Quarterly Commentary
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COMMENTS FROM THE CHIEF OPERATING OFFICER

Rob Dower

This will be my last Quarterly Commentary, and I would like to take the opportunity to wish you well and to thank you sincerely for your support...

Between countries and within a country over time, there is a strong correlation between the proportion of respondents answering on a standard survey that "people can generally be trusted" and the wealth of that country. Academics have tried to answer how this relationship is causal in each direction: Does being more trusting make you better off, or does being better off make you more trusting? By showing a relationship between past trust in different communities and changes in wealth, a study[1] has shown that improvements in trust do seem to make a big difference to future progress.

This makes intuitive sense: All economic activity relies on trust. We trust that the money we are paid each month will be accepted by shops, that banks will pay out our deposits, that drivers will accept our Uber payments, and that the person signing a deed of sale will really pay up when a house is transferred. The more trust there is, the less effort we have to spend checking up on people, the more efficiently we can work together, and the more progress we make.

In the week that I am writing this, the World Bank has revised its growth forecast for South Africa for 2018 and the South African Reserve Bank has said that GDP growth could exceed its forecast. The forecast rates of growth are not nearly what we need, but at least the trend is upwards. Our economy's increased optimism and confidence are being driven by increased trust between society, government and business, resulting from the big political changes that happened in February and March. In the same SA economic update, the World Bank pointed to its March report on poverty and inequality in South Africa: We remain the most unequal country in its database. Inequality is very strongly correlated with low trust, and in this case, the relationship is clearly causal. Inequality of opportunity undermines trust and low trust undermines economic activity.

Maybe this is an obvious point to make, but we have to use this breathing space to build a more equal and trusting

[1] "Inherited Trust and Growth", Algan and Cahuc, 2010

society or, in no time at all, we will turn back to acrimonious finger-pointing and economic stagnation.

Ownership responsibilities

We are keenly aware that part of our role is to act as a bridge of trust between you and the companies in which we invest your savings. In her piece this quarter, Raine Naudé delves into responsible investing and how it influences our thinking. Some may consider environmental, social and governance (ESG) factors as separate from the investment process, but for us they are integral. While it is the responsibility of the analyst assigned to a particular company to assess and analyse ESG issues, we also have an environmental and social analyst, as well as a governance analyst who are both available to assist the primary analyst in the research process and in flagging and analysing any ESG risks that may arise. We report on ESG matters in our annual Stewardship Report, which is available via our website.

Linked to this theme, Leonard Krüger shares the intricacies of our investment process and philosophy, while Nadia van der Merwe provides useful insights in this quarter's Investing Tutorial on the inner workings of a company, including the roles, responsibilities and remuneration of executives.

Offshore investing

People are more inclined to trust those close to them so it is very helpful that we share a founder, as well as our approach to investing, with our offshore partner, Orbis. A focus on intrinsic value and independent research has helped Orbis to outperform its benchmark and its peers in a period in which the average global equity manager has substantially underperformed the MSCI World Index.

While our investment philosophy is firmly rooted in core values, we opt for resilience and agility over rigidity in applying the philosophy. Matt Adams explains why this is so important in a world where the traditional rules of the game appear to break down. He believes that compelling investment opportunities remain for those who think differently and aren't afraid to look in less obvious places.

We were pleased with National Treasury's move to up the offshore exposure limits in the February 2018 Budget. Taking advantage of current rand strength to diversify away from our concentrated local share market, our investment team has raised the offshore exposure of our Balanced and Stable funds to 29.6% and 28.5% respectively (in addition to their investments in African bonds and equities). The Allan Gray Equity Fund's offshore holdings have been increased to 28.8%.

Risky business

A conversation about investing invariably becomes a conversation about risk. Risk is complex – it needs to be considered holistically from the point of view of yourself and your generational and cultural influences, your time horizon and the characteristics of your chosen investment. In his piece, Rob Formby helps us understand how our risk profiles are shaped and gives us some pointers on how to understand our tolerance levels and make more considered investment decisions.

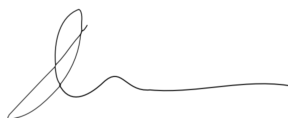
A new broom

This will be my last Quarterly Commentary, and I would like to take the opportunity to wish you well and to thank you sincerely for your support for Allan Gray during my time as chief operating officer. This job has been a privilege and a joy for me, but it is time for someone else to have a turn. Rob Formby will take over in the next two months, having previously done a great job running a substantial part of our business.

Rob Formby and Andrew Lapping and their teams are extremely capable and passionate advocates of the Allan Gray values and I know they will look after your (and my) savings with due care.

Thank you for trusting us with your investments.

Kind regards



Rob Dower

LONG-TERM INVESTING SHOULD HAVE NOTHING TO FEAR FROM THE VICEROYS

Leonard Krüger

...we believe we are well-positioned to deal with the fear and speculation caused in an era of activist scrutiny.

Activist short sellers have been a prominent feature in stock markets for many years. It's easy to get caught up in the hype when their ideas hit the news. Leonard Krüger explains how a disciplined investment process, applied consistently over time, helps to overcome the temptation to pile in (or out) based on the headlines.

In December 2017, an American investment firm, Viceroy Research, published an explosive report on Steinhoff International just as the company announced the delay of its financial results due to accounting irregularities and the immediate departure of its CEO. The dramatic collapse of Steinhoff's share price that followed inflicted large losses on shareholders, and Viceroy's happy coincidence of timing allowed it to claim a major scalp for activist short sellers.

Trepidation and rumour quickly spread when Viceroy announced shortly thereafter another pending research report on a major listed South African company. This caused large share price declines in Aspen Pharmacare and the Resilient stable of property companies. Ultimately, a report on Capitec Bank was released, with a greater than 20% share price fall in its aftermath.

While we won't always get things right, we believe we are well-positioned to deal with the fear and speculation caused in an era of increased public activist scrutiny. Our investment philosophy, at its core, involves proprietary fundamental research for every share we consider for investment in client portfolios. Assessing the risk/reward trade-offs and margin of safety is a key consideration of our investment process. This investment process has been refined over many economic cycles but remains dynamic as we are always trying to learn from our mistakes and to make improvements over time. Responsible investing considerations, which Raine Naudé discusses in her article, form an explicit part of the investment process.

The value of our investment philosophy and process can be illustrated using examples of companies that were the subject of recent short-selling rumours.

Steinhoff International

Graph 1 shows the share price rise and fall, as well as

Graph 1: The rise and fall of Steinhoff

10-year % change	
# Shares in issue	282%
Intangible assets	330%
Debt	155%
Employees	196%
Return on equity	-11%
Earnings per share	17%

Source: IRESS, Allan Gray research

the change in some of Steinhoff's high-level metrics over the past 10 years. The table accompanying the graph highlights the massive increase in issued shares, intangible assets, debt and employees as the business grew and made acquisitions over this period. Important shareholder metrics, like return on equity (ROE) and growth in earnings per share (EPS) were, however, uninspiring. ROE declined from 20% in 2007 to only 9% in 2017 and EPS grew by only 17% in euros, or 1.6% per annum.

During this period, Steinhoff went through the full Allan Gray investment process on six different occasions. This was in addition to the regular review of company results, news events and management meetings. Numerous warning signs and inexplicable actions flagged Steinhoff as a high risk and below-average prospective investment. Disappointingly, in October 2017, with the stock down 40% relative to the market over 18 months, we believed the price was sufficiently low to justify a small (less than 1%) position in client portfolios. Due to the risks flagged in our investment process a strict limit was placed on the maximum possible exposure to Steinhoff. Although this didn't make us feel any better about the outcome, it did help to avoid a bigger loss.

Resilient REIT

Another recent example demonstrating the value of a robust investment process amid uncertainty and activist short seller rumours is the Resilient REIT property company.

Graph 2 (on page 6) shows the share price compared to the net asset value (NAV) or book value of Resilient over time and the dramatic recent loss in value.

The substantial historical premiums of the share price over NAV show the very high expectations the market held for Resilient. This implied little or no margin of safety for shareholders in the event of any unforeseen events. This was despite a number of potential risks that were identified during our research process:

- A cross-shareholding structure between related companies with ever-changing holding sizes.
- Premium upon premium: The market was placing a premium on Resilient's shareholding in other companies, which were already trading on a premium themselves.
- Gearing upon gearing: Both Resilient and the underlying cross-shareholdings are funded partly by debt, which means that the ultimate returns for shareholders are geared more than once, increasing risk.

