QC
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ALLAN GRAY



# On the commodity boom and other South African fables (and foibles)

# CONTENTS

## COMMENTS FROM THE CHIEF OPERATING OFFICER

**Mahesh Cooper**

… despite all the changes we have experienced and adaptations we have had to endure, the business remains true to being focused on generating long-term wealth for our clients.

I am in the privileged position of returning to Allan Gray after having left just over five years ago. Even though five years may not seem like a long time in the bigger scheme of things, it is incredible how the world has changed in those five years, and particularly in the last three. Personally, I draw comfort from the fact that, despite all the changes we have experienced and adaptations we have had to endure, the business remains true to being focused on generating long-term wealth for our clients.

This is a function of an unchanging investment philosophy, which has remained the same since the firm was founded in 1973. An investment philosophy is essentially how an asset manager thinks about investments; it is a set of principles that guide the investment process. An asset manager should be confident in their investment philosophy and it should be applied consistently, regardless of market conditions. This means that there will be times when their investment philosophy is out of favour with the markets, resulting in underperformance. However, the real test of conviction is whether the asset manager stays true to their investment philosophy in the face of that underperformance.

### Volatility persists

There has been no respite from the extreme events the world has had to face in the last six months, be it war, or closer to home, devastating flooding, surging fuel prices, high inflation and rising interest rates or falling asset prices. Given the current highly volatile state of the world, this quarter we include both a local and global positioning piece. Importantly, while we adopt a bottom-up approach to investing, which focuses on business fundamentals and value, we don't ignore economic factors; we understand that we must be cognisant of the environment in which we make investment decisions. Sandy McGregor discusses the increasingly turbulent response of global financial markets to rapidly rising inflation, while Thalia Petousis cautions us against pinning our hopes on strong commodity prices entirely alleviating South Africa's fiscal woes.

In their piece, Gladness Rupare and Martine Damonse unpack how we build resilient multi-asset class portfolios, like our Balanced Fund, in light of such extreme events. Falling asset prices provide opportunities for stockpickers like ourselves and our offshore partner, Orbis.

Graeme Forster, from Orbis, shares some insight into how Orbis currently sees sources of risk and opportunity in the global markets. Given the increased focus on environmental, social and governance factors, Raine Adams reminds us of our approach to responsible investing in the context of our investment philosophy.

> … we adopt a bottom-up approach to investing, which focuses on business fundamentals and value …

The past two and a half COVID-affected years serve as a reminder of the frailty of life. In this quarter's Investing Tutorial, Felicia Hlophe outlines what we should be thinking about with regard to our children and our investments when we are no longer around.

### Farewell to Rob Formby

Finally, I would like to take this opportunity to thank Rob Formby for his 13 years of committed service as he passes the baton to me. He has steered the firm ably through the pandemic and all its associated challenges with a characteristic calm and steady approach. His focus on continual improvement and disciplined execution will be felt across the business for many years to come.

I would also like to thank all of you for your trust and commitment and to pledge mine as I settle into my new role.

Kind regards

Mahesh Cooper

# WHITHER INFLATION?

**Sandy McGregor**

A decade of inappropriate monetary policy is taking its toll. The inflation genie is out the bottle.

*In the past 12 months, global inflation has surged. Sandy McGregor discusses the increasingly turbulent response of the financial markets.*

In Sir Arthur Conan Doyle's short story *Silver Blaze* there is the following conversation between Sherlock Holmes and Mr Gregory, a Scotland Yard detective:

Gregory: *"Is there any other point to which you would wish to draw my attention?"*

Holmes: *"To the curious incident of the dog in the night-time."*

Gregory: *"The dog did nothing in the night-time."*

Holmes: *"That was the curious incident."*

## The dog that did not bark

When one contemplates the response of interest rates to the biggest surge in inflation in more than 40 years, the dog that did not bark in the night comes to mind. In the 12 months to February 2021, US consumer prices increased 1.7%, equal to the average inflation rate of the previous decade. By June 2022, US inflation had reached 9.1%. The yield on 10-year US government bonds, which was at a low of 0.55% in August 2020, responded by moving inexorably upwards, and surged to 3.5% in the week after the May inflation print was announced on 10 June, before retreating to about 3.0%.

Europe faces similar inflationary pressures, with eurozone inflation reaching 8.6% in June. Its bond yields have reacted similarly. However, after adjusting for current inflation, real bond yields are at historical lows only equalled immediately after the end of the Second World War. Given the magnitude and widespread nature of this inflation, the response of the bond markets must be regarded as muted. The bond market dog has started to bark, but not very loudly. This raises the question: Are developed economy bond investors presciently anticipating a return to price stability or are they delusional?

## Central banks abandon the transitory narrative

During 2021, as month after month the prices of goods and services rapidly increased, there was a growing debate among market participants as to whether this inflation was going to be transitory or prove persistent.

Initially, developed economy central banks were firmly in the transitory camp and downplayed inflationary risks. Probably a significant reason for their complacency was that they were inappropriately positioned for an inflation shock, with short-term policy rates at zero or even negative.

Investors often persist with an investment strategy in which they strongly believe long after it has proved to be wrong. Central banks are very conventional organisations and are equally prone to such mistakes. Most developed market central banks have been operating on models that have been totally discredited by events. By the middle of 2021, as inflation continued to surprise on the upside, doubts started to emerge and in October, the Federal Reserve Board (the Fed) announced that by March 2022 it would end its US$120bn per month asset purchase programme and then embark on a cycle of rate hikes. This it has done. The pace at which rates are being increased has been accelerated from the originally envisaged 0.25% at each of the Federal Open Market Committee (FOMC) meetings. An increase on 4 May of 0.5% was followed on 15 June by a 0.75% hike, which together brought its policy rate up to 1.5%.

> An important lesson relevant to our present crisis is that in 1982 inflation was brought under control not by higher interest rates themselves, but by a recession triggered by higher rates.

The language emanating from the Fed is becoming increasingly hawkish. At the 15 June meeting, members of the FOMC were forecasting that their policy rate at the end of 2022 would be 3.4%. In testimony to Congress on 22 June, Fed Chairman Jerome Powell said rate increases would continue until there was compelling evidence that inflation was returning to the Fed's 2% target.

The Bank of England (BoE) has also initiated a series of rate hikes and the European Central Bank (ECB) has done the same, bringing its policy rate back to zero, ending eight years of negative rates. Among major central banks, only those in Japan and China persist with an easy money policy. The Bank of Japan (BoJ) has continued its asset purchase programme to keep the long-term Japanese government bond yield at 0.25%. However, as this has caused serious depreciation of the yen versus other currencies, increasingly the policy stance of the BoJ is being questioned.

### Neutral rates

With most central banks abandoning a flawed zero interest rate policy, the debate is now about what is an appropriate short-term rate in current circumstances. Interest rates at or below zero no longer have many proponents outside Japan and China but there is no agreement as to what rates should be.

Economists postulate that there is a neutral rate, at which monetary policy is neither expansionary nor contractionary. Currently the Fed thinks that in the United States, if output is close to potential and inflation is 2%, an appropriate neutral rate will be somewhere between 2% and 3%. The BoE and the ECB also target inflation at about 2%. The BoE assumes the neutral nominal rate required to achieve this target lies between 1.25% and 2.5%. The ECB believes that in the eurozone the real neutral rate is negative and that its nominal neutral rate is somewhere between 1% and 2%.

Prior to the 10 June announcement of US inflation, in May 10-year government bond yields were roughly equal to these neutral rate assumptions, which suggests large numbers of investors believed these rates to be the ultimate endgame and that current inflation will indeed prove transitory. The turbulent market response to unexpectedly high inflation in May suggests doubts regarding this optimistic prognostication are increasing.

A problem is that a neutral rate is a theoretical construct, the value of which is impossible to determine with any accuracy. No one knows what the neutral rate is. The economy is a complex feedback loop, which makes such certainty impossible. Neutrality is a moving target. Between 1980 and 2020 there was a secular decline in inflation, which implied neutral rates also declined. This virtuous trend has come to an end and neutral rates are on the rise. Furthermore, merely increasing policy rates to the prevailing estimate of neutrality is unlikely of itself to bring the current surge in prices under control; much higher rates probably will be required. This was the experience in the 1970s, when inflation was elevated for a decade, and aggressive action by Fed Chairman Paul Volcker was needed to restore price stability.

## Inflation in the United States in the 1970s

As can be seen in **Graph 1**, inflation in the United States in the 1970s came in three waves. The first wave commenced in 1968 and peaked at 6.4% in 1970, the second peaked at 11.7% early in 1975 and the third peaked at 14.3% in 1980.

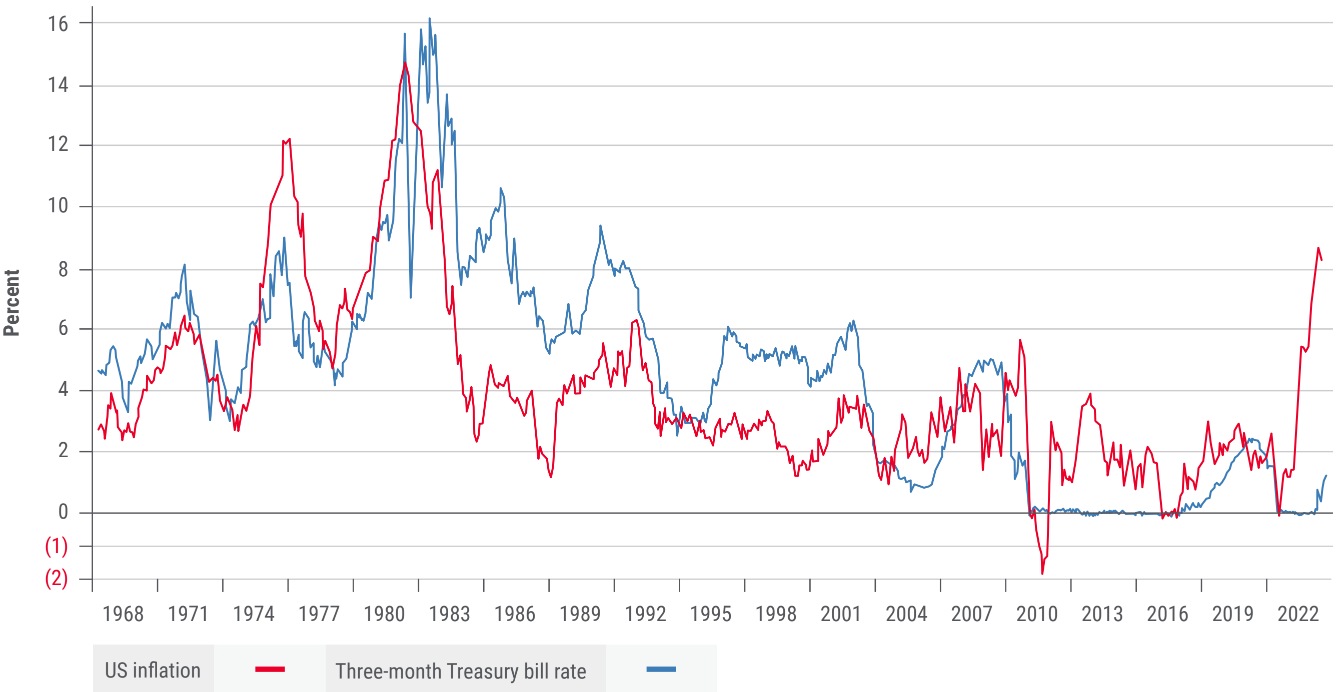
When money lacks value, it is used imprudently, promoting an inefficient allocation of resources, which further contributes to inflation.

While oil price shocks were important causes of the second and third waves, spiralling wages in response to an increased cost of living were also to blame. It was normal practice to index wage agreements between employers and employees to inflation, which automatically created an inflationary spiral. Business responded to higher operating costs with increased prices. Inflation generated more inflation.

While at any one time a particular cost increase may have predominated, the upward pressure on prices became widespread. Between 1973 and 1979 this was aggravated by the Fed keeping its policy rate substantially lower than inflation (see **Graph 2**). When money lacks value, it is used imprudently, promoting an inefficient allocation of resources, which further contributes to inflation. An inflationary mindset had become totally entrenched and economic decisions were being made assuming that inflation was a permanent reality.

Something had to be done. On 6 August 1979, President Jimmy Carter appointed Paul Volcker to be chairman of the Fed, replacing William Miller, who had totally lost the confidence of the financial markets. Volcker acted rapidly to increase the Fed's policy rate. In June 1981, the federal funds rate reached 20% and the prime lending rate of banks 21.5%. The US economy entered a severe recession. Unemployment soared, reaching 10.8% at the end of 1982. But the inflationary spiral was broken. In August 1983, US inflation was 2.4% and it remained subdued for 37 years until our present troubles started in 2021. Volcker realised that inflation was caused by demand for goods and services exceeding the economy's ability

## Graph 1: US inflation vs. three-month Treasury bill rate




**Source:** IRESS

to supply them. He used high interest rates to force a recession, which reduced demand, thereby eliminating the imbalances causing inflation. He subsequently kept the federal funds rate substantially higher than inflation, so ensuring that monetary policy continued to promote price stability. An important lesson relevant to our present crisis is that in 1982 inflation was brought under control not by higher interest rates themselves, but by a recession triggered by higher rates.

