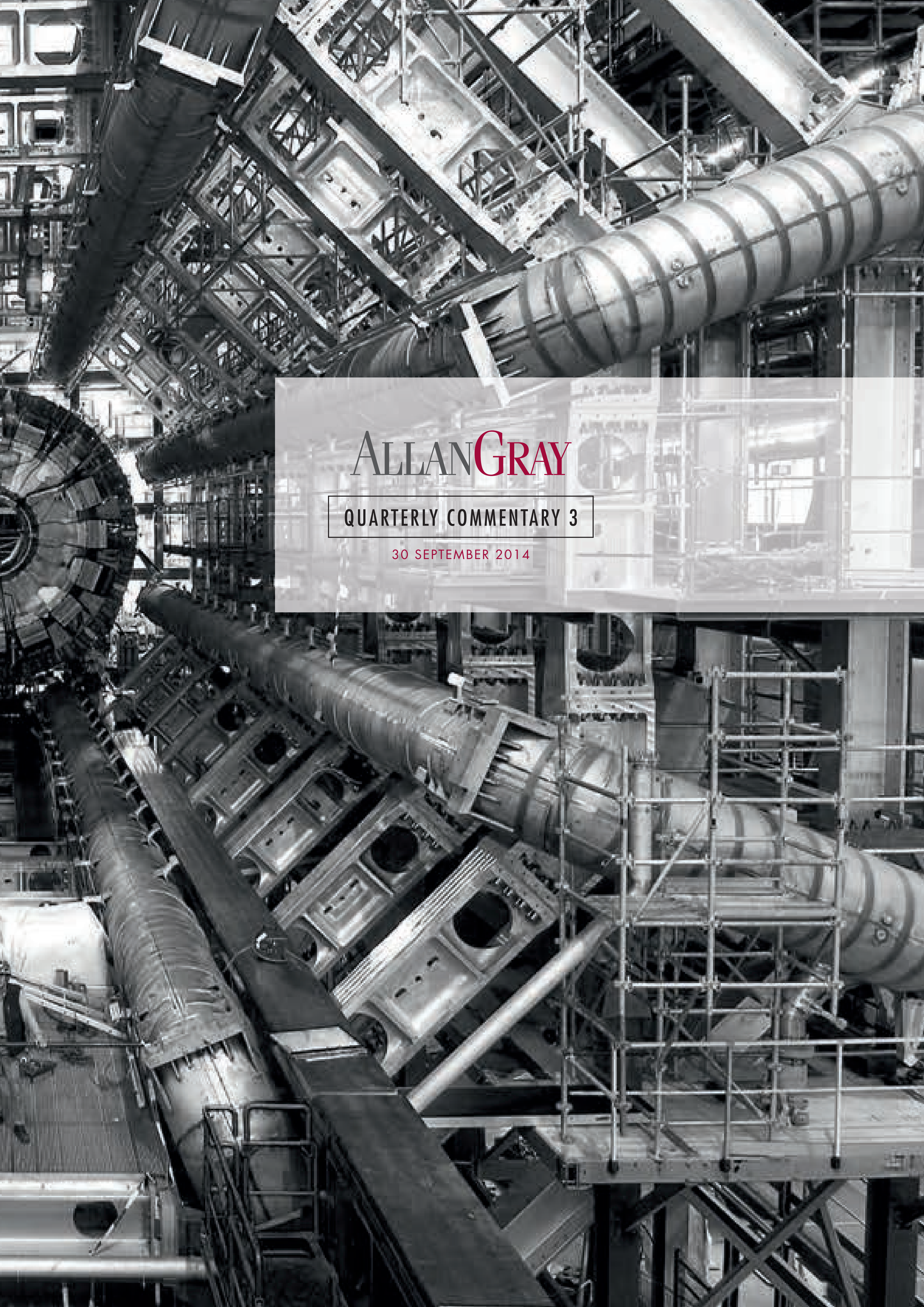
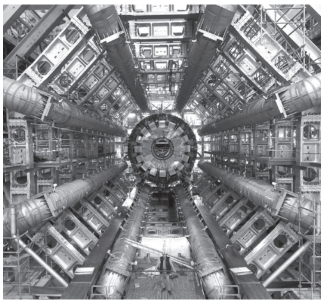


Allan Gray

QUARTERLY COMMENTARY 3

30 SEPTEMBER 2014

LONG-TERM THINKING IN ACTION



The cover of this Quarterly Commentary features ATLAS – one of the particle detector experiments at the Large Hadron Collider in Switzerland. ATLAS looks for answers to some of the biggest mysteries surrounding our existence, such as extra dimensions, the particles that make up dark matter and the Higgs boson particle – the theoretical force behind the Big Bang.

This experiment is no small feat. ATLAS is 46 metres long, 25 metres in diameter, weighs 7 000 tonnes and contains about 3 000 kilometres of cable. And since its inception in 1994, it has involved an estimated 3 000 physicists from some 174 institutes in 38 countries.

ATLAS was completed in 2008 and on 4 July 2012 – 18 years after it was first proposed – it made its first big breakthrough: detecting a new particle consistent with the Higgs boson. But it will be some years before ATLAS and its associated experiments at the Large Hadron Collider will be able to prove that it is, indeed, the sought-after boson.

The careful construction of ATLAS, and its meticulous process of substantiating nuclear theories, reminds us of our long-term approach to investing. We base each investment we make on thorough research, data collection and analysis and then give it as much time as it needs to reap rewards, long into the future.

The Allan Gray Quarterly Commentary is printed on LumiSilk, a paper made from trees grown specifically for paper manufacturing.
The paper is certified by the Forest Stewardship Council (FSC), an organisation which promotes responsible management of the world's forests.

CONTENTS

ROB DOWER

COMMENTS FROM THE CHIEF OPERATING OFFICER

My early career and training was as a mechanical engineer. Engineers deal with uncertainty in design by applying a 'safety factor' to their sums: if theoretical calculations show that a shaft needs to be 'X' mm in diameter to handle a required load without failing, the engineer will multiply 'X' by a safety factor to account for the uncertainties involved in the design process, such as the quality of the metal or the nature or type of load applied. Because the real world involves a lot of uncertainty, if engineers didn't use safety factors their designs would fail all the time. Since engineers often design things that will harm people if they fail unexpectedly, or at least cause a lot of inconvenience, safety factors often double the strength of a structure. Incidentally, the Eiffel Tower is designed with a safety factor of 4.5 times. As you probably know, it is an accidental example of long-termism, having been built as a temporary structure at the entrance to the Paris World's Fair in 1889.

The engineering safety factor has an analogy in investing. Portfolio managers and analysts have access to a lot of historical data from which they are normally able to form a theoretical view on what a company is worth. Because the companies they are valuing operate in the real world, this theoretical view has to be adjusted to take account of uncertainties. At Allan Gray we deal with these uncertainties in three ways. First we consider the impact of key uncertainties on the theoretical value in a sensitivity or scenario analysis. Second, just like engineers, we prefer to invest in a company's shares when they are priced sufficiently below our estimate of their value to provide a margin of safety. Thirdly, we recognise that we can have higher confidence in our estimates of intrinsic value in some companies than in others, and our internal peer review process and our portfolio managers incorporate this conviction level into setting appropriate portfolio weights and limits.

What makes investing different from engineering, is that investment managers can do an extremely good job for their clients – possibly even 5% per annum better than their benchmarks – if they can get just 60% of their decisions right.

There are not many 'Eiffel Tower decisions' in investing, so if we waited to find investments that were priced at four times less than they were worth, we would hardly ever invest a cent and we would fail on your behalf. At the current high market valuations it is especially hard to find many shares priced to provide a significant margin of safety.

We do not expect to get things right all of the time. But this doesn't mean that we take it lightly when we get things wrong. Encouragingly, so far this year the impact of successful investment decisions has more than offset those that have gone against us, as is evident from the performance tables later in this magazine.

African Bank

We have had questions from some clients about the impact of the failure of African Bank on your portfolios. As with all investments we make on your behalf, we conducted in-depth qualitative and quantitative analysis on African Bank (ABIL) and vigorously debated the investment case internally before investing. While we identified risks, these concerns were widely known, and so it could be argued that they were fully discounted in ABIL's share price. It often proves profitable to buy shares when the risks and concerns are 'top of mind', as investors sell the shares at a low price which doesn't factor in the probability of circumstances improving for the company at some time in the future. In this instance, conditions deteriorated significantly more than we expected.

When we invested in ABIL's senior debt (which is essentially borrowed money that a company must pay back first if it goes out of business), we considered the probability of the bank being placed under curatorship and the senior debt suffering a 'haircut' as possible, but unlikely. At the time, ABIL's accounts showed a significant capital buffer (provided by shareholders and subordinated debt) to absorb losses on its lending book before the senior debt would be impacted. In August, surprise announcements by ABIL, and then the Reserve Bank, disclosed that the bank's book of loans was performing worse than previously indicated, and the unlikely transpired.

Although these investments went against us, the resulting losses in client portfolios were fortunately relatively small, as we limited our portfolio positions in recognition of the higher-than-normal risk of negative surprises.

Nevertheless, our investments in ABIL shares and senior debt were proven to be poor and we sincerely regret and apologise for the impact of this on your portfolios.

What it means to be 'contrarian'

It is not easy being a contrarian investor. One has to look for opportunities where others fear to tread and see potential where others see underperformance, and yet also try to avoid situations like ABIL. We share this approach with Orbis and Allan Gray Australia, both of whom write about being contrarian in this issue of Quarterly Commentary. Seema Dala discusses how, in the face of growth, Orbis has worked hard to maintain a small team culture and to encourage contrarian thinking. This has contributed to the track record of the Orbis Global Equity Fund, which has delivered 5.5% outperformance to its clients, compared to its benchmark since inception.

Across the ocean and down under, LJ Collyer and JD de Lange illustrate how the Australian Equity Fund differs from its benchmark, noting that the small and mid-cap stocks it chooses give its portfolio an edge, and also offer South African investors diversification that is not only geographic.
The Fund is invested in many sectors and companies that are unavailable (and often unknown), locally.