- The business model requires continuous and substantial additional capital from the market.
- Below-average quality of distributable income and actual cash flows below the level of declared dividends.

Graph 3 illustrates our assessment of the quality of distributed income from Resilient compared to domestic peers Growthpoint and Hyprop. Resilient derives a substantial portion of its income from sources that we classify as of a low or medium quality. Actual cash flows only covered 78% of the most recent dividend as "low-quality" sources of income like interest earned on loans granted are recognised as income by Resilient even though it does not receive the actual cash. Peers' actual cash flows more closely reflect their distributable income declared as dividends.

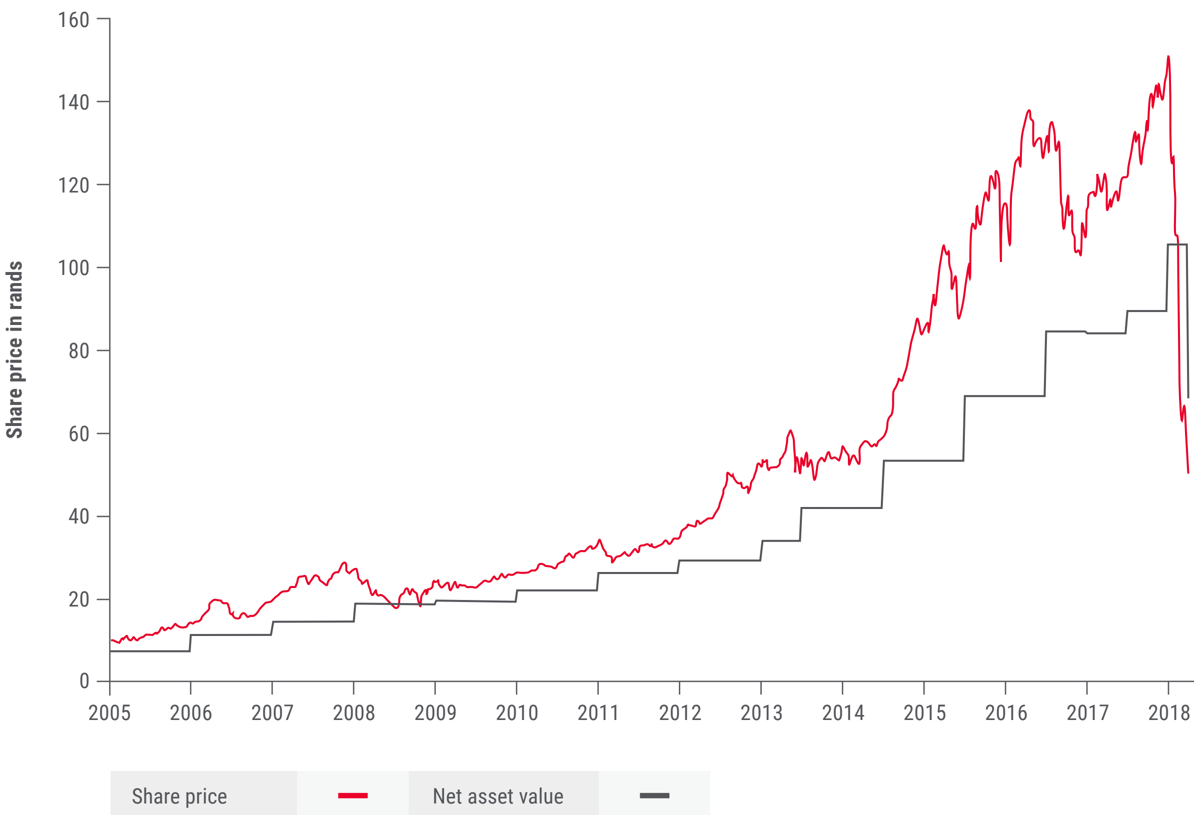
With no margin of safety and some material risks identified in the investment research process, Allan Gray holds no exposure to Resilient REIT.

Doing our own work

Short-selling activists like Viceroy perform a useful function in the market by making people more aware of the potential risks in shares like the two examples shown here. They should hold no fear for the diligent, active fund manager, nor for the rational, disciplined investor. Doing our own work to understand the risks, potential returns and the margin of safety is part and parcel of the research effort.

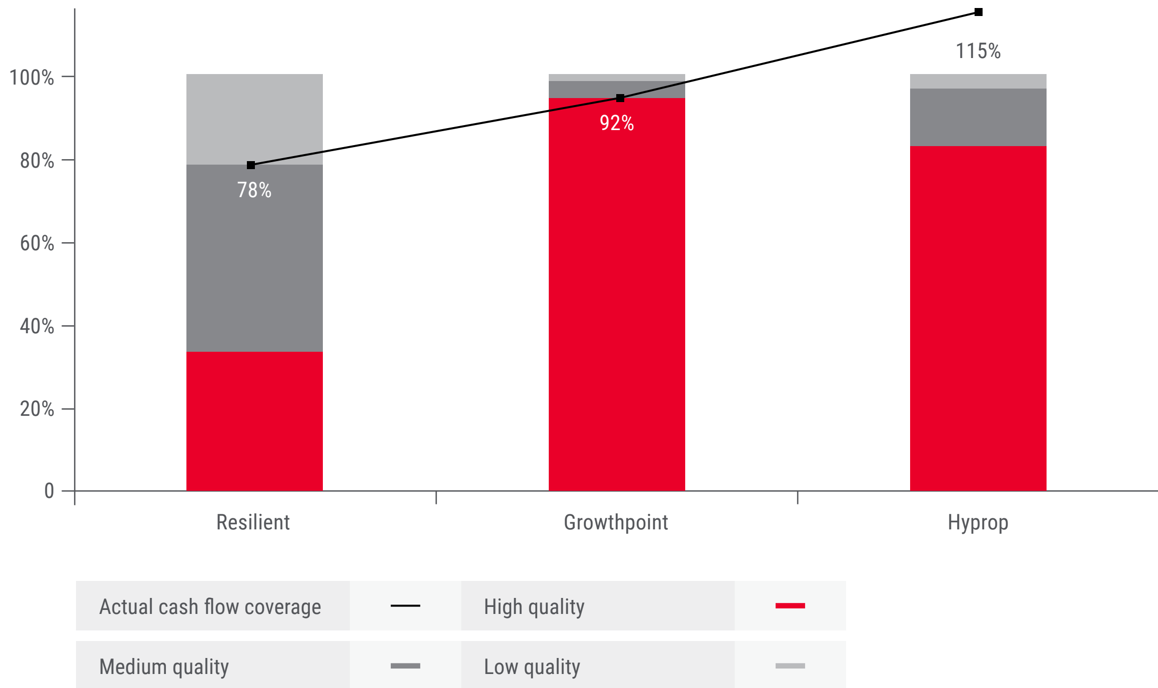
We don't always get things right, but having a robust process for assessing value and a philosophy that has been proven over long periods allows us to make up our own minds about which shares to avoid and where to take advantage of large short-term share price declines. The ability to limit or avoid losses from permanent capital destruction, as occurred in the cases of Steinhoff and Resilient, can be as important as finding the next big winner.

Graph 2: Resilient share price vs net asset value



Source: IRESS, Company reports

Graph 3: Quality and actual cash flow coverage of distributable income in property companies



Actual cash flow coverage	—	High quality	—
Medium quality	—	Low quality	—

Source: Allan Gray research

Leonard joined Allan Gray in 2007 as an equity analyst. He began managing a portion of our clients' equity and balanced portfolios earmarked for associate portfolio managers from July 2014 and was appointed as portfolio manager of the Stable portfolio in November 2015. Leonard completed his BSc (Hons) Actuarial Mathematics at the University of Pretoria and is a qualified actuary.

HOW TO BE A RESPONSIBLE INVESTOR

Raine Naudé

Shareholder activism is a key component of our responsible investing strategy...

Responsible investing has become a front-page issue in the last year as companies, investors and asset managers have had to respond to a number of ethical and governance lapses that have made the news. Raine Naudé discusses the different approaches to responsible investing and explains how we incorporate an assessment of environmental, social and governance concerns into our investment process.

