ALLANGRAY

QUARTERLY COMMENTARY 4

31 DECEMBER 2015

LONG-TERM THINKING IN ACTION

Over three decades ago, scientists across the globe started the Human Genome Project – a collaborative undertaking to decode the complete genetic blueprint of a human being.

The overarching goal was to map and sequence all existing genes – known as the genome – to provide researchers, scientists and medical practitioners with the tools to understand the genetic factors in human diseases. They believed that this would pave the way for new methods of diagnosis, treatment and prevention and lay the foundation for improving healthcare.

The benefits of the Human Genome Project are evident today. Not only did the project usher in a new era in medicine, but it also led to breakthroughs in the types of technology used to sequence DNA. This visionary thinking inspires us at Allan Gray. It demonstrates what can be achieved through rigorous research and adopting a long-term approach.

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ROB DOWER

COMMENTS FROM THE CHIEF OPERATING OFFICER

As set out in his letter on page 3, our founder, Allan WB Gray, and his family have transferred their controlling interests in Allan Gray and Orbis to the newly established Allan & Gill Gray Foundation. The Foundation has no owners in the traditional sense and is instead designed to exist in perpetuity and to serve two equally important purposes: to promote the commercial success, continuity and independence of Allan Gray and Orbis and to ensure that the distributable profits the Foundation receives from these firms are ultimately devoted exclusively to philanthropy.

Value-oriented, contrarian investment firms do better with committed shareholders

We are keen participants on your behalf in the public share markets, using their convenient rules and systems to invest in companies where we think we can generate a return for our clients. If there were no public markets for companies' shares our jobs would be much harder. We believe that public ownership is a good model for other businesses, so why do we attach so much value to our own private and independent ownership?

When you buy a bar of soap or a toaster or even a night in a hotel, you benefit (or not!) from your decision immediately and can react to it, either by buying more or by taking your business elsewhere. If you are a shareholder, or a potential shareholder, of a soap or hotel company you can see quite quickly how well the managers of those businesses are doing for their customers by trying out the product, looking at sales volumes, or analysing their latest financial results.

In our business this isn't always the case. Because of our investment philosophy, there can be long periods when we temporarily underperform in spite of making good long-term investment decisions. At times like these, it is critical that our shareholders understand and support our investment philosophy, while holding us accountable over the long term. A shareholder with low conviction in our philosophy observing underperformance and client outflows could be tempted to force a switch in that philosophy at exactly the wrong time. This would be a disaster for client returns and for our business.

Our shareholders hold management accountable for those things that drive long-term success: the quality of investment decisions, the long-term returns achieved for clients, the quality, accuracy and efficiency of our client service, our effectiveness in using technology to serve clients better and our ability to attract good people and grow and motivate them. All of these things add up to doing a good job for clients, which is visible in long-term investment returns and in client loyalty over time.

The new Foundation entrusts control of the firm to Orbis Allan Gray Limited, a holding company whose board consists of a majority of executives of Allan Gray and Orbis. The board also includes non-executive directors with power over critical issues of governance, for example remuneration. With perpetual ownership in strong hands, we can focus entirely on adding value for clients for generations to come.

I am sure some of you will have questions about the Foundation. Please refer to the frequently asked questions on page 4, where Tamryn Lamb provides further detail, and you can also read the Foundation's charter on our website.

The news about the Gray family's donation was an optimistic exception in an otherwise very strained few weeks for race relations and politics in South Africa. Hopefully our founder's generosity will inspire more of us to help those less fortunate with their progress, or to reach out between communities, or to make a difference in some other way. Our country has many difficult problems to solve and they won't solve themselves.

The new Allan & Gill Gray Foundation should not be confused with the 10-year old Allan Gray Orbis Foundation, which is making fantastic progress, as described by Zimkhita Peter in her update on page 19. We will continue to fund the education of hundreds of high potential scholars and students through our donations to the Allan Gray Orbis Foundation, and our empowerment partner E^2 stands ready to finance the entrepreneurial ventures of graduating Allan Gray fellows.

You play an important role in your own investment success

We are excited by the potential for the new Foundation to contribute to the common good at home and globally, but we are very mindful that what matters most to you and to our success is long-term investment returns.

The past year was a tough one for investors; between the falling oil price, the crumbling rand and political upheaval, the markets have been quite up-and-down. Our portfolios were not immune, but our flagship Allan Gray Balanced, Stable and Equity Funds ended 2015 well ahead of their respective benchmarks and of inflation and all are also now ahead of their benchmarks over one, three, five and ten year periods. Allan Gray investors are better at long-term investing than the average in our industry: thank you for staying the course. As you know, performance does not come in a straight line. Graeme Forster and John Christy explain this in more detail in the Orbis contribution.

It is helpful to think about choosing an investment manager as a long-term partner but some investors look to add extra value by switching. If you are tempted to try to switch out of unit trusts at a high and in at a low, bear in mind that the timing is very hard to get right. Rather than reacting to short-term performance, it is generally better to make changes to your investment in an unemotional and methodical fashion, in response to changes in your life stage and investment goals, or after a careful review. Wanita Isaacs offers some useful tips on how to approach your review in this quarter's Investing Tutorial.

Tax-free investing

I am pleased to announce that we are launching the Allan Gray Tax-Free Balanced Fund and it will be available in our new Tax-Free Investment Account, a savings product suitable if you are investing up to R2 500 a month and are saving for the long term. This Fund will be managed in broadly the same way as the Allan Gray Balanced Fund, but it has a fixed fee, to comply with legislation that stipulates that investors can only invest in fixed fees in tax-free savings and investment accounts.

Earl Van Zyl and Richard Carter look at the product features. You can learn more about our tax-free investment account and invest via our website. Note that if you are keen to benefit from tax savings in this account this year, you need to complete the investment process before 26 February.

I wish you all the best for the year ahead.

Kind regards

Rob Dower

A LETTER FROM OUR FOUNDER

31 DECEMBER 2015

Dear Client

In starting Allan Gray Investment Counsel in 1973, I was convinced that my passion for investing could be deployed to demonstrably enhance clients' savings and wealth and provide them with good value for their money. This was our raison d'être, our driving sense of purpose. We focused on earning and retaining the trust and confidence of our clients, leaving them to determine through their actions whether the firm would grow and prosper – or languish and fail. Our financial services were to be bought and not sold. Thus, if the firm prospered we would know we were making a positive difference to others in our daily work.

The same is true today. This client-centric sense of purpose continues to be our driving motivation at Orbis and Allan Gray – and we hope that it will endure in perpetuity. To ensure that control will remain indefinitely in the hands of those who best exemplify the ethos that has served our clients so well in the past, the newly established Allan & Gill Gray Foundation has been endowed with our family's controlling interests in the Orbis and Allan Gray groups. At the same time, we have been mindful to provide capacity to further increase executives' participation in the firms' profits as appropriate.

In particular, we believe it is absolutely essential for the firms' owners and key decision-makers to share the conviction necessary to stand behind our investment philosophy. For more than forty years, our experience has shown that taking a long-term perspective with a contrarian stance can produce demonstrably superior results – but only if one can withstand uncomfortably long periods of underperformance. Further, the perpetual nature of the Foundation empowers the executives to focus entirely on doing what is in the best long-term interests of clients, free from the short-term pressures that third-party ownership can bring. Indeed, all employees can be secure in knowing that nothing will change in this regard after the firms' founders pass on.

Another equally important purpose of the Foundation is to ensure that the fruits from its controlling interests in Orbis and Allan Gray are ultimately devoted entirely and exclusively to philanthropy in keeping with the family's long held intentions. We consider this both the right thing to do and a small but necessary contribution toward a society full of hope for all humanity. The free enterprise system has done so much for so many, and it behoves the few whom it rewards particularly well to help those less fortunate.

Rather than being a way of "giving back", I firmly believe that philanthropy is a natural extension of what Orbis and Allan Gray already do each and every day. Just as these firms strive to promote their clients' financial security and peace of mind, so too will the Allan & Gill Gray Foundation strive to make a positive contribution to the common good. It is this holistic view of business entrepreneurship and the symbiotic relationship amongst all stakeholders – clients, employees, owners, and society – that the Foundation seeks to preserve.

Needless to say it is you, our clients, who have made possible this thrilling voyage spanning four decades. Thank you most sincerely for your valued support. As planned, I am now passing on my remaining responsibilities at Orbis to focus on the Foundation. I do so with the utmost confidence that the management of Orbis and Allan Gray remains in strong and capable hands.

I am also enormously grateful to my wife Gill, my soulmate and partner for over 50 years; our three children, Trevor, Jennifer and William, whose enthusiastic participation and selflessness has made the Foundation possible; and their descendants, who will be indispensable to the Foundation's long-term success. So too will contributions from the wider family of all past, present and future colleagues at Orbis and Allan Gray whose shared sense of business purpose and excellence will continue to enhance your financial interests whilst also securing the Foundation's philanthropy. It is hoped that the people at each firm will take pride in seeing the impact that profits attributable to the Foundation's shareholdings are having in furthering the common good.

Yours sincerely

Allan W B Gray

TAMRYN LAMB

FREQUENTLY ASKED QUESTIONS ABOUT THE NEWLY CREATED ALLAN & GILL GRAY FOUNDATION

We have fielded many questions about the nature and objectives of Allan & Gill Gray Foundation (the Foundation). Tamryn Lamb offers some insights.

How does the new Foundation impact my investment at Allan Gray or Orbis?

There will be no change to the day-to-day management of these businesses, and no change in the way in which your investments are managed.

This move, initiated by the Gray family, entailed a transfer of their ownership in the businesses to a foundation. This transfer of ownership ensures that our businesses will remain privately owned by a committed shareholder who has a deep understanding of and shares our philosophy and values. This means that the executives of the businesses can focus entirely on what we have always done: adding value for clients for generations to come.

The Foundation has dual purposes: to lend continuity to and to promote the ongoing success of the businesses, while ultimately devoting the economic benefit from the Foundation's interests in those businesses exclusively to charitable, benevolent or philanthropic ventures. Only if we do well for our clients will the funding for philanthropy be secured.

When was the new Foundation established?

The Foundation was established in Guernsey in April 2015. The charter is available for you to read in the 'Our ownership' section of 'About us' on our website. Effective 1 January 2016, the Foundation holds a controlling interest in the Allan Gray and Orbis Groups.

Does the Foundation manage the Allan Gray Group?

No. The Foundation is a shareholder which entrusts control and oversight of the firm to Orbis Allan Gray Limited, a holding company whose board consists of a majority of executives of Allan Gray and Orbis and includes non-executive directors. The board of Orbis Allan Gray Limited is appointed by the Foundation.

