Quarterly Commentary
Vol. 3 30 September 2017

ALLANGRAY

THE VALUE OF BITCOIN
PAGE 08

BAD PREDICTIONS AND GOOD DECISIONS
PAGE 16

GETTING TO THE HEART OF EDUCATION IN SOUTH AFRICA
PAGE 18

The benefits of being counter-cyclical in a cyclical world

PAGE 04

EMERGING MARKET EQUITIES: LOOKING BEYOND THE MEGA-CAPS
PAGE 11

THE FOUR FUNDAMENTAL SKILLS OF ALL INVESTING
PAGE 14

COMMENTS FROM THE CHIEF OPERATING OFFICER
Rob Dower — 2

THE BENEFITS OF BEING COUNTER-CYCLICAL IN A CYCLICAL WORLD
Rory Kutisker-Jacobson — 4

THE VALUE OF BITCOIN
Jacques Plaut — 8

EMERGING MARKET EQUITIES: LOOKING BEYOND THE MEGA-CAPS
Woojin Choi — 11

THE FOUR FUNDAMENTAL SKILLS OF ALL INVESTING
Morgan Housel — 14

BAD PREDICTIONS AND GOOD DECISIONS
Lettie Mzwinila — 16

GETTING TO THE HEART OF EDUCATION IN SOUTH AFRICA
Jeremy Gibbon — 18

ALLAN GRAY BALANCED, STABLE AND EQUITY FUND PORTFOLIOS — 22

INVESTMENT TRACK RECORD — 23

PERFORMANCE AND TOTAL EXPENSE RATIOS AND TRANSACTION COSTS — 24

IMPORTANT INFORMATION FOR INVESTORS — 28

COMMENTS FROM THE CHIEF OPERATING OFFICER

Rob Dower

We and Orbis use our core skill…to invest in a collection of businesses that must each stand up to careful scrutiny to earn their place in our portfolios.

Over the course of history, scientists and engineers have made steady progress, with each discovery or innovation building on the last. On the other hand, many social sciences (including economics) have made improvements in *understanding* human behaviour, but not very much in *changing* behaviour. Humans tend to repeat mistakes.

Take mining as an example. The industry has enjoyed significant engineering and scientific progress over time. Every few years new techniques and equipment emerge to identify and extract mineral deposits more efficiently. But there are also recurring human challenges that must be tackled. Mining companies need to avoid common decision-making biases, for example, by using conservative commodity prices, capital budgets and project plans when they develop or expand mines instead of extrapolating recent high prices, or of falling prey to optimism. Once a project is underway, wise managers are aware of "sunk cost" decision traps, where they may be tempted to pour good money after bad. Poorly timed or poorly executed capital allocation decisions at a high point in the commodity cycle can risk an entire mining group if a large project is undertaken on overly optimistic price, cost and execution assumptions. In his article on valuing commodity companies, Rory Kutisker-Jacobson finds some of these pitfalls in Anglo American's historic decision making.

South Africa's mines face additional challenges. Gold and platinum mining in South Africa is labour-intensive, difficult and dangerous. Wages have increased well ahead of inflation for a decade. Other input costs, like energy, have risen even faster over the last few years while the prices of many of our mined commodities have languished. The industry and its responsible government ministry are at odds over licensing, investment and transformation. Like fishing rights, mining rights are theoretically separable from the skill required to exploit them, so they are contentious to allocate and extremely vulnerable to corruption.

Under this kind of uncertainty most mining companies have simply not been able to responsibly make the

long-term investments needed to expand capacity and may be missing the beginning of the latest cycle. At exactly the time when they should be ramping up to meet increasing global demand, mining employment and production are both locked in a steady decline. For the sake of our country, political leaders have to prioritise growth in employment and investment over arguments about sharing the shrinking pie, business leaders need to be beyond reproach on transformation, and neither can afford to disengage.

What will happen to the price of bitcoin?

Jacques Plaut writes about bitcoin, which is also mined, albeit not often underground. We can't claim to have the answer to what heights or depths speculators will drive the price of bitcoin, nor whether or not it is the currency of the future. Jacques' somewhat sceptical article demonstrates an approach to analysing virtual currencies that mirrors our approach to valuing shares and other assets, and explains why bitcoin is not a likely investment in your Allan Gray portfolios.

Where to from here for emerging markets?

Knowing how we analyse and pick shares, you may be wondering how we apply this thinking to countries or regions. The short answer is that we don't. Our portfolios are built by comparing the attractiveness of individual stock ideas and we guard against making predictions about a whole sector, country or region. Looking at the Orbis Emerging Markets Equity Strategy, Woojin Choi, from our offshore partner Orbis, explains how we and Orbis use our core skill – assessing the relationship between the share price and fundamentals of individual businesses – to invest in a collection of businesses that must each stand up to careful scrutiny to earn their place in our portfolios.

How to make good decisions

As investors, we don't always realise how our decisions are inadvertently based on predictions. When we decide to switch between unit trusts, we are making a prediction about their future performance; when we worry about short-term underperformance, we are predicting a pattern of this continuing into the future; when we race offshore when the rand plummets we are predicting that the currency will only get weaker in the future. Rather than basing your personal investment decisions on predictions, Lettie Mzwinila offers some rules for better decision-making.

Our guest writer for this issue – Morgan Housel – echoes this sentiment. Morgan is an expert on behavioural finance and investing history. Having seen the investing world from several different angles, he suggests that there are four skills that govern most outcomes. Making accurate predictions is not one of them.

Introducing the Jakes Gerwel Fellowship

Most of you are familiar with the good work that the Allan Gray Orbis Foundation is doing in developing entrepreneurial talent in our country. As a premium scholarship provider, the Foundation has country-wide contact with school principals and teachers, and has seen from close quarters the incredible potential impact of teaching excellence in schools.

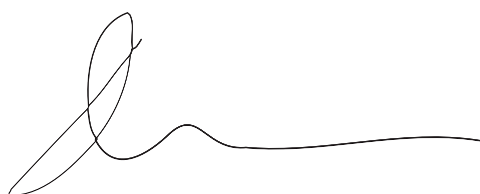
In April 2017, the Board of Allan Gray Orbis Foundation Endowment gave the commitment to create the Jakes Gerwel Fellowship to honour the legacy of a true, high-impact teacher who was also the Foundation's inaugural chairperson and a close confident to former President Nelson Mandela.

To give you some insight into what the Jakes Gerwel Fellowship is about, Jeremy Gibbon looks at the state of education both in South Africa and globally and discusses how the Fellowship aims to achieve its vision by identifying, educating and equipping demographically diverse individuals who have the potential to make a significant impact in education.

If you know of any talented young people who want to play a leading role in developing our country, and see the classroom as a powerful channel to do so, please send them in the direction of the Fellowship.

Thank you for trusting us with your savings.

Kind regards



Rob Dower

THE BENEFITS OF BEING COUNTER-CYCLICAL IN A CYCLICAL WORLD

Rory Kutisker-Jacobson

Being pro-cyclical can be damaging, whereas being counter-cyclical can be very financially rewarding.

"Prediction is very difficult, especially about the future." – Niels Bohr

In cyclical industries, understanding where we are in the cycle and acting counter-cyclically can both be helpful for making successful long-term investment decisions. Using commodities in general and three examples from Anglo American in particular, Rory Kutisker-Jacobson discusses.

In theory, the fair value of any company is the present value of future cash flows one expects the company to generate over its lifetime, discounted at an appropriate rate. For a mining company, this free cash flow is, simplistically, a function of commodity prices, volumes and costs. With analysis, one can get a reasonable degree of confidence around the volumes a mine is likely to produce and the costs it is likely to incur in doing so. No doubt the future will be different from one's expectations, but it is rare that a mine has unexpected movements of 20% or more in its costs or volumes. In contrast, it is not uncommon for commodity prices to move by 50% or more in a single year.

As an example, let's assume there is a mine producing 100 000 ounces of gold at an all-in cost of US$1 000 per ounce (/oz). With the gold price at US$1 300/oz, it is generating free cash flow of US$300/oz or US$30m in total, before tax. If the gold price suddenly rallies to US$1 900/oz, all else being equal, that same mine will be generating free cash flow of US$900/oz or US$90m in total before tax. This is a three-fold increase in free cash flow from just a 46% increase in the price.

Thus, when valuing a commodity business, the overriding determinant of fair value is the "normal" commodity price one assumes.

But the future is inherently uncertain, and commodities tend to exhibit large and unexpected movements in their prices over relatively short periods of time. If one doesn't know what the future holds, how does one know what commodity price to plug into one's model?

In investing, when looking forward, it is helpful to look backwards

What we know from history is that commodity prices tend to move in cycles with a relatively recurring nature. That is not to say we can predict the magnitude of a cycle, or when the cycle is likely to turn, but we can have some degree of confidence as to where we are in a cycle. Knowing where we are in a cycle makes all the difference, as it allows us to make some assumptions about future prices, as cycles tend to be self-correcting.

A low commodity price:

- Induces people to consume more, increasing demand for that commodity.
- Negatively affects the supply for that commodity: current production falls as high-cost producers become loss-making and go out of business, while future production is curtailed as the economic incentive of exploring for and developing mines of that commodity declines.

As demand grows and supply shrinks – both as a result of low prices – demand begins to exceed the available supply at each level of cost, driving prices higher. Thus low prices create the environment that eventually leads to higher prices. The opposite is also true: increases in commodity prices reduce demand while they incentivise new production, increasing supply and leading to lower prices.