It has become common for terms like "sustainable investing", "socially responsible investing (SRI)" and "environmental, social and governance (ESG) integration" to be used interchangeably; however, there are important differences between them. For the purposes of this article we use "responsible investing" broadly, meaning that an investor invests responsibly by taking one or more investment approaches, including ESG integration and SRI. These different approaches enable investors to find the responsible investment strategy that works best for them.

Screening: not black and white

Investment managers sometimes offer funds that screen out or exclude certain shares or include others. For example, SRI funds use negative screening to exclude companies or sectors based on ESG and ethical criteria. Common historical exclusions from these SRI funds include "sin" stocks such as tobacco, alcohol, gambling and weapons. Increasingly, companies that produce or use large amounts of fossil fuel are excluded due to their environmental impact.

Depending on the lens applied by the company, the same ESG principles are often applied esoterically, giving different exclusion or inclusion lists. For example, Parnassus Investments and Domini Impact Investments are two US companies specialising in responsible investing. The Parnassus Core Equity Fund, one of the largest SRI funds in the US, historically has excluded Coca-Cola because it sells unhealthy products. On the other hand, Domini's Impact Equity Fund invests in Coca-Cola as it met its "investment impact standards" through strong charity initiatives and activities in the development of minorities and communities.

All companies may have both positive and negative impacts on the environment and/or society. These can be complex to weigh up: what happens if a company has a positive social impact, but is damaging to the environment?

Furthermore, different social and environmental concerns resonate with different people. A survey of a diverse group of people will be likely to draw a broad range of companies and sectors and plenty of disagreement on what is excluded. We have a responsibility to act in the best interests of *all* clients, which makes maintaining a universally acceptable exclusion list difficult – especially within the confines of the JSE.

Our only screening exception is the chief investment officer (CIO) veto. This may be used to prohibit investments in a company that the CIO deems unethical in nature. The CIO is accountable to the Allan Gray board for his decision to veto a share (or not).

Sustainability themed and impact investing

Sustainability themed investment targets companies along the themes of environmental sustainability and sustainable development. There is not a broad enough choice on the JSE to make this a practical approach. Similarly, impact investing targets investments that generate a positive environmental and/or social impact alongside a financial return. Importantly, the benefits must be measurable and reported with investment returns. This approach lends itself to private equity investments in unlisted companies and SMEs, which are outside our investment universe.

ESG integration

The most common approach to responsible investing is ESG integration, which the United Nations Principles for Responsible Investment (UN PRI) defines as:

"...an approach to investing that aims to incorporate ESG factors into investment decisions, to better manage risk and generate sustainable long-term returns."

We follow this approach and we are a signatory of the UN PRI. Material ESG factors are incorporated into our investment research and are robustly debated in our internal policy group meetings, in which we discuss the investment case for shares or bonds to be included or excluded from our portfolios. Many of these issues are dynamic and we continually monitor ESG risks throughout the life of an investment. We do not have a standardised ESG risk-rating system; rather we evaluate each investment on a case-by-case basis using fundamental research to avoid "box-ticking".

Shareholder activism

Shareholder activism is the approach you will hear of most in the press. It includes filing shareholder proposals, proxy voting at company AGMs and directly engaging with executives and board members on ESG matters to influence a company's behaviour. There has been a pronounced global increase in shareholder activism on governance issues over the past decade. More recently, the number of environmental and social shareholder resolutions being proposed and supported at AGMs is growing.

Shareholder activism is a key component of our responsible investing strategy and we have been successful in influencing a number of positive changes in companies in which we invest. We publish our proxy voting record quarterly on our website and report on our ESG engagements in our annual Stewardship Report, also available on our website.

We believe that financial performance is often linked to managing ESG risks in a sustainable manner, so it makes sense to invest in companies with a strong ESG focus. However, investing at the right share price is critical. A brilliantly managed company can be a poor investment if you pay too much.

Our investment philosophy is to select stocks that we believe are undervalued by the market and will offer capital growth as their value is realised. A company that is putting effort into maintaining its social licence to operate, while behaving ethically and in an environmentally sustainable way, is more likely to produce sustainable free cash flow and financial returns over the long term. A company that does not manage its ESG risks appropriately will erode its ability to generate sustainable free cash flow over the long term. In practice, the impact of ESG factors on a company's intrinsic value is usually dynamic and requires diligent analysis.

Investors should select an investment manager or fund where the responsible investing strategy best aligns with their needs and values. In our opinion, ESG integration is the most pragmatic way to balance financial returns with ESG considerations. In addition, by actively managing your fund and engaging with the companies in which we invest, we contribute both to safeguarding your investments and to helping your investments have a net positive effect on society.

Raine is a member of the investment team. She assists with research into the environmental and social impacts of the companies in which Allan Gray invests. Raine graduated from UCT and is a qualified CA (SA). She has worked at Allan Gray for four and a half years, including as a trainee investment analyst.

ORBIS GLOBAL EQUITY: INVESTING DIFFERENTLY

Matt Adams

While the Orbis investment philosophy is firmly rooted in a set of core principles… we have never been dogmatic in our interpretation of these principles.

Over the last five years, the median global equity manager has underperformed the MSCI World Index and many value-oriented global equity managers have done even worse. Our offshore partner Orbis's Global Equity Fund has fared better in the face of these headwinds, prompting the question of how Orbis has managed to do so. Matt Adams from Orbis explains that while many factors have contributed, our shared focus on intrinsic value and the independent nature of our research process have enabled Orbis to remain flexible and resilient at a time when the traditional rules of the game no longer seem to apply.

In his excellent book *The Art of Learning*, former junior chess prodigy and International Master Josh Waitzkin observed: "The stronger chess player is often the one who is less attached to a dogmatic interpretation of the principles." While the Orbis investment philosophy is firmly rooted in a set of core principles – taking a long-term perspective, analysing individual companies, focusing on intrinsic value, and demanding a margin of safety – we have never been dogmatic in our interpretation of these principles.

For instance, we are not dogmatic about valuation methods (e.g. discounted cash flow, multiples, replacement value) or levels (e.g. maximum multiple of earnings, minimum dividend yield). Nor are we dogmatic about investment style or factors such as "value" or "growth". Instead, we recognise that markets are dynamic and discounts to intrinsic value can arise in all types of businesses. While this may frustrate those who want to categorise our investment style, we believe it affords us the agility to uncover opportunities in a variety of market environments. Indeed, we have historically outperformed in both value and growth markets.

One thing we do insist on is a significant discount to our estimate of intrinsic value – defined as the value of a business to a long-term buyer who will own it in its entirety and hold it in perpetuity – but even then we allow our analysts flexibility to use their independent judgement and creativity.

Resilience in the face of change

An important consequence of this less dogmatic approach is greater resilience when the traditional rules of the game appear to break down. In chess, Waitzkin would seek

to create chaos by radically deviating from convention. His opponents, who were often schooled strictly in the traditional principles, would struggle amid the chaos. Leveraging an exceptional foundation in the fundamentals, innate creativity, and a less dogmatic interpretation of the way the game was "supposed to be" played, Waitzkin was able to exploit the opportunities created in the disorder.

This reminds us of the current market environment, in which longstanding "rules" have been upended. For instance, there remain trillions of dollars of sovereign bonds with negative nominal yields – something that shouldn't happen according to conventional economic models. Central banks have printed extraordinary amounts of money, yet inflation in the real economy has been absent until recently. Growth stocks have outperformed value stocks for the longest stretch on record. At the same time, the extraordinary growth of passive funds and the rise of algorithmic traders are impacting the market in ways that are still difficult to understand.

The result is a strange and confusing environment for those who rely exclusively on rigid or formulaic interpretations of what worked in the past. But amid the confusion, we believe compelling investment opportunities remain for those who think differently and aren't afraid to look in less obvious places.

Finding compelling opportunities

The US market is a good example. By any traditional valuation measures, the US market looks expensive. Yet the Orbis Global Equity Fund ("the Fund") has retained meaningful exposure to the US market in recent years, and our stock selections there have added significant value. We have done this by being highly selective, taking a longer-term view than most, and by focusing on company-specific circumstances that others have overlooked or misunderstood.

