties, while others encountered 24 varieties. A greater percentage of shoppers were attracted to the larger display, but they were 10 times less likely to purchase jam after the tasting than those who tasted from the smaller display (3% versus 30%).[1]

With important purchases, people may intend to consider their options carefully when they have the time to do so. However, in today's busy world, that day may never come.

For investments, a delayed decision either results in lost returns or yield while funds languish in low-interest bank accounts or, potentially more damagingly, in unintentional risk of capital loss while remaining invested at the peak of a bull market.

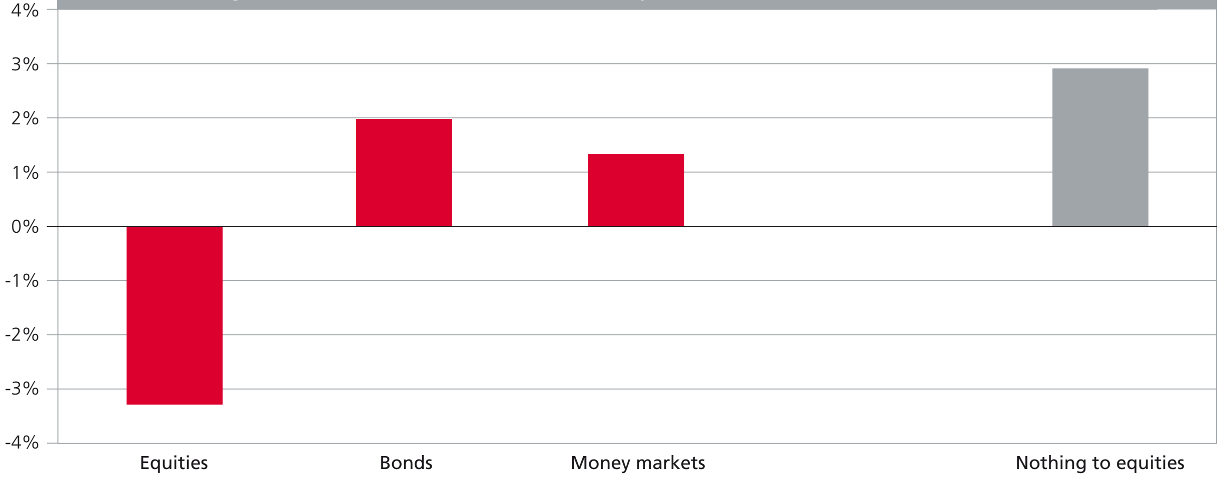
Case study: Participation rates in retirement savings plans are at their highest when fewer funds are offered.

One study looked at a sample of almost 900 000 employees across 69 industries – all clients of US investment management company the Vanguard Group.

The findings indicated that employees who were offered retirement savings plans with more investment fund options were less likely to participate in the plans. Participation rates were highest (75%) for plans with only two funds offered and lowest (60%) for plans with the maximum of 69 funds offered. For every 10 additional funds offered, there was an associated decrease of 2% in the participation rate.

Source: Research by Sheena Iyengar, Wei Jiang, and Gur Huberman (2003)

GRAPH 1 Change in investment allocation choice for every additional 10 funds offered



Source: Sheena Iyengar and Emir Kamenica

Making worse decisions

Decision quality may be compromised when there are many options to consider. With greater choice, people are more likely to become overwhelmed and mentally fatigued. As a result, they will be more inclined to make a snap judgement rather than a carefully thought out decision. Researchers at the National Sun Yat-Sen University in Taiwan demonstrated this in the realm of online dating. Users randomly matched with more potential partners were less careful in making their selection than those randomly matched with fewer potential partners. The first group failed to eliminate unsuitable options.

In the investment context, investors are less likely to make proper asset allocation decisions when confronted with an overwhelming number of funds to choose from. Asset allocation is a key factor in determining the returns an investor will enjoy, and inappropriate allocations have far-reaching consequences.

A 2008 study analysing the retirement savings records of more than 500 000 employees across 638 institutions found that when more funds were offered, investors allocated more money to asset classes they perceived to be simpler – money market and fixed interest – and less to equity, irrespective of their time horizon and risk profile. As shown in **Graph 1**, for each additional 10 funds, there was an associated 3.28 percentage point decrease in equity allocation and, more worryingly, a 2.87 percentage point increase in the likelihood that a participant would not select any equity funds at all.[2]

Buyer's remorse

When there are many alternatives on offer, our expectations are higher. We have a greater tendency to believe that the optimal choice is available, we worry that we did not choose it and we blame ourselves for making an incorrect decision. The more choices that are available at the outset, the more opportunities there are to fantasise about 'what if' scenarios and to regret our decisions – even if the initial decision was, in fact, the most favourable.

This was demonstrated in a 2004 experiment in which participants were asked to choose from a list of possible investment funds. They were randomly assigned to receive either a list of six funds or a list of 60. Those that were given the shorter list of options reported higher satisfaction levels with the decision they made than those who chose from the longer list.[3]

In the investment environment, buyer's remorse can lead to inopportune switching as investors chase past performance. With investments you can pick up a newspaper to see how all of the funds available have performed. And, unlike a pair of shoes or a new gadget, investments are often easily redeemable long after purchase. If you are invested through an investment platform, it can be easy and free to switch between funds. However, even if there is no immediate monetary cost of switching, the longer-term erosion of value can be tremendous.

By chasing recent winners, investors make decisions by looking in the rear-view mirror and engage in a systematic process of buying high and selling low. The ensuing performance gap can be wide. Investors do not always stay invested long enough to enjoy the benefits of an asset manager's investment approach, so their investments do not always perform as well as the funds in which they have invested.[4]

Does more choice mean better decisions?