Interested investors can access the Orbis and Allan Gray Australia funds via our offshore platform, which provides many diversification opportunities.

Uncertainty at home

Diversifying offshore is appealing in the face of political uncertainty and economic stagnation at home. In his piece this quarter, Sandy McGregor looks at our history to find some solutions to deal with the current lack of economic growth. In a harsh reality check he discusses how we cannot count on a recovery in commodity prices to save us this time. New ideas and actions soundly based on economic realities are required to generate the higher growth rate South Africa desperately needs.

I encourage you to remain committed to your long-term investment objectives. Thank you for your support.

Kind regards

Rob Dower

SANDY MCGREGOR

WHAT'S WRONG WITH THE SOUTH AFRICAN ECONOMY?

After growing strongly for 10 years, since 2012 the South African economy has been stagnating, which prompts the question: What has gone wrong and how can this be fixed? Sandy McGregor suggests looking back to find a way forward.

A decade of prosperity

South Africa's prosperity in the first decade of this millennium can be attributed largely to two underlying factors. The first was the government's decision in 1997 to embrace fiscal prudence. This was the much maligned Growth, Employment and Redistribution (GEAR) programme, which involved matching government expenditure with revenues. It required considerable political courage to embark on such a programme. Not enough credit is given for the fact that it proved triumphantly successful, creating an environment which allowed a decade of above-average growth. GEAR enabled South Africa to reap considerable benefits from the subsequent boom in commodity prices, which was the second of the two factors promoting rapid growth.

It is no coincidence that South Africa's recent period of strong growth coincided with an emerging market boom. Rapid growth in emerging markets, in particular in China, gave rise to unprecedented high commodity prices. The annual value of South Africa's exports rose from US$31.6bn in 2002 to US$98.4bn in 2011. This three-fold rise in exports is shown in **Graph 1**. The recovery of exports after the 2008 global financial crisis (GFC) was particularly impressive.

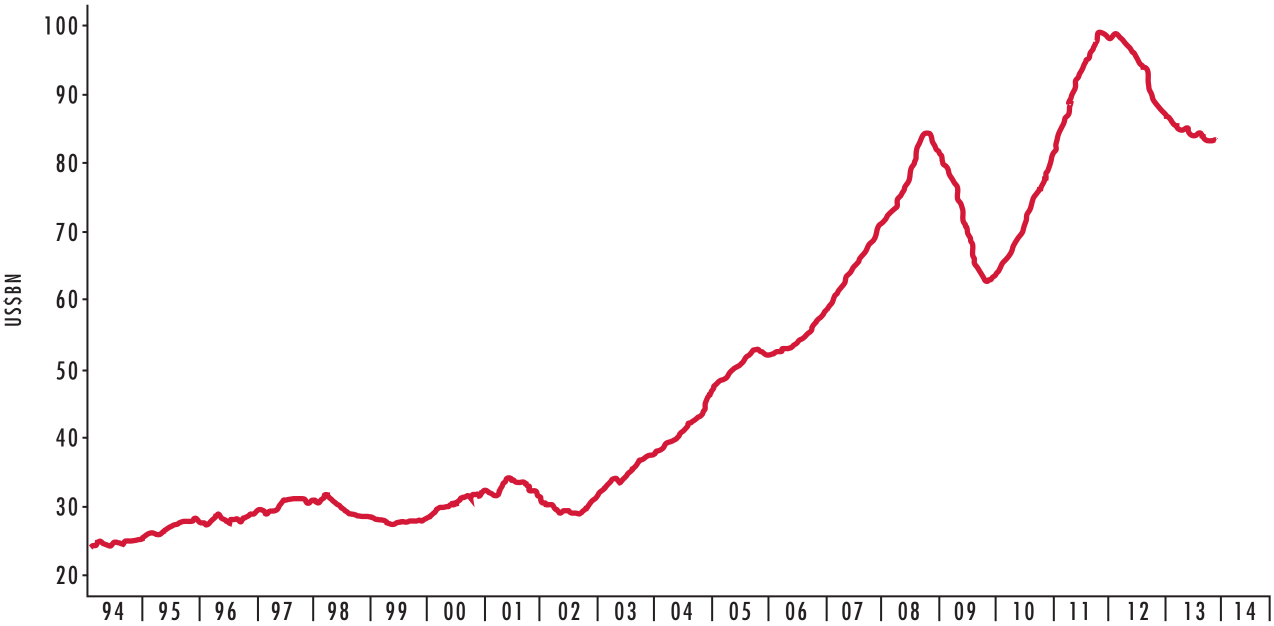
"WHAT IS MOST CONCERNING IS THAT WE CANNOT COUNT ON A RECOVERY IN COMMODITY PRICES ANY TIME SOON."

Growth in developing economies slows

The commonly used acronym for the debacle in 2008, 'GFC', is actually a misnomer. It would be more accurate to describe these events as a 'developed economy financial crisis'. After a brief recession the emerging markets bounced back, and continued to expand rapidly into 2012. Only then did growth falter under the pressure of rising debt and, in certain cases, deteriorating current accounts. This slowdown was precipitated by unsustainable imbalances within the emerging economies themselves, and had little to do with problems in developed economies.

In September 2012, I wrote how market participants were focusing too much on events in the developed countries, when a key determinant of global economic conditions was slowing growth in emerging markets, which account for the majority of global growth (see Quarterly Commentary 3, 2012). This theme remains crucially important for South Africa. Contagion from the emerging markets has contributed to weak growth in our most important trading partner, Europe. Commodity prices have declined significantly as a consequence of slower growth in developing countries. The value of South Africa's exports, which are largely commodities, is currently 22% off its peak.

GRAPH 1 **SOUTH AFRICAN EXPORTS**



Source: I-Net BFA

South Africa suffers adverse consequences

Growing export revenues is a necessary condition for sustainable growth in South Africa. The surge in domestic spending between 2004 and 2007 was only possible because there was a commodity boom. This positive situation was reinforced by the fact that, as a result of the GEAR strategy, fiscal deficits were well contained, and the government did not crowd the private sector out of debt markets. South Africa's limited pool of savings could be fully dedicated to supporting economic growth.

These conditions, which were so favourable for growth, have now reversed. First to go was fiscal discipline. Following the crisis of 2008, government revenues contracted. The Zuma administration does not have the same resolve as the Mbeki administration had to keep spending under control. The number of government employees and their salaries has increased significantly. South Africa has become locked in a cycle in which fiscal deficits have averaged about 5% of GDP. Government again absorbs a significant proportion of domestic savings.

The growing remuneration of public sector employees initially boosted consumption and promoted growth, but these temporary and ephemeral benefits have proved unsustainable.

What is most concerning is that we cannot count on a recovery in commodity prices any time soon. Commodity price booms, such as the one we have recently enjoyed, are infrequent events. New ideas and actions soundly based upon economic realities are needed to generate the higher growth rate we desperately need.

"A REINVIGORATED PRIVATE SECTOR IS THE KEY TO BREAKING OUT OF OUR PRESENT MALAISE AND ACHIEVING MORE RAPID GROWTH."

Since 2012 declining export revenues have taken their toll. A rising current account deficit has weakened the rand, eroding real personal incomes. Mining investment has contracted. The machine that was driving growth has switched off.

These economic woes are most clearly manifest in our large current account deficit, currently 6% of GDP. Given an infrastructure backlog, inadequate education system and poisonous labour relations, South Africa faces huge problems that will take years to fix. An economy continually adjusts to new realities. Given the inflexibility of the economy, the rand exchange rate has to bear the brunt of this adjustment process.

What will get South Africa growing again?

It is an unfortunate truth that the relationship between government and business in South Africa has become dysfunctional. Neither party trusts the other.

The study of economic history suggests that an inevitable consequence of a government's hostility to business is slower economic growth. One of the most interesting examples of this truism is found in the United States in the 1930s. While historians applaud President Franklin Roosevelt's New Deal as the miracle cure to the deep depression of 1931–32, the reality is that the US economy performed poorly through the 1930s when benchmarked against other countries. An important reason for this was Roosevelt's hostility to business. Aggressive regulation and taxation had a devastating effect on business confidence and private sector investment suffered as a consequence. By way of contrast, in the same decade Britain, which had a pro-business government, had one of the best-performing economies. In 1939 as World War Two approached, the US economy reverted to its normal buoyancy. Key to this change in fortunes was not the demand for armaments, but rather the recognition by Roosevelt that he needed the support of business to win the approaching war. Accordingly, he reversed his anti-business stance. A close working relationship between business and government became the key driver of US prosperity over the next 30 years.

Recently France has provided two more examples of how damaging an anti-business government can be to an economy. Both President Francois Mitterrand in 1980 and currently President Francois Hollande entered office on a wave of anti-business sentiment. Both were forced by rapidly deteriorating business conditions to reverse this stance within two years.

A reinvigorated private sector is the key to breaking out of our present malaise and achieving more rapid growth. Currently the private sector faces serious challenges. A plethora of new regulations and government programmes, almost all of which increase the cost of doing business, makes it difficult to justify new investment. South African companies are investing, but increasingly their focus is on expanding internationally, especially in Africa, north of the Limpopo. Private Sector investment within South Africa is focused on increasing productivity to compensate for above-inflation wage increases. The cost of excessive wage demands is reduced employment. South Africa is trapped in a cycle of anaemic growth, which does not create jobs. To escape stagnation, this vicious downward spiral needs to be broken.

The simplest way to fix the South African economy is to learn from history and to promote an environment which allows the private sector to prosper. Investment, job creation and rising tax revenues, which will allow government to achieve its ambitious social agendas, will follow. Introducing the GEAR policy required political courage. The same courage is now needed to create a business-friendly environment.

Sandy joined Allan Gray in October 1991. His current responsibilities include the management of fixed interest and individual client portfolios. Previously he was employed by Gold Fields of South Africa Limited for 22 years where much of his experience was focused on investment-related activities.

