ALLAN GRAY

QUARTERLY COMMENTARY 2

30 JUNE 2015

LONG-TERM THINKING IN ACTION

The cover of this Quarterly Commentary features the pagoda at the Horyu-ji Temple in Japan. It was built in 607AD and is one of the oldest wooden structures still standing today. What makes this feat so remarkable is that it survived countless typhoons and numerous earthquakes. So how did this five-storey structure remain standing for 1400 years?

The Japanese adopted Chinese pagoda architecture in the sixth century. But given the country's challenging conditions, the architects introduced three mutually reinforcing design tweaks: the use of extra-wide eaves, disconnected storeys independent of one another and, above all, a shock-absorbing central pillar known as the shinbashira. With these modifications, the structures would sway and then settle themselves, rather than fight nature's forces and collapse.

The design of Japanese pagodas and their ability to withstand unpredictable weather conditions resonates with us at Allan Gray. We stick to the same tried and tested investment philosophy and process, regardless of market conditions. It is this investment philosophy that has allowed us to create long-term wealth on behalf of our clients since 1974.

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ROB DOWER

COMMENTS FROM THE CHIEF OPERATING OFFICER

The Greek crisis dominated the headlines for much of the second quarter, along with the slowdown in growth and massive stock market volatility in China. Greece's relationship with its creditors makes for distracting news, but it will resolve itself, one way or another. On the other hand, slower growth in China and developed markets may well be a permanent feature. Sandy McGregor argues in his article this quarter that without growing populations, nor much unfulfilled human need, nor a virtuous cycle of productivity-increases-driving-more-skilled-employment, the economies of Japan and of the rich countries in Europe are pulling the world into a much lower 'normal' growth rate than we are used to. On top of this, as populations age, many developed economies – and also China – will struggle with an increase in social security and health costs and a decline in the number of economically active younger people to pay for this.

Back on home soil we face many challenges but, arguably, none so intractable as an ageing population or a state of development that questions the need for further growth. Instead, we have a youth bulge crying out for better skills and better employment. And, while there are some people in South Africa who want for nothing, the vast majority have to make trade-offs each month between quite basic needs. Even those in our growing middle class are not that well off: they are spending on improvements to basic urban housing and small luxuries to improve their general health and well being.

It is a fact to celebrate that our middle class is growing. Unfortunately our best engines for that growth – the industries that employ skilled workers and artisans – are in deep trouble. The symbiotic relationship between mining, manufacturing and infrastructure development should be positive. Instead, right now these sectors are in a downward spiral. Poor performance in mining businesses means less procurement from manufacturers. Inefficient and insufficient infrastructure (for example energy and transport infrastructure) means our mines and our manufacturers are not competitive on global markets. Manufacturers losing volume are less competitive on price and lose orders for infrastructure components or mining supplies to international competitors. The more inputs we import the less a weaker rand helps us. Simon Raubenheimer's article describes the impact of this on South African manufacturing in more detail, and I'm afraid it makes for depressing reading.

The South African economy has always been very dependent on mining. Mining drives industrial demand directly and consumer demand by employing large numbers of people directly and also indirectly in suppliers. With demand for commodities in cyclical decline and many of our gold mines nearing the end of their lives, we have to find sources of growth in new businesses. The Allan Gray Orbis Foundation's vision is to produce high-impact entrepreneurs, with the idea that these individuals will start and lead businesses to drive South Africa's economic growth and employment in the future. The Foundation is now 10 years' old and Anthony Farr reports on the great progress they have made in his article. He has included a few profiles of promising Allan Gray Orbis Foundation entrepreneurs; with about 100 new Fellows graduating each year, it is possible to imagine how they could make enough impact to significantly shift this country's prospects.

As bottom-up investors we try not to get too distracted by macroeconomic and political events. While we need to be cognisant of the environment in which we invest, we make our investment decisions based on thorough research of individual investment opportunities. One of the factors we consider is the 'price-to-earnings' (PE) ratio. In the Investing Tutorial, Wanita Isaacs explains why this can be a useful ratio to assess if a particular share presents good value.

The case for active management

Many valuation-conscious active managers around the world have had a difficult time recently. Adam Karr and Matt Adams, from Orbis' San Francisco office, tackle the question of whether or not active managers add value. They argue that although active management is a zero-sum game, and thus mathematically cannot add value 'on average', this does not mean that some skilled managers cannot do so over time. It will come as no surprise to longstanding investors that we firmly believe that our own active stock picking trumps investing in the index over the long term.

Capital preservation is key

Jack Mitchell, a previous leader of our firm, quipped that he would rather lose a client than a client's money. Capital preservation is key to our investment philosophy and approach. This can lead to periods of underperformance when markets are running. Nevertheless, through the cycle, remaining focused on preserving capital, and thus preserving the base for future growth, delivers a better return than risking a permanent loss of capital. We know this doesn't make you feel better about earning less return than your neighbour when markets are running, but we believe our portfolios are appropriately positioned given the current balance between risk and reward. Shaun Duddy's piece offers a more detailed explanation of the importance of capital preservation.

Thank you for trusting us with your hard-earned savings.

Kind regards

Rob Dower

SANDY MCGREGOR

SECULAR STAGNATION: THE NEW NORMAL?

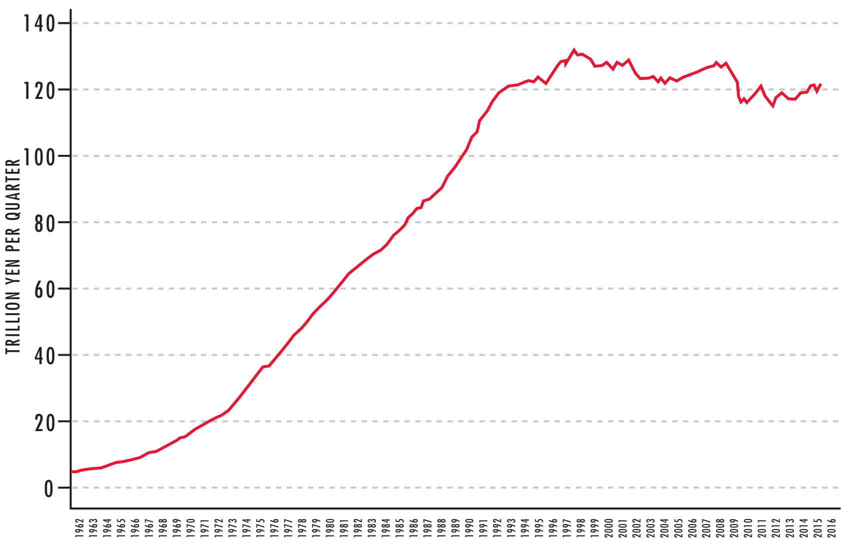
Economists are engaged in an interesting debate about economic growth and what has been described as 'secular stagnation'. The issue has received widespread attention since it was raised by the well-known economist Larry Summers in a speech at an IMF economic conference in September 2013. Sandy McGregor explains why it is pertinent to how governments and monetary authorities should respond to current economic conditions.

What is secular stagnation?

Most of us are conscious of the ebb and flow of the normal business cycle. Our current century commenced with a recession followed by seven years of growth, which in emerging markets was exceptionally robust. The recession of 2008/09 followed, and then the subsequent recovery. However, if we look back over, say, 300 years, such cyclical disturbances have not interrupted a general upward trend in economic activity. The longer-term or secular trend has moved inexorably upwards. As the global economy has grown, so living standards have improved. Ever since the interruption to growth in the Great Depression of the 1930s, a primary agenda of government has been to sustain this process. It is widely assumed that economic growth is the natural order of things, and given correct policies, inevitable.

However, recent economic history has increasingly given grounds to question this optimistic proposition. For example Japan, which for 40 years was one of the world's fastest-growing economies, has stagnated since 1990, as shown in **Graph 1**. Europe has proven unable to recover its former momentum since 2008 (See **Graph 2**). The United States has fared better, but its growth has been disappointing when compared to previous cycles. It is valid to ask whether we are entering a new world where growth is not inevitable and whether the recent history of Japan increasingly will become the norm. The Japanese experience can be described as secular stagnation.

GRAPH 1 **JAPANESE CURRENT GDP**



Source: INET BFA

At the heart of the problem are two features of mature economies which are formidable obstacles to growth: an ageing and static population and an erosion of the benefits of productivity.

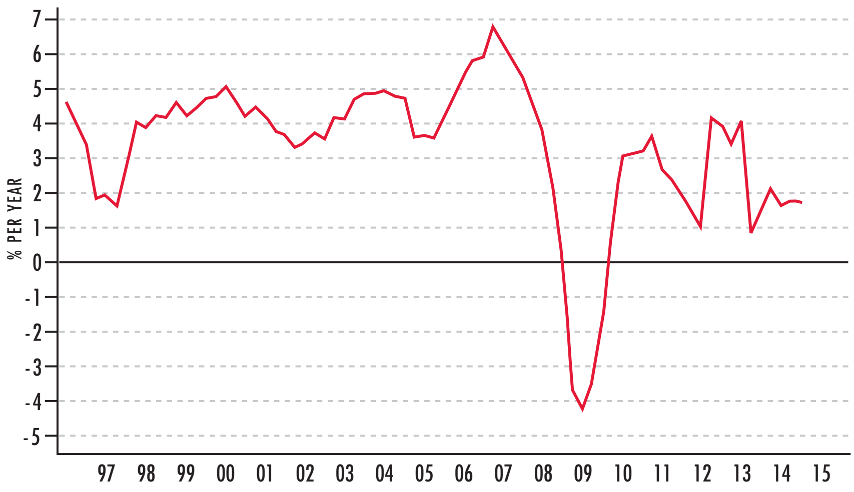
The inexorable consequences of demographics

A growing population can stimulate economic growth. The expansion of the global economy has marched hand in hand with a rising population. However, we are now experiencing something different. In most developed economies population growth has slowed and in many cases, such as Japan or Italy, apart from immigration, has ceased.

Simultaneously longevity has increased dramatically. The developed world is getting older and the burden of supporting an ageing population with pensions and healthcare is growing. Europe's current problems can be described as the crisis of the welfare state. The burden of social welfare is becoming unaffordable. Some emerging markets are experiencing similar demographic stagnation. Most worrying, China is heading towards a condition similar to Japan. It is often said that the challenge China faces is to get rich before it gets old. An ageing and static or even contracting population constitutes a formidable obstacle to economic growth. This lies at the heart of the problems of Europe and Japan.

It is not simply the cost of supporting an ageing population which retards growth. Transforming any society requires the enthusiasm of youth. There are few things more powerful than a generation on the make. Those who fought in the Second World War and then went on to create a prosperous suburban society have been called America's greatest generation. The reconstruction of Europe and Japan after 1945 was the achievement of young people determined to rebuild the world which had been destroyed.

GRAPH 2 **EURO AREA CURRENT GDP GROWTH RATE**



Source: INET BFA

Modern China has been created by the children of those who participated in the Great Cultural Revolution of 1966, with all its disastrous consequences. Strong economic growth does not simply happen. It requires the determination of a dynamic generation of younger people. The dilemma facing so many countries is that they are getting old and increasingly lack the vitality of youth.

increasing economies of scale. The benefits of increased productivity were redistributed through the economy in the form of higher wages, which in turn boosted consumption and growth. Unfortunately, by the end of the 1960s this virtuous cycle of rising productivity and real wages had run its course, as increasing scale no longer generated sufficient gains in efficiency. The world then sank into inflationary stagnation.

> **"WE ARE ENTERING A NEW WORLD WHERE GROWTH IS NOT INEVITABLE..."**

Once a society with a static population has achieved an acceptable average living standard there is no need for further growth. Ultimately the political system in many developed countries will have to accept this reality and adjust accordingly.

An eroding productivity dividend

Economic growth can be described as making things cheaper. Productivity gains are essential if living standards are to improve. The prosperity created in the post-World War Two boom between 1945 and 1973 was the consequence of a massive reduction in manufacturing costs, driven by

A second productivity revolution commenced in the 1980s driven by globalisation and new technology. The world has benefited from a productivity windfall from globalisation. Globalisation has clearly benefited emerging markets, most notably China. There has been a migration of the production of goods and services to countries with a lower cost base. In particular the sudden emergence of China as the second-largest economy has massively increased global trade flows. However, the easy winnings are probably now behind us, and the rate of expansion of world trade is slowing. The positive impact of globalisation is no longer what it used to be.

New technologies, in particular computerisation and artificial intelligence, have dramatically reduced production costs in many industries. Unfortunately, however, this new wave of productivity gains has not resulted in a productivity dividend in the form of higher wages. Part of the problem is that new technologies tend to eliminate the need for labour, requiring only a small, highly paid, technical elite to operate. There are not enough new skilled jobs being created to replace those being destroyed. The virtuous circle of productivity increasing wages, and therefore demand, is broken. The creative spirit seems alive and well. There is a constant flow of new products, but there remains the vexing problem of how to harness new technologies to create widespread prosperity. New products can change spending patterns without necessarily increasing the aggregate amount of expenditure.

The illusion of the recent past

There is a tendency prevalent among governments and investors to look back on the period between 2002 and 2008 as the normal to which we should return. It is important to understand that this was an unusual period of above-average growth generated by the emergence of China and by excessive credit. We now live in a world where China's growth is slowing, and many parts of the global economy are burdened by excessive debt. The proponents of the idea of secular stagnation argue that slower growth will be the norm, the inevitable consequence of demographics and changes in the way economies operate.

Central banks have not bought into this idea. The financial system has been flooded with newly created money in the hope that this will stimulate activity and bring back some halcyon era. This programme has failed because it can do nothing about the real determinants of growth, such as demographics and productivity. Low interest rates will not change the inevitable consequences of demographics. Policies aimed at promoting inflation are a total contradiction of the proposition that growth requires productivity gains.

