Q4

30 DECEMBER 2008
QUARTERLY
COMMENTARY

Santa Claus, the Easter Bunny and risk-free investments

The global economy after Lehman's collapse

A tale of two periods

Are your retirement plans keeping pace with change?

ALLANGRAY

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Greg Fury

COMMENTS FROM THE CHIEF OPERATING OFFICER

The past year has been particularly trying for investors in almost all asset classes and regions. This is unprecedented in our history as a firm. At the same time, our focus on capital preservation has given the marginal comfort that our equity funds have lost much less than their benchmarks, -11.6% versus -23.2% for the FTSE/JSE All Share Index. Meanwhile, many mandates delivered flat or positive returns, again well ahead of their benchmarks. The full detail on our funds' performance appears at the back of this issue.

Be aware of the risks

One positive of the events of the past 18 months, although it might be difficult to see it that way, is that we learnt a lot; not least about risks that we had simply forgotten about or ignored in the preceding bull market.

We are aware that the easiest way to lose your trust is to create a false expectation and, in fact, we would rather not have a client than have one who we are destined to disappoint. With the events of the recent past focusing their minds, Ian Liddle and Andrew Lapping remind investors that there is no such thing as a risk-free investment, and that all funds under our management are exposed to risk of some kind – including our Money Market Fund. Being aware of the risks and consciously accepting them will minimise hopefully the chances of you suffering a nasty surprise one day.

Look for great investment opportunities

But it is not all doom and gloom. In fact, to those with the luxury of a long-term investment horizon, increased volatility and lower valuations may present an opportunity, not a threat. Sandy McGregor reminds us that markets discount the future, not the present, and often behave quite differently from underlying economies. Indeed, some of the biggest market rallies have occurred in the middle of recessions.

On the same theme, but in reverse, most of us were reminded of a tough lesson in 2008: what goes up must come down. Mahesh Cooper compares the 10 months to October 2008 against the same period in 2007. The results show how broad-based the tail of the bull market was and how there has been nowhere to hide for an equity portfolio in the subsequent fall in the markets.

Invest for the long term

Although it is very difficult to predict what the stock markets will do over the short term, we will continue to identify attractive opportunities for investment. Because one of our major concerns has been whether corporate earnings, which for various reasons were at historic highs, would be sustainable, we have looked, and will continue to look, for companies whose earnings we believe will be sustainable, and for industries we think are in very strong competitive positions, where demand for products is fairly stable.

I would like to offer the certainty of a better 2009 but, in truth, we simply do not know what will happen over the short to medium term. All I can say with confidence, just as we did repeatedly when expressing caution that valuations appeared to us to be too high, is that this too shall pass. And this should prevent arrogance when things are going too well and depression in times like these. I wish you all the best in 2009.

Kind regards

Greg Fury

Ian Liddle

Andrew Lapping

SANTA CLAUS, THE EASTER BUNNY AND RISK-FREE INVESTMENTS

EXECUTIVE SUMMARY: The Allan Gray Money Market Fund is not a risk-free investment. It carries its own unique set of risks, which could result in real or even nominal losses for investors in the Fund. Ian Liddle and Andrew Lapping remind investors to be aware of the risks to which they expose themselves when investing. This should help them avoid nasty surprises.

Risk:

- The possibility that something unpleasant will happen
- The possibility of meeting danger or suffering harm or loss

Source: Oxford English Dictionary

We expect that all readers of this article have come to accept by now that Santa did not squeeze down our chimneys this festive season, and that the Easter Bunny will not be knocking on our doors in April. But many of us are still struggling to wean ourselves from a belief in the most fantastical and mythical creature of all: a risk-free investment. So we will say it now: there is no such thing as a risk-free investment.

Understand the risks

The cataclysmic events of 2008 have surprised many of us, but none more than the investor who did not realise the full extent, or even the very existence, of the risk to which he or she was exposed before 'something unpleasant' happened. At Allan Gray we want you to entrust your savings to our care with full knowledge of the risks to which you are exposing yourselves. We strive to communicate clearly and effectively to minimise the risk of you suffering a nasty surprise one day.

> "... there is no such thing as a risk-free investment."

The purpose of this article is to reinforce the message, which is consistently conveyed in our more formal documentation such as fund fact sheets, unit trust deeds and mandates: Allan Gray does not guarantee any of the funds which it manages in any way whatsoever. Investors in all funds and portfolios under our management are exposed to risk. The nature of this risk will vary dramatically depending on the nature of the investment mandate given to us. Nonetheless, this message applies equally to all types of portfolios which we manage, including the Allan Gray Money Market Fund.

One needs look no further than the 2008 annual investment performance numbers for our suite of unit trusts (at the back of this Quarterly Commentary) to see that the Allan Gray Money Market Fund did a good job last year of protecting investors in the Fund from the ravages of falling stock markets – not too surprisingly since its mandate does not allow stock market investments. But that does not mean that the Money Market Fund is a risk-free investment.

On the contrary, investors in the Money Market Fund are exposed to a number of risks, which can result in real (and, in extreme situations, even nominal) capital losses. The rest of this article discusses the three major risks to which investors in the Money Market Fund are exposed:

1. Negative real interest rates
2. Credit risk
3. Liquidity risk

1. Negative real interest rates: the decline of purchasing power

If the rate of inflation exceeds after-tax interest rates, then the spending power of an investor's capital in the Money Market Fund will decline over time even if he or she re-invests all of the after-tax income distributed from the Fund. Some investors may well say that they prefer to go backwards

slowly and predictably rather than very abruptly as happened to equity market investors in 2008. However, most investors probably do not want the purchasing power of their capital to go backwards indefinitely.

Will history repeat itself?

Referring to **Graph 1**, we can see that South African savers have been somewhat spoiled since the mid-1990s when real after-tax interest rates for the man-in-the-street turned positive (we have simplified the analysis by using a consistent tax rate of 25%). What is the chance of real interest rates being negative for an extended period? Quite high, if history repeats itself. With the exception of a few short-term blips, real interest rates in South Africa were negative from 1971 to 1995.

Licensed to print money?

Governments around the world are going to be hard-pressed to deliver on their bail-out and stimulus promises, and the temptation will certainly be there for politicians to 'print money' and/or engineer negative real interest rates.

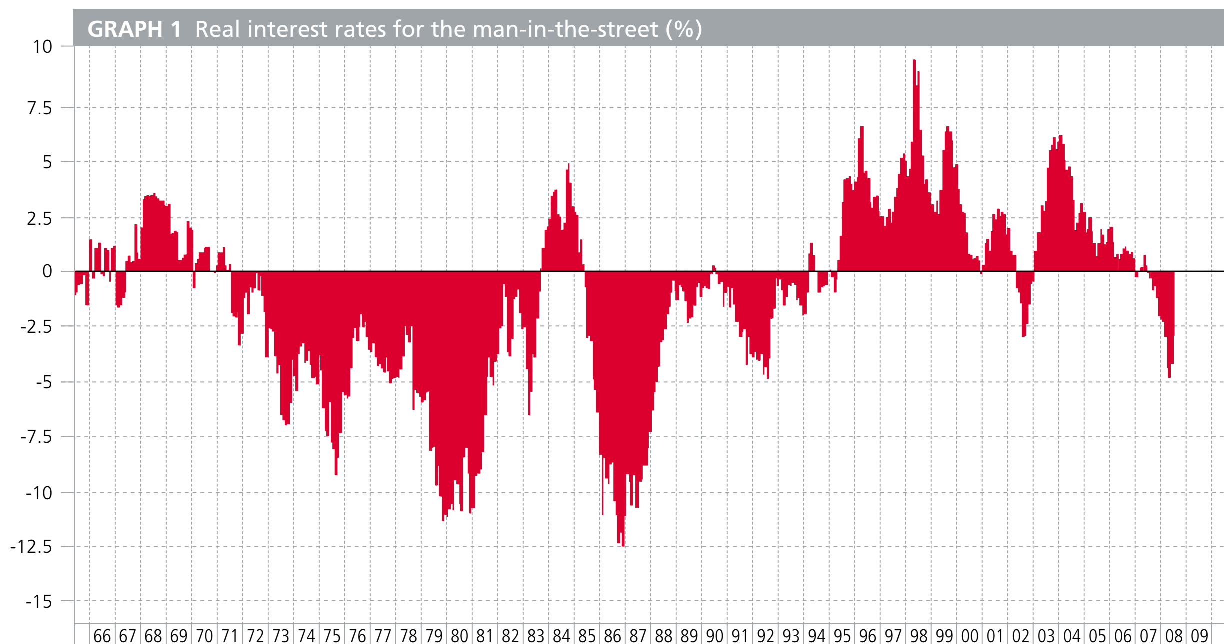
To use an extreme example, if you had had the misfortune of investing in a money market fund in Zimbabwe a few years back, you would not have lost a single Zimbabwean dollar, but you would have lost the entire spending power or real value of your investment.

The Allan Gray Money Market Fund provides great protection from falling stock markets, but it cannot provide any protection from the erosion of your real capital should our country's policymakers choose to administer negative real interest rates (or print truckloads of money in an extreme case). However, other funds in our suite, such as the Allan Gray Equity Fund, Balanced Fund and Stable Fund, may provide some protection from this risk to the extent that they invest in real assets such as equities, as opposed to monetary assets.

2. Credit risk

The Allan Gray Money Market Fund invests in debt instruments (or 'IOUs') which oblige the issuer of the IOU to repay a fixed money amount on a specified date within the next year. If the issuer were to go 'bankrupt' and default (in other words not be able to pay the full amount due when it is due) the Fund and its investors would bear a loss.

One way in which we try to address credit risk is to invest the Fund in a diversified portfolio of debt instruments issued by a range of issuers, so that any potential losses arising from the default of any one issuer will be constrained to a limited portion of the Fund's portfolio. Indeed, the regulations



Explanation: Real interest rate = interest after tax (Banker's Acceptance [BA] rate less 25% tax) minus inflation rate.

Source: I-Net Bridge and Allan Gray research

governing the Fund restrict exposures to different types of issuers to limits which enforce some diversification of the Fund's holdings.

Of course, the benefits of diversification will be tempered if the default of one issuer sets off further defaults by other issuers in a domino-effect crisis. In the event of a systemic crisis like this, governments around the world have typically stepped in to shore up and stabilise the financial system (as has happened in the US and elsewhere in 2008).

Obviously, some issuers are more at risk of defaulting than others. Typically, these 'riskier' issuers have to pay a higher interest rate on their debt to compensate investors for the extra risk. Assessing whether or not this higher interest rate is sufficient compensation for the extra risk is inherently subjective and it depends on one's own assessment of the likelihood of uncertain future events. There is no way to assess the right or wrong answer at the time of investment – investors in any debt instrument need to exercise their own judgement as to whether there is sufficient potential reward for the credit risk.