The memory of the average market participant tends to be short

Perhaps it is human nature, but we tend to be very poor at learning from history. When a recent trend persists, all too often one hears "this time it's different", and the market makes investment decisions based on the current trend persisting into perpetuity. Consequently, from time to time, situations arise where commodity companies are priced by the market as if high commodity prices and profits will persist forever and, conversely, at times they are priced as if prices and profits are likely to remain depressed forever. This is seldom true in either case. Thus, being pro-cyclical – i.e. buying when prices and expectations are high – can be damaging, whereas being counter-cyclical – i.e. buying when prices and expectations are low – can be very financially rewarding. This is true for both investors and the companies in which they invest.

Anglo American, a company whose history is intertwined with that of South Africa, celebrates its centenary this year. Here are some recent real-life examples of investment decisions made by Anglo, and how these decisions have impacted on the fortunes of the company and its shareholders.

Minas-Rio

Anglo's foray into Brazilian iron ore is an example of the dangers of being pro-cyclical. For a long period of time up until the end of 2003, the seaborne iron ore price traded at around US$30 per tonne (/t). Thereafter, the price began to rise appreciably, primarily as a result of seemingly insatiable demand out of China.

By December 2006, the price had more than doubled to US$80/t. With prices and profits rapidly rising, iron ore mining became a very attractive proposition.

By April 2007, Anglo could no longer resist the temptation and made its first investment in Brazil, acquiring 49% of an iron ore deposit called Minas-Rio for US$1.15bn. Situated some 525 km from the port, Minas-Rio was expected to begin production by late 2009 after a further capital investment of US$2.35bn. It was envisaged that it would produce 26.5 million tonnes (mt) of iron ore per annum, with optionality to expand this to 90 mt per annum over time.

> Perhaps it is human nature, but we tend to be very poor at learning from history.

By January of 2008, the iron ore price had again more than doubled to around US$180/t and Anglo decided to acquire the remaining 51% of Minas-Rio, announcing the remaining stake would cost a significantly higher US$5.5bn. While the outlook for increased demand from China continued to be rosy, at this stage, two things were certain: the price of iron ore and industry profitability were both very high relative to history.

Shortly thereafter the first bad news emerged when it was announced that the capital expenditure required had been increased to US$3.6bn and, due to issues

with environmental licensing and access to land, first production had been pushed out to early 2012. This was a sign of things to come. It slowly began to emerge that in its desire to acquire Brazilian iron ore exposure, Anglo had overlooked the technical and licensing challenges facing the project.

Fast-forward to today, and the company has spent US$8.4bn in capex to bring Minas-Rio online. While the mine is now operational, it is producing only between 16 mt and 18 mt per annum. At the same time, the iron ore price is now less than US$70/t; still high relative to history, but a far cry from the heady heights of 2007 to 2011. As **Graph 1** shows, Anglo timed the peak of the market almost perfectly when it announced the acquisition of the remaining stake.

All in, Anglo has spent over US$15.5bn on Minas-Rio, a project that is likely to generate marginal returns from here. To put that in context, the total current market value for the whole of Anglo is around US$22.6bn.

Metallurgical coal

More recently, Anglo's metallurgical (met) coal business is an example of the benefits of making counter-cyclical decisions. Just 18 months ago, Anglo looked to be in dire straits. Commodity prices across the board had fallen materially and, as a result of overburdening the company with debt during the good times, it appeared that Anglo would need to sell assets or have a rights issue to strengthen its balance sheet.

One asset earmarked for disposal was Anglo's met coal business. From a peak of around US$300/t in 2011, the met coal price had fallen consistently since to around US$80/t by February 2016. With costs at a similar level, the division was barely breaking even. Coal in general had become a four-letter word and, despite Anglo having world-class assets, arguments abounded as to why the division would never again earn a decent return on capital.

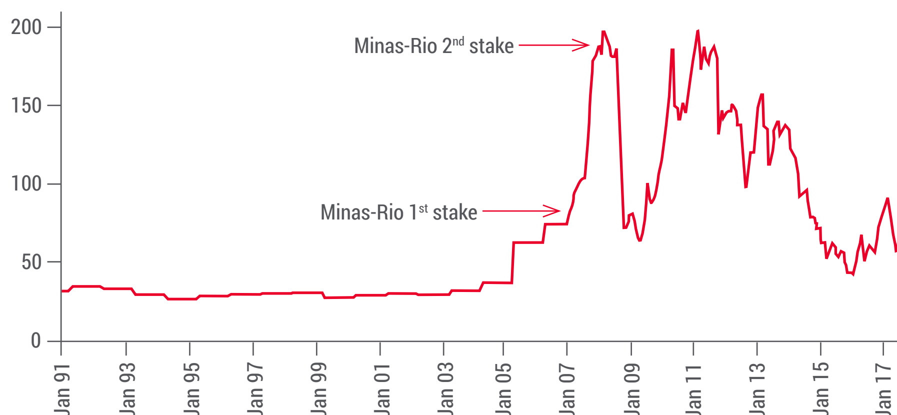
Anglo entered discussions to dispose of the met coal division with various parties and, by July of that year, was said to be close to finalising a deal, with press reports suggesting Anglo would receive between US$1.3bn and US$1.5bn for the division. To its credit, throughout this process Anglo was adamant it would not dispose of any asset below its estimate of fair value.

Before a deal could be concluded, the met coal price began to rally, and by year-end, it was back at around US$200/t. The long-term met coal business hadn't changed at all, but because the commodity price cycle had turned in the short term, it was suddenly a much more attractive prospect. For the 12 months to June 2017, the met coal division earned US$1.1bn. Fortuitously for shareholders, Anglo never sold. It now looks likely that Anglo will earn more in 18 months than what the market anticipated it would get for selling the entire division. Perhaps management was lucky, but credit must go to them for holding out for a higher price and the subsequent outcome.

Mondi

Anglo's unbundling of Mondi in July 2007 demonstrates a third point: shareholders can benefit from making up their own minds about commodity cycles.

Graph 1: Nominal iron ore price



Source: IRESS, Allan Gray research

Anglo unbundled the paper and packaging group to shareholders, transferring the active decision of staying invested or divesting to each shareholder, rather than making that decision on their behalf. In effect, the transaction gave shareholders 91 Anglo shares and 35 Mondi shares[1] for every 100 Anglo shares held.

Assuming shareholders stayed fully invested in these two shares, they had three options:

- Option One: Do nothing, i.e. retain Anglo and Mondi shares.
- Option Two: Sell Mondi shares and invest the proceeds in Anglo.
- Option Three: Sell Anglo shares and invest the proceeds in Mondi.

What was the right investment decision?

For those shareholders who pursued Option One and did nothing, for every R100 invested on 2 July 2007, they would have R103 today. Hardly an optimal outcome, when to just keep pace with inflation one's investment would need to be worth R181 today. Those who pursued Option Two and invested solely in Anglo, would have fared even worse, with an investment worth a meagre R66 today. That's a negative return in nominal terms over 10 years! Finally, those who invested solely in Mondi would have an investment valued at R754 today.

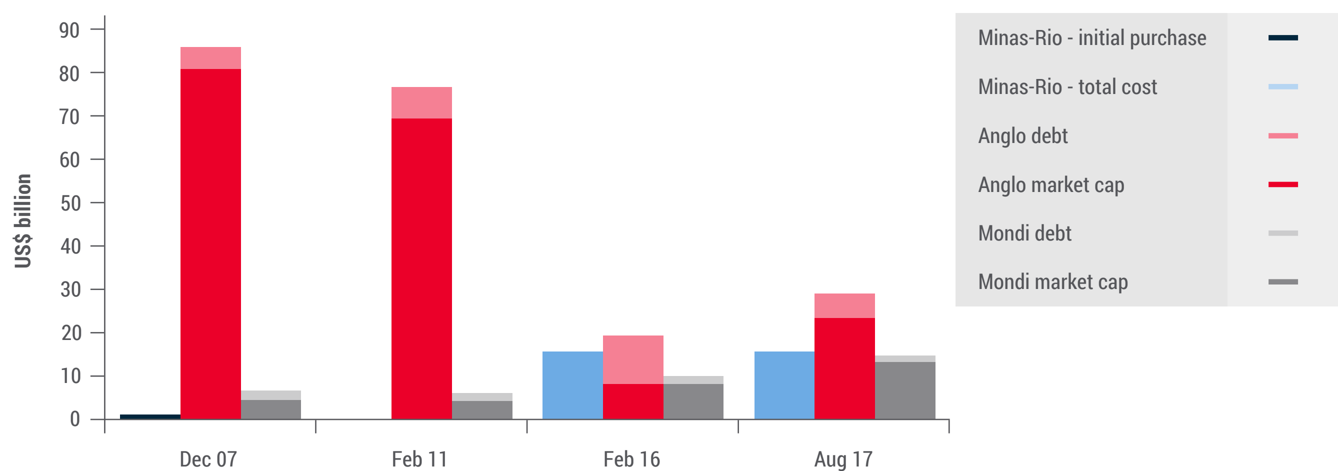
As **Graph 2** suggests, the largest cause of such a wide disparity in outcomes was the starting valuation. At the time, Anglo was priced for perfection, with investors extrapolating that high commodity prices would persist into perpetuity, whereas questions were being asked about what an increasingly digital world meant for paper consumption in the long term.

Anglo's remaining diversified mining businesses were at the top of their cycles, trading on 19 times historic earnings, despite those earnings being at a record high. Mondi traded on just 11 times earnings, despite 2006 reported earnings being 36% below that achieved in 2003. A decade later, Mondi trades on 19 times earnings, that are materially higher, whereas Anglo trades on just 8 times historic earnings, despite commodity prices generally being lower today than they were at the peak. There were other factors at play, but counter-cyclical investors were well rewarded and they would not have had the chance to benefit without Anglo's decision to unbundle.