"STRONG ECONOMIC GROWTH ... REQUIRES THE DETERMINATION OF A DYNAMIC GENERATION OF YOUNGER PEOPLE."

It is no coincidence that high interest rates in the 1980s generated growth by eliminating an inefficient allocation of resources, whereas the experiment of zero rates has promoted inefficiency and has failed to generate robust growth. Since 2012 Japan has embarked on the most aggressive campaign of monetary easing ever attempted – with remarkably little effect on its real economy.

Larry Summers has argued that the solution to secular stagnation lies in investment in infrastructure. This is more likely to have a positive outcome than what monetary policy has achieved in recent years. However, there remains the question of how this would be financed. Adding to an already-excessive level of debt is likely to inhibit, rather than promote, growth.

It is probable that governments and central banks can do little to combat secular stagnation. The best they can do is create an environment in which excessive indebtedness is reduced and where human ingenuity can thrive, and hope for the best.

A new reality

Secular stagnation is already a challenge facing developed countries. In the not too distant future middle income economies, such as China, will face similar problems. Perpetually slower growth will require totally new responses from governments and private sector business. Investors must be cognisant of this new reality. It is not that growth will necessarily cease, although in some countries this will be the case. However, we shall have to get used to the idea that what we used to think of as normal will no longer be the case. As popular wisdom has it: the future is no longer what it used to be.

While this is an issue for countries well advanced in the development cycle, large parts of the world, including Africa and India, have a long way to go before they face these problems. Increasingly it will be these countries which become the focus of global growth. However, ultimately even they will also reach a limit to their growth.

The debate on secular stagnation has particular relevance for South Africa because we are an unusual case of being a developing economy which is growing very slowly. While, theoretically, we have favourable demographics, in practice our dysfunctional education system prevents us from reaping the benefits which should be enjoyed by a country with a very young population. We are witnessing the cost of an inflexible economy and legislation which imposes huge burdens on business. Unless South Africa can restore its economic competitiveness it too faces a future of secular stagnation.

Sandy joined Allan Gray in October 1991. His current responsibilities include the management of fixed interest and individual client portfolios. Previously he was employed by Gold Fields of South Africa Limited for 22 years where much of his experience was focused on investment-related activities.

SIMON RAUBENHEIMER

MANUFACTURING IN MELTDOWN

The manufacturing sector is currently in a woeful state. Simon Raubenheimer discusses why we are where we are.

'The Board of Directors has taken the decision to conclude operations at Giflo Engineering (Bophuthatswana) (Pty) Ltd ("Giflo").

The decision was made on the back of poor margins and a labour dispute with NUMSA which has resulted in a labour strike which started on the 12th of January 2015 and is still currently ongoing.

The strike has been incredibly violent with a number of our working staff and staff of our suppliers and customers being hospitalised. Our trucks, as well as those of our suppliers have been damaged, working staff houses have been set alight and the factory has been brought to a halt as a result of the strikers stoning all vehicles in the vicinity of the Giflo factory and cutting off the company's water supply.

The company has reserved its rights against NUMSA and has obtained a court interdict to allow it to operate unhindered, something which is easier documented in theory than it is in reality.'

Excerpt from Argent Industrial SENS announcement 23/04/2015.

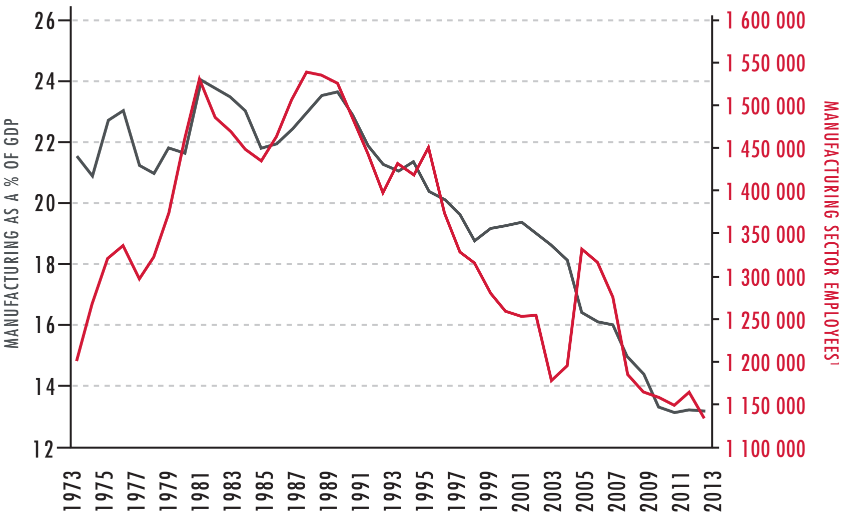
The deindustrialisation of South Africa

Throughout history, manufacturing has been the pathway for the development of nations. From the Netherlands in the 17th century, England in the 19th century, the US, Germany, Japan in the 20th century to China, Korea and Taiwan today, manufacturing has been fundamental to national development and prosperity.

South African manufacturing is in a perilous state. Manufacturing's contribution to South African GDP has fallen from 24% in the early 1980s to 13% today, as shown in **Graph 1**. The number of people employed in the manufacturing sector has reduced by over 25% over the same time period[1].

Various dynamics have contributed to the deindustrialisation of South Africa. Some are complex and deep-rooted

GRAPH 1 **SA MANUFACTURING**



Source: Stats SA, South African Reserve Bank

– going back almost a century, when South Africa adopted a policy of import substitution as a vehicle for economic development in the 1920s. Complicated tariff structures, high tariff walls, duties and quantitative restrictions were enacted to protect and nurture domestic industries[2]. Our isolation under Apartheid made things worse and by the end of the 1980s, South Africa had the most tariff rates, the widest range of tariffs and the second-highest level of tariff dispersion among a range of developing countries[3]. Decades-long trade protectionism left many South African companies bloated and inefficient.

Post-Apartheid era trade liberalisation exposed these inadequacies, as many manufacturing businesses found it hard to adjust to a more open economy. Since the early 1990s, the performance of South African manufacturers has been cyclical and patchy, subject to the whims of exchange rates, commodity prices and foreign (particularly Chinese) demand, amongst other factors.

A whole host of challenges

A confluence of long-standing and recent challenges has made the last few years particularly painful. Unfolding against a backdrop of already weak infrastructure spending in South Africa, these issues reinforce themselves through a negative feedback loop:

- **Administered prices:** Between 1980 and 2007, electricity prices rose by 9% per annum (p.a.), or 1% less than inflation. Since 2007, electricity prices have risen by 17% p.a., or 11% more than inflation every year. Water, sanitation and municipal charges have increased in some years by more than electricity prices. Our port charges are among the highest in the world, especially container, cargo, automotive and terminal handling charges.

- **Productivity:** Workforce management company Adcorp estimates that for South Africa collectively, labour productivity has fallen by almost one-third since 1967[4]. A back-of-the-matchbox calculation indicates that labour productivity in the manufacturing sector has lagged the rest of South Africa's labour productivity by as much as 35% over a similar period[5].

- **Labour unrest:** The South African Reserve Bank notes: 'Disconcertingly, the number of workdays lost due to industrial action has increased notably in recent years; the average annual number of workdays lost between 2008 and 2014 (excluding 2010, due to the public sector strike) amounted to 5.1 million, compared with an annual average of only 1.8 million for the 13 years from 1994 to 2006.'[6] Data published by the Department of Labour points to an almost 15-fold increase in the wages lost due to strike activity between the 2005–2010 average and 2013. In 2014, the platinum strike alone resulted in a greater loss in wages than all 114 strikes in 2013 combined.

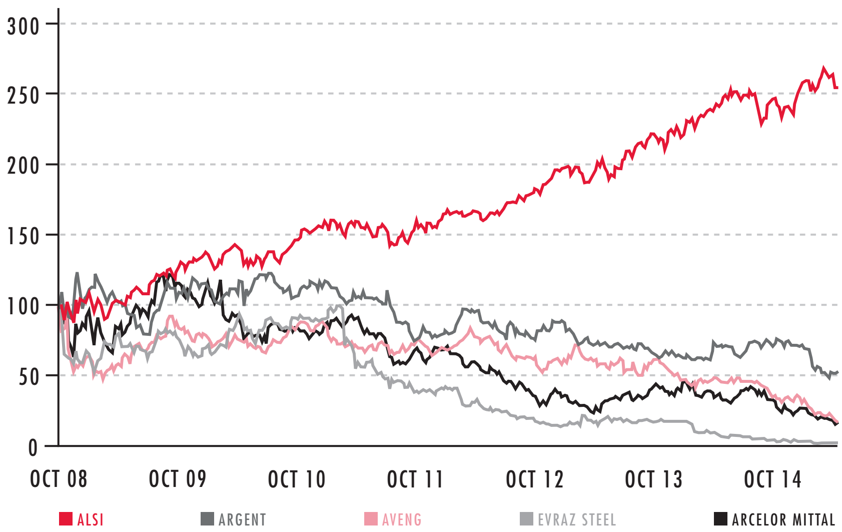
- **Infrastructure bottlenecks:** Coal, iron ore and manganese production and exports from South Africa are constrained by rail capacity limitations. An ageing water pipeline is holding up mining activity in the Northern Cape Kalahari basin. South African port and road congestion is infamous. The South African National Roads Agency estimates that the repair and maintenance backlog on roads that are in 'poor' and 'very poor' conditions in South Africa amounts to R200bn. This excludes upgrading our 182 000km network of gravel to paved roads (22 000km) and ongoing resurfacing and traffic congestion alleviation work[7]. Rolling blackouts have introduced further uncertainty. It is estimated that load shedding is costing the economy upwards of R20bn (or 0.5% of GDP) per month.

- **Policy uncertainty:** There is much confusion around BEE codes, property rights, minimum wages, labour reform, importing of rare skills and domestic beneficiation. Rumours of further state involvement, for example the mooted establishment of a five million ton greenfield steel plant by an Industrial Development Corporation/Chinese consortium, are further fuelling private sector insecurity. The same establishment guilty of creating the confusion is also responsible for protecting the sugar, chicken, cement, textile, clothing, footwear, automotive, plastic, polymer and wood industries (to name a few) via tariffs or quotas.

- **Exogenous factors:** The weak global recovery post the 2007/08 financial crisis has simultaneously lowered the demand for South African exports and increased import competition. Steel & Engineering Industries Federation of South Africa research estimates the level of intermediate inputs imported by South Africa's metals and engineering sector has 'risen strongly from around 22% 20 years ago to over 35% currently.'[8] A very volatile exchange rate has made long-term projections, budgets and planning difficult.

"THROUGHOUT HISTORY, MANUFACTURING HAS BEEN THE PATHWAY FOR THE DEVELOPMENT OF NATIONS."

GRAPH 2 **SHARE PRICES BASED TO 100**



Source: Allan Gray research, INET BFA

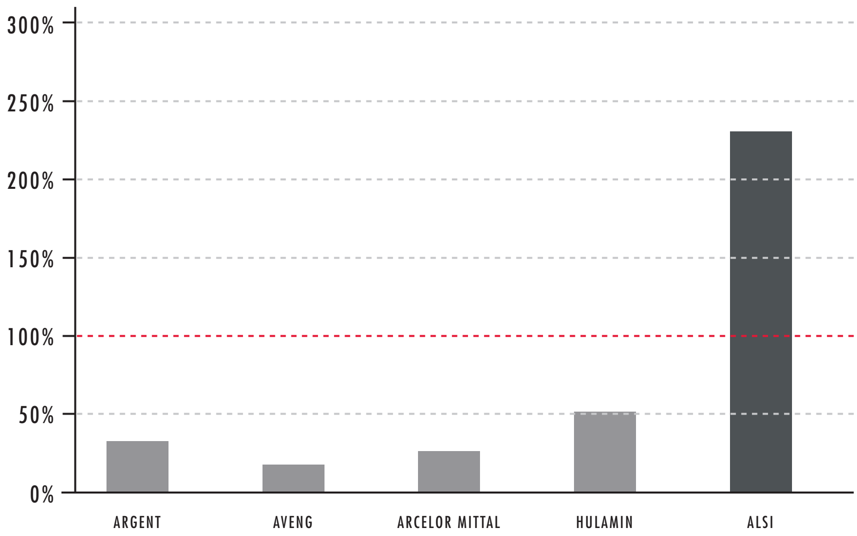
Fall from grace

The travails of South Africa-focused manufacturing businesses are echoed in the stock market. Many listed businesses have disappeared altogether: AG Industries, Dorbyl, B&W Instrumentation, Control Instruments, Racec, Alert Steel, Brikor, Protech Khuthele, Sanyati and Sea Kay to name a few. The remaining SA-only manufacturers have mostly lagged the FTSE/JSE All Share Index (ALSI). Companies exposed to the metals and engineering sectors – collectively accounting for one-third of South Africa's manufacturing sector – have fared particularly badly, falling by between 50% and 100%, while the market has risen more than two and a half-fold since 2008. Evraz Highveld Steel, South Africa's second biggest steelmaker, applied for business rescue in April.

It is hard to imagine that Aveng, Arcelor Mittal and Murray & Roberts were among the top 40 'large-cap' companies on the JSE as recently as 2008. Today, having fallen by over 90% from their highs (see **Graph 2**), they are classified as 'small caps', too small for the top 100 'mid-cap' shares by market capitalisation. If one added the three companies together, the combined entity would have to grow almost threefold to qualify for the ALSI 40. A standalone Aveng would have to be 15x bigger!

Argent, Aveng, Arcelor Mittal and Hulamin are currently priced at discounts of between 45% and 75% to the claimed value of the net assets on their balance sheets, reflecting the dim view taken by the market on these companies. By contrast, the average company on the JSE trades at a premium to its net asset value of 130%, as shown in **Graph 3**.