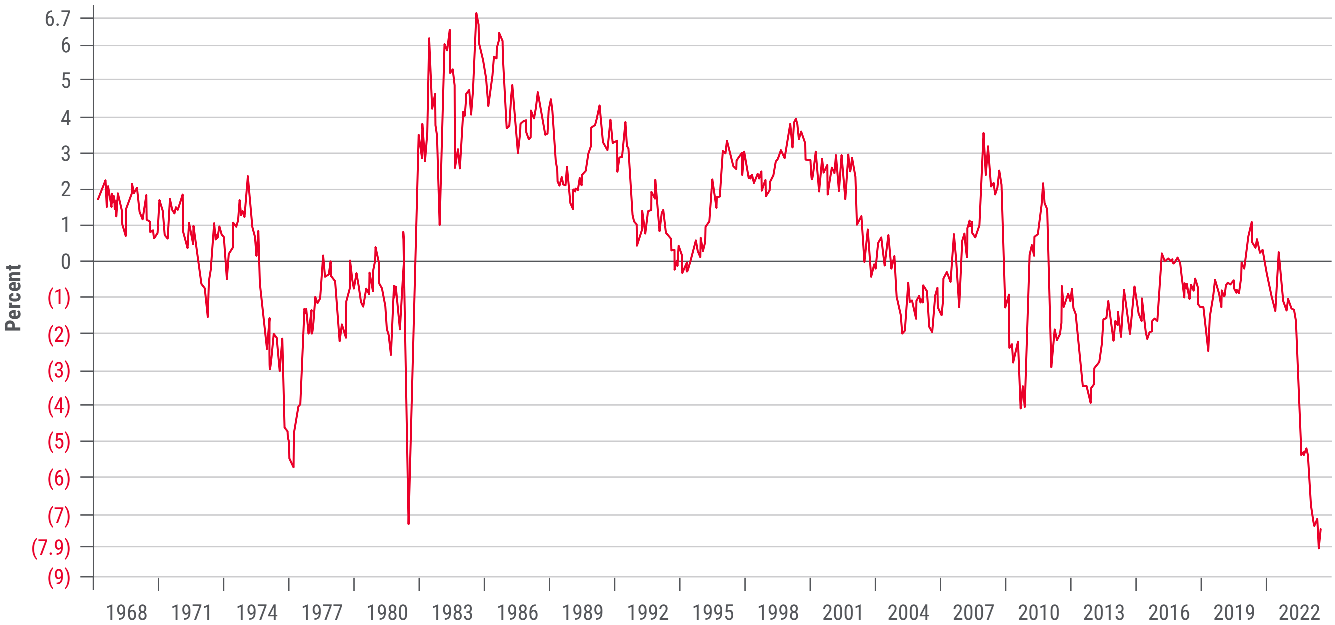
## The current outlook for inflation

Currently inflationary pressures are extremely widespread and diverse. They include the war in Ukraine, elevated energy prices, a global food shortage, supply chain disruptions, notably a shortage of computer chips and fertilisers, transport congestion, and labour shortages. Among the larger economies, inflation is highest in the United States, whose fiscal response to the pandemic exceeded that of any other country. This created a pool of excess savings waiting to be spent. US banks have over US$1.3tn excess reserves deposited with the Fed, which they can use to boost lending. However, this is not only an American phenomenon. Globally there is still a lot of money on the sidelines, which can sustain spending. The combination of robust consumer demand and supply disruptions has had a dramatic impact on prices. Eliminating inflation requires the cooling of an overheated economy, possibly a recession.

There are signs that a global slowdown has commenced. Elevated energy prices are crowding out other expenditures and promoting stagflation (a toxic combination of rising prices and slowing growth). Expenditures by governments to compensate for the adverse consequences of the pandemic have largely ended and fiscal deficits, while still large, are contracting. The consumption of certain goods which boomed during lockdowns, for example electronics, is slowing because the consumer is satiated. Global trade is slowing. Higher interest rates are having an adverse effect on property markets. China, which has been the largest contributor to global growth over the past 20 years, is now struggling to meet its 5.5% growth target. While recent draconian Chinese lockdowns to contain the spread of corona infections are now being eased, two sectors which have been key drivers of its growth, exports and housing, have been negatively impacted by weaker demand. In contrast to the rest of the world, China will probably try to reverse these adverse trends with greater government spending, but it will be unable to revert to its former higher rates of growth.

The important question is, will this slowdown be sufficient to tame inflation? I believe the answer is no and that there is a significant possibility that stagflation will become prevalent. A decade of inappropriate monetary policy is taking its toll. The inflation genie is out the bottle. As was

### Graph 2: Real US three-month interest rate (three-month Treasury bills less inflation)




**Source:** IRESS

the case in the 1970s, inflation has developed a life of its own, where it pushes up business costs and business responds by increasing prices. In many countries a long period of wage stability has ended. Past experience is that spiralling wages are difficult to control and as wages tend to be set annually, it takes a number of years to do so.

All this is happening in a world where a previous declining secular trend in inflation has reversed. For 40 years globalisation promoted price stability. Efficient supply chains spanned the world and provided an abundant supply of cheap goods, which reduced the cost of living everywhere. In 2020, globalisation was already in retreat due to the erratic policies of Donald Trump, but the pandemic and the war in Ukraine have now focused the attention of business and governments on its risks.

> If monetary policy is to play an effective role in stabilising prices, interest rates must exceed the inflation rate.

Security of supply is the new mantra and achieving this will come with higher costs. Critically, there will be an increased demand for local skills, which will inflate labour costs. Demographic trends and rising popular hostility to migration will aggravate labour shortages. In addition to the cost of deglobalisation is the cost of decarbonising the global economy. Recent events have forced governments to postpone their aggressive climate change agendas, but these will not go away. Their cost is widely underestimated and will be paid for by the consumer through higher prices. If this is not enough, there is also the rising cost of underfunded retirement and health obligations.

There is a prevalent complacency about future inflation, but these secular trends suggest that, in coming years, it will be more persistent than is currently expected. Restoring the price stability we enjoyed prior to 2020 will require a far deeper recession and greater economic adjustments than will be politically acceptable.

### Whither interest rates?

With the notable exception of Japan, developed economy central banks now recognise they have been way behind the curve and are rapidly increasing their policy rates to what they presently consider to be neutral. By the first quarter of 2023, most will reach their neutral targets. However, these rates will still be substantially lower than prevailing inflation. Some central banks may then use a slowing economy as justification to pause, but others will continue to push upwards towards what they anticipate inflation will be in 2023. Based on their present rhetoric, the ECB will be among the former and the Fed among the latter. If inflation persists at more than 4%, which is a distinct probability, they will still be behind the curve.

Extremely low rates, such as have been commonplace for the last two decades, have proven ineffective, either to promote economic growth or to generate the inflation central banks wanted. Mispriced low rates merely create economic distortions such as asset bubbles. There is no place for them in an inflationary world. Any central bank which persists with substantially negative real rates will simply stoke the inflationary fires, as did the Fed between 1973 and 1979. If monetary policy is to play an effective role in stabilising prices, interest rates must exceed the inflation rate. This is especially true after a surge in prices such as we are currently experiencing.

Graph 2 shows the real return on three-month US Treasury bills since 1966. In the 18 years after the Volcker recession of 1982 they were initially 5% and then about 3%. If the inflation pessimists prove correct, interest rates will have to be substantially higher than they are at present. Inflation of say 4% demands an interest rate of 6%.

### Will the central banks resist demands for lower rates?

Higher interest rates inflict collateral damage elsewhere in an economy. Rising mortgage costs threaten an edifice of inflated property prices. Higher borrowing costs threaten fiscal stability. Overleveraged businesses get into difficulties. The cost of holding inventories rises. It is commonplace for borrowers to hedge themselves against higher interest rates but when rates rise, this simply passes the loss to someone else. Rising interest rates put downward pressure on bond and equity prices.

As economic pain rises, central banks will come under increasing pressure to suspend rate hikes and make debt more affordable. A good example of this was seen at the end of 2018 when an equity market decline put the Fed under pressure from Wall Street to abandon its intention to further increase its policy rate. The Fed did what the market wanted. Famously, Volcker resisted all such pressures and crushed inflation in 1982. But will the present generation of central bankers show such fortitude?

After more than a decade of zero rates, low borrowing costs have become an addiction. The pressures to keep rates low will be massive. As the monetary policy bureaucracy has been so committed for so long to low rates, it is likely to support demands to moderate hikes. Some talk about Fed Chairman Jerome Powell having his Volcker moment. However, history suggests he will behave otherwise and, even though substantially higher rates may be required, the Fed and other central banks will hesitate about delivering them. In the 1970s, it took a decade of hesitation before things got so bad, the Fed had to act. The odds are that if inflation is persistently high, the rate response of central banks will be inadequate. This will entrench inflation.

We are going to relearn through trial and error how to cope with these challenges.

### What of emerging markets?

This discussion has focused on developed market central banks in North America and Europe, which are currently at the centre of the inflationary storm. The US is always of critical importance because the dollar is the world's reserve currency and a majority of financial assets are denominated in dollars. To a significant extent China is isolated by exchange control barriers and can go its own way. Currently its inflation is benign and, in response to a slowing economy, it is likely its monetary conditions will be eased.

During the pandemic, emerging markets did not enjoy the same freedom to lavishly print money to sustain economic activity as developed countries. They had to follow more conventionally prudent policies. As global inflation accelerated, emerging market central banks took the lead in increasing their interest rates, which generally, with a few notable exceptions, now are not too distant from what is appropriate for their domestic economic conditions. However, further increases in global inflation may require even higher rates, both to contain the passthrough into domestic prices and to sustain capital inflows as developed economies respond by further increasing their rates.

### Learning how to cope with new circumstances

Inflation may be much higher and more persistent than is currently priced into financial assets. After 40 years of price stability, the market has become complacent about these risks. Economic history teaches us that long periods of price stability are the norm and inflation is an abnormality associated with wars, natural disasters and gross economic mismanagement. Unfortunately, we are experiencing all three of these conditions. The biggest danger is flawed economic policy. Huge fiscal deficits funded by lavish money-printing have put us on the brink of financial disaster.

That we shall ultimately navigate through these difficulties I do not doubt. The narrative of the 1970s provides an encouraging message. Inflation was tamed and a long period of prosperity followed. However, people learn from their experiences rather than history. We are going to relearn through trial and error how to cope with these challenges.

**Sandy** joined Allan Gray as an investment analyst and economist in October 1991. Previously, he was employed by Gold Fields of South Africa Limited in a variety of management positions for 22 years, where much of his experience was focused on investment-related activities. His current responsibilities include the management of the balanced fixed interest portfolios. Sandy was a director of Allan Gray Limited from 1997 to 2006.

# ON THE COMMODITY BOOM AND OTHER SOUTH AFRICAN FABLES (AND FOIBLES)

**Thalia Petousis**

Fiscal sustainability rests on implementing growth-enhancing reforms and allocating capital to its most productive economic use.

*Just as the economic destruction from the COVID-19 pandemic rose to crisis levels, strong commodity export prices swept in to alleviate South Africa's fiscal woes. To pin our hopes for the entire domestic recovery on a cyclical pricing story may prove foolish, especially with a spluttering local production base and a host of domestic challenges. With inflation fuelling import and export account imbalances, it is critical for both us and our African continent peers to tighten our belts and prepare for what may be tough times ahead. Thalia Petousis discusses.*