Is there any impact on Allan Gray's BEE status?

No, this has no impact on Allan Gray's BEE status.

How is the Foundation governed?

The Foundation is governed by a council, currently comprising members of the Gray family. The council operates in a similar way to a board of directors. A guardian has also been appointed and her primary role is to ensure that the council carries out its functions in order to achieve the purposes of the Foundation.

Which philanthropic purposes will the Foundation support and is it possible to apply for funding?

The Foundation's policy, rather than grant giving, will be to engage in active strategic philanthropy. In due course, the Foundation intends to implement projects for the public benefit, which aim to meet unfilled needs, initially in communities in which Allan Gray and Orbis have offices. These philanthropic projects will invariably require their own dedicated staff and financial resources to bring their long-term objectives to fruition. Our experience over the past decade with the Allan Gray Orbis Foundation (www.allangrayorbis.org), is an example of such a project. We expect its success will encourage those in the new Foundation to follow a similar route.

How much of the dividends will be used for philanthropy?

In terms of its charter, the Foundation must ultimately devote all of the dividends it receives entirely and exclusively for philanthropic purposes. The charter does not require the Foundation to spend all of its income in any one year though.

Who are the beneficiaries of the Foundation?

The Foundation has no specific beneficiaries. It has been established with enduring, exclusively philanthropic purposes and it is intended to be perpetual in nature. Hopefully the philanthropic activities of the Foundation will make a difference and contribute to the common good as it chooses areas of focus over time. According to the charter, the Gray family is specifically excluded from economic benefit from the Foundation.

In which countries will the philanthropic endeavours take place?

The Foundation is not restricted by its charter and this will be a decision for the council to make.

Is there any impact on the cash flows to the Allan Gray Orbis Foundation?

It is important to clarify that Allan & Gill Gray Foundation is a new initiative and separate from the Allan Gray Orbis Foundation, which was established over 10 years ago. There will be no impact on the cash flows to the Allan Gray Orbis Foundation and Allan Gray will continue to donate 5% of its pre-tax profits in perpetuity to the Allan Gray Orbis Foundation. The Allan Gray Orbis Foundation will also continue to be managed as it has been previously.

How much of Allan Gray and Orbis did the Gray family own?

The family held a controlling interest (more than 50% of voting and economic interests) in both Allan Gray and Orbis. Minority shareholders in the Allan Gray group remain unchanged and include E^2 (our empowerment partner), a staff share trust and past and current executives.

How much in annual dividends will be donated to the Foundation?

We do not disclose these numbers. Our profits and dividends vary in line with the investment returns that we earn for our clients, so they can change significantly from year to year. If we continue to do a good job for our clients and retain their trust and confidence, we hope that the annual dividends from Allan Gray will run to hundreds of millions of rands.

After the transfer, what is Allan's role in the investment management businesses?

None. Allan stepped off the board of the Allan Gray Group in South Africa many years ago. He has also not been involved in the day-to-day running of Orbis (including the investment process) for many years. He is passing on his responsibilities at Orbis so that he can focus his time on the Foundation. This completes a succession plan that began more than a decade ago.

Tamryn is head of Orbis client servicing in South Africa (Orbis is Allan Gray's offshore investment partner). She joined Orbis in London in 2006 as an investment analyst, moving on to the Orbis Investment Counsellor Group in 2010 to focus on client- and consultant-facing responsibilities. She relocated to Cape Town in 2012 and joined institutional client services. Tamryn completed her BBusSc degree at UCT and is a qualified Chartered Accountant (SA) and Chartered Financial Analyst.

SANDY MCGREGOR

THE TRIUMPH OF THE BUREAUCRATS

There is a widespread lament that economic growth is disappointing. While demographics and structural problems are largely to blame, the increasing cost of interventions by governments in economies is also having a significantly adverse effect. Sandy McGregor discusses.

The response to the global financial crisis of 2008 has been a massive increase in regulation and legislation, much of which is having unintended negative consequences. These interventions are seldom subjected to cost-benefit analysis and compliance is becoming increasingly burdensome. There seems to be an inverse correlation between the size of government and economic growth: the bigger the share of government in the economy, the slower the economy grows. Rising productivity and efficiency play an important role in generating growth. Governments, with few exceptions, tend to use resources inefficiently. Transferring resources from the efficient private sector to inefficient government is bad for growth. Accordingly, it is unsurprising that since 2008 growth has disappointed.

The return of big government

These trends are clearly visible in South Africa but they are a global phenomenon. Prior to 1930 in most countries governments were, by modern standards, very small. The Great Depression of the 1930s and the subsequent World War changed all of that. Governments' share of GDP expanded rapidly until it ultimately became unsustainably large, and the global economy collapsed into a frightening combination of stagnation and inflation. In the 1970s voters in democracies became extremely disgruntled. Tax revolts became the norm. There followed a change in political leadership, which implemented a retreat from excessive regulation and put a brake on the continuing growth of government. More important, globalisation destroyed the power of the nation state to conduct economic policy without regard to economic logic. Inflation was brought under control and growth resumed. Between 1982 and 2008 the world experienced one of its strongest periods of economic expansion driven by new technologies, emerging markets and expanding global trade. This ended in 2008 for developed economies and 2012 for emerging markets. An age of big government has returned.

One of the reasons why big government is bad for growth is that mistaken interventions are not easily corrected. In the private sector a company which makes a mistake either loses money or goes out of business. Government is not subject to this discipline. Indeed, the instinct of bureaucracy is to respond to failure by arguing that it did not do enough. When violence fails, the military argue we need more violence. When the US Federal Reserve or the Bank of Japan's policy of quantitative easing (QE) failed to restore growth, the response was more QE. When legislation has unintended adverse consequences the response is not to repeal legislation, but rather to pass more laws. Flawed regulations breed more regulations. The process is endless.

Private sector under pressure

Ever-increasing legislation and regulation are placing a growing burden on the private sector. The regulatory environment has become so complex that it is beyond the ability of any individual to comprehend. At one time common laws defining how business should behave were simple, requiring integrity and honesty. Today thousands of lawyers are needed to implement the requirements of Byzantine legislation. As a business has to pass on its costs to its customers, the cost of regulation is borne by the consumer. A growing share of disposable income is going to fund this cost at the expense of what the consumer might regard as preferable.

The complexity of regulation is increasing. Two notorious examples are recent US laws regulating healthcare and banks. Both are about 10 000 pages long and have created employment for many thousands of lawyers. A common feature is that legislators understood little about the laws they were passing. In error, a speech praising US Senator Edward Kennedy was incorporated into the text of the healthcare legislation and no one picked it up. This is a good example of the poor vetting of complex legislation. The response of the bureaucracy to growing complexity is to encourage legislators to devolve their powers to government agencies. Increasingly broad powers are handed over to institutions which are subject to few democratic controls.

In history, devolved powers have often ended badly. The most notorious case is the German Third Reich, which was legally based on the Reichstag's decision in 1933 to grant Adolf Hitler far-ranging powers to address the nation's problems. The modern dilemma is that government has become too complex to operate without devolved powers.

Problems on home shores

We see all these alarming trends in South Africa. Government departments promote legislation without performing a cost-benefit analysis. The recent debacle regarding visas is a good example. It was obvious that the legislation would have a negative impact on tourism, the one business sector in South Africa which could potentially produce a lot of new jobs. The outcome was exactly what was expected by everyone except the Department of Home Affairs. Yet it took 15 months to fix this error. Part of the problem is that many government departments lack the skills to analyse the consequences of what they are doing. It is human nature to become defensive about error. In business a failure to admit error invites the risk of financial loss or bankruptcy. Government is not subject to these constraints and can persist in error.

"ONE OF THE REASONS WHY BIG GOVERNMENT IS BAD FOR GROWTH IS THAT MISTAKEN INTERVENTIONS ARE NOT EASILY CORRECTED."

More and more, as the role of government grows, the success or failure of nations will depend on the quality of their public service. Interestingly France, despite having a government constituting about 55% of GDP, manages to carry on without total disaster. Perhaps the reason why this is possible is that for generations France has recruited the best students from universities to become public servants. China is another example of a country where the best brains end up in government. Given our poor education system, which in itself is an example of uncontrolled government failure, it is difficult to replicate this in South Africa.

One concerning feature of the bureaucratic state is a global trend that the wages of government employees are growing faster than those in the private sector. In South Africa average wages of public servants now significantly exceed those in the private sector.

The recent big pay hike for public employees has pushed government finances into a crisis situation where tax increases are probable. Rising salaries have crowded out other expenditures and have eliminated the state's freedom to pursue other objectives. This is a manifestation of increasing bureaucratic power.

Where to from here?

The private sector adjusts to bureaucratic overreach by expanding into less regulated activities and jurisdictions. For example, increasing restrictions on the activities of banks is changing the structure of credit and investment markets. In response to an increasingly business-unfriendly environment, companies will relocate to more welcoming jurisdictions. As personal taxes rise to fund the government juggernaut, skills will migrate elsewhere. We all pay for the growth in the public sector not only directly through increased taxes, but also through higher costs of goods and services and slower growth and job creation. The burden placed on the economy by increasing government is an important contributor to the current economic malaise.

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.

ANDREW LAPPING

HOW THINGS CHANGE

Global mining businesses have had a remarkable fall from grace over the past 18 months. Talk has moved from a 20-year supercycle and commodity shortages to that of bankruptcy risk and the need for additional equity capital. Andrew Lapping examines the situation.

When an industry is booming, whether it is IT, banking or metals, it is very difficult to see any future other than a continuation of the trend. During the commodity boom, just about all the mining company management teams bought into the higher-for-longer theory and were supported by their shareholders. A good example of the extent to which management believed in the supercycle is BHP Billiton's progressive dividend policy, which sets out that BHP aims to pay a dividend that only goes up over time. Management went into denial about the fact that BHP is a cyclical commodity business and began to think the business had the stability of a Nestle or a Unilever. BHP has yet to cut its dividend but is now having to use debt to finance the payout – an unhealthy situation.

Investors who own mining companies during booms clearly believe the good times will continue, otherwise they would not own the shares. These bullish shareholders encourage management to borrow money for organic and acquisitive growth. Since investors who don't believe in the supercycle vote with their feet and don't own the shares, their dissenting voices that would otherwise balance a debate are not heard at all. The result is skewed and extremely poor capital allocation as management teams invest in marginal projects, buy back expensive shares and pay unsustainable dividends.

"THE INCENTIVE PRICE IS A MOVING TARGET AS CURRENCIES, COSTS, THE AVAILABILITY OF CAPITAL AND TECHNOLOGY CHANGE."