TABLE 1 Exposure by issuer at 31 December 2008

	% Fund
Government and Parastatal	
RSA	22.0
Transnet	4.7
TCTA	0.7
Total	27.4
Corporates	
Anglo American	4.8
SAB	4.4
Toyota	2.5
Mercedes	2.1
Unilever	1.9
Total	15.7
Bank Deposits*	
ABSA	14.5
Nedbank	13.7
Standard	12.6
FirstRand	8.7
Citibank	3.8
Investec	3.6
Total	56.9
Total	**100.0**

* Bank Deposits include negotiable certificates of deposit (NCDs), fixed deposits and call deposits.

"Allan Gray does not guarantee any of the funds which it manages in any way whatsoever."

When managing the Money Market Fund, we have a very low risk tolerance as we are mindful that the objectives of capital preservation and liquidity are paramount for investors in the Fund. **Table 1** shows the Fund's portfolio on 31 December 2008. We believe the Fund is very conservatively positioned, with 27.4% of the Fund invested in government or parastatal securities, 15.7% in corporate paper backed by multinationals with the same or higher credit ratings than the South African government, and 56.9% on deposit with South Africa's major banks.

3. Extreme circumstances can heighten liquidity risk

In most circumstances, investors in the Money Market Fund can give one day's notice of their intent to withdraw all their funds, but we do not invest the entire Fund on call deposit as we think it unlikely that all the Fund's investors would suddenly want to withdraw all their funds on the same day. By investing in longer-dated paper we can improve the yield earned by the Fund and its investors.

However, in extreme circumstances (such as were experienced in the US money markets in 2008), withdrawals can be unexpectedly large, and this may force the Money Market Fund to sell its longer-dated paper in order to fund the withdrawals. If this paper is sold at a loss (as there may be other money market funds all trying to sell the same paper at the same time), then that loss will be borne by the Fund and its investors.

How we alleviate liquidity risk

There are several ways in which we attempt to mitigate liquidity risk:

Maintain a buffer

First, we structure the Fund's investments so that there is a relatively smooth flow of maturities for funding withdrawals in the ordinary course. We also maintain a buffer on call deposit to fund a certain level of unusual withdrawals.

There is a plan in place to fund withdrawals

Secondly, under more extreme circumstances, we have the right to borrow up to 10% of the assets of the portfolio in order to fund withdrawals and have banking facilities in place should this be necessary. This allows us to buy some time to realise assets and reduces the risk of the Fund being forced

to sell investments at short notice which would prejudice the remaining unitholders.

'Ring fencing' protects remaining investors from large withdrawals

Finally, we have the right to 'ring fence' large withdrawals. What this means is that should the Fund experience net withdrawals equal to more than 5% of its assets on any one day, we are allowed to set aside a representative 5% 'slice' of the portfolio and realise the investments in an orderly fashion over a period of time and pay the withdrawing unitholders out of the proceeds. This means that withdrawing investors may wait for more than the customary one day to receive their cash, but those investors remaining in the Fund are protected from the consequences of a fire-sale.

Understand your investment risks

This article is not an attempt to either encourage or discourage investors from investing in our Money Market Fund. But, after a year in which the Allan Gray Money Market Fund has been one of the top-performing funds in our unit trust suite, we thought it appropriate to emphasise that, although the Fund does avoid stock market risk, it carries its own unique set of risks, which in an extreme scenario could result in losses for investors in the Fund. The Allan Gray Money Market Fund is not a risk-free investment.

Sandy McGregor

THE GLOBAL ECONOMY AFTER LEHMAN'S COLLAPSE

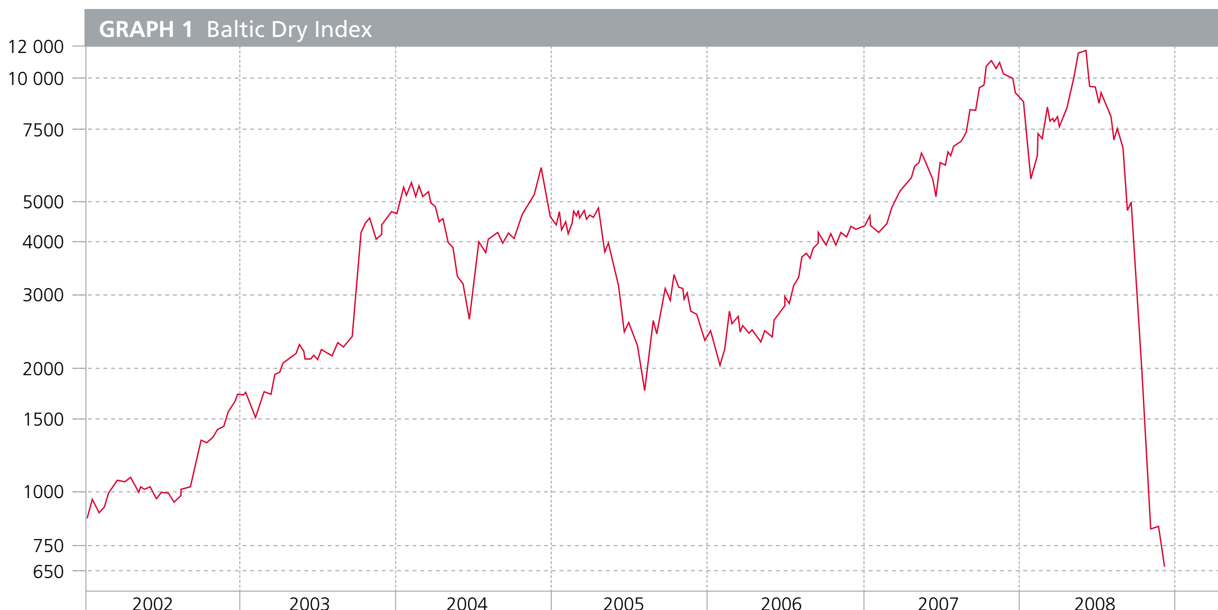
EXECUTIVE SUMMARY: The world is going through the most trying economic times since the 1930s. Sandy McGregor discusses what has happened and some of the risks and opportunities we face.

The domino effect of Lehman's collapse

With the collapse of Lehman Brothers on 14 September 2008 the global economic crisis entered a new, more damaging, phase. Following the Lehman failure, credit markets froze. Despite massive central bank intervention, with the US Federal Reserve (Fed) taking about US$1trn of assets onto its balance sheet in five weeks, interbank interest rates rose significantly.

With credit suddenly unavailable, global trade slowed dramatically, which in turn caused commodity prices to collapse. Industrial production has been slashed. For example, the world's largest steel producer, Arcelor Mittal, has cut production by 30%. Since June, the Baltic Dry Index, a measure of shipping freight rates and one of the best barometers of global trade conditions, has fallen 93% (see **Graph 1**). There has been a sharp rise in unemployment.

The impact on equity prices has been devastating. On 15 September the Morgan Stanley World Index was 1 283, down 23% from its peak in October 2007. By 20 November it had fallen to 771, 40% lower than on 15 September and 51% off its high (see **Graph 2** on page 7). The focus of investors has shifted rapidly from the sub-prime crisis to the severe global economic downturn, which is decimating corporate earnings and balance sheets.



The Baltic Dry Index is a measure of sea freight rates. Unprecedented collapse is an indication of how serious the downturn is in global trade.

Source: I-Net Bridge and Allan Gray research

From sub-prime crisis to severe economic downturn

The recession in Europe and the US caused by the sub-prime debacle has now become a global phenomenon. The astonishingly rapid deterioration of business conditions has taken almost everyone by surprise. The only recent precedent is the recession of 1974 which was triggered by a tenfold rise in oil prices. Otherwise we have to look back to the outbreak of the First World War in August 1914 to find a similar sudden cessation of world trade. In both cases, economic collapse was precipitated by a sudden shock from exogenous forces.

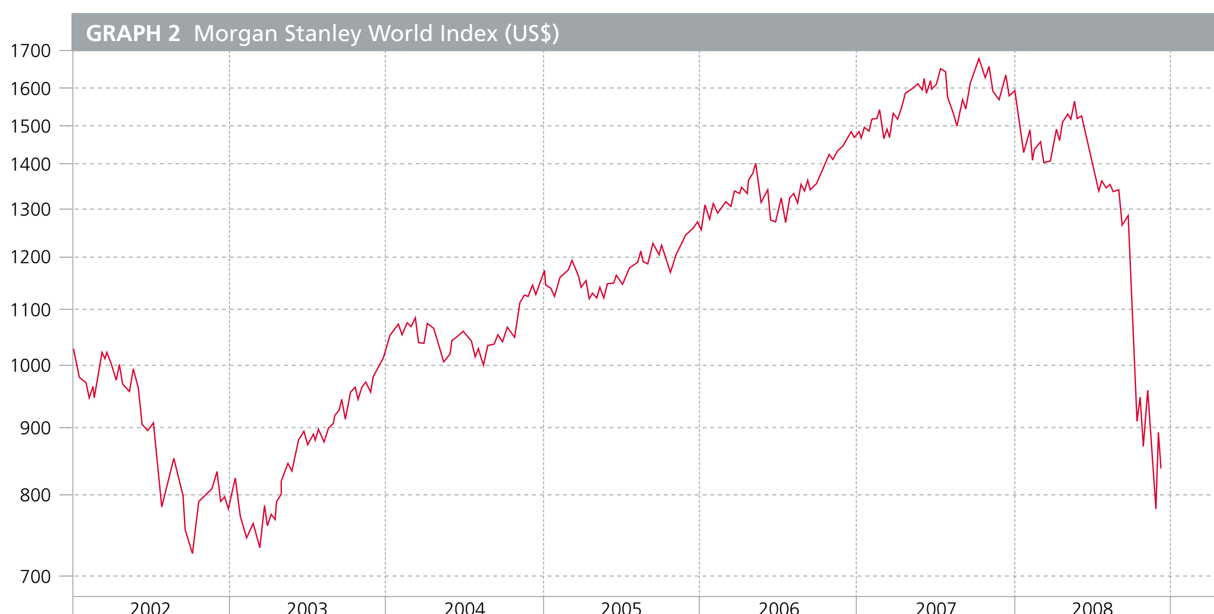
Many countries which previously looked as if they would get through the financial crisis relatively unscathed are now in serious difficulties. Russia, Brazil, Australia and South Africa are all suffering the adverse consequences of a sharp fall in commodity prices. Even the rich oil exporters in the Middle East will have to dip into their huge foreign reserves to pay their bills. Most significantly, Chinese growth has slowed considerably. Exports have been an important engine of Chinese growth. China was already facing problems due to over-investment in real estate. On its own this may not have been a problem, but in conjunction with the sudden contraction in exports, over-investment is now causing a severe slowdown.