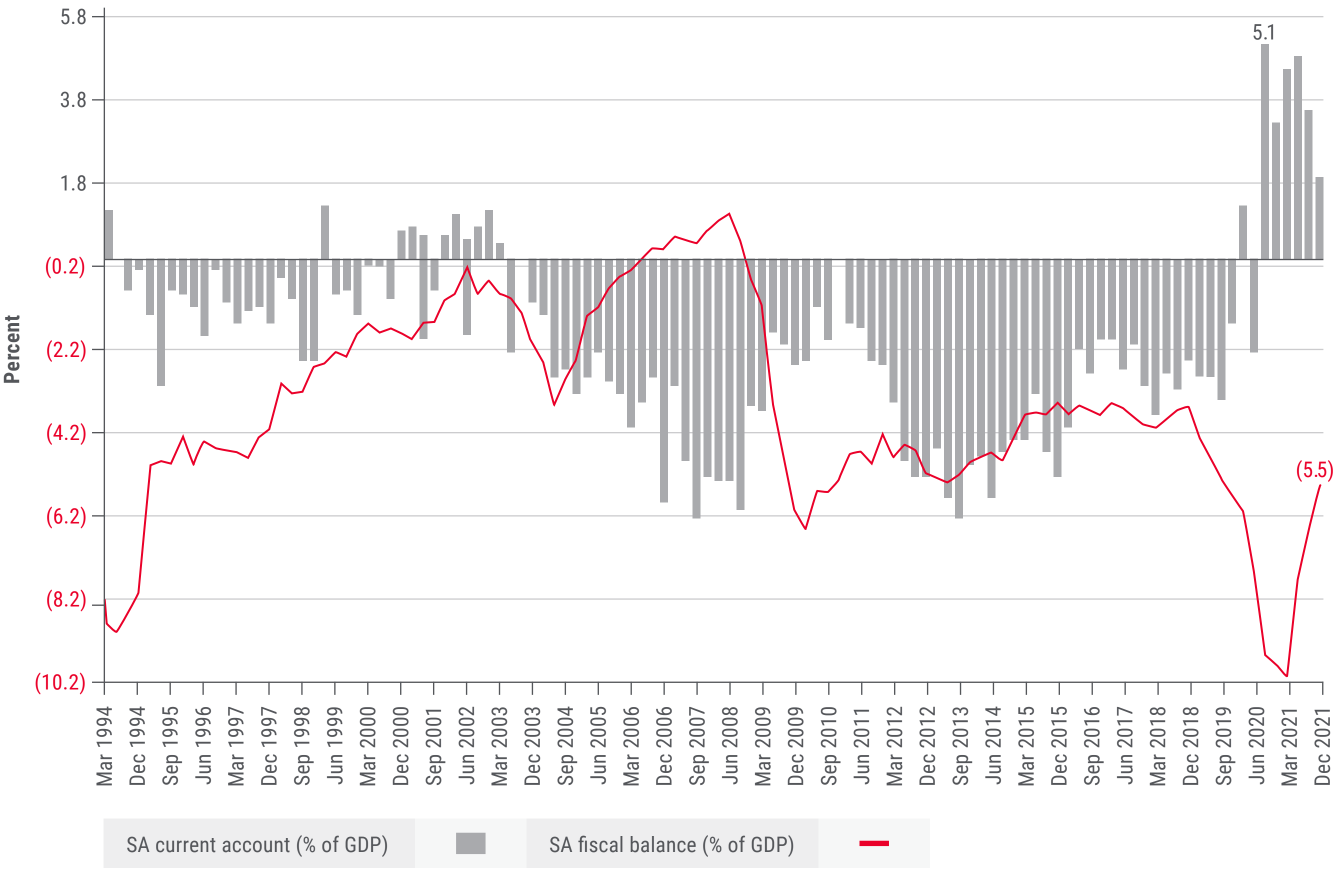
The past 40 years of global order and NATO-enabled peacetime trade have allowed intercontinental supply chains to flourish, facilitating worldwide growth and poverty reduction. While the US-China trade war, Brexit, and even the COVID-19 pandemic sowed the seeds of doubt in such trade alliances, the Russia-Ukraine war has arguably tipped the scales even further in favour of both domestic protectionism and deglobalisation. Both of these forces are surely the enemy of low prices, and are wreaking havoc in already-disrupted supply chains.

As Sandy McGregor discusses in his piece on page 4, global inflation has ventured into an inferno – and taken commodity prices along for the bumpy ride. In the first half of this year, the prices of oil, gas, wheat and a basket of platinum group metals (PGMs) had each risen in excess of 60% at their respective peaks. For this, the Russia-Ukraine war alone cannot be blamed. While the war threatened to take two giants of the exporting industry out of the market, the fire of inflation had already been ignited in the last two years – in part by excessive US monetary and fiscal stimuli.

The commodity story has meant that South Africa's trade balance (our exported goods and services minus our imports) has soared. This allowed our current account[1] to reach a record high surplus of 5% of GDP in 2021,

[1] A country's current account records the net value of its exports less the value of its imports of both goods and services, as well as the net value of international transfers of capital.

## Graph 1: Commodity prices alleviating SA's twin deficit pressures




**Source:** Bloomberg, data to 28 February 2022

as shown in **Graph 1**. Strong commodity prices have also provided some fiscal relief to the SA government via a bumper season of corporate income tax collections from SA miners and exporters. This additional revenue has resulted in a tightening of our fiscal deficit (government's excess spending above revenue), as seen in the same graph.

SA's total exports registered R1.8tn in 2021, representing a 40% increase from 2019. Rhodium[2], a little-known and niche metal barely discussed outside commodity circles, suddenly found fame among SA bond investors, who welcomed its price gains as the revenue spill-over lowered government's borrowing requirements in fixed interest markets.

Within the broader export basket, **Graph 2** on page 12 unpacks the rand value of SA's key commodity exports of rhodium, iron ore, gold, palladium, coal, platinum, manganese and diamonds in 2021, which registered an 80% increase from 2019. Business is booming – or is it?

Loadshedding, strikes and weak port and rail infrastructure are weighing on mining production ...

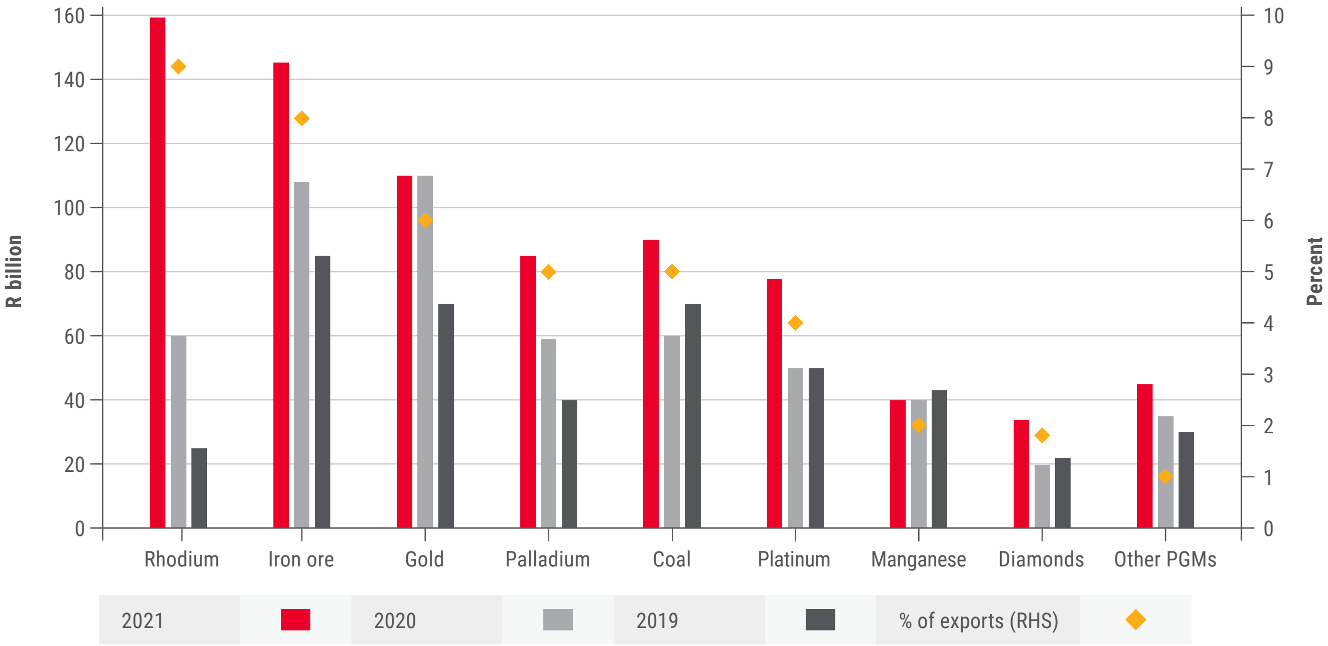
### The fable and the foibles

The rand value of exports tells an excellent story, but it neatly banishes another narrative to the footnotes – the story we get when we strip out *prices* and only look at production and export *volumes*.

[2] Rhodium is a rare platinum group metal that is predominantly used in catalytic converters for cars.

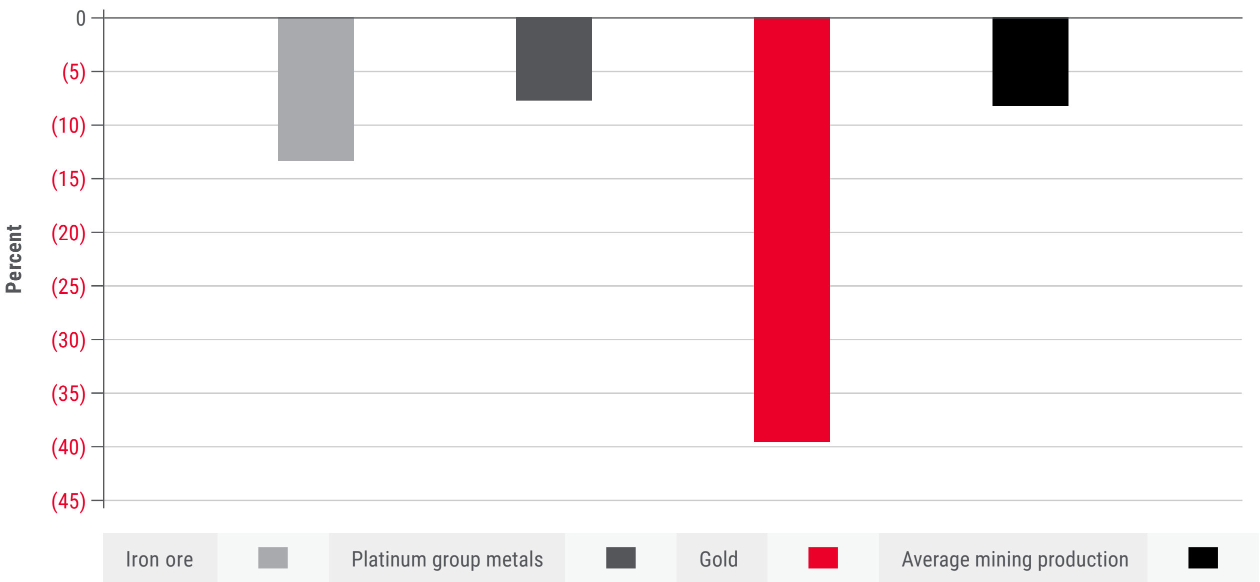
**Graph 3** contains mining production output rebased to 2015 levels. It is looking far from healthy, recording declines in major categories over the last several years. Loadshedding, strikes and weak port and rail infrastructure are weighing on mining production and raising the barriers to get contracted volumes offshore. Transnet's rail network has been crippled by copper cable theft and locomotive failures. The theft of metal and even electricity pylons is well documented by Eskom and Transnet, given the rising global demand for copper scrap and steel. In short, SA cannot take advantage of the commodity boom to the extent that we should be doing so.

## Graph 2: Key commodities – 80% increase in Rbn exported in 2021 from 2019




**Sources:** HSBC Research, Bloomberg, SARS, Department of Trade, Industry and Competition, data to 28 February 2022

## Graph 3: SA mining production – percentage change in volumes in 2022 vs. 2015




**Note:** The graph compares the production volumes of iron ore, platinum group metals, gold, and SA's total average mining production volume for the period February to April 2022, using 2015 as the base year for comparison. The index has been seasonally adjusted.
**Sources:** Statistics South Africa, Allan Gray research

Where to from here in our commodities saga? Will the SA current account surplus remain robust, providing more near-term relief?

SA's largest imports are mineral products (23% of imports – mainly oil) and machinery (20% of imports), followed by chemicals (12% of imports – mainly pharmaceuticals, raw chemicals and fertilisers). Thus far in 2022, an escalation in the price of imported goods is seeing the positive trade balance beginning to erode. The rising cost of oil and disappointing mining production volumes have narrowed the current account balance from a record 5.1% to a slightly less robust 2.2% of GDP. This is not excellent news for the SA fiscus, which is under enormous pressure due to a struggling municipal model, the growing social requirements for poverty and relief grants, and a structural shortage of energy.

### Where the story may unravel

A far more dire picture is beginning to emerge across the rest of the African continent, most notably for countries with large oil and food-heavy import bills. Many African countries are *surprisingly* ill-equipped to benefit from the commodity boom, and some experience heavy fiscal bleed via fuel and food subsidies to alleviate the burden on the consumer. The result has been that some on the continent are experiencing severe distortions in their trade balances.

Nigeria is a country which historically benefited from rising oil prices, but it is producing less than its Organization of the Petroleum Exporting Countries (OPEC) oil quota. Oil production has almost halved from 2.5 million barrels per day 10 years ago to 1.3 million barrels per day in 2021. Not only that, but fuel subsidies have risen to around US$4bn a year (0.9% of GDP, or a staggering one-third of all fiscal revenue!). Lack of investment due to naira liquidity constraints, conflict with host communities, vandalism, and delays in enacting proper regulations have resulted in fuel shortages, hurting the economy and consumer sentiment. As such, Nigeria's foreign exchange reserves have fallen despite the oil rally this year.

While rising gas prices benefit Egypt's (gas) exports, as a major importer of wheat and grain (subsidised by the fiscus) and alongside their problematic debt burden, they have had to rely on Saudi Arabian aid this year. "Bread riots" following subsidy cuts and increased food prices led to violent clashes in Egypt in 1977, 2011 (the Arab Spring) and 2017.

## Global trade disruption breeds imbalances in prices.

In Kenya, foreign exchange pressures and a US dollar and fuel shortage have begun to emerge. This is not only due to large oil imports, but a lagging supply of US dollars into the economy via key exports of coffee and flowers. Global trade disruption breeds imbalances in prices.

Decades of easy offshore monetary policy have also enabled certain African borrowers to binge on oversubscribed Eurobond issuances, pushing the weak to the brink of debt distress. This is problematic as the reversal in *global trade flows* – in part due to rising protectionism and supply chain disruption at ports – is also being mirrored in the financial markets as a reversal in *global capital flows*. Rampant developed market inflation, quantitative tightening and rising interest rates will hamper the ability of African borrowers to refinance their debt.

Ultimately, debt stabilisation rests on sticking to the spending plan and reducing wasteful expenditure. Fiscal sustainability rests on implementing growth-enhancing reforms and allocating capital to its most productive economic use.