XPO Logistics, currently the largest holding, is a good illustration. It has been the largest contributor to the Fund's performance over the past 12 months and is among its top ten contributors since inception in 1990. Today, at US$102 per share, XPO's price has more than quadrupled since our initial purchase in 2013.

But it was hardly an obvious opportunity at the time. The company had negative tangible book value, negative earnings before interest, tax, depreciation, and amortisation (EBITDA), negative cash from operations, and negative free cash flow (FCF). Through our fundamental research, however, we developed deep conviction in management's ability to create significant long-term value for shareholders through the company's aggressive acquisition strategy in the transportation and logistics industry. And by taking a longer-term perspective than others, and developing insight into management's skill, alignment and integrity, we were able to recognise the long-term potential of the investment.

In fact, the opportunity wasn't even obvious to us at the time. Many of our analysts vocally challenged the thesis and argued that we should sell the position. It is probably fair to say that a firm with a consensus-based system would probably not have owned XPO. Similarly, those with more dogmatic approaches to valuation or style would also likely have avoided the stock. And it would have been hard for many to stick with the position during the uncomfortable period when it wasn't adding value in the short term.

> ...we believe compelling investment opportunities remain for those who think differently and aren't afraid to look in less obvious places.

As **Graph 1** on page 12 shows, performance doesn't come in a straight line, and that's why a long-term perspective is so critical. Fortunately for clients, our process and culture embrace individual decision-making and accountability, and we empower stock-pickers to express unpopular views and to stick with them in the moments of greatest opportunity.

What is particularly exciting to us in this instance is that, despite such strong performance over the past several years, we believe that XPO continues to present an attractive long-term investment opportunity. Through strategic vision, savvy capital allocation, and strong execution, chief executive Brad Jacobs and his team have built XPO into a global logistics leader with highly differentiated technology and capabilities in the area of contract logistics.

In particular, the opportunity to provide logistics services to e-commerce customers, which now comprise nearly a third

of XPO's revenue, is driving approximately 10% per annum organic revenue growth for XPO. In turn, this is likely to fuel mid-teens growth in EBITDA and 20-30% growth in FCF as the company is able to leverage its fixed infrastructure and drive efficiencies. With the stock currently trading at about a 4% FCF yield on 2018 estimates, we see good potential for an annualised return of 25% or more over the next several years.

Importantly, this enthusiastic outlook for XPO's prospects does not give any credit for management's ability to create incremental value through additional acquisitions – something management is actively pursuing. With an exceptional track record in this regard, highly aligned interests, and a tiny 1.5% share of the trillion dollar global logistics market, XPO offers exciting long-term prospects for continued highly accretive capital deployment.

Some traditional "value" stocks warrant attention

This is not to suggest, however, that we haven't found any traditional "value" stocks. An example here would be AbbVie, one of the world's largest biopharmaceutical companies. AbbVie derives more than 60% of its revenue from its blockbuster drug Humira, which treats several autoimmune diseases. Despite robust growth, the market is sceptical that AbbVie's earnings are sustainable given the perceived threat of biosimilars to Humira and doubts about the company's drug pipeline. Consequently, the market is pricing AbbVie at a bargain 12 times our estimate of 2018 earnings and a 4% indicated dividend yield.

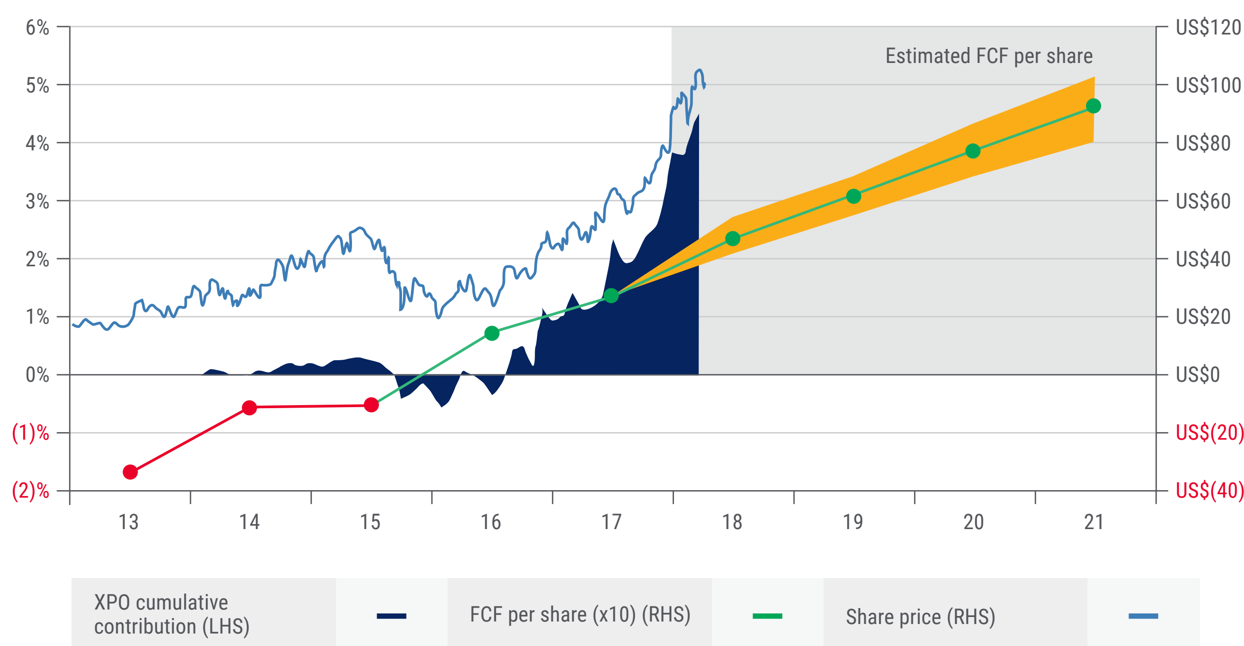
In contrast to the market's cautious view, we've developed conviction through our fundamental research that not only are biosimilars less of a threat to Humira than is perceived, but AbbVie's drug pipeline is also underappreciated. While not every pipeline drug will succeed, we see good potential for AbbVie's collective portfolio of future drugs to drive sustained earnings and revenue growth over the long term. And due to the uncorrelated nature of these factors with the overall economy, we see an attractive return profile for AbbVie under a wide range of scenarios.

We don't always get it right

Of course, we are not always right in our assessments. Consider Arconic, a leading manufacturer of highly engineered, lightweight metal products for the global

Graph 1: XPO – Share price does not reflect continued growth in free cash flow

XPO Logistics price, free cash flow (FCF), and cumulative contribution to the relative returns of the Orbis Global Equity Strategy, 2013 to March 2018, with estimates through 2021



Source: Datastream, company reports, Orbis

aerospace industry. The company has struggled over the past year in the face of a distracting proxy contest, management turnover, and significant operational challenges as the company works to meet aggressive production schedules for an unprecedented number of new aircraft engines. Unsurprisingly, Arconic shares have underperformed the World Index by more than 20% over the past year, and the position was a top detractor for the Fund over that period. Despite these challenges, we remain positive on the company's prospects and have added to the position substantially as the discount to our assessment of intrinsic value has widened.

We continue to believe that Arconic is a company with excellent assets, strong customer relationships, and great potential that has suffered primarily from poor governance and poor management. Fortunately, both have been dramatically improved in the past year, including a new chairman, a new CEO, and a substantially reconstituted board that we believe is much more aligned with shareholders. While the company's shares are not an obvious bargain at 19 times 2017 earnings, we see substantial opportunity for idiosyncratic improvements over the next several years as past investments yield results and new management works to improve operations. Looking forward a few years, we believe Arconic can earn between US$2.50 and US$3.00 per share. If we are right, the current share price of US$23 will prove to be a bargain.

Well-positioned overall

These stocks – XPO, AbbVie and Arconic – are examples of how our investment approach, grounded in core principles but undogmatic in their interpretation, has enabled us to find compelling opportunities amid a challenging environment. Not all of these will perform equally well, but we are confident that your capital is well-positioned overall to avoid permanent loss – and our investment team stands ready for any new challenges that the market throws at us in the future.