The mining industry is dealing with the fallout of the most recent cycle of this behaviour and will do so for a number of years to come.

The debt hangover

What seemed like a sustainable level of debt during the good times is now a burden. The ratio of net debt to cash flow before interest, tax and capital expenditure is perhaps the most common measure of debt sustainability. There are a couple of problems with this. Firstly, cash flow increases during times of super profits make the debt ratio appear low; as commodity prices fall, the ratio increases rapidly to a level that suddenly appears unsustainable, even if the actual amount of debt on the balance sheet does not change. The second problem is that interest, tax and capital are very real and necessary costs. A mining company requires capital investment just to stand still, let alone grow. A more appropriate number to look at when assessing a business and its debt level is cash flow after all costs, including maintenance capital, have been deducted, while inputting mid-cycle and trough commodity prices.

A second problem, one which management can do something about, is the overhang of high-cost mines that should never have been built. The additional supply weighs on prices, depressing returns for all mines and the high-cost mines generate cash losses for their owners. Instead of making a tough decision, unfortunately, management teams usually fall prey to the twin traps of denial and hope. They deny the asset is as bad as it seems and they hope to cut costs to a level where the mine makes money. Or they hope commodity prices recover soon to a level where the mine is profitable. The decision to close a mine is obviously very difficult: many jobs are lost and there are immediate cash costs to closing. It is also an active decision. Often managers choose to sustain operating losses for years on end rather than facing the immediate once-off pain of closure (see Ian Liddle's piece in Quarterly Commentary 3, 2015).

Forecast commodity prices at your peril

Chinese industrial commodity demand growth has slowed down or begun to decline off its unsustainable high base. Chinese demand rose to a level where China was consuming more than 50% of the world's iron ore, aluminium, copper and nickel. China is a large and populous country but 66% of global seaborne iron ore is a little excessive. As Chinese demand has slowed and the wave of new supply has reached the market, commodity prices have fallen sharply. Nickel is down to US$9 000/tonne from its peak of US$54 000 in 2007 and US$20 000 in May last year, copper is down 35% over the past 18 months and iron ore is down from US$136/tonne in January 2014 to US$39. Needless to say, the extent and speed of the price declines have shocked observers. Analysts spoke of iron ore not being able to fall below US$80/tonne, as that was the price at which 250 million tonnes of high-cost Chinese supply would leave the market; nobody mentions the Chinese high-cost supply anymore.

Forecasting commodity prices is extremely difficult as shown in **Graph 1**. Analysts build detailed supply and demand models that look to forecast the surplus or deficit into the future. These forecasts do not work, especially in the short term when commodity prices can do almost anything. Still, one can make an assessment of whether prices are unsustainably low or high. Prices are high (and likely to fall at some point) when even the high-cost mines are making good margins, the industry is attracting heavy capital investment and companies are buying back shares with 'excess' cash. Conversely, prices are low (and likely to rise at some point) when even good quality mines are making cash losses, the industry is forced to raise equity capital to fund losses, mines are closing and no projects are in the approval process.

Currently zinc, copper, nickel and oil prices look low. These four sectors have seen severe capital investment cuts, large groups of producers are making cash losses and even the low-cost producers are finding the going tough. For example, more than half of all nickel mines are cash-flow negative before maintenance capital and overheads at spot prices. Meanwhile, 61 of the 62 companies in the Bloomberg North America Independent Exploration and Production Index generated negative free cash flow over the past year.

Historically, investors have reaped rewards by investing in commodity producers when commodity prices are low. In time, low prices cause production to decline and the market to tighten to a level where prices are high enough to incentivise new supply. Other things being equal, low prices should also cause demand growth. Unfortunately it is not possible to know how long it will take for the market to rebalance, nor how quickly and to what level prices will rise. The incentive price (the long-term price corporates have to assume in order to invest in a new project and thus increase supply) is a moving target as currencies, costs, the availability of capital and technology change.

Investment opportunities

Given that the timing of any commodity price recovery is uncertain, it is important that equity investments are able to weather an extended downturn. Unfortunately these opportunities are few and far between.

The only large mining company with a healthy balance sheet and positive cash flow is BHP Billiton; the problem with BHP is that most of its profits come from the iron ore division where industry margins are still high relative to the past (the potential exit of high-cost Chinese supply, which may allow margins to remain high, is something we are looking at closely). Both Anglo American and Glencore have substantial debt burdens. Glencore is actively cutting its debt, has a cash generative trading business and is closing loss-making mines. Anglo American has sold some assets but is not addressing the high-cost structure as aggressively as we think it needs to, nor is the group looking to close high-cost mines. Anglo management also has a particularly poor capital allocation track record.

We are net buyers of mining shares, Glencore and African Rainbow Minerals being the two most significant, but we are cognisant of the risks.

How do we value these businesses given the difficulties in forecasting commodity prices?

Our approach is layered. We look at long-term margins, together with industry returns, and calculate the expected earnings if margins and returns go back to their long-term norms. In an industry like copper or oil, where production on existing assets declines relatively quickly, it is useful to consider the incentive price for new investments. To do this, we look at what recent projects have cost and adjust these costs to reflect the current environment (development costs are lower when commodity prices are low). We also consider the quality of deposits or reserves that may be developed. Of the known metal deposits, it is usually only the poor or high-cost ones that have not yet been developed – this puts the existing assets in a good position, as new mines tend to have higher cost structures. In spite of the current benign engineering costs, very few (zero) mining companies will approve a new nickel, zinc or copper mine development at current prices. If they had a decent ore deposit, they would have developed it when sentiment was positive and cash freely available.

After valuing a mining company using normal margins, replacement costs and cash flows at incentive prices, we only invest if the risk/reward profile is heavily skewed in our favour. It is important to have a substantial margin of safety when investing in mining businesses given the uncertainties, poor economics and generally weak management in the sector.

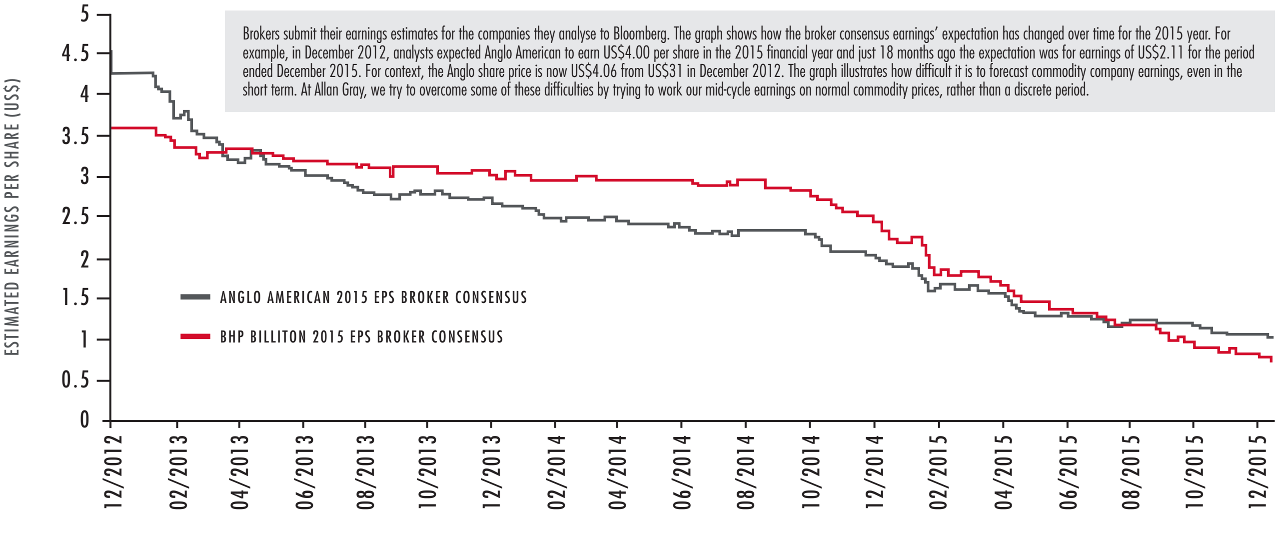
A spot commodity price gives almost no indication of what the price will be in a year's time or average over the next 10 years. Interestingly, many investors use the spot price as the basis for their long-term price assumptions; this is natural as we all tend to anchor our assumptions on the present situation. What is more surprising, is the extent to which equity prices move on a day-to-day basis with the spot commodity price. For example, if the oil price falls 2% on a day it is likely that most oil company share prices will fall at least 2%. If an oil company trades on 10 times annual earnings, the share price should discount the expected average oil price for the next 10 years. So the oil price move on a single day is totally irrelevant (well it does affect 1/3650th of the value, so a 2% lower price on a single day should move the share price by 2%/3650 or 0.00055%).

Share price volatility tells us that investors use the spot price as the main input into future prices. This can result in exceptional equity investment opportunities if, as investors, we can form a strong view on the long-term sustainable prices for a commodity. We can take advantage of the market's short termism and invest when the share price discounts an unsustainably low commodity price. This applies when spot prices are well above the sustainable price, as well as below.

The oil story

The position where we have the strongest sense of a sustainable price is oil. We believe an oil price of US$40 is totally unsustainable. Outside of Russia, Saudi Arabia, Iraq, Libya, Iran and the UAE (these six countries account for 38% of supply), the rest of the world cannot sustain production at these prices: in our view, prices need to be at least US$60 to maintain production. Fortunately in Sasol we can express this view. Even better, Sasol is cash-flow positive before growth capital at spot oil prices and, as of June 2015, was debt free, so time is on our side. The lower risk profile and favourable time dynamic of Sasol is why it is one of our largest shares, while the cash flow negative, indebted mining companies are far smaller positions.

GRAPH 1 **FORECASTING THE FUTURE IS VERY DIFFICULT**



Source: Bloomberg

Andrew joined Allan Gray in 2001 as a fixed interest trader and became an equity analyst in 2003. He was appointed as fixed interest portfolio manager in 2006 and deputy chief investment officer in May 2015. Andrew completed his BSc (Eng) and BCom at UCT and is a Chartered Financial Analyst.

GRAEME FORSTER AND JOHN CHRISTY

DISCIPLINE IS KEY

The Orbis Global Equity Fund (the Fund) lagged the MSCI and FTSE World Indices in 2015, extending a period of underperformance that began in early 2014. As frustrating as these periods may be, they are not inconsistent with superior long-term returns. Graeme Forster and John Christy, from our offshore partner Orbis, explain.

The path of the Orbis Global Equity Strategy's cumulative relative performance since inception is shown in **Graph 1**. In order to isolate the performance of our investment decisions, the returns are shown before fees. It is clear that performance does not come in a straight line and Global has underperformed meaningfully during many periods over its history. Some of these have been deep but short, with performance recovering quickly, while others were shallow but uncomfortably long. The one thing they all share in common is the temptation to conclude that something is 'broken'.