For South Africa and the rest of the continent, the commodity boom alone cannot work wonders. The heroes in this story can only emerge when they strive to achieve sustainable growth beyond a short-term pricing cycle.

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

# OUR APPROACH TO RESPONSIBLE INVESTING

**Raine Adams**

Good stewardship of our clients' capital requires truly active ownership.

*We are navigating an increasingly complex world in the wake of the pandemic and in the shadow of the Russia-Ukraine war. This brings to the forefront the importance of carefully researching environmental, social and governance risks when evaluating investment decisions. Raine Adams provides a high-level explanation of how we approach responsible investing at Allan Gray. For in-depth details of our approach, including examples, please see our latest Stewardship and Business Sustainability Reports, available via our website.*

Sustainability is embedded in how we invest on behalf of our clients, operate our business, and interact with society.

## Integrating ESG factors into our research is intrinsic to our investment philosophy

As long-term investors, we spend a lot of time trying to calculate a company's potential, sustainable free cash flow. Companies that operate unethically or do not appropriately manage their societal and environmental externalities face a greater risk of cash flow erosion over the long term. This can manifest in multiple ways, including regulatory fines, loss of an environmental permit or a company's social licence to operate, or even reduced demand for its products due to reputational damage or shifting societal preferences.

That said, companies have positive and negative environmental, social and governance (ESG) impacts, and forming a holistic view based on these is far more complicated, and at times subjective, than it seems at face value. At Allan Gray, we value independent thinking and strive to do what we believe is right. This does not mean taking a binary view on investments – whether they are "good" or "bad" – and making related portfolio inclusions or exclusions; instead, we believe in taking a balanced approach, recognising that, unfortunately, there are often trade-offs that need to be made between environmental, social and governance considerations.

Tackling climate change is a critical global priority, but in a developing country such as South Africa, the need to address social issues, like socioeconomic inequality and transformation, cannot be ignored. We seek to evaluate these factors as holistically as possible, and the answers are not always so clear-cut as to simply disinvest.

## How we approach ESG research

Our ESG research is conducted in-house and integrated into our investment analysis across all asset classes. Investment analysts are responsible for researching material ESG issues relating to the instruments they cover and highlighting these in their research reports. We also have three ESG analysts who assist with monitoring, as well as thematic and detailed company-specific research. Key ESG issues are debated when we discuss investment opportunities and vote on issuer "buy" or "sell" ratings.

Material ESG risks are factored into company valuations, either by adjusting earnings or cash flow if the risk is quantifiable, or by adjusting the valuation multiple of the company or division if the risk is significant but uncertain. We may also limit the size of our holding in a company or choose not to invest if the ESG risks are significant.

Our portfolio managers are ultimately accountable for managing the ESG risks in our clients' portfolios, but we also report biannually to our board of directors, who provide additional oversight. Our internal research and communication channels are illustrated in **Figure 1**.

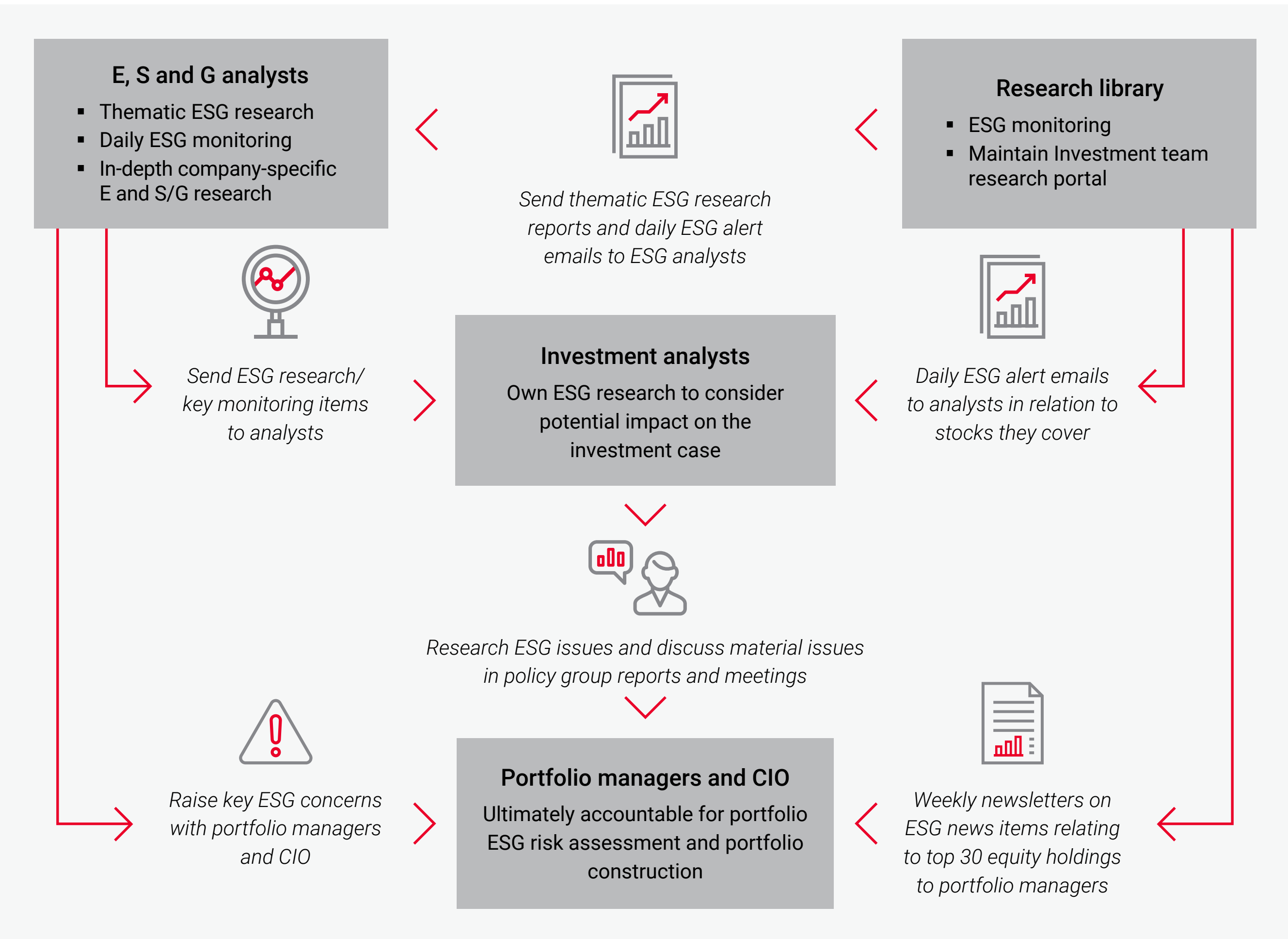
... we strive for a carefully considered, balanced and meaningful approach to ESG.

## We are active owners once invested

We continue to monitor and research ESG factors once we are invested. This is crucial because ESG issues are dynamic and sometimes concerns may only arise post investment.

Good stewardship of our clients' capital requires truly active ownership. We engage frequently and meaningfully with company boards and management teams and,

## Figure 1: ESG process overview



where we are invested in instruments that have negative environmental or social impacts, we encourage a focus on minimising harm and holding management teams and boards to account.

We also think critically about how we vote on behalf of our clients at company meetings. For example, our governance analyst prepared 56 remuneration reports for our Investment team in 2021, which provided a detailed assessment of companies' executive remuneration disclosures, performance conditions and quantum, among other things. We publish our voting recommendations, together with the outcome of the shareholders' vote on each relevant resolution, on our website quarterly in arrears.

In addition to engaging with our investee companies, we actively partake in initiatives that promote sound corporate governance and sustainable business practices.

### How we are advancing ESG at Allan Gray

As discussed, we strive for a carefully considered, balanced and meaningful approach to ESG. While incorporating ESG factors into our investment decision-making has always been part of our philosophy, we continue to work on improvements in our approach. Our recent and ongoing process improvements include the following:

- Increasing the number of analysts on our ESG team, which is housed within the Investment team.
- Introducing quarterly ESG reports. These address key thematic issues, such as updates on the energy transition or benchmarking the incorporation of ESG factors into executive remuneration across sectors.
- Rolling out ESG "deep dive" assessments for our clients' top 20 holdings. These will provide granular assessments across multiple E, S and G subcategories, relevant to both the company's sector and individual complexities.
- Developing remuneration assessment frameworks to enhance our evaluation of companies' remuneration policies and implementation thereof.
- Increased communication with our sister companies, Orbis and Allan Gray Australia, on ESG matters. This includes two quarterly meetings on ESG in the investment case and ESG in regulation and reporting, respectively, as well as climate-focused quarterly meetings.
- Increased reporting to our board of directors. We now produce four reports per year for our board subcommittees. This provides valuable independent input and oversight to our team.

Our stewardship activities are geared at achieving good outcomes and, within this, we place particular emphasis on governance. Stronger corporate governance has shown a link to stronger environmental and social performance as well.

We remain committed to improving our processes and the effectiveness of our ESG engagements year-on-year.

**Raine** first joined Allan Gray in 2011 as a CA trainee and is currently an ESG analyst in the Investment team. She holds a Bachelor of Business Science (Honours) degree in Finance and a Postgraduate Diploma in Accounting, both from the University of Cape Town. Raine is a qualified Chartered Accountant.

## ORBIS GLOBAL EQUITY: THE DURATION DISLOCATION

**Graeme Forster**

While the duration dislocation is unusual, it is not unprecedented. Similar conditions in the 1960s and the 1990s led to ... the "Nifty Fifty" bubble in the early 1970s and the dotcom bubble in 2000.

*In investing, risk and opportunity are two sides of the same coin. Graeme Forster from our offshore partner, Orbis, unpacks current distortions in the market, including the "duration dislocation", and provides insight into how Orbis is weighing up the risks versus the opportunities in the Orbis Global Equity Fund.*

As painful as the first six months of 2022 have been for global stock markets, it's worth keeping the decline in perspective. Since 2009, global equities have returned 12.5% per annum during a time when the yield on safe cash has collapsed to near zero. The difference between the two – the compensation that investors receive for buying risky assets – has been unusually wide, thanks in no small part to unprecedented support from central bank actions. Those actions have led the financial world to a strange and precarious place.

Today, we see three giant sources of risk and opportunity in global stock markets. First, and most importantly for us, valuation dislocations are extremely stretched and should unwind. Second, economic conditions may look extremely different from those of the last decade. Third, many industries may face a future that is extremely different from their recent past. And crucially, these three forces feed on each other.

Our job is to search around the world for the most attractively valued individual companies we can find. That leads us fairly naturally to be on the cheap side of valuation dislocations. Today, we are finding that many of the shares that look most attractively priced to us are *also* on the right side of the other two forces. The energy sector offers some of the clearest examples and serves as an excellent illustration of how we see markets today.

We will start by touching on the distortions in economic conditions and valuations, then we will walk through the current opportunity in energy to show how the three forces come together.

### Duration dislocation

Since 2009, central banks have suppressed interest rates and bond yields, distorting the signals that interest rates usually provide. Normally, cash today should be more valuable than the promise of cash later, and normally one would expect compensation for the "time risk" of locking up money for a long time.

The past decade has not been normal. In this strange world, investors have been happy to pay up for the promise of potential profits in the distant future, sometimes even valuing faraway cash flows at a *premium* to more immediate cash flows. We call this the "duration dislocation", and it seems to defy both conventional financial theory and common sense.

Within equities, it has – until the last few months – been fantastic for the valuations of speculative growth companies which lose money now but promise untold riches later, and it has been painful for the valuations of boring old economy companies that make plenty of cash now. The duration dislocation explains much of the valuation gap between value and growth shares, which has only begun to unwind after reaching levels rarely seen in history, as well as wide valuation gaps between US and ex-US shares and between the technology and energy sectors.

While the duration dislocation is unusual, it is not unprecedented. Similar conditions in the 1960s and the 1990s led to highly dislocated markets – the "Nifty Fifty" bubble in the early 1970s and the dotcom bubble in 2000. These valuation distortions did not just affect the performance of stock prices – they also had a profound impact on how capital was allocated in the real economy.

The same thing is happening now, and the energy sector offers a timely illustration.

## Underinvesting in an energy crunch

As a society, we have gone through a remarkable transformation over the past two centuries. It wasn't long ago that we relied almost entirely on human and animal muscle for farming, construction and manufacturing. The energy in the economy came largely from people and animals literally pushing things around. Modern machinery is far more efficient and powerful – as is the fuel that powers it.

Harnessing fossil fuels has been an enormous windfall for growth and productivity, as Vaclav Smil's latest book, *How The World Really Works*, explains. Smil quantifies the "surplus" energy available to people today compared to pre-industrial levels. In the developed world, each person enjoys surplus energy equivalent to 60 adults working for you non-stop day and night, allowing for vast improvements in living conditions. In richer countries, like the US, surplus energy is more like 240 workers per person. But one of humanity's greatest challenges is how unequally our energy windfall has been distributed – over one billion people in the world remain in energy poverty, consuming less than the average American fridge.

Given the importance of energy in our modern economy, we should expect to see steady capital investment over time to drive further gains in productivity and quality of life. It's striking, therefore, that capital investment in primary energy has *dropped* significantly in recent years.

The recent dip in capital spending has been bigger than in prior cycles, so it will likely take longer to recover.