DUNCAN ARTUS

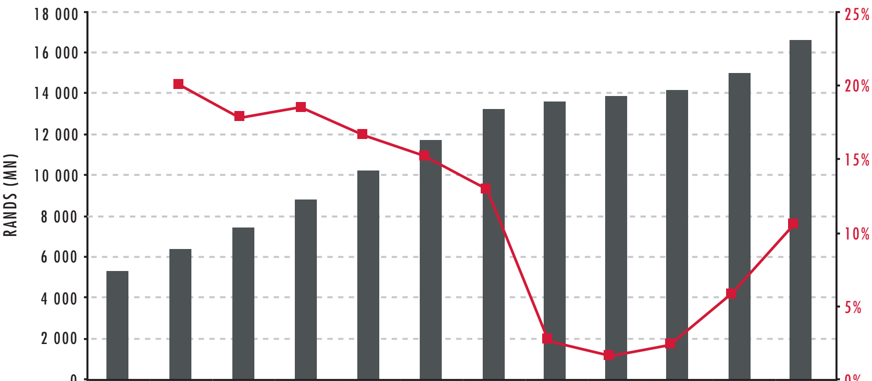
CHANGING THE ODDS

Sun International, South Africa's second-largest casino and resort operator, is undergoing significant change after a number of years of underperformance. Duncan Artus sets out the investment case for the company.*

Casinos are effectively local monopolies in South Africa since competition is restricted by the finite number of licences available. However, they do have to compete with spend on goods and services, as well as other forms of leisure activity.

As shown in **Graph 1**, growth in gross gaming revenue (GGR) has been very slow since 2008, lagging the growth in turnover of listed retailers by far more than we expected. In a typical casino, 30% of customers can generate over 70% of revenue. These customers have probably not benefited to the same extent from credit extension and the strong growth in the public sector wage bill and social grants as those who have driven retail growth.

GRAPH 1 **GROWTH IN GROSS GAMING REVENUE**



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
GGR	5 204	6 240	7 340	8 691	10 125	11 657	13 163	13 510	13 726	14 043	14 855	16 411
GROWTH		20%	18%	18%	17%	15%	13%	3%	2%	2%	6%	10%

Source: Prescient Securities, Provincial Gaming Boards

Customers still visit casinos but spend less per person than before. This causes margins to fall as casinos still incur the same costs, but receive less revenue.

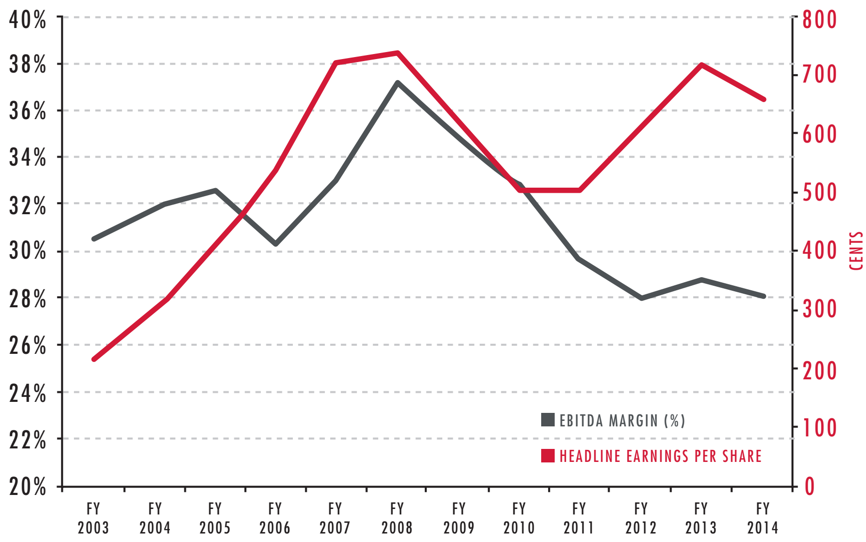
Other than the taxes paid on GGR, a casino's short-term cost base is mostly fixed, magnifying any change in revenue on the bottom line. It is difficult for casinos to raise prices (this would mean changing the win ratio) to offset rises in costs.

Focus on Sun International

Sun International's share price, margin and earnings have yet to match their respective 2007/08 nominal peaks, as shown in **Graphs 2 & 3** on page 7. The poor performance has been driven by a number of factors, including:

- Turnover growth at casinos slowing down materially, causing profit margins to fall
- Investing too much capital in Port Elizabeth to renew the licence and exclusivity of the Boardwalk Casino
- Investor concern over the implications of the potential loss of exclusivity, or the amount of the capital needed to

GRAPH 2 **SUN INTERNATIONAL: MARGIN AND EARNINGS**



Source: Allan Gray research

GRAPH 3 **SUN INTERNATIONAL: SHARE PRICE**

Source: I-Net BFA

maintain exclusivity, in Cape Town for GrandWest Casino

- Investor concerns about regulatory risk and higher tax rates on gaming revenue
- Hotels struggling in an over-supplied market following the World Cup in 2010

Time to rethink?

When a company or industry goes through a prolonged difficult period, change invariably comes about. Senior management changed at Sun International and, after reviewing the business, decisions were made to firstly aggressively reduce costs and secondly, to restructure the portfolio of assets.

1. Cost cutting

Faced with negligible growth in gaming revenue, low hotel occupancies and the need for continuous capital investment to maintain operations, management had to take a hard look at the cost base and search for new revenue-generating opportunities. The outcome is a significant restructuring of the cost base. The potential cost saving seems to be as high as R300m which, on a revenue base of R10bn, would go a long way to restoring margins without relying on a rebound in GGR.

2. Restructuring the portfolio

Sun International plans to reduce downside risk, exit low return assets and reinvest in opportunities with better returns. These plans are summarised below.

- **SunWest:** Propose to sell 14.8% of SunWest, which owns GrandWest Casino, Table Bay and the Worcester Casino, to Tsogo Holdings, a potential rival bidder for a new casino in Cape Town, for R635m. Tsogo Holdings has also bought a further 25% from Grand Parade Investments. This should result in a rational outcome for all the parties involved in Cape Town gaming.
- **Monticello Casino Chile:** Invest R1.3bn to buy out their partners, increasing exposure to one of Latin America's best casinos, which they already manage.
- **African operations:** Sell majority stakes in all the operations in Africa, except Nigeria, for R664m. This is at an attractive valuation considering the future capital investment the operations need.
- **Morula Casino:** Applied to move the license from the declining Morula Casino to Menlyn in Pretoria and invest R3bn in a casino development in the attractive and under-serviced Pretoria market.
- **Grand Parade Investments slots:** Buy a 25% stake for R285m, with an option to acquire up to 70%, as Limited Payout Machines and Electronic Bingo Terminals continue to grow much faster than the casino market.
- **Panama & Colombia:** Invested over R1bn in a casino in Panama City, which opened in September,

with attractive economics. The investment in Colombia is far smaller, but creates opportunities for potential expansion.

- **Sun City**: Despite R1.4bn in revenue, Sun City generates little cash flow after capital expenditure. There is potential to significantly increase cash flow by turning Sun City into a destination casino once again on a restructured cost base. With a very high replacement value, Sun City could also possibly be sold at an attractive price.

Upsides and downsides in investing

There are risks in any business and for Sun International these include continued low revenue growth, a full public smoking ban in South Africa, higher taxes and potentially bad capital allocation in Latin America.

There are also potential upsides. An unexpected recovery in GGR at the South African operations would result in a meaningful increase in cash flow given the lower cost base. In addition, the cash flow needed to be spent on maintaining the operations would reduce as a proportion of revenue. With the major global casino operators focusing on Asia, Sun International has the opportunity to continue growing in Latin America without having to overspend to establish or acquire new casinos.

The share price has already begun to discount many of the changes in the business, but we believe Sun International provides an attractive opportunity on depressed cash flows in an expensive stock market.

*The analyst holds Sun International shares in his personal capacity.

Duncan is a portfolio manager and director of Allan Gray Group Proprietary Limited. He joined Allan Gray in 2001 and holds both the CFA and CMT charters.

SEEMA DALA

ORBIS FUNDS: FINDING THE BEST LONG-TERM VALUE FOR CLIENTS

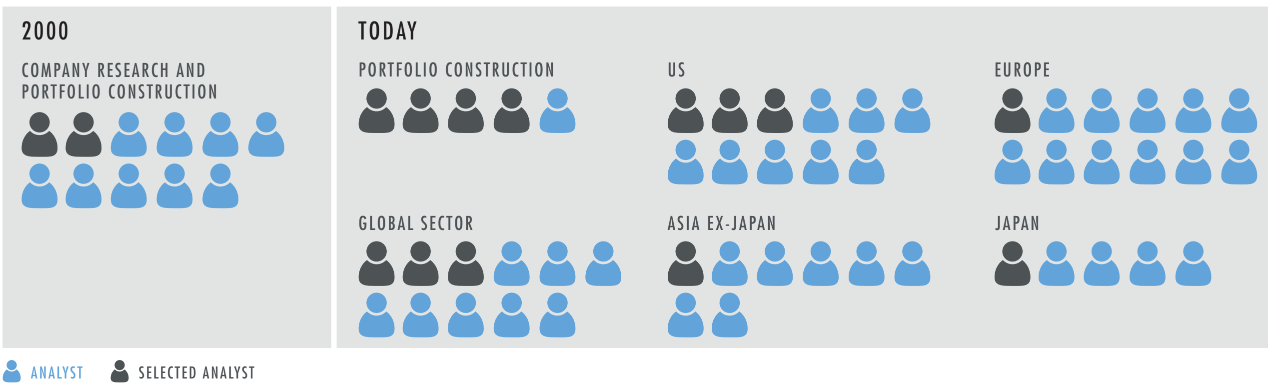
The Orbis Global Equity Fund will mark its 25th year at the end of December. In that time, Orbis has provided access to the same fundamental, contrarian, long-term philosophy that Allan Gray has applied through its 40-year history. Of course, a proven investment philosophy does little good without a process to harness it and the right people to execute it. Seema Dala discusses how, by applying our shared investment philosophy through Orbis' research process, its investment team has delivered client returns 5.5% higher than the benchmark since the inception of the Orbis Global Equity Fund in 1990.

