

# ALLAN GRAY

## ALLAN GRAY BOND FUND

**Fund manager:** Mark Dunley-Owen. **Inception date:** 1 October 2004

### Fund description and summary of investment policy

The Fund invests in South African interest bearing securities. Securities include national government, parastatal, municipal, corporate bonds and money market instruments. The Fund price is sensitive to interest rate movements because of the long-term nature of the Fund's investments. The duration of the Fund may differ materially from the benchmark. The Fund is managed to comply with investment limits governing retirement funds.

**ASISA unit trust category:** South African - Interest Bearing - Variable Term

### Fund objective and benchmark

The Fund aims to provide investors with a real return over the long-term and outperform the JSE All Bond Index at no greater risk.

### How we aim to achieve the Fund's objective

We formulate a view of the long-term inflation rate. This forecast together with an estimate of a reasonable real return requirement for bond investors is used to determine a fair value for the various bonds in the South African market. The assets in the fund are then optimised to give investors the highest returns based on the managers' fair value estimates.

### Suitable for those investors who

- Seek a bond 'building block' for a diversified multi-asset class portfolio
- Are looking for returns in excess of those provided by money market or cash investments
- Are prepared to accept more risk of capital depreciation than in a money market or cash investment

### Minimum investment amounts

Minimum lump sum per investor account	<b>R20 000</b>
Additional lump sum	<b>R500</b>
Minimum debit order*	<b>R500</b>

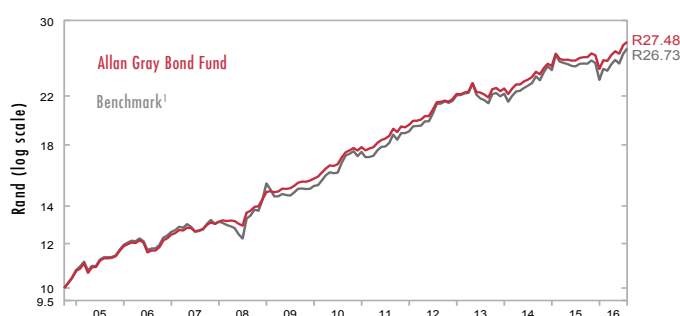
\*Only available to investors with a South African bank account.

### Fund information on 31 July 2016

Fund size	<b>R0.5bn</b>
Number of units	<b>47 556 281</b>
Price (net asset value per unit)	<b>R10.90</b>
Fund duration (years)	<b>4.6</b>
Gross yield (before fees)	<b>9.3%</b>
Class	<b>A</b>

### Performance net of all fees and expenses

Value of R10 invested at inception with all distributions reinvested



% Returns	Fund	Benchmark <sup>1</sup>	CPI inflation <sup>2</sup>
<b>Cumulative:</b>			
Since inception	174.8	167.3	98.2
<b>Annualised:</b>			
Since inception	8.9	8.7	6.0
Latest 10 years	8.9	8.6	6.3
Latest 5 years	8.0	8.1	5.7
Latest 3 years	7.5	7.3	5.9
Latest 2 years	7.5	7.4	5.5
Latest 1 year	6.8	6.5	6.3
Year-to-date (not annualised)	11.7	13.7	4.5
<b>Risk measures (since inception)</b>			
Maximum drawdown <sup>3</sup>	-11.7	-14.4	n/a
Percentage positive months <sup>4</sup>	71.8	68.3	n/a
Annualised monthly volatility <sup>5</sup>	5.4	7.3	n/a
Highest annual return <sup>6</sup>	18.0	21.2	n/a
Lowest annual return <sup>6</sup>	-2.6	-5.6	n/a

1. JSE All Bond Index (source: INET BFA), performance as calculated by Allan Gray as at 31 July 2016.

2. This is based on the latest numbers published by INET BFA as at 30 June 2016.

3. Maximum percentage decline over any period. The maximum drawdown occurred from 30 January 2015 to 11 December 2015 and maximum benchmark drawdown occurred from 29 January 2015 to 11 December 2015. Drawdown is calculated on the total return of the Fund/benchmark (i.e. including income).

4. The percentage of calendar months in which the Fund produced a positive monthly return since inception.

5. The standard deviation of the Fund's monthly return. This is a measure of how much an investment's return varies from its average over time.

6. These are the highest or lowest consecutive 12-month returns since inception. This is a measure of how much the Fund and the benchmark returns have varied per rolling 12-month period. The Fund's highest annual return occurred during the 12 months ended 31 January 2015 and the benchmark's occurred during the 12 months ended 31 January 2015. The Fund's lowest annual return occurred during the 12 months ended 31 January 2016 and the benchmark's occurred during the 12 months ended 31 January 2016. All rolling 12-month figures for the Fund and the benchmark are available from our Client Service Centre on request.