Matt joined Orbis in 2010. Based in San Francisco, he is a member of the US investment team and his responsibilities include leading the team's investment process and researching the US industrials sector. Matt is a member of the firm's US Board of Directors. He previously served as an officer in the United States Army, where he held a variety of leadership roles.

DO YOU NEED TO RETHINK YOUR OFFSHORE INVESTMENT EXPOSURE?

Earl van Zyl

...our analysis suggests investors should hold between 30% and 50% of their total investment portfolio offshore.

Treasury's decision to increase offshore investment limits for unit trusts, investment managers and long-term insurers is great news for savers and their diversification needs. Earl van Zyl explains the impact of these changes and how you can best take advantage of them.

Commentary on the 2018 Budget has understandably been centred on the government's decision to increase the VAT rate from 14% to 15% in an attempt to address South Africa's fiscal challenges. Not much airtime has been given to another significant change: the increase in foreign exposure limits. National Treasury announced that the limits on foreign assets held on behalf of individual investors by institutions, such as retirement funds and long-term insurers, would be increased by five percentage points to a total of 30% offshore (plus 10% in Africa outside SA) for retirement funds and 40% offshore (plus 10% in Africa ex-SA) for long-term insurers and management companies of unit trusts. This is a significant relaxation of exchange controls and great news for savers, and National Treasury should be commended.

How do these changes impact investors?

Some savvy investors have made use of the already-generous personal overseas investment allowances – R1 million annually without the need for SARS clearance and up to R10 million annually with SARS approval. These allowances have tended to benefit wealthy investors who can afford the higher minimum investment amounts and are prepared to deal with the extra complexity of buying offshore currency (we are working on reducing these barriers on our offshore platform, as discussed on page 17). But by far the majority of SA investors hold their long-term savings as members of pension or retirement funds, in long-term insurance policies, or in a local unit trust account. Offshore controls at institutional level are a significant policy issue because they directly impact millions of pension fund members and everyday investors.

Regulation 28 of the Pension Funds Act limits the proportion that retirement fund members can allocate to investments considered higher risk. An effective limit of 75% applies to South African listed equities. These include a selection of international companies that happen to

be listed on the Johannesburg Stock Exchange but are not inherently safer or more attractive on average than their global peers (consider Steinhoff). Yet overseas investments, including the very safe cash deposits held by retirement funds in overseas bank accounts, have until now been capped at 25%. The move to 30% is welcome and there are good arguments that it should be lifted further. It is interesting that the relatively rich retirement savers in very developed markets can invest their pensions all over the world, but pension fund members in South Africa, who have a much greater need to diversify away from the JSE's limited share selection, are kept in check.

Some argue that we need the large pool of savings held in local pension funds to be invested in local businesses. They can draw confidence from the last 15 years of gradually relaxing foreign exchange controls, where money flowing from international investors has easily offset the investments made overseas by local retirement funds, with both benefiting from the diversification. The cost of capital on local markets has declined, the discipline of markets has helped us deal with governance issues in the public and private sector, and SA pension fund members have enjoyed returns well above inflation.

How should investors take advantage of the increase in offshore allowances?

As a retirement fund member, you may benefit from your fund or underlying unit trust reallocating some of their investments (for example a balanced unit trust held in your retirement annuity (RA), or a pension fund investing for its members), or you could act directly by allocating 5% more of your RA portfolio to a rand-denominated feeder fund.

For investors in linked insurance policies, such as living annuities, there are indirect benefits from the increased limits. Individual living annuitants currently may invest up to 100% of their living annuity offshore, subject to the insurer of the policy having sufficient offshore capacity (see **text box** on page 16). However, since living annuity investors tend to use Regulation 28-compliant unit trusts, the average living annuitant will likely experience an increase in their offshore allocation over time, assuming no change in their unit trust allocation.

If you hold a basic local unit trust investment, not within an RA or insurance product, you will also benefit from the increased allocation. The portfolio managers of our Equity, Balanced and Stable funds, for example, have the option of allocating an additional 5% of assets offshore to Orbis, our offshore investment partner – and indeed, they are taking advantage of this opportunity.

How much offshore exposure should you have, and how much risk should you take?

The answer to this question depends on, among other things, your objectives and investment time horizon, so it is difficult to give a single number that is appropriate for everyone. Depending on your household's spending habits, our analysis suggests investors should hold between 30% and 50% of their total investment portfolio offshore.

> This is a significant relaxation of exchange controls and great news for savers, and National Treasury should be commended.

Table 1 on page 16, based on the last five years, illustrates the trade-offs that an investor would need to make were they to consider using a fund managed by Orbis, our offshore partner, for this allocation. For simplicity we include only the Orbis Global Balanced, Global Equity and Global Optimal funds in the investor's choice set.

The data in the table shows that over this period, there would have been a clear benefit from allocating to offshore assets beyond what an investor would expect from a local balanced fund mandate and, in the long run, we would also expect this to be the case. Whether investors should pick an offshore balanced fund, equity fund or absolute return fund, such as Orbis Optimal, depends on their appetite for risk and their long-term return goals. There are a number of funds in each of these categories available via our local and offshore platforms that investors can use to meet their objectives.

Assuming you would want an average of 40% of your overall portfolio to be in offshore assets, you would need to consider putting 15% into an offshore fund if you have 85% in a balanced fund which maximises the new offshore limits.

Table 1: Offshore exposure (5 years to February 2018)

Portfolio	Offshore exposure	5-yr return per annum	5-yr volatility	5-yr max peak to trough drop
100% Allan Gray Balanced	25%	10.5%	6.8%	7.1%
80% Allan Gray Balanced + 20% Orbis Global Balanced	40%	11.5%	7.6%	9.2%
80% Allan Gray Balanced + 20% Orbis Global Equity	40%	12.2%	8.0%	9.0%
80% Allan Gray Balanced + 20% Orbis Optimal	40%	10.4%	7.3%	9.0%

Source: Allan Gray research

Long-term investing and offshore exposures

In summary, most investors will likely see their offshore exposure increase through the local solution unit trusts that they are invested in, to the extent that these funds are able to use the increased offshore limits. It is important to be aware of this when considering the overall composition of your portfolio. While local portfolio managers are likely to take advantage of this increased allowance, if you construct your own portfolios it is important to remember that how much you decide to take offshore, and your asset allocation, should be based on your own investment objectives, risk tolerance and personal circumstances. It's also important to take a long-term view. A good, independent financial adviser can assist you in making decisions that are right for your circumstances.

Offshore limits in the Allan Gray Living Annuity and Endowment

Investors in Allan Gray's Living Annuity and Endowment can invest up to 60% of their portfolio value in offshore assets through the unit trusts available on Allan Gray's local investment platform.

Existing investors in these products whose offshore exposure exceeds this limit are able to maintain their current allocation, but may not increase it.

Reduced minimums for the offshore investment platform

If you wish to invest directly in offshore funds, but prefer to use a local administrator rather than have to open accounts with several offshore managers in different jurisdictions, you can do so via a locally administered offshore investment platform, such as Allan Gray's.

The Allan Gray offshore investment platform offers funds from a range of international investment managers. The platform can process instructions for several funds at the same time, sent to a single address, with local telephone lines for instructions and physical offices. You can invest or transfer cash or existing offshore investments to the platform without the need to repatriate them first. Our secure website (the same website through which you manage your other investments) offers easy reporting and online transacting.

As part of our ongoing drive to reduce the barriers to offshore investing, we have lowered the minimum investment amounts required to open and add to your account on the Allan Gray offshore investment platform, effective 16 April 2018. The new minimums are shown in **Table 2**.

How will the change impact switch and withdrawal instructions?

The minimum switch and withdrawal amount will change from US$1 000 to US$400 per unit trust. For partial switches and withdrawals, the remaining balance in each unit trust after the switch or withdrawal must be greater than US$400 (or foreign currency equivalent). If the remaining balance is below US$400, we will process a full switch or withdrawal.

Assistance with foreign exchanges administration services

We have negotiated with Incompass to offer you foreign exchange administration services at preferential rates. For each transaction where Incompass is required to process a transfer that is less than R50 000, they will charge a SWIFT fee of R250.

