QC

Quarterly Commentary
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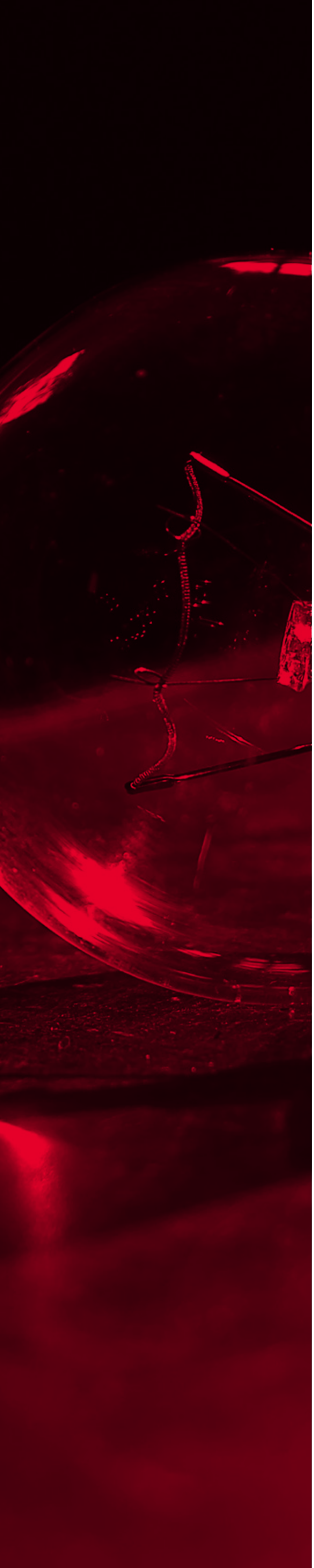
ALLAN GRAY

Shedding dark on the issue of South Africa's economic growth



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COMMENTS FROM THE CHIEF OPERATING OFFICER

Mahesh Cooper

Our golden jubilee gives us a chance to honour the roots that hold us steady … we remain focused on creating long-term wealth for you, and on making a real difference to society in the 50 years to come.

This year marks 50 years since Allan Gray began offering investment management services in South Africa. The local unit trust industry was in its infancy, and Allan, having recently returned to South Africa from the US, was determined to introduce professional investment management to the country. He later noted: "My objective was to try and make a difference."

Our golden jubilee gives us a chance to honour the roots that hold us steady, the track record we have grown and nurtured, the dedicated employees who give their all every day, and you, our clients, without whom there would be no business. We appreciate the trust and confidence you place in us.

Our founding principles have provided a consistent framework that has helped us navigate dynamic global and local investment environments through the years. From the gold crash in 1982 to Black Monday in 1987, the Asian financial crisis of 1997, the dotcom bubble in 1999/2000, the global financial crisis of 2007/08 and, more recently, the impact of COVID-19 and the Russia-Ukraine war, we continue to apply the same investment philosophy in managing your portfolios.

The current investment context

The local and global investment environments continue to be challenging. At the Monetary Policy Committee meeting in March, the South African Reserve Bank raised rates by a higher-than-expected 50 basis points in its efforts to cool inflation. While this means that the South African money market is fast becoming a saver's haven, local businesses and consumers are feeling the pressure, compounded by the costs of the electricity crisis. Companies are reallocating billions of rands towards alleviating the impact of loadshedding. Invariably, part of these expenses is absorbed through the narrowing of corporate profit margins, which will ultimately bleed into lower tax revenue generation, and a portion is passed along to the consumer in the form of higher prices. Government's prospects for debt stabilisation and the growth outlook are at risk until such time as energy reform can bear fruit, as Thalia Petousis explains in her context-setting article.

The power of compounding

As an active investment manager, we recognise the compounding power of doing slightly better than the market over time. This has a material impact on long-term outcomes – in both investments and, interestingly, professional tennis. In comparing the two disciplines, Radhesen Naidoo discovers how a marginal 1% difference in performance can result in meaningful long-term success. He discusses this in a fascinating piece of analysis.

Valuations matter

The impact of the decline in global banking shares following the collapse of Silicon Valley Bank has had the market questioning whether the US Federal Reserve will pause its interest rate hikes, and possibly even cut rates, rather than persist in its fight against inflation. Equity markets have responded as if we are heading back to the low-inflation, low-rates environment of the past 15 years, and investors seem to believe that the playbook of the last cycle will continue to produce wins.

Our offshore partner, Orbis, believes it might be dangerous to assume that the investing landscape over the next 20 years will be similar to that of the recent past. In his article, Alec Cutler walks us through the previous megacycle, touches on the current cycle and explains how Orbis is positioned to take advantage of the opportunities on offer.

A key message that comes through from the Orbis commentary is the importance of focusing on valuations. This sentiment is echoed in Siphesihle Zwane and Varshan Maharaj's article on the tobacco industry. They note that, while there have been significant changes in this sector over the last decade, with a pronounced shift towards vapour and tobacco-heating products, the attractive aspects of tobacco economics still hold. Cheaper valuations should compensate for increased uncertainty and risk.

These two investment pieces reflect how our and Orbis' research-intensive approach, combined with a longer-term outlook, allows us to buy great businesses at low valuations, especially in times of heightened uncertainty. As Alec concludes, if valuations are any indication, it is an exciting time to be a contrarian.

Our Stable Fund: Balancing stability and growth

Long-term data reveals that investment portfolios often require an equity component to ensure long-term real – above-inflation – returns. In recent years, partly due to the ongoing turmoil in the markets, we have witnessed some investors shying away from equity exposure, including low-equity funds like the Allan Gray Stable Fund, and rather opting for unit trusts that have little to no equity exposure. Martine Damonse discusses why our Stable Fund, with its proven ability to manage asset allocation through a bottom-up process while taking advantage of equity, fixed interest and offshore opportunities, remains a relevant option for the more risk-averse investor.

It is easy to get distracted

It is important to remember that returns are not achieved in a straight line, and that there is a trade-off: short-term volatility for longer-term returns. Staying the course to realise returns over the longer term means not getting distracted by the short-term noise or falling victim to common behavioural biases and investing mistakes. This is often easier said than done. In this quarter's Investing Tutorial, Thandi Skade explores the opportunity cost of failing to stick to your long-term investment plan and how you can avoid paying behavioural penalties.

As we celebrate our 50th anniversary, we are mindful of the collective efforts of individuals past and present in building our long-term track record. The journey continues as we remain focused on creating long-term wealth for you, and on making a real difference to society in the 50 years to come.

Thank you for your ongoing trust and confidence.

Kind regards

Mahesh Cooper

SHEDDING DARK ON THE ISSUE OF SOUTH AFRICA'S ECONOMIC GROWTH

Thalia Petousis

While our growth projections make for gloomy reading in the near term, I would caution against viewing South Africa's long-term outlook as simply resigned to the shadows.

South African companies are reallocating billions of rands towards the extraordinary costs associated with loadshedding, whether it be via diesel-run power expenses, ongoing generator maintenance, or lost business hours. Invariably, part of these expenses is absorbed through the narrowing of corporate profit margins, which will ultimately bleed into lower tax revenue generation, and a portion is passed along to the consumer in the form of higher prices for goods and services, which is already being seen in South Africa's elevated inflationary prints. Government's prospects for debt stabilisation and the growth outlook are at risk until such time as energy reform can bear fruit. Thalia Petousis discusses.

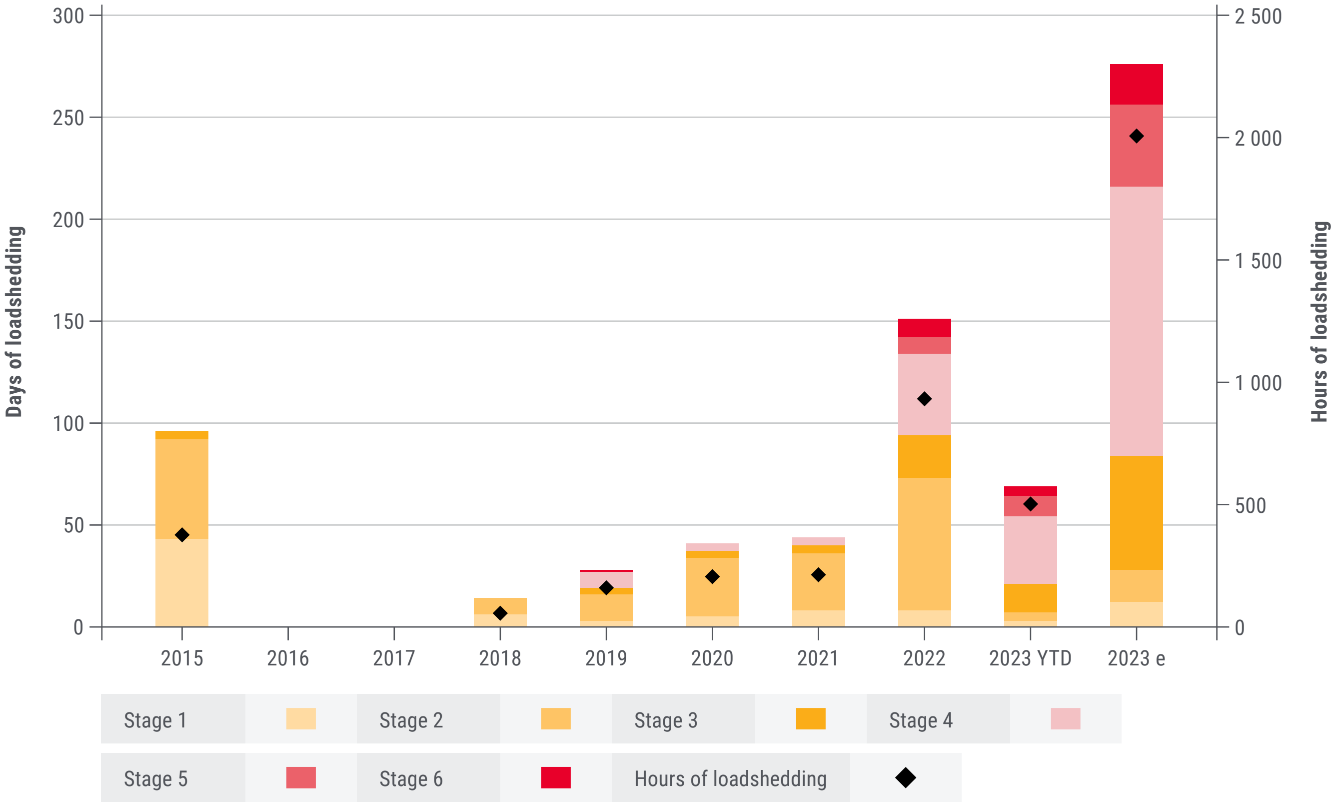
"An electrified Africa will increase production output, increase economic health, diminish debt and lead to a growing sense of self-worth. We are committed to illuminating this proverbial dark continent and to integrating it into the global economy as a participant worthy of unconditional respect." – Eskom Annual Report 1998

To read extracts from Eskom's annual report penned a quarter of a century ago is both significant and poignant. It highlights the optimism that was felt during the "Africa Rising" era of the early 2000s, when rapid economic growth was being experienced, and both rising incomes and the emergence of a robust new middle class were greatly anticipated. Under this hopeful narrative, the illumination of South Africa and the continent was a foregone conclusion.

Fast-forward to the present and the outcome could not be more stark: South Africans were hit by record levels of loadshedding in 2022 in terms of days, stages, and number of hours, as shown in **Graph 1**. When looking at the data in terms of cumulative gigawatt hours (GWh) shed from the grid per week, 2023 is setting a new record, as seen in **Graph 2** – and the outlook for the remainder of the year appears bleak. Data from prior years in Graph 2 suggests that the winter months see a spike in consumer demand for electricity and heightened stages of loadshedding, despite Eskom's attempts to bring back into service additional generation units during this period.

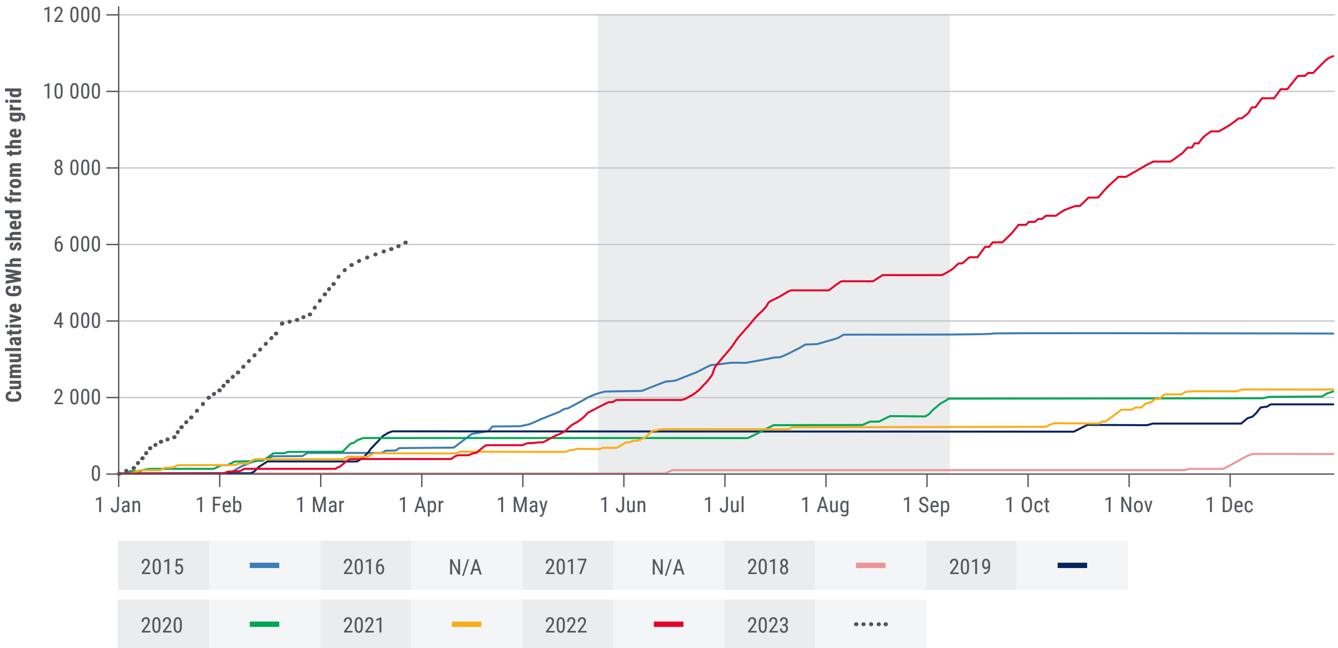
What went wrong with South Africa's energy availability since the so-called "golden renaissance" of the early 2000s?

Graph 1: Risks to the South African outlook



Note: Hours and days are estimates of the loadshedding experienced by any one national user in a particular municipal zone.
YTD = year to date, e = estimate.
Sources: EskomSePush, Allan Gray analyst calculations. Data to 31 March 2023.

Graph 2: A cold winter looming? Loadshedding (in gigawatt hours), cumulative by each week of the year



The above uses the highest stage of loadshedding reached per day and extrapolates this stage over a full 24-hour period.
Sources: EskomSePush, Allan Gray analyst calculations. Data to 31 March 2023.

Various narratives have woven their way through popular discourse, although some are perhaps less useful than others. The argument that Eskom's bloated employee costs have contributed to the utility's loss of profitability is less persuasive when one considers that the R35bn spent on staff in 2022 was at a 20-year low when expressed as a percentage of revenue, as seen in **Graph 3**.