GRAPH 3 **PRICE TO NET ASSETS**



Source: Allan Gray research, Bloomberg

Plastering the wounds

There is no easy cure for SA's manufacturing sector woes. Tackling the problems will require discipline and determination. Some issues will ebb and flow; some are permanent. It is pretty clear, for example, that real electricity price increases will remain higher than their historic averages for a long time even with our best collective efforts. It is equally difficult to imagine wages rising by less than inflation.

Manufacturers seem to agree. Where labour can be substituted with capital, one response of industrial South Africa has been to accelerate the rate of mechanisation: do more with fewer workers. Consumer food and goods conglomerate AVI has neatly arbitraged the gap between labour and capital productivity – it has managed to more than double its revenue over the past 10 years by doubling its plant and machinery, while only growing its workforce by 15%. Revenue per employee has risen by 90% since 2005; operating profit has risen fourfold.

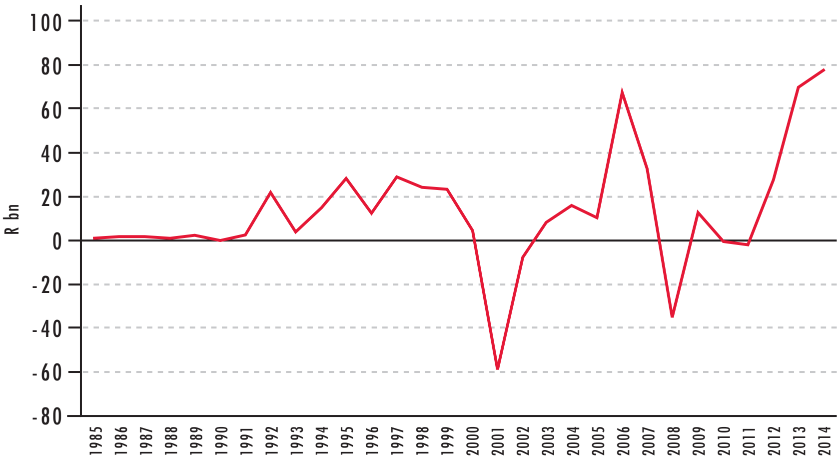
Across the board, from steel, aluminium and cabling, to packaging, cement and industrial gas, employee numbers in listed manufacturing businesses have fallen –

often by more than 30% – over the past few years. Many have not survived. Low return manufacturing businesses are closing down and big parts of certain industries are disappearing altogether. Over 80 000 jobs have been lost in the clothing and textile industries alone between 2002 and today[9].

The second major imperative among SA businesses is one of 'geographic diversification'. The desire to grow offshore is more widespread and fervent than ever. From the smallest of manufacturing businesses like infrastructure solution provider Megatron (a division of electrical manufacturer Ellies), to industrial manufacturing giants like Sasol, AECI and Nampak, construction-related companies like Murray & Roberts and PPC and food businesses like Tiger Brands, capital is being redirected to other parts of the world.

This trend is reflected in South Africa's capital account: after an already record year of outward-bound foreign direct investment (FDI) in 2013, South African companies stepped up their efforts another notch by growing their direct investments abroad by a further 17% in 2014, with no respite in 2015[10], as shown in **Graph 4**. Foreign investment into South Africa is falling by 23% per year, adding insult to injury. (As an aside, FDI into developing economies globally rose by 4% in 2014, indicating that we are batting well below the average.[11])

GRAPH 4 **REAL OUTWARD FOREIGN DIRECT INVESTMENT**



Source: INET BFA, South African Reserve Bank

Long-term outlook

These trends do not bode well for the long run. As South Africans, we cannot spend and consume our way to prosperity. The gap between what we consume and what we produce has to narrow. South Africa desperately needs an environment that will facilitate more capital investment locally. In truth, the country needs to up its investment in fixed or productive assets (like factories, infrastructure and agriculture) by 30% - 50% to remain globally relevant. Lower-middle income economies around the world are investing 25% of their GDP in fixed assets; middle income economies more than 30%, on average[12]. We are investing less than 20%. Improving our infrastructure would be one way to start breaking the vicious cycle that is plaguing SA manufacturing.

The manufacturing sector is important to South Africa given its upstream links to mining and downstream links to the infrastructure, construction and automotive sectors. Unfortunately manufacturing appears to be following in the footsteps of our mining sector. The share prices suggest permanent change: profit margins are not going back to where they came from. Plenty of businesses have gone under, and at these share prices, many of the remaining SA industrial businesses will find it hard to raise capital to grow locally.

Money flows to where it is treated best. Currently that appears to be in anything that can reduce employment or is located outside of South Africa. Innovation that reduces cost and improves efficiency is inevitable and should be lauded. But technical innovation and labour employment can be complementary. South Africa needs both.

[1]Using Quarterly Employment Statistics (QES) data. The QES is a survey of formal businesses and excludes the agricultural sector and sole proprietors.
[2]Source: ITAC.org.za
[3]Source: Lawrence Edwards "Has South Africa Liberalised its Trade?", 2006, Belli et al (1993).
[4]Source: www.adcorp.co.za news pages. In calculating this number, Adcorp standardises "the output-per-worker measure by the amount of capital used in the production process, which yields output per worker, per capital" – Loane Sharp, Adcorp labour economist.
[5]It takes 53% more workers to produce 1 unit of GDP today than it did in 1973 in the manufacturing sector, using the Quarterly Employment Statistics and Stats SA. Gross Fixed Capital Formation in Manufacturing in SA has oscillated around 3% over 50 years.
[6]Source: SARB March 2015 Quarterly Bulletin.
[7]Source: Kannemeyer SARF/IRF 2014, www.sarf.org.za, www.sanral.co.za
[8]Source: H Langenhoven / T Creamer, www.engineeringnews.co.za, May 2015.
[9]Source: HCI.
[10]Source: SARB, INET BFA.
[11]Source: SARB March 2015 Quarterly Bulletin.
[12]Source: World Bank. Gross Fixed Capital Formation as % of GDP. Middle income countries include 55 countries like SA, China, Mexico, Brazil, Turkey. Lower-middle income countries include India, Indonesia, Nigeria, Vietnam, etc.

Simon is an equity and balanced portfolio manager and a director of Allan Gray Investment Services Proprietary Limited. He is a CFA charter holder and has been with Allan Gray since 2002.

MATT ADAMS & ADAM KARR

THE CASE FOR ACTIVE MANAGEMENT

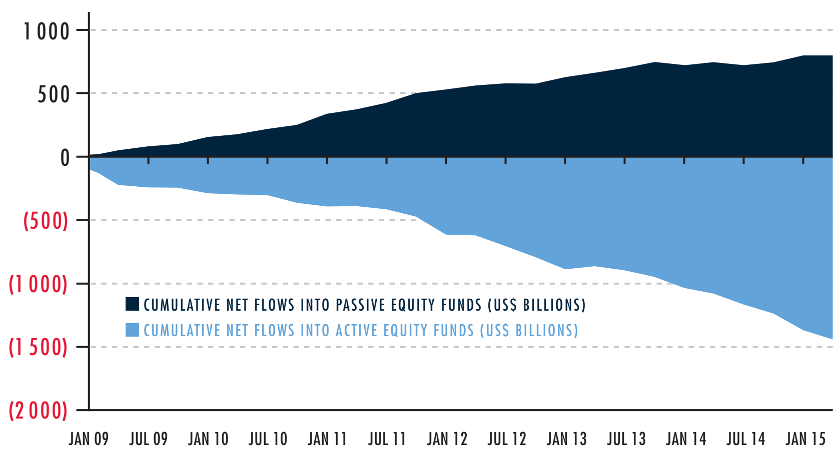
It is popular these days to talk about how difficult the past several years have been for active managers. In a sense, however, active management is always difficult because it is a zero-sum game. For one manager to outperform, another has to underperform. As the Nobel laureate William Sharpe demonstrated succinctly many years ago, both active and passive investors must, on average, have the same return before fees, which must also equate to the same return as the market overall. Layer on higher fees, tax inefficiencies and misguided investor behaviour (e.g. buying and selling at the wrong time), and the realised performance difference between the average active manager and a passive alternative can be very meaningful. Matt Adams and Adam Karr, from our offshore partner Orbis, argue the case for active management, despite the current challenges.

The past five years have been unusually difficult for certain active managers, particularly valuation-conscious managers such as Orbis. Unsurprisingly, the chorus proclaiming the death of active management has grown louder, and this is reflected in the flow of assets from active funds to passive strategies such as index funds or index-tracking exchange-traded funds (ETFs). Since 2009, nearly US$1.4 trillion has flowed from active equity funds globally, while more than US$800 billion has flowed to passive funds. Much of this movement has occurred in the past four years, as shown in **Graph 1.**

Cyclical vs secular

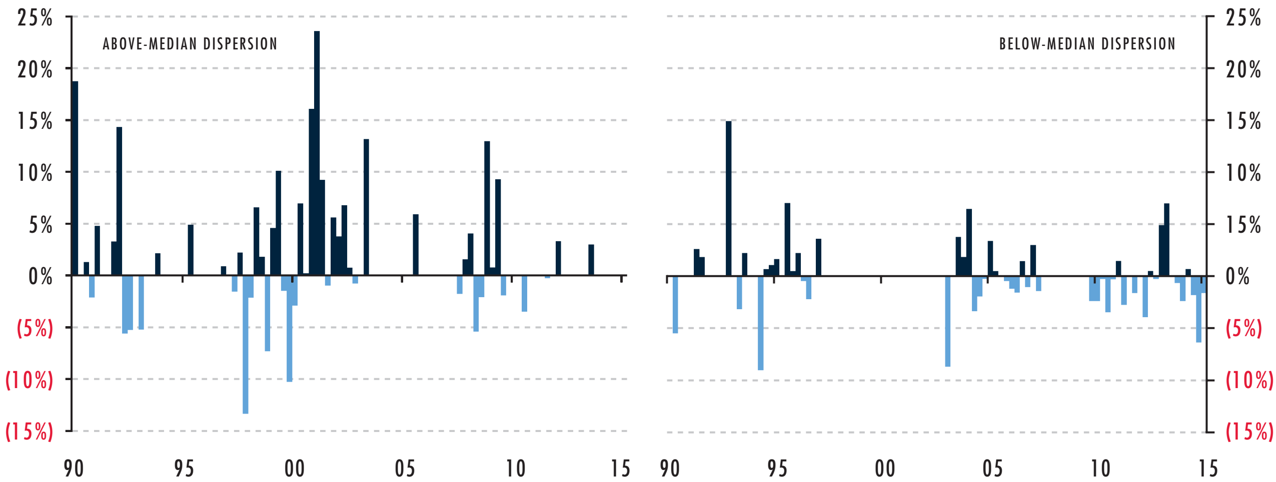
An important reality, sometimes lost in the discussion of the zero-sum arithmetic and headline-grabbing fund flows, is that there is a wide distribution of managers, some of whom will outperform and some of whom will not. The fact that active management cannot add value 'on average' does not prove that some skilled managers cannot do so over time. It will come as no surprise to longstanding investors with Orbis that we firmly believe stock picking can add value. Our objective, therefore, is not to argue the 'active versus passive' debate, but rather to offer our perspective as practitioners. One of the most relevant questions today, in our view, is whether the headwinds faced by active managers have been the result of cyclical or secular factors.

GRAPH 1 **ACTIVE VS PASSIVE FUND FLOWS**



Source: eVestment

GRAPH 2 **ORBIS GLOBAL EQUITY RELATIVE RETURNS IN HIGH- AND LOW-DISPERSION QUARTERS**



AVG QUARTERLY RELATIVE RETURN: 2.5% OUTPERFORMANCE IN 63% OF QUARTERS

AVG QUARTERLY RELATIVE RETURN: 0.1% OUTPERFORMANCE IN 42% OF QUARTERS

Source: Orbis

The argument for a secular decline is generally based on the view that competition is getting steadily more intense as the number of active funds grows, managers within the industry consistently improve their capabilities, and retail investors, a traditional source of outperformance for active managers, increasingly give up on picking stocks and move to passive alternatives. The consequence of these trends, critics contend, is declining active manager performance and less divergence between active managers.

While we don't disagree that competition is probably becoming more intense – what industry is not becoming more competitive? We think such arguments greatly overstate the case for structural change. Imagine a stock market in which every stock moves exactly in unison. By definition, every active manager would achieve the market return, and, after fees, would destroy value. In contrast, imagine a market where the range of returns between winners and losers is very wide. While the average manager is still doomed to underperform after fees, such an environment at least offers the possibility that a skilled active manager can add value by owning the winners and avoiding the losers. The point we are seeking to illustrate is that the dispersion of returns offered in the market is an important determinant of the possibility for a skilled active manager to add value.

"THE FACT THAT ACTIVE MANAGEMENT CANNOT ADD VALUE 'ON AVERAGE' DOES NOT PROVE THAT SOME SKILLED MANAGERS CANNOT DO SO OVER TIME."

Consistent stock-picking performance

Our own experience is supportive of the important relationship between the opportunity set offered in the market through the dispersion of stock returns and the ability to add value through stock-picking skill. **Graph 2** shows that over the past 25 years, our flagship Orbis Global Equity Fund has outperformed (net of fees) 63% of the time during quarters of above-average dispersion and achieved an average quarterly relative return of 2.5%. In contrast, during quarters of below-average dispersion, the strategy outperformed just 42% of the time and achieved an average relative return of 0.1%.

In this regard, the past five years have been unusual, with the dispersion of market returns well below the historical median. In fact, there have only been two quarters during which dispersion has been above the historical median! From this perspective, our stock-picking performance over the period is very consistent with our history. The question, then, is to what extent the low dispersion over the period is itself cyclical or secular. We can think of two possible reasons that it could be structural, but don't see evidence to support either.