Great stock pickers are rare – and mortal. As such, Orbis cannot rely on one set of individuals to deliver superior performance now, as well as another quarter century from now. From the beginning, Orbis recognised that, if it was successful, future generations of stock pickers would be required to deploy an increasingly large pool of capital over time. It has long been clear that to deliver sustained long-term superior performance, Orbis would have to master not only stock picking itself, but also the ability to regenerate and grow its stock-picking capability – just as Allan Gray has done.

Over time, the Orbis investment team has evolved yet, importantly, while its stock-picking capabilities have expanded, it has retained the key principles that underlie its investment philosophy and process, including its culture of small, independent teams. In the late 1990s, Orbis had a single team of about seven analysts researching around 60 stocks for clients. It now has five company research teams, with an average of nine people in each, as well as a standalone portfolio construction team (see **Figure 1**).

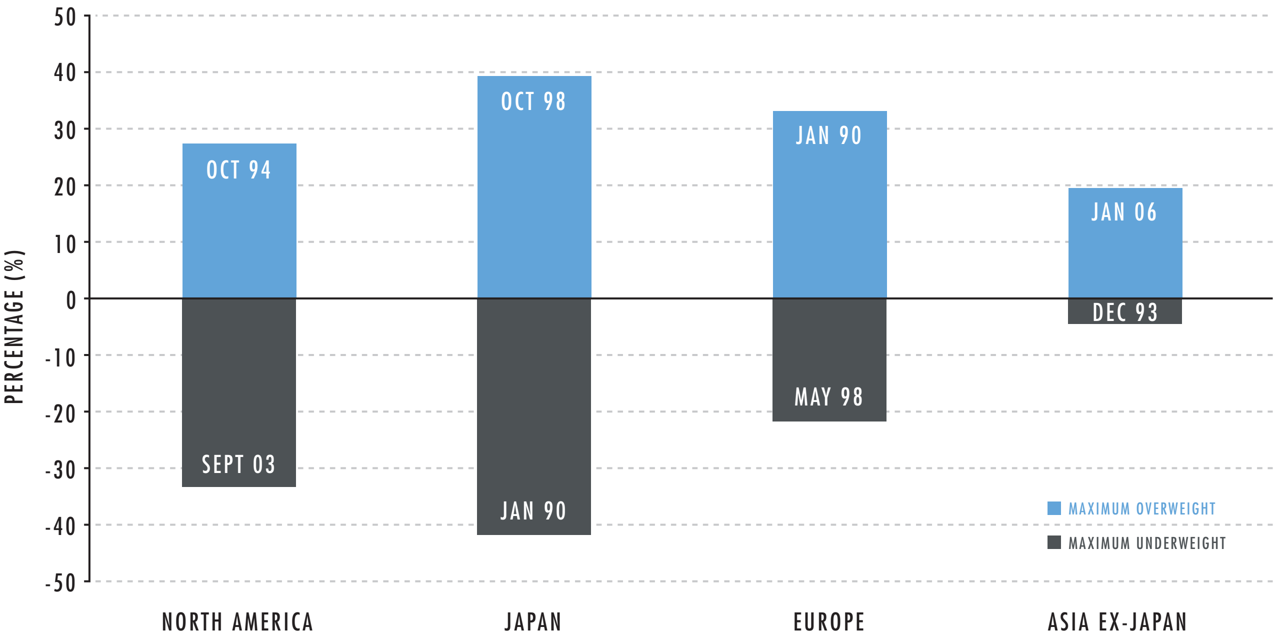
These teams focus on regions or global sectors, and each researches about as

FIGURE 1 **BUILDING OUR COMPANY RESEARCH CAPABILITY THROUGH SMALL, INDEPENDENT TEAMS**



Source: Orbis

GRAPH 1 **EXTREME HISTORICAL EXPOSURES IN THE ORBIS GLOBAL EQUITY FUND VS THE FTSE WORLD INDEX**



Source: Orbis

many companies as the original team did in the past. Over time, a number of analysts have demonstrated superior ability in security selection and, as a result, have been asked to take on more responsibility. In addition to performing their own bottom-up research, these 'selected analysts' form independent views on ideas also researched by others. The recommendations of this smaller group serve as the main reference point for Orbis' Bermuda-based portfolio construction team.

With these research teams generating a larger number of high-quality ideas, the number of stocks in the Orbis Global Equity Fund has also increased. In 1990 Orbis Global Equity held 22 positions, with the smallest holding at 3% of the Fund's net assets. In June 2000, it held 73 stocks and 84% of its net assets in larger (>1%) positions. Today there are 125 positions in the Fund and holdings >1% represent 63% of the Fund. On average, each of the selected analysts recommends the same number of ideas that the Fund held at inception. So rather than diluting conviction by increasing the number of ideas per analyst, Orbis has a greater number of analysts each researching the same number of companies as before – and hopefully in even greater depth.

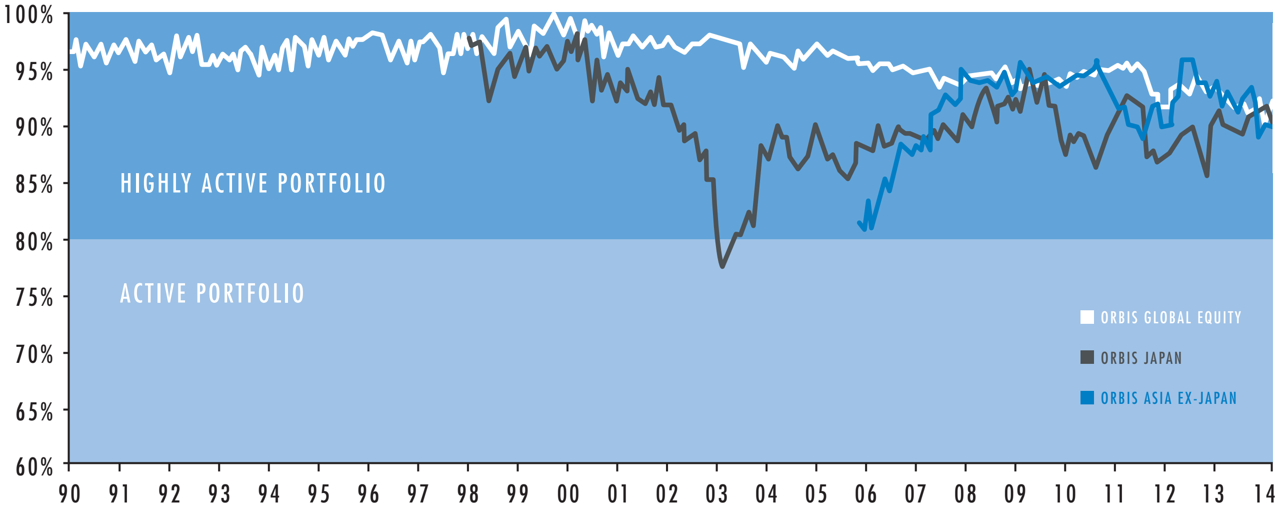
Orbis believes this approach will enhance its ability to capture a larger share of the top-performing stocks in its investment universe. The purchase universe for the Orbis Global Equity Fund is around 5 500 stocks, and in the past 12 months 1 700 of these have outperformed global stock markets by 10% or more. The Orbis Funds held about 50 of these shares – or a 'market share' of about 3%. With more analysts working in small, focused teams, Orbis believes they can uncover a larger number of great investment opportunities.

At the portfolio level, this approach offers several benefits. First, the analysts can seek opportunities in lesser-known securities that would be difficult to access if Orbis relied on smaller teams. Second, Orbis can pursue certain opportunities through a basket of related securities at smaller position sizes. This lets them act on a high-conviction thesis, while reducing idiosyncratic risk (the risk of a price change due to the unique circumstances of a particular security) and liquidity risk. And third, Orbis can gain exposure to high-return (but higher-risk) opportunities that might not be appropriate investments at larger position sizes.

A history of contrarian thinking

To deliver above-average investment returns, Orbis believes that one must be willing to take a different view from the market. Consequently, Orbis is comfortable for its portfolios to deviate from their benchmarks, sometimes substantially. So, has the increased number of stocks in the Orbis Global Equity Fund resulted in it more closely resembling its benchmark? One way to consider this question is to look at how different the geographic positioning of the Orbis Global Equity Fund has been relative to its benchmark at certain points in time, as shown in **Graph 1**. For example, the Fund had 40% more exposure to Japan than its benchmark, the FTSE World Index, in October 1998 (i.e. it was overweight Japan), yet it was underweight Japan by a similar magnitude when the Fund launched in 1990. In September 2003, the Fund was 33% underweight in North American shares. Most recently, at the end of June 2014, it had an

GRAPH 2 **ACTIVE SHARE SINCE INCEPTION**



Benchmarks: The Orbis Global Equity Fund: FTSE World Index; Orbis Japan Equity Fund: Topix; Orbis Asia ex-Japan Fund: MSCI All Country Asia ex-Japan Index.
Source: Orbis, FTSE, Tokyo Stock Exchange, MSCI

18% overweighting in Asia ex-Japan, a testament to Orbis' continued willingness to pursue attractive opportunities in areas scorned by other investors.

"TO DELIVER ABOVE-AVERAGE INVESTMENT RETURNS, WE BELIEVE THAT ONE MUST BE WILLING TO TAKE A DIFFERENT VIEW FROM THE MARKET."

How different are the Orbis Funds from their benchmarks today?

While extreme exposures are a likely symptom of contrarian thinking, it is also helpful to see how much a portfolio as a whole deviates from its benchmark. To quantify how much the Orbis Funds differ from their benchmarks, one can use a measure called 'active share', devised in 2006 by Martijn Cremers and Antti Petajisto at the Yale School of Management. Active share compares the weights of individual holdings in the fund and benchmark. A portfolio with an active share of 0% holds the same holdings as the benchmark, in the same weights, and one with an active share of 100% has no overlap at all with the index. An active share of 80% is generally considered to be 'highly active'.