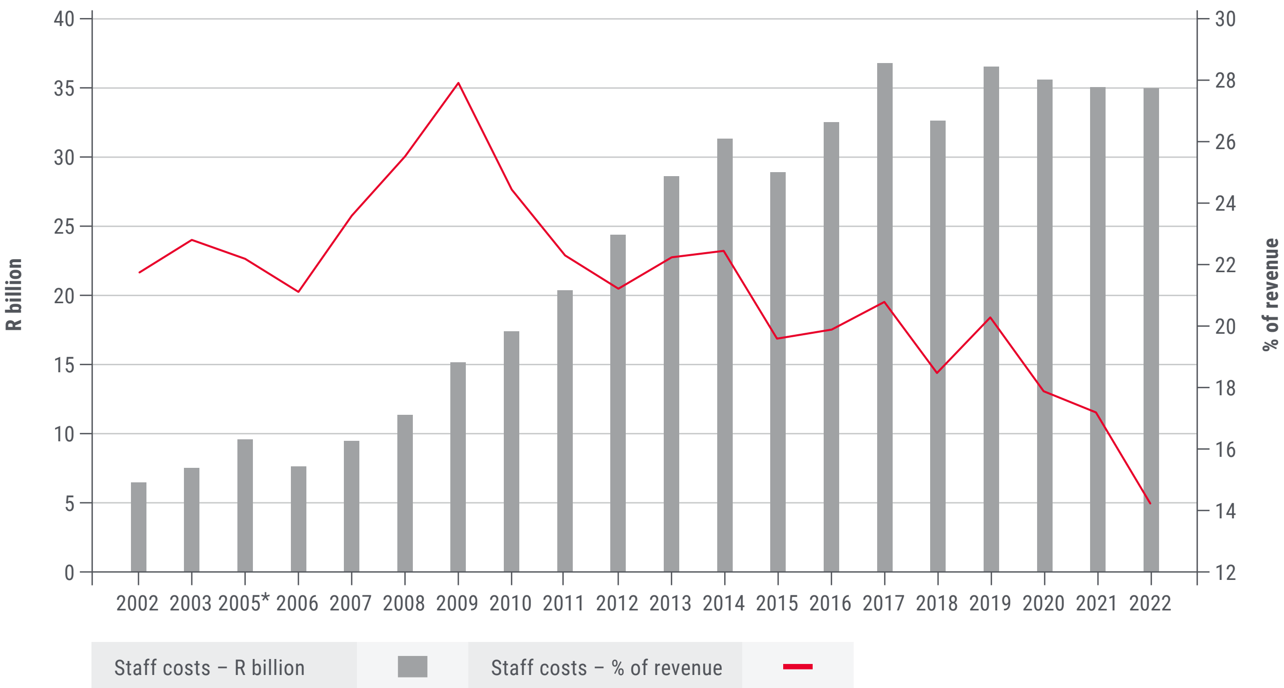
Important to consider, however, is that while the number of employees has only grown by 1% per year over that 20-year period, the average salary per employee has grown by an almost 9% compound growth rate per year – well in excess of average inflation of 5.6%. If Eskom were paying up for key technical and engineering skills, this may be duly warranted, but it is unclear whether Eskom has maintained the appropriate skills mix in its workforce. While the utility took on over 3 000 engineering and technical learners in 2013, it took on only 13 in 2019.

Over the 20-year period in review, Eskom has also raised more than R400bn in debt to finance roughly R700bn of investment in new assets, capital expenditure and maintenance – although maintenance accounted for only one-third of that spend. Clearly, Eskom's retained earnings were not sufficient to fund these activities.

While ex-CEO André de Ruyter has argued that electricity tariffs have not been cost-reflective and were set far too low to fund the much-needed investment programme, there is some degree of circular reasoning at play to argue that a so-called cost-reflective tariff would have saved the utility, given that any wastage and excessive costs borne by Eskom would be "reflected" in the said tariff passed along to the consumer. Other arguments rest on the idea that government as shareholder should have recapitalised Eskom to enable an investment programme to get off the ground in the year that Eskom executives first requested it, namely 1998.

Perhaps a more pressing issue, and one that De Ruyter has illuminated in painstaking detail, is that Eskom's energy availability factor has been falling over time even while cash was being ploughed into capital investment projects, as seen in **Graph 4**. Per De Ruyter's testimony, new generation capacity was funnelled towards poorly designed and built power stations, the tenders for which were awarded to inexperienced or inappropriate contractors for the job at hand. Additionally, cash was siphoned out of these projects via inherent corruption during procurement and ongoing business activities.

Graph 3: Eskom staff costs, 2002-2022



*Prior to 2004, Eskom reported their results annually in December. They then adjusted their reporting period to March. The March 2005 reporting period covers the period of time December 2003 – March 2005.
Sources: Eskom's annual reports

Loadshedding is hitting financial results now, but will appear in tax revenue with a lag

In local city centres, the dull hum of a diesel-run generator has become white noise in the background of many a South African's daily work routine. Against this, consider that diesel prices remain roughly 50% more expensive in rands than they were in pre-pandemic 2019, and that diesel-generated power is 40-60% more expensive than the average Eskom tariff per unit of electricity. Additionally, many of these diesel-run generators were simply not designed to run continuously for as many as 12 hours per day. Frequent generator breakdowns and maintenance bear their own financial costs, as well as those of lost business hours. Renewable energy and battery storage can also be very problematic in dense industrial areas due to lack of space.

The recent corporate financial reporting period has made one thing abundantly clear: **South African companies are reallocating billions of rands towards the extraordinary costs associated with loadshedding**.

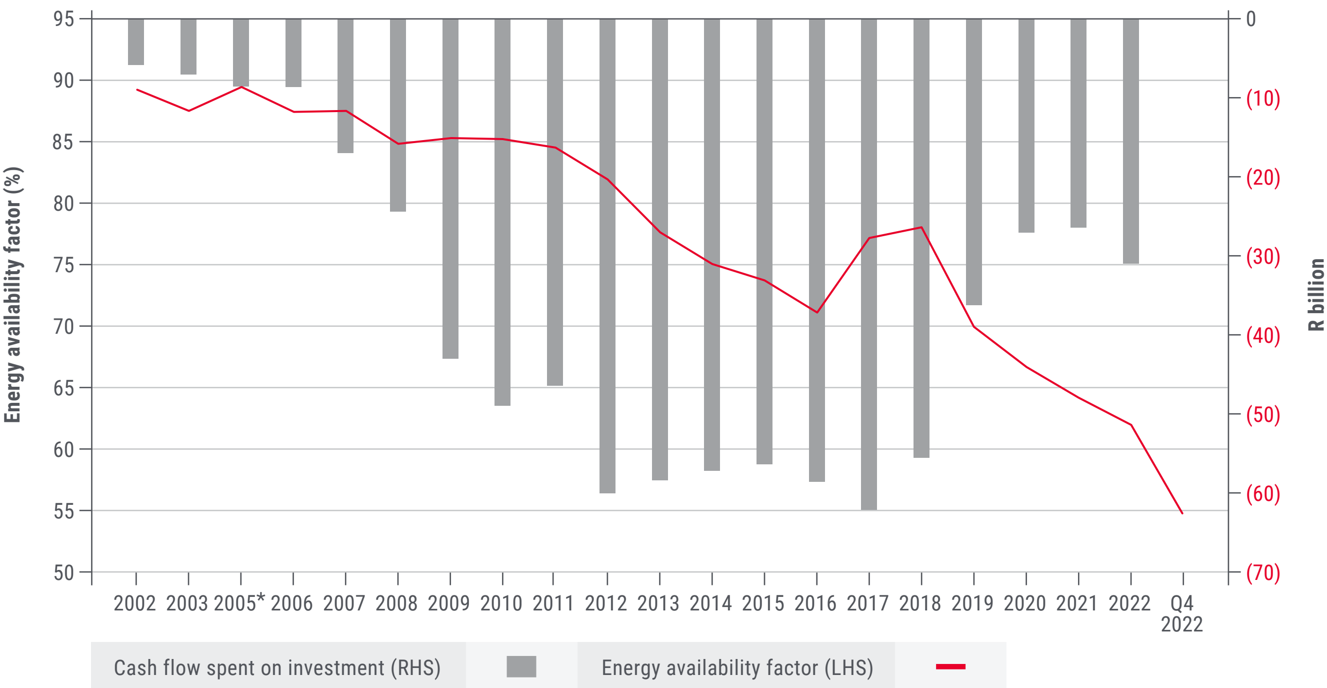
Sectors across the South African business landscape are being hit with the raised cost of production, and not only due to the extraordinary price of diesel consumption. Consider South Africa's **mining industry**: Aside from just softer platinum group metal export prices, operating margins are being decimated as intermittent power hampers production and processing output. At elevated levels of loadshedding, various mining operations are often ground to a halt and power supply is used only to evacuate underground employees and maintain safe working conditions.

Meanwhile, extended power cuts wreak havoc for **telecommunication companies** and mobile operators, leading to lost revenue as a result of the depletion of their tower batteries, which causes dropped signal and reduced network availability. The additional cost of heightened security in dealing with battery theft has dealt some operators, like MTN, a double blow.

Even in the **banking sector** there remains a notable sense of unease about the health of their smaller business customers and the prospects for a rise in non-performing loans. Various corporates have expressed similar concerns that their smaller suppliers with low gross profit margins will fall over.

Clothing retailers, like Truworths, that do not have sufficient backup power in outlying malls are losing trading hours to loadshedding. Similarly, while the rising cost of production and irrigation is hitting the South African agriculture industry,

Graph 4: Cash spent on investment – but to what avail?



*Prior to 2004, Eskom reported their results annually in December. They then adjusted their reporting period to March. The March 2005 reporting period covers the period of time December 2003 – March 2005.
Sources: Eskom's annual reports

major **food retailers**, like Shoprite, Pick n Pay and Woolworths, are absorbing and passing along a litany of expenses further down the supply chain as they try to maintain the uninterrupted refrigeration of produce. Upholding the integrity of stock often requires removing it from sale if the cold supply chain has been broken at any point in the supplier logistical network. Some retailers must even use their own generators at night as their landlords limit after-hours usage.

It is perhaps unsurprising, then, that South African consumer food price inflation continues to rise at multi-year highs, increasing by 14.4% year-on-year in March 2023, as shown in **Graph 5**. To add salt to the wound, once produce is on the grocery store shelf, the retailers' difficulties do not end: Customer demand for fresh food items is often dampened by concern that food may spoil due to *at-home* power interruptions.

Various businesses are suggesting that both water supply and quality are becoming a major issue in their operations as local water-pumping stations suffer from low or no pressure during prolonged stages of high loadshedding.

In boardroom conversations, it is not uncommon to hear management speak about risk mitigation strategies in the event of a nationwide blackout. More startling, perhaps, is the "failed state" narrative and the suggestion that the deindustrialisation of South Africa could be underway.

The other shoe is waiting to drop: the read-through to growth figures

Given such a bleak near-term outlook, it was surprising to see the National Treasury forecast an increase in tax revenue of 6% per year on average over the next three years, as discussed in our recent research piece, "The 2023 Budget: A crisis of credibility in the outer years of the forecast", available on our website. Loadshedding is hitting financial results now, but will bleed into tax revenue and growth with a lag.

Treasury has forecast average South African real growth rates (i.e. growth in excess of inflation) of 1.4% over the next three years. This should be considered while keeping in mind that South Africa was only growing at a 0.3% annual real growth rate prior to the pandemic. Such estimates have a material impact on tax revenue estimates and underpin

Graph 5: Loadshedding bleeds into the price of food

Source: Statistics South Africa

Treasury's forecasted stabilisation of government debt at a peak figure of 73.6% of GDP.

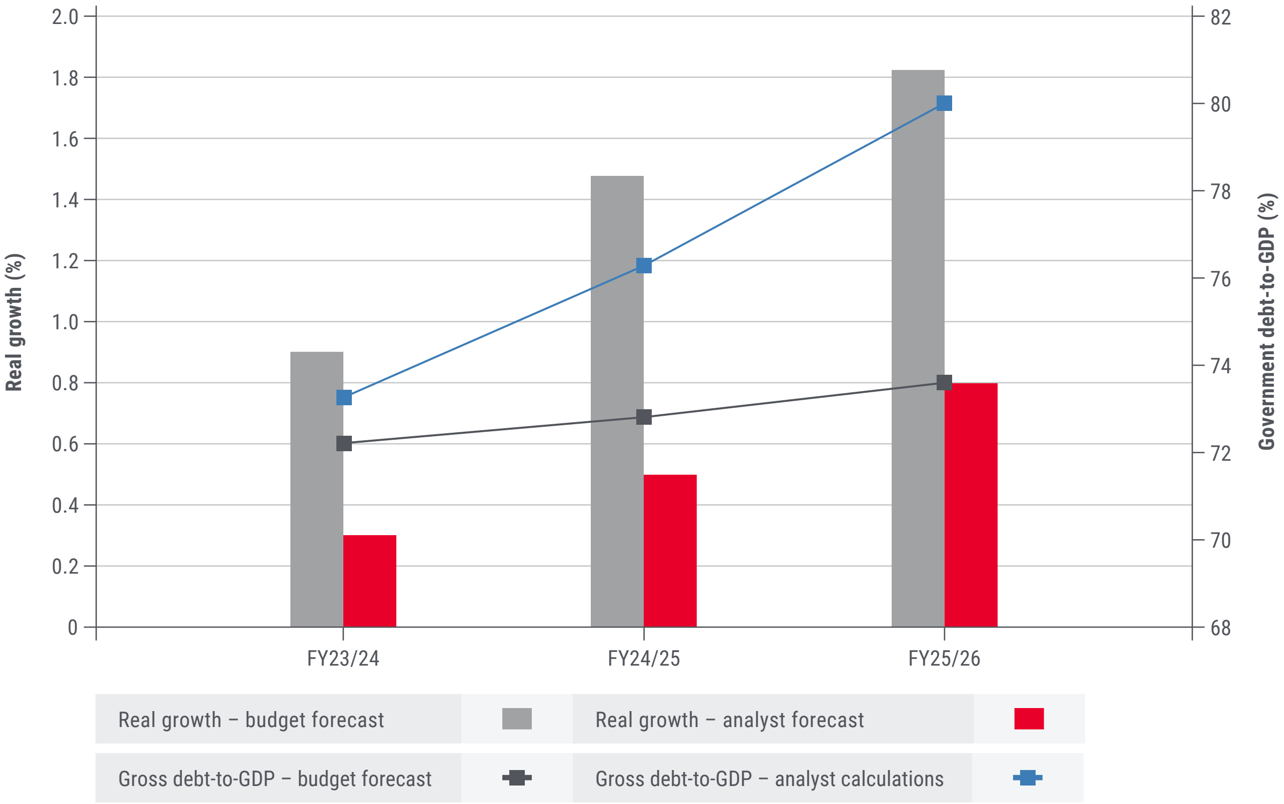
Using an average real growth rate of 0.5% per year over 2023-2025, and factoring in slippage in the public sector wage bill such that the government grants 7% per year increases over each of the next three years, in fact wipes out government's primary surplus and implies that debt rises to 80% of GDP, as seen in **Graph 6**, without stabilisation. Against population growth rates of 1.2% per year, such a meagre growth outlook suggests that living standards will continue to fall, as presumably will municipal electricity and water collection rates alongside them.

What, then, are we to make of those hopeful sentiments penned by Eskom's management decades ago, and can South Africa still be integrated into the global economy as a high-performing participant?

While our growth projections make for gloomy reading in the near term, I would caution against viewing South Africa's long-term outlook as simply resigned to the shadows. Not only have our corporates proven remarkably resilient through various crises, but there are a multitude of private sector renewable energy projects that are being accelerated alongside more friendly government policy. This should add additional capacity to the grid over the next two to three years as solar, wind and gas initiatives, as well as Eskom's own battery storage project, bear fruit.

The optimist in me tends to think that it is always darkest before the dawn.

Graph 6: Debt stabilisation? South African growth forecast is the major swing factor



Sources: National Treasury, Allan Gray analyst calculations

Thalia joined Allan Gray as a fixed interest trader in 2015. She was appointed as a portfolio manager in 2019 and currently manages the money market portfolio, the bond portfolio, as well as portions of the balanced fixed interest and the Africa fixed interest portfolios. Thalia holds a Master of Commerce degree in Mathematical Statistics from the University of Cape Town and is a CFA® charterholder.

PEERING THROUGH THE SMOKE

Siphesihle Zwane and Varshan Maharaj

A lot has changed in the tobacco industry in the last decade or so. Despite the changes in what used to be a stable industry, the attractive aspects of tobacco economics still hold, with a cheaper valuation compensating for the increased uncertainty and disruption. Siphesihle Zwane and Varshan Maharaj provide an update on the current landscape and the industry's prospects.

When we wrote about British American Tobacco (BAT) in our Q2 2010 Quarterly Commentary, the company had recently been listed on the JSE and represented a significant holding in the Allan Gray Equity Fund. Today, we are still investors in the stock, despite the disruption facing the global tobacco industry.