Table 2: Minimum investments for the offshore platform

Scenario	Previous minimum (US$ or foreign currency equivalent)	New minimum from 16 April 2018 (US$ or foreign currency equivalent)
Lump sum investment	US$10 000	US$1 500
Lump sum per unit trust*	US$1 000	US$400
Additional contribution per unit trust*	US$1 000	US$400
Preferred fee unit trust (Allan Gray Money Market Fund)	R10 000	R1 500

* The minimum investment, switch and withdrawal amounts for the Orbis SICAV Japan Equity (Yen) Fund will remain unchanged at US$1 000.

Earl joined Allan Gray in 2015 as a manager in product development, spent two years leading our Digital teams and currently heads up the product development department. He has an MBA from Chicago Booth at the University of Chicago and a BSc (Aeronautical Engineering) from Wits University.

THINKING ABOUT YOUR VIEW OF RISK

Rob Formby

A successful investment is when there is a match between the risk you expect or perceive and the actual risk of the fund.

Our primary concern as an investment manager is creating wealth for clients. To do this, we need to balance investment performance for clients with the risk incurred in generating this performance, which is really the risk of losing our clients' capital. This informs every decision we make and is built into our investment philosophy. Rob Formby explains how what you think about risk effects your investment.

Investors want to avoid loss of capital, but risk can manifest as volatility of performance, sustained underperformance or longevity of capital, and the effects of these are often overlooked. An investor who overestimates the risk of an investment, and is too conservative, may miss out on returns in the long term. We see this with some retirees who invest in the money market fund exclusively, in fear of the volatility of other investments. In the short run, their money is probably safe, but the returns that a money market fund offers may not keep up with inflation over time. In the long run, returns will not be enough to sustain them in retirement. In the reverse, if risk is underestimated, the ups and downs may be too much to bear for an investor and it may force them to withdraw before an investment has had time to give them their required returns, or exit at the worst possible moment, like when press coverage is negative and an investment is underperforming.

We manage a range of unit trusts with different levels of risk: As a rule of thumb, the more equities a fund invests in the more risky it is likely to be. However, our part is only half the equation. The way you think about risk relative to performance and the individual tolerance that you have for this are as important, as they influence the investment choices you make. A successful investment is when there is a match between the risk you expect or perceive and the actual risk of the fund. Calibrating your risk tolerance is a problem of psychology and the most difficult psychology to solve is often your own.

Generational and cultural influences

The way we think about risk is not formed in a vacuum. Past experiences play a big role in the way we perceive it. Overlaying your personal perceptions of risk are generational views of risk. The shared history of a cohort

means that the risk perceptions of millennials (generally accepted as people born between 1982 and ~2000) are markedly different from that of their parents' generation and of their grandparents' generation.

A US study done by Legg Mason about the views of millennials on investment shows this in practice: 85% described themselves as conservative investors, with a lower portion of their investments in equities compared to that of their parents' generation, despite the age difference. Millennials experienced the disruption of the global financial crisis up close either directly or through their families. It is no surprise that this left a risk-averse mindset in its wake, especially in the more impressionable generation that experienced it early on in life.

Closer to home it makes more sense to compare born-frees and the generation before them. Someone whose formative years were occupied by a ceaseless state of emergency in the 80s and culminated in the very real threat of civil war in the early 90s would have a different view of risk from someone whose history begins with free elections and strong local returns over the past few decades.

Likewise, wealth and cultural differences play a role. Being raised in a household where investments are discussed gives one a comfort with market risk that someone who learns of these ideas later will take time to acquire. It is easy to overlook how important comfort with markets is in becoming a successful investor. Stokvels are prevalent because many South Africans are more comfortable with the risks associated with trusting our neighbours than the sometimes opaque forces of the market or even the trustworthiness of a savings provider.

Your personal perception of risk

As much as our generational and cultural influences affect our perception of risk, we also all have a personal slant. A successful investment may have made us a bit overconfident or perhaps a negative experience has tainted how we view investments.

Risk perceptions can be quite irrational. Many people are afraid of flying, but are quite comfortable with the statistically riskier activity of driving because they are in control. The perception of control can affect how we personally feel about the riskiness of an activity.

So where does this leave us as investors?

We should put more intentional thought into what "risk" means for us and how this is likely to affect our tolerance levels and investment decisions. You can achieve this by doing the following:

1. Determine how risk could impact you. It is important that you understand what you are trying to avoid – is it loss of capital, it is performance below expectation for an extended period, or is it performance that varies? Often it is less scary than the permanent loss of capital that the term "risk" conjures up.

2. Work out your tolerance levels. Understand at what point you will become uncomfortable and under what conditions this is likely to happen. Remember that everyone will have different points based on generational, cultural and personal factors.

3. Match the risk tolerance with the profile of the products you want to invest in. Some unit trust fact sheets include a risk spectrum indicator to show the fund's profile, but generally, the higher the equity exposure the higher the risk.

If you are uncomfortable with any of the above steps it may be worthwhile consulting an independent financial adviser. Having someone test your outlook can give you a more objective view. Alternatively you can use risk profiling tools (which you can find online).

Lastly, a way to correct your perception of risk is to feel a measure of control. Be the driver of your investment and not a passenger. This may mean that you research your investment so that you feel less like a victim of the vagaries of the market. Of course no-one can know what the market will do, but knowing a little bit more may make you feel more comfortable with investing in it.

If this is done well and your risk perception matches that of the investment you choose, it can go a long way in ensuring that you start off on the right foot.

Rob is chief operating officer designate. He joined Allan Gray in 2009 taking on joint responsibility for the retail business, specifically operations, technology and financial management. He was previously employed at Mvelaphanda Group as a strategy consultant and holds an MBA from INSEAD and an engineering degree from UCT.

HOW ARE COMPANIES GOVERNED?

Nadia van der Merwe

It is important to remember that the ultimate owner of the investments we make is you.

When you invest in equities – either directly or through a unit trust – you become the part-owner of the business. Nadia van der Merwe explains the role of a business owner in public companies.

A company is an institution that consumes various types of resources, including skills, time and money (capital), to produce various outputs, including the profits made from providing a service or selling goods. When they need extra capital, for example to build a new factory or buy another firm or even just to expand their business, some companies choose to offer shares to the public as a way to raise money. Companies that have many shareholders usually list their shares for trading on a stock exchange like the Johannesburg Stock Exchange (JSE) and are referred to as public companies. This helps their shareholders to buy and sell shares more conveniently and safely.

The mechanics of a company

In exchange for providing capital to fund the business, shareholders require an acceptable return on their investment and to have confidence that the business is being managed with their interests in mind. Just as a passenger in a car needs to know the direction it is headed in and how well the journey is progressing, shareholders need regular information from companies in order to make good decisions about whether to stay on board. When things are going wrong, or when it looks like the car may cause some damage to others, shareholders can jump out or they may try to replace the driver. If the company needs to be fixed, the shareholders may need to contribute insight or additional capital. An investor who is simply a passive and unskilled passenger is not in a good position to exercise their rights and fulfil their responsibilities as a shareholder.

Most public companies have thousands of shareholders. Running a company with a committee of thousands would be impractical, so the ultimate responsibility for the strategic direction of a company is vested in a board of directors – with the biggest shareholders stepping in if a situation warrants it. Shareholders are responsible for electing directors to the board by voting them in at

the company's annual general meeting (AGM). The board is generally made up of non-executive directors (people who are not employees of the company) and a few executive directors. Usually about a third of the board is required to stand for re-election at any given AGM. Executive management's task is to execute the strategy set out by the board, which means managing the company on a day-to-day basis, providing regular updates and reporting to the board as well as the shareholders.

To extend the analogy: The board picks the destination of the car, which route it wants to take to get there, and whether it wants to get there in a hurry or not (i.e. how much risk it wants to take). It is then up to the executives to implement this plan – that is, to do the day-to-day driving and maintenance to ensure the car gets to where it needs to go.

Importantly, the board decides how best to incentivise executives to do their job and also monitors their performance. Each year, shareholders are allowed to vote on the company's executive remuneration policy and remuneration report at the AGM, but these votes are not binding. Nevertheless, most boards make changes to improve the policy if less than 75% of the votes are in favour.

What is our role?