So where do we stand today?

Is this just one of those 'normal' periods of underperformance, or is it symptomatic of a deeper flaw in our investment approach? While we can't predict when performance will improve, we have been here before, and we remain confident that our investment philosophy works over the long term. Part of the reason for this overall assessment is the fact that we quite often see similar performance patterns at the individual stock level.

NetEase: discipline rewarded

As an illustration, consider the Chinese online gaming company NetEase, currently the portfolio's largest holding. After strong performance over the

GRAPH 1 **RELATIVE RETURNS DO NOT COME IN A STRAIGHT LINE**

CUMULATIVE GROSS RELATIVE RETURN OF THE ORBIS GLOBAL EQUITY STRATEGY VS THE FTSE WORLD INDEX

Source: Orbis

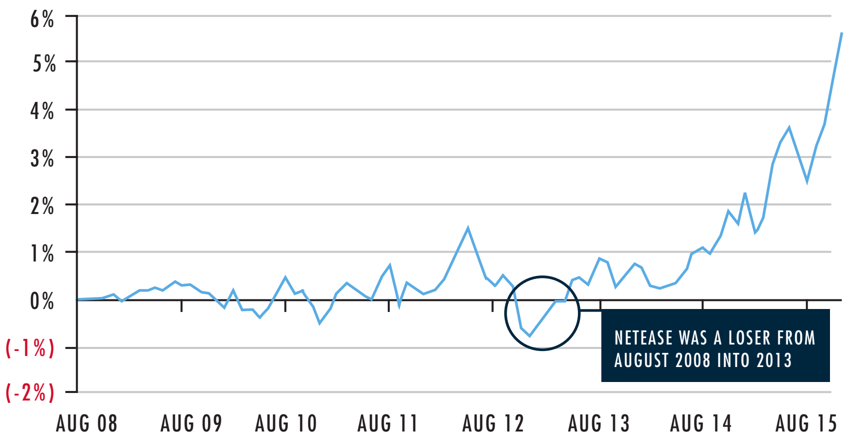
past 12 months, NetEase now ranks among the top 10 contributors to relative performance in the Fund's 26-year history. While it is obvious today that NetEase has been one of our best stock selections, it wasn't always apparent that it would add value. Indeed, as shown in **Graph 2**, NetEase detracted from the Fund's performance relative to the FTSE World Index from its initial purchase in August 2008 through early 2013 – a period of more than four years!

As the NetEase example shows, we can never know how long it will take for the stock market to share our view, if at all. Even when we correctly identify a mispriced stock, it can still produce disappointing returns for many years. Likewise, there will be instances when our analysis is wrong, yet the stock still goes on to perform well anyhow. In other words, we will experience our share of good and bad luck, all of which will contribute to the volatility of the Fund's short-term performance. In the case of NetEase, we spent years getting to know the company and developing the conviction necessary not only to stay the course but to build a larger position.

We continue to find NetEase attractive today. The business is highly cash generative and managed by an entrepreneurial founder, William Ding, who has a strong record of creating shareholder value. With a loyal customer base and the industry's largest research and development capability, we believe NetEase is positioned to deliver nearly 20% per annum earnings growth from both new and existing games as well as other businesses such as China's largest email service. NetEase should also continue to benefit

GRAPH 2 **PERFORMANCE DOES NOT COME IN A STRAIGHT LINE FOR INDIVIDUAL STOCKS EITHER**

CUMULATIVE CONTRIBUTION OF NETEASE TO ORBIS GLOBAL'S RELATIVE RETURNS VS THE FTSE WORLD INDEX



Source: Orbis

from a tailwind of greater internet penetration in China, which at 45% is still low relative to levels in developed markets. While there is no guarantee that the positive potential we see will translate into higher share prices, we are pleased that NetEase remains a part of the Fund.

Finding value in China's JD.com

Another beneficiary of increased Chinese internet penetration is JD.com — which we added earlier this year amid pessimism about Chinese shares. JD is the second largest e-commerce player in China and the country's largest retailer. While the stock market is concerned about the company's earnings visibility, we believe this is perfectly normal for a nascent e-commerce player and the investments that JD is making in its logistics and infrastructure network are a critical competitive edge. Trading at less than 0.5 times gross merchandise value, its valuation is well below levels that have proven to be extraordinary long-term buying opportunities for other rapidly growing retailers in the past such as Amazon and Walmart.

"...WITHSTANDING PERIODS OF UNCOMFORTABLE PERFORMANCE IS AN ESSENTIAL PART OF SUCCESSFUL INVESTING..."

US holdings: QUALCOMM and Motorola

Within developed markets, the Fund is positioned in selected shares that we believe will be able to deliver superior returns over the long term, despite generally elevated valuations. Examples here include QUALCOMM and Motorola Solutions, the Fund's two largest US holdings, which together account for 10% of the portfolio. At a time when valuations in the US look extended after a six-year rally following the global financial crisis, we are excited to be able to identify shares in which our investment thesis is highly company-specific, as is the case with both of these positions.

QUALCOMM develops and owns technology used in cellular communications, and is also a leading maker of semiconductors used in mobile phones and other electronic devices. The company collects royalties from manufacturers on nearly every 3G/4G handset sold globally. Over the past year, QUALCOMM has lagged world stock markets by 30% as the company has been hit with a confluence of negative events in both its semiconductor and licensing businesses. We believe, however, that these difficulties will prove temporary, and that the current adversity offers a compelling opportunity for us as contrarians with a long-term perspective. At just 11 times our estimate of 2016 earnings, the company trades well below the S&P 500's weighted median multiple of 17 times forward earnings. The shares are even more attractive considering that QUALCOMM's profit margins are at depressed levels and its net cash and other current assets are worth more than 25% of its market value.

While QUALCOMM's future growth rate will likely be slower relative to its history, we believe the share price currently reflects assumptions that are far too pessimistic. The company has a durable and predictable earnings stream, which we believe can grow at an above-average rate of about 10% per annum over our investment horizon, driven by increased smartphone sales, especially in emerging markets, and a dominant research and development capability. QUALCOMM can also generate meaningful revenues from previously untapped segments, including notebooks, servers, automobiles and the various network-connected items called the 'Internet of Things'.

Motorola Solutions is an under-appreciated, high-quality business. It is the dominant provider of communications systems for public safety networks and mission-critical applications such as law enforcement and emergency responders. While the market sees a company with dated radio technology that is struggling to grow, we see a company with an entrenched competitive position – about 80% market share – that can deliver revenue growth in the low-mid single digits across the cycle, while generating return on investment of greater than 30%. Although management has already significantly improved the profitability of the business through substantial cost reductions, we see ample opportunity to expand margins with further streamlining of the business. Additionally, we expect the company to return nearly US$5 billion to shareholders over the next four years, equivalent to about 35% of its current market capitalisation. Despite these attractive attributes, the shares trade at less than 12 times our estimate of next year's free cash flow, a substantial discount to the S&P 500's multiple of 20 times. Only time will tell whether the market's current pessimism or our current optimism is better founded.

Investing with conviction

As was the case with NetEase a few years ago, there are a number of large positions in the Fund that have detracted from relative performance since their inception, but in which we still have a great deal of excitement. That's not to say we are merely being 'patient' and hoping for the best. Quite the contrary, we are constantly challenging our assumptions about existing holdings — just as we did with NetEase — while actively looking for new opportunities.

We share your pain and frustration as many of these stock selections have yet to reflect the true value that we believe is inherent in the underlying businesses. But we have learned from our winners and losers alike that withstanding periods of uncomfortable performance is an essential part of successful investing and we are confident that our discipline at times like these will be rewarded over the long term.

Graeme joined Orbis in 2007 and is a member of Orbis' portfolio management and construction team in Bermuda. Before moving to Bermuda, Graeme spent five years in London where his primary responsibility was global quantitative equity research. He has a Master of Arts (Honours) in Mathematics (University of Oxford), Master of Research in Applied Mathematics (University of York), Doctor of Philosophy in Mathematical Epidemiology and Economics (University of Cambridge), and is a CFA charter holder.

John joined Orbis in 2010. He is a member of Orbis' team of investment counsellors with primary responsibility for institutional client and consultant communications, and in doing so he works closely with our investment professionals. He has previous experience in financial journalism as a senior editor at Forbes and Bloomberg News. John has a Bachelor of Arts in Economics from Fordham University, an MBA from Carnegie Mellon University and is a Chartered Financial Analyst.

ORBIS

RICHARD CARTER AND EARL VAN ZYL

PRESENTING THE ALLAN GRAY TAX-FREE BALANCED FUND

We are excited to announce the launch of the Allan Gray Tax-Free Balanced Fund. This new unit trust will be managed in broadly the same way as our flagship Balanced Fund but will have a different fee structure, and will allow you to take advantage of the tax-free legislation that came into effect on 1 March 2015. Richard Carter and Earl Van Zyl explain our offering in more detail.

The government introduced a new type of regulated investment account in March last year called a tax-free investment (a 'TFI'), with limits currently set at R30 000 per year and R500 000 over your lifetime. This is not the only regulated savings product that offers tax benefits (see **Table 1**), and we recognise that having another kind of vehicle and a unit trust with a different fee structure makes things more complicated for clients. However, with no tax on gains or income, and no restrictions on withdrawals, and fewer investment restrictions than retirement funds, even if you have more to invest over a year it probably makes sense to use a tax-free product for the first R30 000, if you are investing for the long term.

The Allan Gray Tax-Free Balanced Fund will be added to our range of unit trusts in February and you can access it through our new Allan Gray Tax-Free Investment Account.

Why a different fee structure?

In line with their general aim for simplicity, regulations require that all tax-free investment options charge fixed investment management fees. As long-time Allan Gray clients will know, we remain strong proponents of the benefits of performance fees, which mean clients pay lower fees when a unit trust underperforms and higher fees for outperformance. We think well-designed performance fees give clients better value for money. Yet, while we disagree with the outright ban on performance fees in TFI products, and have argued (and continue to do so) that clients should be allowed to make a choice for themselves on fees, we are also keen that our clients benefit from the new legislation. We are thus offering a TFI-qualifying Allan Gray unit trust that complies with the fee constraint.

Our Tax-Free Balanced Fund will have the same mandate and objectives as the existing Allan Gray Balanced Fund, and except for the different fee structure, we expect that over time it will offer clients a very similar return outcome. The investment management fee will be fixed on both the portions managed by Allan Gray and Orbis and will average out at a TER of approximately 1.57% including all investment management fees, trading costs, administration fees and VAT.