> "In retrospect, it is clear that it was a mistake to allow Lehman to fail."

In retrospect, it is clear that it was a mistake to allow Lehman to fail. We now know what happens when a bank which is 'too big to fail' does fail. For the central banks the experience has been sobering. It is extremely unlikely that any other large bank will be allowed to fail. We saw an example of the renewed commitment to shoring up the banking system on 23 November, when the US Fed and Treasury announced a guarantee of US$306bn on certain assets owned by Citibank. Given the difficulties banks are experiencing in raising further equity capital, a large part of the banking system is moving inexorably into some form of public ownership.

Budgetary caution thrown to the winds

The sudden descent of the world economy into recession has caught central bankers and governments by surprise. The political world is responding with unprecedented fiscal and monetary stimulus. The recent G20 meeting in Washington was rather thin on results. However, everyone agreed that the thinking of John Maynard Keynes, who in the 1930s prescribed government spending as the way out of a recession, was the appropriate way to go. Budgetary caution has been thrown to the winds. It now looks as if the US fiscal deficit will be US$1trn in 2009. Europe has announced a €300bn spending plan and the Chinese are doing something similar.



Source: I-Net Bridge and Allan Gray research

Interest rates are being cut aggressively – in the US they are now almost at zero. Accordingly, the Fed has to use other monetary tools to stimulate the US economy. It has adopted a policy previously used in Japan called 'quantitative easing'. This is a technical name for what ordinary people would call 'printing money'. The Fed's objective is to reduce the cost of mortgage finance, which perversely has increased over the period since August 2007, despite the Fed cutting its base rate by 5.0%. The initial impact of quantitative easing has been to do just that.

Transferring risk from the private to the public sector

It looks as if massive government intervention has prevented the financial system from imploding and business conditions are starting to stabilise. However, the consequences of the global meltdown will be with us for a long time. The principle causes of the crisis are an over-leveraged banking system, over-borrowed consumers, imprudent lending and over-investment in real estate.

> "…, the consequences of the global meltdown will be with us for a long time."

During long periods of prosperity the economic system develops inefficiencies which ultimately become unsustainable and give rise to painful periods of adjustment. Sustainable recovery requires a reduction in debt and a restoration of balance sheets through increased saving. This process of deleveraging invariably leads to a long period of slower growth. For example, Japan took more than a decade to sort out the mess created by its asset bubble which burst in 1990. Unfortunately, the panacea of government intervention will not solve the problem of over-extended balance sheets. It merely transfers risk from the private to the public sector. Governments can stabilise the system, but in the long term have limited capacity to make an economy grow.

Will we learn from past mistakes?

Tax policy can have a profound effect on share prices. Which policies governments will choose to follow is uncertain. How will they finance these enormous expenditures? One of the great myths of the 20th century is that Franklin Roosevelt caused the US economy to recover from the depression of 1932 through New Deal spending. In fact, due to his hostility to business and high taxes, he prevented the economy from achieving a sustainable recovery. US economic performance in the 1930s was worse than most other countries. It is possible that Roosevelt's errors will be repeated. There is a real danger that a combination of tax increases required to pay for lavish government spending and a rising hostility to business will extend the period of economic stagnation, preventing the recovery in profits needed to sustain higher share prices.

Another threat is inflation. For the immediate future, collapsing demand and rising unemployment will keep prices stable. However, interest rates have been slashed to sustain growth and, especially in emerging markets, are probably already too low. A massive fiscal deficit funded by printing money is a formula for serious inflation. Policy makers may be too sanguine about inflation because of Japan's deflationary experience. Unlike Japan, the US has a significant current account deficit. Massive money creation may destroy the external value of the dollar which in turn will undermine domestic price stability in the US. Rising global inflation could condemn us to a period like the 1970s with high interest rates and volatile, but ultimately static share prices.

Look for great investment opportunities

Typically, a recession such as we are currently experiencing lasts for at least two years. The actual slowdown may last only two or three quarters, but the recovery initially tends to be slow. Statisticians may declare the economy is growing again but it will not feel like it. Given the scale of the problem in the US and Europe, the developed economies will probably stagnate for a lengthy period. The example of Japan is not encouraging. However, emerging markets will bounce back much more quickly and become the focus of global growth. The era of Asia's economic hegemony is upon us.

For investors, the recession creates special challenges. The decline in equity prices suggests the market is anticipating a significant fall in corporate profits. The average earnings per share of companies included in the S&P 500 Index are already down 46% from their peak in September 2007. However, investors will now start anticipating the recovery. Some of the biggest market rallies have occurred in the middle of recessions. It is important to remember that it is in times like the present that great investment opportunities develop.

Mahesh Cooper

A TALE OF TWO PERIODS

EXECUTIVE SUMMARY: Over the last 10 months investors all over the world have been reminded of a tough lesson: what goes up must come down. What we find interesting is how quickly the attraction of investing in stock markets has fallen following the significant declines they have experienced. While it is very difficult to predict what stock markets will do over the short term, Orbis continues to identify attractive opportunities for investors based on its contrarian philosophy and bottom-up stock selection process.

The poor dollar returns experienced by stock markets over the last year have returned the notion that investing in stocks can be risky. Also the saying 'what goes up must come down' seemed to be forgotten in the bull market experienced over the last seven years.

Not a pretty picture

The world maps (**Map 1** on page 10 and **Map 2** on page 11) use colour to illustrate stock market returns over the first 10 months to October in 2007 and 2008. Those countries whose stock markets delivered a positive dollar return are shown in green, and those countries whose markets delivered a negative dollar return are shown in red. In the 10 months to 31 October 2008 there is no green on the map as stock markets around the world collapsed. Many markets more than halved over the period, and collapsing emerging market currencies relative to the dollar reduced dollar returns even further.

The BRIC countries were particularly hard hit in dollar terms: Brazil lost 54%, Russia 72%, and India and China 65% each. South Africa was down in line with the emerging market index, which fell 53%, while developed markets faired slightly better, losing 38%. Overall the FTSE World Index dropped 40% in US dollar terms.

When markets react so violently on the downside, it drives emotion into the investment-making decision, which often results in further selling as investors panic. This is what has happened in many markets across the world, and the situation was made worse by the 'limit down' rules in many stock markets. The 'limit down' rule causes stock markets to close during the day if they fall by a predetermined level. What is interesting is how quickly the attraction of investing in stock markets has tumbled as a result of their recent significant declines.

If you draw the same map, but a year earlier, a very different picture emerges. The 10-month period to the end of October 2007 shows that, with the exception of Japan, stock markets around the world delivered positive dollar returns. In US dollar terms, emerging markets were up almost 50% and the World Index up nearly 19%, with many stock markets posting very strong dollar returns.

> "... there has been nowhere to hide for an equity portfolio ..."

Investors were very much of the view that stock markets would continue to deliver the stunning returns that they had delivered over the previous six years.

Nowhere to hide for equity portfolios

A similar chart emerges (see **Graph 1** on page 12) when one looks at the performance of the global sectors in the World Index for the 10 months to end October 2007 and 2008. While all sectors rose during the 2007 period, all fell during the 2008 period.

The result shows how broad-based the tail of the bull market was and that there has been nowhere to hide for an equity portfolio in the subsequent fall in the markets. In addition, the global financial crisis has resulted in many fatalities. The Orbis Global Equity Fund was successful in avoiding most of these. However, the Fund held AIG and Hypo Real Estate, both of which suffered as a result of the liquidity crunch that followed the failure of Lehman Brothers.

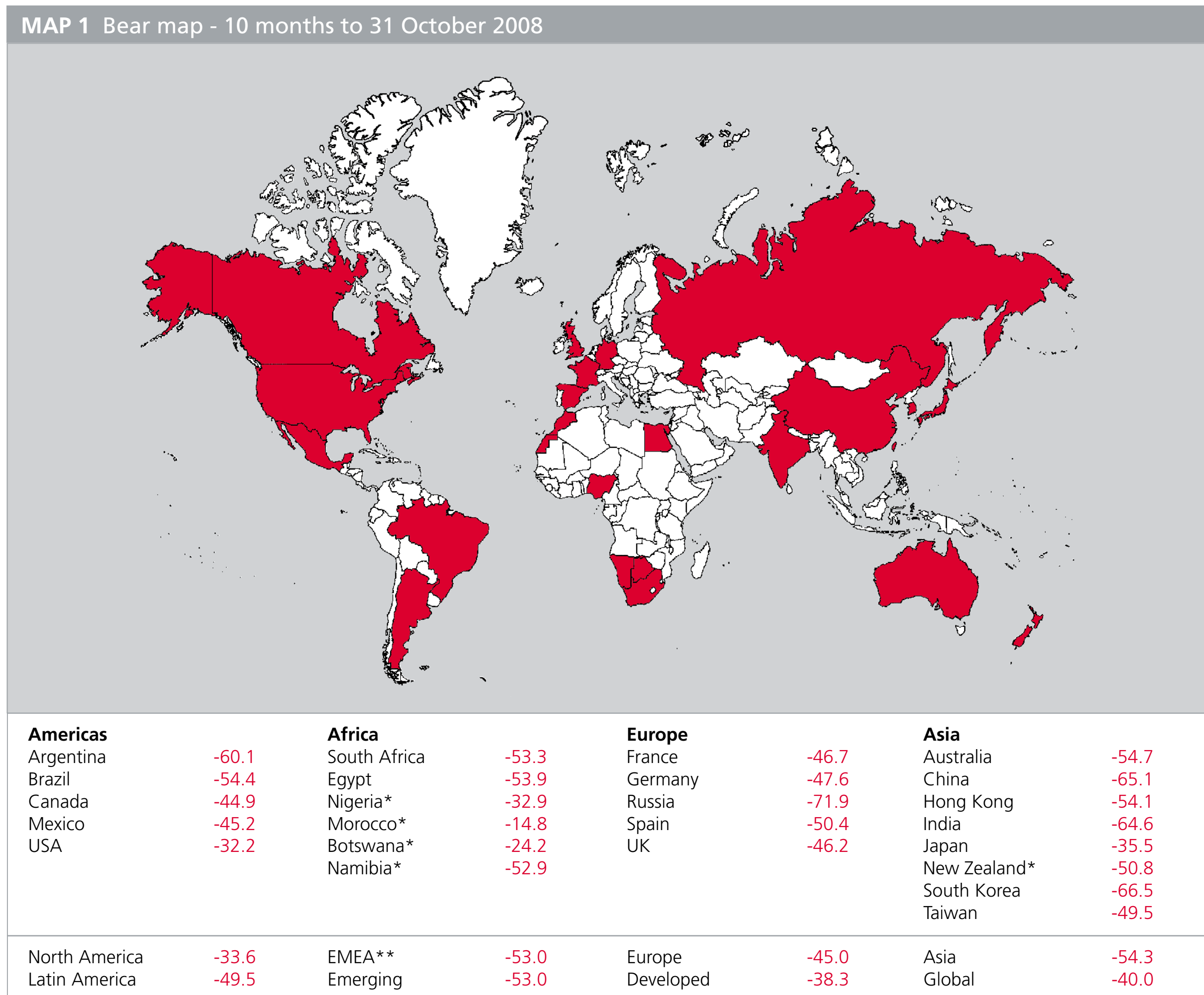
Do not ignore simple investment ideas

It is often during these volatile and emotional times that the simplest investment ideas are ignored. For example, Microsoft is one of the largest and best-known global companies and, despite being able to grow its earnings and buy back shares (Microsoft has over US$20bn in cash and investments on its balance sheet), its share price has fallen by more than the market this year. This is because in a bear market all stocks are sold down, especially the larger stocks, as they tend to be more liquid. Microsoft remains one of the largest holdings in the Orbis Global Equity Fund, trading at a discount to Orbis' valuation.