There's nothing new about capital cycles. High energy prices ultimately cure high prices by attracting new investment and greater supply, which brings prices back down. This typically takes five to 10 years to play out in full. In the current environment, however, a longer and less efficient capital cycle heightens the possibility that we will see long-lasting volatility and scarcity of energy. The recent dip in capital spending has been bigger than in prior cycles, so it will likely take longer to recover. See **Graph 1**.

The current underinvestment is partly due to the duration dislocation. When investors value faraway cash as highly as cash today, they pour capital into startups that burn money to grow quickly, and they drain capital from old economy businesses that make money but grow slowly.

The falling investment in energy has also been driven by increasingly urgent climate concerns. *For the first time in history, we are faced with the challenge of optimising our energy system not just for cost, but also for carbon*. As stewards of our clients' capital, our challenge is to understand how much of this energy transition is priced into current valuations, while also acting as responsible shareholders. As we look across businesses exposed both negatively and positively to longer-term energy prices, we don't think the risk of prolonged energy scarcity is sufficiently appreciated.

Consider Shell, a roughly 2% position in the Orbis Global Equity Fund. Most people see Shell as a fossil fuel company, but we see it more as a diversified energy business that is well positioned to aid the transition by delivering various forms of energy to customers in an efficient and increasingly clean way.

In time, we should expect to end up in a world where capital efficiency is restored … but it looks set to be a bumpy ride.

In South Africa, Shell's planned offshore seismic survey is a particular focus, and Orbis and Allan Gray analysts engaged with the company regarding this in December. Shell laid out the industry's long experience with offshore surveys, the assessments they have conducted, and the planned mitigation measures that give them the confidence that they can conduct the survey responsibly while minimising risks to wildlife. We encouraged the company to publish a summary of their environmental impact assessment and to share the scientific evidence on which their views are based.

The planned survey is currently suspended, and aspects of the project are now being debated in courts.

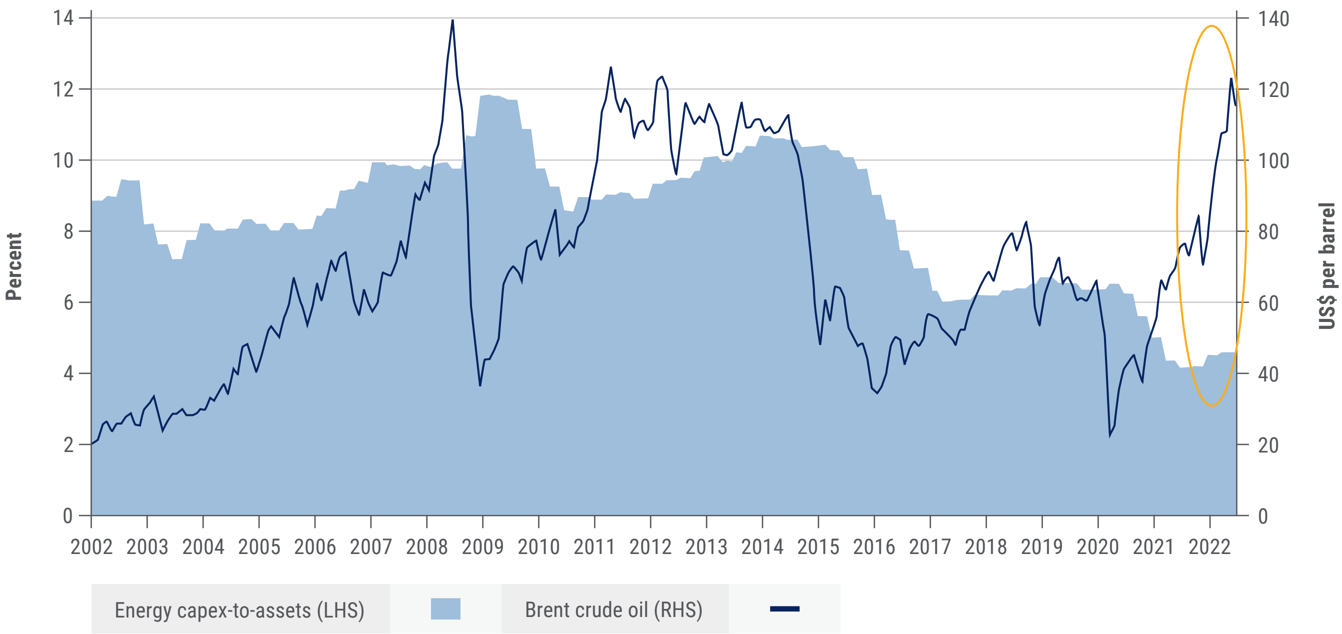
Globally, Shell has committed to net-zero emissions by 2050 along with interim targets for 2035 – targets that include not only its own emissions but also the impact of the energy products it sells to customers.

A key part of this is through Shell's exposure to natural gas – a fuel that we see as key to facilitate the transition – but also through renewables, infrastructure and retail operations (refuelling stations). Shell's trading arm, which plays a critical role in matching supply and demand for energy around the world, is unique in scale and likely to be increasingly valuable in a volatile and scarce energy environment.

One would expect Shell – as well as other critical energy infrastructure holdings such as Sunrun (solar), Vestas Wind Systems (wind), Constellation Energy (nuclear) and Kinder Morgan (pipelines) – to trade at a premium given the concerns around energy security that are beginning to emerge in all corners of the global economy. Rather than offering the promise of cash flows in the distant future, Shell is returning hard cash to investors today in the form of dividends and share buybacks, as well as increasing capital expenditures to more sustainable levels. On top of that,

## Graph 1: High prices are not currently a cure for high prices

**Capex-to-assets ratio for developed market energy companies, with Brent oil price**




"Capex" stands for "capital expenditure".
**Sources:** Refinitiv, Orbis

it offers longer-term inflation protection and resilience against energy shocks. But like many cash-producing businesses, Shell is still very conservatively priced, offering a mid-teens free cash flow yield.

Shell is just one example, but there are other companies in the Orbis Global Equity Fund that we believe will benefit from the unwinding of what, in our view, is a historic valuation dislocation. Today's misallocation of capital has echoes of those in the 1960s and 1990s, but to us looks even more extreme. The current dislocation, coupled with the critical need to reduce carbon emissions, will likely drive higher and more volatile energy prices in the coming decade, improving fundamentals for businesses like Shell. It is also likely that the resulting inflationary environment will force central banks away from manipulating bond yields, providing an additional tailwind as cash today once again becomes more highly valued.

In time, we should expect to end up in a world where capital efficiency is restored, bringing things back into balance, but it looks set to be a bumpy ride.

Orbis
Invest Differently

**Graeme** joined Orbis in 2007 and is a director of Orbis Holdings Limited. He is one of the stockpickers who direct client capital in the Orbis Global Equity Strategy and is responsible for the Orbis International Equity and Optimal Strategies. Graeme holds a Master of Arts (Honours) degree in Mathematics from the University of Oxford and a Doctor of Philosophy degree in Mathematical Epidemiology and Economics from the University of Cambridge. He is also a CFA® charterholder.

## HOW DO YOU CATER FOR EXTREME EVENTS WHEN CONSTRUCTING RESILIENT MULTI-ASSET PORTFOLIOS?

**Gladness Rupare and Martine Damonse**

*Over the past two months, we have had the privilege of meeting with many clients and advisers at our first in-person events in over two years, and via webinars. Top of mind during the Q&A panel discussions was how to position portfolios to withstand uncertainty. This makes sense bearing in mind the backdrop of the pandemic, the devastating floods in KwaZulu-Natal and the tragic war in Ukraine. Gladness Rupare and Martine Damonse, who hosted panels with members of the Allan Gray and Orbis Investment teams at the events, capture some of the key questions asked and insights delivered, which illustrate how the Allan Gray Balanced Fund is positioned to be resilient and deliver returns in different scenarios.*

Since the start of this year, most equity markets have nosedived into negative territory. The same central banks that were printing money are now aggressively trying to rein in inflation exacerbated by the crisis in Ukraine, which has caused acute shortages in some areas of the global supply chain. Meanwhile, the South African market and the rand have remained surprisingly strong relative to our global counterparts, supported by commodity prices.

Given this backdrop, clients were keen to find out how we filter through all the information to make investment decisions.

### What are our key focus areas amid the market noise?

As long-term investors, we try to ignore the noise and stay focused on the two things we can control when investing:

**1. Buying assets for less than they are worth**

The price we pay for any asset is the key determinant of the return from that asset in the future – regardless of the prevailing market conditions. Ideally, we want to buy a share when it trades below what we have calculated as its true worth, but this often happens when there is bad news and the share is unpopular. Buying an unpopular share with a margin of safety (a discount to our estimate of its intrinsic value) can feel uncomfortable, but it is the best way to reduce potential capital loss in the future, which increases the resilience of the portfolio. We sell an asset when it reaches our estimate of its true worth.

### 2. Diversifying the portfolios

The old adage of not putting all your eggs in one basket is sage advice. Diversification is an exercise in portfolio risk management that ensures you have a portfolio of assets that perform differently under different circumstances.

Within a multi-asset fund, like the Allan Gray Balanced Fund, we have the ability to diversify across asset classes. For example, we can increase the bond exposure when bonds are cheap and equities are expensive, and vice versa, and we can increase the foreign exposure when South African assets look expensive. Right now, SA bonds and equities offer good value, but they may be exposed to SA-specific risks. A well-diversified portfolio also takes the position size of individual instruments and their risks into consideration.

*Clients were hungry for more information about these aspects of investing, and had challenging questions about some of the equity holdings in our Balanced Fund.*

## What is the investment case for Woolworths?

Woolworths needs little introduction. The company has a presence in Australasia through David Jones and Country Road. We believe that the market is currently undervaluing Woolworths, presenting a buying opportunity. Many of the aspects the company needs to improve are within its control, as discussed below.

### Opportunity to grow earnings in fashion, beauty and home

In recent years, the fashion teams at Woolies have lost track of their core customer, moving closer to fast fashion and away from the quality basics the brand was known for. Poor merchandising has meant Woolies has had to sell increasingly on promotion.

We believe Woolies has a credible strategy to improve full-priced sales in fashion, beauty and home. Despite the high execution risk, this represents the biggest opportunity for Woolies to grow earnings given the high revenue base. Woolies is also in the process of rationalising space, prioritising profit per square metre rather than market share.

### Strong food business

Most investors recognise the high quality of Woolies' food business, but are concerned that it may lose market share given its premium positioning in uncertain economic times. We believe Woolies should be able to pass on inflationary increases to its customers, making its food business defensive in high-inflation environments.

In our view, Woolies food is one of the best food businesses globally. It has grown its operating margin consistently over the last few years and offers a high return on capital with the ability to reinvest into the business. Although there is an increasing threat posed by peers, we believe its food business can maintain its strong competitive position given its supply chain superiority and entrenched supplier relationships.

Active, contrarian investing has rarely looked more necessary than now …

### David Jones issues ring-fenced; Country Road the hidden gem

When Woolies purchased David Jones in 2014, it not only overpaid for the business, but also overestimated its ability to turn it around quickly. This has weighed heavily on investor sentiment. While David Jones was a poor acquisition, the business is ring-fenced from both Woolies South Africa and Country Road. The requirement for a turnaround to be self-funding adds a floor to the value of the business.

Country Road, on the other hand, is one of the hidden gems within the Woolies group. Gross margins are in line with luxury companies', and it has a large, growing online business reflecting more profitable sales than in-store. Debt concerns from two years ago have also abated, given the high-priced sale of two David Jones properties and reduced capital expenditure.

At a group level, Woolies had net cash on the balance sheet at end-December 2021. Its ability to generate free cash flow (the cash a company can generate after capital expenditures to maintain or maximise its asset base) remains high.

We still believe that Woolworths trades below its true worth.

*While the Woolies story resonated with our audiences, it naturally elicited questions about SA-specific and other risks.*

## Are all the top 10 holdings in the Balanced Fund subject to similar risks?

There are some equities within our top 10 holdings that don't have SA-specific risks, even though they are included in the FTSE/JSE All Share Index, such as British American

Tobacco (BAT). BAT operates in over 100 countries, the largest of which is the US; a great example of a geographically diversified business.

One of the biggest risks to the SA market is not obvious, but it affects our diversified miners, commodity shares and a few other large shares on the JSE, including Richemont and Naspers: SA's reliance on China. These businesses depend on China continuing to demand as much in the future as it does today.

Interestingly, BAT has no exposure to China as its Chinese holdings were nationalised many years ago. We continuously monitor the portfolio's overall direct and indirect exposure to China.

*While we have been finding more value locally than offshore, offshore exposure brings another important element of diversification to the Balanced Fund. With the recent change in legislation allowing the Fund to invest up to 45% offshore, clients were keen to know our views on the offshore opportunity set – especially given that global markets have dropped dramatically since the start of the year.*

## Is local still lekker or is it time to go global?

Global markets, as represented by the MSCI World Index, have fallen by more than 20% in dollars on a year-to-date basis due to higher-than-expected US inflation numbers, which have sparked fears that central banks across the globe will be forced into aggressive monetary policy tightening and tip the world economy into a recession. In a tightening monetary policy environment, a reduction in the money supply, or raising interest rates, can significantly help slow down an economy and protect domestic currencies.

Despite these concerns and rising negative sentiment, the relative valuation gap within stock markets today is still wider than anything we saw during the global financial crisis or dotcom bubble in 2000, and even more extreme than the Japanese bubble of the late 1980s, creating opportunity for bottom-up investors.