Moderation is the best strategy for many things in life, including choice. Too little choice is stifling; but too much choice is confusing and, ultimately, counter-productive – particularly when it comes to investments. People are attracted to choice, but that does not mean that having more choice will lead to better decisions, or a better decision-making process.

1. Research by Sheena Iyengar and Mark Lepper (2000)

2. Research by Sheena Iyengar and Emir Kamenica (2008)

3. Research by Julie Agnew and Lisa Szykman (2004)

4. Jonathan Brodie and Trevor Black covered this subject in some detail in the previous issue of the Quarterly Commentary in their piece 'Turmoil reigns in the markets. What should I do next?'. (You can also read this piece on our website, www.allangray.co.za under the 'Latest news' tab.)

Other interesting reading includes:
Academic articles by Sheena Iyengar, the author of some of the case studies discussed (see http://www.columbia.edu/~ss957/publications.shtml).

A non-academic book by Barry Schwartz – 'The Paradox of Choice'.

Allan Gray offers a limited selection of funds

Our research has shown that, while our investors and advisers want choice, they prefer it to be limited. Allan Gray Unit Trust Management Limited, despite being the second largest unit trust company in South Africa, offers only eight funds. And we do not offer more than one fund in the same category.

On the Allan Gray investment platform, where you can choose from other fund managers in addition to Allan Gray, we currently offer 43 local funds including our own. On our offshore investment platform we offer 30 funds, including the Orbis funds. We do not intend to expand this offering significantly in the future – our overall aim is to ensure the choice is adequate and manageable.

We offer only funds which:

- Have been registered by the Financial Services Board (FSB), local and offshore
- Have a minimum fund size for liquidity purposes

We try to offer more choice where there is potential for differences in fund performance. This means we offer fewer fixed income funds than equity funds, and aim for a good spread across the asset classes. We also steer away from specialist/sector specific funds as they move in and out of favour.

To make space for new funds, we 'cap' the funds that have not received significant flows over at least a two-year period. When we 'cap' a fund we keep it open for existing investors, but we take it off the 'buy list' for new investors. Sometimes we will ask investors to switch out of a fund, but only if very few people remain invested.

When it comes to investments, if you have little knowledge of the sector, having less choice does not mean that you will make the right decision. If you are not comfortable making your own investment decisions, or do not have the time to do so, we recommend that you engage the services of an independent financial adviser.

Tracy Hirst

SO MUCH MORE CAN BE ACHIEVED WITH TIME

EXECUTIVE SUMMARY: We recently launched new television, print and airport advertising that reinforces the importance of time in building wealth. The television advert picks up on a theme we have been running for some time in magazines, where we use examples of famous people who have died young, and ask our audience to imagine what they could have achieved if they had been given more time.

James Dean did not live for very long, but he lived his short life to the full. Imagine what a life it could have been if he had lived for longer. A fictional version of Dean's life as it might have been is the subject of our latest television advertisement with the campaign line 'Given more time, imagine the possibilities'. The message reinforces an important aspect of our investment philosophy: time is an essential ingredient in the recipe to create wealth. None of what we do at Allan Gray is of any good if investors do not give us their time.

'Legend'

The commercial opens (year 2009) with an elderly man in his late 70s on his stud farm; he is surrounded by a loving family. It is a peaceful and happy scene. A few years earlier, at a younger age, he is seen racing cars; receiving a lifetime achievement award; still younger, doing humanitarian work; directing a movie; swamped by paparazzi and fans; walking through New York... all the time getting progressively more youthful. Clearly a life in reverse taking us all the way back to 1955.

> "We try to use advertising to deepen understanding, not just to build awareness."

Throughout the commercial there is a feeling of familiarity about this man, but perhaps viewers cannot quite put their finger on it. Ultimately, we come to a point where the lead character is aged 24, we see him driving along a road in a silver Porsche Spyder. A car coming towards him in the other lane turns in front of him, cutting him off. There is almost a head-on collision, but the driver just manages to pull to the side and, in a storm of dust, avoids the collision. By this point most viewers will have realised that we have been following the life of James Dean (who was in fact tragically killed in this car accident).

The team at our advertising agency King James spent an enormous amount of time researching and preparing for the advert. Although it is short, the film aims to be an earnest representation of what might have been James Dean's life after 1955. Some narrative clues are provided through the journey to aid recognition and to give the advert longevity and mystique.

An illustration of the benefits of time

The new advert is an extension of a theme we began in 2008. As an illustration of the benefits of time, last year we launched a magazine campaign which told the stories of the full and inspirational lives of Joan of Arc, Nkosi Johnson and Wolfgang Mozart that were sadly cut short. All three of them, just like our newly launched television commercial persona, became household names

in their respective times. In the print adverts the reader is left to ponder the same thought 'Given more time, imagine the possibilities'. There is no suggestion given as to what more history may have written about these people, had they lived long lives. In the launch of the TV advert 'Legend' we continue to explore this territory by taking the analogy a step further. We offer a fictional account of a long and successful life as it may have been lived by James Dean.

The 2009 commercial takes the approach of not focusing on Allan Gray, but on the investor as an integral part of our investment philosophy. Our chief investment officer Ian Liddle refers to this, the relationship between client and asset manager, as an 'investment partnership'. Richard Carter, head of product development, wrote an article in QC3, 2008 entitled 'What you can do to improve your investment returns'. The piece focuses on the gap between fund returns and investor returns i.e. the value that is destroyed in the absence of time.

Magazine and newspaper advertising

We are also proud of our three new magazine adverts, which take stories of long-term thinking and relate them to memories from our childhoods. Remember taking karate lessons? Remember finding sea monkeys in the back of comic books? Ever watched a group of under-7s playing a soccer match? Each of these adverts tells the story of the patience and planning that we believe is required to invest successfully.