As **Graph 2** shows, the active shares of Orbis' Strategies have fluctuated, but all have consistently remained in the 'highly active' category. Today, the Orbis Global Equity, Japan Equity, and Asia ex-Japan Equity Funds all have active share levels above 90%. Specifically, Orbis Global Equity has remained a highly active portfolio despite the increase in the number of stocks in the Fund.

Sticking to its guns

One of the most pressing challenges facing organisations is to maintain their key principles as they grow. It is counterintuitive, but the aspects of the firm which gave way to its success can be the hardest to uphold. We believe that by retaining a small team structure, Orbis has empowered its individuals to always challenge consensus and make contrarian decisions, while ensuring the Orbis Funds retain the ability to be very different from their benchmarks and continue to deliver long-term outperformance to our clients.

Seema is a member of the Institutional Client Servicing team at Allan Gray and is Head of Orbis Client Servicing in South Africa (Orbis is Allan Gray's offshore investment partner). She is also a trustee of the Allan Gray Limited Employee Empowerment Share Trust. She joined Allan Gray in 2007 as an investment analyst and is a qualified CA (SA).

JD DE LANGE & LJ COLLYER

THE SAME CONTRARIAN APPROACH FROM CAPE TOWN TO CANBERRA

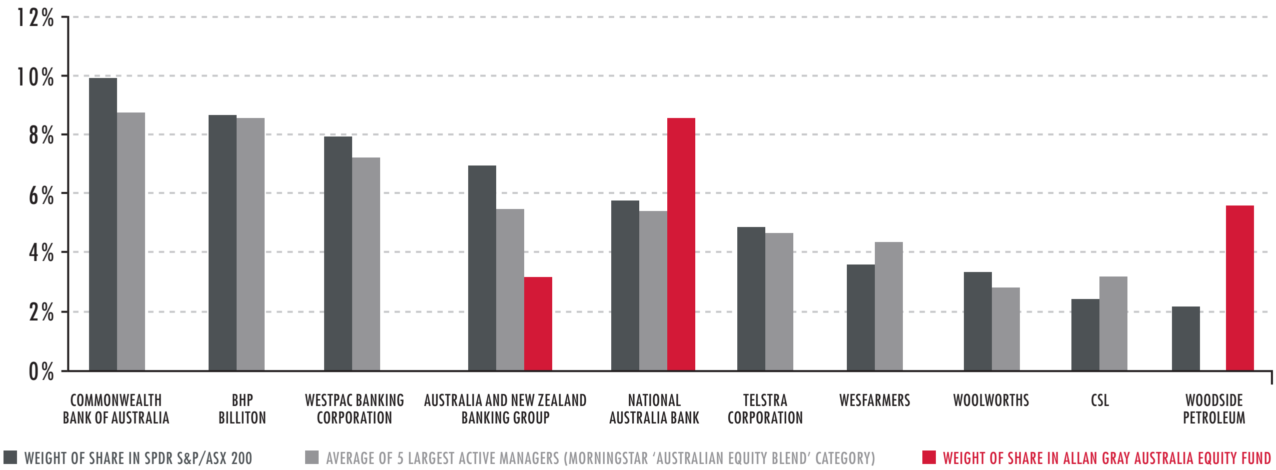
Being 'contrarian' is about culture and about behaviour, and the outcome is reflected in portfolios that are different from the market. LJ Collyer and JD de Lange use the Allan Gray Australia Equity Fund to illustrate Allan Gray Australia's contrarian approach to investing, an approach that it shares with its local counterpart and Orbis.

The problem that many analysts face is that, if they invest in an unpopular company and it goes well, they may get a bonus, but if it goes wrong they may well lose their job. Although an unpopular investment may prove to be the correct choice over time, external pressures often don't allow money managers to hold their unpopular investments for long enough to unlock the value.

For most investment managers, the downside 'career risk' of being contrarian is much higher than the possible 'career upside'. This is one reason why many larger corporate asset managers across the world use a benchmark as their departure point when they make investment decisions. Like Allan Gray locally, Allan Gray Australia does not believe in using a benchmark as a starting point. Rather, analysts start from scratch and invest in undervalued companies, which they believe have the potential to deliver superior returns for clients over the long term.

Graph 1 demonstrates the results of this approach, reflecting two key points:

GRAPH 1 **ALLAN GRAY AUSTRALIA EQUITY FUND: OFFERS EQUITY INVESTORS A DIFFERENTIATED APPROACH**



Source: Allan Gray Australia research

1. In Australia, the largest five 'active' investment managers tend to follow the index

The dark grey bars show the weight of the 10 largest stocks in the S&P/ASX 200 Accumulation Index (ASX) benchmark. This highlights the concentration of the Australian market to the larger shares, with the top 10 shares in the S&P/ASX 200 Accumulation Index (ASX) making up a full 55% of the market.

The light grey bars show the average holdings in the same stocks for the five largest Australian equity fund managers who claim to take an 'active' investment approach. The extent to which these well-known and well-supported managers give investors access to broadly the same holdings is indicative of the challenge for equity investors who want exposure to a differentiated equity opportunity set in Australia.

2. The Allan Gray Australia Equity Fund looks very different from the index and its peers

The red bars on the graph show the Allan Gray Australia Equity Fund's holdings in the same stocks. The conclusion is that the Fund is vastly different from the index and the largest active managers. Indeed, the top 10 shares listed on the ASX make up just 17% of the Australia Equity Fund.

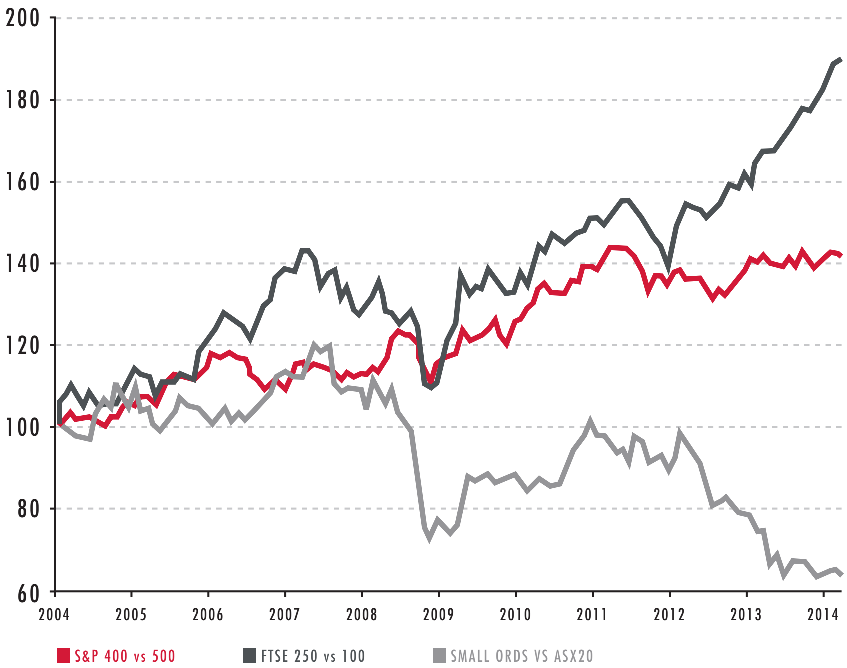
companies that are out of favour with the market. We look past faults others may find and try to identify areas of value that the market doesn't fully recognise. Over the past five or six years, small- and mid-cap stocks in Australia have underperformed considerably relative to large-cap stocks, as shown by the light grey line in **Graph 2**. This is in contrast to most other developed markets where the smaller end of the market has outperformed the large caps (the dark grey and red lines).

> **"PERHAPS THE BIGGEST RISK FOR THE CONTRARIAN INVESTOR IS ABANDONING ONE'S DISCIPLINE AT THE WORST MOMENT."**

Being contrarian means finding value in unrecognised opportunities

So if the Australia Equity Fund is not invested in top tier stocks, where is it finding opportunities? As contrarian investors, we spend most of our time analysing

GRAPH 2 **SMALL- AND MID-CAP STOCKS VS LARGE CAPS IN DIFFERENT REGIONS**



Note: The S&P 400 is the mid-cap index for the US market and the S&P 500 is the largest 500 stocks on the US market. Thus the S&P 400 vs 500 (red line) means that the mid-caps have done better than the large-caps. Likewise with the UK's FTSE 250 vs 100 (dark grey line). Australia's Small Ordinaries Index vs the ASX20 (light grey line) shows that the small-caps have done worse than the large-caps.

Source: Allan Gray Australia research

Therefore, it should not be surprising that Allan Gray Australia analysts have been finding many of their ideas in the small and mid-cap space. Currently, 77.3% of the equity portfolio is invested in small and mid-cap stocks, versus 26.7% in larger holdings. Some examples of the Fund's holdings include:

- **Nanosonic:** A biotech company that creates innovative materials using nanotechnology and polymer chemistry. It specifically focuses on a patented technology to disinfect medical probes.
- **Ausnet Services:** An Australian utilities company that delivers electricity and gas to households in Victoria, in the south-east of Australia.
- **Austal:** A global defence contractor and a designer and manufacturer of defence and commercial ships.

Many of these businesses have no counterparts in South Africa; these sectors simply do not exist locally. This is useful for South African investors looking to truly diversify their investment portfolios, as Allan Gray Australia not only provides country diversification, but also offers access to different and innovative industries.

Managing the risk of being contrarian

If you don't hold most of the market constituents in your portfolio, it stands to reason that your performance will be very different from the index. This is reflected in **Table 1**, which shows that the Australia Equity Fund's return profile has been quite different to the index over the last five years. Some investors see this as a risk and shy away from what is called 'tracking error' (a statistical measure of how much returns differ from the benchmark). As contrarian investors aiming to beat the market and create long-term wealth, tracking error simply is not a measure that we use to assess risk.