> "It is often during these volatile and emotional times that the simplest investment ideas are ignored."

While it is very difficult to predict what the stock markets will do over the short term, Orbis continues to identify attractive opportunities for investors based on its contrarian philosophy and bottom-up stock selection process. Increasingly, more of these opportunities have emerged in selected domestic Japanese counters, which have been sold off with global markets despite trading at discounts to their intrinsic values. The Japanese stock market is trading at its 25-year low reached

MAP 1 Bear map - 10 months to 31 October 2008



Americas		Africa		Europe		Asia	
Argentina	-60.1	South Africa	-53.3	France	-46.7	Australia	-54.7
Brazil	-54.4	Egypt	-53.9	Germany	-47.6	China	-65.1
Canada	-44.9	Nigeria*	-32.9	Russia	-71.9	Hong Kong	-54.1
Mexico	-45.2	Morocco*	-14.8	Spain	-50.4	India	-64.6
USA	-32.2	Botswana*	-24.2	UK	-46.2	Japan	-35.5
		Namibia*	-52.9			New Zealand*	-50.8
						South Korea	-66.5
						Taiwan	-49.5
North America	-33.6	EMEA**	-53.0	Europe	-45.0	Asia	-54.3
Latin America	-49.5	Emerging	-53.0	Developed	-38.3	Global	-40.0

* Price movement only
** Europe, Middle East and Africa

Source: The Economist, JP Morgan, Bloomberg

in 2003, which is incredible considering the improvement in earnings and the increased strength of balance sheets in Japan since then.

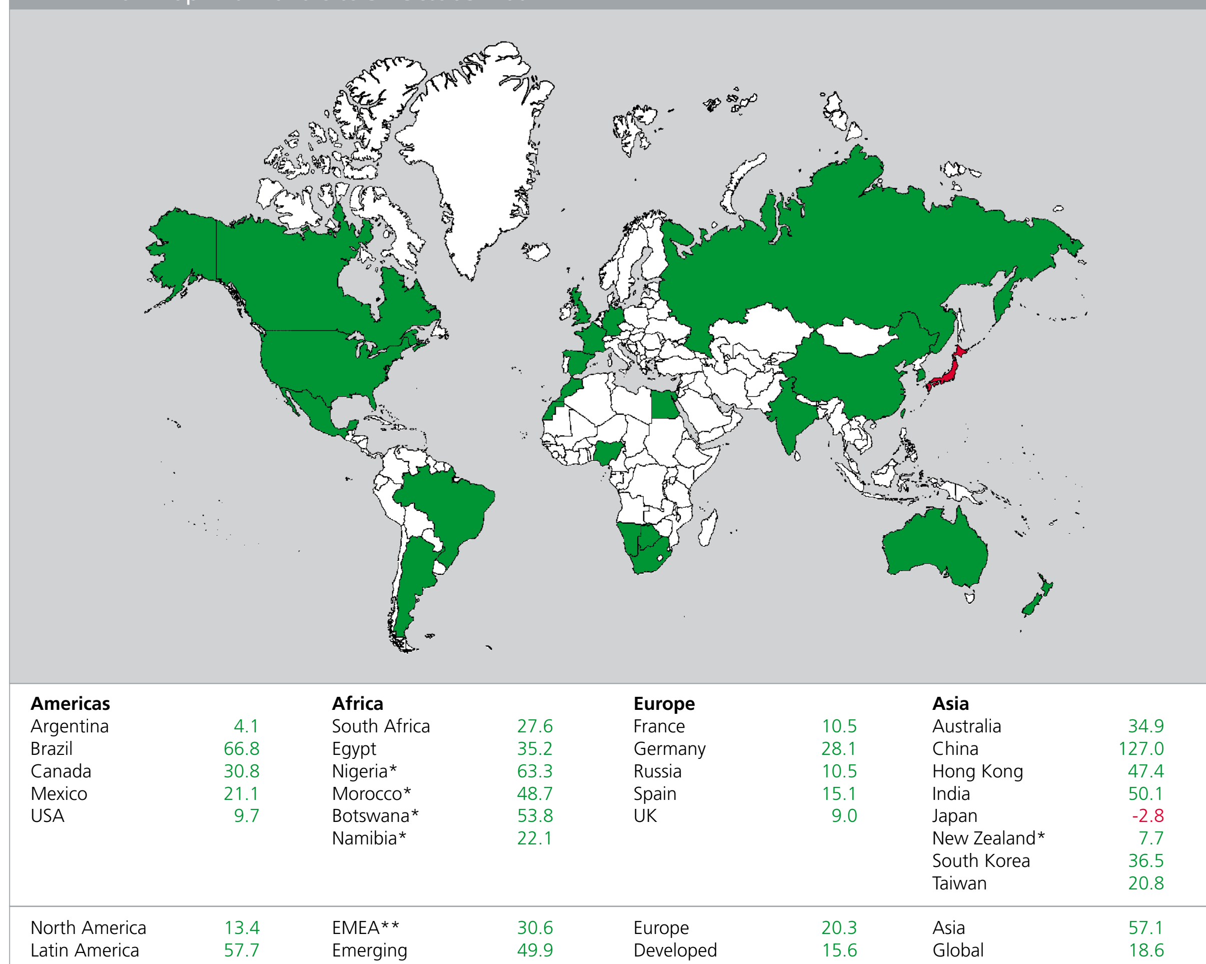
Yen well positioned to maintain purchasing power

Part of the Global Fund's mandate is to manage the currency selection. The overweight position in the yen hurt the Fund for some time due to the 'carry trade'. This allowed investors to borrow at low interest rates in Japan and to use the funds to invest in higher yielding assets in other countries. The carry trade has now started to unwind, resulting in the yen appreciating significantly against other major currencies. Although Orbis has reduced its yen position, it continues to believe that the yen is attractive relative to other currencies and remains overweight relative to the benchmark. Orbis believes the yen is better positioned in the long term to maintain its purchasing power relative to other major currencies.

Invest for the long term

It is markets such as these that provide opportunities for stock pickers like Orbis. In a bull market it is easy to pick stocks as a rising tide tends to lift all boats. It is during market turmoil that Orbis is able to continue to methodically apply its investment philosophy, not only in an attempt to avoid further casualties, but also to look for opportunities amongst the turmoil. Whilst it is possible that stock markets will continue

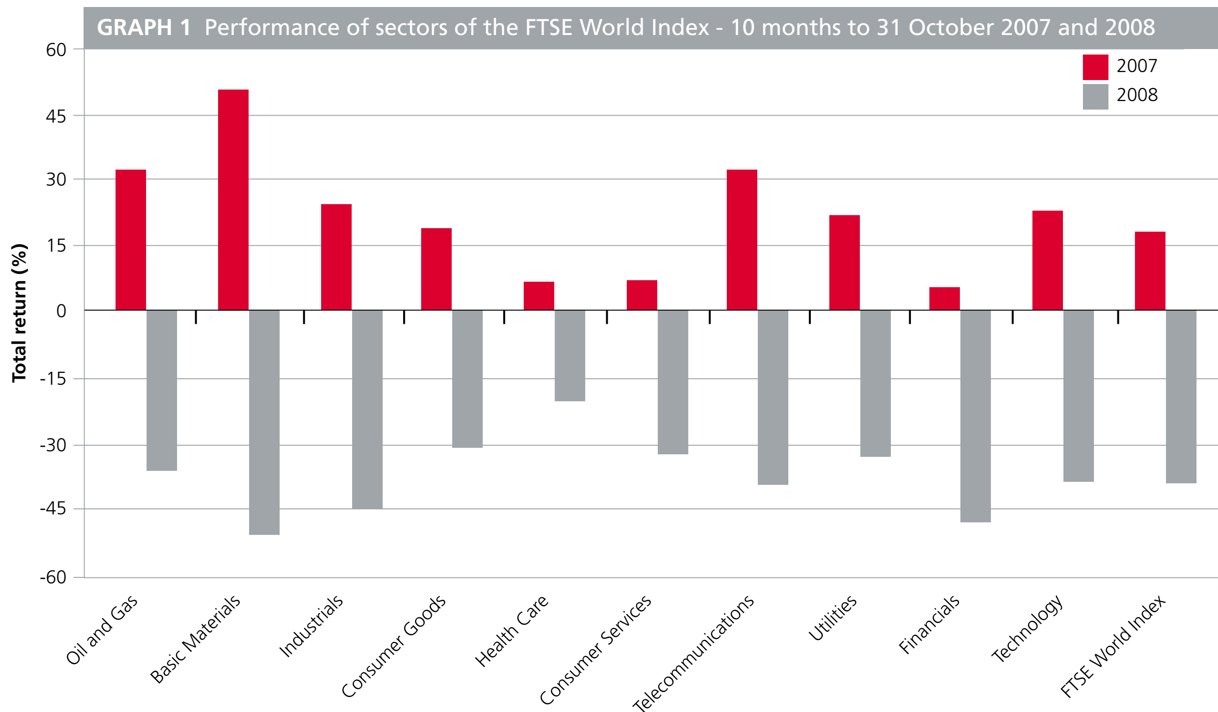
MAP 2 Bull map - 10 months to 31 October 2007



Americas		**Africa**		**Europe**		**Asia**	
Argentina	4.1	South Africa	27.6	France	10.5	Australia	34.9
Brazil	66.8	Egypt	35.2	Germany	28.1	China	127.0
Canada	30.8	Nigeria*	63.3	Russia	10.5	Hong Kong	47.4
Mexico	21.1	Morocco*	48.7	Spain	15.1	India	50.1
USA	9.7	Botswana*	53.8	UK	9.0	Japan	-2.8
		Namibia*	22.1			New Zealand*	7.7
						South Korea	36.5
						Taiwan	20.8
North America	13.4	EMEA**	30.6	Europe	20.3	Asia	57.1
Latin America	57.7	Emerging	49.9	Developed	15.6	Global	18.6

* Price movement only
** Europe, Middle East and Africa

Source: The Economist, JP Morgan, Bloomberg



GRAPH 1 Performance of sectors of the FTSE World Index - 10 months to 31 October 2007 and 2008

Source: Nomura

to decline further, Orbis believes that the Fund should provide higher long-term returns than cash.