In conclusion, while we believe that it is always important to take a long-term view in investing, this is particularly true in cyclical industries, where overreacting to short-term noise can mean missing out on opportunities or making costly mistakes.

[1] Every 100 Anglo shares were consolidated into 91 shares to adjust the share price for the demerger, and shareholders received 25 Mondi PLC shares and 10 Mondi Ltd shares.

Graph 2: Enterprise values



Source: Datastream, Allan Gray research

Rory joined Allan Gray as an equity analyst in 2008. He has a Bachelor of Business Science and is a CFA charterholder.

THE VALUE OF BITCOIN

Jacques Plaut

The problem comes in when people stop connecting the price of the asset to any underlying economic reality. If you believe the story, no price is too high.

The total market value of all bitcoins is US$80bn, which is more than the value of Richemont and triple the value of Anglo American. It is the topic on which we currently receive the most questions from clients. In this article, Jacques Plaut discusses how we would apply our valuation techniques to virtual currencies, and whether we would own them for clients.

Before I say anything else, let me first say this: I do not know where the price of bitcoin is going. If you are looking for a price forecast, I'm afraid this is not the article for you. The best I can do is to tell you that it will fluctuate. Nonetheless, I hope that I will still be able to say some useful things about the value of bitcoin, and its suitability as an investment.

Bitcoin is a virtual currency. In many ways it is like electronic Monopoly money, except the price is up 300 times in the past five years. At the time of writing you could exchange one bitcoin for US$5 200. Does this mean a bitcoin has intrinsic value of US$5 200? Is it really "worth" that amount? In one sense, yes: any asset is worth what you can sell it for. In another sense, no: market prices change – especially in the case of bitcoin – and at times bear no resemblance to intrinsic value.

One could say a bitcoin has zero intrinsic value, because ones and zeros on a computer, in isolation, have no use to anyone. But by the same argument a dollar also has zero intrinsic value. Unless you are like Scrooge McDuck, who gets joy from counting his money, a dollar is only valuable as long as someone will exchange it for some real-world good or service. The value of any currency is largely a matter of faith. But since I do not plan to talk in terms of loaves of bread, and since this is not a philosophy journal, I will speak of value relative to dollars for the sake of convenience.

Bitcoin as an asset

The usual methods for valuing an asset are not readily applicable here:

The present value of future cash flows: There are no future cash flows associated with bitcoin, except the price at which you will sell it one day. This price depends on the next selling price, etc.

Historical prices: The first bitcoin was traded in 2009. This is a short history compared with, say, the 150-year history we have for oil and the 2 000-year history we have for gold (which is the asset most similar to bitcoin). And the history we do have is not very stable.

Supply-demand analysis: The demand and the supply come mostly from speculators, and the attitude of speculators is notoriously hard to foresee.

Relative scarcity: The ultimate supply of bitcoin is limited to 21 million coins. The supply of dollars is unlimited. Therefore, bitcoin should appreciate indefinitely against the dollar. The snag is that you could also apply this argument to property in Harare, or paintings by Sylvester Stallone. And while the supply of bitcoin is limited, the supply of virtual currency is not. There are at least 1 100 others, including Ethereum, Gnosis, Mysterium, and my favourite: PonziCoin. Some of these have better underlying technology than bitcoin.

Bitcoin as a currency

One could say that bitcoin is not an asset but a currency. Some even say that it will eventually become the world's reserve currency. These people usually go on to explain that you need a monetary base of several trillion dollars for a global reserve currency. As mentioned, the supply of bitcoin is limited to 21 million coins. Several trillion divided by 21 million equals several hundred thousand, which is where the price of bitcoin is headed (they say).

First, I'm not sure that bitcoin will be the new reserve currency. The underlying technology is somewhat clunky and, like I mentioned, there is lots of competition from other virtual currencies. Also, people tend to value stability in their reserve currencies. One that is rapidly increasing in value will cause people to hoard it; one that is decreasing will cause people to spend. The current system of having a central bank that manages the stability of the currency by altering the supply of money, has worked quite well for a hundred years. Governments will presumably have a say in all this, and might not approve. It was illegal for US citizens to own gold from 1933 until 1975.

Second, I'm not sure the global reserve currency needs a monetary base of several trillion. At my church's annual fair, you pay for everything with vouchers. If the supply of vouchers were too low, one possibility is that people would bid up the price of vouchers. But there are several other possibilities. People who run stalls could recycle their vouchers back into the pool more rapidly. Or people could write out IOUs: "I'll pay you as soon as I get my hands on a voucher." Or we could all go back to using rands. Money is, after all, a matter of convenience.

We normally value currencies by looking at the price history, the quality and track record of the issuing central bank, the amount of foreign reserves, the fundamentals of the sovereign, and the Big Mac Index. These are not easily applied to bitcoin.

The value of any currency is largely a matter of faith.

Tulips

"There can be few fields of human endeavour in which history counts for so little as in the world of finance. Past experience, to the extent that it is part of memory at all, is dismissed as the primitive refuge of those who do not have the insight to appreciate the incredible wonders of the present." – *A Short History of Financial Euphoria,* John Kenneth Galbraith

Can behavioural psychology give us any insight into bitcoin?

The title of this section refers to "tulip mania" – an episode of frantic speculation on the price of tulips. It happened in Holland in 1637. There have been many similar episodes, involving Florida real estate (1926), gold (1980), Japanese assets (1990), and internet stocks (2000), to name a few. There is always some underlying justification, or "story", at least at the start. Scarcity of bulbs, the Florida climate, gold's virtue as an inflation hedge, the wisdom of Japanese policymakers, or the internet's ability to change the world – these are the justifications that served for my examples above. The problem comes in when people stop connecting the price of the asset to any underlying economic reality. If you believe the story, no price is too high.

In the case of virtual currencies, the "story" which has captured the public imagination is blockchain technology. Blockchain technology is a way of enabling the digital transfer of money between two parties without an intermediary. The idea has lots of potential, and virtual currency is only one of many possible applications. But this does not make bitcoin worth anything, just like the existence of the internet was not enough to make Pets.com a valuable asset.

I don't know whether bitcoin deserves to be classed with episodes like tulip mania. I see some similarities with previous bubbles, but all the signs are not yet there. For example, the abuse of debt in some form is a standard feature of any bubble, and I'm not aware that people are using it to buy bitcoin, yet.

Three more things:

- Bitcoin is not a friend of the environment. According to one estimate, the total amount of electricity consumed by processing bitcoin transactions is enough to power 1.6 million US households for a year. Bitcoin uses more electricity than Lebanon or Cuba.
- Some blame central banks for the rise of virtual currencies. Because the US Federal Reserve is keeping rates low and printing money, they say, people are putting their faith in other assets. I'm sceptical of this explanation. Bubbles can happen in any interest rate environment. When the price of gold peaked in 1980, US interest rates were 14%.
- The idea of an alternative currency is not a new thing. Before Lincoln signed the National Banking Act of 1863, the US had hundreds of currencies, issued by individual banks. They were often backed, to varying extents, by gold. Those that weren't tended to end in collapse.

Would we own bitcoin for clients?

Regulations do not currently allow this for most of our funds. But regulations aside, we are always looking for good ways to preserve capital and earn returns for clients. We do not think bitcoin is an instrument which will enable us to do this. Indeed, we see material risk of capital loss.

Jacques joined Allan Gray in 2008 as an equity analyst after working as a management consultant. He began managing a portion of client equity and balanced portfolios earmarked for associate portfolio managers in March 2013 and was appointed as portfolio manager in November 2015. Jacques completed his BSc (Hons) in Mathematics at UCT.

EMERGING MARKET EQUITIES: LOOKING BEYOND THE MEGA-CAPS

Woojin Choi

Taking a fine-tooth comb to the market gives us the opportunity to avoid low-quality companies...

Our offshore partner Orbis launched an Emerging Markets Equity Strategy in January 2016. Later that year it broadened the mandate of its Asia ex-Japan Equity Fund to include all emerging markets. This was done in the belief that emerging market equities offered excellent long-term investment opportunities. Initially the timing looked foolish, as emerging markets continued to underperform. However, since then they have rallied, with most of the good performance coming in 2017. To date this year, the Strategy has lagged the broader market. Woojin Choi explains how Orbis invests, and examines the recent market environment.

We build the portfolio by comparing the attractiveness of individual ideas. Our favourite ideas have the highest weights, and if we aren't confident that a stock trades at a discount to its intrinsic value, we don't buy it at all.

This competition for capital has little to do with a stock's weight in the benchmark, which naturally increases if the stock outperforms. Attractively priced shares could be small index constituents, or they might be big in the benchmark. In building the portfolio, benchmark weights don't really matter to us. But they do matter when calculating relative returns. Since the portfolio can differ substantially from its benchmark, so too can its performance, especially in the short term.

"Mega-cap" outperformance has been a notable feature of emerging market (EM) stock markets so far this year. The MSCI EM Index comprises over 800 stocks, but its five largest constituents – currently Tencent, Samsung Electronics, Alibaba, Taiwan Semiconductor Manufacturing Company (TSMC) and Naspers – make up nearly 20% of the total capitalisation. These five companies' shares have performed particularly well, as shown in **Graph 1** on page 13.

It has been difficult to generate outperformance without being overweight these stocks: in the first nine months of this year, less than 40% of all

EM shares outperformed – the lowest proportion in any calendar year since 2005.

The relationship between share price and fundamentals

The surge in mega-cap shares may well have resulted from large inflows into EMs from global investors seeking higher returns by buying the largest and most liquid EM shares. So far this year, tens of billions of dollars have flowed into EM equities.