In newspapers we have kept with the previous forthright approach, with a series of investment insights that have simply been given a fresh but perhaps a more bold and courageous look.

Airport advertising

We have launched a new campaign that you may have seen if you have been travelling through OR Tambo or frequenting Cape Town airport. The messages here are the mirror image of the new television advert. They address the impact of time from the beginning of a life, with anticipation, rather than from the end of it. The varying executions show young children who are displaying a talent early: a toddler learning the piano, a three-year old the guitar, a budding tennis star and a six-year old golfer. After all, any parent of an aspiring superstar will tell you that the best investments take time and the earlier you start the better.

We welcome your opinion

We know that advertising is subjective, but we hope that with the new campaigns we have managed to tap into human truths about investing that connect us to our clients, in different ways from any of our previous campaigns. We are always interested in hearing your thoughts and feedback.

The evolution continues

We try to use advertising to deepen understanding, not just to build awareness. 'Long-term investing', our new pay-off line visible on all of our advertising, is at the heart of Allan Gray as a company, its culture and its brand. This message is aimed at highlighting and reinforcing a key aspect of the Allan Gray investment philosophy. Our past commercials highlight similar important aspects of our approach:

2003:	Single-minded is good
2004:	Commitment is rare
2005:	Human beings are ruled by emotions; investment decisions should not be
2006:	Few things last as long as our track record
2007:	While others chase instant wealth, we have learnt that patience is handsomely rewarded
2008:	First look for potential, then have patience to wait for it
2009:	Time is an essential ingredient in the recipe to create wealth

Chris du Toit

THE BENEFITS AND PITFALLS OF FOREIGN DIVERSIFICATION

EXECUTIVE SUMMARY: Most South African investors looking to diversify will choose to include offshore assets in their portfolio. The trick is to select the right combination of foreign assets and asset managers, in order to produce the desired result i.e. diversification without sacrificing long-term performance. The concepts of volatility and correlation play a central role in understanding the benefits and pitfalls of diversifying by investing offshore. Chris du Toit explains.

South Africa is a relatively small, open economy. Our stock market consists of some 370 companies and makes up just over 1% of the world's total listed equity universe by market capitalisation. For South African investors, offshore assets are a natural option when looking to build a diversified portfolio.

Shares of companies that operate in different industries and different parts of the world should behave differently. Business and economic cycles favour different companies at any given point in time, and therefore investing in those different companies should yield different (unrelated) returns over time.

> "..., we would favour a maximum exposure to foreign assets."

Correlation and volatility

According to the text books, a diversified portfolio of assets should produce returns at lower levels of volatility over the long term. The concepts of correlation and volatility are central to portfolio diversification. Correlation measures the strength of the relationship between two assets' returns. A positive correlation indicates a strong positive relationship, i.e. the two assets tend to have higher and lower returns at the same time. A negative correlation implies the opposite, i.e. the two assets' returns move in opposite directions at any given time. A correlation of zero implies that no relationship (positive or negative) exists between the returns of the two assets.

A portfolio consisting of assets that are all positively correlated with each other is not diversified. An undiversified portfolio is not a problem if all the assets are performing well, but it is a problem if all the assets are performing poorly.

By adding assets with zero, or negative correlation, a portfolio becomes more diversified. We measure the effectiveness of diversification by the extent to which the portfolio's overall volatility, or deviation of its returns, is reduced. Intuitively, a portfolio consisting of correlated assets will show larger deviations in its overall returns (a high volatility), and a portfolio consisting of uncorrelated assets should show smaller deviations in its overall returns.

How different are the assets that you are investing in?

As indicated in previous commentary, the returns of South African shares are highly correlated with broader emerging markets, partly due to the behaviour of global investors who treat all emerging markets as a single asset class. In **Graph 1** on page 18 note how closely the performance of the FTSE/JSE All Share Index (ALSI) and the Morgan Stanley Capital International (MSCI) Emerging Market Index (EMI) (measured in US dollars) follow each other.

A map of past correlation and volatility

The I-Maps Visual Portfolio Positioning system provides us with a useful tool to look at past correlation and volatility in the context of offshore assets (see **Map 1** on page 18 and **Map 2** on page 19). The positions of the portfolios on the maps are determined by two factors:

1. The volatility of each portfolio is indicated by its distance from the centre of the map. Portfolios with a high volatility are further away from the centre.
2. The angle between two portfolios from the centre measures the correlation between them. A smaller angle (in other words portfolios that are closer together) implies a strong positive correlation. A larger angle (portfolios far apart) implies lower correlation.