As with Allan Gray, Orbis believes it is difficult to predict the bottom of a bear market or exactly when a stock will revert to fair value. Therefore Orbis continues to invest with a long-term perspective through the cycles, consistently applying their investment philosophy and process which they have done successfully over the last 18 years.

Christo Terblanche

THE IMPORTANCE OF A LONG-TERM APPROACH TO FUNDING RETIREMENT BENEFITS

EXECUTIVE SUMMARY: In our last Quarterly Commentary we introduced some of the main issues being debated in the South African retirement fund reform process. In this article, Christo Terblanche provides some insight into why Allan Gray believes retirement benefits should be based on a 'Fully Funded' rather than a 'Pay-As-You-Go' system.

Everyone will be affected by retirement reform and the outcome of the debates presently being conducted. New retirement system design decisions will have a material impact on how comfortable you will be, both during your working life and in retirement. These decisions include how contributions will be determined; how these will be administered; if and how your contributions will be invested; how benefits will be determined and the amount of choice that you will have in the process.

Current debates

The government, in collaboration with labour and the private sector, is still in the process of making many of the proposed system design decisions. Through a series of articles, we plan to consider a number of these issues, including:

- The choice between Defined Benefit (DB) and Defined Contribution (DC)
- A single fund versus individual accounts
- Public versus private administration and investment management
- The extent of individual choice in the system

In this article we examine how your retirement benefit will be funded. What we mean by 'funded' in this context is how your retirement benefit or pension payments will be provided. In other words, when you retire, will your pension be paid by:

- Those who are in the workforce at the time that you retire (also referred to as a Pay-As-You-Go or PAYG system) or
- The accumulated assets that you contributed when you were working plus investment returns (also referred to as a Fully Funded or FF system)?

Pay-As-You-Go and Fully Funded systems defined

Pay-As-You-Go (PAYG) systems transfer the contributions of today's labour force to pay the benefits of today's retirees. Contributions are not saved and invested. Rather, they are immediately spent on the pensions of current retirees. In exchange for their contributions, today's workers are promised that tomorrow's workers will pay their benefits.

Fully Funded (FF) systems retain the contributions of today's workers to pay them their benefits in their retirement. How these funds are managed and invested can differ, but the critical point is that contributions are put aside for the future rather than spent immediately.

The implicit rate of return of a PAYG system

The rate of return of a PAYG system may not be immediately evident, as assets are not accumulated. Rather, the rate of return is an implicit one. Each year, the total contributions from a PAYG system will be equal to the number of workers multiplied by the average wage multiplied by the contribution rate. Taking the contribution rate as a constant, the amount of money paid each year will increase (decrease) if there are more (less) workers and if the real wage has increased (decreased). Therefore, the implicit rate of return is the growth of real wages plus the growth of the labour force.

There are three key reasons why Allan Gray prefers an FF system to PAYG for retirement benefits:

1. We believe FF systems enjoy a higher rate of return in the long run

It may be tempting to argue for a PAYG system because the current generation of retired people may be more likely to experience immediate benefit. Relative to an FF system, a PAYG system is easy to put together and can start paying out benefits immediately. This means that those who have not contributed at all and those who will contribute for only a portion of their working life could get a higher and immediate return.

"If we seek to reduce the overall volatility of a person's portfolio, then we believe a PAYG system is not the appropriate choice."

However, we believe that, in the long run, the rate of return (to those who will enjoy the benefits in retirement) of an FF system is higher than the return of the PAYG system. After the initial windfall has been spent, the rate of return of a PAYG system diminishes considerably. The challenge is that an FF system is a long-term project which will take decades to mature.

Factors that affect the rate of return
Fully Funded
The rate of return of the FF system is the return of capital net of fees. It is affected by: • The rate of investment returns • Fees
Pay As You Go
The rate of return of a PAYG system is the growth rate of total real wages. It is affected by: • The growth of real wages • Population growth rate

Population growth can affect whether a PAYG or FF system is more attractive

The experience of a wide range of countries shows that, in the long run, the rate of return on a combination of stocks and bonds generally outperforms the growth rate of real wages by between two and three percentage points. This implies that, if a country's population is growing rapidly, i.e. by more than 2-3%, then a PAYG system is more attractive than an FF system. However, over the last 50 years population growth rates have slowed considerably and many countries across the world have stagnant or even declining populations.

Africa may be the youngest continent in the world with the highest population growth, but we are not immune to the problem of ageing. South Africa's population growth rate has been declining since 2001. Currently, the population growth rate is less than 1% and is expected to continue to decrease. This is largely due to the HIV/AIDS pandemic. HIV/AIDS is particularly harmful to a PAYG system's implicit rate of return because it is a disease which primarily strikes the working age population.

We believe that it is easier for the free market and competition (if need be, regulated by government) to control and thereby reduce fees (the factor that affects the return of an FF system) than it is to increase the growth of real wages and the population growth rate (the factors that affect the return of a PAYG system).

South Africa has the luxury of having a blank slate. We can learn from the experience of the countries that implemented PAYG systems 50 years ago and which are now paying the costs. In our view, we have an opportunity to be responsible and take a long-term perspective, choose to implement an FF system from the start and expect to enjoy the higher rate of return.

2. The risks present in an FF system can be better managed than those in a PAYG system

PAYG supporters argue that, while the returns on an FF system exceed those of the PAYG system, capital market returns are much too risky. While it is true that stocks and bonds are more volatile (as recent experience shows) than the real wage bill, PAYG benefits may be promised but they are not risk-free.

PAYG benefits are subject to political risk

PAYG benefits are subject to the risk that policies will be changed. Also, the sustainability of contribution and benefit rates are subject to future fertility, immigration, mortality and real wage growth rates – variables with highly uncertain future paths. Over time, the government would have to make periodic adjustments to the parameters of the system – by increasing contribution rates or decreasing benefit rates – in order to keep the system financially solvent. This means that

people cannot rely on the benefits they have been promised. Benefits are up to the generosity of future generations – they must be willing to vote for an increase in contribution rates to support the benefits that have been promised. These policy changes are unpredictable, partly because they are subject to political will and partly because the costs of a PAYG system are less transparent than those in an FF system.

Investment managers are able to reduce or 'hedge' risk through diversified portfolios, governments can regulate investment options, and limit or restrict investment into 'risky' assets, but we believe that it is more difficult to anticipate, manage, limit or hedge against political risk.

The FF system adds capital market risk, but this is not correlated with wage growth and reduces individual portfolio risk

For the majority of people, salaries are the single most important determinant of lifetime income. An individual's salary is highly subject to the total real wage growth of the population. A PAYG system imposes even more of this risk onto people. If we seek to reduce the overall volatility of a person's portfolio, then we believe a PAYG system is not the appropriate choice. The better choice is an FF system because, although it adds capital market risk, this is not perfectly correlated with real wage growth (the two move up and down largely independently of each other) and therefore reduces individual portfolio risk.

"An FF system is better than a PAYG system because it can increase national savings and help to improve our current account balance."

3. FF systems can raise national savings and thus benefit the economy

Investment is essential for economic growth. In South Africa we have a current account deficit. The more South Africans save, the less dependent we will be on foreign capital inflows to balance this deficit. An FF system is better than a PAYG system because it can increase national savings and help to improve our current account balance.

An FF system will increase national savings if we assume that the mandated savings will not result in an equal decrease in voluntary savings. This is a reasonably safe assumption to make in the South African context. South Africans currently save very little. Household savings as a percentage of disposable household income has dropped sharply since the early 1990s, from 5.35% in 1992 to a negative (i.e. the amount of borrowing exceeds the amount of savings) 0.74% in the first quarter of 2008. While it is possible that people may choose to borrow even more, it is unlikely they will be able to, given the already high levels of debt, the 2007 National Credit Act (NCA) – which has made it much more difficult to borrow – and high interest rates. With household debt already at a historic high of 78.16% of disposable income as of the first quarter of 2008, it is not likely that South Africans will be able to offset the new mandated savings via increased borrowing.

A PAYG system may reduce national savings

In contrast, a PAYG system could decrease national savings to the extent that the mandatory system reduces voluntary savings. Why? In a PAYG system the mandated contribution is not actually saved, but rather transferred to retirees. This implies that, if people reduce their voluntary savings at all when the mandatory system is put in place, savings which may have been put in the bank, bonds, stocks or unit trusts will be handed over instead to retirees to be consumed. The effect is a reduction in overall national savings which will further increase our current account deficit.

Allan Gray believes in taking a considered and long-term approach to investment

Our arguments in favour of an FF system apply to the retirement funding pillar or component of retirement fund reform. Certain other parts of retirement fund reform may be better suited to other systems of funding. For example, a PAYG system may work very well for the basic state pension (social security). This is because individuals who need to rely on this do not have disposable income (if any income at all) and are therefore unable to save for themselves. Even up to a reasonable income bracket a wage subsidy may help alleviate the pressure of the contributions.

We believe South Africa needs an FF system for retirement benefit funding to increase savings and promote transparency and competition in retirement provision. This will enhance individual accountability and is in line with our investment approach of taking a long-term view.

Rodver Simmons

ARE YOUR RETIREMENT PLANS KEEPING PACE WITH CHANGE?

EXECUTIVE SUMMARY: Planning for retirement and then managing your retirement income can be challenging without the additional burden of keeping pace with legislative changes. While we try to keep things as simple as possible with our retirement products, there have been a number of legislative and retirement fund rule changes of which you should be aware. Rodver Simmons gives you an overview of these changes.

If you are saving for retirement and are a member of one of the Allan Gray retirement funds, or if you are using an Allan Gray Living Annuity to manage your retirement income, you need to be aware of changes that have taken place.