As investment managers, we search for companies for our clients' investments whose share price is below what we consider to be the true value that the business will realise over time (the intrinsic value). The company could be undervalued for many reasons, such as market sentiment, a downturn that is unrelated to its operational strength, or perhaps that it has temporarily lost its way. To really stretch the analogy, this is a bit like looking for a car that has a reliable or powerful engine but may have some scratches on the paintwork, an unfashionable look, or taken a small detour from the main road.

Sometimes a company may be suffering from institutional problems, whether it is a board that is misdirecting the company or a management team that is not managing risks effectively. On occasion, these problems may require intervention from shareholders, like us, to ensure that the company is creating value as it should.

Our role as shareholders on your behalf is to help appoint the board to steer the company towards better returns and sometimes to suggest mechanical changes that may help improve its running. This may involve helping with remuneration policies that align management's interests with that of the investors, engagements with the executive team, voting according to our recommendations at AGMs or written communication.

How does this affect you?

If things go well, the company may be able to pay some of its profits back to shareholders as dividends. Dividends are usually only paid if the company has sufficiently invested for the future. The other way you get returns is if the share price rises to a point where we can sell it for a higher price than you paid for it, thereby making a profit. Both of these ultimately rely on the mechanics of a company being sound: The board needs to provide a plan, the executives need to execute it, and shareholders must hold them to account.

It is important to remember that the ultimate owner of the investments we make is you. When engaging with management or the board on your behalf, or making voting recommendations for resolutions at company AGMs, we do so in the best interest of our clients with the ultimate aim being to maximise long-term shareholder value.

Our annual Stewardship Report, which is available on our website, provides an overview of our engagements with companies.

Nadia joined Allan Gray in 2010 and is a business analyst in the Institutional Client Servicing team. She completed her BCom (Hons) Actuarial Science at Stellenbosch University and is a qualified actuary.

Allan Gray Balanced and Stable Fund asset allocation as at 31 March 2018

	Balanced Fund % of portfolio			Stable Fund % of portfolio		
	Total	SA	Foreign*	Total	SA	Foreign*
Net equities	60.3	45.5	14.9	33.4	24.6	8.8
Hedged equities	10.9	0.9	10.0	14.5	0.3	14.2
Property	1.3	0.8	0.5	3.5	3.1	0.4
Commodity-linked	3.9	3.5	0.4	2.4	2.0	0.4
Bonds	12.2	10.0	2.2	21.2	17.8	3.4
Money market and bank deposits	11.4	7.1	4.3	25.0	19.6	5.5
Total	**100.0**	**67.7**	**32.3**	**100.0**	**67.3**	**32.7**

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 March 2018

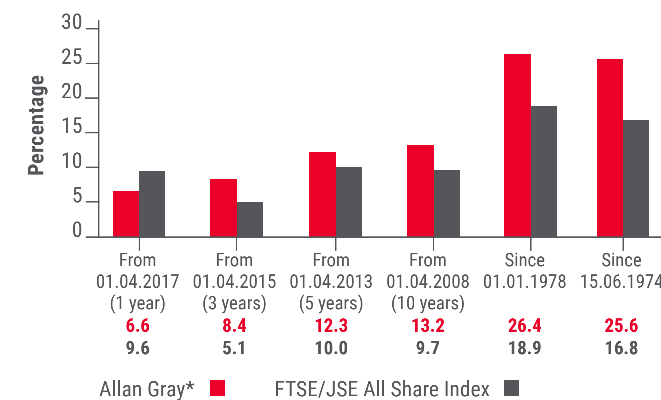
Security (Ranked by sector)	Market value (R million)	% of Fund	FTSE/JSE ALSI weight (%)
South Africa	**29 158**	**71.2**	
South African equities	**28 087**	**68.6**	
Resources	**6 013**	**14.7**	**20.9**
Sasol	3 227	7.9	
Glencore	448	1.1	
BHP Billiton	421	1.0	
Goldfields	357	0.9	
Impala Platinum	326	0.8	
Positions less than 1%[1]	1 234	3.0	
Financials	**9 273**	**22.6**	**27.2**
Old Mutual	2 432	5.9	
Standard Bank	2 162	5.3	
Investec	1 219	3.0	
Reinet Investment SCA	788	1.9	
Rand Merchant Investment[2]	461	1.1	
MMI Holdings	360	0.9	
Nedbank	316	0.8	
Positions less than 1%[1]	1 535	3.7	
Industrials	**12 582**	**30.7**	**51.9**
Naspers[2]	2 636	6.4	
British American Tobacco	2 168	5.3	
Remgro	1 464	3.6	
Netcare	920	2.2	
Life Healthcare	882	2.2	
KAP Industrial	670	1.6	
Woolworths	651	1.6	
Super Group	450	1.1	
Nampak	344	0.8	
Tsogo Sun	304	0.7	
Positions less than 1%[1]	2 093	5.1	
Other securities	**218**	**0.5**	
Positions less than 1%[1]	218	0.5	
Commodity-linked securities	**494**	**1.2**	
Positions less than 1%[1]	494	1.2	
Money market and bank deposits	**577**	**1.4**	
Foreign ex-Africa	**10 989**	**26.8**	
Equity Funds	**10 161**	**24.8**	
Orbis Global Equity Fund	7 475	18.2	
Orbis SICAV International Equity Fund[3]	2 185	5.3	
Orbis SICAV Emerging Markets Equity Fund	453	1.1	
Allan Gray Frontier Markets Equity Fund[3]	48	0.1	
Money market and bank deposits	**829**	**2.0**	
Africa ex-SA	**824**	**2.0**	
Equity funds	**824**	**2.0**	
Allan Gray Africa ex-SA Equity Fund	824	2.0	
Totals	**40 972**	**100.0**	

[1] JSE-listed securities include equities, property and commodity-linked instruments.
[2] Including stub certificates.
[3] This fund is not approved for marketing in South Africa. Reference to this fund is solely for disclosure purposes and is not intended for, nor does it constitute, solicitation for investment. **Note:** There may be slight discrepancies in the totals due to rounding. For other fund-specific information, please refer to the monthly 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	15.6	21.0	−5.4
2018 (to 31.03)	**−4.9**	**−6.0**	**1.1**

Returns annualised to 31.03.2018

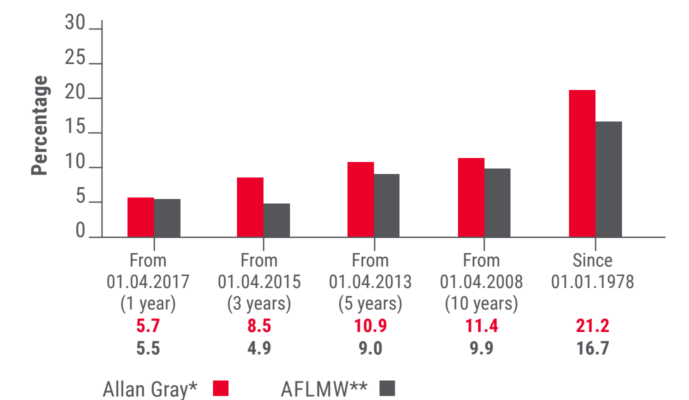


An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R219 696 251 by 31 March 2018. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R9 122 713. Returns are before fees.