GRAPH 1 The ALSI and MSCI EMI are positively correlated

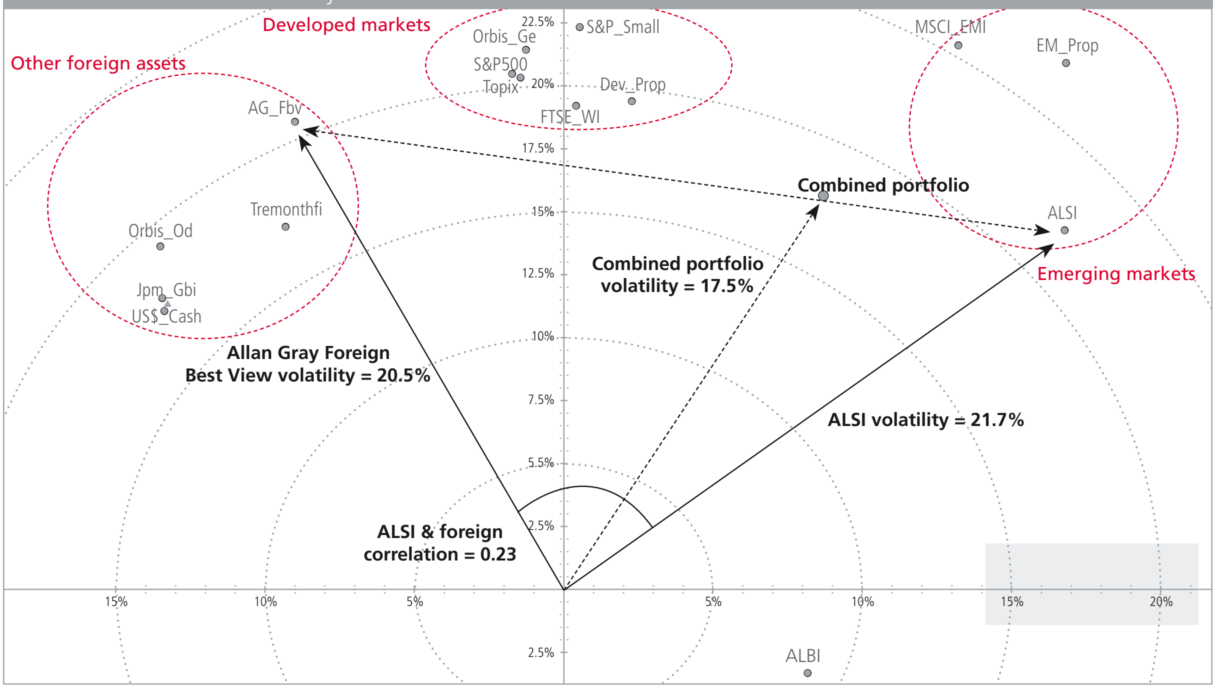
Source: I-graph

We have plotted various foreign asset classes and portfolios on the maps to investigate the effectiveness of these options in terms of portfolio diversification for South African investors. All the returns are monthly and measured in rands.

Allan Gray's fully discretionary foreign balanced mandates (such as the Allan Gray-Orbis Global Fund of Funds) are able to invest in a range of Orbis' Equity and Optimal SA funds. This combination of offshore funds is shown on the maps (AG_Fbv).

The closer portfolios and assets are to each other on the maps, the more highly correlated they are. For example three distinct groups of portfolios that are close to each other are circled on Map 1. The ALSI, MSCI EMI and Emerging Market Property Index are highly correlated and indicated as 'Emerging markets' on the right of the maps. The FTSE World Index, S&P500, Topix and the Orbis Global Equity Fund are highly correlated with each other and are shown as 'Developed markets' in the middle of the maps.

MAP 1 Correlation and volatility of various asset classes



Period: 28/08/1997 to 31/07/09 | Returns: Monthly | Absolute | 20/08/09. Key to map on page 19.

Source: I-Maps, Allan Gray research

The developed markets' portfolios are reasonably uncorrelated with the emerging market portfolios. On the far left we group the 'Other foreign assets' being US$ cash, global bonds, hedge funds, the Orbis Optimal US$ Strategy and Allan Gray's Foreign Best View portfolio (a specialist balanced portfolio for institutional investors). The other foreign asset portfolios are highly uncorrelated to the emerging market group.

A useful feature of these maps is the ability to combine different assets into one portfolio. For example, Map 1 combines the ALSI and Allan Gray's Foreign Best View to form a portfolio of South African and foreign assets (Combined portfolio). Adding this mix of (low correlation) Orbis Funds to South African shares has meaningfully reduced the overall volatility of the portfolio to 17.5%, as shown by the dotted arrow in the maps, versus 20.5% for the Foreign Best View and 21.7% for the ALSI.

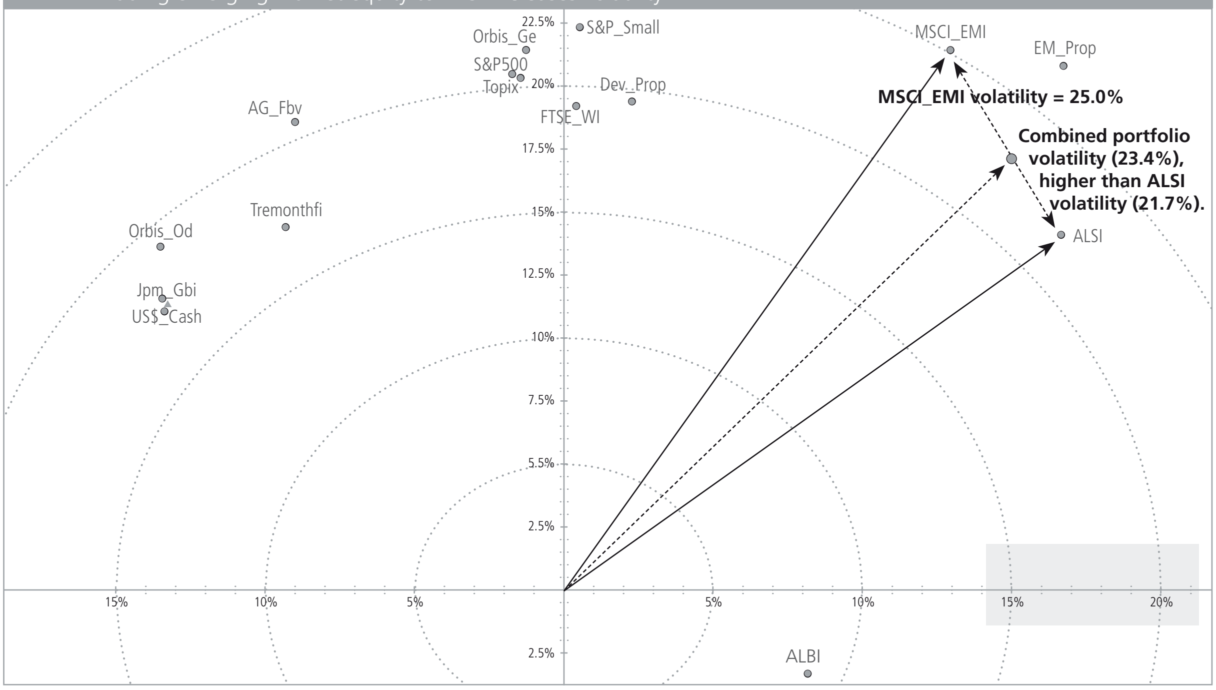
Because emerging markets and equities are highly correlated to the ALSI, adding the two together produces a portfolio with higher volatility than the ALSI (see Map 2). This illustrates the importance of investing in uncorrelated foreign assets if and when you are looking to diversify your overall portfolio.