The first possibility is that the investment universe itself has changed such that fundamental business performance has become more homogeneous, resulting in less stock return divergence. A potential explanation for such a convergence of fundamentals might be that better corporate management and governance has left 'fewer mutts in the kennel,' so to speak, making it harder to outperform by simply avoiding the worst companies. If this were true, it should be reflected in a declining dispersion of fundamental performance, with the worst companies in particular showing the most improvement. As shown in **Graph 3** however, the opposite is actually true – the divergence of fundamentals appears to be widening!

A second possible reason that low dispersion could be structural is that the market has become more efficient, resulting in fewer mispriced stocks. While we have no desire to step into the general debate about market efficiency, what we can say is that although dispersion does not imply mispricings, the two variables are probably correlated. Thus, the tendency of return dispersion to stay relatively flat over the long term is more consistent with the conclusion that efficiency is not increasing than if the dispersion trend were sharply downward. What we observe very clearly, however, is that return dispersion is cyclical and that the current stretch has been unusually long (see **Graph 4**).

"OUR STOCK-PICKING PERFORMANCE OVER THE PERIOD IS VERY CONSISTENT WITH OUR HISTORY."

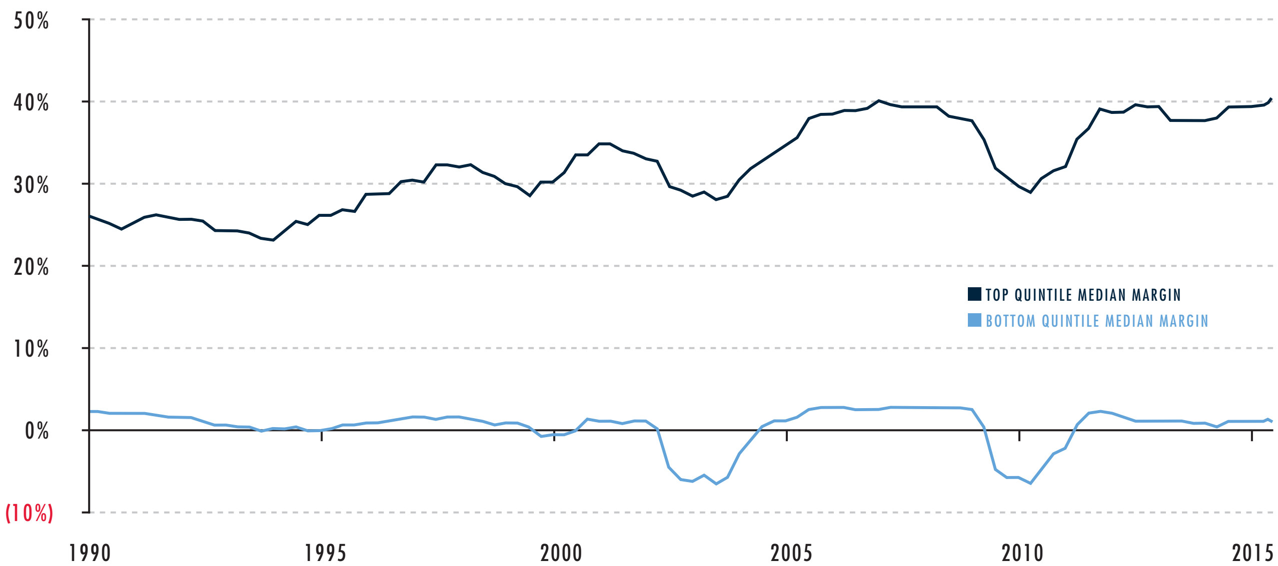
A challenging environment

Indeed, the current period of low dispersion is most notable not for its depth but for its duration. There have been other extended periods of low dispersion since the Orbis Global Equity strategy's inception, such as the mid-1990s during the run-up to the tech bubble, as well as the mid-2000s, but none have lasted as long as the current period. This painfully long episode of sustained low dispersion has, in the classic pattern of herds, led many to conclude that the environment has fundamentally changed and that attempting to achieve an above-average return by actively picking stocks has become a fool's errand.

We think, however, that the primary culprit is not a structural change in the market but rather the massive quantitative easing across much of the developed market, which has pushed up the prices of all assets, irrespective of their intrinsic values. In this sense, low dispersion is a close cousin of the 'trending' phenomenon that we wrote about last quarter.

The flood of money into passive strategies in recent years, without regard for the investment merits or valuations of individual stocks, has also caused shares to increasingly move together. This, in turn, fuels even more benchmark-hugging behaviour by active managers who are fearful of being left behind. While each of these phenomena would have been difficult independently, the combination of low dispersion and high trending has conspired to create a particularly

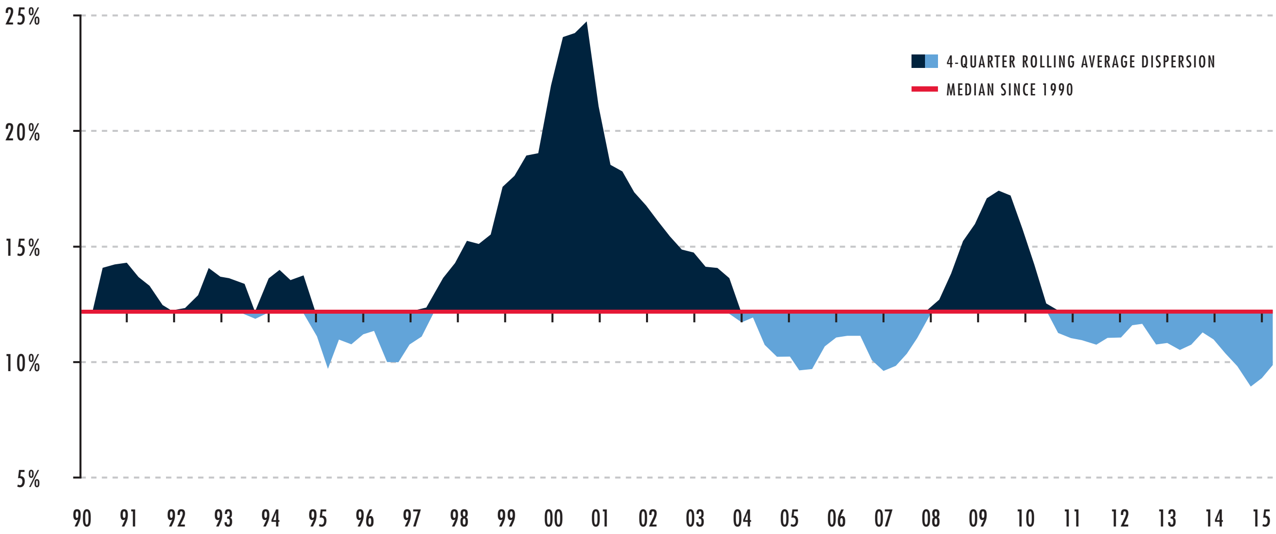
GRAPH 3 **DIVERGENCE OF FUNDAMENTALS IS WIDENING**



Median one-year pre-tax profit margin of top and bottom quintile shares in the FTSE World Index, 1990 to June 2015

Source: Orbis

GRAPH 4 **ROLLING DISPERSIONS VS LONG-TERM MEDIAN**



Four-quarter rolling average dispersion in returns of shares in the FTSE World Index, and the median,1990 through March 2015

Source: Orbis

challenging environment for value-oriented managers like Orbis.

While we can't predict when radical monetary policy in the developed markets will end, or when the flows into passive investments will slow, we remain confident that neither will continue forever. When they do end, we believe that individual company fundamentals will once again play a more prominent role. In fact, it may be the case that merely the anticipation of a more 'normal' policy environment will be enough to change the current trends. In this regard, we may be seeing the early green shoots of a new spring, with dispersion year-to-date rebounding from the 2014 trough. Time will tell whether this was a true turning point or simply short-term noise. Either way, we will continue to focus our efforts on finding shares that are priced at a meaningful discount to our assessment of intrinsic value in the belief that this is ultimately the best way to create value on your behalf over the long term.

Adam joined Orbis in 2002 having previously worked in private equity and investment banking. He is the managing director of Orbis Investment Management (US) LLC and a director of Orbis Investment Management Limited.

Matt joined Orbis in 2010, having previous experience as an officer in the United States Army. He researches US industrial shares, and is responsible for leading the investment research process for Orbis' US analyst team.

SHAUN DUDDY

THE UPSIDE TO DOWNSIDE PROTECTION

Warren Buffet famously said that there are two rules when investing, 'Rule No.1: Never lose money, Rule No.2: Never forget rule No.1.' Shaun Duddy discusses why capital protection is so important for the creation of wealth over the long term, and the role that our investment philosophy plays in maximising capital protection.

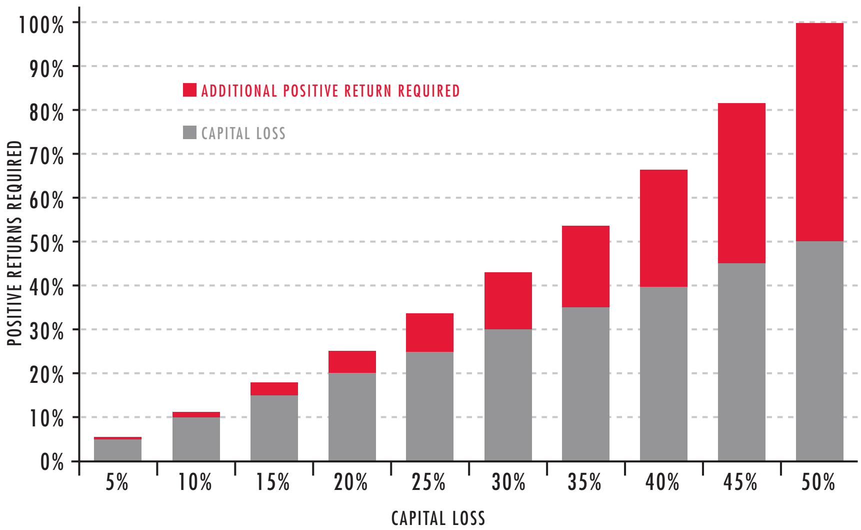
The impact of a capital loss

We have discussed the benefits of compounding returns on numerous occasions. The basic principle is that the returns earned over a given period are earned on the total value of the investment at the start of that period, not only on the original capital contribution. This means that as an investment grows there is a larger base on which to earn subsequent returns.

However, the reverse is also true. If an investment experiences negative returns (i.e. capital losses), the base on which future returns are earned is smaller. This means that the positive percentage return required to make up the loss will always have to be greater than the negative percentage return that caused the loss. **Graph 1** shows that although the extra return required is small for small losses, it increases exponentially and quickly becomes a significant number.

The risk of capital loss differs considerably between unit trusts. It is important that you are comfortable with the risk your unit trust will take in pursuit of return. Equity unit trusts, for example, are mandated to invest 100% in equities, which tend to be more volatile than other asset classes, resulting in a greater risk of capital loss over the short term. Asset allocation unit trusts, on the other hand, have more limited equity exposure and allow fund managers to invest in other asset classes, providing a greater number of investment options to select from when managing the risk versus return trade-off. However, even within equity-only mandates, managers can take on different levels of risk, depending on the shares they choose

GRAPH 1 **POSITIVE RETURNS REQUIRED TO COMPENSATE FOR DIFFERENT LEVELS OF CAPITAL LOSS**



Source: Allan Gray research

TABLE 1 **ALSI DRAWDOWNS AND TIME TO RECOVER VS ALLAN GRAY EQUITY FUND DRAWDOWNS AND TIME TO RECOVER**

	ALSI			ALLAN GRAY EQUITY FUND		
Drawdown	Start date	Drawdown	Days to recover	Start date	Drawdown	Days to recover
Worst	2008 May	45.4%	896	2008 May	31.3%	657
2nd worst	2002 May	34.6%	611	2000 Feb	21.0%	336
3rd worst	2000 Jan	27.6%	368	2003 Jan	17.0%	202

Source: Allan Gray research, INET BFA

to invest in. Even in our equity-only mandates, we try our best to limit the risk of capital loss as we believe this gives our clients the best chance of growing wealth over the long term.

The benefits of capital protection

From its peak in May 2008 to its low in November 2008 the FTSE/JSE All Share Index (ALSI) lost more than 45%. Graph 1 shows us that the positive return required to make up that loss would have been approximately 83%. Over the same period, the Allan Gray Equity Fund lost approximately 31%. Although only 14 percentage points less than the ALSI's loss, the positive return required to make up that loss was just 45%, fully 38 percentage points less than that required by the ALSI.

Smaller losses are easier to make up and, by extension, tend to be made up more quickly than larger losses, increasing the time available to earn returns on a higher base, which ultimately leads to greater growth of your wealth. This is illustrated in **Table 1**, which compares the three largest drawdowns for the ALSI and the Equity Fund since the Equity Fund's inception in October 1998.

Following this logic, if investment managers could maintain 100% of investors' capital during 'down' periods, and participate fully in 'up' periods, they would produce significant outperformance and wealth for their investors. Unfortunately, this is near impossible to achieve for at least two reasons:

1. Few shares can completely escape the drag of a significant market decline, preventing full capital protection during these periods.
2. To avoid market declines, a manager has to invest differently from the index, often preventing full participation during positive periods.