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### Meeting the Fund objective

Since inception and over the latest 10 years, the Fund has outperformed its benchmark. The Fund has lagged the benchmark by 0.1% over the last five years. The Fund has provided returns in excess of CPI inflation for all three periods. The Fund aims to take no greater risk than its benchmark. The maximum drawdown and lowest annual return numbers, in the 'Performance net of all fees and expenses' table, show that the Fund has successfully reduced downside risk in periods of negative market returns.

### Income distributions for the last 12 months

Actual payout, the Fund distributes quarterly	30 Sep 2015	31 Dec 2015	31 Mar 2016	30 Jun 2016
<b>Cents per unit</b>	<b>22.5558</b>	<b>22.2728</b>	<b>22.3000</b>	<b>22.4224</b>

### Annual management fee

The fee rate is calculated daily by comparing the Fund's total performance over the last year, to that of the benchmark adjusted for Fund expenses and cash flows.

**Minimum fee:** 0.25% p.a. excl. VAT

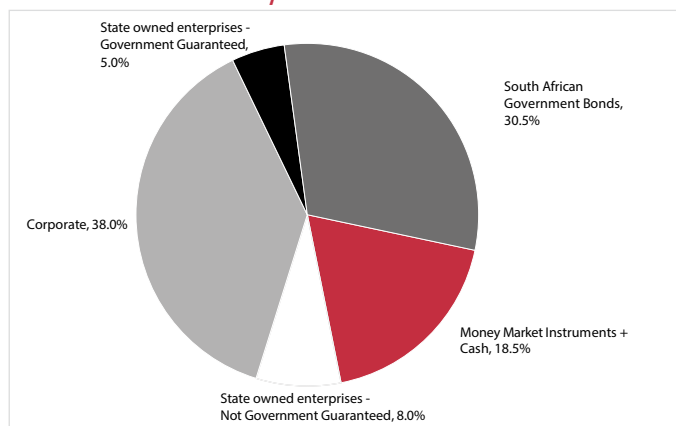
If the Fund outperforms its benchmark, for each percentage of performance above the benchmark we add 0.25% to the minimum fee to a maximum fee of 0.75% p.a. excl. VAT. The fee rate is applied to the daily value of the Fund.

### Total expense ratio (TER) and Transaction costs

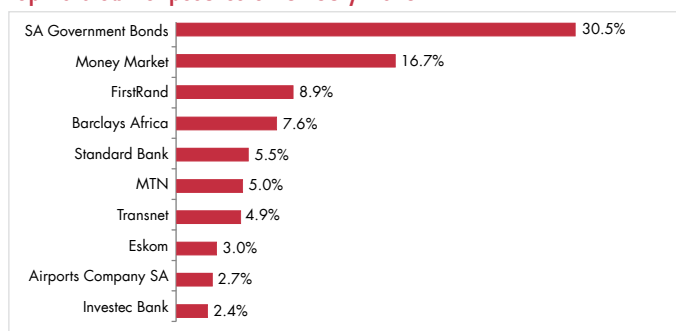
The annual management fee is included in the TER. The TER is a measure of the actual expenses incurred by the Fund over a 3-year period (annualised). Since Fund returns are quoted after deduction of these expenses, the TER should not be deducted from the published returns (refer to page 4 for further information). Transaction costs are disclosed separately.

TER and Transaction costs breakdown for the 3-year period ending 30 June 2016	%
<b>Total expense ratio</b>	<b>0.65</b>
Fee for benchmark performance	0.25
Performance fees	0.30
Other costs excluding transaction costs	0.02
VAT	0.08
<b>Transaction costs (including VAT)</b>	<b>0.00</b>
<b>Total investment charge</b>	<b>0.65</b>

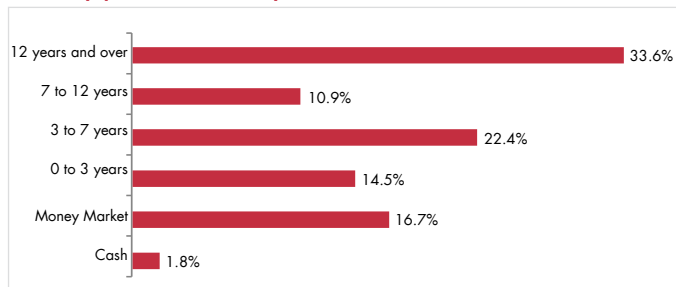
### Asset allocation on 31 July 2016



### Top 10 credit exposures on 31 July 2016



### Maturity profile on 31 July 2016



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

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### Fund manager quarterly commentary as at 30 June 2016

Two notable developments during the quarter were the rating agencies' decisions to maintain South Africa's investment grade status, and the UK referendum vote to leave the EU. Both were positive for bond yields. South African bonds regained the losses suffered in December 2015, while developed market bond yields made historic lows on renewed demand for so-called safe haven assets. The average 10-year bond yield for the large four developed markets (US, UK, Germany and Japan) is now close to 0.5%.