Perhaps the biggest risk for the contrarian investor is abandoning one's discipline at the worst moment. Being contrarian can be very uncomfortable – the successful contrarian investor understands the importance of a consistent and focused approach, and investing with conviction. Our single-minded approach should offer the greatest comfort to prospective investors.

TABLE 1 **ALLAN GRAY AUSTRALIA EQUITY FUND PERFORMANCE***

	ALLAN GRAY AUSTRALIA EQUITY FUND	S&P/ASX 300 ACCUMULATION INDEX	RELATIVE PERFORMANCE
ANNUALISED			
Since public launch	7.3	4.6	2.7
Latest 5 years	9.3	6.6	2.7
Latest 3 years	16.8	14.4	2.4
Latest year	14.2	5.7	8.5
NOT ANNUALISED			
Calender year to date	11.6	2.3	9.3
Latest 3 months	3.5	-0.6	4.1

* Returns are in Australian dollars, measured until 30 September 2014. Returns are net of fees and assume reinvestment of distributions.

Source: Allan Gray Australia

How to access Allan Gray Australia funds

The Allan Gray Australia Equity Fund is suitable for investors who are comfortable with market fluctuations and mentally prepared for the long time horizon (at least five years) required to take advantage of Allan Gray Australia's contrarian approach. Investors looking for investment exposure to Australia, without taking on equity market risk, should follow the same approach as they would when picking a local fund, and look for funds that are not as exposed to the equity markets. The Allan Gray Australia Opportunity Fund seeks to invest in a combination of cash and shares and aims to beat the Reserve Bank of Australia cash rate.

Both the Allan Gray Australia Equity Fund and the Allan Gray Opportunity Fund are available via the Allan Gray Offshore Investment Platform and have been approved by the FSB for marketing to South African investors.

JD joined Allan Gray Australia in 2010 as head of retail after spending nine years with Allan Gray South Africa as a director of Allan Gray Unit Trust Management (RF) Proprietary Limited. He holds a B Proc Degree (University of Pretoria) and is an admitted attorney and CFP in South Africa.

LJ joined Allan Gray South Africa in 2005. He is responsible for the distribution of the Allan Gray Australia funds in South Africa. He holds a B Com, MBA and is a CFP.

WANITA ISAACS

YOUR ROLE IN YOUR INVESTMENT SUCCESS

For some time now we have been saying that across asset classes, prices are high. Many of you may be wondering whether or not you should be making changes to your investments. Wanita Isaacs discusses the partnership required between you and your adviser on the one hand, and your investment manager on the other, in making a long-term success of investing, through different market cycles.

It's the role of investment managers to deliver the best returns they can within each unit trust's investment mandate

Regardless of current market or economic conditions, our role as investment managers is to select the combination of investments we believe will deliver the best return possible, within the appropriate level of risk for that unit trust. We do this by making judgments about expected risk and return and, since we take a valuation-based approach, by looking for investments that are priced lower than our estimates of their underlying value.

Over time, market prices tend to reflect underlying value. In particular, when markets are overvalued and eventually correct, the resultant negative performance can cause a permanent loss of wealth. In fact, buying undervalued investments has meant that most of our long-term outperformance across our unit trusts has come from preserving investors' capital during periods in which markets have delivered negative returns.

While there are always price differences for investments within an asset class, asset markets as a whole, for example the equity, property or bond market, can each be generally expensive at times. We are better able to find the best value investments in unit trusts, where the mandate allows us to invest in more than one kind of asset, such as our Balanced and Stable Funds. These unit trusts provide a 'solution' for investors by investing across different types of assets, to meet specific objectives. Managers can avoid expensive assets in either local or offshore equity markets – and if everything is expensive, they can retreat to cash. This saves investors having to switch.

The Balanced and Stable Funds' current positioning, as shown on page 19, illustrates this. Note that the net equity exposure of the Balanced Fund is at 55.8%, lower than its average since inception (62.7%). The Fund's offshore exposure is at its maximum, but almost half of this is hedged, i.e. insured against a fall in international share prices. A significant portion (14%) of the Fund's holdings is in cash, which means that we are able to take opportunities to invest in any of the Fund's asset classes if prices fall.

On the other hand, 'building block' unit trusts, such as our Equity and Money Market Funds, invest in a single asset class. Investors in these unit trusts have to build their own portfolios and decide how much to allocate to each asset class and when to switch or rebalance. We believe solution unit trusts do a better job than building block unit trusts for most investors over the long term.

It's your role to pick a unit trust that you understand and can stick with – based on the unit trust's objective and not its most recent performance

You need to stay invested in the unit trust you have chosen for long enough to benefit from it. But this means that you first have to choose one that you are able to stick with through different market cycles. Therefore, your role, with the assistance of a good, independent adviser if required, is choosing an appropriate unit trust offered by an investment manager whose approach you understand and with whom you can form an investment partnership.

'Appropriate' depends on your unique situation and preferences. The majority of investors prefer to hand over all the investment decision-making, including picking individual shares and other investments and deciding how much to invest in each asset class, to the investment manager. This normally doesn't cost any more in fees – and often costs less than making up your own diversified portfolio of unit trusts. Your unit trust choice should always be based on your investment objectives: your time frame and your ability to stomach risk, balanced with your need to grow your investment.

There are also some sophisticated investors who may not have the time to pick their own individual investments, e.g. stocks or bonds, but who are keen to make their own decisions about when to have more or less of their investment allocated to different asset classes. Some of these investors make good decisions, but on average, switching between unit trusts destroys value.

What should you do when asset prices are high?

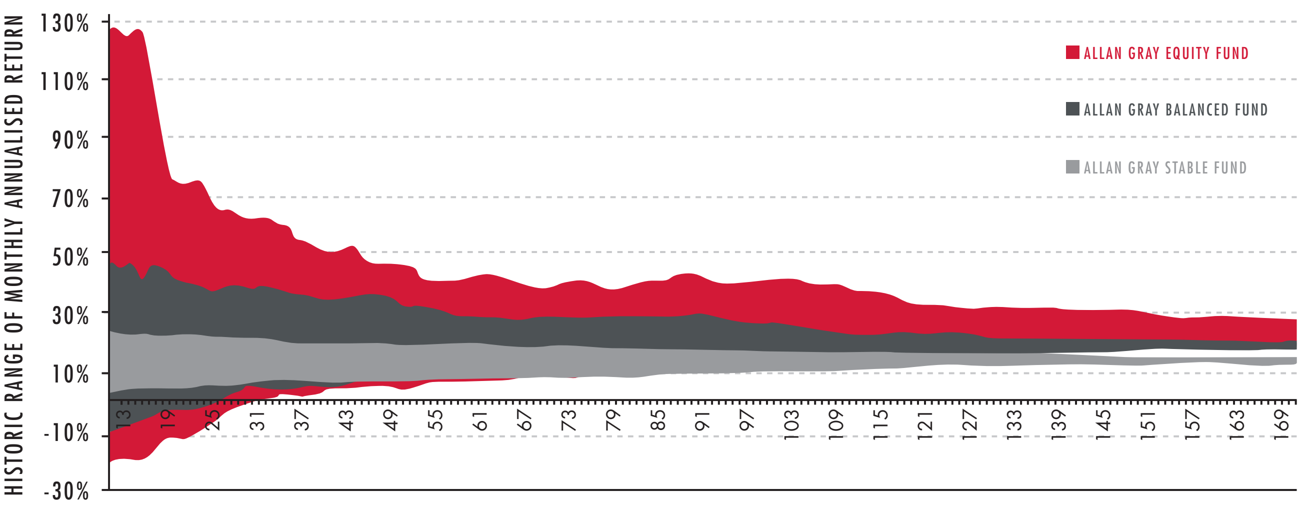
There is a human tendency to chase, or run from, past performance by investing when an investment has done well, or switching or withdrawing after it has done badly. Both of these behaviours impact negatively on your returns. If you are (1) with a manager that you understand and trust, (2) in the right 'solution' unit trust and (3) have invested for your long-term needs, you shouldn't need to worry about high asset prices. However, you definitely should take the time to check and re-check that you are in the right solution unit trust for your long-term needs.

Make sure you are invested appropriately

Graph 1 shows the historic range of returns experienced by investors who invested in the Allan Gray Equity, Balanced and Stable Funds, over different lengths of time, measured in months. The graph starts with a period of one year (12 months) – i.e. it shows the range of return outcomes experienced by investors that invested in each unit trust for a period of one year, and periods longer than a year. The red area shows that, historically, investors who have been invested in the Equity Fund for any period of up to 17 months could have experienced a wide variation of returns. As the length of time investors remained invested increased, towards the right of the graph, the range of returns decreased. For example, investors who were in the Fund for 30 months or more always received positive returns. The dark grey shows the narrower range of returns for the Balanced Fund and the light grey shows the more consistent return delivered by the Stable Fund over any time period.

Since benefiting from a unit trust's long-term return means experiencing its short-term return, make sure you are comfortable with what might be in store before you invest.

GRAPH 1 **FLUCTUATION OVER INCREASING TIME PERIODS**



Source: Allan Gray

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.

THANDI NGWANE

UNDERSTAND THE IMPACT OF INFLATION

There are different types of investment risks, some more obvious than others. One risk that people often forget about is the risk that their invested money won't grow enough to keep up with inflation. When assessing the success of an investment at protecting and growing wealth, it is important to take inflation into account. Thandi Ngwane explains.

Time allows our invested money to grow, and thanks to the power of compounding, it allows it to grow exponentially. But time can also erode the value of our money, meaning we are able to buy less with the same amount of rands, as the prices of goods and services rise. This is called inflation. While it is quite easy to understand inflation's impact in terms of standards of living, what about its relevance in investment decisions and retirement planning?

The not-so-obvious risk

It is important to understand the nature of the risks you face as an investor and to decide how comfortable you are with each, so that you can make the right choices. Investors who cannot stomach fluctuations in returns usually opt for more conservative investments, which promise steady returns. They see investments that are volatile as more risky. However, very conservative investors often forget to account for a less obvious risk: the risk that their returns won't keep up with inflation, meaning that their savings will drop in buying power, even if they don't actually lose rands. Many seemingly 'safe bets' are guaranteed to not grow enough to protect us from inflation, for example keeping cash in the bank.