1. Changes that affect members of the Allan Gray Retirement Annuity Fund (the Fund):

You have more flexibility to choose when you wish to retire from the Fund.	You no longer have to retire from the Fund at age 70
When you die, your dependants/ beneficiaries have more flexibility and more time to make a decision about whether to take any death benefit as an annuity or a lump sum payment.	Options available when a member dies are more flexible • Your dependants/beneficiaries can choose to receive the death benefit allocated to them by the trustees as an annuity or a cash lump sum or a combination of both. • There is no six-month time pressure for your dependants/ beneficiaries to choose a lump sum payment. • If there is no beneficiary or no dependants have been found, your estate will be paid.
If you emigrate, you have flexibility to access your benefit in the Fund before you retire.	Members who emigrate can now withdraw their full benefit Members do not have to wait until their retirement date to access their benefit in the Fund. If you have already emigrated and have South African Reserve Bank approval then you may access your benefit in the Fund. Please note that the benefit is subject to South African Revenue Service approval and it may be taxable.
You may now withdraw from the Fund before retirement, subject to the value of your interest in the Fund.	If your interest in the Fund is less than R7 000 you can withdraw from the Fund If you are no longer contributing to the Fund and the market value of your interest in the Fund is less than R7 000, you may take a withdrawal benefit before retirement.
If you have accumulated retirement savings in a foreign retirement fund, you may now transfer these into the Fund.	The Fund is now able to accept transfers from any retirement annuity fund, including foreign funds Transfers are subject to the approval and rules of the transferring fund and foreign country requirements.

2. Changes that affect members of the Allan Gray Pension and Provident Preservation Funds (the Preservation Funds):

It is easier for you to transfer accumulated savings in another retirement fund to the Preservation Funds.	Transfers to and between preservation funds no longer require an employer/employee relationship Your employer no longer has to be a 'participating employer' in the Preservation Funds. A member of an employer retirement fund or another preservation fund will be able to transfer from that fund to one of the Preservation Funds without the employer being a participating employer in the applicable Preservation Fund. These transfers may be subject to the transferring fund having changed their rules. You need to confirm with your transferring fund if they are able to transfer your benefit if you are not employed or if your employer is not a participating employer in the applicable Preservation Fund. Reminder: Pension preservation funds may only receive transfers from: • Employer pension funds • Pension preservation funds Provident preservation funds may only receive transfers from: • Employer provident funds • Provident preservation funds
You have more flexibility to choose when you wish to retire from the Allan Gray Preservation Funds.	You no longer have to retire from the Fund at age 70 Please be aware however, that your retirement date and benefits may be subject to conditions imposed by the transferring fund.
Divorce orders: • Giving effect to them • Transfers of divorce benefits to preservation funds	A court can now make an order against a preservation fund and make an award of your pension interest in that fund to a non-member spouse. A non-member spouse is now able to transfer the pension interest awarded to him/her in terms of a divorce order to another retirement fund of his/her choice or take this in cash. Reminder: Pension preservation funds may only receive transfers from: • Employer pension funds • Pension preservation funds Provident preservation funds may only receive transfers from: • Employer provident funds • Provident preservation funds There are however proposals to allow transfers to any preservation fund.
If you are a member of a pension preservation fund and you die, your dependants/beneficiaries have more flexibility and more time to make a decision about whether to take any death benefit as an annuity or a lump sum payment.	Options available when a member dies are more flexible • Your dependants/beneficiaries can choose to receive the death benefit allocated to them by the trustees as an annuity, a cash lump sum or a combination of both. • There is no six-month time pressure for your dependants/beneficiaries to choose a lump sum payment. • If there is no beneficiary or no dependants have been found, your estate will be paid.

3. Changes that affect Allan Gray Living Annuity policyholders:

You may be able to access the full value of your living annuity in cash, subject to certain conditions.	If you did not take any of your retirement benefit in cash when you retired from your retirement fund and the market value of your living annuity is R75 000 or less, you may cash in your living annuity. Please be aware that tax may be payable. If you took any of your retirement benefit in cash when you retired from your retirement fund and the market value of your living annuity is R50 000 or less, you may cash in your living annuity.
Beneficiaries have more flexibility with regard to their options when you die.	When you die, your beneficiary may choose to receive the death benefit as an annuity or a lump sum payment or a combination of both. If you do not nominate a beneficiary, the death benefit will be paid as a lump sum into your estate. You may now also nominate a trust and/or a legal entity as a beneficiary. If you make such a nomination, the benefit must be paid in cash.

In all instances, for more information or if you have any questions about how these changes may affect you, please speak to your financial adviser. You may also contact the Allan Gray Client Service Centre on 0860 000 654 for more detail about the changes or to access the Conditions of Membership applicable to each of the Allan Gray retirement funds. These are also available from www.allangray.co.za.

Anthony Farr

THE ALLAN GRAY ORBIS FOUNDATION UPDATE

EXECUTIVE SUMMARY: The year ahead will be an exciting one for the Allan Gray Orbis Foundation as it watches its first group of Allan Gray Fellows make the transition from university student to enterprising citizen. Anthony Farr reflects on the programme to date, and looks forward to observing the progress of more than 200 Allan Gray Fellows and 34 Allan Gray Scholars in 2009.

It has been an important year for the Allan Gray Orbis Foundation. The first Allan Gray Fellows, who began their journey in 2006, have now completed the Foundation's entrepreneurship programme, heading out of university into the future armed with a sense of connection and possibility. And the initial 12 Allan Gray Scholars, the pioneers of many more to follow, have finished their first year at leading high schools, completing a transition to an educational context that only a year ago would have seemed nearly impossible.

This maturing and opening up to the next phase of the overall vision was well captured by one of the graduating Allan Gray Fellows at the year-end function when he stated in his address:

"The introduction of the Allan Gray Scholarship has brought a fresh dynamic into the overall Foundation."

'Like Yeats says in his famous poem, The Second Coming – "the new must oust the old" – this is the natural process of life. We can be this new force and the status quo will never satisfy our innovative and creative energies. Thanks to the Foundation, they will always be behind us in their thinking.'

Over 200 Allan Gray Fellows in 2009

The annual Allan Gray Fellowship selection processes culminated in our offering 86 new Allan Gray Fellowships. This means that there will be more than 200 Allan Gray Fellows participating in the programme in 2009.

The Foundation maintains two entry points into the Allan Gray Fellowship – the majority enter the Fellowship at the end of matric and the remainder at the end of first year university. Following a national marketing campaign which included media, university and school visits, career expos and correspondence, we received nearly 2 000 applications from over 420 schools and the seven participating universities. After careful assessment, approximately 400 candidates were called to interviews around the country.

The final stage of selection was a three-day camp hosted at the world heritage site, Maropeng, Cradle of Humankind. There were four selection camps held this year, where 176 candidates were given the platform to demonstrate their potential during numerous entrepreneurial challenges. In the words of one of the attendees:

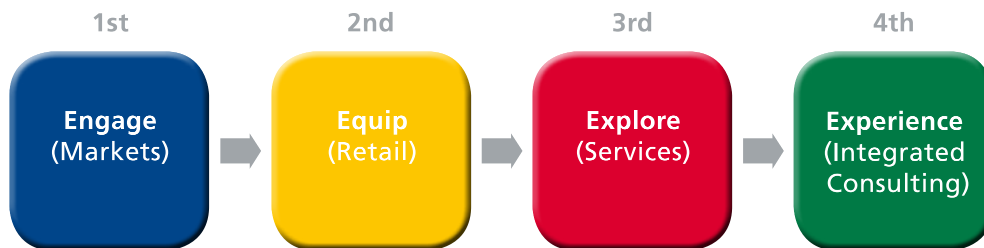
'It was the most challenging experience of my life both physically and mentally. I welcomed the challenge as it made me aware of my true potential and made me grow as an individual. I am more powerful now.'

The Foundation's footprint extends to the other countries in which Allan Gray operates, namely Namibia, Botswana and Swaziland. We offered eight places to applicants from these countries this year.

Extending the Fellowship to tap into the power of diversity

We believe the network emerging from the Allan Gray Fellows needs to get to grips with the principles of the rule of law and to reflect on the ideals of society's structure. These areas are understood most clearly by individuals studying philosophy, politics and economics. Therefore, in 2008 we decided to extend the Allan Gray Fellowship selection for first year university students to certain fields in the social sciences. The Fellowship was limited previously to the fields of commerce, engineering and pure science. We expect these

Yearly themes



students to bring a rich new perspective into the programme. This reinforces our belief in the power of diversity as a means of unlocking creativity and potential.

We hope that greater interaction between the hard sciences of commerce, science and engineering with those of the social sciences will foster increased understanding between these different sectors of society in the years ahead. Co-operation is critical for the country's future effectiveness.

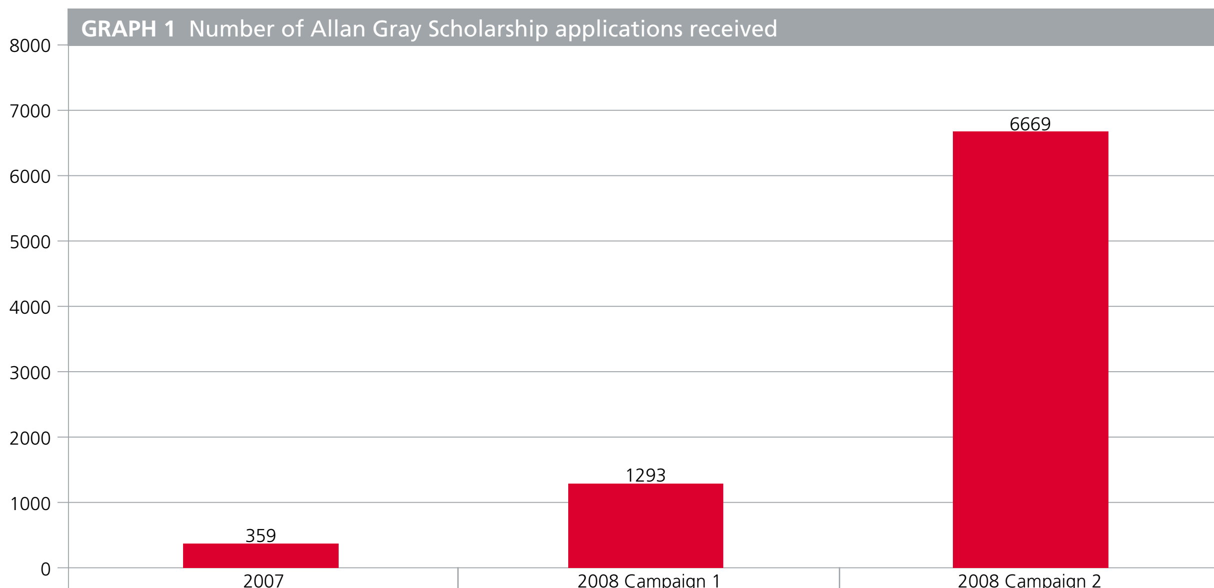
Based on this extension, we were particularly pleased to make three initial offers to students in the social science faculties at the end of the 2008 selection process.

Completing the transition from university student to enterprising citizen

Every year we try to extend the boundaries of the entrepreneurial programme by creating the right content and experience for that year. In 2008 we implemented the fourth and final year of the programme known as 'Year Experience'. 'Year Experience' aims to complete the transition from a university mindset into that of a more fully equipped enterprising citizen.