These trends could persist, but rather than try to predict the magnitude and direction of EM flows, we prefer instead to focus on our core skill: assessing the relationship between the share price and fundamentals of individual businesses.

A selective approach allows us to invest in a collection of businesses that must each stand up to careful scrutiny...

This approach resulted in the Orbis Emerging Markets Equity Strategy holding four of the five mega-cap shares at the start of the year: Tencent, Samsung Electronics, Naspers and TSMC. When we stacked them up against other opportunities, they were attractive enough to earn a place in the portfolio, but they were not the very best ideas we could find. As a result, they collectively accounted for less than 10% of the Strategy. While many of the mega-cap shares have subsequently increased their intrinsic value, we continue to believe that other EM shares – which have lagged the mega-caps – continue to look more attractive from a long-term perspective.

A similar story has played out in individual countries, particularly Korea. Samsung Electronics is the goliath of the Korean stock market, accounting for over a fifth of the local market index. The Korean stock market has performed well this year, and its 20% absolute return has been largely driven by a more than 40% return for Samsung.

The Strategy owned Samsung's shares until the end of the first quarter of 2017, when it exited the position. Samsung remains held in other Orbis Strategies which have different mandates and opportunity sets.

A stock's potential determines its weighting

We think it is imperative that a stock's long-term return potential is the key factor that determines its weighting in our portfolios. By contrast, passive funds – which aim to be invested in the benchmark and have attracted five times more capital than active funds in EMs this year – are insensitive to the price they pay for shares and, by their very nature, support outperformers. We make them compete for capital on the same terms as every other share. As Samsung delivered strong performance, we reallocated capital to other attractive EM shares.

We have found greater value in shares like Kiwoom Securities, a leading Korean online brokerage company, and a 4% position in the Strategy. Throughout its history, Kiwoom has grown its intrinsic value faster than the market by dominating online brokerage – where it claims 25% market share – and proactively seizing new business opportunities in mutual savings, banking and asset management. Over the past decade, its return on equity has averaged 15% per annum and we believe it can sustain this performance over our long-term investment horizon, yet its market value is a modest 1.1 times the value of its net assets. Kiwoom faces significant risks – including that of a conflict with North Korea – but we believe the balance of risk and potential long-term rewards is favourable.

...our bottom-up, fundamental stock-picking approach is well suited to capitalising on investment opportunities in EMs...

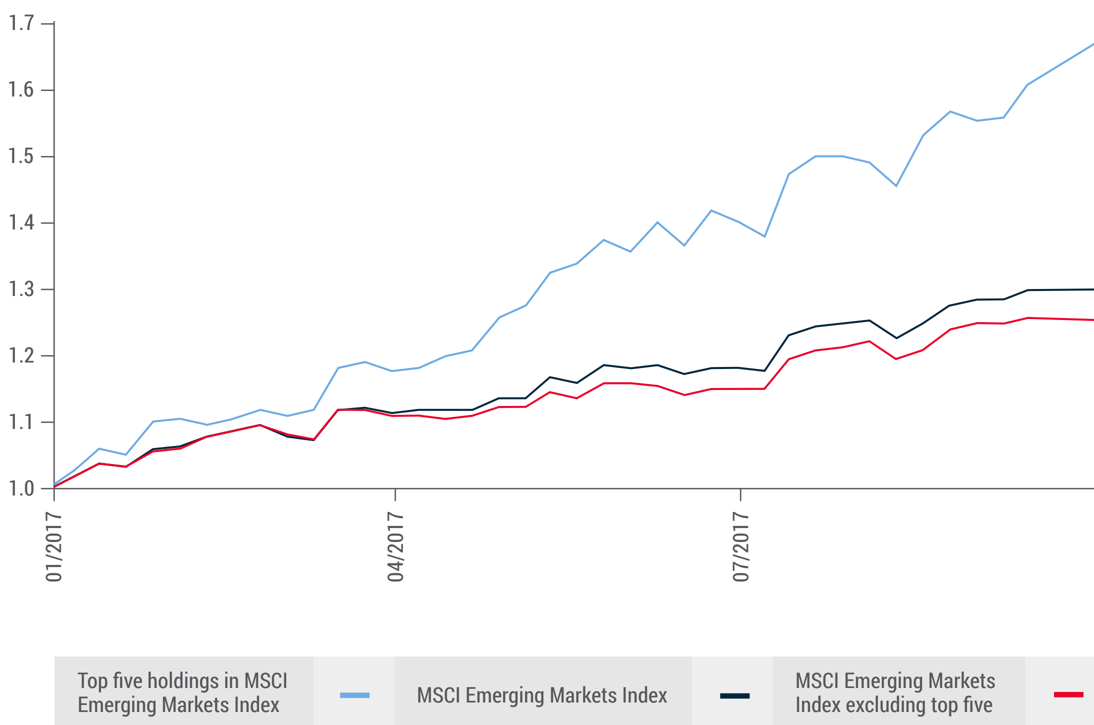
Taking a fine-tooth comb to the market also gives us the opportunity to avoid low-quality companies – particularly relevant in the EM universe, where corporate governance and transparency standards diverge meaningfully. Kiwoom's management team retains a meaningful ownership stake, which we

view positively because we look to align ourselves with high-quality management teams that have “skin in the game”. Yet this has the effect of lowering the company’s “investible” market capitalisation, and with it the stock’s weighting in the benchmark.

Our conviction that our bottom-up, fundamental stock-picking approach is well suited to capitalising on investment opportunities in EMs is even stronger today than when we launched the Strategy. A selective approach allows us to invest in a collection of businesses that must each stand up to careful scrutiny to earn their place in the portfolio – a competition for capital that we believe bodes well for long-term returns.

Graph 1: Mega-caps have trounced other emerging market shares

US$ total returns of the MSCI Emerging Markets Index, its top five constituents by weight, and the rest of the Index, Jan to Sep 2017.



Source: MSCI, Orbis

Woojin is a member of Orbis’s Hong Kong-based emerging market investment team. His primary responsibility is researching Korean stocks. Woojin joined Orbis in 2007. He earned his bachelor’s degree at Yonsei University in South Korea.

THE FOUR FUNDAMENTAL SKILLS OF ALL INVESTING

Morgan Housel

...a lot of what all of us believe about investing is either right but temporary, or wrong but convincing.

We are excited to introduce guest contributor Morgan Housel, a partner at the Collaborative Fund (US), and an expert in behavioural finance and investing history.

In his book *Succeeding*, John T. Reed wrote one of the smartest things I've ever read: "When you first start to study a field, it seems like you have to memorize a zillion things. You don't. What you need is to identify the core principles—generally three to twelve of them—that govern the field. The million things you thought you had to memorize are simply various combinations of the core principles."

This extends beyond those learning a new field. I think it's most relevant for those who consider themselves experts. The root of a lot of professional error is ignoring simple ideas that seem too basic for those with experience to pay attention to. Having seen the investing world from several different angles, four skills stand out for me as governing most outcomes:

1. The ability to distinguish "temporarily out of favour" from "wrong"

The two strongest forces in investing are "this investment looks broken because that's how opportunity presents itself", and "this investment looks broken because it's actually broken". It's hard to tell the difference in real time. Distinguishing between the two relies on accurately calculating the odds that something will eventually come along to heal or promote the market or company that looks broken. And since those odds are always less than 100%, it can take a while to tell if you're any good at it, because even when the odds are in your favour, the outcome can go the wrong way. It's hard to do. But worse, and more common, is forgetting that a distinction needs to be made in the first place.

2. The willingness to adapt views you wish were permanent

Economies grow because businesses, consumers, and technology change and adapt. It's ironic how many investors attempt to ride this wave of change with

rigid beliefs. There is a set of truly timeless investing ideas. But most of what guides us are beliefs that reflect what we've happened to experience in the narrow view of our own lives. Even when investors study history, they put more weight on stories that align with their own experiences, because those stories are easier to understand and confirm their beliefs.

It's painful to contemplate, but a lot of what all of us believe about investing is either right but temporary, or wrong but convincing. If you're unwilling to update your views when the world changes, or be open-minded enough to realise that some of your views were anecdotal to begin with, boy, you will be eaten alive in this field.

3. The ability to be comfortable being miserable

This is the most fundamental of all investment principles. You can't enjoy the benefits of exercise without some sort of discomfort, because being out of breath, sore, or tired is the sign that you've put in enough effort to deserve a reward. Same in investing. The financial rewards for being comfortable as an investor are the same as the physical rewards for sitting on the couch.

Returns do not come for free. They demand a price, and they accept payment in uncertainty, confusion, short-term loss, surprise, nonsense, stretches of boredom, regret, anxiety, fear, and sometimes even ridicule. Most markets are efficient enough to not offer any coupons. You have to pay the bill.

4. The ability to distinguish when analytics vs. psychology is necessary

If investing were only about numbers, no one would be good at it, because computers would arbitrage away all opportunities. And if it were only about psychology, no one would be good at it, because every investor has different, arbitrary goals, and markets would never coalesce around something objective.

Good investing is some part analytical and some part psychological. An art and a science. The trick is knowing when which skill is necessary, and how one affects the other.

Parts of investing are counter-intuitive – like the prevalence of volatility, margin analysis, or moats repelling competition – and require data to understand. But there are things data can't help with, like the tendency to embrace false narratives that justify our actions, or one's willingness to throw strategy out the window after the emotions of a big win or loss. Data doesn't teach you about fear or patience, and psychology doesn't teach you about discount rates and EBITDA.

The hard part is that analytics and psychology couldn't be more different. One is rational and stable, the other makes no sense and changes all the time. One is numbers you can see, the other is emotions you can sort of feel, sometimes.

Good investing is some part analytical and some part psychological. An art and a science.

Only four skills?