During the second half of 2008 and into early 2009 the global credit crisis caused a massive sell-off in all asset classes. We were reminded again that the past is not a guarantee of the future, as the correlation between all equity markets rose to levels way above historical norms. During such periods of high correlation the benefits of diversification can indeed disappear. Reassuringly, Allan Gray's Foreign Best View portfolio and Orbis' Optimal funds maintained their very low correlation with South African assets during this crisis.

South Africa, along with all emerging markets, has outperformed world markets meaningfully over the last 10 years. The ALSI has returned 13.7% per year in US dollars but world markets have returned only 1.3% per year. Allan Gray's Foreign Best View portfolio has returned 12.8% in US dollars. Clearly, a diversified portfolio (i.e. including foreign) is likely to have underperformed a potentially less diversified local-only portfolio. However, given current valuations of shares in South Africa compared with those outside South Africa, we would favour a maximum exposure to foreign assets.

The trick is to select the right combination of foreign assets and asset managers, in order to produce the desired result i.e. diversification without sacrificing long-term performance.

MAP 2 Adding emerging market equity to ALSI increases volatility



Period: 28/08/1997 to 31/07/09 | Returns: Monthly | Absolute | 20/08/09

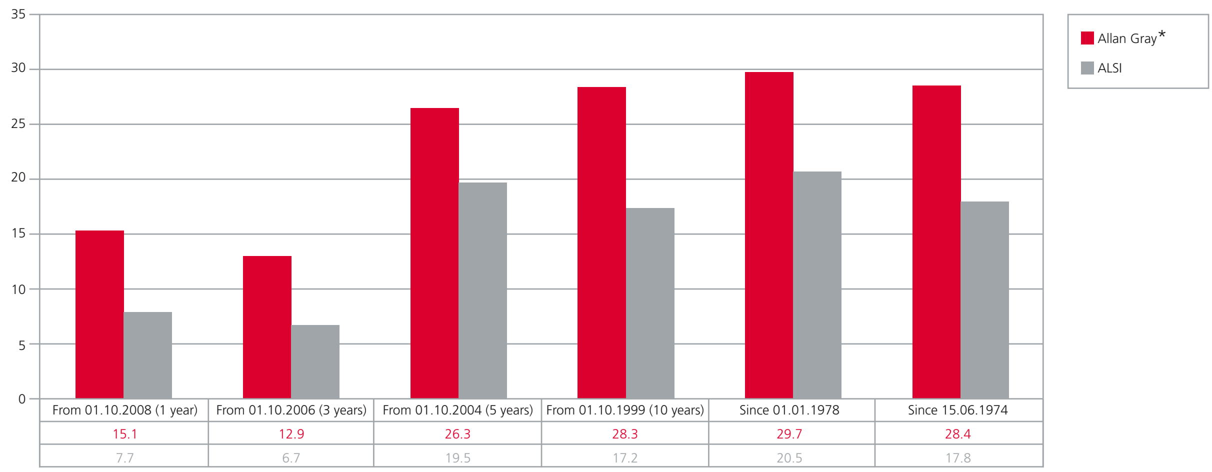
Source: I-Maps, Allan Gray research

Key to I-Map Portfolios

ALSI = FTSE/JSE All Share Index, **ALBI** = All Bond Index, **EM_Prop** = Emerging Market Property Index, **MSCI_EMI** = MSCI Emerging Market Index, **FTSE_WI** = FTSE World Index, **Dev_Prop** = Developed Market Property Index, **Topix** = TOPIX Japanese Equity Index, **S&P500** = S&P500 Equity Index, **S&P_Small** =S&P Small Cap Equity Index, **Orbis_Ge** = Orbis Global Equity Fund, **Tremonthfi** = Tremont Hedge Fund Index, **Orbis_Od** = Orbis Optimal Strategy, **Jpm_Gbi** = JP Morgan Global Government Bond Index, **US$_Cash** = US$ Bank deposits

Allan Gray Limited global mandate share returns vs. FTSE/JSE All Share Index

Period	Allan Gray*	FTSE/JSE All Share Index	Out/Underperformance
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	-12.6	-23.2	10.6
2009 (to 30.09)	17.3	18.6	-1.3
Annualised to 30.09.2009			
From 01.10.2008 (1 year)	15.1	7.7	7.4
From 01.10.2006 (3 years)	12.9	6.7	6.2
From 01.10.2004 (5 years)	26.3	19.5	6.8
From 01.10.1999 (10 years)	28.3	17.2	11.1
Since 01.01.1978	29.7	20.5	9.2
Since 15.06.1974	28.4	17.8	10.6
Average outperformance			10.6
Number of calendar years outperformed			27
Number of calendar years underperformed			7



Annualised to 30.09.2009

* 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.