What are the potential tax savings?

In a basic unit trust investment (i.e. without a tax-free investment account), different types of tax may apply, depending on the underlying investments:

Dividend withholding tax, at 15% of the gross dividend, is usually deducted directly from the dividend amount and decreases the dividend return that the investor receives. No dividend withholding tax is deducted in a tax-free investment account.

In a basic unit trust investment, when you complete your tax return you are liable for tax on your interest income and capital gains (if they are above the tax thresholds of R23 800 and R30 000 respectively), calculated according to your marginal income tax rate. In a tax-free investment, each of these taxes is reduced to zero.

Graph 1 shows the potential value of an investment in the Allan Gray Balanced Fund through a regular unit trust account compared to a TFI account. We have illustrated the maximum tax benefit by assuming that every rand of growth in the regular unit trust falls above the current tax exclusion allowances for interest and capital gains. For this illustration we assumed 13.3% total return with the split between capital gains, interest and dividends based on our Balanced Fund's track record since inception, and that the investor contributes the maximum R2 500 per month for 15 years. In the first few years the benefit is small. But as long as the unit trust delivers a meaningful positive return, the TFI account will generate meaningful value compared to a regular unit trust investment over the very long term. The potential difference after 15 years could be as much as an extra 30% in value, driven by the value of compounding all gains tax free.

Are TFI products suitable for everyone?

There has been considerable debate among market commentators about the benefits or otherwise of TFI accounts versus retirement products such as retirement annuities (RAs) and other products, like endowments and unit trusts. These products meet different needs, with different costs and benefits associated with each. There is one important 'catch' with TFI: SARS will levy a 40% penalty on the value of contributions over and above the limits, which are for all tax-free savings and investment accounts you may have across different product providers. It will be your responsibility to make sure that you don't breach these limits if you are invested with more than one provider.

As withdrawals are allowed, but cannot be 'replaced' given the way the contribution limits have been designed, investors would benefit most from using their TFI allowance as part of their long-term savings plan, rather than for shorter-term goals like saving for an end-of-year holiday or for an 'emergency fund'.

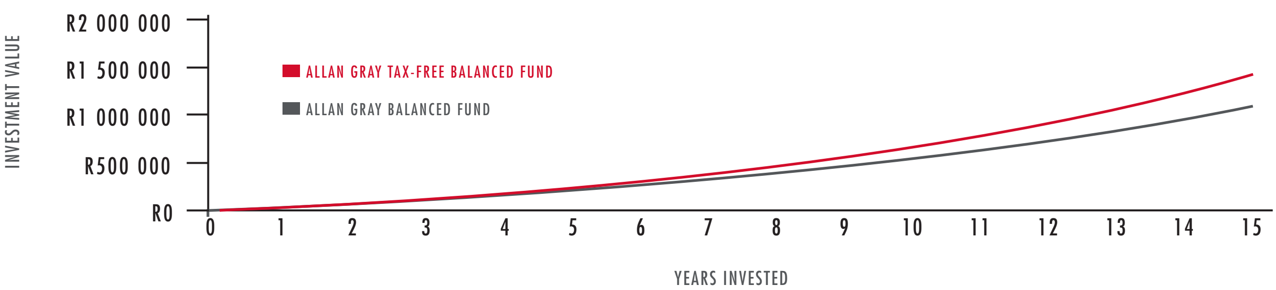
Table 1 highlights some characteristics to consider when evaluating TFI accounts against other product options. Choosing an appropriate product can be complex. A good, independent financial adviser can play an important role in helping you to make informed product choices.

"...WITH NO TAX ON GAINS OR INCOME, AND NO RESTRICTIONS ON WITHDRAWALS, AND FEWER INVESTMENT RESTRICTIONS THAN RETIREMENT FUNDS, EVEN IF YOU HAVE MORE TO INVEST OVER A YEAR IT PROBABLY MAKES SENSE TO USE A TAX-FREE PRODUCT FOR THE FIRST R30 000 IF YOU ARE INVESTING FOR THE LONG TERM."

Key features of the Allan Gray Tax-Free Investment Account

Allan Gray Life underwrites the product as a life policy to provide investors with all of the estate planning benefits but without the liquidity restrictions normally associated with a policy: you can access your investment at any time at no cost. Although it is underwritten by Allan Gray Life, when you invest in the Allan Gray Tax-Free Investment Account your investment returns come from the specific unit trusts you choose in the account. As discussed above, current legislation limits your investment options to unit trusts that charge fixed fees. The Allan Gray Tax-Free Balanced Fund is available as one of the underlying unit trust options in our TFI product, alongside our Money Market Fund and any of the fixed fee third party unit trusts available via our investment platform. Investors can consult our latest Allan Gray Tax-Free Investment Unit Trust List, available via our website or from our Client Service Centre, for a full list of available unit trusts. Consistent with all of our other products, the administration fees that we charge will be based on the

GRAPH 1 **VALUE OF INVESTING TAX FREE**



Source: Allan Gray.

same tiered pricing structure of our other platform products and will be determined based on the total value of all of your unit trust-based investments with us. There are no additional transaction fees and no penalties for withdrawing any portion of the investment value. You can manage your account at your convenience entirely online.

TABLE 1 **COMPARING FEATURES OF INVESTMENT PRODUCTS**

	TAX-FREE INVESTMENT	RETIREMENT ANNUITY	ENDOWMENT	UNIT TRUST
Are investments tax deductible?	No	Yes, up to certain maximums.	No	No
Are there annual investment limits?	R30 000 (may be adjusted over time).	No	No, but with conditions.	No
Are there lifetime investment limits?	R500 000 (may be adjusted over time).	No	No	No
What happens if I invest more than the limits?	You will have to pay a penalty of 40% of the amount you invest above the maximum, across all your accounts.	Not applicable	Your five-year restriction period will be extended if you invest more over one year than 120% of your investments over either of the past two years, into the same account.	Not applicable
How much tax will I pay?	Tax free	Investment return is tax free. Any money you take out at retirement may be taxed according to the retirement tax tables and your income in retirement will be taxed at your marginal tax rate at the time.	Taxed at 30%.	Taxed at your marginal rate (for income and capital gains exceeding current tax-free thresholds).
Can I have access to my money?	Yes	No withdrawals prior to retirement (except under specific circumstances) and limited access at retirement.	Yes, but with restrictions.	Yes
Are there any investment restrictions?	May not invest in direct shares or derivatives.	Must comply with the retirement fund investment limits.	None	None
Does the product offer estate planning benefits?	You may nominate beneficiaries when the TFI is a life policy. If you do, although estate duty is payable, there are no executor's fees.	You may nominate beneficiaries, although the trustees determine the allocation between your dependants and nominees. Not part of your estate.	You may nominate beneficiaries. If you do, although estate duty is payable, there are no executor's fees.	Forms part of your estate.

The deadline to invest in the 2015/2016 tax year is 14:00 on Friday, 26 February 2016. If you would like to invest in an Allan Gray Tax-Free Investment before the end of the tax year, please ensure that we receive your instructions and supporting documents before the deadline. Please note that EFTs will not be allowed – to ensure that you do not exceed the contribution limits in your Allan Gray Tax-Free Investment, we will collect the money from your bank account via a direct debit.

Richard joined Allan Gray in 2007 after working for several years in financial services in the UK. He is jointly responsible for the retail business, heading up product development and is also a director of Allan Gray Life. Richard completed his B Bus Sc degree at UCT and is a qualified actuary.

Earl joined Allan Gray in 2015 as a manager in product development. He is now a member of our technology team with a focus on developing Allan Gray's digital platform. Earl has an MBA from Chicago Booth at the University of Chicago and BSc (Aeronautical Engineering) from Wits University.

WANITA ISAACS

TIME TO REVIEW YOUR INVESTMENTS

The start of the year is a good time to do a financial health check: review your budget and your savings plan. Wanita Isaacs offers a simple framework for reviewing your investments.

Ask the right questions

Answer the following questions to assess if you are on track to meet your objectives and to check if you need to make any changes:

Are my investments meeting or beating my goals and their own benchmarks over the long term?
It is always best to measure progress against a yardstick, so it helps to start with a clear grasp of the level of return you need to meet your goals. This is your personal investment benchmark and will help you to assess if you should be pleased or disappointed with your return. The unit trusts you are invested in each have their own benchmarks, which represent their goals. Rather than looking at short-term performance, it is important to look at the return a unit trust has delivered over the time frame appropriate to that unit trust, and to your goals.

Have my investments performed as expected?
Investment managers set out the objective and investment strategy of unit trusts in their factsheets. You should assess your performance against your unit trust's stated mandate. For example, if you are invested in a low risk 'defensive' or 'stable' unit trust you would not expect to see big swings in performance (down or up). Depending on the objective and strategy, your investments could perform very differently from each other and from the market.

Has anything significant changed at the company (or companies) that I entrust with my investments?
When reviewing your investment, your biggest risk is that you decide to change managers based on short-term performance, switching out of your unit trust at the bottom and into one offered by a different manager at the top of a performance cycle. However, sometimes a unit trust or a management company loses a key person or changes ownership or in some other way changes a driver of their long-term track record. It is a good discipline to check each year whether your money is being looked after in the same way you originally intended.

Are there new opportunities or risks that I hadn't considered before?
It is impossible to time an investment in the short term but it is useful to consider from time to time whether markets are at a very low or high point and take on a bit more or less risk as a result.

Have my needs changed?
As you encounter life changes – like marriage, children and retirement – you may need to reconsider whether your investments are still appropriate to your changing needs. You may need to save more, change the mix of assets in your portfolio, or start drawing an income.

Interpreting your investment returns

The most convenient way to assess your investments is by looking at percentage growth, but this can be misleading for a number of reasons. As we discussed in the Investment Tutorial last quarter ('*What is outperformance?*' in Quarterly Commentary 3, 2015), this figure often does not account for the amount of risk that your investment manager took on to achieve the return. Risky investments that fluctuate significantly may not suit your temperament and may cause you to switch at the wrong moment.

Return is usually reported as either 'unannualised' (also called 'cumulative') or an 'annualised' percentage. Unannualised return is the percentage by which your investment has changed over a period. Annualised return, on the other hand, states the return as a percentage earned per year over the period. This makes it look as though the same percentage return was delivered every year. In reality, the actual return each year may have been a lot more or less than the reported annualised return.

Annualised return simplifies planning as it is easier to aim for a certain percentage return per year than to aim for an overall total return. However, if you chose an investment that is likely to fluctuate in the short to medium term, your return may be more or less than you need in any year, without this being cause for concern. The compound average over time should concern you more than the actual return in any particular year.