Industry fundamentals

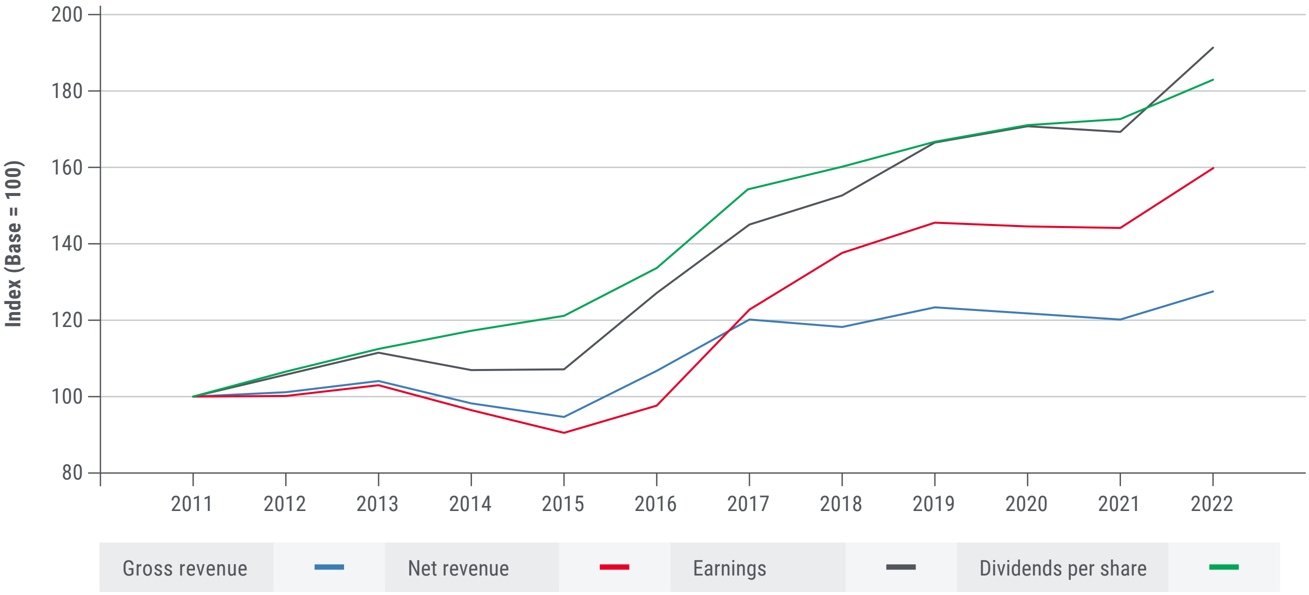
Of the companies we research, the tobacco industry has some of the best structural fundamentals. Tobacco consumption is relatively price-inelastic, which means that price increases can make up for falls in sales volumes. Taxes make up a large portion of sale prices. This creates price leverage, causing consumer prices to rise by less than net revenues received by the business when excise rates do not change. In addition, specific taxes in some countries and efficient distribution make it difficult for new entrants to compete on price, especially since marketing is not allowed in most countries.

Combine all of this with a business that doesn't need to reinvest a large portion of its earnings, given a simple product and falling volumes, and you get companies that are able to grow while paying out a large portion of their earnings in the form of dividends.

BAT is a good example of how these fundamentals have played out. Earnings have grown faster than net revenues, which have grown faster than gross revenues, with consistent dividends keeping up with earnings growth, as shown in **Graph 1**. These economics have hardly changed, despite changes in sentiment around the sustainability of profits.

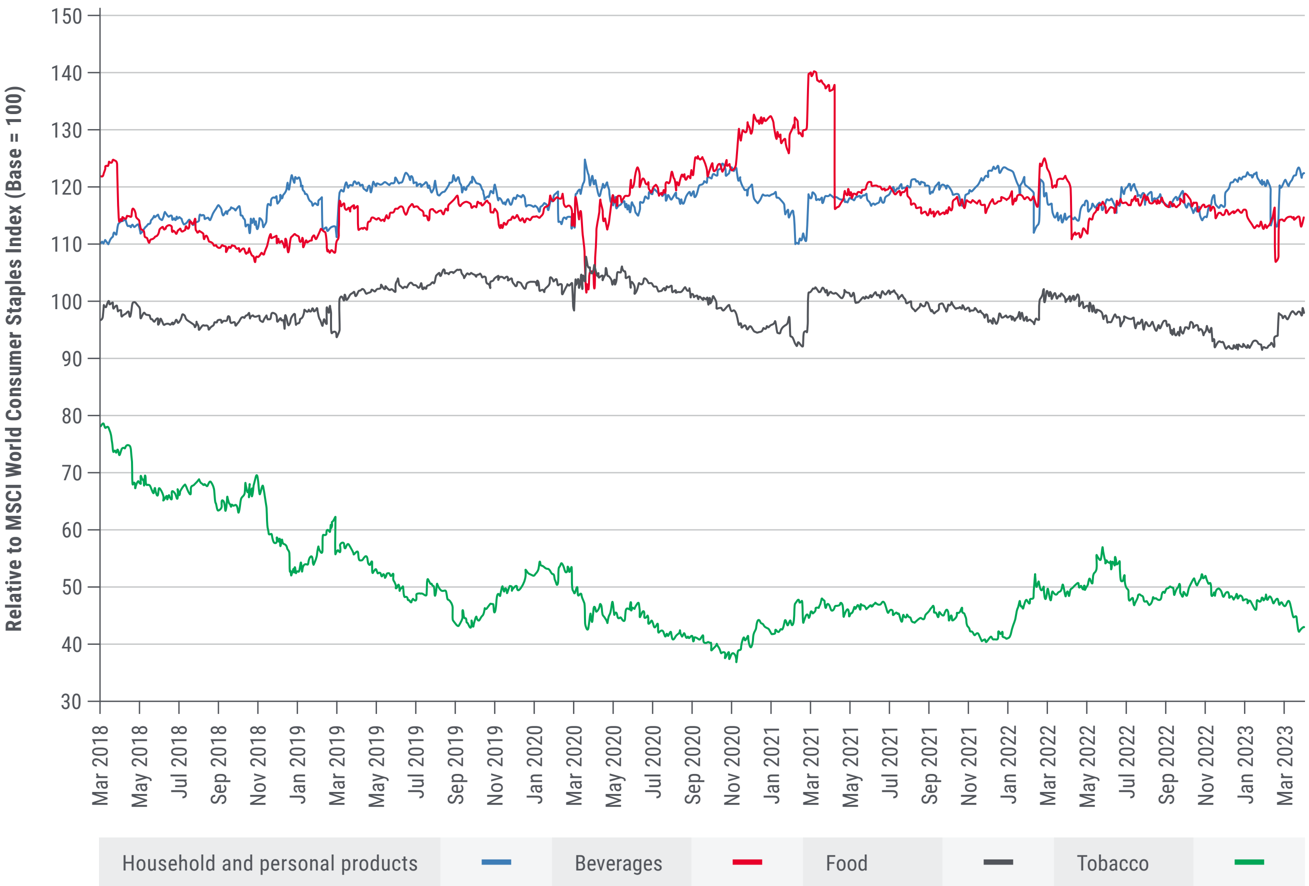
High barriers to entry have historically made it difficult for new entrants to disturb the incumbents, with investors happy to pay up for this. In fact, the tobacco industry used to trade at only a small discount to consumer staples – difficult to believe, given the large discount it trades at now, as shown in **Graph 2**.

Graph 1: BAT growth per share



Sources: Company reports

Graph 2: Consumer staples subsectors*



*12-month forward P/E ratios for various MSCI World Consumer Staples Index subsectors relative to the MSCI World Consumer Staples Index. The graph shows the forward P/E multiple of several consumer staples subsectors relative to the forward P/E multiple of the overall consumer staples index over time. A higher value represents a higher price and greater expectations relative to other consumer staples segments.
Sources: Allan Gray research, Bloomberg. Data to 31 March 2023.

Disruption

To protect attractive cigarette economics, the industry never invested aggressively in new ways to consume nicotine. This changed when JUUL, a vapour brand, began to significantly grow in the United States by introducing innovative products with flavours and marketing that turned their brand name into a verb. This uptick in "JUULing" forced incumbents to increase their investment in next-generation products (NGPs), a major shift from the stable nature of the industry.

… we do continue to monitor the science as population studies are conducted to better understand the longer-term impacts.

Harm from smoking mostly comes from burning tobacco, with non-combustible vapour reducing the risk of exposure for users compared to smoking traditional cigarettes. NGPs are therefore attractive due to their improved long-term business sustainability, despite the shorter-term uncertainty of their economics and market shares.

While JUUL initially captured significant market share, they did so in an irresponsible manner that helped spark a surge in underage vaping, leading to significant litigation. A history of litigation has taught "Big Tobacco" to be more measured and responsible when launching and marketing new products.

BAT reacted to the disruption by launching three different products, believing that preferences built on differences in regional tobacco products and cultural norms are best served by a menu of products. These are described below.

Vapour products: These products use vapourised liquid with nicotine salts and, in many instances, different flavours. BAT has the highest market share in the major markets for these products, including the US.

Tobacco-heating products: These products heat a tobacco stick inserted into the device at a high enough temperature to release nicotine, but not high enough for combustion. BAT is a far second to Philip Morris International (PMI)'s brand in this market, IQOS, which was introduced in 2014.

Modern oral products: These products come in the form of a teabag-like pouch that is placed between the upper lip and gum, releasing nicotine over time. They are inconspicuous and most popular in Scandinavian countries, where BAT has an incredibly high market share.

All the options described above looked to pose significantly less harm to the consumer, but with untested economics and often deep investment cycles. BAT's NGP losses peaked at as high as 4% of total group sales in 2020, or 9% of adjusted operating earnings. This has been improving as the business realises the unit cost benefits of scale, with most recent reported losses reducing by two-thirds to just under 1.5% of group sales.

Most large market regulators have accepted the principle of harm reduction, differentially taxing NGPs versus cigarettes. While this advantage is unlikely to stay forever, it supports the industry while it builds scale to lower unit costs. Even if profitability at market maturity is lower than that of the cigarette market, the reduced harm of these products to consumers and those around them will likely mean more sustainable cash flows over the long term, deserving of a higher valuation multiple.

Big Tobacco is encouraging smokers to quit or, if they are unable to do so, switch to NGPs via various consumer education initiatives, such as stores in malls. These products are all relatively new and the current science regarding harm reduction has been positive, showing as high as a 90%-plus reduced risk of exposure to harmful substances. However, we do continue to monitor the science as population studies are conducted to better understand the longer-term impacts.

Extensive global distribution networks, existing customer bases, and available funds to finance the large investment required to reach scale give incumbents an edge in the NGP market. In addition, as the regulation around these products becomes more closely aligned with that of cigarettes, barriers to entry should start to more closely resemble those of the pre-NGP tobacco landscape.

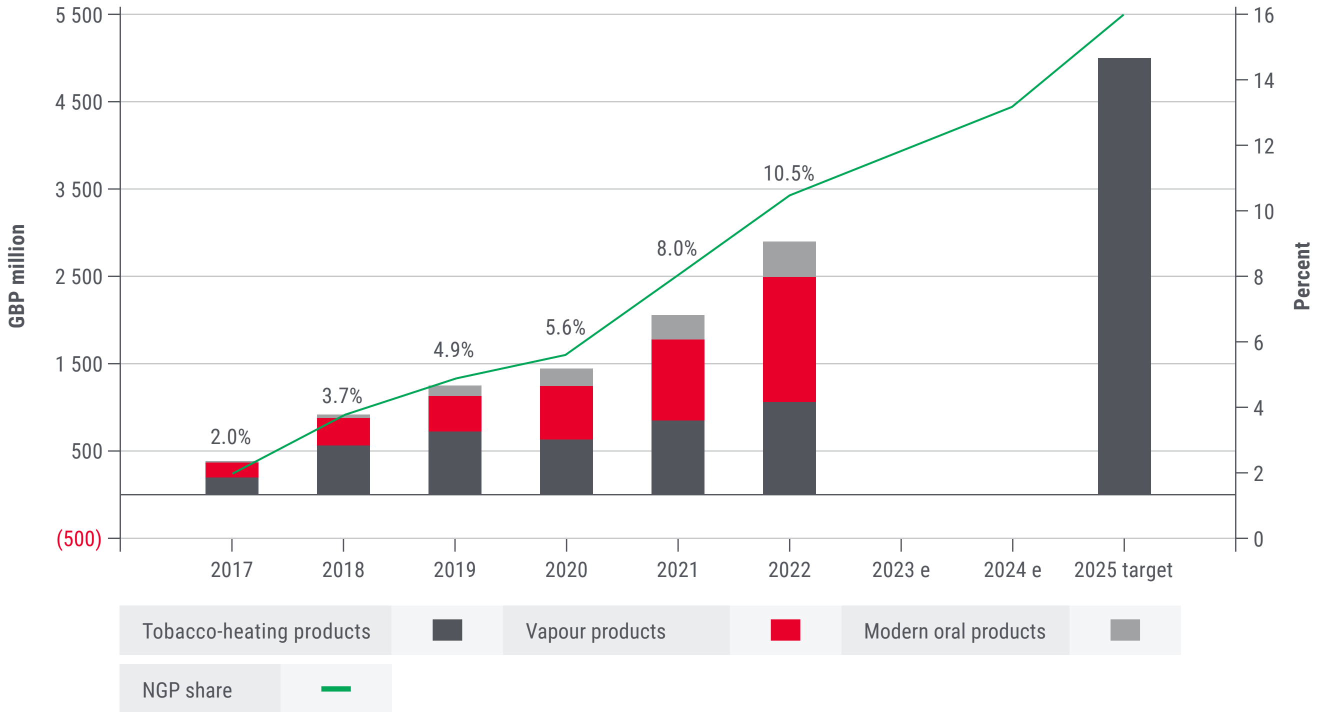
The competitive landscape

BAT is currently targeting GBP5bn NGP revenue by 2025, as shown in **Graph 3**, and break-even by 2024, with 50 million NGP consumers by 2030. Further out, they expect at least 50% of group revenues to come from NGPs by 2050. This won't be easy, as the overall industry also sees the benefits of these new products:

- PMI's focus is on tobacco-heating products, which form the largest and fastest-growing NGP category, offering the best economics. BAT, Japan Tobacco International and Imperial Brands moved more slowly and are trying to catch up in this space.
- Japan Tobacco International is accelerating its Ploom X brand and aiming to reach NGP break-even by 2028.
- Altria recently announced the acquisition of NJOY in the US, after continued issues with JUUL. The device will be integrated into their strong distribution channels in the country.
- Imperial Brands is the laggard, having pulled back initial investment.

Players with a larger share of their revenues coming from NGPs have better revenue growth and margin prospects, and the market is rewarding them with higher earnings multiples, as shown in **Table 1**. The value to trade buyers is also reflected in PMI's recent acquisition of Swedish Match,

Graph 3: BAT next-generation product revenue



e = estimate
Sources: Company reports, Allan Gray analysis

Table 1: Price-to-earnings ratios compared to NGP contribution

Player	NGPs as a percentage of net revenue	Forward P/E per Bloomberg as at 31 March 2023
Philip Morris	32.1%	15.5
British American Tobacco	10.5%	7.3
Altria	10.4%	8.8
Japan Tobacco	3.3%	11.5
Imperial Brands	2.7%	6.4

Sources: Company reports, Bloomberg

which was done on a multiple of 28 times trailing earnings. Swedish Match derived 69% of its net revenue from NGPs at the time of the acquisition.

Our research-intensive approach, combined with a longer-term outlook, allows us to buy great businesses at low valuations, especially in times of heightened risk and disruption.

PMI's progress is an indication of the upside potential if BAT can successfully execute its NGP strategy. Once smokers fully convert to PMI's IQOS, very few go back, as it closely matches the taste, experience, nicotine delivery and rituals of cigarettes at a lower cost and risk to the user. PMI's NGP results are improving as they have already spent heavily on advertising, leading to declining acquisition costs and rising retention. While BAT is still at a loss-making investment stage, PMI's IQOS already seems to be twice as profitable as cigarettes on a unit basis due to similar manufacturing costs and lower taxation rates.