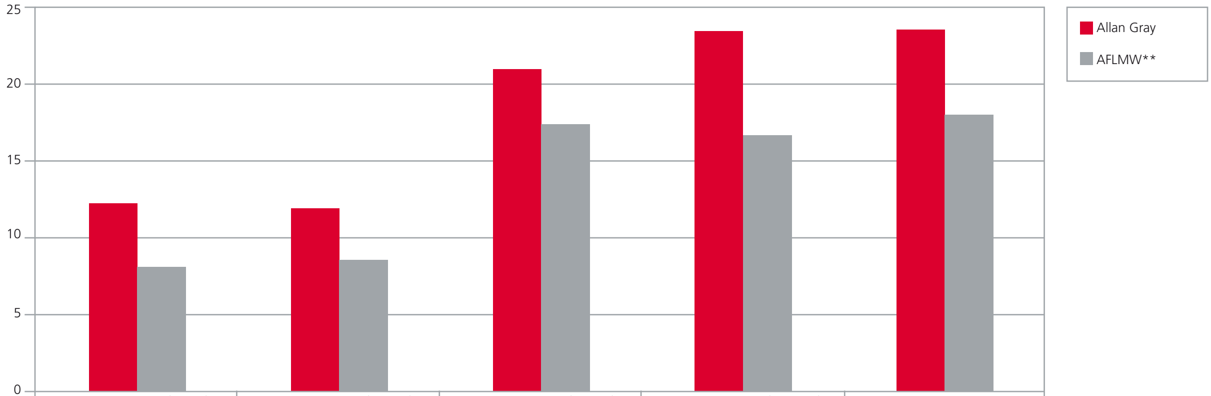
Note: Listed property included from 1 July 2002.

An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to **R67 001 041** by 30 September 2009. By comparison, the returns generated by the FTSE/JSE All Share Index (ALSI) over the same period would have grown a similar investment to **R3 203 926**.

Investment track record

Allan Gray Limited global mandate total returns vs. Alexander Forbes Large Manager Watch

Period	Allan Gray	AFLMW**	Out/Underperformance
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 (to 30.09)	10.3	13.7	-3.4
Annualised to 30.09.2009			
From 01.10.2008 (1 year)	12.3	8.2	4.1
From 01.10.2006 (3 years)	11.9	8.5	3.4
From 01.10.2004 (5 years)	21.0	17.4	3.6
From 01.10.1999 (10 years)	23.5	16.7	6.8
Since 01.01.1978	23.6	18.0	5.6
Average outperformance			5.6
Number of calendar years outperformed			25
Number of calendar years underperformed			6



	From 01.10.2008 (1 year)	From 01.10.2006 (3 years)	From 01.10.2004 (5 years)	From 01.10.1999 (10 years)	Since 01.01.1978
Allan Gray	12.3	11.9	21.0	23.5	23.6
AFLMW**	8.2	8.5	17.4	16.7	18.0

Annualised to 30.09.2009

** Consulting Actuaries Survey returns used up to December 1997. The return for September 2009 is an estimate.

An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to **R8 365 700** by 30 September 2009. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to **R1 935 299**.

Allan Gray annualised performance in percentage per annum to 30 September 2009	THIRD QUARTER (unannualised)
UNIT TRUSTS[1]	
EQUITY FUND (AGEF)	[3]
FTSE/JSE All Share Index	
BALANCED FUND (AGBF)	[3]
Average of both Prudential Medium Equity category and Prudential Variable Equity category (excl. AGBF)	
STABLE FUND (AGSF) - (NET OF TAX)	[3]
Call deposits plus two percentage points (Net of tax)	
STABLE FUND (AGSF) - (GROSS OF TAX)	[3]
Call deposits plus two percentage points (Gross of tax)	
MONEY MARKET FUND (AGMF)	[3]
Domestic fixed interest money market unit trust sector (excl. AGMF)	
OPTIMAL FUND (AGOF)	[3]
Daily call rate of FirstRand Bank Ltd	
BOND FUND (AGBD)	[3]
BEASSA All Bond Index (total return)	
GLOBAL FUND OF FUNDS (AGGF)	[3]
60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index (Rands)	
GLOBAL EQUITY FEEDER FUND (AGOE)	[3]
FTSE World Index (Rands)	
LIFE POOLED PORTFOLIOS	
GLOBAL BALANCED PORTFOLIO	9.6
Mean of Alexander Forbes Global Large Manager Watch [2]	11.7
DOMESTIC BALANCED PORTFOLIO	10.8
Mean of Alexander Forbes Domestic Manager Watch [2]	11.7
DOMESTIC EQUITY PORTFOLIO	12.9
FTSE/JSE All Share Index	13.9
DOMESTIC ABSOLUTE PORTFOLIO	10.9
Mean of Alexander Forbes Domestic Manager Watch [2]	11.7
DOMESTIC STABLE PORTFOLIO	5.8
Alexander Forbes Three-Month Deposit Index plus 2%	2.3
DOMESTIC OPTIMAL PORTFOLIO [1]	1.2
Daily Call Rate of Nedcor Bank Limited	1.6
GLOBAL ABSOLUTE PORTFOLIO	9.5
Mean of Alexander Forbes Global Large Manager Watch [2]	11.7
DOMESTIC MEDICAL SCHEME PORTFOLIO	5.6
Consumer Price Index plus 3% p.a. [2]	2.4
GLOBAL STABLE PORTFOLIO	4.8
Alexander Forbes Three-Month Deposit Index plus 2%	2.3
RELATIVE DOMESTIC EQUITY PORTFOLIO	12.4
FTSE/JSE CAPI Index	13.7
MONEY MARKET PORTFOLIO [1]	2.0
Alexander Forbes Three-Month Deposit Index	1.8
FOREIGN PORTFOLIO [1]	5.4
60% of the MSCI Index and 40% JP Morgan Global Government Bond Index (Rands)	10.5
ORBIS GLOBAL EQUITY PORTFOLIO [1]	13.4
FTSE World Index (Rands)	15.5
SEGREGATED PORTFOLIOS [5]	
GLOBAL BALANCED COMPOSITE	9.6
Mean of Alexander Forbes Global Large Manager Watch [2, 4]	11.7
DOMESTIC BALANCED COMPOSITE	10.7
Mean of Alexander Forbes Domestic Manager Watch [2]	11.7
DOMESTIC EQUITY COMPOSITE	13.2
FTSE/JSE All Share Index	13.9
GLOBAL BALANCED NAMIBIAN HIGH FOREIGN COMPOSITE	8.2
Mean of Alexander Forbes Namibia Average Manager [2]	11.7
RELATIVE DOMESTIC COMPOSITE	12.9
Weighted average of client specific benchmarks [2]	14.0
FOREIGN BEST VIEW (RANDS) COMPOSITE	6.6
60% of the MSCI and 40% of the JP Morgan Global Government Bond Index (Rands)	10.5
ORBIS FUNDS (RANDS) [1, 6]	
ORBIS GLOBAL EQUITY FUND (RANDS)	13.5
FTSE World Index (Rands)	15.6
ORBIS JAPAN EQUITY (YEN) FUND (RANDS)	4.3
Tokyo Stock Price Index (Rands)	3.7
ORBIS OPTIMAL SA FUND-US$ CLASS (RANDS)	-0.4
US$ Bank Deposits (Rands)	-2.2
ORBIS OPTIMAL SA FUND-EURO CLASS (RANDS)	3.1
Euro Bank Deposits (Rands)	1.9
ORBIS ASIA EX-JAPAN EQUITY FUND (RANDS)	22.6
MSCI Asia Ex-Japan (Rands)	16.3