Perform a review once a year

Regularly reviewing your investments is important, but some investors check on their investments too frequently – sometimes daily! This is dangerous behaviour as you may be tempted to make changes in response to short-term performance, which could result in locking in losses. A temporary dip in the markets is only a loss on paper unless you disinvest.

Reviewing once a year is a good rule of thumb. While even a year is too short a time period to assess a medium to long-term investment, an annual review gives you a good picture of how your investments are performing and allows you to revisit your choices as you go along.

Checklist: How to approach your review

- Decide on the frequency of the reviews: the more volatile your investments, the less frequently you should review them.

- Review your long-term investment performance against your personal benchmark. Do your investments measure up?

- Be clear on your objectives. How have your needs changed and have you been through any major life changes that need to be addressed?

- Research the market to see if your investments have performed in line with, or better, than market conditions.

- Read your investment's factsheet to get insights into what your investment manager has done to achieve returns. Understand the return relative to the unit trust's objective and the market and make sure the manager's actions align with the stated investment strategy.

If you are uncomfortable doing this on your own, a financial adviser can help you through the process.

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.

ZIMKHITHA PETER

ALLAN GRAY ORBIS FOUNDATION UPDATE

'All talents explode with early identification and intentional development.' Jim Clifton

In 2014, international research organisation Gallup released 'Entrepreneurial StrengthsFinder', a book authored by its CEO Jim Clifton, which focuses on the challenge of identifying entrepreneurial talent. Zimkhitha Peter explains how the Allan Gray Orbis Foundation embodies Clifton's solution.

Society is very good at identifying certain types of talent – IQ, music and sporting ability, to name a few. If you are exceptionally gifted in these areas there are systems that will no doubt find you and allow those talents to be fully developed. However, this is not the case with the important societal ability of exceptional entrepreneurial talent. This is surprising when one considers that exceptional entrepreneurial talent is extremely rare: Gallup suggests that only five in 1 000 people have the aptitude for starting and growing a significant business while 20 in 1 000 have IQs high enough to be accepted into MENSA, the world's largest high IQ society.

Clifton's intriguing solution

Clifton has come up with the following solution:

1. Create a national early identification assessment system for entrepreneurial talent at the end of high school and university.

2. Place those with the highest potential from this assessment in an accelerated entrepreneurship development programme, including specialised curriculum, meaningful work experience and mentorship.

Clifton believes that the result of this solution would be game changing. On an annual basis a country would know the best potential entrepreneurs emerging from high school and have a clear pathway for them to translate that potential into achievement. A very specific human talent would have new value and respect, resulting in significant impact on the future of cities and nations. Let us indulge in a thought experiment. What if the Clifton solution had been implemented, not in response to the book, but 10 years earlier at the tip of Africa? Further, what if this experiment had led to a cumulative 43 000 applicants for the entrepreneurship development programme, resulting in the funding of 2 500 years of education and requiring 300 full-time equivalent years of labour to make it happen? What if the experiment was taken even further, not ending with education and skills development, but continuing to complete the cycle with the offer of dedicated venture capital funding? What would this look like?

The Foundation embodies Clifton's solution

Fortunately, we don't require much imagination to conduct this experiment as it is exactly what the Allan Gray Orbis Foundation has done over the past decade. This has resulted in over 750 beneficiaries – our 'assets under management' – honing their skills as high potential entrepreneurs across our pipeline from high school and university to their initial careers and enterprises.

Table 1 reflects the number of beneficiaries in the programme and the rest of this piece provides some highlights of the current impact of the Foundation's implementation of the Clifton solution.

TABLE 1 **NUMBER OF BENEFICIARIES IN THE PROGRAMME**

BENEFICIARY CATEGORY	PROGRAMME CATEGORY	NEW INTAKE FOR 2016 (ESTIMATED)	CUMULATIVE TOTAL IN 2016
Scholars (High school learners)	Scholarship	31	156
Candidate Fellows (University students)	Fellowship	100	305
Fellows (Graduates / Alumni)	Association	56	296
GRAND TOTAL			**757**

Source: Allan Gray Orbis Foundation

Allan Gray Scholarship

Our pool of youngest beneficiaries had an exciting year, with 36 of our Scholars, from Grade 8 to Matric, receiving top accolades at international, national, provincial and school level in the academic, sporting and cultural spheres.

Our older scholars made us proud through their various awards and recognition. A Grade 10 girl was one of two from her school chosen for the 2015 Roundtable Project in India. Another was chosen to play for the UCT Philharmonic Orchestra.

Allan Gray Fellowship

We were proud to have a Year Engage (First Year) Candidate Fellow serve as South African Ambassador at the G(irls)20 Summit, as well as representing the Youth Policy Committee at a Global Youth Consultation on the World Humanitarian Summit in Doha.

The First Prize in the *Best Innovative Student Business Idea Category* of the Western Cape Premier's Entrepreneurship Recognition Awards was won by a Candidate Fellow at Stellenbosch University. It was also encouraging to see our Candidate Fellows remain socially invested. For example, one Candidate Fellow designed an HIV/AIDS awareness game.

At the end of the year a Year Explore (Third Year) Candidate Fellow won the World Universities Debating Championship. Towards the end of the year we were pleased to learn that six Candidate Fellows and Fellows had been selected as Mandela Rhodes Scholars, bringing a total of 15 Mandela Rhodes Scholars chosen from the Fellowship over the last two years.

To learn more about the growth, changes and impact of our Candidate Fellows, please watch a video of our biggest annual event, the national Jamboree, at **www.youtube.com/user/AGOFoundation**

Association of Allan Gray Fellows

The Association now has over 20 full-time businesses started by Allan Gray Fellows, a portfolio which is currently conservatively valued at around R400 million, as well as over 200 professionals applying their entrepreneurial skills in a wide range of South African corporates and sectors. In June 2015 our Fellows tested the viability of their business ideas at the Startership Seminar – a national event where they have the opportunity to get practical advice about their businesses.

"ONLY FIVE IN 1 000 PEOPLE HAVE THE APTITUDE FOR STARTING AND GROWING A SIGNIFICANT BUSINESS."

Circle of Excellence

In September 2015 we hosted the sixth annual Circle of Excellence (COE) Principals Conference in Johannesburg at the African Leadership Academy, which brought together 55 leaders of our member schools. The COE celebrates and promotes the development of holistic educational excellence in South Africa. It was launched in 2008 to identify and celebrate the country's top 100 secondary schools for their excellence in education and their consistent delivery of successful candidates to the Fellowship. A complete list of the COE schools can be found at **www.allangrayorbis.org/circle-excellence-schools-list/**

Pitches for final funding took place at a seminar hosted by the Association's Venture Capital Fund, E^2.

The E^2 judges were impressed with the quality of this year's pitches, with Benjamin Shaw's *HouseMe* service taking the top prize. Ben's service is an innovative solution that optimises the rental market through an auction mechanism and other value-added services.

Finally, 17 intrepid Fellows travelled to Accra, Ghana in November 2015. Dubbed 'Expand your horizons', the purpose of the trip was to explore the Ghanaian entrepreneurial ecosystem and to foster learning and collaboration

Allan Gray Fellows – Class of 2015

in addressing challenges and unlocking opportunities around youth entrepreneurship.

A watershed year

As we reflect on 2015, a watershed year for the youth of our country, the year of #rhodesmustfall and #feesmustfall, Mr Allan Gray's words ring true: *'We should have great confidence in the ability of youth.'*

Indeed, we underestimate the youth at our peril. From every corner of the country, from crowded cities to rural communities, we remain honoured to be able to invest in and work with our young ambassadors of change, to be co-creators in their visions that focus on solutions rather than problems. And, as always, we can't help but be optimistic about what the future holds because the potential of these young citizens is identified early and intentionally developed.

Keep abreast of developments at the Foundation by subscribing to our blog at **www.allangrayorbis.org**

Allan Gray Orbis Foundation

Zimkhitha Peter is the Head of Programmes at the Allan Gray Orbis Foundation. She joined the Foundation in 2008 and holds a BCom Honours in Industrial Psychology (UNISA) and a Leadership Development qualification from Harvard Business School. She is passionate about seeing the Foundation as the centre of excellence in the development of entrepreneurial capabilities.

NOTES

ALLAN GRAY BALANCED AND STABLE FUND ASSET ALLOCATION AS AT 31 DECEMBER 2015

	BALANCED FUND % OF PORTFOLIO			STABLE FUND % OF PORTFOLIO		
	TOTAL	SA	FOREIGN*	TOTAL	SA	FOREIGN*
Net equities	60.0	45.4	14.6	24.7	17.8	6.9
Hedged equities	11.5	1.7	9.8	27.9	11.8	16.1
Property	1.7	0.9	0.8	2.6	1.8	0.8
Commodity-linked	5.5	5.5	0.0	5.0	5.0	0.0
Bonds	12.5	10.9	1.6	12.1	10.7	1.4
Money market and bank deposits	8.8	7.1	1.7	27.7	25.2	2.5
TOTAL	**100.0**	**71.5**	**28.5**	**100.0**	**72.3**	**27.7**

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 31 DECEMBER 2015

SECURITY (RANKED BY SECTOR)	MARKET VALUE (R MILLION)	% OF FUND	FTSE/JSE ALSI WEIGHT (%)
SOUTH AFRICA	**32 786**	**86.5**	
SOUTH AFRICAN EQUITIES	**31 689**	**83.6**	
RESOURCES	**7 369**	**19.4**	**15.1**
Sasol	3 636	9.6	
Sappi	814	2.1	
Goldfields	385	1.0	
Positions less than 1%	2 533	6.7	
FINANCIALS	**9 459**	**25.0**	**22.2**
Standard Bank	2 212	5.8	
Old Mutual	2 050	5.4	
Reinet Investments SCA	1 370	3.6	
Investec	910	2.4	
Rand Merchant Insurance[1]	590	1.6	
Nedbank	337	0.9	
Positions less than 1%	1 989	5.2	
INDUSTRIALS	**14 675**	**38.7**	**62.7**
British American Tobacco	3 314	8.7	
SABMiller	1 930	5.1	
Naspers[2]	1 801	4.8	
Remgro	1 317	3.5	
Kap Industrial	549	1.4	
Super Group	496	1.3	
Aspen Pharmacare	420	1.1	
Netcare	370	1.0	
Positions less than 1%	4 478	11.8	
OTHER SECURITIES	**187**	**0.5**	
Positions less than 1%	187	0.5	
COMMODITY-LINKED SECURITIES	**727**	**1.9**	
New Gold Platinum ETF	371	1.0	
Positions less than 1%	356	0.9	
MONEY MARKET AND BANK DEPOSITS	**370**	**1.0**	
FOREIGN EX-AFRICA	**4 826**	**12.7**	
EQUITY FUNDS	**3 505**	**9.2**	
Orbis Global Equity Fund	3 505	9.2	
MONEY MARKET AND BANK DEPOSITS	**1 321**	**3.5**	
AFRICA EX-SA	**295**	**0.8**	
TOTALS	**37 907**	**100.0**	

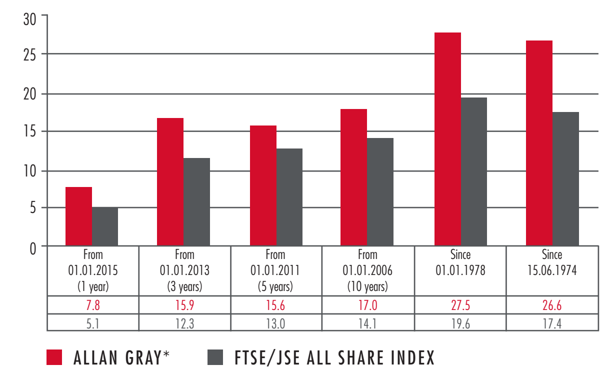
Note: There might be slight discrepancies in the totals due to rounding. Positions less then 1% include positions that are individually less than 1% of total JSE-listed equities, property and community-linked instruments held by the Fund.
[1] Including positions in Rand Merchant Insurance stub certificates.
[2] Including positions in Naspers stub certificates.