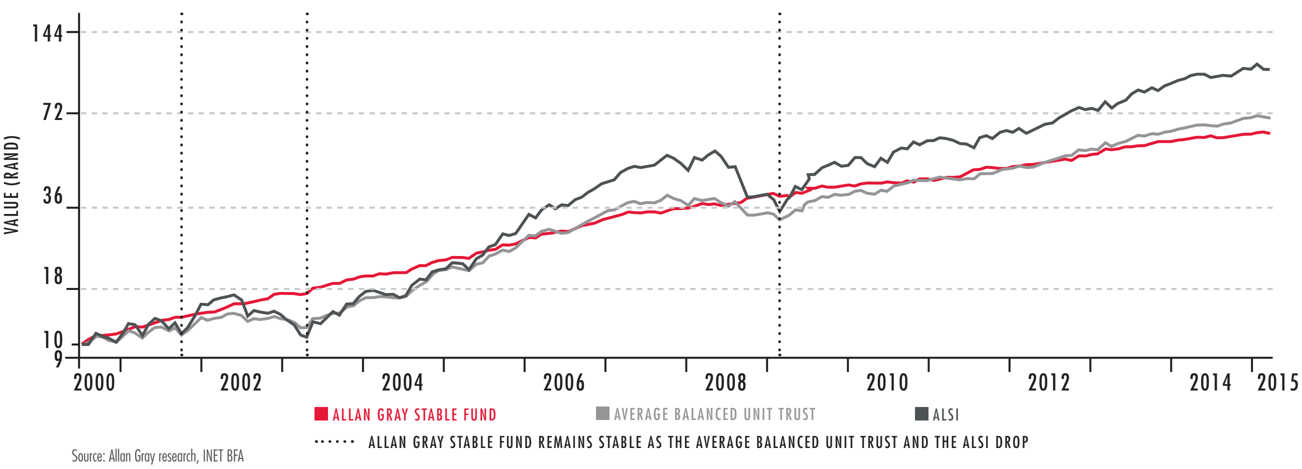
Therefore, the best that managers can do is to limit their participation in the market's negative performance. But is limiting the downside really worth sacrificing some upside?

Over periods that include a significant market decline, the benefits of this sacrifice are easier to see. In a bull market, however, the counter argument may be that the dominant trend is upwards, there are few negative periods to protect against, and therefore sacrificing positive returns for capital protection makes little sense. In actual fact, even during bull markets there tend to be a significant number of 'down' periods. For example, during the September 1998 to May 2002 bull market, 40% of the months were 'down' months, between May 2003 and May 2008 it was 30%, and since March 2009 it has been 36%.

Sacrificing some positive return in pursuit of capital protection is therefore a worthwhile investment strategy over the long term. While this may appear to be a conservative approach, it can often result in a better investment outcome than alternative investments that take a lot more risk.

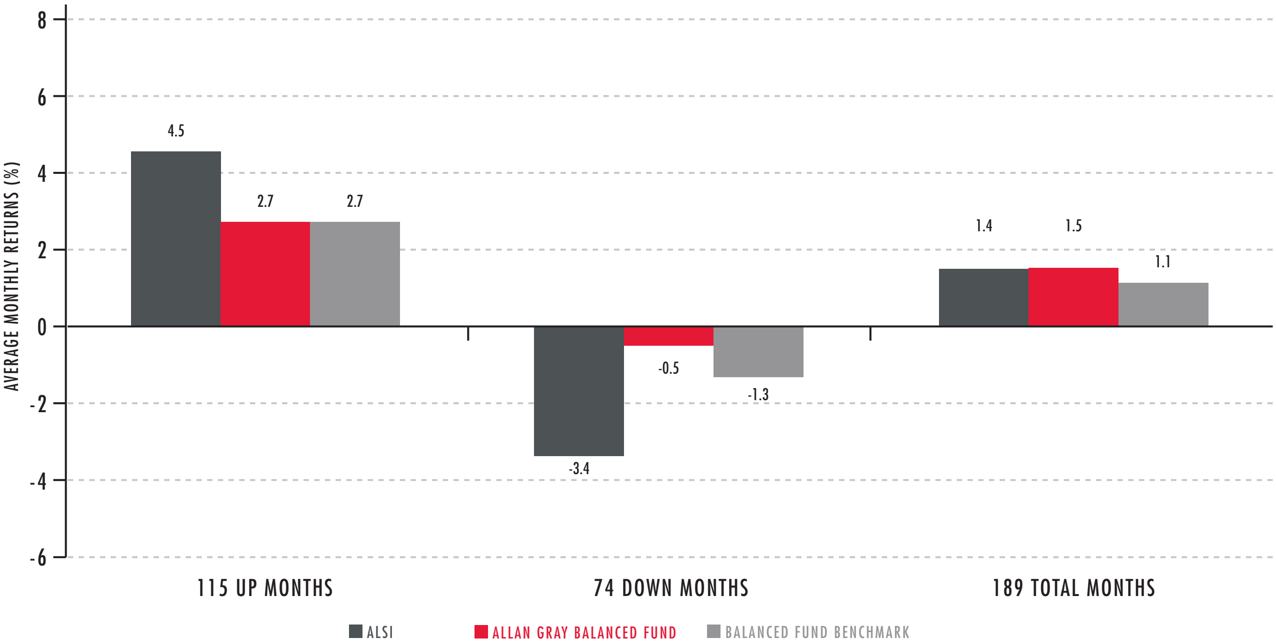
Graph 2 compares the performance of the Allan Gray Stable Fund (maximum 40% equity exposure) to both the ALSI and the average balanced unit trust

GRAPH 2 **ALLAN GRAY STABLE FUND PERFORMANCE SINCE INCEPTION VS THE ALSI AND AVERAGE BALANCED UNIT TRUST**



Source: Allan Gray research, INET BFA

GRAPH 3 **ALLAN GRAY BALANCED FUND VS THE ALSI IN POSITIVE MONTHS, NEGATIVE MONTHS AND THE COMBINED EFFECT**



Source: Allan Gray research, INET BFA

(maximum 75% equity exposure). Since the Stable Fund's inception, there have been three periods where the market has gone down. During all three, the Stable Fund has done what it says on the tin: taken on less risk and remained stable. This has resulted in the Stable Fund being ahead at all three points, with both the market and the average balanced unit trust often taking years to catch back up. This is deliberately a somewhat unfair comparison: the Stable Fund competes with much lower return peers than those included in the average balanced unit trust.

> **"WE ARE ALWAYS WILLING TO SACRIFICE SOME UPSIDE TO PROTECT YOUR INVESTMENT WHEN THE MARKET INEVITABLY MOVES DOWN."**

Our investment philosophy: capital protection built in

We use a 'bottom-up' approach when selecting investments, thoroughly analysing and understanding individual shares to identify those that are trading below what we identify as their intrinsic value. We are interested in the opportunity that each individual share presents. This differs to a 'top-down' approach, which uses broad macroeconomic and sector views as a starting point. In our Balanced and Stable Funds, we use the same 'bottom-up' analysis to invest only in those assets that we believe have a reasonable likelihood of outperforming cash.

By investing in undervalued assets, we aim to provide investors with return when the price reverts to its intrinsic value. This provides a level of capital protection. Investing only when the market price is well below intrinsic value (i.e. with a margin of safety) serves to further minimise the probability of capital losses, while increasing the potential level of future returns. In other words, the further the market price has already fallen relative to the true intrinsic value, the less likely it is to fall further and the greater the return that can be achieved before the market value equals the true intrinsic value. However, it is important to note that there will be periods where very few shares offer a margin of safety, even though there may be some shares trading at discounts to intrinsic value.

Capital protection in practice

Over the course of our history, consistently implementing our investment approach has allowed us to translate the theoretical benefits of capital protection into reality.

Graph 3 shows that since inception, the Allan Gray Balanced Fund has performed in line with the ALSI overall, but lost much less along the way. This can also be seen from the maximum drawdown and lowest annual return numbers, now shown at the back of this magazine in the performance tables. Our unit trusts typically experience smaller negative returns when the market goes down, helping them to outperform over the long term.

Balancing risk and reward

When deciding how to invest your money, we pay little attention to how our competitors choose to invest, the latest investment trends and even our benchmarks. While many managers define risk as the risk of being different, we believe that our contrarian philosophy and focus on capital protection make a positive difference to your investments.

With markets at current high levels, investors should not be surprised that there are fewer shares that meet our investment criteria. This has resulted in lower net equity weightings in our Balanced and Stable Funds, currently around 56% (versus a 75% maximum) and 17% (versus a 40% maximum) respectively, and a higher proportion of defensive shares (i.e. shares that tend to be less risky than the market) across our unit trusts.

We believe that our positioning has been, and continues to be, appropriate given the current balance between risk and reward. However, it has led to recent underperformance relative to our peers, as the market has continued to rise despite being expensive by historical standards, benefiting unit trusts holding a higher percentage in equities. Nevertheless, if our view that markets are expensive is proven correct, and our unit trusts protect your capital through the correction, then the returns that you have given up in the short term will be more than compensated for in the long term.

We are always willing to sacrifice some upside to protect your investment when the market inevitably moves down. We believe our approach gives you the best chance of growing your wealth over the long term.

Shaun joined Allan Gray in 2010 and is a business analyst in the Product Development team. He has a Bachelor of Business Science in Actuarial Science from UCT.

WANITA ISAACS

WHAT IS A PE RATIO?

Central to our investment philosophy at Allan Gray is buying shares that the market has priced below what we believe they are worth. We then sell these shares when they reach our estimate of a fair price. We arrive at our assessment of a fair share price by thoroughly researching all aspects of a company. One of the factors we consider is the 'price-to-earnings' (PE) ratio. Wanita Isaacs explains this concept.

A PE ratio helps to assess value

The PE ratio is what investors are willing to pay for a rand of earnings. To get the PE ratio you divide a company's share price by its earnings per share (EPS). Price means the actual price of the share on the stock exchange at a given point in time and represents what investors are willing to pay for that company. EPS represents the portion of the company's profits allocated to each share, i.e., the total profit divided by the number of shares in issue. If a company's share price is R120, and its EPS is R10, its PE would be 12. This means an investor would be willing to pay R12 for R1 of earnings. It is important to note that the PE is based on historic earnings.

The concept of normal earnings

One of the problems with taking a PE based on historic earnings at face value is that profits can be cyclical. For example, a commodity company that reported profits for the year ending six months ago would have earned these profits on commodity prices that are now, on average, 12 months old. If the commodity price has changed over the last 12 months, its current profit run-rate could be very much higher or lower than the last reported numbers, and the market would try to anticipate this change in the share price. This adjustment for anticipated changes in earnings would appear as a high or low PE.

Therefore, instead of using actual earnings, we prefer to assess the level of profitability and profit growth we think is sustainable over time, which we refer to as 'normalised' or 'trendline' earnings. This allows us to separate out two factors in estimating a share's fundamental value: our estimate of future earnings, and the price we would be prepared to pay for each rand of those earnings.

Ignoring the impact of short-term changes to profit, a higher PE ratio indicates perceived better growth prospects, or less risk to profits, than the average company. Thus, absent other factors, a company with a proven long-term track record of growing profits would normally trade at a high PE ratio and a company with low growth, or a patchy profit history, would trade at a lower PE ratio. Poor reporting, transparency or governance may affect investors' perception of risk and thus reduce the PE ratio they are prepared to pay for earnings.

Context counts

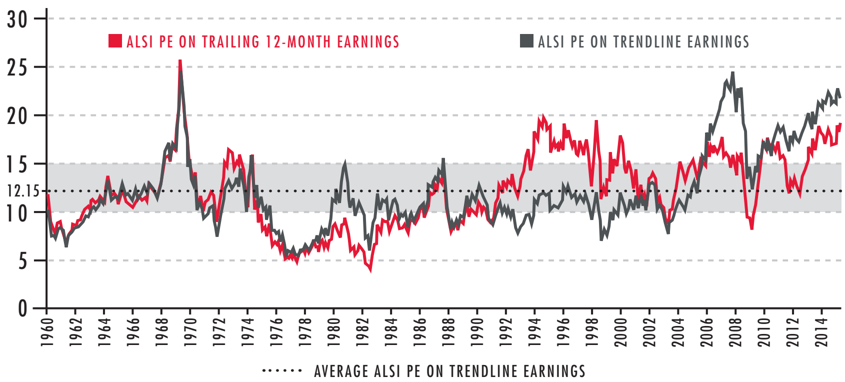
We also consider PE ratios in context. Firstly, we look at what other investments are available at the time. Interest rates on cash are low and the prices of bonds and property funds are high, and this may explain why current PE ratios are also high.

Secondly, we consider at what PE we think we may be able to buy or sell a share in the future. The long-term history of the FTSE/JSE All Share Index (ALSI) is shown in **Graph 1**. The trendline PE for the ALSI is currently 21x, well above the long-term average of 12x. Holding cash, even when it is not paying very much in interest, lets us buy shares in the future when they return to more normal valuations.

What can you do?

A 'balanced' unit trust, where the investment manager looks for the best value investments across different asset classes on your behalf, can provide you with some comfort, and protection from dramatic fluctuations in return. However, in an environment of high prices, you should still prepare yourself for less exciting returns that we have seen in the past.

GRAPH 1 **ALSI PE – BASED ON RECENT AND TRENDLINE EARNINGS**



Source: INET BFA and Allan Gray Research, data to 30.06.2015

Wanita was appointed as head of investor education at the start of 2013. Prior to that she was a business analyst in the Product Development team. She is a medical doctor and a UCT graduate and has been with Allan Gray since 2008.

ANTHONY FARR

ALLAN GRAY ORBIS FOUNDATION: A DECADE INTO THE JOURNEY

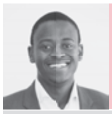
Ten years ago, in July 2005, the Allan Gray Orbis Foundation journey began. On reaching this milestone, Anthony Farr reflects on progress so far, acknowledging that the Foundation is still at the foothills of an overall vision that is unusually long-term in nature.