Our offshore partner, Orbis, believes the price correction has created a measure of comfort on valuations, with prices of some of the high-flying technology stocks, such as Microsoft, Alphabet, Netflix and Spotify, declining considerably. Orbis' analysts are starting to take a look at some of these "fallen angels". For example, Alphabet was a significant purchase in the Orbis Global Equity Fund in May, as its valuation now compares much more favourably with those of the Chinese tech names without having the additional layer of China-related risks.

Only time will tell how global stock markets will fare. However, Orbis remains excited about the prospects for its holdings and the opportunity to generate real returns. The average stock held is meaningfully cheaper than the MSCI World Index and has better fundamentals. This suggests that the opportunity to add value is still high.

*One thing that became clear over the course of our interactions is that the recent extreme world events have shown clients the importance of building up a nest egg, but many have become more risk-averse and are wondering what the best approach is given the current circumstances.*

## Have we changed our approach given the current circumstances?

Active, contrarian investing has rarely looked more necessary than now, as the current market environment marks the end of "lazy investing" – i.e. the ability to get away with disregarding the fundamentals and simply following the trends. Our experience has shown that some of the best contrarian opportunities arise whenever fear or uncertainty gives rise to short-term thinking or forced selling on the part of other market participants.

Building a well-diversified, multi-asset fund with undervalued assets from the bottom up can deliver superior returns and protect investors' capital over the long term. The Allan Gray Balanced Fund is well positioned for multiple possible outcomes, increasing the likelihood of its resilience through further extreme shocks.

**Gladness** joined Allan Gray in 2017 and is an investment specialist in the ManCo Distribution team. She holds a Bachelor of Science degree in Computational and Applied Mathematics from the University of the Witwatersrand.

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

# WHAT HAPPENS TO YOUR MINOR CHILDREN WHEN YOU DIE?

**Felicia Hlophe**

Make sure that your loved ones, or those appointed to take care of them, know what will need to be done in the event of your death …

*While undoubtedly the worst-case scenario to consider, as parents, we need to make sure our children's needs are accounted for in the tragic event of our untimely death. Felicia Hlophe offers some critical pointers for parents, who may not realise the dire consequences of failing to plan.*

It is important to take a long-term, considered view of providing for your minor dependants in the event of your death. Follow the steps below to make sure your bases are covered.

## 1. Draft a valid will

To nominate a legal guardian for your children and control how the assets in your estate are to be distributed, you must execute a valid will, keep it updated, and store it in a safe place where it can be found after your death. It is never too early or too late to execute a will.

There are templates available online to assist you with putting a will together, but you may wish to get assistance from a professional – like your banker, lawyer or financial adviser – to ensure it is valid. Update your will every time there is a life-changing event, such as a marriage, the birth of a child or a death in the family.

While you would have been asked to nominate beneficiaries for some of your investments (see point 3), your will should discuss how you want your other assets to be distributed.

Dying without a valid will in place has terrible repercussions for your children (see point 2). In addition, your assets will be distributed according to the Intestate Succession Act. This may result in your assets being inherited by people other than those you would like to leave those assets to. The winding up of your estate could also take longer and cost more.

## 2. Appoint a legal guardian for your minor children

As stressed above, a key component of your will is to nominate a legal guardian to take care of your minor children in the event that both parents pass away. This is a legal appointment in terms of the Children's Act. The guardian will be expected to take on full parental responsibilities and, unless a trust has been set up, administer any inherited assets until your children turn 18 (see points 3 and 4). A guardian is typically a trusted family member or friend who has agreed to take on this responsibility.

If you do not appoint a legal guardian in your will, one may be appointed by way of an application to the High Court of South Africa. However, a court application is often a lengthy process, which could leave your children without a guardian for a significant period.

**What happens to your assets if your children are left without a guardian?**

If you leave assets directly to minor children who do not have a legal guardian, you run the risk of these assets being transferred to the government's Guardian's Fund, where they will be administered until your children turn 18.

The Guardian's Fund falls under the administration of the Master of the High Court, and maintenance for your minor children would have to be claimed from this Fund. Claiming from the Guardian's Fund as an individual who is looking after your children is an administration-heavy process and not ideal when funds are required immediately for your children's needs. Retirement funds are treated differently (as discussed in point 3).

## 3. Keep the beneficiaries of your various policies up to date, and familiarise yourself with the restrictions on a minor's inheritance

When planning your estate, it is important to understand the death claims process for each of your investment products and make sure that you have taken the necessary steps to make the process as easy as possible for those you will leave behind.

According to South African law, a child under the age of 18 is considered a minor and may not inherit cash payouts or any other assets directly. If you nominate your minor child as a beneficiary of your investments, your child will not be able to take control of those assets until they turn 18 (the age of majority); all assets your minor child inherits from you must be managed by their legal guardian.

Following is an explanation of the inheritance rules around various investment products.

**Living annuities, tax-free investments and endowments**

With Allan Gray, your living annuity, endowment or tax-free investment account is structured as a life policy and requires you to appoint beneficiaries. While you can nominate anyone, including a minor child, as a beneficiary, when you pass away, the child's legal guardian will act on their behalf and receive the benefit.

For living annuity benefits, the legal guardian will need to decide whether to receive the full amount as a cash lump sum, purchase an annuity product or take the benefit as a combination of a cash lump sum and an annuity.

Make sure you update your beneficiaries with your financial services provider to ensure that your intended beneficiaries actually receive the benefit.

According to South African law, a child under the age of 18 is considered a minor and may not inherit cash payouts or any other assets directly.

**Retirement funds**

Retirement annuity funds, pension funds and provident funds (including preservation funds) are governed by specific fund rules and legal requirements, which affect how death benefits are paid out. These investments are treated differently from your other investments, and are expressly excluded from your estate.

Although you can nominate beneficiaries, including minor children, every retirement fund is managed by a board of trustees, and these trustees are responsible for allocating and distributing the benefits according to section 37C of the Pension Funds Act. The trustees are responsible for identifying and tracing dependants, investigating their financial circumstances and determining how the benefits should be paid out.

There are three ways minor children's benefits can be paid:

i. To the legal guardian
ii. To a trust that has been nominated either by the member, or a person recognised in law or appointed by a court as the person responsible for managing the minors' affairs or meeting their daily care needs

iii. To a beneficiary fund designed to accept and administer lump sum death benefits

In cases where a minor does not have an appointed legal guardian, the facts of each case will determine whether the benefit is to be paid to the minor's caregiver, or into a trust or beneficiary fund.

**Unit trusts**

You cannot appoint a beneficiary for unit trust investments. These investments will be treated as part of your estate and should be allocated in your will, along with your other assets. Your executor will then ensure they are distributed according to your instructions.

**Offshore investments**

Foreign currency investments made via the Allan Gray Offshore Investment Platform should be included in your South African will, but may also be included in a foreign will if you have one. If included in your South African will, your Allan Gray Offshore Investment Platform investment will not be subject to the administrative complications of estate laws in offshore jurisdictions or require the appointment of a foreign executor, as is the case with many offshore-domiciled investments. Your South African executor will then ensure that your investment is distributed according to the instructions in your will.

## 4. Consider setting up a testamentary trust

Another way to ensure that your minor children's interests are protected is to provide for a trust in terms of your will, known as a testamentary trust. In the event of your death, the trustees of this testamentary trust will administer your children's benefits on their behalf until they turn 18 (or a more advanced age that you can specify).

You may also indicate exactly how your children's inheritance must be used, or empower the appointed trustees to administer the inheritance as they see fit. It is important to carefully choose the right trustees, who will act in your children's best interests.

If you provide for a testamentary trust, you may name that testamentary trust as a beneficiary of your living annuity, tax-free investment or endowment policy. You can also stipulate that, on your death, the trust must manage your other assets, including any unit trust investment. In the event of your death, the funds from your investments would then be paid into the trust – which *may* include your retirement fund death benefits, if this is the decision of the trustees of the retirement fund.

A testamentary trust has ongoing expenses as well as tax and legislative consequences and is not suitable for everybody. It is worthwhile seeking professional advice regarding the types of trusts that are available and their legislative and tax implications.

## Keep your affairs in order

Many investors overlook the importance of good estate planning when thinking about their broader financial plan. Neglecting to think about what will happen to our assets when we are gone can have disastrous consequences for our loved ones – particularly minor children if we don't appoint a legal guardian.

Half the task is creating a plan, but it is just as important to share your plan: Make sure that your loved ones, or those appointed to take care of them, know what will need to be done in the event of your death to make the process as seamless as possible.

**Felicia** joined Allan Gray in 2021 and is a legal adviser in the Retail Legal team. She holds a Bachelor of Laws degree from the University of Cape Town. Felicia was admitted as an attorney of the High Court and obtained her right of appearance in the High Court in 2018.

# NOTES

## Allan Gray Balanced and Stable Fund asset allocation as at 30 June 2022

| | Balanced Fund % of portfolio | | | Stable Fund % of portfolio | | |
|---|---|---|---|---|---|---|
| | **Total** | **SA** | **Foreign*** | **Total** | **SA** | **Foreign*** |
| Net equities | 69.8 | 50.4 | 19.4 | 34.5 | 25.2 | 9.3 |
| Hedged equities | 8.5 | 3.2 | 5.3 | 12.6 | 3.2 | 9.4 |
| Property | 1.1 | 0.9 | 0.2 | 0.9 | 0.8 | 0.1 |
| Commodity-linked | 3.1 | 2.4 | 0.7 | 2.9 | 2.4 | 0.5 |
| Bonds | 12.7 | 9.0 | 3.8 | 32.3 | 25.5 | 6.8 |
| Money market and bank deposits | 4.8 | 2.4 | 2.4 | 16.8 | 10.7 | 6.2 |
| **Total** | **100.0** | **68.3** | **31.7** | **100.0** | **67.8** | **32.2** |

**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 2022

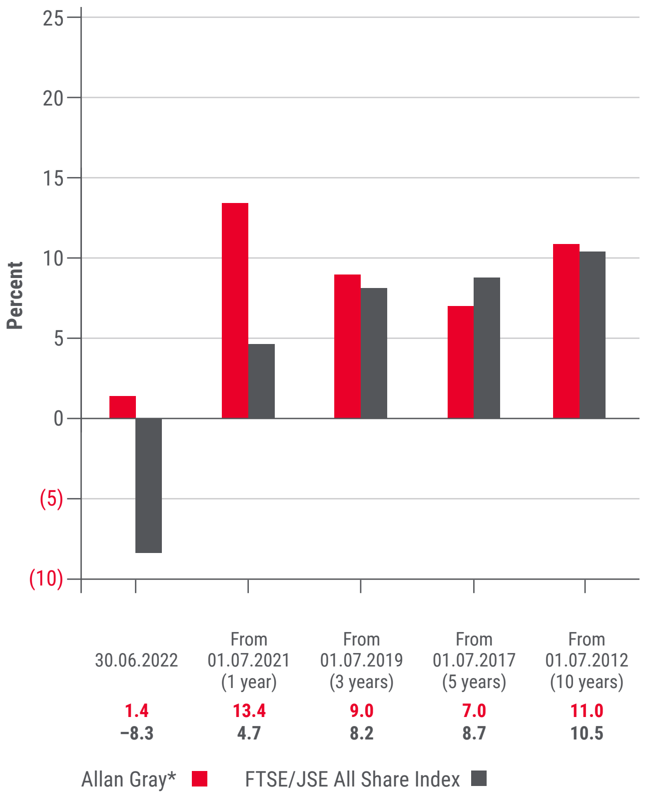
| Security (Ranked by sector) | Market value (R million) | % of Fund | FTSE/JSE ALSI weight (%) |
|---|---|---|---|
| **South Africa** | **26 269** | **69.8** | |
| **Equities** | **25 612** | **68.1** | |
| **Resources** | **6 995** | **18.6** | **28.5** |
| Glencore | 2 080 | 5.5 | |
| Sasol | 1 186 | 3.2 | |
| Sibanye-Stillwater | 892 | 2.4 | |
| Gold Fields | 509 | 1.4 | |
| Sappi | 453 | 1.2 | |
| Impala Platinum | 350 | 0.9 | |
| Northam Platinum | 324 | 0.9 | |
| AngloGold Ashanti | 304 | 0.8 | |
| Positions individually less than 1% of total JSE-listed securities held by the Fund[1] | 898 | 2.4 | |
| **Financials** | **7 123** | **18.9** | **24.0** |
| Nedbank | 1 160 | 3.1 | |
| Remgro | 1 079 | 2.9 | |
| Standard Bank | 1 011 | 2.7 | |
| FirstRand | 610 | 1.6 | |
| Reinet | 568 | 1.5 | |
| Old Mutual | 450 | 1.2 | |
| Investec | 438 | 1.2 | |
| Ninety One | 314 | 0.8 | |
| Positions individually less than 1% of total JSE-listed securities held by the Fund[1] | 1 493 | 4.0 | |
| **Industrials** | **11 494** | **30.6** | **47.4** |
| Naspers[2] | 2 699 | 7.2 | |
| British American Tobacco | 2 284 | 6.1 | |
| Woolworths | 1 229 | 3.3 | |
| AB InBev | 1 112 | 3.0 | |
| Mondi | 491 | 1.3 | |
| Life Healthcare | 352 | 0.9 | |
| KAP Industrial | 338 | 0.9 | |
| Tiger Brands | 316 | 0.8 | |
| Super Group | 314 | 0.8 | |
| MultiChoice | 300 | 0.8 | |
| AVI Limited | 294 | 0.8 | |
| Positions individually less than 1% of total JSE-listed securities held by the Fund[1] | 1 766 | 4.7 | |
| **Commodity-linked securities** | **216** | **0.6** | |
| Positions individually less than 1% of total JSE-listed securities held by the Fund[1] | 216 | 0.6 | |
| **Bonds** | **28** | **0.1** | |
| Positions individually less than 1% of the Fund | 28 | 0.1 | |
| **Cash** | **413** | **1.1** | |
| **Africa ex-SA** | **1 052** | **2.8** | |
| **Equity funds** | **1 052** | **2.8** | |
| Allan Gray Africa ex-SA Equity Fund | 1 052 | 2.8 | |
| **Foreign ex-Africa** | **10 288** | **27.4** | |
| **Equities** | **32** | **0.1** | |
| **Resources** | **32** | **0.1** | |
| Positions individually less than 1% of total JSE-listed securities held by the Fund[1] | 32 | 0.1 | |
| **Equity funds** | **10 169** | **27.0** | |
| Orbis Global Equity Fund | 4 606 | 12.2 | |
| Orbis SICAV International Equity Fund[3] | 3 316 | 8.8 | |
| Allan Gray Frontier Markets Equity Fund | 1 472 | 3.9 | |
| Orbis SICAV Japan Equity (Yen) Fund | 420 | 1.1 | |
| Orbis SICAV Emerging Markets Equity Fund | 354 | 0.9 | |
| **Cash** | **88** | **0.2** | |
| **Totals** | **37 610** | **100.0** | |