Key to this transition is exposure to real strategic business consulting. The Allan Gray Fellows moved from the realm

GRAPH 1 Number of Allan Gray Scholarship applications received



Source: Allan Gray Orbis Foundation

of the hypothetical to a real life situation. They were put in front of the business owners of a well-known food and entertainment business and told to investigate challenges in the business and present possible solutions. They spent two days in intensive and continuous research and investigation mode. The final presentations were impressive in terms of their level of understanding of the business and the depth of insight.

Using early education to unlock opportunity

The introduction of the Allan Gray Scholarship has brought a fresh dynamic into the overall Foundation. We now have another means through which we can use the power of education to unlock opportunity.

The momentum behind the Allan Gray Scholarship selection campaigns has grown exponentially. In 2008, 12 Allan Gray Scholars were placed in Grade 8 at four schools (Bishops, St Cyprians, Selborne and Collegiate). The initial 2008 campaign resulted in just under 1 300 applications with a further 22 Scholars being offered places in 2009. These offers include placement at four additional schools (Clarendon, Paul Roos Gymnasium, Rhenish and St Andrew's College).

Based on the experience of the first two selection campaigns, we have decided to move the timing of the selection campaign forward to start in Grade 6. This will allow placement schools to have a clear view of the scholarship talent pool prior to making final decisions about overall applications to the schools for Grade 8. This change resulted in a second campaign for Grade 6 learners in the second half of 2008. The campaign is still in progress, but the growing momentum was clearly demonstrated with nearly 6 700 applications received.

Closing dates for applications	
Allan Gray Fellows (Grade 12)	Closing date: 30 June 2009
Allan Gray Fellows (University)	Closing date: 31 August 2009
Allan Gray Scholars (Grade 6)	Closing date: 18 September 2009

Investment track record

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

Period	Allan Gray*	FTSE/JSE All Share Index	Out/Underperformance
1974 (from 15.06)	-0.8	-0.8	0.0
1975	23.7	-18.9	42.6
1976	2.7	-10.9	13.6
1977	38.2	20.6	17.6
1978	36.9	37.2	-0.3
1979	86.9	94.4	-7.5
1980	53.7	40.9	12.8
1981	23.2	0.8	22.4
1982	34.0	38.4	-4.4
1983	41.0	14.4	26.6
1984	10.9	9.4	1.5
1985	59.2	42.0	17.2
1986	59.5	55.9	3.6
1987	9.1	-4.3	13.4
1988	36.2	14.8	21.4
1989	58.1	55.7	2.4
1990	4.5	-5.1	9.6
1991	30.0	31.1	-1.1
1992	-13.0	-2.0	-11.0
1993	57.5	54.7	2.8
1994	40.8	22.7	18.1
1995	16.2	8.8	7.4
1996	18.1	9.4	8.7
1997	-17.4	-4.5	-12.9
1998	1.5	-10.0	11.5
1999	122.4	61.4	61.0
2000	13.2	0.0	13.2
2001	38.1	29.3	8.8
2002	25.6	-8.1	33.7
2003	29.4	16.1	13.3
2004	31.8	25.4	6.4
2005	56.5	47.3	9.2
2006	49.7	41.2	8.5
2007	17.6	19.2	-1.6
2008 (to 31.12)	-12.6	-23.2	10.6
Annualised to 31.12.2008			
From 01.01.2008 (1 year)	-12.6	-23.2	10.6
From 01.01.2006 (3 years)	15.5	8.9	6.6
From 01.01.2004 (5 years)	26.0	19.0	7.0
From 01.01.1999 (10 years)	33.5	18.2	15.3
Since 01.01.1978	29.8	20.4	9.4
Since 15.06.1974	28.5	17.6	10.9
Average outperformance			10.9
Number of calendar years outperformed			27
Number of calendar years underperformed			7

* 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.

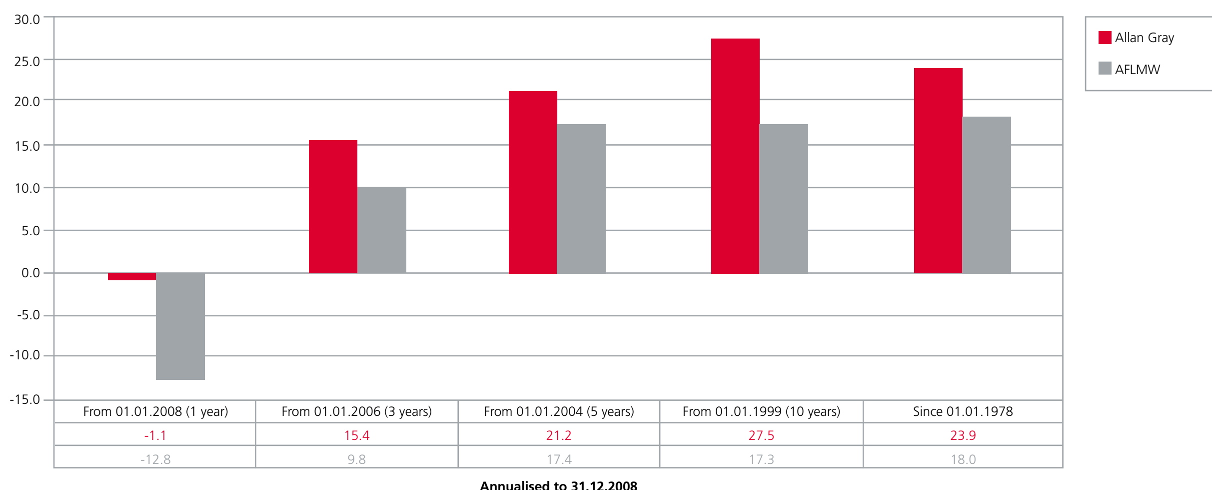
Note: Listed property included from 1 July 2002.

An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to **R57 119 374** by 31 December 2008. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to **R2 702 196**.

Investment track record

Allan Gray Limited global mandate total returns vs. Alexander Forbes Large Manager Watch

Period	Allan Gray	AFLMW**	Out/Underperformance
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 (to 31.12)	-1.1	-12.8	11.7
Annualised to 31.12.2008			
From 01.01.2008 (1 year)	-1.1	-12.8	11.7
From 01.01.2006 (3 years)	15.4	9.8	5.6
From 01.01.2004 (5 years)	21.2	17.4	3.8
From 01.01.1999 (10 years)	27.5	17.3	10.2
Since 01.01.1978	23.9	18.0	5.9
Average outperformance			5.9
Number of calendar years outperformed			25
Number of calendar years underperformed			6



** Consulting Actuaries Survey returns used up to December 1997. The return for December 2008 is an estimate.

An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to **R7 584 008** by 31 December 2008. The average total performance of global mandates of large managers over the same period would have grown a similar investment to **R1 692 674**.

Allan Gray annualised performance in percentage per annum to 31 December 2008

	FOURTH QUARTER (unannualised)
UNIT TRUSTS [1]	
EQUITY FUND (AGEF)	[3]
FTSE/JSE All Share Index	
BALANCED FUND (AGBF)	[3]
Average of both Prudential Medium Equity category and Prudential Variable Equity category (excl. AGBF)	
STABLE FUND (AGSF) - (NET OF TAX)	[3]
After-tax return of call deposits plus two percentage points (Net of tax)	
STABLE FUND (AGSF) - (GROSS OF TAX)	[3]
After-tax return of call deposits plus two percentage points (Gross of tax)	
MONEY MARKET FUND (AGMF)	[3]
Domestic fixed interest money market unit trust sector (excl. AGMF)	
OPTIMAL FUND (AGOF)	[3]
Daily call rate of FirstRand Bank Ltd	
BOND FUND (AGBD)	[3]
BEASSA All Bond Index (total return)	
GLOBAL FUND OF FUNDS (AGGF)	[3]
60% of the FTSE World Index and 40% of the JP Morgan Government Bond Index Global (Rands)	
GLOBAL EQUITY FEEDER FUND (AGOE)	[3]
FTSE World Index (Rands)	
LIFE POOLED PORTFOLIOS	
GLOBAL BALANCED PORTFOLIO	**1.4**
Mean of Alexander Forbes Global Large Manager Watch [2]	-5.4
DOMESTIC BALANCED PORTFOLIO	**0.1**
Mean of Alexander Forbes Domestic Manager Watch [2]	-5.6
DOMESTIC EQUITY PORTFOLIO	**-3.0**
FTSE/JSE All Share Index	-9.2
DOMESTIC ABSOLUTE PORTFOLIO	**3.4**
Mean of Alexander Forbes Domestic Manager Watch [2]	-5.6
DOMESTIC STABLE PORTFOLIO	**4.1**
Alexander Forbes Three-Month Deposit Index plus 2%	3.4
DOMESTIC OPTIMAL PORTFOLIO [1]	**4.7**
Daily Call Rate of Nedcor Bank Limited	2.8
GLOBAL ABSOLUTE PORTFOLIO	**5.8**
Mean of Alexander Forbes Global Large Manager Watch [2]	-5.4
DOMESTIC MEDICAL SCHEME PORTFOLIO	**3.7**
Consumer Price Index plus 3% p.a. [2]	0.9
GLOBAL STABLE PORTFOLIO	**5.5**
Alexander Forbes Three-Month Deposit Index plus 2%	3.4
RELATIVE DOMESTIC EQUITY PORTFOLIO	**-4.5**
FTSE/JSE CAPI Index	-8.9
MONEY MARKET PORTFOLIO [1]	**3.1**
Alexander Forbes Three-Month Deposit Index	2.9
FOREIGN PORTFOLIO [1]	**13.4**
60% of the MSCI Index and 40% JP Morgan Government Bond Index Global (Rands)	1.6
GLOBAL EQUITY PORTFOLIO [1]	**0.3**
FTSE World Index (Rands)	-11.7
SEGREGATED PORTFOLIOS [5]	
GLOBAL BALANCED COMPOSITE	**1.8**
Mean of Alexander Forbes Global Large Manager Watch [2, 4]	-5.4
DOMESTIC BALANCED COMPOSITE	**-0.1**
Mean of Alexander Forbes Domestic Manager Watch [2]	-5.6
DOMESTIC EQUITY COMPOSITE	**-3.1**
FTSE/JSE All Share Index	-9.2
GLOBAL BALANCED NAMIBIAN HIGH FOREIGN COMPOSITE	**3.9**
Mean of Alexander Forbes Namibia Average Manager [2]	-5.4
RELATIVE DOMESTIC COMPOSITE	**-4.0**
Weighted average of client specific benchmarks [2]	-8.9
FOREIGN BEST VIEW (RANDS) COMPOSITE	**8.9**
60% of the MSCI and 40% of the JP Morgan Government Bond Index Global (Rands)	1.6
ORBIS FUNDS (RANDS) [1, 6]	
ORBIS GLOBAL EQUITY FUND (RANDS)	**-0.4**
FTSE World Index (Rands)	-11.7
ORBIS JAPAN EQUITY (YEN) FUND (RANDS)	**14.2**
Tokyo Stock Price Index (Rands)	5.2
ORBIS OPTIMAL SA FUND-US$ CLASS (RANDS)	**16.4**
US$ Bank Deposits (Rands)	14.0
ORBIS OPTIMAL SA FUND-EURO CLASS (RANDS)	**16.6**
Euro Bank Deposits (Rands)	14.3
ORBIS ASIA EX-JAPAN EQUITY FUND (RANDS)	**-8.7**
MSCI Asia Ex-Japan (Rands)	-11.2