Little document, big ideas

As noted in the first Allan Gray Orbis Foundation update in Quarterly Commentary 2, 2007, the Foundation is the fruition of a vision germinated as far back as 1984 to give a 20% interest in the then partnership of Allan Gray Investment Counsel to the Allan Gray Development Trust to sponsor black entrepreneurs. Around 20 years later the Foundation emerged, directed by a three-page document capturing the proposed intent of the initiative, starting with the clear mission to promote prosperity through entrepreneurship in an integrated South Africa. This little document, which formed the basis of the Foundation's Trust Deed, has guided us remarkably well over the years – especially on the main tasks of selecting and developing entrepreneurial ability.

The document made the following comment on selection: 'The Foundation will fund an annual intake into the programme of about 100 students.' It took us a full 10 years to fulfil that objective when, at the end of 2014, we were able to select over 100 Candidate Fellows of the right quality.

Our selection journey has largely been symbolised by our iconic three-day camps that represent the final stage of selection. From the first camp at the UCT Graduate School of Business in December 2005, we have hosted camps on Robben Island, adjacent the Vredefort Dome and at a game reserve in Limpopo before settling on Maropeng, the Cradle of Humankind. There have been nearly 40 camps touching around 1 700 lives. During this time we have constantly refined our understanding of how to best select for entrepreneurial potential, always anchored in the Foundation's five pillars of intellectual imagination, personal initiative, spirit of significance, courageous commitment and achievement excellence. This has resulted in our 'success profile model', shown in **Image 1**, which appreciates the multifaceted nature of human endeavour.



LUDWICK MARISHANE: SOCIAL INNOVATOR

Founder & MD – Headboy Industries Inc. which produces DryBath® Gel and the Excel@Uni programme

BBusSc Finance & Accounting (UCT)

3 full-time owner-managers
10 temporary factory staff

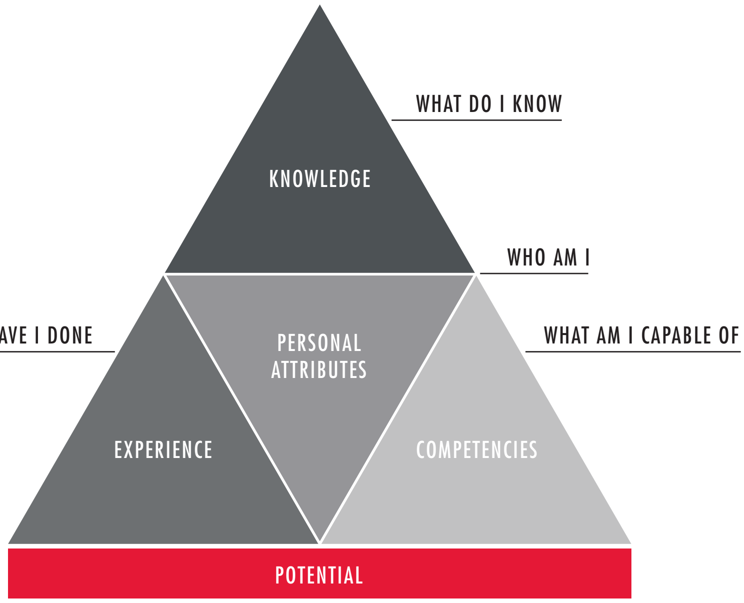
DryBath® Gel:

- The world's first bath-substituting® skin gel
- Predominantly sold online to US (60%) and EU (25%) – retailing in SA supermarkets late 2015
- A hygiene solution for the 2bn people with inadequate water access globally

Excel@Uni programme:

- Provides bursary students with effective support for their academic and professional development
- Has led to 10% increase in student academic marks, 75% decline in drop-out rates, 400% increase in employability

IMAGE 1 **SUCCESS PROFILE MODEL**



Source: Allan Gray Orbis Foundation

BRADLEY WATTRUS: A SMARTER WAY TO ACCEPT PAYMENTS

Co-founder & director – Yoco

Hons BSc ActSci (Wits)

Business owners should be able to get access to the tools they need to run their businesses and engage with their customers. Even today, many smaller businesses can't afford, or don't qualify for, basic traditional card terminal solutions.

Established in 2013, the Cape Town-based company Yoco is offering a simple, high-quality mobile point-of-sale application and card-reader that allows businesses to accept card payments, track their sales and manage their business both at their stores and on the go. Going beyond payments, Yoco is on a mission to make commerce delightful for buyers and sellers.

The same three-page document suggested that the Foundation would promote the development of entrepreneurs by creating a 'systematic programme focused on education, skill development, job placement and mentoring.' It envisaged that a holistic approach would be adopted towards the development of the Candidate Fellows, including 'a general socialisation to the business world, sensitisation to cultural diversity in our global society, and exposure to appropriate business ethics and values, including seminars and activities to promote practical skills development and networking amongst current and former Allan Gray Fellows.'

From paper to practice

The programme no longer sits only on a piece of paper, but lives across the nation, touching 10 universities in the main hubs of Gauteng, the Eastern Cape and the Western Cape. It looks to develop an exceptional, responsible, entrepreneurial mindset in the Candidate Fellows in their four years of the Fellowship, before inducting them into the Association of Allan Gray Fellows. This is achieved through a number of different types of interactions, including face-to-face sessions with the Foundation's Programme Officers, as well as a process to familiarise the Candidate Fellows with the opportunity recognition that is required for the entrepreneurial discovery process, framed into a platform known as 'Ignitions'. This system is quantified and culminates in an annual National Jamboree which showcases the best of these ideas. Over the last five years there have been 11 400 ignitions submitted by Candidate Allan Gray Fellows.

The ongoing development of appropriate mindsets has been facilitated by creating an online portal known as iShift, which explores the Foundation's 120 mindsets contributing to entrepreneurial success. Over the five years of iShift's existence, 10 500 mindset insights have been shared by the Candidate Fellows. These interventions, in addition to ongoing mentorship, community building and interaction with paradigm-shaping guest speakers, have led the Foundation on an intense exploration of the requirements for harnessing the fullness of entrepreneurial potential.

This is captured in our theory of change, which progresses from selection right through to creating enterprises that offer meaningful employment. Our journey has resulted in the Foundation becoming a founder member of the Global Entrepreneurship Research Network, which seeks to understand global best practice in assessing the effectiveness of entrepreneurship interventions.

Yet at some point potential must be translated into achievement – and it is in the final phase of the Foundation pipeline, the Association of Allan Gray Fellows, that this impact will be realised. To date there are 245 Allan Gray Fellows in the Association – and they have started to make their mark in a number of different fields. Examples of their impact are provided in the profiles in this article (see text boxes).

At the end of 2014, a prominent South African venture capitalist bemoaned the lack of entrepreneurial role models in South Africa after the success of Mark Shuttleworth nearly 17 years ago. He then went on to list six individuals whom he saw as the new entrepreneurial role models of South Africa. Two of those six were Allan Gray Fellows.

There is still a long, long way to go, but one of the early cornerstones of success is a community that carries within itself values that reflect the aspirations of the vision. After years of driving the expectations we had of Allan Gray Scholars and Fellows, the Association returned the favour by articulating its own leadership charter, as shown in **Image 2**. The learners have become the teachers.

SIYABULELA XUZA: ENERGY ENTREPRENEUR

- Masters Chemical Engineering (Harvard)
- NASA-affiliated Lincoln Laboratory named a giant asteroid near Jupiter after him
- Youngest member of an energy advisory panel to the African Union
- Patent for inventing a micro fuel cell able to charge a mobile phone for two weeks

As a 12-year old, Siya baked 'rocket fuel cookies' in his mother's kitchen in the Eastern Cape and was reprimanded for causing fires. With a few refinements, his rocket fuel won him the top prize at the Intel International Science and Engineering Fair. In his company, Galactic Energy Ventures, Siya combines entrepreneurship with renewable energy to foster sustainable African development.

IMAGE 2 **ASSOCIATION LEADERSHIP CHARTER**

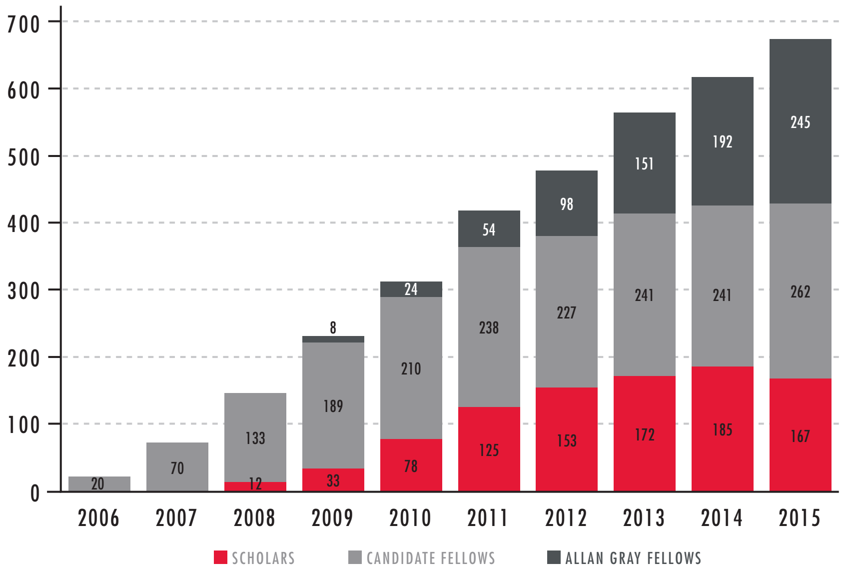
- Allan Gray Fellows live a **purpose-driven** life and believe in making a **long-term contribution** to the world they live in **through responsible entrepreneurship**
- Allan Gray Fellows are **humble**
- Allan Gray Fellows treat others with **empathy and respect**
- Allan Gray Fellows have the **courage to be pioneers** who **challenge the status quo**
- Allan Gray Fellows are **relentlessly resilient**
- Allan Gray Fellows are continuously **learning**, **improving and evolving**
- Allan Gray Fellows share their **knowledge and skills** with others
- Allan Gray Fellows **proactively take initiative**
- Allan Gray Fellows set **personal excellence** as a benchmark and strive to achieve this standard
- Allan Gray Fellows have a **lifelong entrepreneurial mindset** and have a **strong bias for entrepreneurial action**; converting **ideas into ventures**

From dream to reality

Many years before the Foundation offically opened its doors, Mr Gray dreamed of making a contribution to increase the levels of enterprise in South Africa as a powerful mechanism for attacking poverty in this country. The initial fruits of this vision are captured in **Graph 1**, the Foundation's 'assets under management.'

Nearly 700 individuals carry the aspirations of the Foundation to foster entrepreneurship for the common good. In the decades ahead the Foundation will continue building this pipeline without distraction, for in the words of a participant's journal in one of the first selection camps nine years ago: 'When chasing elephants, don't stop to throw stones at birds.'

GRAPH 1 **FOUNDATION BENEFICIARIES**



Source: Allan Gray Orbis Foundation

Allan Gray Orbis Foundation

Anthony is a qualified chartered accountant. Prior to joining the Allan Gray Orbis Foundation in 2005 he worked at the Starfish Greathearts Foundation.

NOTES

ALLAN GRAY BALANCED AND STABLE FUND ASSET ALLOCATION AS AT 30 JUNE 2015

	BALANCED FUND % OF PORTFOLIO			STABLE FUND % OF PORTFOLIO		
	TOTAL	SA	FOREIGN*	TOTAL	SA	FOREIGN*
Net equities	56.1	43.7	12.4	17.1	12.6	4.5
Hedged equities	13.4	2.3	11.1	33.8	16.0	17.8
Property	1.8	1.1	0.7	2.3	1.7	0.7
Commodity-linked	4.8	4.8	0.0	4.8	4.8	0.0
Bonds	12.8	11.6	1.2	11.9	10.9	1.0
Money market and bank deposits	11.1	8.7	2.3	30.2	27.2	3.0
TOTAL	**100.0**	**72.2**	**27.8**	**100.0**	**73.1**	**26.9**

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

* This includes African ex-SA assets.

ALLAN GRAY EQUITY FUND NET ASSETS AS AT 30 JUNE 2015

SECURITY (RANKED BY SECTOR)	MARKET VALUE (R MILLION)	% OF FUND	FTSE/JSE ALSI WEIGHT (%)
SOUTH AFRICA	**37 060**	**91.8**	
SOUTH AFRICAN EQUITIES	**35 970**	**89.1**	
RESOURCES	**2 571**	**6.4**	**13.6**
Anglo American	690	1.7	
Positions less than 1%	1 881	4.7	
FINANCIALS	**11 911**	**29.5**	**23.2**
Standard Bank	3 676	9.1	
Old Mutual	2 073	5.1	
Reinet Investments SCA	1 650	4.1	
Investec	1 295	3.2	
Rand Merchant Insurance[1]	685	1.7	
Positions less than 1%	2 532	6.3	
INDUSTRIALS	**21 272**	**52.7**	**63.2**
Sasol	4 095	10.1	
British American Tobacco	3 924	9.7	
SABMiller	2 861	7.1	
Remgro	1 567	3.9	
Naspers[2]	833	2.1	
Sappi	580	1.4	
Netcare	518	1.3	
Kap International	497	1.2	
Aspen	488	1.2	
Tongaat Hulett	397	1.0	
Mondi	393	1.0	
Nampak	379	0.9	
Super Group	368	0.9	
Positions less than 1%	4 372	10.8	
OTHER SECURITIES	**216**	**0.5**	
Positions less than 1%	216	0.5	
COMMODITY-LINKED SECURITIES	**659**	**1.6**	
Positions less than 1%	659	1.6	
MONEY MARKET AND BANK DEPOSITS	**430**	**1.1**	
FOREIGN	**3 331**	**8.2**	
EQUITY FUNDS	**2 924**	**7.2**	
Orbis Global Equity Fund	2 924	7.2	
MONEY MARKET AND BANK DEPOSITS	**406**	**1.0**	
TOTALS	**40 391**	**100.0**	

Note: There might be slight discrepancies in the totals due to rounding. Positions less then 1% include positions that are individually less than 1% of total JSE-listed equities, property and community-linked instruments held by the Fund.