Some of the risks associated with tobacco investments

The sector does, however, come with some significant risks, the largest of which are regulatory. These risks have not had a large noticeable impact on earnings yet, but have caused the sector to trade on a lower multiple of earnings. Outsized excise-driven price increases could lead to a large-scale shift to illicit trade, which currently makes up 9% of total volumes and costs governments around US$40bn per year in taxes. Big Tobacco is an efficient tax collection and regulation enforcement machine, which is preferable to the industry being controlled by illicit players.

BAT has a high debt burden at 2.9 times EBITDA (earnings before interest, taxes, depreciation and amortisation). This is, however, well protected against the short-term impact of higher interest rates. BAT's average cost of debt is 4%, 97% is fixed rate and the average maturity is 9.9 years. The business has paused share buybacks to allocate funds to debt repayment as the outlook for longer-term rates has increased. One of the elements driving higher rates, namely inflation, also benefits the revenue line, given strong pricing power, with the associated interest rate cost coming over a longer time, given the above-mentioned protection.

The risk of declining volumes is always top of mind. Smoking prevalence is declining, and the population is growing. The net effect is that the number of smokers has remained between 1 billion and 1.1 billion since 1990. BAT is likely to grow revenue and margins, assuming that long-term combustible volumes do not fall rapidly, low single-digit real price increases per year are achieved and profit-per-stick improves as the mix changes in favour of NGPs.

Integrating environmental, social and governance (ESG) factors into our research is intrinsic to our investment philosophy. There are several nuances and complexities, and emerging news headlines and trends have to be examined in the context of each company, and the sector and country within which it operates. A rational approach is key. A good example is the fine that BAT will have to pay to the US over North Korea sanction violations – an issue that has just hit the news, but has in fact been under investigation since 2019. BAT has conveyed tangible steps to deal with this and other governance-related matters, but we continue to monitor the situation closely. For in-depth details of our approach, see our latest Stewardship and Business Sustainability Reports, available via our website.

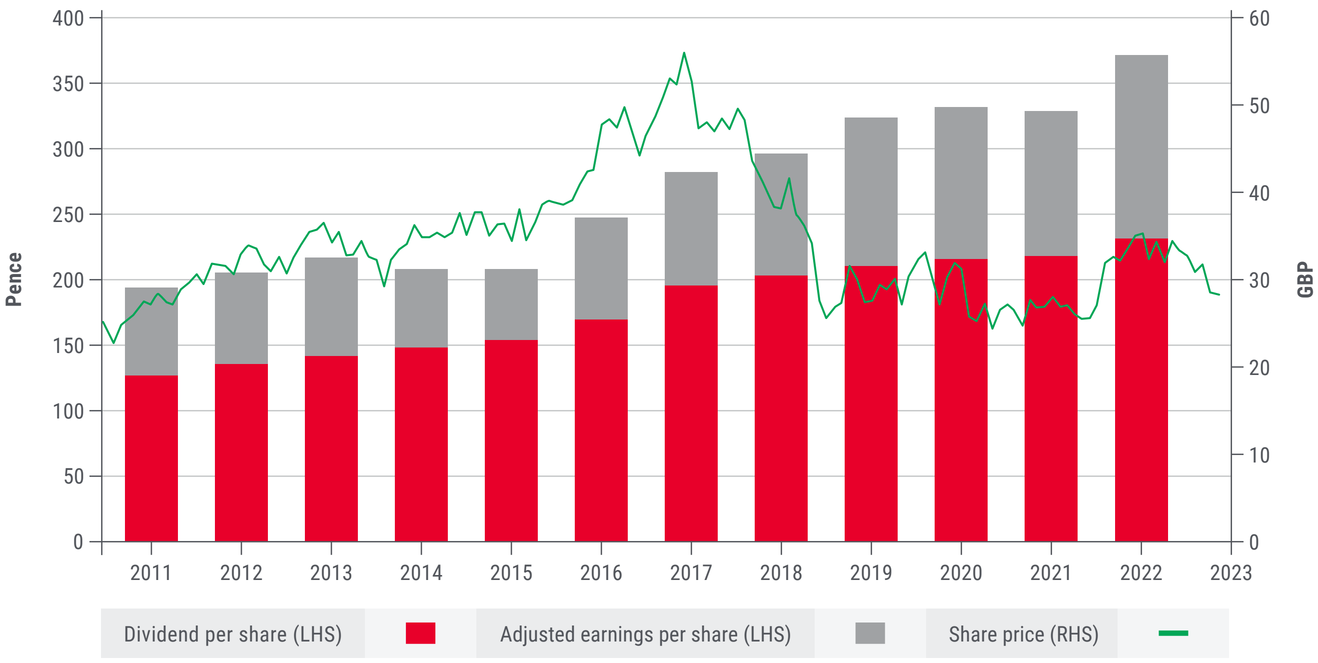
We invest as business owners, considering the sustainable cash flow that a business can generate over the long term.

A long-term opportunity for patient investors

Our research-intensive approach, combined with a longer-term outlook, allows us to buy great businesses at low valuations, especially in times of heightened risk and disruption. A look at BAT's financials reveals little impact from this disruption, given the company's measured approach to handling it – see **Graph 4**.

BAT has managed to invest in NGPs with limited impact on the cadence of reported results, likely improving the longevity of its business in the process. We invest as business owners, considering the sustainable cash flow that a business can generate over the long term. BAT's share price has not reflected the fundamental results of the business in recent years, but at a growing 7% GBP dividend yield, shareholders should be well rewarded for their patience.

Graph 4: BAT's financial performance



Sources: Company reports, IRESS

Siphesihle joined Allan Gray in 2017 and is an analyst in the Investment team. He holds a Bachelor of Commerce (Honours) degree in Economics and Finance from the University of Cape Town.

Varshan joined Allan Gray in 2014 as an equity analyst. He was appointed as a portfolio manager in 2020 and manages a portion of the frontier markets equity portfolio. Varshan holds a Bachelor of Business Science degree from the University of Cape Town. He is a qualified Chartered Accountant and a CFA® charterholder.

ORBIS GLOBAL BALANCED: INVESTING THROUGH THE CYCLES

Alec Cutler

… if valuations are any indication, it is an exciting time to be a contrarian.

History seemingly often repeats itself, but it might be dangerous to assume that the investing landscape over the next 20 years will be similar to that of the recent past. Alec Cutler, from our offshore partner, Orbis, walks us through the previous megacycle, touches on the current cycle and explains how Orbis is positioned to take advantage of the opportunities on offer.

The failure of Silicon Valley Bank (SVB) has made markets worry about banks everywhere. In the case of Credit Suisse, that worry was well founded. We believe it is unfounded for the Japanese, Korean and Irish banks we hold. We sold out of also-robust ING Groep, which we had been trimming anyway on valuation grounds, and rotated some of that capital into Korean banks at bombed-out valuations. The rest of the banks we hold continue to look compelling, and we continue to hold them.

But the slide in bank stocks was not the only – or even the biggest – market impact of the current panic. The panic in banks has led to a massive shift in the expected path of interest rates. A month ago, markets expected US interest rates to end the year at 5.5%. They now expect rates to end the year near 4%, well below current levels. In other words, the market now expects the Federal Reserve Board (the Fed) to cut rates, rather than persisting in its fight against inflation. That is no sure thing, but equity markets have responded as if we are heading back to the low-inflation, low-rates environment of the past 15 years, and investors seem all too happy to believe that the playbook of the last cycle will continue to produce wins. Growth stocks have enjoyed that shift – Silicon Valley's stock index, the Nasdaq, is now *up* since things with SVB kicked off, and so is the broader S&P 500.

It's worth putting the bond market moves in context. On the Monday after SVB failed, yields on two-year US Treasuries fell by 0.56% – more than on the day Lehman went bankrupt, or on the day markets reopened after 9/11. In March, we have seen two-year yields rise or fall by 0.2% almost every day since the panic. Set against the tranquillity of the last 15 years, those are *four standard deviation* moves (in other words, if yield changes were normally distributed, these would occur one trading day every century or so). But in the 1990s, such moves weren't uncommon. In the 1980s, they were pedestrian.

The suppressed volatility we have seen over this low-inflation, low-interest rates cycle is the exception, not the norm.

Against that backdrop, this banking "crisis" seems a tiny distraction, or perhaps a shot across the bow, warning of what's to come with a period of powerful inflationary impulses.

> The panic in banks has led to a massive shift in the expected path of interest rates.

The previous megacycle

Events long ago teed up a tremendous period for corporations and investors via seemingly ever-lower interest rates, lower labour costs, technology-led productivity, and a peace dividend, topped off in recent years by massive liquidity injections. It would be difficult to think of a better setup for financial assets, and long-duration investments in particular. How did this come about?

1981

After US inflation peaked at over 14%, short-term interest rates peak above 20%, and the 10-year US Treasury yield peaks at 15%. With Paul Volcker at the helm, the Fed eventually breaks inflation, starting a four-decade cycle of ever-lower bond yields and borrowing costs.

The same year, Ronald Reagan fires the striking air traffic controllers, starting a 40-year swing in power from labour to capital.

1985

Margaret Thatcher beats the coal miners' union, setting the same pendulum swinging in the UK.

1989

The Berlin Wall falls, and for the next three decades, liberal democracies enjoy the peace dividend, with defence spending as a percent of gross domestic product dropping from above 2.5% to below 1.5% in many European countries by 2018.

1995

Windows computers, Intel processors, email and the early rise of the internet spark a productivity boom. The Age of the Semiconductor begins in earnest.

2001

China joins the World Trade Organization, accelerating a wave of globalisation that lasts until 2016. Offshoring suppresses inflation, boosts corporate profitability and weighs on labour power in the developed world.

2008

The global financial crisis sparks central banks to drive interest rates down to zero and beyond, culminating in over 20% of global bonds trading at negative yields in 2020. The Fed alone prints US$3tn, with the Bank of Japan, European Central Bank and Bank of England collectively printing trillions more.

2020

COVID-19 sparks another surge of liquidity from central banks. The Fed prints another US$5tn and, with a wink and a nod, encourages the government to launch fiscal stimulus. Politicians happily oblige, with US$6tn in stimulus spending from US Congress and another US$1tn from the administration.

(As an aside, the word "trillion" – 1 000 000 000 000 – has become so commonplace in finance that we have completely lost our sense of its scale. A trillion seconds ago was 30 000 BC – before all recorded human history. A trillion is a lot!)

> So much has changed from the last cycle, but many assets that were forgotten in the last cycle continue to trade at attractive valuations.

This cycle

All good things must come to an end, and so it looks to be with the backdrop for corporations and long-duration investments. More recent events point to reversals of the various tailwind-generating trends of the past.

2012

Facebook acquires Instagram, cementing the rise of social media and smartphones, and perhaps marking the point where the Age of the Semiconductor tips away from increasing society's productivity.

2018
The US puts tariffs on imports from China, a death knell for the trend of ever-increasing globalisation, removing a powerful disinflationary force on the global economy.

2019
Major countries sign on to the Paris Climate Accords and start pressuring those who have not, kicking off the mega wave that is the electrification of the global economy. According to the investor Jeremy Grantham, an avowed global warming warrior, decarbonising the global economy could cost US$100tn over the next several decades, in today's money. Barring a miracle, this will be nearly completely unproductive so far as costs are concerned. Rather than optimising the energy system for cost, we are now optimising it for a balance of cost and carbon. Similar to defence spending, if carbon dioxide is indeed the enemy, then this US$100tn is just a cost of societal survival. It is, thus, inflationary.

2021
Inflation breaches 7% in the US, with inflation in Europe, the UK and even Japan rising shortly behind.

The portion of the US workforce represented by unions hits a new low. Yet now, polls show public support for unionisation to be rising to levels not seen since 1965. This should drive labour costs higher, turbocharged by super-low unemployment (itself a reflection of labour costs that got too low). This pushes consumer prices up and corporate margins down.

COVID-19 has shown China, whose labour rates had already been driving towards the global average, to be a less ideal outsourcing partner than the profit-seeking capitalists thought, and focus has toggled to supply security. That means higher inventories, more local production and more redundant supply chains, all of which are inflationary.

2022
Russia invades Ukraine, again. After over three decades of a perceived peace dividend, people are slowly coming around to the notion that the Cold War has resumed. Spending on defence is required to ensure society has the ability to be productive, but that spending is itself unproductive, and either takes away from more productive uses (education, infrastructure, healthcare) or increases tax burdens, or both. Both are inflationary.

Central banks start raising rates and pulling liquidity from the system after finally admitting that inflationary pressures aren't just transitory.

How we're positioned

So much has changed from the last cycle, but many assets that were forgotten in the last cycle continue to trade at attractive valuations.

We start with inflation-protected bonds. We can currently lock in an inflation-protected yield of 1.4% in US Treasury Inflation Protected Securities (TIPS), set against market expectations of close to 2% inflation over any long horizon. In other words, despite all that's changed, the market expects central banks to get inflation right where they want it. That means we don't have to pay over the odds for inflation protection. Locking in a 1.4% increase in purchasing power looks reasonable, so we own TIPS.

TIPS also set a good bar. To earn a place in the portfolio, everything else must do better than a 1.4% real yield. And they can do better. A *lot* better.

In credit, we can now get yields of 7-9% lending to good, profitable businesses and getting the money back in a few years. That looks attractive.

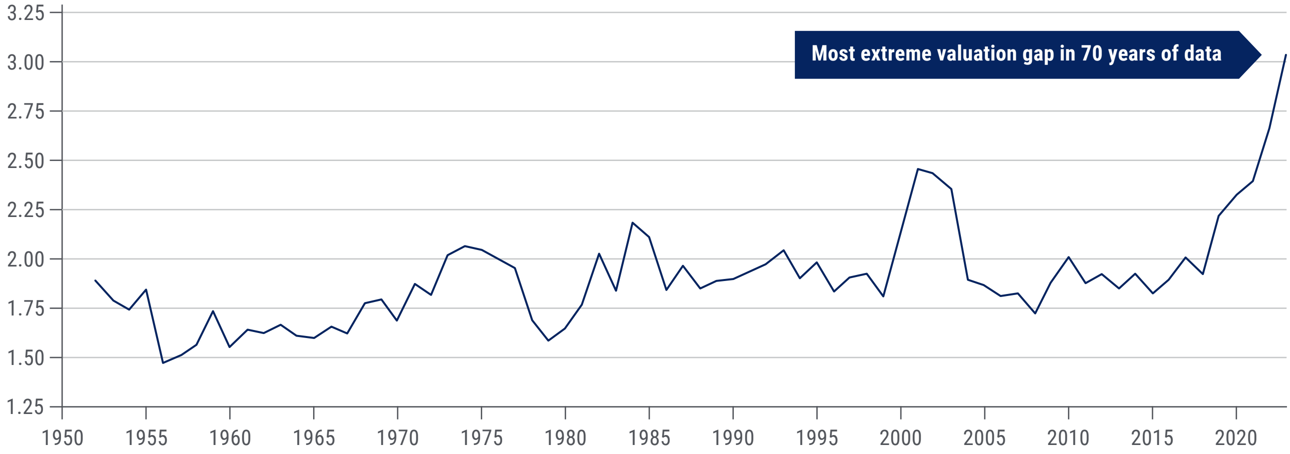
In equities, bottom-up opportunities abound, because the valuation gap between fundamentally cheap and expensive businesses remains extraordinarily wide. Using the US for its longer data history, **Graph 1** shows that the gap in price-to-earnings valuations between cheaply and richly priced shares ended 2022 at its widest level in 70 years. While low-multiple shares have outperformed on price over the last 18 months, they have also outperformed on earnings, so on price-to-earnings, the valuation gap did not close.

Selected companies in defence, energy infrastructure, semiconductors, and oil and gas services provide things the world needs, and which are in short supply. Yet we have found several such businesses trading for less than 10 times our assessment of their sustainable free cash flows. Better still, in many cases those cash flows are either explicitly protected against inflation, or should be able to grow with inflation as supply shortages bite.

Who knows how history will unfold, but life from here could look incredibly different from the last megacycle. That could prove challenging for investors sticking to the last cycle's playbook. But if valuations are any indication, it is an exciting time to be a contrarian.