PERFORMANCE AS CALCULATED BY ALLAN GRAY

[1] The fund returns are net of investment management fees
[2] The return for Quarter 3, 2009 is an estimate as the relevant survey results have not yet been released
[3] Unable to disclose due to ASISA regulations
[4] Consulting Actuaries Survey returns used to 31 December 1997. Alexander Forbes Global Large Manager Watch used from 1 January 1998
[5] The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate
[6] Amounts invested by the Allan Gray client portfolios in the Orbis Funds are included in the assets under management figures in the table above

1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R million)	INCEPTION DATE
11.2	9.4	21.9	23.8	30.7	19 034.1	01.10.98
7.7	6.7	19.5	17.2	19.0		
11.9	10.1	18.6	21.8	21.8	29 162.9	01.10.99
7.2	7.3	15.6	14.3	14.3		
11.5	10.2	13.3	-	14.2	28 455.7	01.07.00
8.3	8.4	7.3	-	7.9		
12.7	11.3	14.2	-	15.5	28 455.7	01.07.00
11.2	11.3	9.9	-	10.7		
10.4	10.4	9.1	-	9.6	9 588.1	03.07.01
10.3	10.2	8.9	-	9.6		
9.2	9.9	8.9	-	9.9	2 561.1	01.10.02
9.0	9.1	7.7	-	8.2		
10.9	9.4	-	-	9.1	135.1	01.10.04
9.1	8.0	-	-	8.5		
12.3	6.8	13.3	-	9.7	6 499.8	03.02.04
-3.0	1.6	9.5	-	7.0		
11.5	1.4	-	-	12.9	3 427.1	01.04.05
-8.8	-3.6	-	-	7.8		
12.0	11.9	20.8	-	22.2	13 230.6	01.09.00
8.2	8.5	17.4	-	15.3		
13.0	13.4	22.9	-	22.8	5 394.4	01.09.01
10.7	10.8	19.1	-	17.7		
11.8	12.9	26.1	-	26.4	5 415.7	01.02.01
7.7	6.7	19.5	-	15.8		
18.7	18.6	25.5	-	27.0	529.0	06.07.01
10.7	10.8	19.1	-	17.3		
14.6	13.8	17.3	-	17.5	475.7	01.12.01
12.1	12.2	11.0	-	11.7		
10.0	10.8	9.8	-	10.0	171.8	04.12.02
9.2	9.5	8.1	-	8.3		
17.2	17.4	24.5	-	22.9	1 218.2	01.03.04
8.2	8.5	17.4	-	17.6		
13.9	13.5	15.7	-	16.2	1 292.3	01.05.04
8.0	11.6	10.1	-	9.7		
12.1	12.3	16.2	-	16.9	2 731.7	15.07.04
12.1	12.2	11.0	-	11.0		
11.3	9.7	22.6	-	26.7	657.9	05.05.03
8.2	7.6	20.2	-	24.4		
10.7	10.5	9.1	-	9.9	888.4	21.09.00
9.9	10.0	8.9	-	9.6		
12.8	6.5	13.2	-	5.8	1 597.9	23.01.02
-2.7	1.7	9.5	-	1.2		
11.9	1.9	13.5	-	12.6	2 014.5	18.05.04
-8.5	-3.6	8.4	-	8.2		
12.3	11.9	21.0	23.5	23.6	24 076.9	01.01.78
8.2	8.5	17.4	16.7	18.0		
13.0	13.5	22.8	24.1	24.1	24 949.2	01.01.78
10.7	10.8	19.1	18.2	18.5		
12.1	13.3	26.4	27.2	22.6	42 674.7	01.01.90
7.7	6.6	19.5	17.2	14.7		
12.1	12.8	20.9	23.1	21.0	5 361.7	01.01.94
8.2	10.7	17.9	16.5	14.7		
11.9	9.8	22.3	-	22.5	9 231.6	19.04.00
8.2	7.8	19.7	-	16.2		
8.8	4.8	12.2	16.9	15.5	5 205.7	23.05.96
-2.7	1.7	9.5	6.7	10.6		
11.2	1.7	13.6	13.9	19.3	-	01.01.90
-8.5	-3.6	8.4	4.6	11.9		
8.7	-2.3	9.0	6.9	15.0	-	01.01.98
-7.9	-8.7	5.0	0.1	6.1		
6.1	6.3	-	-	13.6	-	01.01.05
-7.8	2.5	-	-	10.3		
9.0	10.1	-	-	14.1	-	01.01.05
-3.6	7.5	-	-	11.3		
36.1	12.6	-	-	19.7	-	01.01.06
15.4	6.6	-	-	15.3		