Attacking a complex competitive problem with both psychology and numbers in real time is hard. In fact, all of the four skills I've described here are a lot harder to practise than to describe. But it isn't a very complicated list of skills, and things that are hard to do normally reward thoughtful perseverance. Investing does.

Morgan is a partner at the Collaborative Fund, a US venture capital firm. Previously, he was a columnist at *The Wall Street Journal* and *The Motley Fool*. He is a two-time winner of the Best in Business Award from the Society of American Business Editors and Writers and was selected by the Columbia Journalism Review for *The Best Business Writing* anthology. In 2013 and 2016, he was a finalist for the Gerald Loeb Award and Scripps Howard Award respectively. He has authored two books.

BAD PREDICTIONS AND GOOD DECISIONS

Lettie Mzwinila

...we take shortcuts, placing too much value on our gut feeling or the casual opinions of friends.

"Most of us view the world as more benign than it really is, our own attributes as more favourable than they truly are, and the goals we adopt as more achievable than they are likely to be. We tend to exaggerate our ability to forecast the future, which fosters optimistic overconfidence." Lettie Mzwinila explains why this quote by renowned behavioural economist Daniel Kahneman matters for successful investing.

The sun will rise (somewhere) tomorrow. The earth will spin on its axis for the foreseeable future, and time will keep going.

These things we take for granted are all predictions; some of the few that we can rely on. Nothing guarantees them, but few doubt them. This confidence in the movement of celestial objects and nature's faithful progress encourages us to believe in the power of prediction – even when the odds prove otherwise.

Making decisions based on bad predictions

The next few months are going to be a critical period in the history of our country. The elective conference in December and its fallout will attract predictions before and after. You may have predictions about what will happen to the economy, and by false extension, to your investments.

It is instructive to remember our recent history. When the former finance minister was removed from his position in December 2015, a consensus quickly formed that the steep exchange rate drop recommended investing offshore. The currency paid no mind to this consensus and investors who fled at R16.97/US$ (on 11/01/2016) now have to make sense of an exchange rate hovering around R13/US$ (at the time of writing).

How bad predictions hurt you

We make prediction mistakes in at least two ways: by extrapolating the recent past, and by mistaking logical patterns. We may wrongly extrapolate that an investment award this year means a unit trust will continue to perform as well next year: statistically, last year's short-term winners are more likely to be

next year's losers. We may wrongly think that strong GDP growth means higher future investment returns: statistically, GDP growth and investment returns are almost entirely uncorrelated.

We are vulnerable to these errors because we don't have the time to get to all the facts, so we take shortcuts, placing too much value on our gut feeling or the casual opinions of friends. This even applies to an investor in something like a unit trust, where the investment decisions are made by a professional fund manager – because of the temptations of switching. Moving your investment from a recent poorly performing unit trust into a recent top performer and then back again after the previous winner does badly, is a common drag on returns.

Some rules for better decision-making

Using the following three steps (an algorithm, if you will) can help you consider the quality of your predictions so that you do not make rash choices.

1. Establish the facts the prediction is based on. In a world saturated with information, it is remarkable that decisions often come from a factless basis. It is not enough to assume that market commentators or your friends have done their homework when it is your money that will be affected by the decision you make. It is equally important to resist the strong temptation to cherry-pick information that confirms your view.

2. Consider the motivations of the source. If a prediction is made by a news source that is ideologically required to colour its coverage in positive upbeat tone or a negative bearish shade, this may compromise that prediction. More importantly, you need to consider your own psychology. Are your emotions predisposing you to think in a certain way? Merely acknowledging your own emotional state can help you take it into account.

3. Consider the opposite. What if your prediction is wrong? Whatever decision you make should account for a range of outcomes. When professional portfolio managers construct a portfolio, they normally try to combine investments that have different risks and upsides, so that if one performs badly, the other may perform well, or will at least not be impacted.

The future is unknowable and beyond our power, but we do have the power to choose how we respond to it in the decisions we make (and the facts and implied predictions those decisions are based on).

Lettie joined Allan Gray in 2013 and is currently a Business Development Manager in retail distribution, having previously filled the role of Client Relationship Manager. She holds a BCom in Financial Planning (NMMU) and a BCom Honours in Business Management focusing on Investment Management (NMMU).

GETTING TO THE HEART OF EDUCATION IN SOUTH AFRICA

Jeremy Gibbon

Of the top ten positive influences on a child's learning, eight of them relate directly to the influence of a teacher.

The Jakes Gerwel Fellowship, an independent and aspirational initiative birthed out of Allan Gray Orbis Foundation Endowment, is committed to creating a pipeline of high-impact, expert teachers and educational leaders. Jeremy Gibbon looks at the state of education both in South Africa and globally, and discusses how the Fellowship aims to achieve its vision.

There are very few important issues in our country that carry any measure of consensus, yet the state of education is almost certainly one of them. Regardless of one's political views or socio-economic vantage point, there is a shared belief that our current system is failing most of our children at the very basic level of literacy and numeracy, let alone supporting the development of our future knowledge workers or providing the foundation for the social transformation we so desperately long for.

As a country, we are not alone in facing these challenges. Matthew Hood, director of the Institute for Advanced Teaching in the UK, recently remarked: "Every education system around the world faces two major challenges: closing the stubborn achievement gap between disadvantaged children and their wealthier peers, and ensuring that young people leave compulsory education with the knowledge, skills and characteristics they need in order to thrive in the modern world. Failure to address these challenges is morally indefensible and economically unsustainable."

A tale of two education systems

The post-apartheid government in South Africa has made significant strides in terms of access to education with almost universal attendance at primary school level. In terms of funding, over 20% of the national budget is allocated to education and these funds are distributed in a reasonably equitable manner across provinces. However, the quality of the former and the efficiency of the latter still leave much to be desired.

Dr Nic Spaull, senior researcher at Stellenbosch University, notes that when considering data sets from the South African education system, the "phenomenon

of two education systems presents itself in the form of what is called a bimodal distribution". Reading scores that he calculated from the 2007 Southern and Eastern Africa Consortium for Monitoring Educational Quality (SACMEQ) assessments illustrate the point well, with the wealthiest quartile significantly outperforming their poorer classmates, as shown in **Graph 1** on page 20.

South African children consistently perform extremely poorly in almost all international scholastic tests. What is often ignored in these findings is that even students in quintile 5 and independent schools achieved average scores in the 2011 Trends in International Mathematics and Science Study (TIMSS) assessment that were below the centre point of 500 for Mathematics (see **Graph 2** on page 20).

These are particularly worrying as they were written by SA students in Grade 9, rather than in Grade 8, as intended, and their scores only place them on a par with their peers in middle-income countries such as Kazakhstan, Lithuania and the Ukraine – still well below the top performers such as Korea and Singapore.

Addressing the challenges

The three local philanthropic entities established by Allan WB Gray – Allan Gray Orbis Foundation (Foundation), E^2 and Allan Gray Orbis Foundation Endowment (Endowment) – have been working for over a decade to address the challenges of unemployment and inequality. The Foundation is committed to creating a pipeline of high-impact, responsible entrepreneurs who will contribute to positive economic, social and political change. It has demonstrated measurable and strategic impact by identifying, selecting and investing in individuals who show potential for responsible entrepreneurship through scholarship and fellowship opportunities. The continued success of this entrepreneurial pipeline is heavily dependent on an effective education system.

So in 2016, the Endowment committed to creating a brand new, independent and aspirational teaching initiative, named the Jakes Gerwel Fellowship, in honour of the inaugural chairperson of the Foundation and an education icon of his time. In response to the education crisis we face in South Africa, the Fellowship aims to develop the very best students to become the expert teachers, education leaders and social entrepreneurs of the future.

With so much dysfunction in our current education system it is tempting to bypass the established structures and attempt to create change through after-school programmes or technological interventions. While such a great challenge requires a multitude of interventions, at all levels, research consistently identifies the pivotal role that expert teachers play in improving learning outcomes for students.

Prof John Hattie, director of the Melbourne Education Research Institute, published a seminal ranking of various influences related to learning and achievement that had been identified through the largest meta-analysis ever performed in this area. He identified that of the top ten positive influences on a child's learning, eight of them relate directly to the influence of a teacher.

McKinsey's 2007 study, *How the world's best-performing schools come out on top*, found that two of the three things that mattered most were getting the right people to become teachers, and developing them into effective instructors.

> ...our best students today should become our best teachers of the future.

In light of these findings, the Jakes Gerwel Fellowship aims to empower passionate individuals with subject matter expertise and pedagogical content knowledge to become expert teachers. Through effective communities of practice, their influence will be amplified to mobilise broader systemic change.