We remain committed to our long-term, fundamental investment approach. This suggests that many fixed interest investments have substantial downside risk with limited upside potential at current levels.

Consider for example that the yield on the 50-year Swiss government bond is now negative. It seems unlikely that a negative return is a good investment outcome over the next 50 years. So, why are investors buying such bonds? We don't know, but we suspect they are short-term orientated with confidence in their ability to time the market and sell before yields start rising. We don't claim to have such ability; instead we try to understand the major fundamental factors over the long term. One such factor is inflation. Global inflation is currently low, which argues for low nominal bond yields, but we would be surprised if inflation remains at current levels over the next 50 years. If we are right, a reversion to historical averages would mean substantial losses for holders of long-duration Swiss bonds.

In South Africa, the yield on the R2023 government bond that matures in February 2023 is now lower than the yield on one-year bank deposits (negotiable certificates of deposit or NCDs). Investors should question whether they are being compensated for taking on the extra duration risk of a seven-year rather than a one-year instrument. An argument for doing so would be an improvement in macroeconomic fundamentals that justifies lower long-term yields. Yet South Africa's fundamentals remain weak, and have arguably worsened. GDP growth is close to zero, government debt is high with no obvious means to reduce it, and political uncertainties are escalating ahead of the local government elections. It seems sensible to limit risk in this environment.

The Fund remains below benchmark duration with almost half the portfolio invested in liquid money market instruments and government securities. During the quarter, we reduced exposure to the middle of the curve following the rally in yields. We increased exposure to short duration bank NCDs that offer reasonable real yields, and long duration government bonds that we believe have relative yield support.

*Commentary contributed by Mark Dunley-Owen*

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### Notes for consideration

#### Management Company

Allan Gray Unit Trust Management (RF) Proprietary Limited (the 'Management Company') is registered as a management company under the Collective Investment Schemes Control Act 45 of 2002, in terms of which it operates 11 unit trust portfolios under the Allan Gray Unit Trust Scheme, and is supervised by the Financial Services Board ('FSB'). The Management Company is incorporated under the laws of South Africa and has been approved by the regulatory authority of Botswana to market its unit trusts in Botswana, however it is not supervised or licensed in Botswana. Allan Gray Proprietary Limited (the 'Investment Manager'), an authorised financial services provider, is the appointed Investment Manager of the Management Company and is a member of the Association for Savings & Investment South Africa (ASISA). The trustee/custodian of the Allan Gray Unit Trust Scheme is Rand Merchant Bank, a division of FirstRand Bank Limited. The trustee/custodian can be contacted at RMB Custody and Trustee Services: Tel: +27 (0)87 736 1732 or [www.rmb.co.za](http://www.rmb.co.za)

#### Performance

Collective Investment Schemes in Securities (unit trusts or funds) are generally medium- to long-term investments. The value of units may go down as well as up and past performance is not necessarily a guide to future performance. The Management Company does not provide any guarantee regarding the capital or the performance of the Fund. Performance figures are provided by the Investment Manager and are for lump sum investments with income distributions reinvested. Where annualised performance is mentioned, this refers to the average return per year over the period. Actual investor performance may differ as a result of the investment date, the date of reinvestment and applicable taxes.

#### Fund mandate

The Fund may be closed to new investments at any time in order to be managed according to its mandate. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. The Fund may borrow up to 10% of its market value to bridge insufficient liquidity.

#### Unit price

Unit trust prices are calculated on a net asset value basis, which is the total market value of all assets in the Fund including any income accruals and less any permissible deductions from the Fund divided by the number of units in issue. Forward pricing is used and fund valuations take place at approximately 16:00 each business day. Purchase and redemption requests must be received by the Management Company by 14:00 each business day to receive that day's price. Unit trust prices are available daily on [www.allangray.co.za](http://www.allangray.co.za)

#### Yield

The Allan Gray Bond Fund yield is current, calculated as at month-end.

#### Fees

Permissible deductions may include management fees, brokerage, Securities Transfer Tax (STT), auditor's fees, bank charges and trustee fees. A schedule of fees, charges and maximum commissions is available on request from Allan Gray.

#### Total expense ratio (TER) and Transaction costs

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

#### Compliance with Regulation 28

The Fund is managed to comply with Regulation 28 of the Pension Funds Act. Exposures in excess of the limits will be corrected immediately, except where due to a change in the fair value or characteristic of an asset, e.g. market value fluctuations, in which case they will be corrected within a reasonable time period. The Management Company does not monitor compliance by retirement funds with section 19(4) of the Pension Funds Act (item 6 of Table 1 to Regulation 28).

#### Need more information?

You can obtain additional information about your proposed investment from Allan Gray free of charge either via our website [www.allangray.co.za](http://www.allangray.co.za) or via our Client Service Centre on 0860 000 654.