[1] JSE-listed securities include equities, property and commodity-linked instruments. [2] Includes holding in stub certificates or Prosus N.V., if applicable. [3] This fund is not approved for marketing in South Africa. Reference to this fund is solely for disclosure purposes and is not intended for, nor does it constitute, solicitation for investment. **Note:** There may be slight discrepancies in the totals due to rounding. For other fund-specific information, please refer to the monthly factsheets.

## Investment track record – share returns

| Allan Gray Proprietary Limited global mandate share returns vs FTSE/JSE All Share Index | | | |
|---|---|---|---|
| **Period** | **Allan Gray*** | **FTSE/JSE All Share Index** | **Out-/Under-performance** |
| 1974 (from 15.6) | –0.8 | –0.8 | 0.0 |
| 1975 | 23.7 | –18.9 | 42.6 |
| 1976 | 2.7 | –10.9 | 13.6 |
| 1977 | 38.2 | 20.6 | 17.6 |
| 1978 | 36.9 | 37.2 | –0.3 |
| 1979 | 86.9 | 94.4 | –7.5 |
| 1980 | 53.7 | 40.9 | 12.8 |
| 1981 | 23.2 | 0.8 | 22.4 |
| 1982 | 34.0 | 38.4 | –4.4 |
| 1983 | 41.0 | 14.4 | 26.6 |
| 1984 | 10.9 | 9.4 | 1.5 |
| 1985 | 59.2 | 42.0 | 17.2 |
| 1986 | 59.5 | 55.9 | 3.6 |
| 1987 | 9.1 | –4.3 | 13.4 |
| 1988 | 36.2 | 14.8 | 21.4 |
| 1989 | 58.1 | 55.7 | 2.4 |
| 1990 | 4.5 | –5.1 | 9.6 |
| 1991 | 30.0 | 31.1 | –1.1 |
| 1992 | –13.0 | –2.0 | –11.0 |
| 1993 | 57.5 | 54.7 | 2.8 |
| 1994 | 40.8 | 22.7 | 18.1 |
| 1995 | 16.2 | 8.8 | 7.4 |
| 1996 | 18.1 | 9.4 | 8.7 |
| 1997 | –17.4 | –4.5 | –12.9 |
| 1998 | 1.5 | –10.0 | 11.5 |
| 1999 | 122.4 | 61.4 | 61.0 |
| 2000 | 13.2 | 0.0 | 13.2 |
| 2001 | 38.1 | 29.3 | 8.8 |
| 2002 | 25.6 | –8.1 | 33.7 |
| 2003 | 29.4 | 16.1 | 13.3 |
| 2004 | 31.8 | 25.4 | 6.4 |
| 2005 | 56.5 | 47.3 | 9.2 |
| 2006 | 49.7 | 41.2 | 8.5 |
| 2007 | 17.6 | 19.2 | –1.6 |
| 2008 | –13.7 | –23.2 | 9.5 |
| 2009 | 27.0 | 32.1 | –5.1 |
| 2010 | 20.3 | 19.0 | 1.3 |
| 2011 | 9.9 | 2.6 | 7.3 |
| 2012 | 20.6 | 26.7 | –6.1 |
| 2013 | 24.3 | 21.4 | 2.9 |
| 2014 | 16.2 | 10.9 | 5.3 |
| 2015 | 7.8 | 5.1 | 2.7 |
| 2016 | 12.2 | 2.6 | 9.6 |
| 2017 | 15.6 | 21.0 | –5.4 |
| 2018 | –8.0 | –8.5 | 0.5 |
| 2019 | 6.2 | 12.0 | –5.8 |
| 2020 | –3.5 | 7.0 | –10.5 |
| 2021 | 28.9 | 29.2 | –0.3 |
| **2022 (to 30.06)** | **1.4** | **–8.3** | **9.7** |

### Returns annualised to 30.06.2022



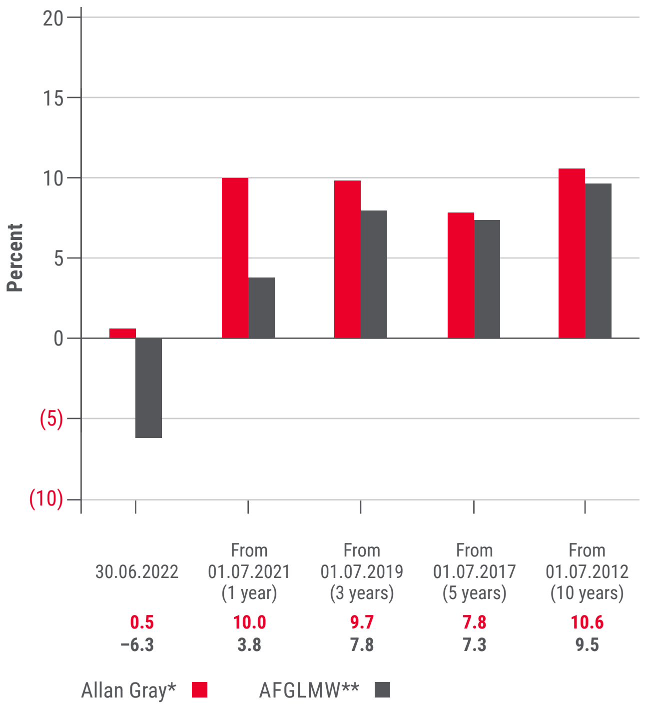

An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R284 726 371 by 30 June 2022. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R12 608 830. Returns are before fees.

*Allan Gray commenced managing pension funds on 1 January 1978. The returns prior to 1 January 1978 are of individuals managed by Allan Gray, and these returns exclude income. Returns are before fees.
**Note:** Listed property included from 1 July 2002. Inward listed included from November 2008 to November 2011.

## Investment track record – balanced returns

| Allan Gray Proprietary Limited global mandate total returns vs Alexander Forbes Global Large Manager Watch | | | |
|---|---|---|---|
| **Period** | **Allan Gray*** | **AFGLMW**** | **Out-/Under-performance** |
| 1974 | – | – | – |
| 1975 | – | – | – |
| 1976 | – | – | – |
| 1977 | – | – | – |
| 1978 | 34.5 | 28.0 | 6.5 |
| 1979 | 40.4 | 35.7 | 4.7 |
| 1980 | 36.2 | 15.4 | 20.8 |
| 1981 | 15.7 | 9.5 | 6.2 |
| 1982 | 25.3 | 26.2 | –0.9 |
| 1983 | 24.1 | 10.6 | 13.5 |
| 1984 | 9.9 | 6.3 | 3.6 |
| 1985 | 38.2 | 28.4 | 9.8 |
| 1986 | 40.3 | 39.9 | 0.4 |
| 1987 | 11.9 | 6.6 | 5.3 |
| 1988 | 22.7 | 19.4 | 3.3 |
| 1989 | 39.2 | 38.2 | 1.0 |
| 1990 | 11.6 | 8.0 | 3.6 |
| 1991 | 22.8 | 28.3 | –5.5 |
| 1992 | 1.2 | 7.6 | –6.4 |
| 1993 | 41.9 | 34.3 | 7.6 |
| 1994 | 27.5 | 18.8 | 8.7 |
| 1995 | 18.2 | 16.9 | 1.3 |
| 1996 | 13.5 | 10.3 | 3.2 |
| 1997 | –1.8 | 9.5 | –11.3 |
| 1998 | 6.9 | –1.0 | 7.9 |
| 1999 | 80.0 | 46.8 | 33.1 |
| 2000 | 21.7 | 7.6 | 14.1 |
| 2001 | 44.0 | 23.5 | 20.5 |
| 2002 | 13.4 | –3.6 | 17.1 |
| 2003 | 21.5 | 17.8 | 3.7 |
| 2004 | 21.8 | 28.1 | –6.3 |
| 2005 | 40.0 | 31.9 | 8.1 |
| 2006 | 35.6 | 31.7 | 3.9 |
| 2007 | 14.5 | 15.1 | –0.6 |
| 2008 | –1.1 | –12.3 | 11.2 |
| 2009 | 15.6 | 20.3 | –4.7 |
| 2010 | 11.7 | 14.5 | –2.8 |
| 2011 | 12.6 | 8.8 | 3.8 |
| 2012 | 15.1 | 20.0 | –4.9 |
| 2013 | 25.0 | 23.3 | 1.7 |
| 2014 | 10.3 | 10.3 | 0.0 |
| 2015 | 12.8 | 6.9 | 5.9 |
| 2016 | 7.5 | 3.7 | 3.8 |
| 2017 | 11.9 | 11.5 | 0.4 |
| 2018 | –1.4 | –2.1 | 0.7 |
| 2019 | 6.5 | 10.9 | –4.4 |
| 2020 | 5.3 | 6.3 | –1.0 |
| 2021 | 20.4 | 21.9 | –1.5 |
| **2022 (to 30.06)** | **0.5** | **–6.3** | **6.8** |

### Returns annualised to 30.06.2022




An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R31 816 363 by 30 June 2022. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R6 775 176. Returns are before fees.

*Allan Gray commenced managing pension funds on 1 January 1978. The returns prior to 1 January 1978 are of individuals managed by Allan Gray, and these returns exclude income. Returns are before fees.
**Consulting Actuaries Survey returns used up to December 1997. The return for June 2022 is an estimate. The return from 1 April 2010 is the average of the non-investable Alexander Forbes Global Large Manager Watch.
**Note:** Listed property included from 1 July 2002. Inward listed included from November 2008 to November 2011.

## Allan Gray South African unit trusts annualised performance (rand) in percentage per annum to 30 June 2022 (net of fees)