Consider buying power

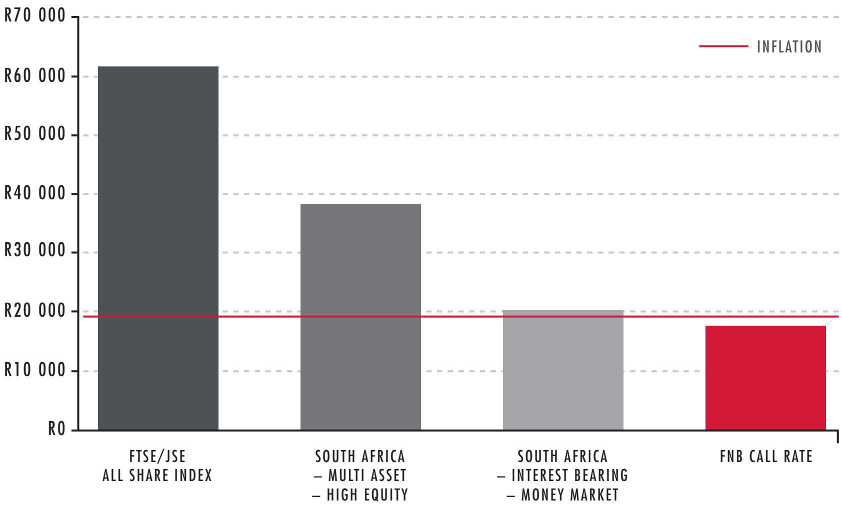
The most meaningful way to measure wealth is in terms of buying power, as opposed to number of rands. Therefore, when evaluating your returns, look at the 'real return', which is your return after inflation, not the 'nominal return', which is the growth on your investment before the effects of inflation are considered. The returns on your investment should be at least enough to compensate you for the length of time that you invest so that the value of your money is maintained.

Graph 1 uses the last 10 years of returns to illustrate that a significant portion of investment return compensates for inflation first (everything below the red line) before any real return is earned (everything above the red line). If you had invested a R10 000 lump sum 10 years ago in equities, an average balanced fund, an average money market fund, or the bank, in most cases inflation would have accounted for the biggest piece of the pie.

Where investments are intended to provide an income, for example, in a living annuity, it is particularly important to take inflation into account when figuring out both withdrawal rates and asset allocation. Many retirees believe that they are at the end of their investing cycle. Actually, nowadays, at retirement you are likely to have to live on your pension for more than 15 or 20 years. Despite the fact that you need to draw a steady income, your invested money needs to continue to grow enough to be able to support your lifestyle over time and to help you cope with rising medical needs and costs. This means that you should consider investing a portion of your portfolio in assets that are likely to grow, such as equities.

The trade-off between risk and returns is a very personal decision and getting it right is key to successful investing. If you are not confident making investment choices, you may wish to consider talking to an independent financial adviser.

GRAPH 1 **TEN-YEAR RETURNS**



Source: Allan Gray research

Thandi joined Allan Gray in 2008. She is a senior member of the distribution team having previously worked in legal and compliance and marketing in the financial services sector. Thandi completed her Masters of Business Law at the University of KwaZulu-Natal and is an admitted attorney.

NOTES

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

	BALANCED FUND % OF PORTFOLIO			STABLE FUND % OF PORTFOLIO		
	TOTAL	SA	FOREIGN*	TOTAL	SA	FOREIGN*
Net equities	55.8	43.5	12.3	16.4	11.6	4.7
Hedged equities	13.3	2.3	11.0	31.4	14.3	17.1
Property	1.6	1.3	0.4	2.8	2.5	0.3
Commodity-linked	3.6	3.6	0.0	4.4	4.4	0.0
Bonds	11.7	11.1	0.6	12.6	11.8	0.8
Money market and bank deposits	13.9	11.3	2.6	32.4	28.9	3.5
TOTAL	**100.0**	**73.0**	**27.0**	**100.0**	**73.5**	**26.5**

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 SEPTEMBER 2014

SECURITY (RANKED BY SECTOR)	MARKET VALUE (R MILLION)	% OF FUND	FTSE/JSE ALSI WEIGHT (%)
SOUTH AFRICAN EQUITIES	**39 541**	**97.4**	
RESOURCES	**8 345**	**20.5**	**24.4**
Sasol	4 972	12.2	
Anglo American	1 012	2.5	
Positions less than 1%	2 360	5.8	
FINANCIALS	**11 291**	**27.8**	**20.2**
Standard Bank	3 151	7.8	
Reinet Investments SA	1 765	4.3	
Old Mutual	1 483	3.7	
Investec	1 194	2.9	
Rand Merchant Insurance	604	1.5	
Sanlam	495	1.2	
Barclays Africa	462	1.1	
Positions less than 1%	2 138	5.3	
INDUSTRIALS	**19 905**	**49.0**	**55.4**
British American Tobacco	4 686	11.5	
SABMiller	3 573	8.8	
Remgro	2 206	5.4	
Netcare	746	1.8	
Tongaat Hulett	605	1.5	
Sappi	564	1.4	
Aspen Pharmacare	541	1.3	
Nampak	537	1.3	
Mondi	477	1.2	
Naspers	431	1.1	
Positions less than 1%	5 540	13.6	
COMMODITY-LINKED SECURITIES	**171**	**0.4**	
Positions less than 1%	171	0.4	
MONEY MARKET AND BANK DEPOSITS	**903**	**2.2**	
TOTALS	**40 615**	**100.0**	**100.0**

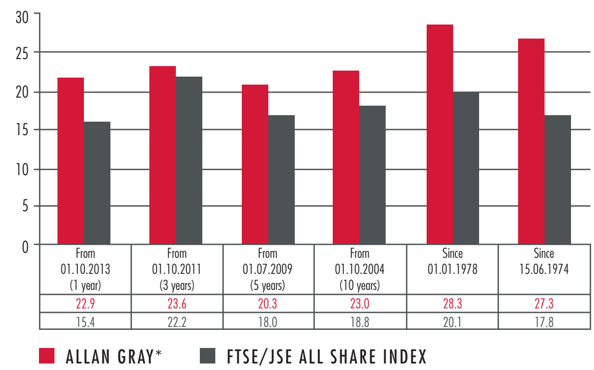
Note: There might be slight discrepancies in the totals due to rounding.

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 (from15.6)	-0.8	-0.8	0.0
1975	23.7	-18.9	42.6
1976	2.7	-10.9	13.6
1977	38.2	20.6	17.6
1978	36.9	37.2	-0.3
1979	86.9	94.4	-7.5
1980	53.7	40.9	12.8
1981	23.2	0.8	22.4
1982	34.0	38.4	-4.4
1983	41.0	14.4	26.6
1984	10.9	9.4	1.5
1985	59.2	42.0	17.2
1986	59.5	55.9	3.6
1987	9.1	-4.3	13.4
1988	36.2	14.8	21.4
1989	58.1	55.7	2.4
1990	4.5	-5.1	9.6
1991	30.0	31.1	-1.1
1992	-13.0	-2.0	-11.0
1993	57.5	54.7	2.8
1994	40.8	22.7	18.1
1995	16.2	8.8	7.4
1996	18.1	9.4	8.7
1997	-17.4	-4.5	-12.9
1998	1.5	-10.0	11.5
1999	122.4	61.4	61.0
2000	13.2	0.0	13.2
2001	38.1	29.3	8.8
2002	25.6	-8.1	33.7
2003	29.4	16.1	13.3
2004	31.8	25.4	6.4
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 30.09)	16.1	9.4	6.7

RETURNS ANNUALISED TO 30.09.2014



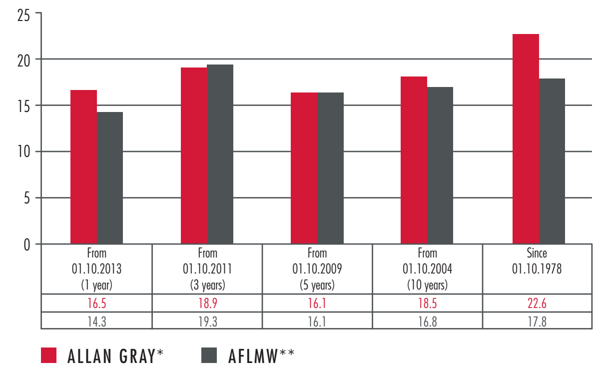
An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R164 987 772 by 30 September 2014. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R7 334 292. Returns are before fees.

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 30.09)	11.2	8.5	2.7

RETURNS ANNUALISED TO 30.09.2014



An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R17 652 875 by 30 September 2014. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R4 092 033. Returns are before fees.

* 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.
** 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 September 2014 is an estimate.
Note: Listed property included from 1 July 2002. Inward listed included from November 2008 to November 2011.