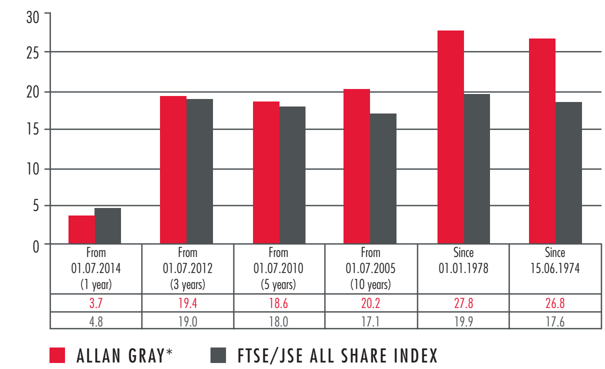
[1] Including positions in Rand Merchant Insurance stub certificates.
[2] Including positions in Naspers Limited – N stub certificates.

INVESTMENT TRACK RECORD – SHARE RETURNS

ALLAN GRAY PROPRIETARY LIMITED GLOBAL MANDATE SHARE RETURNS VS FTSE/JSE ALL SHARE INDEX

PERIOD	ALLAN GRAY*	FTSE/JSE ALL SHARE INDEX	OUT/UNDER-PERFORMANCE
1974 (from 15.06)	- 0.8	- 0.8	0.0
1975	23.7	- 18.9	42.6
1976	2.7	- 10.9	13.6
1977	38.2	20.6	17.6
1978	36.9	37.2	- 0.3
1979	86.9	94.4	- 7.5
1980	53.7	40.9	12.8
1981	23.2	0.8	22.4
1982	34.0	38.4	- 4.4
1983	41.0	14.4	26.6
1984	10.9	9.4	1.5
1985	59.2	42.0	17.2
1986	59.5	55.9	3.6
1987	9.1	- 4.3	13.4
1988	36.2	14.8	21.4
1989	58.1	55.7	2.4
1990	4.5	- 5.1	9.6
1991	30.0	31.1	- 1.1
1992	- 13.0	- 2.0	- 11.0
1993	57.5	54.7	2.8
1994	40.8	22.7	18.1
1995	16.2	8.8	7.4
1996	18.1	9.4	8.7
1997	- 17.4	- 4.5	- 12.9
1998	1.5	- 10.0	11.5
1999	122.4	61.4	61.0
2000	13.2	0.0	13.2
2001	38.1	29.3	8.8
2002	25.6	- 8.1	33.7
2003	29.4	16.1	13.3
2004	31.8	25.4	6.4
2005	56.5	47.3	9.2
2006	49.7	41.2	8.5
2007	17.6	19.2	- 1.6
2008	- 13.7	- 23.2	9.5
2009	27.0	32.1	- 5.1
2010	20.3	19.0	1.3
2011	9.9	2.6	7.3
2012	20.6	26.7	- 6.1
2013	24.3	21.4	2.9
2014	16.2	10.9	5.3
2015 (to 30.06)	3.9	5.6	- 1.7

RETURNS ANNUALISED TO 30.06.2015



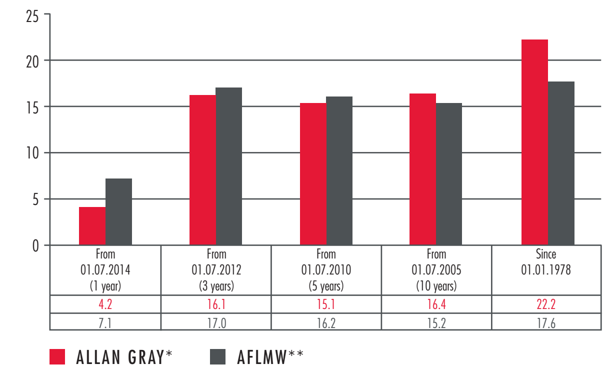
An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R171 599 777 by 30 June 2015. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R7 853 286. Returns are before fees.

INVESTMENT TRACK RECORD – BALANCED RETURNS

ALLAN GRAY PROPRIETARY LIMITED GLOBAL MANDATE TOTAL RETURNS VS ALEXANDER FORBES GLOBAL MANAGER WATCH

PERIOD	ALLAN GRAY*	AFLMW**	OUT/UNDER-PERFORMANCE
1974	–	–	–
1975	–	–	–
1976	–	–	–
1977	–	–	–
1978	34.5	28.0	6.5
1979	40.4	35.7	4.7
1980	36.2	15.4	20.8
1981	15.7	9.5	6.2
1982	25.3	26.2	- 0.9
1983	24.1	10.6	13.5
1984	9.9	6.3	3.6
1985	38.2	28.4	9.8
1986	40.3	39.9	0.4
1987	11.9	6.6	5.3
1988	22.7	19.4	3.3
1989	39.2	38.2	1.0
1990	11.6	8.0	3.6
1991	22.8	28.3	- 5.5
1992	1.2	7.6	- 6.4
1993	41.9	34.3	7.6
1994	27.5	18.8	8.7
1995	18.2	16.9	1.3
1996	13.5	10.3	3.2
1997	- 1.8	9.5	- 11.3
1998	6.9	- 1.0	7.9
1999	80.0	46.8	33.1
2000	21.7	7.6	14.1
2001	44.0	23.5	20.5
2002	13.4	- 3.6	17.1
2003	21.5	17.8	3.7
2004	21.8	28.1	- 6.3
2005	40.0	31.9	8.1
2006	35.6	31.7	3.9
2007	14.5	15.1	- 0.6
2008	- 1.1	- 12.3	11.2
2009	15.6	20.3	- 4.7
2010	11.7	14.5	- 2.8
2011	12.6	8.8	3.8
2012	15.1	20.0	- 4.9
2013	25.0	23.3	1.7
2014	10.3	10.3	0.0
2015 (to 30.06)	3.8	4.9	- 1.1

RETURNS ANNUALISED TO 30.06.2015



An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R18 178 543 by 30 June 2015. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R4 364 191. 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 from 1 April 2010 is the average of the non-investable Alexander Forbes Large Manager Watch. The return for June 2015 is an estimate.
Note: Listed property included from 1 July 2002. Inward listed included from November 2008 to November 2011.

ALLAN GRAY SOUTH AFRICAN UNIT TRUSTS ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 30 JUNE 2015 (NET OF FEES)

	ASSETS UNDER MANAGEMENT (R BILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR	HIGHEST ANNUAL RETURN[4]	LOWEST ANNUAL RETURN[4]
HIGH NET EQUITY EXPOSURE (100%)									
Allan Gray Equity Fund (AGEF)	40.4	01.10.1998	**25.4**	**17.3**	**16.3**	**17.1**	**2.1**	**125.8**	**– 20.7**
Average of South African - Equity - General category (excl. Allan Gray Funds)[1]			18.2	17.2	18.1	19.0	4.9	38.3	– 27.7
Allan Gray-Orbis Global Equity Feeder Fund (AGOE)	14.2	01.04.2005	**15.6**	**14.7**	**22.9**	**31.9**	**7.3**	**78.2**	**– 29.7**
FTSE World Index			14.2	13.7	23.8	30.0	15.8	54.2	– 32.7
MEDIUM NET EQUITY EXPOSURE (40% - 75%)									
Allan Gray Balanced Fund (AGBF)	106.2	01.10.1999	**18.6**	**14.6**	**13.9**	**15.0**	**3.8**	**46.1**	**– 8.3**
Average of South African - Multi Asset - High Equity category (excl. AGBF)[2]			13.8	13.1	13.9	15.1	6.9	41.9	– 16.7
Allan Gray-Orbis Global Fund of Funds (AGGF)	11.2	03.02.2004	**11.1**	**12.6**	**16.5**	**23.3**	**7.8**	**55.6**	**– 13.7**
60% of the FTSE World Index and 40% of the JP Morgan Global Government Bond Index			11.3	12.5	18.9	22.4	11.9	38.8	0.6
LOW NET EQUITY EXPOSURE (0% - 40%)									
Allan Gray Stable Fund (AGSF)	35.3	01.07.2000	**12.8**	**10.7**	**8.9**	**9.4**	**4.5**	**23.3**	**3.3**
Daily interest rate of FirstRand Bank Limited plus 2%			9.2	8.3	6.7	6.5	7.0	7.5	7.9
VERY LOW NET EQUITY EXPOSURE (0% - 20%)									
Allan Gray Optimal Fund (AGOF)	1.2	01.10.2002	**8.2**	**7.6**	**6.1**	**7.8**	**11.9**	**18.1**	**1.6**
Daily interest rate of FirstRand Bank Limited			6.6	6.1	4.6	4.4	4.9	11.9	4.4
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO)	1.0	02.03.2010	**9.8**	**–**	**11.2**	**15.8**	**4.8**	**39.6**	**– 8.4**
Average of US$ bank deposits and euro bank deposits			7.6	–	9.2	11.9	4.0	26.6	– 5.5
NO EQUITY EXPOSURE									
Allan Gray Bond Fund (AGBD)	0.7	01.10.2004	**9.1**	**8.6**	**8.9**	**6.9**	**8.2**	**18.0**	**– 0.5**
JSE All Bond Index (total return)			8.8	8.3	9.1	6.6	8.2	21.2	– 3.0
Allan Gray Money Market Fund (AGMF)	9.2	03.07.2001	**8.1**	**7.4**	**5.8**	**5.7**	**6.5**	**12.8**	**5.2**
Alexander Forbes Short-term Fixed Interest (STeFI) Composite Index[3]			8.0	7.3	5.7	5.7	6.3	13.3	5.2

[1] Since inception to 28 February 2015 the benchmark was the FTSE/JSE All Share Index including income.
[2] Since inception to 31 January 2013 the benchmark was the market value-weighted average return of the funds in both the Domestic Asset Allocation Medium Equity and Domestic Asset Allocation Variable Equity sectors of the previous ASISA Fund Classification Standard, excluding the Allan Gray Balanced Fund.
[3] Since inception to 31 March 2003, the benchmark was the Alexander Forbes 3-Month Deposit Index. From 1 April 2003 to 31 October 2011 the benchmark was the Domestic Fixed Interest Money Market Collective Investment Scheme sector excluding the Allan Gray Money Market Fund.
[4] This is the highest or lowest consecutive 12-month return the Fund has experienced since inception, along with the benchmark performance for the corresponding period. 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 FOR THE YEAR ENDING 30 JUNE 2015

	FEE FOR BENCHMARK PERFORMANCE	PERFORMANCE FEES	OTHER COSTS INCLUDING TRADING COSTS	VAT	TOTAL EXPENSE RATIO
Allan Gray Equity Fund	1.37%	0.50%	0.05%	0.26%	2.18%
Allan Gray-Orbis Global Equity Feeder Fund	1.50%	0.68%	0.22%	0.00%	2.40%
Allan Gray Balanced Fund	1.07%	0.27%	0.09%	0.13%	1.56%
Allan Gray-Orbis Global Fund of Funds	1.30%	0.33%	0.25%	0.00%	1.88%
Allan Gray Stable Fund	1.03%	0.38%	0.09%	0.16%	1.66%
Allan Gray Optimal Fund	1.00%	1.35%	0.14%	0.34%	2.83%
Allan Gray-Orbis Global Optimal Fund of Funds	1.00%	0.01%	0.23%	0.00%	1.24%
Allan Gray Bond Fund	0.25%	0.09%	0.02%	0.05%	0.41%
Allan Gray Money Market Fund	0.25%	N/A	0.00%	0.04%	0.29%

The Total Expense Ratio (TER) is the percentage of the Fund's average assets under management that has been used to pay the Fund's operating expenses over the past year. The TER includes the annual management fees that have been charged (both the fee at benchmark and any performance component charged), trading costs (including brokerage, Securities Transfer Tax (STT), STRATE and FSB Investor Protection Levy), VAT and other expenses. Since unit trust expenses vary, the current TER cannot be used as an indication of future TERs. The Fund's performance figures are quoted after the deduction of costs incurred within the Fund so the TER is not a new cost. 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. TERs should then be used to evaluate whether the Fund performance offers value for money.