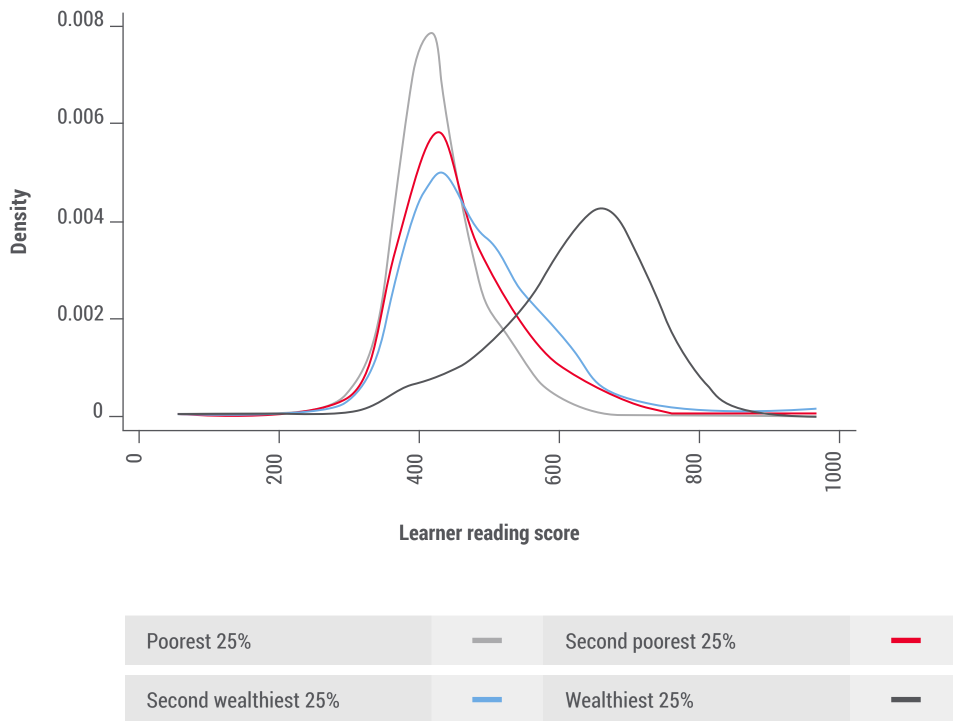
One of the challenges the Fellowship team is addressing is to promote the teaching profession as an aspirational vocation for high performers; fostering the belief that our best students today should become our best teachers of the future.

Fellowship update

After an extensive national marketing campaign, the Fellowship team collected applications from over 300 high-performing Grade 12s. One hundred of these were recently interviewed and a final elite group of 50 aspirant teachers will attend a selection camp

Graph 1: The impact of wealth on reading ability

Distribution of Grade 6 reading performance by school wealth quartile

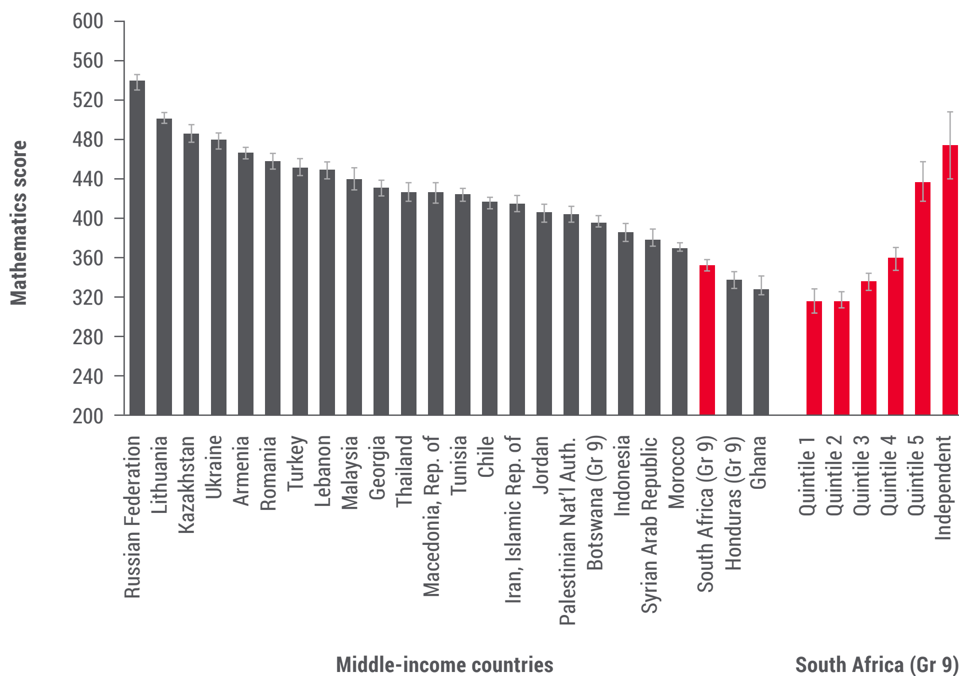


Poorest 25%		Second poorest 25%	
Second wealthiest 25%		Wealthiest 25%	

Source: Calculations done on SACMEQ III 2007 data

Graph 2: South African children underperform

Average Grade 8 Mathematics test scores for middle-income countries participating in TIMSS 2011 (+95% confidence intervals around the mean)



Source: Trends in International Mathematics and Science Study 2011

before the final cohort of inaugural Candidate Jakes Gerwel Fellows will be announced later this year.

At full strength, the Fellowship intends to select up to 60 aspirant teachers per year. Over time, this will allow for a professional community of over 1 500 expert teachers and education leaders who will be focused on creating systemic impact on the broader education environment.

The students will begin their degree studies at the University of Cape Town and the University of Pretoria, the two partner universities, at the start of 2018 and eventually complete a Postgraduate Certificate in Education to qualify as teachers.

The heart of the Fellowship's ambition is to inspire a groundswell of social transformation, one classroom at a time.

A comprehensive programme will wrap around the students during their four years at university to provide personal and leadership development, as well as mentoring and coaching by some of South Africa's best teachers in our top schools. Students will spend regular time inside these high-performing classrooms to learn their craft from the very best. Experiential learning opportunities in a variety of exciting and innovative environments across the country, through Africa and around the globe, will stimulate and inspire the Fellows to develop a global perspective with a local focus.

Preparing teachers for where education is going

One of the Fellowship's foundational values leans on the notion described by the famous Canadian ice hockey player, Wayne Gretzky, who attributed his phenomenal success in the sport to always trying "to skate to where the puck will be".

In this spirit, the Fellowship is committed to preparing teachers for where education is going, rather than where it currently is. That is, preparing for the role that virtual or augmented reality and artificial intelligence will play, the insights from neuroscience that will change our approach to learning, and the increasing focus on developing learning competencies or modalities that will allow our children not only to cope, but to flourish in the future that they will inherit.

The heart of the Fellowship's ambition is to inspire a groundswell of social transformation, one classroom at a time. If South Africa is to realise the dream of all her children flourishing and equipped to thrive in the modern world, regardless of socio-economic position, then it will be the cohort of expert teachers and education leaders who will show the way.

With over 20 years' experience, **Jeremy** has a deep understanding of the South African educational context. He was principal of Pinelands High School, a vibrant, diverse, co-educational high school in Cape Town, and draws on research knowledge from his master's degree in Education at the University of Cambridge. Jeremy carries a fervent belief in the potential of all children and a burning desire to see this potential realised across South Africa.

Allan Gray Balanced and Stable Fund asset allocation as at 30 September 2017

	Balanced Fund % of portfolio			Stable Fund % of portfolio		
	Total	SA	Foreign*	Total	SA	Foreign*
Net equities	62.7	46.7	16.1	36.7	24.9	11.8
Hedged equities	8.1	0.0	8.1	13.5	2.0	11.6
Property	1.6	0.9	0.7	2.8	2.0	0.8
Commodity-linked	4.5	4.3	0.2	3.6	3.1	0.4
Bonds	11.3	9.5	1.7	19.6	16.8	2.8
Money market and bank deposits	11.8	9.7	2.1	23.9	21.6	2.3
Total	**100.0**	**71.0**	**29.0**	**100.0**	**70.4**	**29.6**

Note: There might be slight discrepancies in the totals due to rounding. * This includes African ex-SA assets.

Allan Gray Equity Fund net assets as at 30 September 2017

Security (Ranked by sector)	Market value (R million)	% of Fund	FTSE/JSE ALSI weight (%)
South Africa	**31 341**	**77.3**	
South African equities	**29 388**	**72.5**	
Resources	**6 214**	**15.3**	**21.2%**
Sasol	3 060	7.5	
Glencore	516	1.3	
Goldfields	465	1.1	
BHP Billiton	464	1.1	
Impala Platinum	385	0.9	
Positions less than 1%[1]	1 325	3.3	
Financials	**10 323**	**25.5**	**24.0%**
Old Mutual	2 423	6.0	
Standard Bank	2 323	5.7	
Investec	1 123	2.8	
Reinet	1 019	2.5	
Rand Merchant Investment [2]	620	1.5	
Barclays Africa	548	1.4	
Nedbank	323	0.8	
Positions less than 1%[1]	1 945	4.8	
Industrials	**12 633**	**31.2**	**54.8%**
Naspers[2]	2 993	7.4	
British American Tobacco	2 004	4.9	
Remgro	1 415	3.5	
Life Healthcare	743	1.8	
Netcare	659	1.6	
KAP Industrial	635	1.6	
Super Group	526	1.3	
Nampak	388	1.0	
Woolworths	359	0.9	
Blue Label Telecoms	331	0.8	
Positions less than 1%[1]	2 581	6.4	
Other securities	**218**	**0.5**	
Positions less than 1%[1]	218	0.5	
Commodity-linked securities	**544**	**1.3**	
Positions less than 1%[1]	544	1.3	
Money market and bank deposits	**1 410**	**3.5**	
Foreign ex-Africa	**8 799**	**21.7**	
Equity Funds	**8 502**	**21.0**	
Orbis Global Equity Fund	8 009	19.8	
Orbis SICAV Emerging Markets Equity Fund	493	1.2	
Money market and bank deposits	**297**	**0.7**	
Africa ex-SA	**388**	**1.0**	
Equity funds	**388**	**1.0**	
Allan Gray Africa ex-SA Equity Fund	388	1.0	
Totals	**40 529**	**100.0**	

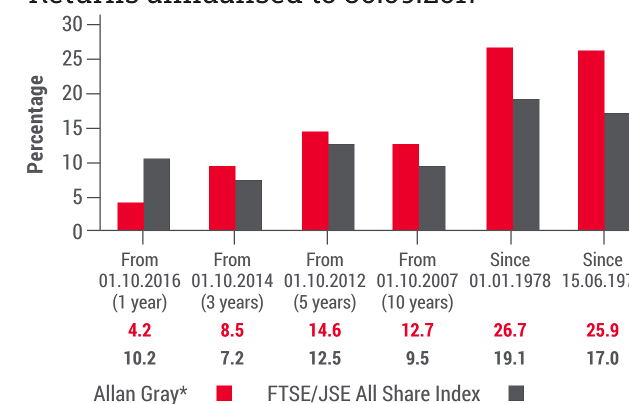
[1] JSE-listed securities include equities, property and commodity-linked instruments.
[2] Including stub certificates. **Note:** There may be slight discrepancies in the totals due to rounding. For other fund-specific information, please refer to the monthly fund factsheets.