Allan Gray Balanced Fund Quarterly Disclosure as at 30 September 2009

	% of Fund
South African equities	**51.1**
Resources	**12.5**
Anglogold Ashanti	4.3
Sasol	4.0
Harmony Gold Mining Co.	1.9
African Rainbow Minerals	1.6
Positions individually less than 1% of total JSE-listed securities held by the Fund	0.6
Financials	**8.0**
Sanlam	3.0
Standard Bank Group	1.6
Reinet Investments SA	0.9
Firstrand	0.8
Positions individually less than 1% of total JSE-listed securities held by the Fund	1.7
Industrials	**30.5**
SABMiller	7.2
Remgro	3.8
MTN Group	3.2
Compagnie Fin Richemont SA	2.2
Sappi	1.9
Nampak	1.6
Dimension Data Holdings	1.4
Illovo Sugar	1.4
Sun International	1.0
Tongaat-Hulett	0.9
Shoprite Holdings	0.7
Mondi Limited	0.6
Aspen Healthcare Holdings	0.6
Positions individually less than 1% of total JSE-listed securities held by the Fund	4.1
Other securities	**0.1**
Positions individually less than 1% of total JSE-listed securities held by the Fund	0.1
Derivatives	**-0.5**
ALSI 40 1209-RMB	-0.5
---- Net South African equities ----	*50.6*
Hedged South African Equities	**0.5**
Commodities	**4.0**
New Gold ETF	4.0
Bonds	**4.7**
RSA Bonds	1.9
Parastatal Bonds	0.2
Corporate Bonds	2.7
Money market and call deposits	**19.9**
Foreign - JSE inward listed shares	**4.2**
British American Tobacco	4.2
Foreign - Orbis absolute return funds	**8.0**
Orbis Optimal SA Fund (US$)	5.0
Orbis Optimal SA Fund (Euro)	3.0
Foreign - Orbis equity funds	**8.0**
Orbis Global Equity Fund	4.7
Orbis Japan Equity Fund (Yen)	3.3
Totals:	**100.0**

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

Total Expense Ratios (TERs)

	Equity Fund	Balanced Fund	Stable Fund	Optimal Fund	Bond Fund	Money Market Fund	Global Fund of Funds	Global Equity Feeder Fund
Performance component	1.17%	0.49%	0.14%	0.43%	0.18%	0.00%	0.29%	0.43%
Fee at benchmark	1.71%	1.15%	1.14%	1.14%	0.29%	0.29%	1.28%	1.49%
Trading costs	0.12%	0.06%	0.04%	0.45%	0.00%	0.00%	0.06%	0.17%
Other expenses	0.01%	0.03%	0.02%	0.02%	0.09%	0.01%	0.18%	0.34%
Total Expense Ratio (TER)	3.01%	1.73%	1.34%	2.04%	0.56%	0.30%	1.81%	2.43%

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 the end of June 2009. 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.

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Collective Investment Schemes (unit trusts) are generally medium- to long-term investments. The value of participatory interest (units) may go down as well as up. Past performance is not necessarily a guide to the future. Unit trust prices are calculated on a net asset value basis, which, for money market funds, is the total book value of all assets in the portfolio divided by the number of units in issue. The Allan Gray Money Market Fund aims to maintain a constant price of 100 cents per unit. The total return to the investor is primarily made up of interest received but may also include any gain or loss made on any particular instrument held. In most cases this will have the effect of increasing or decreasing the daily yield, but in some cases, for example in the event of a default on the part of an issuer of any instrument held by the Fund, it can have the effect of a capital loss. Such losses will be borne by the Allan Gray Money Market Fund and its investors and in order to maintain a constant price of 100 cents per unit, investors' unit holdings will be reduced to the extent of such losses. Fluctuations or movements in exchange rates may also be the cause of the value of underlying international investments going up or down. Unit trusts are traded at ruling prices. Commissions and incentives may be paid and if so, would be included in the overall costs. Different classes of units apply to the Allan Gray Equity, Balanced, Stable and Optimal Funds only and are subject to different fees and charges. A detailed schedule of fees and charges and maximum commissions is available on request from the company. Forward pricing is used. A fund of funds unit trust may only invest in other unit trusts, which levy their own charges that could result in a higher fee structure for these portfolios. A feeder fund is a unit trust fund that, apart from assets in liquid form, consists solely of units in a single portfolio of a collective investment scheme. All of the unit trusts except the Allan Gray Money Market Fund may be capped at any time in order for them to be managed in accordance with their mandates. Allan Gray Unit Trust Management Limited is a member of the Association for Savings & Investment SA (ASISA).

KINGJAMES rsvp