Graph 1: A patience-testing cycle for value has created attractive opportunities

Rich US shares price-to-earnings (P/E) divided by cheap US shares P/E, 1951 through 2022



Sources: Kenneth French, Orbis. The line plots the P/E of the 75th percentile US stock on P/E divided by the P/E of the 25th percentile US stock on P/E.

Orbis
Invest Differently

Alec joined Orbis in 2004. He is a member of the Bermuda-based Multi-Asset Investment team and is responsible for the Orbis Global Balanced Strategy. Alec holds a Bachelor of Science (Honours) degree in Naval Architecture from the United States Naval Academy and a Master of Business Administration from The Wharton School of the University of Pennsylvania. He is also a CFA® charterholder.

EQUITIES MATTER – EVEN FOR A CAUTIOUS INVESTOR

Martine Damonse

... over the long term, and especially with higher inflation rates, equities play an important role in any multi-asset class portfolio ...

In recent years, we have witnessed investors on our platform moving their assets away from low-equity funds to funds that have little to no equity exposure (de-risking), and with that, the relevance of low-equity funds, like the Allan Gray Stable Fund, has been tested. Martine Damonse discusses why investors would be remiss to overlook the Allan Gray Stable Fund.

Conventional wisdom suggests that to achieve a better return, one should be willing to take on more risk. But looking at returns across asset classes over the five years to end-December 2022, this theory has been tested – a story best told by the FTSE/JSE All Share (ALSI)'s lacklustre returns of 8.0% per year compared to the FTSE/JSE All Bond Index's of 7.8% over the period, but taking investors on a much bumpier ride. Considering the volatility and lack of obvious reward, it is not surprising that some conservative investors have sought perceived safety and steered away from equity markets to assets with smoother return profiles.

While equity markets are volatile and can underperform cash and bonds over shorter periods, over the long term, investors have been compensated for this volatility with substantially higher returns. A look at very long-term data reveals that from 1900 to 31 December 2022, South African equities have delivered on average 9.1% above inflation per year, whereas cash has only delivered 1.1% and bonds 2.3%. This suggests that, over the long term, and especially with higher inflation rates, equities play an important role in any multi-asset class portfolio – including those of risk-averse investors who seek long-term real growth, but also need to protect the purchasing power of their investment.

But how much equity exposure is enough, and how can investors balance the risk-return aspect of their portfolios? A low-equity unit trust can offer a solution.

The Allan Gray Stable Fund created a new category

Our Stable Fund was launched in July 2000 during a period of heightened equity market uncertainty. Investors had only just stopped reeling from the 1998 crash and were in the midst of what would later become known as the tech bubble. South Africans were battling with the decision of whether to take their money offshore, given the political uncertainty and high interest rates, while local equities were deeply out of favour. Similar to today, conservative investors were fearful of investing in equities.

Against this backdrop, we identified the need for a fund that would offer limited exposure to equities with reduced risk of loss (versus balanced and equity funds), while aiming to deliver superior returns to cash. The Allan Gray Stable Fund was therefore the first of its kind – a low-equity multi-asset class fund for investors seeking to preserve capital and/or wanting a reasonable income, while at the same time looking to grow their investment in real terms.

How the Fund meets its objectives

At launch, the Stable Fund had two equally important objectives, which remain in place today:

- To provide inflation-beating returns
- To protect capital over a two-year period

The Fund achieves its objectives by actively managing asset allocation from the bottom up and carefully considering equity exposure while providing conscious protection against a falling market. We go into more detail on these below.

Actively managing asset allocation

The Fund's allocation to equities, offshore and fixed income is managed from the bottom up. This means that we compare the expected return on each share we choose with the expected returns on cash and other assets and then weigh up whether the expected return is worth taking on the extra risk to own it.

We have the flexibility to have little to no equities in the Fund in times when we believe that equities are expensive or when other asset classes are trading on more attractive valuations, but we also have the flexibility to increase our net equities to the maximum of 40%, should we find equities attractive relative to other asset classes.

The Fund is managed to comply with Regulation 28 of the Pension Funds Act, which restricts exposure to certain asset classes and securities, including offshore exposure. The recent increase in the offshore investment limit allows us to increase offshore exposure up to 45%. While the increased offshore flexibility gives us more levers to pull, we are mindful of the additional volatility offshore exposure brings, including the risk of exchange rate fluctuations.

Carefully considering equity exposure

As active investors, we don't invest passively in the index – we choose individual equities for the Stable Fund using the same investment philosophy as for our Equity and Balanced funds. We conduct rigorous research, actively choose the shares we want to own, and patiently wait for the market to realise the shares' potential.

However, we have a slightly different investment process in managing the Stable Fund: We are more cognisant of downside risk when choosing the underlying shares. We can therefore choose to have a lower weighting to individual shares (versus the Balanced Fund) that we believe are too risky – i.e. have a wider range of potential outcomes – and a higher weighting to shares we believe have a higher certainty of outcome, some of which may offer a higher dividend-paying potential. We carefully select securities that we believe can outperform inflation meaningfully over the long term.

Adding equities to a portfolio can increase the volatility of a fund, however, we don't view volatility as the only risk to mitigate; for us, the most important risk to avoid is permanent loss of capital incurred by overpaying for an asset.

We carefully select securities that we believe can outperform inflation meaningfully over the long term.

Providing conscious protection against a falling market

The Stable Fund will be the first among our equity-exposed flagship funds to show any sign of caution towards the stock market becoming expensive. We can employ equity market hedging (a form of insurance) to protect against the risk of markets falling, while maintaining exposure to our selection of shares, which we would expect to outperform the market in such conditions.

The large weighting towards fixed income (cash and bonds) is a key component of the Stable Fund, as it helps us achieve appropriate diversification and assists in managing volatility. However, it is not *without* risk; our portfolio managers pay careful attention to the risks attached to the fixed interest instruments, including credit risk (the willingness and ability to repay interest and capital in full and on time), liquidity risk (the risk of having to sell quickly at a lower-than-expected price), duration risk (sensitivity to interest rate changes) and valuation risk (the risk of overpaying for an asset).

The Fund's fixed income is also conservatively managed to protect the Fund against the negative effect that interest rate shocks can have on bonds. Given the percentage allocation to interest-bearing securities, the Fund also produces a reasonable level of income.

As stated earlier, the Stable Fund aims to protect capital over a two-year period. If the Fund fails to deliver on this objective, Allan Gray will charge zero investment management fees.

Performance review

Our Stable Fund has protected capital and outperformed inflation meaningfully since inception, delivering 11.2% versus inflation at 5.5% (as at 31 March 2023). **Graph 1** illustrates the range of absolute annualised returns achieved over different rolling periods (shifted monthly). It is clear that, over the short term, there is more variability in the returns, with the best-performing result for the Fund over any one-year period being 23.3%, and the worst, -7.4%. However, as you extend your time horizon in the Fund, the range of return outcomes narrows significantly.

Typically, the Fund has been able to protect investors in falling equity markets while outperforming its cash + 2% benchmark in rising equity markets, as shown in **Graph 2**. Looking at the average of the down months (when the ALSI delivered a negative return) since inception of the Fund (110 months to 31 March 2023), the ALSI had an average monthly return of -3.3%, while the Stable Fund still managed to protect capital and produce a positive average monthly return of 0.3%. During the up months, the Fund was able to return 1.3% on average compared to its benchmark, which returned 0.7% on average.

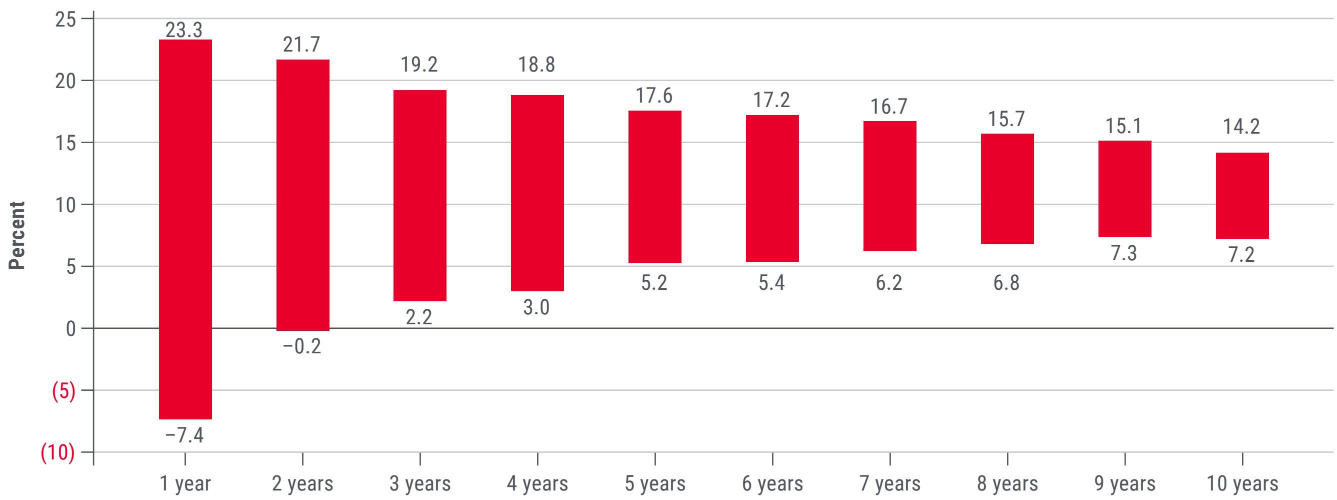
The ability to invest across asset classes … provides us with the necessary flexibility to both generate real returns and focus on capital preservation.

The Fund experienced its first and only negative two-year period (-0.2%) in 22 years in March 2020 during the COVID-19 crash. While a negative two-year return is disappointing, the nature of the market reaction to the pandemic outbreak was unprecedented, leaving very few places to hide, and the market recovered swiftly.

Is the Fund right for your portfolio?

The Stable Fund is appropriate for risk-averse long-term investors who aim to, at the very least, keep up with inflation, but also need some degree of capital protection. Likewise, it is suitable for investors with shorter investment

Graph 1: Range of total returns for the Allan Gray Stable Fund (1 July 2000 – 31 March 2023)

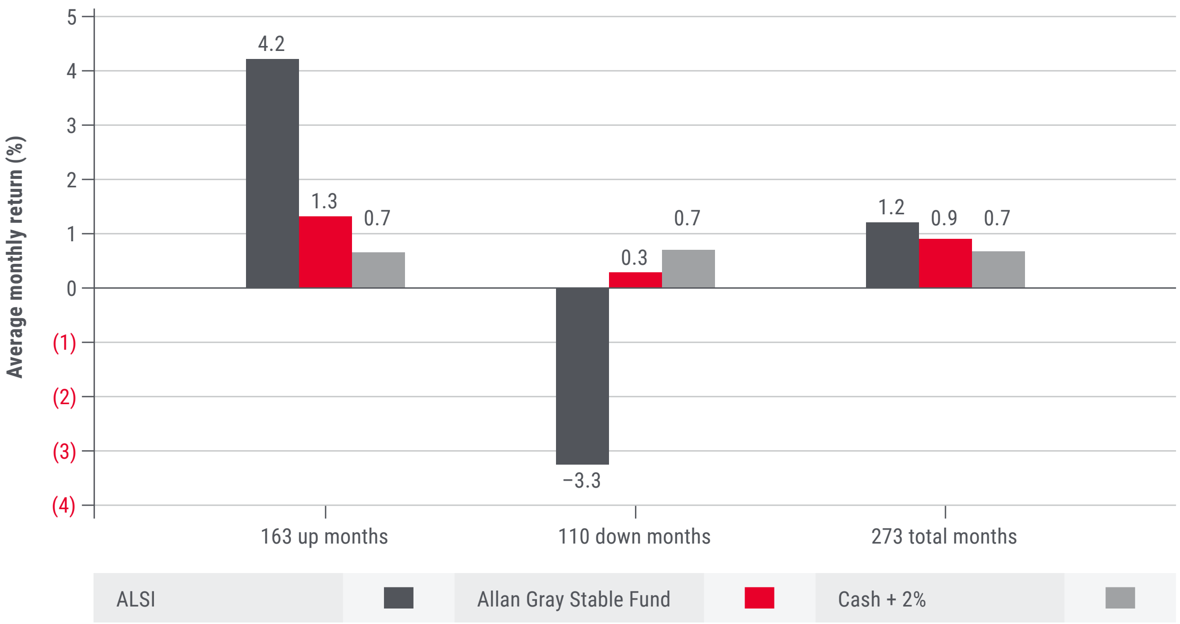


Source: Allan Gray research

time frames (but longer than two years). The Fund is also appropriate as part of a life-staging portfolio, where investors wish to reduce their equity risk in the last few years before retirement, particularly if they are planning to take a cash lump sum at retirement. It is also an option for retirees or any investor who wants to draw a reasonable and sustainable income from their investment.

With an allocation to equities being key to long-term growth, we believe the Allan Gray Stable Fund remains as relevant now as it has been since its inception. The ability to invest across asset classes, including equities, within predetermined limits, provides us with the necessary flexibility to both generate real returns and focus on capital preservation.

Graph 2: Unit trust returns in bull and bear markets (July 2000 – March 2023)



Source: Allan Gray research

Martine joined Allan Gray in 2009 and is currently an investment specialist in the ManCo Distribution team. She holds a Bachelor of Commerce degree in Politics, Philosophy and Economics from the University of Cape Town, as well as a Postgraduate Diploma in Financial Planning from Stellenbosch University. Martine is also a CFP® professional.

THE POWER OF 1%

Radhesen Naidoo

... every 1% return we can add makes a meaningful difference to the long-term rand outcomes that our clients experience.

As we celebrate our 50th anniversary, we are mindful of the collective efforts of teams, past and present, in building our long-term track record. Fascinatingly, achieving a long-term track record in investing has much in common with achieving success in professional tennis. In comparing the two disciplines, Radhesen Naidoo was excited to discover how meaningful a difference of 1% is to long-term success. Naidoo serves up some thought-provoking takeaways.

In 2022, all-time tennis great Roger Federer laid down his racquet, sending shockwaves through his fanbase. For over 20 years, this precision shotmaker redefined the game for generations to come. As investment managers, we are intrigued by stories hidden in data; it was therefore serendipitous to find a connection to investment management when crunching the numbers and underlying data of Federer's success on the tennis court.

Sport analogies are powerful in understanding what is needed to achieve success. Professional tennis and investment management both require a long-term mindset. Both disciplines are about patience, hard work and commitment to hone your skill, as well as resisting the urge to make rash decisions.

In tennis, a match may last for two to three hours, and a tournament lasts for two weeks, but a career, multiple years. To play exceptionally well consistently is difficult. Similarly, many investment managers may achieve stellar investment returns over one quarter or a year, but over decades and through different market cycles, outperformance becomes challenging. Adhering to a tried-and-tested investment philosophy is key, as is being adaptable, as the investment environment is constantly evolving. Likewise, in tennis, professional players use strategies that enhance their strengths, but as their opponents and the playing conditions change, these need to be tweaked to win.

While these concepts are shared by multiple disciplines, an interesting aspect about professional sport is the margins by which you win. Being marginally better can translate into substantial advantages – and is particularly relevant when thinking about what we aim to do as investment managers.

What is the difference between a good and a great tennis player?

There are numerous data points available for professional tennis players, but one that stands out and is easy to interpret is the percentage of points won compared to the percentage of matches won. **Graph 1** plots this data for each calendar year that Federer played professional tennis – from 1998 until 2021. The results are rather striking.