Investment track record – share returns

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

Period	Allan Gray*	FTSE/JSE All Share Index	Out-/Under-performance
1974 (from 15.06)	-0.8	-0.8	0.0
1975	23.7	-18.9	42.6
1976	2.7	-10.9	13.6
1977	38.2	20.6	17.6
1978	36.9	37.2	-0.3
1979	86.9	94.4	-7.5
1980	53.7	40.9	12.8
1981	23.2	0.8	22.4
1982	34.0	38.4	-4.4
1983	41.0	14.4	26.6
1984	10.9	9.4	1.5
1985	59.2	42.0	17.2
1986	59.5	55.9	3.6
1987	9.1	-4.3	13.4
1988	36.2	14.8	21.4
1989	58.1	55.7	2.4
1990	4.5	-5.1	9.6
1991	30.0	31.1	-1.1
1992	-13.0	-2.0	-11.0
1993	57.5	54.7	2.8
1994	40.8	22.7	18.1
1995	16.2	8.8	7.4
1996	18.1	9.4	8.7
1997	-17.4	-4.5	-12.9
1998	1.5	-10.0	11.5
1999	122.4	61.4	61.0
2000	13.2	0.0	13.2
2001	38.1	29.3	8.8
2002	25.6	-8.1	33.7
2003	29.4	16.1	13.3
2004	31.8	25.4	6.4
2005	56.5	47.3	9.2
2006	49.7	41.2	8.5
2007	17.6	19.2	-1.6
2008	-13.7	-23.2	9.5
2009	27.0	32.1	-5.1
2010	20.3	19.0	1.3
2011	9.9	2.6	7.3
2012	20.6	26.7	-6.1
2013	24.3	21.4	2.9
2014	16.2	10.9	5.3
2015	7.8	5.1	2.7
2016	12.2	2.6	9.6
2017 (to 30.09)	**5.6**	**12.6**	**-7.0**

Returns annualised to 30.09.2017



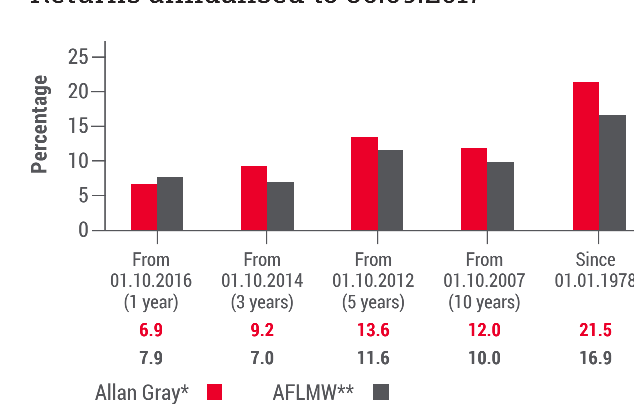
An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R211 021 648 by 30 September 2017. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R9 030 301. Returns are before fees.

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	6.9	5.9
2016	7.5	3.7	3.8
2017 (to 30.09)	**8.2**	**8.6**	**-0.4**

Returns annualised to 30.09.2017



An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R22 972 094 by 30 September 2017. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R5 007 909. 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 for September 2017 is an estimate. The return from 1 April 2010 is the average of the non-investable Alexander Forbes Large Manager Watch. **Note:** Listed property included from 1 July 2002. Inward listed included from November 2008 to November 2011.

Allan Gray South African unit trusts annualised performance (rand) in percentage per annum to 30 September 2017 (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)	**40.5**	**01.10.1998**	**23.3**	**10.6**	**12.8**	**7.4**	**5.2**	**125.8**	**−20.7**
Average of South African - Equity - General category (excl. Allan Gray funds)[1]			16.4	8.8	11.1	4.9	4.4	73.0	−37.6
Allan Gray-Orbis Global Equity Feeder Fund (AGOE)	**19.8**	**01.04.2005**	**16.0**	**13.8**	**25.2**	**15.1**	**17.7**	**78.2**	**−29.7**
FTSE World Index			14.3	12.0	22.5	14.7	16.8	54.2	−32.7
Medium net equity exposure (40% - 75%)									
Allan Gray Balanced Fund (AGBF)	**138.1**	**01.10.1999**	**17.5**	**10.8**	**12.5**	**8.3**	**5.9**	**46.1**	**−8.3**
Average of South African - Multi Asset - High Equity category (excl. Allan Gray funds)[2]			12.8	8.7	10.5	6.8	6.9	41.9	−16.7
Allan Gray-Orbis Global Fund of Funds (AGGF)	**14.1**	**03.02.2004**	**12.0**	**12.9**	**20.1**	**13.2**	**12.2**	**55.6**	**−13.7**
60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index			11.5	11.8	17.5	11.9	7.6	38.8	−17.0
Low net equity exposure (0% - 40%)									
Allan Gray Stable Fund (AGSF)	**45.0**	**01.07.2000**	**12.5**	**9.5**	**10.0**	**8.9**	**8.1**	**23.3**	**2.8**
Daily interest rate of FirstRand Bank Limited plus 2%			9.1	8.1	7.2	7.8	8.3	14.6	6.2
Very low net equity exposure (0% - 20%)									
Allan Gray Optimal Fund (AGOF)	**1.5**	**01.10.2002**	**7.9**	**7.1**	**7.4**	**7.4**	**0.7**	**18.1**	**0.7**
Daily interest rate of FirstRand Bank Limited			6.5	6.0	5.1	5.6	6.1	11.9	4.1
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO)	**1.3**	**02.03.2010**	**10.2**	**–**	**13.7**	**8.4**	**4.1**	**39.6**	**−12.4**
Average of US$ bank deposits and euro bank deposits			7.2	–	9.6	5.2	0.8	35.6	−19.1
No equity exposure									
Allan Gray Bond Fund (AGBD)	**0.7**	**01.10.2004**	**9.0**	**9.0**	**7.2**	**8.4**	**9.5**	**18.0**	**−2.6**
JSE All Bond Index (Total return)			8.6	8.4	6.3	7.6	8.2	21.2	−5.6
Allan Gray Money Market Fund (AGMF)	**14.5**	**03.07.2001**	**8.0**	**7.4**	**6.6**	**7.3**	**8.0**	**12.8**	**5.2**
Alexander Forbes Short-Term Fixed Interest (STeFI) Composite Index[3]			7.9	7.2	6.4	7.0	7.6	13.3	5.2

[1] From inception to 28 February 2015 the benchmark was the FTSE/JSE All Share Index including income (source: IRESS).
[2] From 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] From 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 returns 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 3-year period ending 30 September 2017

	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	1.14%	0.77%	0.01%	0.24%	2.16%	0.07%	2.23%
Allan Gray-Orbis Global Equity Feeder Fund	1.50%	0.30%	0.06%	0.01%	1.87%	0.15%	2.02%
Allan Gray Balanced Fund	1.08%	0.36%	0.02%	0.14%	1.60%	0.07%	1.67%
Allan Gray-Orbis Global Fund of Funds	1.37%	0.39%	0.08%	0.00%	1.84%	0.13%	1.97%
Allan Gray Stable Fund	1.06%	0.43%	0.02%	0.15%	1.66%	0.07%	1.73%
Allan Gray Optimal Fund	1.00%	0.76%	0.02%	0.25%	2.03%	0.15%	2.18%
Allan Gray-Orbis Global Optimal Fund of Funds	1.00%	0.45%	0.09%	0.00%	1.54%	0.13%	1.67%
Allan Gray Bond Fund	0.25%	0.25%	0.02%	0.07%	0.59%	0.00%	0.59%
Allan Gray Money Market Fund	0.25%	N/A	0.00%	0.04%	0.29%	0.00%	0.29%

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 Fund and impact Fund 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 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 30 September 2017 (net of fees)