PERFORMANCE AS CALCULATED BY ALLAN GRAY

1 The Fund returns are net of investment management fees
2 The return for Quarter 4, 2008 is an estimate as the relevant survey results have not yet been released
3 Unable to disclose due to ACI regulations
4 Consulting Actuaries Survey returns used to 31 December 1997. Alexander Forbes Global Large Manager Watch used from 1 January 1998
5 The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate
6 Amounts invested by the Allan Gray client portfolios in the Orbis Funds are included in the assets under management figures in the table above

1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R millions)	INCEPTION DATE
-14.4	**12.1**	**21.7**	**29.5**	**31.7**	15,065.9	01.10.98
-23.2	8.9	19.0	18.2	18.5		
-1.8	**13.0**	**19.4**	-	**22.6**	23,951.4	01.10.99
-9.8	8.9	16.2	-	14.3		
11.2	**13.0**	**14.1**	-	**14.9**	21,952.9	01.07.00
9.7	7.9	7.2	-	8.0		
12.4	**14.0**	**15.1**	-	**16.2**	21,952.9	01.07.00
13.2	10.7	9.7	-	10.7		
12.1	**9.7**	**8.8**	-	**9.6**	9,568.6	03.07.01
11.9	9.5	8.6	-	9.5		
12.3	**10.1**	**8.7**	-	**10.3**	1,299.1	01.10.02
11.0	8.5	7.5	-	8.2		
13.0	**7.7**	-	-	**9.7**	109.5	01.10.04
17.0	8.8	-	-	10.6		
18.1	**15.7**	-	-	**11.1**	5,844.6	03.02.04
6.4	13.5	-	-	9.1		
-11.8	**7.3**	-	-	**12.1**	2,587.8	01.04.05
-18.6	5.7	-	-	8.4		
-1.4	**15.4**	**21.1**	-	**23.0**	11,934.0	01.09.00
-12.8	9.8	17.4	-	14.9		
-4.3	**15.7**	**23.3**	-	**23.3**	4,719.6	01.09.01
-13.0	10.2	18.9	-	17.1		
-11.9	**16.1**	**26.3**	-	**26.9**	4,857.2	01.02.01
-23.2	8.9	19.0	-	15.0		
10.6	**20.9**	**23.9**	-	**27.7**	479.1	06.07.01
-13.0	10.2	18.9	-	16.6		
8.7	**15.2**	**17.8**	-	**17.9**	369.9	01.12.01
13.9	11.7	10.8	-	11.8		
13.0	**11.2**	**9.6**	-	**10.4**	158.0	04.12.02
11.5	8.9	7.8	-	8.3		
14.8	**21.0**	-	-	**24.2**	885.1	01.03.04
-12.8	9.8	-	-	17.3		
9.1	**14.4**	-	-	**16.7**	1,114.7	01.05.04
14.2	11.8	-	-	9.7		
13.7	**15.2**	-	-	**18.3**	2,608.0	15.07.04
13.9	11.7	-	-	10.9		
-16.3	**12.9**	**22.3**	-	**27.2**	497.3	05.05.03
-21.7	9.5	19.7	-	24.2		
12.1	**9.8**	**8.9**	-	**9.9**	881.8	21.09.00
11.7	9.5	8.6	-	9.7		
18.3	**15.8**	**13.2**	-	**6.5**	1,446.0	23.01.02
5.5	13.3	10.5	-	2.0		
-10.8	**8.3**	-	-	**12.1**	1,605.6	18.05.04
-18.6	5.7	-	-	8.7		
-1.1	**15.4**	**21.2**	**27.5**	**23.9**	22,676.6	01.01.78
-12.8	9.8	17.4	17.3	18.0		
-4.2	**15.6**	**23.1**	**28.4**	**24.2**	19,799.6	01.01.78
-13.0	10.2	18.9	18.8	18.4		
-11.6	**16.4**	**26.3**	**32.3**	**22.7**	39,125.9	01.01.90
-23.2	8.9	19.0	18.2	14.3		
3.3	**17.2**	**21.7**	**26.8**	**21.5**	5,710.6	01.01.94
-9.3	11.4	17.9	16.9	14.5		
-16.9	**12.3**	**22.5**	-	**22.5**	9,121.7	19.04.00
-23.2	8.6	19.5	-	15.4		
12.7	**13.8**	**12.2**	**19.4**	**16.5**	5,358.6	23.05.96
5.5	13.3	10.5	7.7	11.7		
-11.7	**8.2**	**11.5**	**15.3**	**19.5**	-	01.01.90
-18.6	5.7	7.8	5.3	12.3		
15.7	**5.0**	**10.1**	**11.9**	**16.6**	-	01.01.98
1.6	1.5	8.1	5.8	7.9		
36.3	**19.0**	-	-	**19.2**	-	01.01.05
42.1	19.1	-	-	18.5		
34.0	**24.1**	-	-	**19.0**	-	01.01.05
37.8	25.5	-	-	18.4		
-22.8	-	-	-	**9.6**	-	01.01.06
-34.4	-	-	-	9.6		

Allan Gray Balanced Fund Quarterly Disclosure as at 31 December 2008

	% of Fund
South African equities	**55.2**
Resources	**13.5**
Anglogold Ashanti	4.8
Harmony Gold Mining Co.	3.9
Sasol	2.7
African Rainbow Minerals	1.4
Positions individually less than 1% of total JSE-listed securities held by the Fund	0.7
Financials	**9.3**
Sanlam	3.1
Standard Bank	2.1
ABSA Group	1.5
Reinet Investments SA	0.7
Liberty Holdings	0.6
Firstrand	0.6
Positions individually less than 1% of total JSE-listed securities held by the Fund	0.7
Industrials	**32.2**
SABMiller	6.5
MTN Group	5.2
Remgro	3.2
Sappi	3.0
Compagnie Fin Richemont SA	2.4
Shoprite Holdings	1.9
Nampak	1.5
Sun International	1.3
Dimension Data Holdings	1.2
Illovo Sugar	0.9
Mondi Limited	0.7
Positions individually less than 1% of total JSE-listed securities held by the Fund	4.3
Other securities	**0.2**
Positions individually less than 1% of total JSE-listed securities held by the Fund	0.2
---- Net South African equities ----	*55.2*
Commodities	**2.7**
New Gold ETF	2.7
Bonds	**1.9**
RSA Bonds	0.2
Corporate Bonds	1.6
Money market and call deposits	**16.9**
Foreign - JSE inward listed shares	**5.6**
British American Tobacco	5.4
Mondi Plc	0.2
Foreign - Orbis Absolute Return Funds	**7.3**
Orbis Optimal SA Fund (Euro)	3.7
Orbis Optimal SA Fund (US$)	3.6
Foreign - Orbis Equity Funds	**10.5**
Orbis Global Equity Fund	5.9
Orbis Japan Equity Fund (Yen)	4.6
Totals:	**100.0**

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

Total Expense Ratios (TERs)

	Equity Fund	Balanced Fund	Stable Fund	Optimal Fund	Bond Fund	Money Market Fund	Global Fund of Funds	Global Equity Feeder Fund
Performance component	0.33%	0.42%	0.52%	0.07%	0.53%	0.00%	0.45%	0.91%
Fee at benchmark	1.71%	1.15%	1.14%	1.14%	0.29%	0.29%	1.23%	1.49%
Trading costs	0.08%	0.11%	0.07%	0.20%	0.00%	0.00%	0.19%	0.17%
Other expenses	0.02%	0.05%	0.06%	0.02%	0.10%	0.01%	0.36%	0.41%
Total Expense Ratio (TER)	2.14%	1.73%	1.79%	1.43%	0.92%	0.30%	2.23%	2.98%

A Total Expense Ratio (TER) of a portfolio is a measure of the portfolio's assets that were relinquished as a payment of services rendered in the management of the portfolio. This is expressed as a percentage of the average value of the portfolio, calculated for the year to the end of September 2008. Included in the TER is the proportion of costs incurred by the performance component, fee at benchmark and other expenses. These are disclosed separately as percentages of the net asset value. Trading costs (including brokerage, VAT, STT, STRATE, levy and insider trading levy) are included in the TER. A high TER will not necessarily imply a poor return nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs.

Notes

Notes

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T Mhlambiso AB MBA JD (Non-Executive) **IN Mkhize** BSc MBA (Non-Executive)

COMPANY SECRETARY
CJ Hetherington B Com CA (SA)

Collective Investment Schemes (unit trusts) are generally medium-to long-term investments. The value of participatory interest (units) may go down as well as up. Past performance is not necessarily a guide to the future. Unit trust prices are calculated on a net asset value basis, which, for money market funds, is the total book value of all assets in the portfolio divided by the number of units in issue. The Allan Gray Money Market Fund aims to maintain a constant price of 100 cents per unit. The total return to the investor is primarily made up of interest received but may also include any gain or loss made on any particular instrument held. In most cases this will have the effect of increasing or decreasing the daily yield, but in some cases, for example in the event of a default on the part of an issuer of any instrument held by the Fund, it can have the effect of a capital loss. Such losses will be borne by the Allan Gray Money Market Fund and its investors and in order to maintain a constant price of 100 cents per unit, investors' unit holdings will be reduced to the extent of such losses. Fluctuations or movements in exchange rates may also be the cause of the value of underlying international investments going up or down. Unit trusts are traded at ruling prices. Commissions and incentives may be paid and if so, would be included in the overall costs. Different classes of units apply to the Allan Gray Equity, Balanced, Stable and Optimal Funds only and are subject to different fees and charges. A detailed schedule of fees and charges and maximum commissions is available on request from the company. Forward pricing is used. A fund of funds unit trust may only invest in other unit trusts, which levy their own charges, that could result in a higher fee structure for these portfolios. A feeder fund is a unit trust fund that, apart from assets in liquid form, consists solely of units in a single portfolio of a collective investment scheme. All of the unit trusts except the Allan Gray Money Market Fund may be capped at any time in order for them to be managed in accordance with their mandates. Allan Gray Unit Trust Management Limited is a member of the Association of Collective Investments (ACI).

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