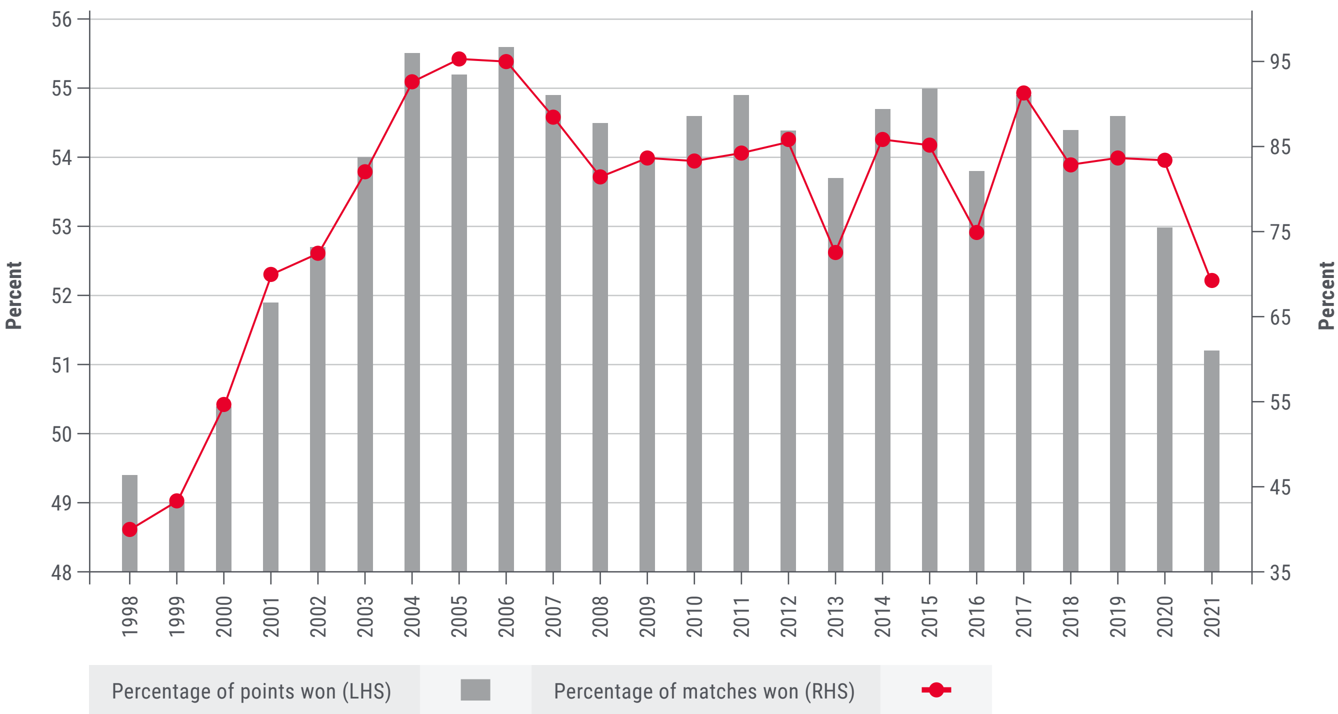
In 1999, Federer started the year ranked outside the top 100. He won 49% of all points played, and 43% of all his matches in that year. During 2001, he was in the top 50 ranked players, winning 52% of all points, and 70% of his matches. In 2005, when he was world number one and dominated the game, he won an incredible 95% of his matches. However, surprisingly, he won only 55% of all points played. Put differently, he was still losing 45% of the points played – but the marginal change in points won had an exponential impact on the number of matches won. What is more remarkable is that he continued to play at this level for the rest of his career, highlighting his ability to consistently improve his game as the competition grew.

The same data for the top 50 men's tennis players in the world each year from 1998 to 2021 presents a similar pattern. We divided the players into four groups based on their ranking: the top three players given the success of Federer, Rafael Nadal and Novak Djokovic over the period, the next seven best players (ranked 4-10), the next 20 (ranked 11-30), and the bottom 20 players (ranked 31-50). **Graph 2** on page 26 plots the average percentage of points won against the average percentage of matches won for each group over the 24-year period. The results are similar – winning more points generally means winning more matches.

> As an active investment manager, we recognise the compounding power of doing even slightly better than the market over time …

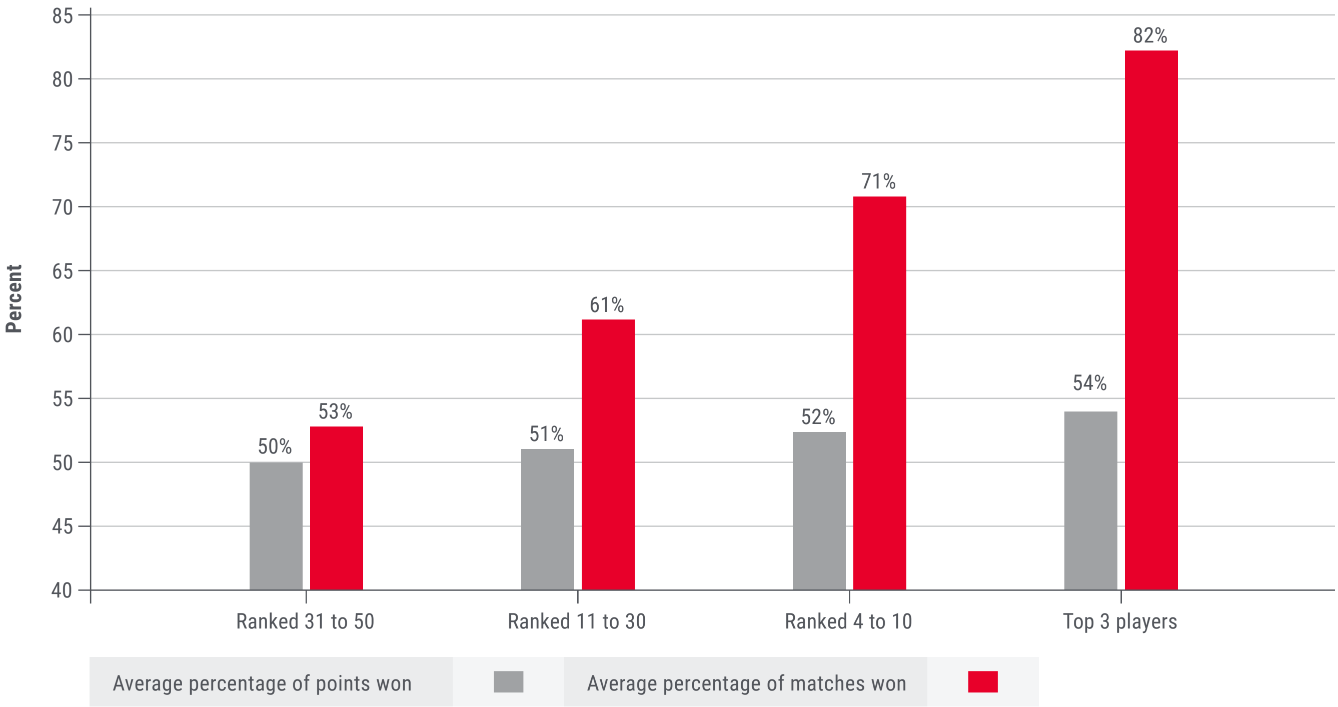
However, look closely and you will notice that while each group improved their points won by roughly 1-2%, the matches won increased by about 10%. The players ranked 31-50 won 50% of their points but only 53% of their matches, while the

Graph 1: Federer's percentage of points won compared to percentage of matches won



Sources: Allan Gray research, Ultimate Tennis Statistics. Data to 31 December 2021.

Graph 2: Top 50 players in men's tennis from 1998 to 2021



Sources: Allan Gray research, Ultimate Tennis Statistics. Data to 31 December 2021.

top three players won just 54% of their points, but over 80% of their matches. We could therefore say it is merely 1% that separates the good from the great in professional tennis. However, it could be more apt to conclude that achieving and maintaining that 1% gap over your peers – which requires tremendous skill and effort – is the mark of a champion.

… staying the course to realise the longer-term returns means not getting distracted by the short-term noise …

1% differences matter over the long term

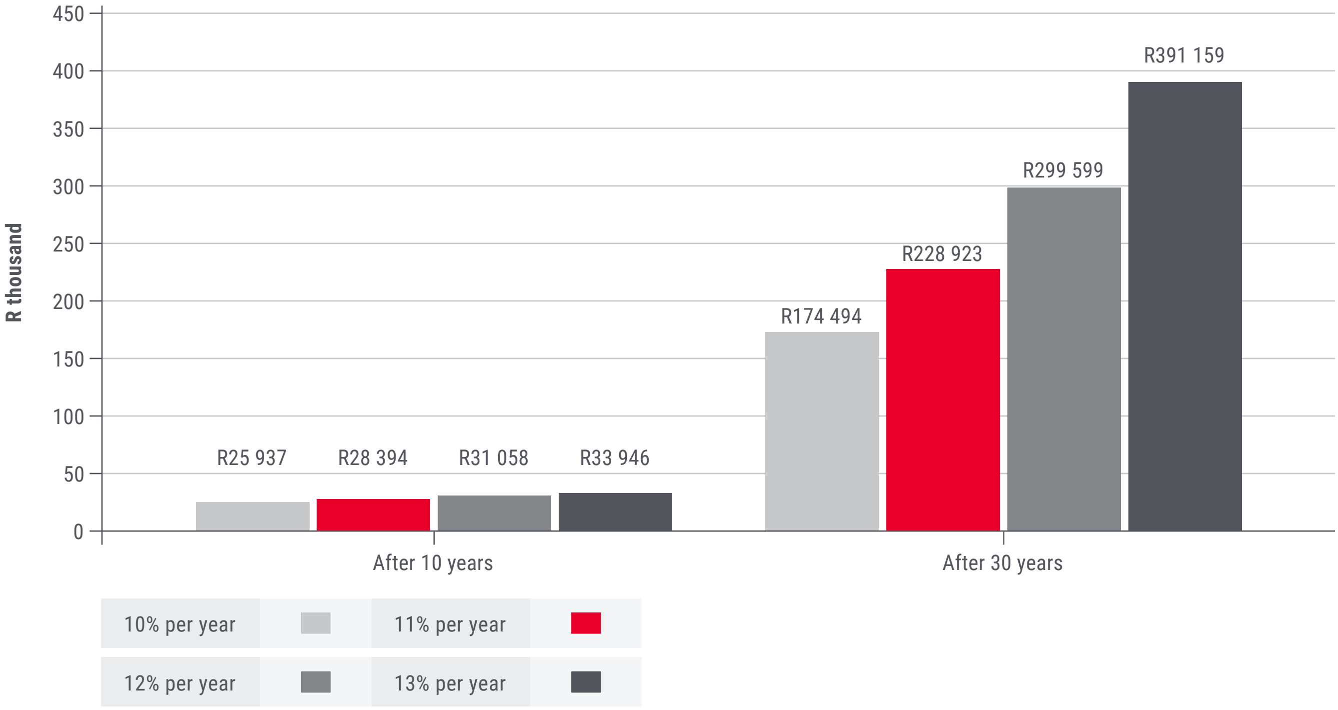
There are several conclusions one can draw when pitting this analysis against investment management. Let's start with the idea of the 1% difference, or what we will refer to as "marginal improvement".

At Allan Gray and Orbis, while our investment philosophy has remained the same since inception, our investment process has evolved. Our aim is to be marginally better each day in our efforts to deliver long-term outperformance. This could involve reflecting on past decisions, investing in better technology, drawing on different research – there isn't a silver bullet to success in this regard. As an active investment manager, we recognise the compounding power of doing even slightly better than the market over time and therefore continuously interrogate where we can make subtle adjustments to gain a slight edge. This matters a great deal to long-term outcomes.

The 1% difference is more simply illustrated with a practical example. Assume you invest R10 000 in a fund and expect an average return of 10% per year. Over the next 10 years, achieving this outcome would mean your money has more than doubled to R25 937. However, if the fund delivered 11% per year rather than 10%, the investment would be worth R28 394, or about 10% more. After 30 years, the difference in outcomes is more pronounced because of compounding, and you would have about 30% more, as shown in **Graph 3**.

As an investment manager who aims to outperform our peers and benchmarks, it is rewarding – and humbling – to recognise that every 1% return we can add makes a meaningful difference to the long-term rand outcomes that our clients experience.

Graph 3: Value of R10 000 at different annual returns after 10 and 30 years



Source: Allan Gray research

Picking your moments; you don't need to get every decision correct

We often say to our clients that achieving a long-term track record does not mean getting every decision correct. What is interesting, though, is that our success rate in choosing shares that outperform is roughly comparable to the percentage of points won by the top tennis players. As shown in Graph 2, the top three tennis players won about 54% of their points – which also means they were still losing 46% of their points. In tennis, a match is often decided by a few key points, and the top players succeed by investing their energy in those decisive moments, reducing unforced errors, and not getting distracted by mistakes when they happen.

Looking at the monthly returns of the flagship Allan Gray and Orbis funds since their respective inception dates, as shown in **Graph 4** on page 28, it is surprising to learn that these funds have outperformed their respective benchmarks in 53-54% of all months. While outperforming in 54% of the months may not sound like a lot, historically this outperformance has occurred during periods when the market has fallen and our funds have held up better – 2022 was an example of this. By minimising the impact of market drawdowns, the Allan Gray Balanced Fund has delivered returns of 15.1% per annum since its inception in 1999 versus the peer benchmark of 11.4%.

From a client perspective, staying the course to realise the longer-term returns means not getting distracted by the short-term noise that occurs when individual shares, and our funds themselves, underperform. Given our contrarian investment approach, this is inevitable as we are typically attracted to securities that are out of favour with the broader market, and it can take time for the market to recognise their true worth.

Marginal improvement tips the scales

In reflecting on the analysis of tennis and investment management, there are many parallels. In the pursuit of becoming a great tennis player and improving the odds of success over a career, 1% is a substantial advantage. As an investment manager, we know that in the pursuit of generating long-term returns for clients, there will be periods of shorter-term pain. Similar to top tennis players not winning every single point, we won't outperform in every single month or year. What enables long-term success is staying true to our investment philosophy through different market cycles – and being mindful of marginal improvements to our investment process. Over the long term, 1% makes a powerful difference.

Graph 4: Number of months that Allan Gray and Orbis flagship funds have outperformed and underperformed

Source: Allan Gray research. Data to 31 March 2023.

Radhesen is joint head of the Institutional Clients team and head of Orbis Client Servicing in South Africa. He joined Allan Gray in 2012 as a business analyst and also worked as a performance analyst at Orbis. Radhesen holds a Bachelor of Science (Honours) degree in Actuarial Science from the University of the Witwatersrand and is a qualified actuary.

HOW STAYING THE COURSE GIVES YOU THE LONG-TERM EDGE

Thandi Skade

Key to enjoying long-term investing success is ensuring that we keep our emotions in check and remain invested.

In a world where instant gratification is king, it can be hard not to get distracted by the lure of short-term gains. But taking a long-term view of your investments and staying the course can give you the edge to achieve better investment returns over time. Thandi Skade explores the opportunity cost of failing to stick to your long-term investment plan and how you can avoid paying behavioural penalties.

It is often said that investing is a game of patience. Like in chess, the best moves are often the ones that require discipline and playing the long game. In some ways, staying the course can be seen as a checkmate move: You "win" by remaining committed to your long-term investment strategy, effectively blocking the common behavioural pitfalls that can lead to inferior investment performance.