	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[5] FTSE World Index	**01.01.1990**	**19.1** 13.7	**13.8** 12.0	**25.5** 22.7	**15.2** 14.7	**18.5** 16.9	**87.6** 54.2	**−47.5** −46.2
Orbis SICAV Japan Equity (Yen) Fund Tokyo Stock Price Index	**01.01.1998**	**15.6** 9.7	**14.3** 9.8	**23.1** 23.2	**17.9** 16.0	**14.7** 14.3	**94.9** 91.0	**−40.1** −46.4
Orbis SICAV Emerging Markets Equity Fund (US$)[6] MSCI Emerging Markets Index (Net) (US$)[6]	**01.01.2006**	**16.1** 15.1	**12.7** 10.1	**18.2** 18.1	**9.3** 13.7	**12.6** 18.0	**58.6** 60.1	**−34.2** −39.7
Allan Gray Africa Ex-SA Equity Fund Standard Bank Africa Total Return Index	**01.01.2012**	**14.9** 4.9	**–** –	**11.4** 0.8	**−4.6** −8.6	**39.0** 4.3	**65.6** 33.6	**−24.3** −29.4
Allan Gray Australia Equity Fund S&P/ASX 300 Accumulation Index	**04.05.2006**	**16.2** 13.2	**12.3** 8.8	**19.2** 14.5	**13.0** 9.6	**16.6** 9.8	**99.5** 55.6	**−55.4** −45.1
Medium net equity exposure								
Orbis SICAV Global Balanced Fund 60% MSCI World Index with net dividends reinvested and 40% JP Morgan Global Government Bond Index	**01.01.2013**	**21.2** 17.7	**–** –	**–** –	**13.7** 11.6	**12.8** 7.2	**54.4** 40.2	**−0.7** −8.4
Low net equity exposure								
Allan Gray Australia Stable Fund Reserve Bank of Australia cash rate	**01.07.2011**	**14.2** 9.1	**–** –	**11.9** 6.5	**9.2** 4.2	**8.6** 2.2	**32.7** 28.8	**−6.3** −12.6
Very low net equity exposure								
Orbis Optimal SA Fund-US$ Class US$ Bank deposits	**01.01.2005**	**11.3** 8.8	**10.5** 7.9	**14.7** 10.8	**9.2** 6.7	**3.3** −1.0	**48.6** 57.9	**−15.7** −25.6
Orbis Optimal SA Fund-Euro Class Euro Bank deposits	**01.01.2005**	**9.6** 7.3	**8.6** 5.8	**12.4** 8.4	**6.2** 3.6	**6.8** 2.8	**44.1** 40.2	**−19.3** −20.9

South African institutional portfolios[7] annualised performance (rand) in percentage per annum to 30 September 2017

	Assets under management (R billion)[8]	Inception date	Since inception	10 years	5 years	3 years	1 year
Local portfolios[9] (before local fees)							
Domestic Equity Composite (Minimum net equity 75% - 95%) **Domestic Equity Pooled Portfolio (Minimum net equity 95%)** FTSE/JSE All Share Index	**56.8** **4.8**	**01.01.1990** **01.02.2001**	**20.3** **20.8** 14.4/14.9	**12.2** **12.4** 9.5	**13.5** **14.1** 12.5	**7.6** **7.8** 7.2	**3.4** **2.9** 10.2
Domestic Balanced Composite **Domestic Balanced Pooled Portfolio** Mean of Alexander Forbes SA Large Manager Watch (Non-investable)[11]	**17.8** **2.2**	**01.01.1978** **01.09.2001**	**21.7** **17.8** 17.2/14.8	**11.4** **11.6** 9.7	**11.8** **11.8** 9.9	**8.8** **8.7** 6.5	**5.2** **5.0** 6.7
Domestic Stable Composite **Domestic Stable Pooled Portfolio** Alexander Forbes Three-Month Deposit Index plus 2%	**4.1** **1.2**	**01.12.2001** **01.12.2001**	**13.0** **13.3** 9.9	**9.7** **9.7** 9.1	**9.1** **9.3** 8.2	**9.2** **9.4** 8.8	**8.5** **8.6** 9.4
Global portfolios[9], limited to 25% foreign exposure (Before local, but after foreign fees)							
Global Balanced Composite **Global Balanced Pooled Portfolio** **Global Balanced (RRF) Portfolio[10]** Mean of Alexander Forbes Global Large Manager Watch (Non-investable)[11,12]	**83.7** **5.0** **28.7**	**01.01.1978** **01.09.2000** **01.09.2000**	**21.5** **18.2** **18.1** 16.9/14.0	**12.0** **12.1** **12.1** 10.0	**13.6** **13.7** **13.6** 11.7	**9.2** **9.3** **9.1** 7.0	**6.9** **6.8** **6.9** 7.9
Global Stable Composite **Global Stable Pooled Portfolio** Alexander Forbes Three-Month Deposit Index plus 2%	**7.4** **6.6**	**15.07.2004** **15.07.2004**	**12.8** **12.8** 9.3	**10.6** **10.6** 9.1	**11.1** **11.1** 8.2	**9.7** **9.6** 8.8	**9.1** **8.9** 9.4
Global Absolute Composite **Global Absolute Pooled Portfolio** Mean of Alexander Forbes Global Large Manager Watch (Non-investable)[11]	**11.8** **3.6**	**01.03.2004** **01.03.2004**	**15.1** **15.4** 14.7	**11.4** **11.7** 10.0	**10.7** **10.7** 11.7	**8.1** **8.2** 7.0	**3.1** **3.4** 7.9
Foreign only portfolios[9] (after fees)							
Orbis Global Equity Pooled Portfolio FTSE World Index	**0.6**	**18.05.2004**	**15.8** 14.0	**13.9** 11.9	**25.4** 22.6	**15.2** 14.7	**18.4** 17.0
Foreign Balanced (Rands) Composite[13] **Foreign Balanced Pooled Portfolio** 60% of the MSCI World Index[14] and 40% of the JP Morgan Global Government Bond Index	**5.1** **0.1**	**23.05.1996** **23.01.2002**	**14.6** **9.3** 12.1/7.9	**12.1** **12.1** 11.6	**19.1** **19.3** 17.4	**11.6** **12.0** 11.9	**12.3** **12.7** 7.9

Performance as calculated by Allan Gray

[4] This is the highest or lowest consecutive 12-month returns since inception. All rolling 12-month figures for the Fund and the benchmark are available from our Client Service Centre on request.

[5] The total assets under management for the Fund are shown, which include institutional and retail clients that invest directly with Orbis.

[6] Since inception to 31 October 2016 this Fund was called the Orbis SICAV Asia Ex-Japan Equity Fund and its benchmark was the MSCI Asia Ex-Japan Index. From 1 November 2016 the Fund's investment mandate was broadened to include all emerging markets. To reflect this, the Fund was renamed and the benchmark was changed.

[7] 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.

[8] The assets under management for institutional portfolios not listed here amount to R81.2bn.

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

[10] The returns prior to 1 August 2015 are those of the Allan Gray Life Global Balanced Portfolio.

[11] The return for the period ending September 2017 is an estimate as the relevant survey results have not yet been released.

[12] From inception to 31 December 1997 the Consulting Actuaries Survey returns were used.

[13] From inception to 31 August 2001 the foreign carve-out returns of the Global Balanced Composite were used.

[14] Morgan Stanley Capital International All Country World Index.

IMPORTANT INFORMATION FOR INVESTORS

Information and content

The information and content of this publication is provided by Allan Gray as general information about the company and its products and services ("Allan Gray" means Allan Gray Proprietary Limited and all of its subsidiaries and associate companies, and "the company" includes all of those entities). Allan Gray does not guarantee the suitability or potential value of any information or particular investment source. The information provided is not intended to nor does it constitute financial, tax, legal, investment, or other advice. Before making any decision or taking any action regarding your finances, it is recommended that you consult an independent, qualified financial adviser regarding your specific situation. Nothing contained in this publication constitutes a solicitation, recommendation, endorsement or offer by Allan Gray, but is merely an invitation to do business.

Allan Gray has taken and will continue to take care that all information provided, in so far as this is under its control, is true and correct. However, Allan Gray shall not be responsible for and therefore disclaims any liability for any loss, liability, damage (whether direct or consequential) or expense of any nature whatsoever, which may be suffered as a result of or which may be attributable, directly or indirectly, to the use of or reliance upon any information provided.

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, in terms of which it operates unit trust portfolios under the Allan Gray Unit Trust Scheme, and is supervised by the Financial Services Board ("FSB"). 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. Where annualised performance is mentioned, this refers to the average return per year over the period. 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. The Equity, Balanced, Stable and Optimal funds each have more than one class of units and these 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 include management fees, brokerage, securities transfer tax, 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

The FTSE/JSE All Share Index is calculated by FTSE International Limited ("FTSE") in conjunction with the JSE Limited ("JSE") in accordance with standard criteria. The FTSE/JSE All Share Index is the proprietary information of FTSE and the JSE. All copyright subsisting in the FTSE/JSE All Share Index values and constituent lists vests in FTSE and the JSE jointly. All their rights are reserved. FTSE is a trademark of the London Stock Exchange Group of Companies. The FTSE World Index is calculated by FTSE International Limited ("FTSE") in accordance with standard criteria and is the proprietary information of FTSE. All copyright subsisting in the FTSE World Index values and constituent lists vests in FTSE. All its rights are reserved.

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. The Allan Gray Equity, Balanced, Stable and rand-denominated offshore funds may invest in foreign funds managed by Orbis Investment Management Limited, our offshore investment partner.

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 fund 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 tax-free investment account, 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 Tax-Free Investment Account, Allan Gray Living Annuity and the Allan Gray Endowment 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).

Copyright notice

© Allan Gray Proprietary Limited, 2017.

All rights reserved. The content and information may not be reproduced or distributed without the prior written consent of Allan Gray Proprietary Limited.

About the paper

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

© ALLAN GRAY PROPRIETARY LIMITED, 2017.

Directors
Executive
R W Dower BSc (Eng) MBA
A R Lapping BSc (Eng) BCom CFA
T Mhlambiso AB MBA JD

Non-Executive
W B Gray BCom MBA CFA (Irish)
I S Liddle BBusSc (Hons) CFA
T J Mahuma BA (Hons) MPhil
K C Morolo BSc (Eng) MEng
N M Nene BCom (Hons)

Company Secretary
C E Solomon BBusSc (Hons) CA (SA)

Registration Number
2005/002576/07

Business Address
1 Silo Square
V&A Waterfront
Cape Town
8001

P O Box 51318
V&A Waterfront
Cape Town
8002
South Africa

Client Service Centre
T 0860 000 654 or +27 (0)21 415 2301
F 0860 000 655 or +27 (0)21 415 2492
E info@allangray.co.za
www.allangray.co.za

ALLANGRAY