FOREIGN DOMICILED FUNDS ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 30 JUNE 2015 (NET OF FEES)

	ASSETS UNDER MANAGEMENT (R BILLION)	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR	HIGHEST ANNUAL RETURN[4]	LOWEST ANNUAL RETURN[4]
HIGH NET EQUITY EXPOSURE									
Orbis Global Equity Fund FTSE World Index	97.1	01.01.1990	**19.1** 13.6	**15.0** 13.6	**22.9** 23.8	**32.0** 30.0	**6.2** 15.3	**87.6** 33.2	**– 47.5** – 46.2
Orbis SICAV Japan Equity (Yen) Fund Tokyo Stock Price Index	22.2	01.01.1998	**15.6** 9.4	**12.9** 10.6	**21.5** 19.9	**28.8** 29.7	**18.4** 24.3	**94.9** 91.0	**– 40.1** – 46.4
Orbis SICAV Asia ex-Japan Equity Fund MSCI Asia ex-Japan Index	32.8	01.01.2006	**17.5** 15.9	- -	**19.9** 17.7	**26.2** 25.1	**8.9** 18.4	**58.6** 34.1	**– 34.2** – 39.7
Allan Gray Africa ex-SA Equity Fund Standard Bank Africa Total Return Index	3.0	01.01.2012	**22.7** 9.2	- -	- -	**22.0** 7.8	**– 14.2** – 19.2	**65.7** 31.8	**– 14.2** – 19.2
Allan Gray Australia Equity Fund S&P/ASX 300 Accumulation Index	7.0	04.05.2006	**14.6** 13.2	- -	**19.2** 17.8	**18.7** 19.1	**– 7.5** – 1.7	**99.5** 55.5	**– 55.4** – 45.1
MEDIUM NET EQUITY EXPOSURE									
Orbis SICAV Global Balanced Fund 60% MSCI World Index with net dividends reinvested and 40% JP Morgan Global Government Bond Index	20.1	01.01.2013	**26.0** 23.0	- -	- -	- -	**8.9** 11.7	**54.4** 40.2	**2.3** 7.1
LOW NET EQUITY EXPOSURE									
Allan Gray Australia Opportunity Fund Reserve Bank of Australia cash rate	0.8	01.07.2011	**13.6** 9.9	- -	- -	**11.0** 6.7	**– 4.4** – 4.7	**32.7** 25.4	**– 4.4** – 4.7
VERY LOW NET EQUITY EXPOSURE									
Orbis Optimal SA Fund-US$ Class US$ Bank Deposits	18.6	01.01.2005	**11.3** 9.5	**9.7** 8.0	**11.2** 9.8	**17.4** 14.3	**9.3** 14.3	**48.6** 57.9	**– 15.7** – 25.3
Orbis Optimal SA Fund-Euro Class Euro Bank Deposits	8.3	01.01.2005	**9.0** 7.2	**8.5** 7.0	**9.4** 8.0	**12.9** 9.3	**– 8.0** – 7.2	**44.1** 29.2	**– 19.2** – 15.1

[4] This is the highest or lowest consecutive 12-month return the Fund has experienced since inception, along with the benchmark performance for the corresponding period. All rolling 12-month figures for the Fund and the benchmark are available from our Client Service Centre on request.

SOUTH AFRICAN INSTITUTIONAL PORTFOLIOS[5] ANNUALISED PERFORMANCE (RAND) IN PERCENTAGE PER ANNUM TO 30 JUNE 2015

	ASSETS UNDER MANAGEMENT (R BILLION)[6]	INCEPTION DATE	SINCE INCEPTION	10 YEARS	5 YEARS	3 YEARS	1 YEAR
LOCAL PORTFOLIOS[7] (BEFORE LOCAL FEES)							
Domestic Equity Composite (minimum net equity 75% - 95%)	**63.0**	**01.01.1990**	**21.4**	**19.9**	**17.4**	**18.3**	**3.4**
Domestic Equity Pooled Portfolio (minimum net equity 90%)	**6.1**	**01.02.2001**	**22.8**	**20.1**	**18.0**	**19.2**	**3.3**
FTSE/JSE All Share Index			15.2/16.3	17.1	18.0	19.0	4.8
Domestic Balanced Composite	**21.6**	**01.01.1978**	**22.5**	**16.7**	**13.8**	**13.6**	**4.2**
Domestic Balanced Pooled Portfolio	**3.0**	**01.09.2001**	**19.1**	**16.9**	**14.1**	**13.7**	**4.1**
Mean of Alexander Forbes SA Large Manager Watch (Non-Investable)[8]			17.9/16.3	15.4	14.9	14.2	5.6
Domestic Stable Composite	**6.3**	**01.12.2001**	**13.4**	**11.8**	**8.3**	**8.1**	**5.3**
Domestic Stable Pooled Portfolio	**2.0**	**01.12.2001**	**13.7**	**12.0**	**8.3**	**8.1**	**5.2**
Alexander Forbes Three-Month Deposit Index plus 2%			10.1	9.3	7.6	7.5	8.1
GLOBAL PORTFOLIOS[7], LIMITED TO 25% FOREIGN EXPOSURE (BEFORE LOCAL, BUT AFTER FOREIGN FEES)							
Global Balanced Composite	**73.0**	**01.01.1978**	**22.2**	**16.4**	**15.1**	**16.1**	**4.2**
Global Balanced Pooled Portfolio	**36.3**	**01.09.2000**	**19.3**	**16.5**	**15.2**	**16.3**	**4.1**
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[8,9]			17.6/15.2	15.2	16.2	17.0	7.1
Global Stable Composite	**5.9**	**15.07.2004**	**13.0**	**12.0**	**9.9**	**10.6**	**4.9**
Global Stable Pooled Portfolio	**5.2**	**15.07.2004**	**13.0**	**12.0**	**10.0**	**10.7**	**4.9**
Alexander Forbes Three-Month Deposit Index plus 2%			9.3	9.3	7.6	7.5	8.1
Global Absolute Composite	**10.3**	**01.03.2004**	**16.3**	**15.6**	**10.6**	**11.2**	**5.4**
Global Absolute Pooled Portfolio	**3.6**	**01.03.2004**	**16.5**	**15.9**	**10.7**	**11.2**	**5.4**
Mean of Alexander Forbes Global Large Manager Watch (Non-Investable)[8]			16.4	15.2	16.2	17.0	7.1
FOREIGN ONLY PORTFOLIOS[7] (AFTER FEES)							
Orbis Global Equity Fund[10]	**97.1**	**01.01.1990**	**19.1**	**15.0**	**22.9**	**32.0**	**6.2**
Orbis Global Equity Pooled Portfolio	**0.9**	**18.05.2004**	**15.2**	**14.9**	**22.8**	**31.9**	**6.3**
FTSE World Index			13.6/13.9	13.6	23.8	30.0	15.3
Foreign Balanced Composite[11]	**4.6**	**23.05.1996**	**14.6**	**12.2**	**15.8**	**22.2**	**4.0**
Foreign Balanced Pooled Portfolio	**0.9**	**23.01.2002**	**8.3**	**12.1**	**15.5**	**21.9**	**3.6**
60% MSCI World Index[12] and 40% JP Morgan Global Government Bond Index			12.1/7.2	12.4	18.6	22.2	11.6

PERFORMANCE AS CALCULATED BY ALLAN GRAY

[5] The composites not listed here include: Domestic Balanced Absolute, Domestic Balanced Low Equity, Domestic Balanced Stable Namibia, Domestic Equity MSCI SA, Domestic Equity Namibia, Domestic Money Market, Domestic Optimal, Domestic Tax Paying, Global Balanced High Foreign, Global Balanced Namibia 35% High Foreign, Global Tax Paying and Non Discretionary Foreign.
[6] The assets under management for institutional portfolios not listed here amount to R69.5bn.
[7] The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate.
[8] The return for the period ending June 2015 is an estimate as the relevant survey results have not yet been released.
[9] Since inception to 31 December 1997 the Consulting Actuaries Survey returns were used.
[10] The total assets under management for the Fund is shown, which includes institutional and retail clients that invest directly with Orbis.
[11] Since inception to 31 August 2001 the foreign carve-out returns of the Global Balanced Composite were used.
[12] Morgan Stanley Capital International All Country World Index.

IMPORTANT INFORMATION FOR INVESTORS

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. The Management Company is a member of the Association for Savings & Investment South Africa (ASISA). Allan Gray Proprietary Limited (the 'Investment Manager') is an authorised financial services provider and member of ASISA. Collective Investment Schemes in Securities (unit trusts or funds) are generally medium- to long-term investments. Except for the Allan Gray Money Market Fund, where the Investment Manager aims to maintain a constant unit price, the value of units may go down as well as up. Past performance is not necessarily a guide to future performance. The Management Company does not provide any guarantee regarding the capital or the performance of its unit trusts. Funds may be closed to new investments at any time in order for them to be managed according to their mandates. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees, charges and maximum commissions is available on request from the Management Company.

PERFORMANCE

Performance figures are for lump sum investments with income distributions reinvested. Actual investor performance may differ as a result of the investment date, the date of reinvestment and dividend withholding tax. Movements in exchange rates may also be the cause of the value of underlying international investments going up or down. Different classes of units apply to the Equity, Balanced, Stable and Optimal funds only and are subject to different fees and charges. Unit trust prices are calculated on a net asset value basis, which is the total market value of all assets in the Fund including any income accruals and less any permissible deductions from the Fund, divided by the number of units in issue. Forward pricing is used and fund valuations take place at approximately 16:00 each business day. Purchase and redemption requests must be received by 14:00 each business day to receive that day's price. Unit trust prices are available daily on www.allangray.co.za. Permissible deductions 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 the Management Company.

BENCHMARKS

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

UNDERSTANDING THE FUNDS

Investors must make sure that they understand the nature of their choice of funds and that their investment objectives are aligned with those of the Fund/s they select.

A feeder fund is a unit trust that invests in another single unit trust which charges its own fees. A fund of funds is a unit trust that invests in other unit trusts, which charge their own fees. Allan Gray does not charge any additional fees in its feeder fund or funds 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 LIVING ANNUITY AND ENDOWMENT

The Allan Gray Retirement Annuity Fund, the Allan Gray Pension Preservation Fund and the Allan Gray Provident Preservation Fund are all administered by Allan Gray Investment Services Proprietary Limited, an authorised administrative financial services provider. The Allan Gray Living Annuity and the Allan Gray Endowment are underwritten by Allan Gray Life Limited, also an authorised financial services provider and licensed under the Long-Term Insurance Act 52 of 1998. The underlying investment options of the Allan Gray individual life and retirement products are portfolios of Collective Investment Schemes in Securities (unit trusts or funds).

THE ALLAN GRAY GROUP	
UNIT TRUSTS	A unit trust is a savings vehicle for investors who want to grow their money and may want to access it before they retire. Unit trusts allow investors to pool their money with other investors who have similar investment objectives. Unit trusts are also known as 'portfolios of collective investment schemes' or 'funds'. Allan Gray has nine funds in its South African stable: Equity, Balanced, Stable, Optimal, Money Market, Bond, Global Equity Feeder, Global Fund of Funds and Global Optimal Fund of Funds.
RETIREMENT ANNUITY*	The Allan Gray Retirement Annuity Fund (RA) is a savings vehicle for investors looking for a flexible, tax-efficient way to save for retirement. Investors can only access their money when they retire. Individually owned RAs can be managed on a group basis, offering employers a flexible solution to the challenge of retirement funding for their staff.
PRESERVATION FUNDS*	The Allan Gray Pension Preservation and Provident Preservation funds are savings vehicles for investors looking for a tax-efficient way to preserve existing retirement benefits when they leave a pension or provident fund, either as a result of a change in employment (e.g. retrenchment or resignation), or when they transfer from another preservation fund.
ENDOWMENT*	The Allan Gray Endowment Policy is a savings policy for investors who want a tax-efficient way to save and wish to create liquidity in their estate.
LIVING ANNUITY*	The Allan Gray Living Annuity gives investors flexibility, within certain regulatory limits, to select an annuity best suited to their income needs after retirement. A living annuity provides investors with a regular income which is not guaranteed, and which is funded by growth on capital and income from interest and dividends.
OFFSHORE FUNDS	Allan Gray International manages Bermuda-listed portfolios in equities and bonds covering the continent of Africa. Through our partnership with Orbis we also offer you a cost-effective way to diversify your portfolio by investing internationally. There are two options for investing offshore through Allan Gray: invest in rand-denominated offshore funds without the need to use your offshore investment allowance, or use your offshore investment allowance to invest in foreign funds.
PLATFORM – LOCAL AND OFFSHORE	Our investment platform provides you with access to all of our products, as well as a focused range of unit trusts from other fund providers. The platform enables you to buy, sell and switch – usually at no charge – between the funds as your needs and objectives change. South African investors who wish to diversify their portfolios can also access funds from certain other offshore fund providers via the same platform.
LIFE POOLED PORTFOLIOS	The minimum investment per client is R20 million. Mandates include risk-profiled pooled portfolios: Stable Portfolio, Balanced Portfolio and Absolute Portfolio; asset class pooled portfolios: Money Market, Equity and Foreign, and finally an Optimal Portfolio.
SEGREGATED PORTFOLIOS	The minimum portfolio size is R500 million. Mandates are of a balanced or asset class specific nature.
BOTSWANA	Allan Gray Botswana manages institutional portfolios on a segregated basis and offers our range of nine South African unit trusts to individual investors.
NAMIBIA	Allan Gray Namibia offers institutional portfolios on a segregated and pooled basis and the Allan Gray Namibia Balanced Fund is available for institutions, retirement funds and individuals.
SWAZILAND	Allan Gray Swaziland manages institutional portfolios on a segregated basis.
ALLAN GRAY ORBIS FOUNDATION	Allan Gray Orbis Foundation is a non-profit organisation that was established in 2005 as an education and development catalyst. It seeks to foster a next generation of high-impact leaders and entrepreneurs for the ultimate purpose of increased job creation in Southern Africa. The Foundation focuses on educational and experiential methods at the secondary and tertiary levels to realise the potential of bright young minds. Through its highly-researched learning programmes, it intends to equip talented young individuals with the skills, attitudes and motivation to have a significant future impact.
E^2	E^2 stands for 'excellence in entrepreneurship' and as a long-term capital fund its purpose is to provide substantial financing to entrepreneurs who are graduates of the Allan Gray Orbis Foundation's Fellowship Programme. In addition, E^2 provides financing for social entrepreneurs who demonstrate exceptional leadership and creative initiative in the not-for-profit sectors.

*This product has unit trusts as its underlying investment option.

NOTES

Directors

Executive

M Cooper	BBusSc FIA FASSA
R W Dower	BSc (Eng) MBA
I S Liddle	BBusSc (Hons) CFA
T Mhlambiso	AB MBA JD

Non-Executive

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T J Mahuma	BA (Hons) MPhil
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