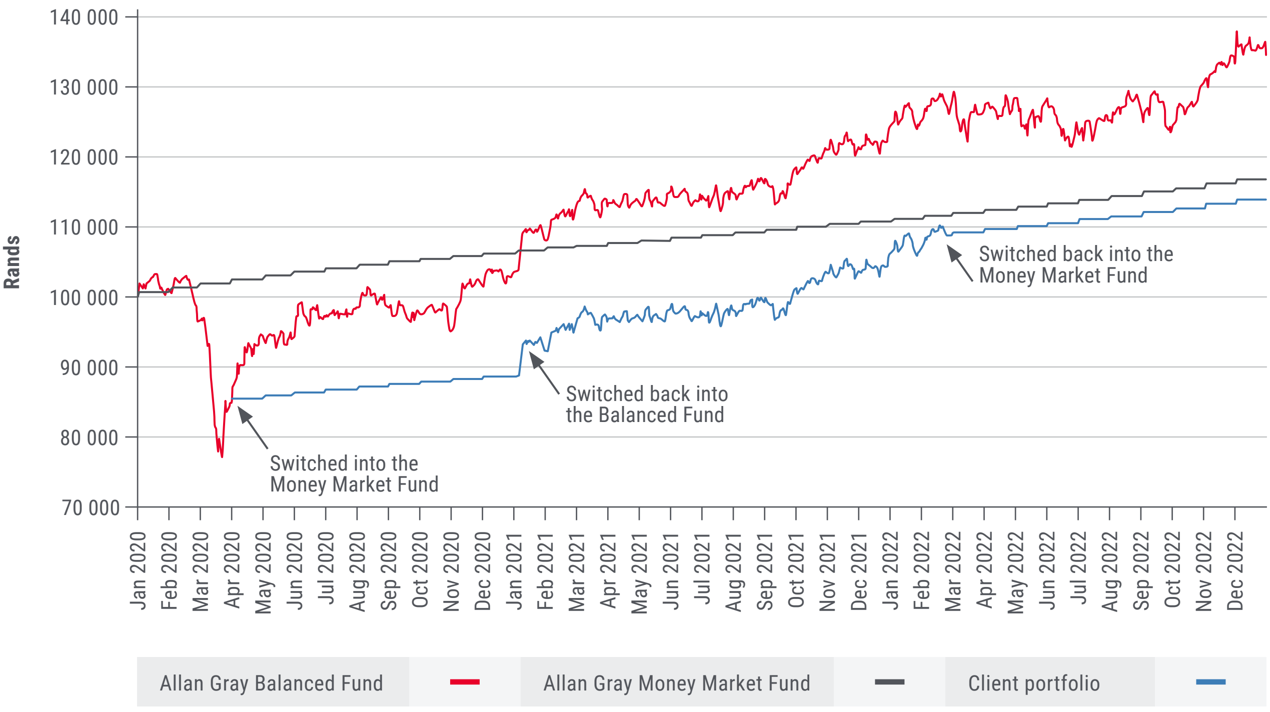
One of the mistakes many investors make is switching between funds or making withdrawals in an emotional response to short-term market movements. This can erode returns over time, as illustrated in **Graph 1** on page 30, which shows behaviour and resultant returns in three hypothetical investment scenarios. In all the scenarios, we measured the performance of a R100 000 investment initiated in January 2020 over the period to December 2022.

The first scenario represents the investor who stayed invested in the Allan Gray Balanced Fund over the entire period. The second scenario represents an investment in the Allan Gray Money Market Fund over the duration of the period, and the third represents the investor who attempted to time the market and made multiple switches between the funds in reaction to market volatility, which was driven by the start of the pandemic in March 2020 and Russia's invasion of Ukraine in late February last year. The difference in outcomes is notable.

Although measured over a relatively short period of time compared to the average investment horizon, Graph 1 reinforces the point that you will likely earn higher returns by remaining consistently invested over time, whether it is in a low- or medium-risk investment. Staying invested allows you to reap the rewards of compound interest – gaining additional returns on the returns already earned from your investments over time. By selling off investments

Graph 1: Behaviour and returns (January 2020 – December 2022)

Three R100 000 investments on 1 January 2020



Source: Allan Gray analysis

or switching between funds, we limit the compounding effect and growth potential of our investments.

While you could argue that we have engineered scenario three to illustrate our point, this type of behaviour and outcome is very common. In fact, behavioural economists have a term for it: The "behaviour gap" refers to the difference between the long-term returns delivered by a fund and the return an individual investor earns; a gap widened by poor behaviour, particularly trying to time the perfect entrance to and exit from the market (which often leads to buying high and selling low).

Graph 2 shows the 10-year return of the Allan Gray Balanced Fund – which is the return an investor would earn over the period by staying invested – compared to our clients' investment returns. It highlights that, on average, our clients locked in a 0.57% investor behaviour penalty over the period. That may not seem like a big difference, but over time, these small differences compound and can have a significant impact, as Radhesen Naidoo discusses in his piece on page 24. Key to enjoying long-term investing success is ensuring that we keep our emotions in check and remain invested.

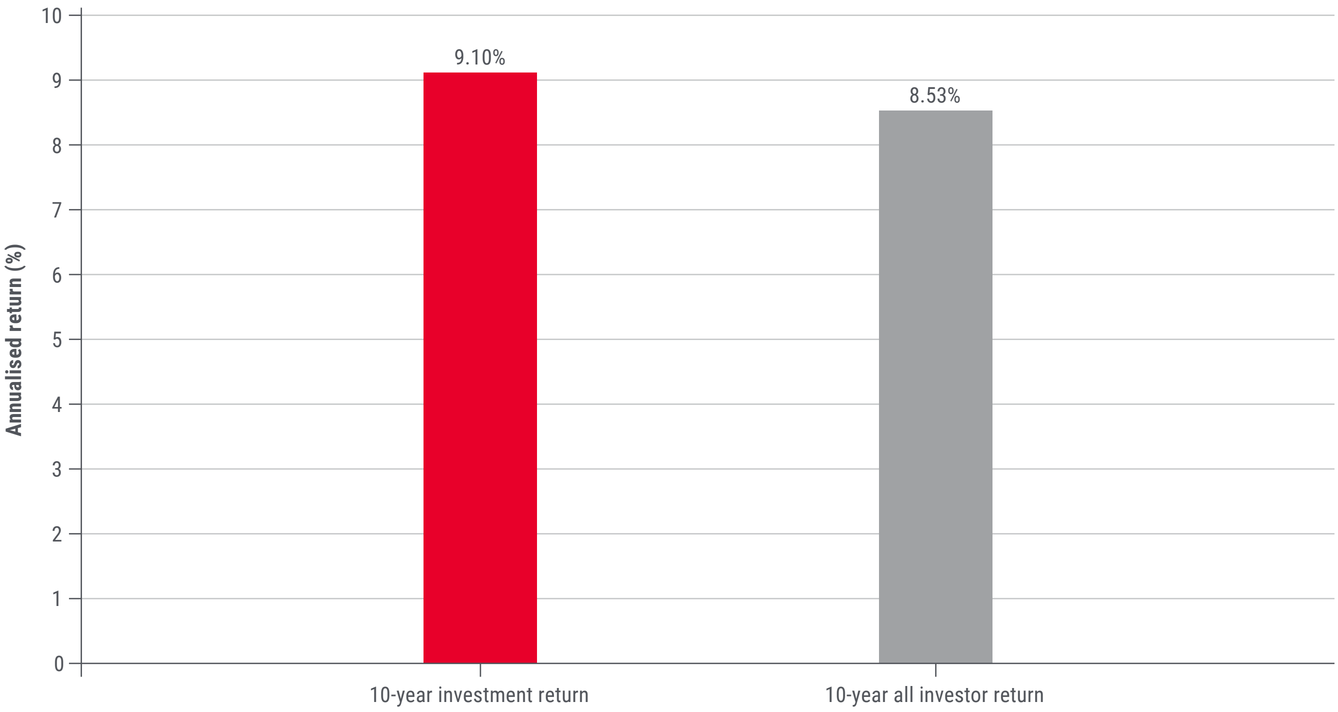
You don't have to go at it alone

While some investors can construct their own financial plans and portfolios and are able to stay the course over the long term, many find these activities and behaviours challenging and could benefit from partnering with a good independent financial adviser (IFA). An IFA can put together a plan based on your long-term goals and should review your investment portfolio annually to ensure that it continues to appropriately meet your needs.

Investors cite the cost of financial advice as the biggest deterrent to seeking professional guidance. However, what is often overlooked are the subtle and less tangible ways in which financial advisers create value for their clients over time. While it is hard to quantify the cost of not receiving advice, it can perhaps be measured by the penalties incurred through poor investor behaviour – which an IFA can help you avoid (see "Common investing mistakes a financial adviser can prevent you from making" on page 32).

A good example of this is evidenced in the contribution and debit order behaviour of our advised and non-advised client base. An analysis of the database over a 10-year period revealed that our advised clients tend to make more regular contributions towards their investment accounts and remain invested for longer than non-advised investors across all our investment products.

Graph 2: 10-year return of the Allan Gray Balanced Fund vs. investor returns



Notes: Investment return is the actual return generated by the unit trust, excluding transactions into/from the unit trust. Investor return is the average return experienced by investors in the Fund, which is influenced by investor behaviour.
Source: Allan Gray research. Data as at 31 March 2023.

This pattern was repeated among clients who pause and restart contributions to their investments: The data shows that advised clients reinstating debit order instructions make contributions for seven months longer than non-advised clients before their first debit order contribution freezes.

Over and above financial planning expertise and behavioural coaching, an IFA also provides estate-planning and comprehensive tax advisory services to help you structure your investment portfolio in the most tax-efficient manner.

So where do you begin if you are keen to partner with an IFA on your investment journey?

> Staying invested allows you to reap the rewards of compound interest …

Trust is fundamental in choosing a financial adviser and maintaining a prosperous relationship with them over the long term. A good place to start is by asking people you trust, and whose judgement you value, for recommendations. You can also make use of the "Find an independent financial adviser" service available on our website, or have an adviser's certification verified by the Financial Sector Conduct Authority (FSCA).

Asking the right questions is a great way to gain insights that can help you determine the best fit (see "Questions to consider asking a prospective financial adviser" on page 32).

Consistency and patience are key

Winning a game of chess requires more than just making the right moves – you have to go into the game with a well-thought-out strategy, and stick to it. The same is true for investing. Being a successful long-term investor begins with determining what you want to achieve, then putting a plan in place to help you get there, and having the patience and conviction to stick to the plan.

At times along your investment journey, and particularly in the face of short-term underperformance or market volatility, you may need to sacrifice gains in the short term in exchange for more rewarding returns over the long term. This can be a lot easier said than done, though, so if you need an accountability partner, a financial adviser will be there to lend a hand.

Common investing mistakes a financial adviser can prevent you from making

Independent financial advisers (IFAs) can help investors avoid the pitfalls of investing on their own. While some investors may not need an IFA to help them achieve this, it pays to be aware of how to avoid these common mistakes:

Attempting to time the market

During times of volatility, many investors struggle to tune out the noise, opting to switch out of higher-risk assets into lower-risk assets, like money market and interest-bearing funds. Switching between investments at the wrong time can lock in losses and prevent you from enjoying any future turnaround. An IFA can serve as a "voice of reason", helping you to be rational rather than emotional and encouraging you to stay the course.

Not accounting for inflation

Money loses value over time. If your investments aren't delivering inflation-beating returns, you will lose purchasing power in the long term. An IFA can make sure your money is invested in the right assets.

Not preserving retirement savings when changing jobs

Failing to preserve retirement savings exposes you to the risk of falling short during your retirement years. An IFA can guide you through the available options to preserve and grow your investment.

Failing to diversify

An IFA will make sure that your investment portfolio is adequately diversified to balance your risk and return requirements, and that you make adjustments at important life stages and milestones.

Questions to consider asking a prospective financial adviser

Are you licensed?

Financial advisers in South Africa must be licensed as an authorised financial services provider by the Financial Sector Conduct Authority (FSCA).

Are you independent?

Not all advisers are equal. Some advisers are restricted to specific or limited product providers. The broader the range of product providers your adviser works with, the more options you will have to achieve all your financial goals.

What credentials do you hold?

As with any professional partnership, it is important to complete due diligence on a prospective adviser. Interrogate the letter of introduction that you will need to sign before you receive financial advice. Check that it contains the name and registration number of the adviser, whether they have professional indemnity insurance, and the categories of business on which the adviser is qualified to give advice.

How can you help me grow my wealth?

It is important to ask questions about both the nature of the adviser's advice and their investment process to make sure these align with your needs and expectations.

How are your fees structured?

Transparency about how the adviser calculates their fee is critical. It is important to know upfront for what you will be expected to pay.

Thandi joined Allan Gray in 2020 as a communications specialist in the Marketing team. She holds a Bachelor of Social Science degree in Media & Writing and Politics from the University of Cape Town.

NOTES

Allan Gray Balanced and Stable Fund asset allocation as at 31 March 2023

	Balanced Fund % of portfolio			Stable Fund % of portfolio		
	Total	SA	Foreign*	Total	SA	Foreign*
Net equities	65.3	42.9	22.4	24.3	14.5	9.7
Hedged equities	10.4	4.8	5.6	21.4	11.3	10.2
Property	1.1	0.9	0.2	1.0	0.9	0.1
Commodity-linked	3.4	2.8	0.7	3.0	2.5	0.5
Bonds	12.8	8.2	4.6	34.0	25.7	8.3
Money market and bank deposits	6.9	5.0	1.9	16.4	11.2	5.2
Total	**100.0**	**64.6**	**35.4**	**100.0**	**66.0**	**34.0**

Note: There may 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 2023

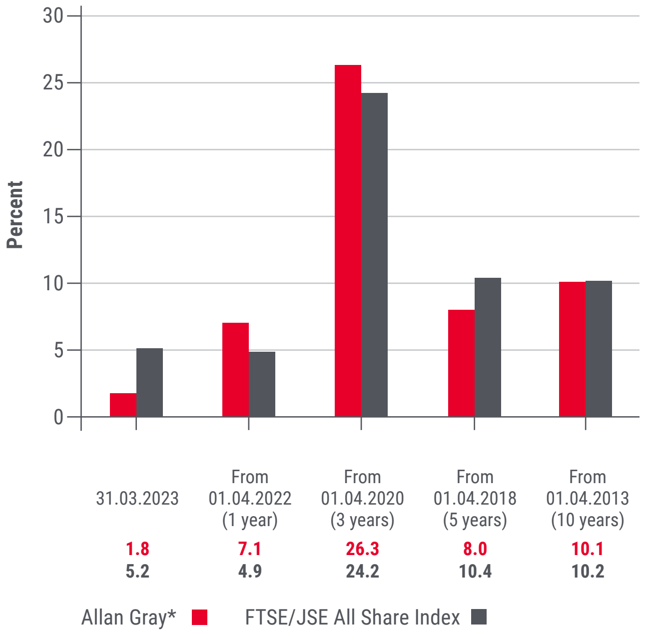
Security (Ranked by sector)	Market value (R million)	% of Fund	FTSE/JSE ALSI weight (%)
South Africa	**27 147**	**65.7**	
South African equities	**25 703**	**62.2**	
Resources	**6 383**	**15.5**	**25.9**
Glencore	1 856	4.5	
Sasol	916	2.2	
Sibanye-Stillwater	834	2.0	
Gold Fields	604	1.5	
Sappi	538	1.3	
AngloGold Ashanti	536	1.3	
BHP	266	0.6	
Positions individually less than 1% of total JSE-listed securities held by the Fund[1]	833	2.0	
Financials	**7 180**	**17.4**	**19.1**
Nedbank	1 206	2.9	
Standard Bank	1 139	2.8	
Remgro	916	2.2	
FirstRand	605	1.5	
Reinet	509	1.2	
Investec	480	1.2	
Old Mutual	369	0.9	
Ninety One	347	0.8	
Momentum Metropolitan Holdings	294	0.7	
Positions individually less than 1% of total JSE-listed securities held by the Fund[1]	1 315	3.2	
Industrials	**12 140**	**29.4**	**55.0**
Naspers & Prosus	2 199	5.3	
British American Tobacco	2 101	5.1	
AB InBev	1 719	4.2	
Woolworths	1 265	3.1	
Mondi Plc	1 026	2.5	
Tiger Brands	472	1.1	
Super Group	355	0.9	
Life Healthcare	334	0.8	
MultiChoice	273	0.7	
Positions individually less than 1% of total JSE-listed securities held by the Fund[1]	2 396	5.8	
Commodity-linked securities	**254**	**0.6**	
Positions individually less than 1% of total JSE-listed securities held by the Fund[1]	254	0.6	
Bonds	**25**	**0.1**	
Positions individually less than 1% of the Fund	25	0.1	
Cash	**1 165**	**2.8**	
Africa ex-SA	**1 047**	**2.5**	
Equity funds	**1 047**	**2.5**	
Allan Gray Africa ex-SA Equity Fund	1 047	2.5	
Foreign ex-Africa	**13 110**	**31.7**	
Equities	**35**	**0.1**	
Resources	**35**	**0.1**	
Positions individually less than 1% of total JSE-listed securities held by the Fund[1]	35	0.1	
Equity funds	**12 959**	**31.4**	
Orbis Global Equity Fund	5 986	14.5	
Orbis SICAV International Equity Fund	4 044	9.8	
Allan Gray Frontier Markets Equity Fund	1 970	4.8	
Orbis SICAV Japan Equity (Yen) Fund	514	1.2	
Orbis SICAV Emerging Markets Equity Fund	445	1.1	
Cash	**116**	**0.3**	
Totals	**41 304**	**100.0**	