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

	ASSETS UNDER MANAGEMENT (R BILLION)	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	**40.6**	**01.10.1998**	**26.5** 18.7	**19.7** 18.8	**17.6** 18.0	**20.8** 22.2	**20.3** 15.4
Allan Gray-Orbis Global Equity Feeder Fund (AGOE) FTSE World Index	**14.8**	**01.04.2005**	**16.4** 14.1	**-** -	**19.6** 20.2	**35.0** 31.6	**21.9** 26.2
MEDIUM NET EQUITY EXPOSURE (40% - 75%)							
Allan Gray Balanced Fund (AGBF) Average of South African - Multi Asset - High Equity category (excl. AGBF)[1]	**101.1**	**01.10.1999**	**19.4** 14.1	**16.7** 14.6	**14.8** 13.6	**17.4** 16.5	**15.4** 11.4
Allan Gray-Orbis Global Fund of Funds (AGGF) 60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index	**12.5**	**03.02.2004**	**11.6** 11.4	**13.6** 13.0	**13.8** 16.5	**23.7** 23.3	**16.2** 20.9
LOW NET EQUITY EXPOSURE (0% - 40%)							
Allan Gray Stable Fund (AGSF) Daily interest rate of FirstRand Bank Limited plus 2%	**37.8**	**01.07.2000**	**13.3** 9.3	**11.8** 8.4	**9.4** 6.8	**10.1** 6.5	**10.2** 6.6
VERY LOW NET EQUITY EXPOSURE (0% - 20%)							
Allan Gray Optimal Fund (AGOF) Daily interest rate of FirstRand Bank Limited	**0.9**	**01.10.2002**	**8.1** 6.7	**7.3** 6.2	**5.6** 4.7	**5.8** 4.4	**10.4** 4.5
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO) Average of US$ Bank deposits and Euro Bank deposits	**1.6**	**02.03.2010**	**11.5** 8.5	**-** -	**-** -	**16.2** 11.0	**11.5** 9.0
NO EQUITY EXPOSURE							
Allan Gray Bond Fund (AGBD) JSE All Bond Index	**0.6**	**01.10.2004**	**9.2** 8.9	**9.2** 8.9	**9.2** 9.3	**8.2** 8.5	**6.3** 5.8
Allan Gray Money Market Fund (AGMF) Alexander Forbes Short-term Fixed Interest (STeFI) Composite Index[2]	**8.3**	**03.07.2001**	**8.2** 8.1	**7.5** 7.4	**6.0** 5.9	**5.5** 5.5	**5.8** 5.6

[1] Since inception to 31 January 2013 the benchmark was the market value-weighted average return of the funds in both the Domestic Asset Allocation Medium Equity and Domestic Asset Allocation Variable Equity sectors of the previous ASISA Fund Classification Standard, excluding the Allan Gray Balanced Fund.

[2] Since inception to 31 March 2003, the benchmark was the Alexander Forbes 3-Month Deposit Index. From 1 April 2003 to 31 October 2011 the benchmark was the Domestic Fixed Interest Money Market Collective Investment Scheme sector excluding the Allan Gray Money Market Fund.

ALLAN GRAY TOTAL EXPENSE RATIOS (TERS) FOR THE YEAR ENDING 30 SEPTEMBER 2014

	FEE FOR BENCHMARK PERFORMANCE	PERFORMANCE FEES	OTHER COSTS INCLUDING TRADING COSTS	VAT	TOTAL EXPENSE RATIO (TER)
Allan Gray Equity Fund	1.50%	0.22%	0.05%	0.24%	2.01%
Allan Gray-Orbis Global Equity Feeder Fund	1.50%	0.81%	0.22%	0.00%	2.53%
Allan Gray Balanced Fund	1.06%	0.34%	0.09%	0.14%	1.63%
Allan Gray-Orbis Global Fund of Funds	1.24%	0.54%	0.25%	0.00%	2.03%
Allan Gray Stable Fund	1.02%	0.48%	0.08%	0.16%	1.74%
Allan Gray Optimal Fund	1.00%	0.28%	0.12%	0.19%	1.59%
Allan Gray-Orbis Global Optimal Fund of Funds	1.00%	0.37%	0.24%	0.00%	1.61%
Allan Gray Bond Fund	0.25%	0.41%	0.02%	0.10%	0.78%
Allan Gray Money Market Fund	0.25%	N/A	0.01%	0.04%	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 30 September 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 SEPTEMBER 2014 (AFTER FEES)

	ASSETS UNDER MANAGEMENT (R BILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR
HIGH NET EQUITY EXPOSURE							
Orbis Global Equity Fund FTSE World Index	161.6	01.01.1990	**19.5** 13.6	**16.6** 14.1	**19.7** 20.2	**35.5** 31.9	**20.9** 25.8
Orbis SICAV Japan Equity (Yen) Fund Tokyo Stock Price Index	17.9	01.01.1998	**15.2** 8.6	**12.4** 9.7	**15.8** 14.6	**21.9** 22.4	**6.8** 13.9
Orbis SICAV Asia ex-Japan Equity Fund MSCI Asia ex-Japan Index	32.8	01.01.2006	**18.5** 15.6	- -	**17.7** 15.8	**32.0** 24.2	**23.4** 21.5
Allan Gray Africa ex-SA Equity Fund Standard Bank Africa Total Return Index	2.7	01.01.2012	**40.8** 21.8	- -	- -	- -	**35.4** 22.2
Allan Gray Australia Equity Fund S&P/ASX 300 Accumulation Index	8.1	04.05.2006	**17.4** 14.4	- -	**18.4** 15.4	**26.3** 23.7	**20.8** 11.8
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	8.5	01.01.2013	**35.1** 28.8	- -	- -	- -	**19.9** 20.6
LOW NET EQUITY EXPOSURE							
Allan Gray Australia Opportunity Fund Reserve Bank of Australia cash rate	0.6	01.07.2011	**18.7** 13.6	- -	- -	**16.6** 11.6	**13.1** 8.4
VERY LOW NET EQUITY EXPOSURE							
Orbis Optimal SA Fund-US$ Class US$ Bank Deposits	26.0	01.01.2005	**11.9** 9.4	- -	**10.2** 8.6	**17.5** 12.2	**13.0** 12.5
Orbis Optimal SA Fund-Euro Class Euro Bank Deposits	3.8	01.01.2005	**10.8** 8.4	- -	**7.6** 5.7	**15.3** 10.1	**7.1** 5.0

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

	ASSETS UNDER MANAGEMENT (R BILLION)[4]	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR
LOCAL PORTFOLIOS[5] (BEFORE LOCAL FEES)							
Domestic Equity Composite (minimum net equity 75% - 95%)	**66.6**	**01.01.1990**	**21.9**	**22.7**	**19.0**	**22.2**	**21.8**
Domestic Equity Pooled Portfolio (minimum net equity 95%)	**8.0**	**01.02.2001**	**23.9**	**22.9**	**19.7**	**23.0**	**22.3**
FTSE/JSE All Share Index			15.3/16.6	18.8	18.0	22.2	15.4
Domestic Balanced Composite	**23.4**	**01.01.1978**	**22.8**	**19.0**	**15.3**	**16.4**	**16.7**
Domestic Balanced Pooled Portfolio	**4.3**	**01.09.2001**	**20.0**	**19.2**	**15.7**	**16.8**	**16.8**
Mean of Alexander Forbes SA Large Manager Watch (Non-Investable)[6]			18.1/16.8	17.2	15.3	17.0	12.2
Domestic Stable Composite	**5.9**	**01.12.2001**	**13.9**	**12.9**	**9.2**	**8.8**	**11.2**
Domestic Stable Pooled Portfolio	**1.9**	**01.12.2001**	**14.2**	**13.2**	**9.2**	**8.8**	**11.2**
Alexander Forbes Three-Month Deposit Index plus 2%			10.2	9.4	7.8	7.4	7.5
GLOBAL PORTFOLIOS[5], LIMITED TO 25% FOREIGN EXPOSURE (BEFORE LOCAL, BUT AFTER FOREIGN FEES)							
Global Balanced Composite	**68.2**	**01.01.1978**	**22.6**	**18.5**	**16.1**	**18.9**	**16.5**
Global Balanced Pooled Portfolio	**32.7**	**01.09.2000**	**20.1**	**18.6**	**16.4**	**19.1**	**16.7**
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[6,7]			17.8/15.6	16.8	16.1	19.3	14.3
Global Stable Composite	**5.6**	**15.07.2004**	**13.7**	**13.3**	**10.5**	**11.5**	**11.4**
Global Stable Pooled Portfolio	**4.8**	**15.07.2004**	**13.7**	**13.3**	**10.6**	**11.6**	**11.4**
Alexander Forbes Three-Month Deposit Index plus 2%			9.4	9.4	7.8	7.4	7.5
Global Absolute Composite	**10.2**	**01.03.2004**	**17.2**	**17.7**	**11.6**	**12.3**	**13.7**
Global Absolute Pooled Portfolio	**3.5**	**01.03.2004**	**17.5**	**18.0**	**11.8**	**12.2**	**14.0**
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[6]			16.9	16.8	16.1	19.3	14.3
FOREIGN ONLY PORTFOLIOS[5] (AFTER FEES)							
Orbis Global Equity Fund	**161.6[8]**	**01.01.1990**	**19.5**	**16.6**	**19.7**	**35.5**	**20.9**
Orbis Global Equity Pooled Portfolio	**5.6**	**18.05.2004**	**16.0**	**16.5**	**19.6**	**35.4**	**20.7**
FTSE World Index			13.6/13.8	14.1	20.2	31.9	25.8
Foreign Balanced Composite[9]	**5.0**	**23.05.1996**	**15.1**	**13.4**	**13.6**	**23.6**	**14.4**
Foreign Balanced Pooled Portfolio	**1.0**	**23.01.2002**	**8.7**	**13.3**	**13.4**	**23.4**	**14.4**
60% MSCI World Index[10] and 40% JP Morgan Global Government Bond Index			12.2/6.9	12.9	16.4	23.2	20.3

[3] The composites not listed here include: Domestic Balanced Absolute, Domestic Balanced Low Equity, Domestic Balanced Stable Namibia, Domestic Equity MSCI SA, Domestic Equity Namibia, Domestic Money Market, Domestic Optimal, Domestic Tax Paying, Global Balanced High Foreign, Global Balanced Namibia 35% High Foreign, Global Tax Paying and Non Discretionary Foreign.
[4] The assets under management for institutional portfolios not listed here amount to R57.1bn.
[5] The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate.
[6] The return for the period ending September 2014 is an estimate as the relevant survey results have not yet been released.
[7] Since inception to 31 December 1997 the Consulting Actuaries Survey returns were used.
[8] The total assets under management for the Fund is shown, which includes institutional and retail clients that invest directly with Orbis.
[9] Since inception to 31 August 2001 the foreign carve-out returns of the Global Balanced Composite were used.
[10] 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 South African 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 offers institutional portfolios on a segregated and pooled basis and the Allan Gray Namibia Balanced Fund is available for institutions, retirements and individuals.
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.

NOTES

NOTES

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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