INVESTMENT TRACK RECORD – SHARE RETURNS

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

PERIOD	ALLAN GRAY*	FTSE/JSE ALL SHARE INDEX	OUT/UNDER-PERFORMANCE
1974 (from 15.6)	- 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	16.2	10.9	5.3
2015	7.8	5.1	2.7

RETURNS ANNUALISED TO 31.12.2015



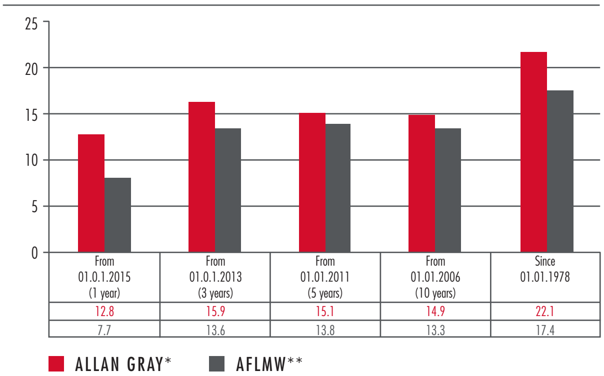
An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R178 061 805 by 31 December 2015. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R7 815 097. Returns are before fees.

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	10.3	10.3	0.0
2015	12.8	7.7	5.1

RETURNS ANNUALISED TO 31.12.2015



An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R19 750 938 by 31 December 2015. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R4 479 943. 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 December 2015 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 31 DECEMBER 2015 (NET OF FEES)

	ASSETS UNDER MANAGEMENT (R BILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR	HIGHEST ANNUAL RETURN[4]	LOWEST ANNUAL RETURN[4]
HIGH NET EQUITY EXPOSURE (100%)									
Allan Gray Equity Fund (AGEF)	37.9	01.10.1998	**24.8**	**14.3**	**13.6**	**13.6**	**6.3**	**125.8**	**– 20.7**
Average of South African - Equity - General category (excl. Allan Gray Funds)[1]			17.4	13.8	12.3	11.2	2.2	73.0	– 37.6
Allan Gray-Orbis Global Equity Feeder Fund (AGOE)	16.3	01.04.2005	**16.7**	**15.6**	**26.4**	**34.5**	**29.5**	**78.2**	**– 29.7**
FTSE World Index			15.7	15.4	27.0	33.4	33.2	54.2	– 32.7
MEDIUM NET EQUITY EXPOSURE (40% - 75%)									
Allan Gray Balanced Fund (AGBF)	111.1	01.10.1999	**18.6**	**13.3**	**14.0**	**14.9**	**12.3**	**46.1**	**– 8.3**
Average of South African - Multi Asset - High Equity category (excl. AGBF)[2]			13.7	11.6	12.1	12.4	8.4	41.9	– 16.7
Allan Gray-Orbis Global Fund of Funds (AGGF)	13.1	03.02.2004	**12.6**	**14.2**	**22.9**	**28.6**	**31.1**	**55.6**	**– 13.7**
60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index			13.0	15.1	24.0	28.0	32.8	38.8	– 17.0
LOW NET EQUITY EXPOSURE (0% - 40%)									
Allan Gray Stable Fund (AGSF)	36.4	01.07.2000	**13.1**	**10.7**	**10.9**	**11.8**	**13.7**	**23.3**	**3.3**
Daily interest rate of FirstRand Bank Limited plus 2%			9.2	8.3	6.7	6.7	7.1	14.6	6.2
VERY LOW NET EQUITY EXPOSURE (0% - 20%)									
Allan Gray Optimal Fund (AGOF)	1.3	01.10.2002	**8.1**	**7.4**	**6.4**	**8.6**	**6.9**	**18.1**	**1.6**
Daily interest rate of FirstRand Bank Limited			6.6	6.1	4.6	4.6	5.0	11.9	4.1
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO)	1.5	02.03.2010	**13.4**	**–**	**19.2**	**23.1**	**32.2**	**39.6**	**– 8.4**
Average of US$ bank deposits and euro bank deposits			11.4	–	16.7	19.0	28.3	28.3	– 7.8
NO EQUITY EXPOSURE									
Allan Gray Bond Fund (AGBD)	0.5	01.10.2004	**8.3**	**7.6**	**6.6**	**3.5**	**-1.2**	**18.0**	**– 1.2**
JSE All Bond Index (total return)			7.9	7.0	6.1	2.1	-3.9	21.2	– 3.9
Allan Gray Money Market Fund (AGMF)	12.0	03.07.2001	**8.1**	**7.4**	**5.8**	**6.0**	**6.6**	**12.8**	**5.2**
Alexander Forbes Short-term Fixed Interest (STeFI) Composite Index[3]			8.0	7.3	5.7	5.8	6.5	13.3	5.2

[1] Since inception to 28 February 2015 the benchmark was the FTSE/JSE All Share Index including income.
[2] 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.
[3] 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.
[4] This is the highest or lowest consecutive 12-month return since inception. All rolling 12-month figures for the Fund and the benchmark are available from our Client Service Centre on request.

ALLAN GRAY TOTAL EXPENSE RATIOS AND TRANSACTION COSTS FOR THE PERIOD ENDING 31 DECEMBER 2015

	FEE FOR BENCHMARK PERFORMANCE	PERFORMANCE FEES	OTHER COSTS EXCLUDING TRANSACTION COSTS	VAT	TOTAL EXPENSE RATIO	TRANSACTION COSTS (INCL. VAT)	TOTAL INVESTMENT CHARGE
Allan Gray Equity Fund	1.39%	0.69%	0.01%	0.28%	2.37%	0.05%	2.42%
Allan Gray-Orbis Global Equity Feeder Fund	1.49%	0.47%	0.05%	0.00%	2.01%	0.13%	2.14%
Allan Gray Balanced Fund	1.07%	0.22%	0.02%	0.13%	1.44%	0.07%	1.51%
Allan Gray-Orbis Global Fund of Funds	1.27%	0.26%	0.06%	0.00%	1.59%	0.14%	1.73%
Allan Gray Stable Fund	1.03%	0.37%	0.02%	0.15%	1.57%	0.06%	1.63%
Allan Gray Optimal Fund	1.00%	0.47%	0.02%	0.21%	1.70%	0.12%	1.82%
Allan Gray-Orbis Global Optimal Fund of Funds	1.00%	- 0.01%	0.07%	0.00%	1.06%	0.14%	1.20%
Allan Gray Bond Fund	0.25%	0.22%	0.02%	0.07%	0.56%	0.00%	0.56%
Allan Gray Money Market Fund	0.25%	N/A	0.01%	0.04%	0.30%	0.00%	0.30%

The annual management fees charged by both Allan Gray and Orbis (if applicable) are included in the total investment charge. The total expense ratio (TER) is the annualised percentage of the Fund's average assets under management that has been used to pay the Fund's actual expenses over the past three years. The TER includes the annual management fees that have been charged (both the fee at benchmark and any performance component charged), VAT and other expenses like audit and trustee fees. Transaction costs (including brokerage, Securities Transfer Tax [STT], STRATE and FSB Investor Protection Levy and VAT thereon) are shown separately. Transaction Costs are a necessary cost in administering the Financial Product and impacts Financial Product returns. They should not be considered in isolation as returns may be impacted by many other factors over time including market returns, the type of Financial Product, the investment decisions of the investment manager and the TER. Since Fund returns are quoted after the deduction of these expenses, the TER and Transaction costs should not be deducted again from published returns. As unit trust expenses vary, the current TER cannot be used as an indication of future TERs. A higher TER ratio does not necessarily imply a poor return, nor does a low TER imply a good return. Instead, when investing, the investment objective of the Fund should be aligned with the investor's objective and compared against the performance of the Fund. The TER and other funds' TERs should then be used to evaluate whether the Fund performance offers value for money. The sum of the TER and Transaction costs is shown as the Total Investment Charge.