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	11.9	11.5	0.4
2018 (to 31.03)	**−2.8**	**−2.8**	**0.0**

Returns annualised to 31.03.2018



An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R23 098 624 by 31 March 2018. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R4 997 760. 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 March 2018 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 31 March 2018 (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)	**41.0**	**01.10.1998**	**22.7**	**10.8**	**10.1**	**6.5**	**5.7**	**125.8**	**−20.7**
Average of South African - Equity - General category (excl. Allan Gray funds)[1]			15.9	8.8	8.4	2.3	4.2	73.0	−37.6
Allan Gray-Orbis Global Equity Feeder Fund (AGOE)	**18.1**	**01.04.2005**	**14.8**	**11.7**	**17.6**	**11.7**	**5.2**	**78.2**	**−29.7**
FTSE World Index			13.0	10.4	15.7	8.0	2.2	54.2	−32.7
Medium net equity exposure (40% - 75%)									
Allan Gray Balanced Fund (AGBF)	**142.1**	**01.10.1999**	**17.0**	**10.2**	**9.9**	**7.5**	**4.6**	**46.1**	**−8.3**
Average of South African - Multi Asset - High Equity category (excl. Allan Gray funds)[2]			12.4	8.5	7.9	4.0	3.7	41.9	−16.7
Allan Gray-Orbis Global Fund of Funds (AGGF)	**12.7**	**03.02.2004**	**10.8**	**9.4**	**13.4**	**9.4**	**0.2**	**55.6**	**−13.7**
60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index			10.4	9.1	12.1	5.9	−0.4	38.8	−17.0
Low net equity exposure (0% - 40%)									
Allan Gray Stable Fund (AGSF)	**46.1**	**01.07.2000**	**12.3**	**8.9**	**8.9**	**9.1**	**7.2**	**23.3**	**2.8**
Daily interest rate of FirstRand Bank Limited plus 2%			9.0	7.9	7.4	8.0	8.1	14.6	6.2
Very low net equity exposure (0% - 20%)									
Allan Gray Optimal Fund (AGOF)	**1.2**	**01.10.2002**	**7.8**	**6.8**	**7.1**	**5.4**	**−1.5**	**18.1**	**−1.5**
Daily interest rate of FirstRand Bank Limited			6.5	5.8	5.3	5.8	6.0	11.9	4.1
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO)	**1.1**	**02.03.2010**	**8.1**	**–**	**8.5**	**6.0**	**−2.5**	**39.6**	**−12.4**
Average of US$ bank deposits and euro bank deposits			5.3	–	5.1	1.8	−4.2	35.6	−19.1
No equity exposure									
Allan Gray Bond Fund (AGBD)	**1.1**	**01.10.2004**	**9.4**	**9.8**	**8.4**	**9.6**	**15.3**	**18.0**	**−2.6**
JSE All Bond Index (Total return)			9.1	9.6	7.7	8.6	16.2	21.2	−5.6
Allan Gray Money Market Fund (AGMF)	**15.1**	**03.07.2001**	**8.0**	**7.2**	**6.8**	**7.5**	**7.9**	**12.8**	**5.2**
Alexander Forbes Short-Term Fixed Interest (STeFI) Composite Index[3]			7.9	7.0	6.6	7.2	7.5	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 31 March 2018

	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	1.08%	0.75%	0.01%	0.22%	2.06%	0.07%	2.13%
Allan Gray-Orbis Global Equity Feeder Fund	1.50%	0.42%	0.05%	0.01%	1.98%	0.14%	2.12%
Allan Gray Balanced Fund	0.99%	0.42%	0.02%	0.14%	1.57%	0.09%	1.66%
Allan Gray-Orbis Global Fund of Funds	1.40%	0.56%	0.08%	0.00%	2.04%	0.13%	2.17%
Allan Gray Stable Fund	1.06%	0.44%	0.02%	0.14%	1.66%	0.07%	1.73%
Allan Gray Optimal Fund	1.00%	0.48%	0.03%	0.21%	1.72%	0.14%	1.86%
Allan Gray-Orbis Global Optimal Fund of Funds	1.00%	0.74%	0.09%	0.00%	1.83%	0.13%	1.96%
Allan Gray Bond Fund	0.25%	0.32%	0.02%	0.08%	0.67%	0.00%	0.67%
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 31 March 2018 (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**	**18.4** 13.2	**11.8** 10.4	**17.7** 15.7	**12.0** 8.0	**5.2** 1.6	**87.6** 54.2	**–47.5** –46.2
Orbis SICAV Japan Equity (Yen) Fund Tokyo Stock Price Index	**01.01.1998**	**15.1** 9.3	**12.0** 9.0	**17.0** 15.9	**13.0** 9.3	**10.6** 7.2	**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**	**14.6** 14.0	**9.9** 9.3	**12.1** 13.4	**6.0** 7.7	**–1.9** 10.3	**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** 4.1	**–** –	**6.5** –1.6	**4.8** –3.2	**40.8** 6.2	**69.1** 24.6	**–38.6** –43.4
Allan Gray Australia Equity Fund S&P/ASX 300 Accumulation Index	**04.05.2006**	**14.5** 11.5	**10.4** 7.4	**9.8** 6.4	**11.3** 3.3	**–4.5** –8.6	**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**	**16.6** 13.7	**–** –	**14.2** 11.9	**8.6** 5.5	**–0.6** –1.8	**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**	**10.7** 6.0	**–** –	**5.2** 1.0	**6.5** 1.1	**–7.5** –9.9	**32.7** 28.8	**–7.4** –12.6
Very low net equity exposure								
Orbis Optimal SA Fund-US$ Class US$ Bank deposits	**01.01.2005**	**9.8** 7.5	**6.5** 4.4	**9.0** 5.7	**5.2** 0.1	**–7.0** –10.6	**48.6** 57.9	**–15.7** –25.5
Orbis Optimal SA Fund-Euro Class Euro Bank deposits	**01.01.2005**	**8.5** 6.2	**4.1** 1.8	**7.5** 4.2	**8.1** 3.5	**3.8** 1.1	**44.1** 40.2	**–19.3** –20.9

South African institutional portfolios[7] annualised performance (rand) in percentage per annum to 31 March 2018

	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	**58.7** **4.9**	**01.01.1990** **01.02.2001**	**20.0** **20.5** 14.2/14.5	**12.4** **12.8** 9.7	**11.3** **11.7** 10.0	**7.6** **7.7** 5.1	**6.5** **6.3** 9.6
Domestic Balanced Composite **Domestic Balanced Pooled Portfolio** Mean of Alexander Forbes SA Large Manager Watch (Non-investable)[11]	**34.7** **2.4**	**01.01.1978** **01.09.2001**	**21.5** **17.5** 17.0/14.5	**11.6** **11.7** 10.1	**10.4** **10.3** 8.4	**8.7** **8.7** 5.3	**6.9** **6.9** 6.9
Domestic Stable Composite **Domestic Stable Pooled Portfolio** Alexander Forbes Three-Month Deposit Index plus 2%	**4.2** **1.2**	**01.12.2001** **01.12.2001**	**13.0** **13.3** 9.9	**9.8** **9.9** 8.9	**9.6** **9.7** 8.4	**10.4** **10.6** 9.0	**11.4** **11.3** 9.2
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]	**58.9** **4.7** **29.6**	**01.01.1978** **01.09.2000** **01.09.2000**	**21.2** **17.6** **17.6** 16.7/13.6	**11.4** **11.5** **11.5** 9.9	**10.9** **10.9** **10.8** 9.0	**8.5** **8.6** **8.4** 4.9	**5.7** **5.5** **6.0** 5.5
Global Stable Composite **Global Stable Pooled Portfolio** Alexander Forbes Three-Month Deposit Index plus 2%	**8.1** **7.0**	**15.07.2004** **15.07.2004**	**12.5** **12.5** 9.3	**9.9** **9.9** 8.9	**9.9** **9.9** 8.4	**10.1** **10.0** 9.0	**8.4** **8.2** 9.2
Global Absolute Composite **Global Absolute Pooled Portfolio** Mean of Alexander Forbes Global Large Manager Watch (Non-investable)[11]	**11.7** **3.6**	**01.03.2004** **01.03.2004**	**14.5** **14.8** 14.1	**9.8** **10.1** 9.9	**8.6** **8.7** 9.0	**7.2** **7.3** 4.9	**1.1** **1.4** 5.5
Foreign only portfolios[9] (after fees)							
Orbis Global Equity Pooled Portfolio FTSE World Index	**0.6**	**18.05.2004**	**14.6** 12.8	**11.9** 10.4	**17.7** 15.7	**12.0** 8.0	**5.1** 1.6
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	**4.9** **0.1**	**23.05.1996** **23.01.2002**	**13.8** **8.4** 11.4/7.0	**8.8** **8.8** 8.9	**12.2** **12.3** 12.0	**8.7** **8.9** 5.9	**0.1** **–0.5** –0.8

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] From 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 R80.9bn.
[9] The composite assets under management figures shown include the assets invested in the pooled portfolios 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 March 2018 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

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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. 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 fee 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 section 13B of the Pension Funds Act as a benefits administrator. The Allan Gray Tax-Free Investment Account, Allan Gray Living Annuity and 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).

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The Allan Gray Quarterly Commentary is printed on LumiSilk, a paper made from trees grown specifically for paper manufacturing.
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NOTES

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