[1] JSE-listed securities include equities, property and commodity-linked instruments. **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 15.6)	−0.8	−0.8	0.0
1975	23.7	−18.9	42.6
1976	2.7	−10.9	13.6
1977	38.2	20.6	17.6
1978	36.9	37.2	−0.3
1979	86.9	94.4	−7.5
1980	53.7	40.9	12.8
1981	23.2	0.8	22.4
1982	34.0	38.4	−4.4
1983	41.0	14.4	26.6
1984	10.9	9.4	1.5
1985	59.2	42.0	17.2
1986	59.5	55.9	3.6
1987	9.1	−4.3	13.4
1988	36.2	14.8	21.4
1989	58.1	55.7	2.4
1990	4.5	−5.1	9.6
1991	30.0	31.1	−1.1
1992	−13.0	−2.0	−11.0
1993	57.5	54.7	2.8
1994	40.8	22.7	18.1
1995	16.2	8.8	7.4
1996	18.1	9.4	8.7
1997	−17.4	−4.5	−12.9
1998	1.5	−10.0	11.5
1999	122.4	61.4	61.0
2000	13.2	0.0	13.2
2001	38.1	29.3	8.8
2002	25.6	−8.1	33.7
2003	29.4	16.1	13.3
2004	31.8	25.4	6.4
2005	56.5	47.3	9.2
2006	49.7	41.2	8.5
2007	17.6	19.2	−1.6
2008	−13.7	−23.2	9.5
2009	27.0	32.1	−5.1
2010	20.3	19.0	1.3
2011	9.9	2.6	7.3
2012	20.6	26.7	−6.1
2013	24.3	21.4	2.9
2014	16.2	10.9	5.3
2015	7.8	5.1	2.7
2016	12.2	2.6	9.6
2017	15.6	21.0	−5.4
2018	−8.0	−8.5	0.5
2019	6.2	12.0	−5.8
2020	−3.5	7.0	−10.5
2021	28.9	29.2	−0.3
2022	13.1	3.6	9.5
2023 (to 31.03)	**1.8**	**5.2**	**−3.4**

Returns annualised to 31.03.2023



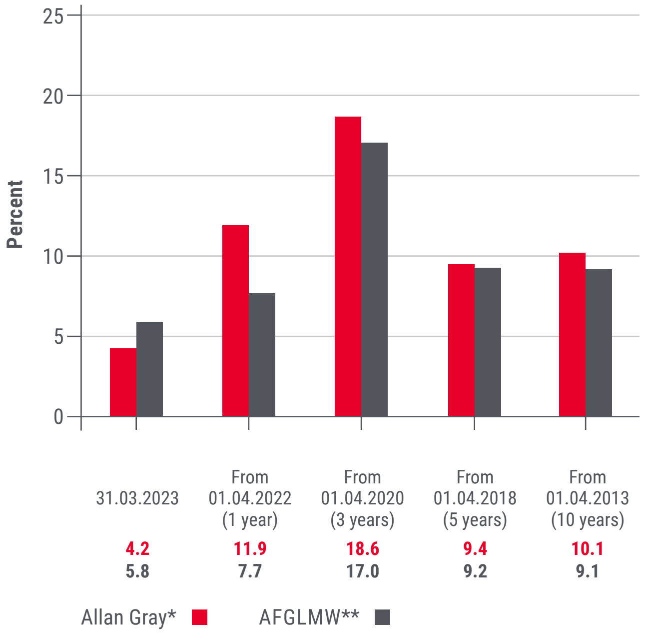
An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R323 192 039 by 31 March 2023. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R14 975 226. Returns are before fees.

*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. **Note:** Listed property included from 1 July 2002. Inward listed included from November 2008 to November 2011.

Investment track record – balanced returns

Allan Gray Proprietary Limited global mandate total returns vs Alexander Forbes Global Large Manager Watch			
Period	**Allan Gray***	**AFGLMW****	**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	−1.4	−2.1	0.7
2019	6.5	10.9	−4.4
2020	5.3	6.3	−1.0
2021	20.4	21.9	−1.5
2022	9.9	1.2	8.7
2023 (to 31.03)	**4.2**	**5.8**	**−1.6**

Returns annualised to 31.03.2023



An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R36 222 748 by 31 March 2023. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R7 744 072. 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 2023 is an estimate. The return from 1 April 2010 is the average of the non-investable Alexander Forbes Global 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 2023 (net of fees)

	Assets under management (R billion)	Inception date	Since inception	10 years	5 years	3 years	1 year	Highest annual return[5]	Lowest annual return[5]
High net equity exposure (100%)									
Allan Gray Equity Fund (AGEF)	**41.3**	**01.10.1998**	**19.4**	**8.8**	**7.5**	**22.7**	**9.7**	**125.8**	**−24.3**
Average of South African - Equity - General category (excl. Allan Gray funds)[1]			14.2	8.2	8.0	23.5	3.6	73.0	−37.6
Allan Gray SA Equity Fund (AGDE)	**3.6**	**13.03.2015**	**6.5**	**–**	**6.6**	**26.0**	**5.0**	**57.3**	**−32.0**
FTSE/JSE All Share Index including income			8.4	–	10.4	24.2	4.9	54.0	−18.4
Allan Gray-Orbis Global Equity Feeder Fund (AGOE)	**25.1**	**01.04.2005**	**13.7**	**14.2**	**10.8**	**14.7**	**16.1**	**78.2**	**−29.7**
FTSE World Index			14.1	16.4	17.0	16.6	13.4	54.2	−32.7
Medium net equity exposure (40% - 75%)									
Allan Gray Balanced Fund (AGBF)	**170.4**	**01.10.1999**	**15.1**	**9.1**	**8.3**	**18.1**	**10.4**	**46.1**	**−14.2**
Allan Gray Tax-Free Balanced Fund (AGTB)	**2.4**	**01.02.2016**	**7.9**	**–**	**8.3**	**17.7**	**11.0**	**31.7**	**−13.4**
Average of South African - Multi Asset - High Equity category (excl. Allan Gray funds)[2]			11.4/7.0	7.9	8.0	15.7	7.0	41.9/30.7	−16.7/−10.3
Allan Gray-Orbis Global Balanced Feeder Fund (AGGF)[3]	**16.5**	**03.02.2004**	**10.9**	**12.4**	**11.3**	**15.1**	**18.8**	**55.6**	**−13.7**
60% MSCI World Index with net dividends reinvested and 40% J.P. Morgan GBI Global Index[3]			11.0	12.5	12.9	7.6	12.4	38.8	−17.0
Low net equity exposure (0% - 40%)									
Allan Gray Stable Fund (AGSF)	**50.1**	**01.07.2000**	**11.2**	**8.2**	**7.6**	**13.1**	**8.9**	**23.3**	**−7.4**
Daily interest rate of FirstRand Bank Limited plus 2%			8.5	6.9	6.5	5.5	7.1	14.6	4.6
Very low net equity exposure (0% - 20%)									
Allan Gray Optimal Fund (AGOF)	**0.9**	**01.10.2002**	**6.8**	**5.4**	**3.7**	**3.6**	**−2.5**	**18.1**	**−8.2**
Daily interest rate of FirstRand Bank Limited			6.0	4.8	4.4	3.5	5.0	11.9	2.5
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO)	**1.7**	**02.03.2010**	**7.7**	**7.7**	**7.0**	**8.7**	**29.5**	**39.6**	**−12.4**
Average of US$ bank deposits and euro bank deposits			6.3	6.4	7.8	0.4	22.9	35.6	−19.1
No equity exposure									
Allan Gray Bond Fund (AGBD)	**6.8**	**01.10.2004**	**8.8**	**7.7**	**7.1**	**10.3**	**5.3**	**18.0**	**−2.6**
FTSE/JSE All Bond Index (Total return)			8.5	7.3	6.9	11.6	5.8	21.2	−5.6
Allan Gray Money Market Fund (AGMF)	**25.9**	**03.07.2001**	**7.6**	**6.5**	**6.2**	**5.3**	**6.3**	**12.8**	**4.3**
Alexander Forbes Short-Term Fixed Interest (STeFI) Composite Index[4]			7.4	6.2	5.8	4.8	6.0	13.3	3.8

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 of the Allan Gray Balanced Fund 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 May 2021, this Fund was called the Allan Gray-Orbis Global Fund of Funds and its benchmark was 60% of the FTSE World Index and 40% of the J.P. Morgan GBI Global Index. From 1 June 2021, the Fund's investment mandate was changed from a fund of funds structure to a feeder fund structure investing solely into the Orbis SICAV Global Balanced Fund. To reflect this, the Fund was renamed and the benchmark was changed.
4 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.
5 This is the highest or lowest consecutive 12-month return since inception. All rolling 12-month figures for the Fund and the benchmark are available from our Client Service Centre on request.

Allan Gray total expense ratios and transaction costs for the 3-year period ending 31 March 2023

	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	1.11%	−0.26%	0.04%	0.08%	0.97%	0.10%	1.07%
Allan Gray SA Equity Fund	1.00%	−0.47%	0.01%	0.08%	0.62%	0.11%	0.73%
Allan Gray Balanced Fund	1.02%	0.01%	0.03%	0.11%	1.17%	0.08%	1.25%
Allan Gray Tax-Free Balanced Fund	1.31%	N/A	0.04%	0.15%	1.50%	0.09%	1.59%
Allan Gray Stable Fund	1.01%	0.16%	0.03%	0.14%	1.34%	0.05%	1.39%
Allan Gray Optimal Fund	1.00%	0.00%	0.02%	0.15%	1.17%	0.12%	1.29%
Allan Gray Bond Fund	0.36%	0.03%	0.01%	0.06%	0.46%	0.00%	0.46%
Allan Gray Money Market Fund	0.25%	N/A	0.00%	0.04%	0.29%	0.00%	0.29%
Allan Gray-Orbis Global Equity Feeder Fund	1.49%	−0.55%	0.05%	0.00%	0.99%	0.11%	1.10%
Allan Gray-Orbis Global Balanced Feeder Fund	1.41%	0.24%	0.06%	0.00%	1.71%	0.09%	1.80%
Allan Gray-Orbis Global Optimal Fund of Funds	1.00%	−0.01%	0.08%	0.00%	1.07%	0.13%	1.20%

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, Share Transactions Totally Electronic (STRATE) and FSCA Investor Protection Levy and VAT thereon) are shown separately. Transaction costs are necessary costs 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 (TIC).

Foreign domiciled funds annualised performance (rand) in percentage per annum to 31 March 2023 (net of fees)

	Inception date	Since inception	10 years	5 years	3 years	1 year	Highest annual return[5]	Lowest annual return[5]
High net equity exposure								
Orbis Global Equity Fund	**01.01.1990**	**17.2**	**14.4**	**11.1**	**15.1**	**17.8**	**87.6**	**−47.5**
FTSE World Index		13.7	16.4	17.1	16.6	13.4	54.2	−46.2
Orbis SICAV Japan Equity (Yen) Fund	**01.01.1998**	**13.9**	**13.0**	**9.3**	**9.1**	**20.8**	**94.9**	**−40.1**
Tokyo Stock Price Index		9.3	12.5	9.3	7.0	16.7	91.0	−46.4
Orbis SICAV Emerging Markets Equity Fund (US$)[6]	**01.01.2006**	**12.8**	**10.4**	**8.8**	**11.4**	**25.8**	**58.6**	**−34.2**
MSCI Emerging Markets Equity (Net) (US$)[6]		12.0	10.3	7.4	7.6	8.5	60.1	−39.7
Allan Gray Africa ex-SA Equity Fund (C class)	**01.01.2012**	**12.0**	**7.5**	**8.8**	**18.6**	**12.7**	**65.6**	**−24.3**
Standard Bank Africa Total Return Index		7.6	5.2	12.5	20.7	3.0	41.4	−29.4
Allan Gray Australia Equity Fund	**04.05.2006**	**14.2**	**11.6**	**13.5**	**25.4**	**8.1**	**99.5**	**−55.4**
S&P/ASX 300 Accumulation Index		12.4	10.4	14.6	19.9	7.7	55.6	−45.1
Allan Gray Frontier Markets Equity Fund (AGFEF)	**03.04.2017**	**9.9**	**–**	**10.5**	**18.8**	**31.5**	**31.5**	**−11.0**
MSCI Frontier Emerging Markets Index		4.4	–	4.1	7.3	1.4	15.9	−12.8
Medium net equity exposure								
Orbis SICAV Global Balanced Fund	**01.01.2013**	**14.5**	**13.2**	**12.1**	**16.1**	**20.5**	**54.4**	**−9.8**
60% MSCI World Index with net dividends reinvested and 40% J.P. Morgan GBI Global Index		13.4	12.5	13.0	7.3	12.3	40.2	−12.1
Allan Gray Australia Balanced Fund	**01.03.2017**	**10.2**	**–**	**12.2**	**16.8**	**12.3**	**29.1**	**−5.3**
The custom benchmark comprises the S&P/ASX 300 Accumulation Index (36%), S&P/ASX Australian Government Bond Index (24%), MSCI World Index (net dividends reinvested) expressed in AUD (24%) and J.P. Morgan GBI Global Index expressed in AUD (16%).		9.6	–	12.4	9.8	9.9	25.1	−8.3
Low net equity exposure								
Allan Gray Australia Stable Fund	**01.07.2011**	**10.5**	**7.7**	**10.0**	**10.2**	**10.8**	**32.7**	**−8.9**
Reserve Bank of Australia cash rate		6.3	3.7	6.6	3.7	10.6	28.8	−15.5
Very low net equity exposure								
Orbis Optimal SA Fund (US$)	**01.01.2005**	**9.7**	**9.1**	**9.3**	**10.0**	**32.1**	**48.6**	**−15.7**
US$ Bank deposits		8.2	8.0	10.2	1.0	25.2	57.9	−25.6
Orbis Optimal SA Fund (Euro)	**01.01.2005**	**7.5**	**6.1**	**4.7**	**8.1**	**26.3**	**44.1**	**−19.3**
Euro Bank deposits		6.0	4.8	5.6	−0.6	19.6	40.2	−20.9
No equity exposure								
Allan Gray Africa Bond Fund (C class)[7]	**27.03.2013**	**11.9**	**11.9**	**10.7**	**5.4**	**8.7**	**28.9**	**−7.4**
FTSE 3-Month US T Bill + 4% Index[7]		8.1	8.2	11.9	10.5	29.6	26.6	−12.3

Performance as calculated by Allan Gray

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

[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] From inception to 31 December 2020, this Fund was called the Allan Gray Africa ex-SA Bond Fund and its benchmark was the J.P. Morgan GBI-EM Global Diversified Index. From 1 January 2021, the Fund's investment mandate was broadened to include South African investments. To reflect this, the Fund was renamed and the benchmark was changed.

IMPORTANT INFORMATION FOR INVESTORS

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Benchmarks

FTSE/JSE All Share Index, FTSE/JSE Capped Shareholder Weighted All Share Index and FTSE/JSE All Bond Index

The FTSE/JSE All Share Index, FTSE/JSE Capped Shareholder Weighted All Share Index, and FTSE/JSE All Bond Index (the FTSE/JSE indices) are calculated by FTSE International Limited ("FTSE") in conjunction with the JSE Limited ("JSE") in accordance with standard criteria. The FTSE/JSE indices are the proprietary information of FTSE and the JSE. All copyright subsisting in the FTSE/JSE indices' values and constituent lists vests in FTSE and the JSE jointly. All their rights are reserved.

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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 fees in its feeder funds 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 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, Allan Gray Pension Preservation Fund, Allan Gray Provident Preservation Fund and Allan Gray Umbrella Retirement Fund (comprising the Allan Gray Umbrella Pension Fund and Allan Gray Umbrella Provident Fund) are all administered by Allan Gray Investment Services (Pty) Ltd, an authorised administrative financial services provider and approved pension funds administrator under section 13B of the Pension Funds Act 24 of 1956. Allan Gray (Pty) Ltd, also an authorised financial services provider, is the sponsor of the Allan Gray retirement funds. The Allan Gray Tax-Free

Investment Account, Allan Gray Living Annuity and Allan Gray Endowment are administered by Allan Gray Investment Services (Pty) Ltd, an authorised administrative financial services provider, and underwritten by Allan Gray Life Limited, an insurer licensed to conduct investment-linked life insurance business as defined in the Insurance Act 18 of 2017. 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) and life-pooled investments.

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Registration number
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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


ALLAN GRAY