FOREIGN DOMICILED FUNDS ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 31 DECEMBER 2015 (NET OF FEES)

	ASSETS UNDER MANAGEMENT (R BILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR	HIGHEST ANNUAL RETURN[4]	LOWEST ANNUAL RETURN[4]
HIGH NET EQUITY EXPOSURE									
Orbis Global Equity Fund	**107.8**	**01.01.1990**	**19.4**	**15.9**	**26.4**	**33.9**	**29.7**	**87.6**	**- 47.5**
FTSE World Index			14.3	15.4	27.0	33.3	33.1	54.2	- 46.2
Orbis SICAV Japan Equity (Yen) Fund	**25.6**	**01.01.1998**	**16.4**	**12.7**	**26.6**	**33.6**	**50.2**	**94.9**	**- 40.1**
Tokyo Stock Price Index			10.4	10.5	24.9	35.9	50.2	91.0	- 46.4
Orbis SICAV Asia Ex-Japan Equity Fund	**40.6**	**01.01.2006**	**18.3**	**-**	**22.6**	**26.1**	**27.8**	**58.6**	**- 34.2**
MSCI Asia Ex-Japan Index			16.2	-	18.5	21.8	22.6	60.1	- 39.7
Allan Gray Africa ex-SA Equity Fund	**3.1**	**01.01.2012**	**18.4**	**-**	**-**	**11.1**	**– 9.0**	**65.7**	**- 24.3**
Standard Bank Africa Total Return Index			7.2	-	-	0.8	– 8.1	33.5	- 29.4
Allan Gray Australia Equity Fund	**8.8**	**04.05.2006**	**15.8**	**-**	**17.7**	**18.6**	**13.9**	**99.5**	**- 55.4**
S&P/ASX 300 Accumulation Index			14.9	-	18.5	19.2	23.9	55.6	- 45.1
MEDIUM NET EQUITY EXPOSURE									
Orbis SICAV Global Balanced Fund	**26.2**	**01.01.2013**	**29.2**	**-**	**-**	**-**	**30.4**	**54.4**	**2.3**
60% MSCI World Index with net dividends reinvested and 40% JP Morgan Global Government Bond Index			28.5	-	-	-	33.2	40.2	7.1
LOW NET EQUITY EXPOSURE									
Allan Gray Australia Opportunity Fund	**1.1**	**01.07.2011**	**17.6**	**-**	**-**	**15.3**	**23.0**	**32.7**	**- 6.1**
Reserve Bank of Australia cash rate			14.0	-	-	12.1	23.0	25.4	- 5.3
VERY LOW NET EQUITY EXPOSURE									
Orbis Optimal SA Fund-US$ Class	**18.0**	**01.01.2005**	**13.2**	**12.7**	**20.7**	**25.3**	**36.8**	**48.6**	**- 15.7**
US$ Bank Deposits			11.6	11.0	18.8	22.7	35.4	57.9	- 25.6
Orbis Optimal SA Fund-Euro Class	**9.6**	**01.01.2005**	**10.9**	**11.5**	**16.6**	**18.9**	**24.2**	**44.1**	**- 19.2**
Euro Bank Deposits			9.1	10.1	14.3	15.2	21.2	40.2	- 20.9

[4] This is the highest or lowest consecutive 12-month return the Fund has experienced since inception, along with the benchmark performance for the corresponding period. All rolling 12-month figures for the Fund and the benchmark are available from our Client Service Centre on request.

SOUTH AFRICAN INSTITUTIONAL PORTFOLIOS[5] ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 31 DECEMBER 2015

	ASSETS UNDER MANAGEMENT (R BILLION)[6]	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR
LOCAL PORTFOLIOS[7] (BEFORE LOCAL FEES)							
Domestic Equity Composite (minimum net equity 75% - 95%)	**59.5**	**01.01.1990**	**21.0**	**16.5**	**14.1**	**14.3**	**5.2**
Domestic Equity Pooled Portfolio (minimum net equity 95%)	**5.8**	**01.02.2001**	**22.1**	**16.7**	**14.6**	**15.0**	**5.2**
FTSE/JSE All Share Index			14.8/15.6	14.1	13.0	12.3	5.1
Domestic Balanced Composite	**15.1**	**01.01.1978**	**22.2**	**14.3**	**12.0**	**11.6**	**6.3**
Domestic Balanced Pooled Portfolio	**2.6**	**01.09.2001**	**18.7**	**14.5**	**12.3**	**11.6**	**6.2**
Mean of Alexander Forbes SA Large Manager Watch (Non-Investable)[8]			17.6/15.5	12.7	10.8	9.1	2.0
Domestic Stable Composite	**5.2**	**01.12.2001**	**13.4**	**11.1**	**8.6**	**9.0**	**9.1**
Domestic Stable Pooled Portfolio	**1.2**	**01.12.2001**	**13.7**	**11.2**	**8.6**	**9.1**	**9.3**
Alexander Forbes Three-Month Deposit Index plus 2%			10.0	9.2	7.6	7.7	8.2
GLOBAL PORTFOLIOS[7], LIMITED TO 25% FOREIGN EXPOSURE (BEFORE LOCAL, BUT AFTER FOREIGN FEES)							
Global Balanced Composite	**79.0**	**01.01.1978**	**22.1**	**14.9**	**15.1**	**15.9**	**12.8**
Global Balanced Pooled Portfolio	**14.2**	**01.09.2000**	**19.2**	**15.0**	**15.3**	**16.0**	**12.9**
Global Balanced (RRF) Portfolio[13]	**23.4**	**01.09.2000**	**19.2**	**15.0**	**15.3**	**16.0**	**12.8**
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[8,9]			17.4/14.9	13.3	13.8	13.6	7.7
Global Stable Composite	**6.9**	**15.07.2004**	**13.4**	**11.8**	**11.9**	**12.8**	**14.6**
Global Stable Pooled Portfolio	**6.1**	**15.07.2004**	**13.4**	**11.8**	**11.9**	**12.8**	**14.5**
Alexander Forbes Three-Month Deposit Index plus 2%			9.3	9.2	7.6	7.7	8.2
Global Absolute Composite	**10.9**	**01.03.2004**	**16.4**	**14.2**	**12.1**	**13.5**	**12.3**
Global Absolute Pooled Portfolio	**3.5**	**01.03.2004**	**16.7**	**14.4**	**12.0**	**13.3**	**11.6**
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[8]			15.9	13.3	13.8	13.6	7.7
FOREIGN ONLY PORTFOLIOS[7] (AFTER FEES)							
Orbis Global Equity Fund[10]	**107.8**	**01.01.1990**	**19.4**	**15.9**	**26.4**	**33.9**	**29.7**
Orbis Global Equity Pooled Portfolio	**0.8**	**18.05.2004**	**16.3**	**15.8**	**26.3**	**33.8**	**29.6**
FTSE World Index			14.3/15.3	15.4	27.0	33.3	33.1
Foreign Balanced Composite[11]	**6.2**	**23.05.1996**	**15.4**	**13.7**	**22.0**	**26.7**	**30.2**
Foreign Balanced Pooled Portfolio	**0.7**	**23.01.2002**	**9.6**	**13.6**	**21.8**	**26.5**	**30.2**
60% of the MSCI World Index[12] and 40% of the JP Morgan Global Government Bond Index			13.1/8.7	15.0	23.7	27.6	32.5

PERFORMANCE AS CALCULATED BY ALLAN GRAY

[5] 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.
[6] The assets under management for institutional portfolios not listed here amount to R73.8bn.
[7] The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate.
[8] The return for the period ending December 2015 is an estimate as the relevant survey results have not yet been released.
[9] Since inception to 31 December 1997 the Consulting Actuaries Survey returns were used.
[10] The total assets under management for the Fund is shown, which includes institutional and retail clients that invest directly with Orbis.
[11] Since inception to 31 August 2001 the foreign carve-out returns of the Global Balanced Composite were used.
[12] Morgan Stanley Capital International All Country World Index.
[13] The returns prior to 1 August 2015 are those of the Allan Gray Life Global Balanced Portfolio.

IMPORTANT INFORMATION FOR INVESTORS

Allan Gray Unit Trust Management (RF) Proprietary Limited (the 'Management Company') is registered as a management company under the Collective Investment Schemes Control Act 45 of 2002. Allan Gray Proprietary Limited (the 'Investment Manager'), an authorised financial services provider, is the appointed investment manager of the Management Company and is a member of the Association for Savings & Investment South Africa (ASISA). Collective Investment Schemes in Securities (unit trusts or funds) are generally medium- to long-term investments. Except for the Allan Gray Money Market Fund, where the Investment Manager aims to maintain a constant unit price, the value of units may go down as well as up. Past performance is not necessarily a guide to future performance. The Management Company does not provide any guarantee regarding the capital or the performance of its unit trusts. Funds may be closed to new investments at any time in order for them to be managed according to their mandates. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending.

PERFORMANCE

Performance figures are for lump sum investments with income distributions reinvested. Actual investor performance may differ as a result of the investment date, the date of reinvestment and dividend withholding tax. Movements in exchange rates may also be the cause of the value of underlying international investments going up or down. Different classes of units apply to the Equity, Balanced, Stable and Optimal funds only and are subject to different fees and charges. Unit trust prices are calculated on a net asset value basis, which is the total market value of all assets in the Fund including any income accruals and less any permissible deductions from the Fund, divided by the number of units in issue. Forward pricing is used and fund valuations take place at approximately 16:00 each business day. Purchase and redemption requests must be received by 14:00 each business day to receive that day's price. Unit trust prices are available daily on www.allangray.co.za. Permissible deductions may include management fees, brokerage, Securities Transfer Tax (STT), auditor's fees, bank charges and trustee fees. A schedule of fees, charges and maximum commissions is available on request from the Management Company.

BENCHMARKS

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UNDERSTANDING THE FUNDS

Investors must make sure that they understand the nature of their choice of funds and that their investment objectives are aligned with those of the Fund/s they select.

A feeder fund is a unit trust that invests in another single unit trust which charges its own fees. A fund of funds is a unit trust that invests in other unit trusts, which charge their own fees. Allan Gray does not charge any additional fees in its feeder fund or funds of funds.

The Allan Gray Money Market Fund is not a bank deposit account. The Fund aims to maintain a constant price of 100 cents per unit. The total return an investor receives is made up of interest received and any gain or loss made on instruments held by the Fund. While capital losses are unlikely, they can occur if, for example, one of the issuers of an instrument defaults. In this event investors may lose some of their capital. To maintain a constant price of 100 cents per unit, investors' unit holdings will be reduced to the extent of such losses. The yield is calculated according to the applicable ASISA Standards. Excessive withdrawals from the Fund may place it under liquidity pressure; if this happens withdrawals may be ring-fenced and managed over a period of time.

ADDITIONAL INFORMATION FOR RETIREMENT FUND MEMBERS AND INVESTORS IN THE LIVING ANNUITY AND ENDOWMENT

The Allan Gray Retirement Annuity Fund, the Allan Gray Pension Preservation Fund and the Allan Gray Provident Preservation Fund are all administered by Allan Gray Investment Services Proprietary Limited, an authorised administrative financial services provider and approved under s13B of the Pension Funds Act as a benefits administrator. The Allan Gray Living Annuity and the Allan Gray Endowment and the Allan Gray Tax-Free Investment Account are underwritten by Allan Gray Life Limited, also an authorised financial services provider and licensed under the Long-Term Insurance Act 52 of 1998. The underlying investment options of the Allan Gray individual life and retirement products are portfolios of Collective Investment Schemes in Securities (unit trusts or funds).

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	Allan Gray International manages Bermuda-listed portfolios in equities and bonds covering the continent of Africa. Through our partnership with Orbis we also offer you a cost-effective way to diversify your portfolio by investing internationally. 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.
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, retirement funds 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 Orbis Foundation's 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

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
K C Morolo	BSc (Eng) MEng

Company Secretary

C E Solomon	BBusSc (Hons) CA (SA)

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