| | Assets under management (R billion) | Inception date | Since inception | 10 years | 5 years | 3 years | 1 year | Highest annual return[5] | Lowest annual return[5] |
|---|---|---|---|---|---|---|---|---|---|
| **High net equity exposure (100%)** | | | | | | | | | |
| **Allan Gray Equity Fund (AGEF)**<br>Average of South African - Equity - General category (excl. Allan Gray funds)[1] | 37.6 | 01.10.1998 | **19.4**<br>14.1 | **9.4**<br>8.9 | **6.0**<br>6.6 | **8.2**<br>8.7 | **8.5**<br>7.9 | **125.8**<br>73.0 | **−24.3**<br>−37.6 |
| **Allan Gray SA Equity Fund (AGDE)**<br>FTSE/JSE All Share Index including income | 4.1 | 13.03.2015 | **5.5**<br>6.7 | **–**<br>– | **5.9**<br>8.7 | **7.8**<br>8.2 | **12.4**<br>4.7 | **57.3**<br>54.0 | **−32.0**<br>−18.4 |
| **Allan Gray-Orbis Global Equity Feeder Fund (AGOE)**<br>FTSE World Index | 22.2 | 01.04.2005 | **13.2**<br>13.5 | **16.0**<br>17.5 | **7.4**<br>12.8 | **10.8**<br>12.7 | **−6.8**<br>−1.4 | **78.2**<br>54.2 | **−29.7**<br>−32.7 |
| **Medium net equity exposure (40% - 75%)** | | | | | | | | | |
| **Allan Gray Balanced Fund (AGBF)**<br>**Allan Gray Tax-Free Balanced Fund (AGTB)**<br>Average of South African - Multi Asset - High Equity category (excl. Allan Gray funds)[2] | 152.2<br>1.9 | 01.10.1999<br>01.02.2016 | **15.0**<br>**6.8**<br>11.2/5.9 | **9.5**<br>**–**<br>8.3 | **6.6**<br>**6.6**<br>6.1 | **8.6**<br>**8.4**<br>6.9 | **8.4**<br>**8.1**<br>2.5 | **46.1**<br>**31.7**<br>41.9/30.7 | **−14.2**<br>**−13.4**<br>−16.7/−10.3 |
| **Allan Gray-Orbis Global Balanced Feeder Fund (AGGF)**[3]<br>60% MSCI World Index with net dividends reinvested and 40% J.P. Morgan GBI Global Index[3] | 14.8 | 03.02.2004 | **10.3**<br>10.7 | **13.1**<br>13.3 | **7.0**<br>9.4 | **11.3**<br>8.4 | **8.7**<br>−1.6 | **55.6**<br>38.8 | **−13.7**<br>−17.0 |
| **Low net equity exposure (0% - 40%)** | | | | | | | | | |
| **Allan Gray Stable Fund (AGSF)**<br>Daily interest rate of FirstRand Bank Limited plus 2% | 47.3 | 01.07.2000 | **11.2**<br>8.5 | **8.2**<br>6.8 | **6.8**<br>6.5 | **7.3**<br>5.6 | **7.9**<br>5.0 | **23.3**<br>14.6 | **−7.4**<br>4.6 |
| **Very low net equity exposure (0% - 20%)** | | | | | | | | | |
| **Allan Gray Optimal Fund (AGOF)**<br>Daily interest rate of FirstRand Bank Limited | 0.9 | 01.10.2002 | **7.0**<br>6.0 | **5.7**<br>4.7 | **3.5**<br>4.4 | **3.4**<br>3.5 | **10.7**<br>2.9 | **18.1**<br>11.9 | **−8.2**<br>2.5 |
| **Allan Gray-Orbis Global Optimal Fund of Funds (AGOO)**<br>Average of US$ bank deposits and euro bank deposits | 1.2 | 02.03.2010 | **6.9**<br>5.7 | **8.0**<br>6.5 | **3.1**<br>4.1 | **7.0**<br>3.8 | **21.6**<br>8.1 | **39.6**<br>35.6 | **−12.4**<br>−19.1 |
| **No equity exposure** | | | | | | | | | |
| **Allan Gray Bond Fund (AGBD)**<br>FTSE/JSE All Bond Index (Total return) | 6.3 | 01.10.2004 | **8.6**<br>8.3 | **7.6**<br>7.2 | **7.8**<br>7.8 | **5.5**<br>5.8 | **1.6**<br>1.3 | **18.0**<br>21.2 | **−2.6**<br>−5.6 |
| **Allan Gray Money Market Fund (AGMF)**<br>Alexander Forbes Short-Term Fixed Interest (STeFI) Composite Index[4] | 24.5 | 03.07.2001 | **7.6**<br>7.5 | **6.4**<br>6.1 | **6.4**<br>5.9 | **5.5**<br>5.0 | **4.7**<br>4.2 | **12.8**<br>13.3 | **4.3**<br>3.8 |

[1] From inception to 28 February 2015, the benchmark was the FTSE/JSE All Share Index including income (source: IRESS).
[2] From inception to 31 January 2013, the benchmark of the Allan Gray Balanced Fund was the market value-weighted average return of the funds in both the Domestic Asset Allocation Medium Equity and Domestic Asset Allocation Variable Equity sectors of the previous ASISA Fund Classification Standard, excluding the Allan Gray Balanced Fund.
[3] From inception to 31 May 2021, this Fund was called the Allan Gray-Orbis Global Fund of Funds and its benchmark was 60% of the FTSE World Index and 40% of the J.P. Morgan GBI Global Index. From 1 June 2021, the Fund's investment mandate was changed from a fund of funds structure to a feeder fund structure investing solely into the Orbis SICAV Global Balanced Fund. To reflect this, the Fund was renamed and the benchmark was changed.
[4] From inception to 31 March 2003, the benchmark was the Alexander Forbes 3-Month Deposit Index. From 1 April 2003 to 31 October 2011, the benchmark was the Domestic Fixed Interest Money Market Collective Investment Scheme sector excluding the Allan Gray Money Market Fund.
[5] This is the highest or lowest consecutive 12-month return since inception. All rolling 12-month figures for the Fund and the benchmark are available from our Client Service Centre on request.

## Allan Gray total expense ratios and transaction costs for the 3-year period ending 30 June 2022

| | Fee for benchmark performance | Performance fees | Other costs excluding transaction costs | VAT | Total expense ratio | Transaction costs (incl. VAT) | Total investment charge |
|---|---|---|---|---|---|---|---|
| Allan Gray Equity Fund | 1.13% | -0.43% | 0.04% | 0.07% | 0.81% | 0.10% | 0.91% |
| Allan Gray SA Equity Fund | 1.00% | -0.76% | 0.01% | 0.04% | 0.29% | 0.11% | 0.40% |
| Allan Gray Balanced Fund | 1.04% | -0.20% | 0.04% | 0.09% | 0.97% | 0.08% | 1.05% |
| Allan Gray Tax-Free Balanced Fund | 1.32% | N/A | 0.04% | 0.15% | 1.51% | 0.10% | 1.61% |
| Allan Gray Stable Fund | 1.03% | -0.11% | 0.03% | 0.11% | 1.06% | 0.06% | 1.12% |
| Allan Gray Optimal Fund | 1.00% | 0.00% | 0.03% | 0.15% | 1.18% | 0.12% | 1.30% |
| Allan Gray Bond Fund | 0.30% | 0.09% | 0.01% | 0.06% | 0.46% | 0.00% | 0.46% |
| Allan Gray Money Market Fund | 0.25% | N/A | 0.00% | 0.04% | 0.29% | 0.00% | 0.29% |
| Allan Gray-Orbis Global Equity Feeder Fund | 1.49% | -0.66% | 0.05% | 0.00% | 0.88% | 0.10% | 0.98% |
| Allan Gray-Orbis Global Balanced Feeder Fund | 1.48% | -0.49% | 0.06% | 0.00% | 1.05% | 0.08% | 1.13% |
| Allan Gray-Orbis Global Optimal Fund of Funds | 1.00% | -0.01% | 0.08% | 0.00% | 1.07% | 0.14% | 1.21% |

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

## Foreign domiciled funds annualised performance (rand) in percentage per annum to 30 June 2022 (net of fees)

| | Inception date | Since inception | 10 years | 5 years | 3 years | 1 year | Highest annual return[5] | Lowest annual return[5] |
|---|---|---|---|---|---|---|---|---|
| **High net equity exposure** | | | | | | | | |
| **Orbis Global Equity Fund** | **01.01.1990** | **17.0** | **16.2** | **7.7** | **11.2** | **−6.4** | **87.6** | **−47.5** |
| MSCI World Index | | 13.4 | 17.5 | 12.8 | 12.7 | −1.9 | 54.2 | −46.2 |
| **Orbis SICAV Japan Equity (Yen) Fund** | **01.01.1998** | **13.3** | **13.7** | **6.6** | **6.9** | **−5.7** | **94.9** | **−40.1** |
| Tokyo Stock Price Index | | 8.7 | 13.4 | 6.0 | 5.8 | −7.9 | 91.0 | −46.4 |
| **Orbis SICAV Emerging Markets Equity Fund (US$)[6]** | **01.01.2006** | **11.9** | **10.9** | **2.9** | **3.6** | **−13.1** | **58.6** | **−34.2** |
| MSCI Emerging Markets Equity (Net) (US$)[6] | | 12.0 | 12.2 | 6.9 | 5.8 | −14.2 | 60.1 | −39.7 |
| **Allan Gray Africa ex-SA Equity Fund (C class)** | **01.01.2012** | **12.2** | **11.6** | **10.6** | **13.3** | **16.3** | **65.6** | **−24.3** |
| Standard Bank Africa Total Return Index | | 6.4 | 5.9 | 9.5 | 9.8 | −4.5 | 41.4 | −29.4 |
| **Allan Gray Australia Equity Fund** | **04.05.2006** | **13.5** | **14.2** | **8.9** | **7.7** | **11.1** | **99.5** | **−55.4** |
| S&P/ASX 300 Accumulation Index | | 11.7 | 12.6 | 9.4 | 8.0 | −2.0 | 55.6 | −45.1 |
| **Allan Gray Frontier Markets Equity Fund (C class)** | **03.04.2017** | **6.3** | **–** | **5.2** | **6.3** | **0.7** | **26.4** | **−11.0** |
| MSCI Frontier Emerging Markets Index | | 3.1 | – | 2.5 | −1.2 | −2.4 | 15.9 | −12.0 |
| **Medium net equity exposure** | | | | | | | | |
| **Orbis SICAV Global Balanced Fund** | **01.01.2013** | **13.5** | **–** | **7.5** | **12.0** | **8.9** | **54.4** | **−9.8** |
| 60% MSCI World Index with net dividends reinvested and 40% J.P. Morgan GBI Global Index | | 12.9 | – | 9.3 | 8.2 | −2.2 | 40.2 | −8.4 |
| **Allan Gray Australia Balanced Fund** | **01.03.2017** | **8.2** | **–** | **7.8** | **9.4** | **7.1** | **29.1** | **−5.3** |
| The custom benchmark comprises the S&P/ASX 300 Accumulation Index (36%), S&P/ASX Australian Government Bond Index (24%), MSCI World Index (net dividends reinvested) expressed in AUD (24%) and J.P. Morgan GBI Global Index expressed in AUD (16%). | | 8.1 | – | 8.0 | 6.7 | −3.3 | 25.1 | −5.8 |
| **Low net equity exposure** | | | | | | | | |
| **Allan Gray Australia Stable Fund** | **01.07.2011** | **10.1** | **9.0** | **6.2** | **7.8** | **8.1** | **32.7** | **−8.9** |
| Reserve Bank of Australia cash rate | | 6.0 | 4.7 | 3.1 | 4.7 | 5.4 | 28.8 | −15.5 |
| **Very low net equity exposure** | | | | | | | | |
| **Orbis Optimal SA Fund (US$)** | **01.01.2005** | **9.2** | **9.5** | **4.8** | **9.3** | **27.2** | **48.6** | **−15.7** |
| US$ Bank deposits | | 7.9 | 8.1 | 5.8 | 6.0 | 15.3 | 57.9 | −25.6 |
| **Orbis Optimal SA Fund (Euro)** | **01.01.2005** | **6.8** | **6.3** | **1.2** | **4.9** | **12.2** | **44.1** | **−19.3** |
| Euro Bank deposits | | 5.5 | 4.8 | 2.3 | 1.7 | 0.7 | 40.2 | −20.9 |
| **No equity exposure** | | | | | | | | |
| **Allan Gray Africa Bond Fund (C class)[7]** | **27.03.2013** | **11.5** | **–** | **8.3** | **4.4** | **−4.1** | **28.9** | **−7.4** |
| FTSE 3-Month US T Bill + 4% Index[7] | | 7.3 | – | 8.7 | 9.8 | 19.6 | 24.7 | −12.3 |

**Performance as calculated by Allan Gray**

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

[6] From inception to 31 October 2016, this Fund was called the Orbis SICAV Asia ex-Japan Equity Fund and its benchmark was the MSCI Asia ex-Japan Index. From 1 November 2016, the Fund's investment mandate was broadened to include all emerging markets. To reflect this, the Fund was renamed and the benchmark was changed.

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

# IMPORTANT INFORMATION FOR INVESTORS

### Information and content

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### Performance

Performance figures are provided by the Investment Manager and are for lump sum investments with income distributions reinvested. Where annualised performance is mentioned, this refers to the average return per year over the period. Actual investor performance may differ as a result of the investment date, the date of reinvestment and applicable taxes. Movements in exchange rates may also cause the value of underlying international investments to go up or down. Certain unit trusts have more than one class of units and these 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 the Management Company by 11:00 each business day for the Allan Gray Money Market Fund, and by 14:00 each business day for any other Allan Gray unit trust 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, auditor's fees, bank charges and trustee fees. A schedule of fees, charges and maximum commissions is available on request from Allan Gray.

### Benchmarks

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

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

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### Understanding the funds

Investors must make sure that they understand the nature of their choice of funds and that their investment objectives are aligned with those of the fund(s) they select. The Allan Gray Equity, Balanced, Stable and rand-denominated offshore funds may invest in foreign funds managed by Orbis Investment Management Limited, our offshore investment partner.

A feeder fund is a unit trust that invests in another single unit trust, which charges its own fees. A fund of funds is a unit trust that invests in other unit trusts, which charge their own fees. Allan Gray does not charge any additional fees in its feeder funds or 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 tax-free investment account, living annuity and endowment

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

Investment Account, Allan Gray Living Annuity and Allan Gray Endowment are administered by Allan Gray Investment Services (Pty) Ltd, an authorised administrative financial services provider, and underwritten by Allan Gray Life Ltd, an insurer licensed to conduct investment-linked life insurance business as defined in the Insurance Act 18 of 2017. The underlying investment options of the Allan Gray individual life and retirement products are portfolios of collective investment schemes in securities (unit trusts or funds) and life-pooled investments.

### Tax note

In accordance with section 11(i) of the Botswana Income Tax Act (Chapter 52;01), an amount accrued to any person shall be deemed to have accrued from a source situated in Botswana where it has accrued to such person in respect of any investment made outside Botswana by a resident of Botswana, provided that section 11(i) shall not apply to foreign investment income of non-citizens resident in Botswana. Botswana residents who have invested in the shares of the Fund are therefore requested to declare income earned from this Fund when preparing their annual tax returns. The Facilities Agent for the Fund in Botswana is Allan Gray Botswana (Pty) Ltd at 2nd Floor, Building 2, Central Square, New CBD, Gaborone, where investors can obtain a prospectus and financial reports.



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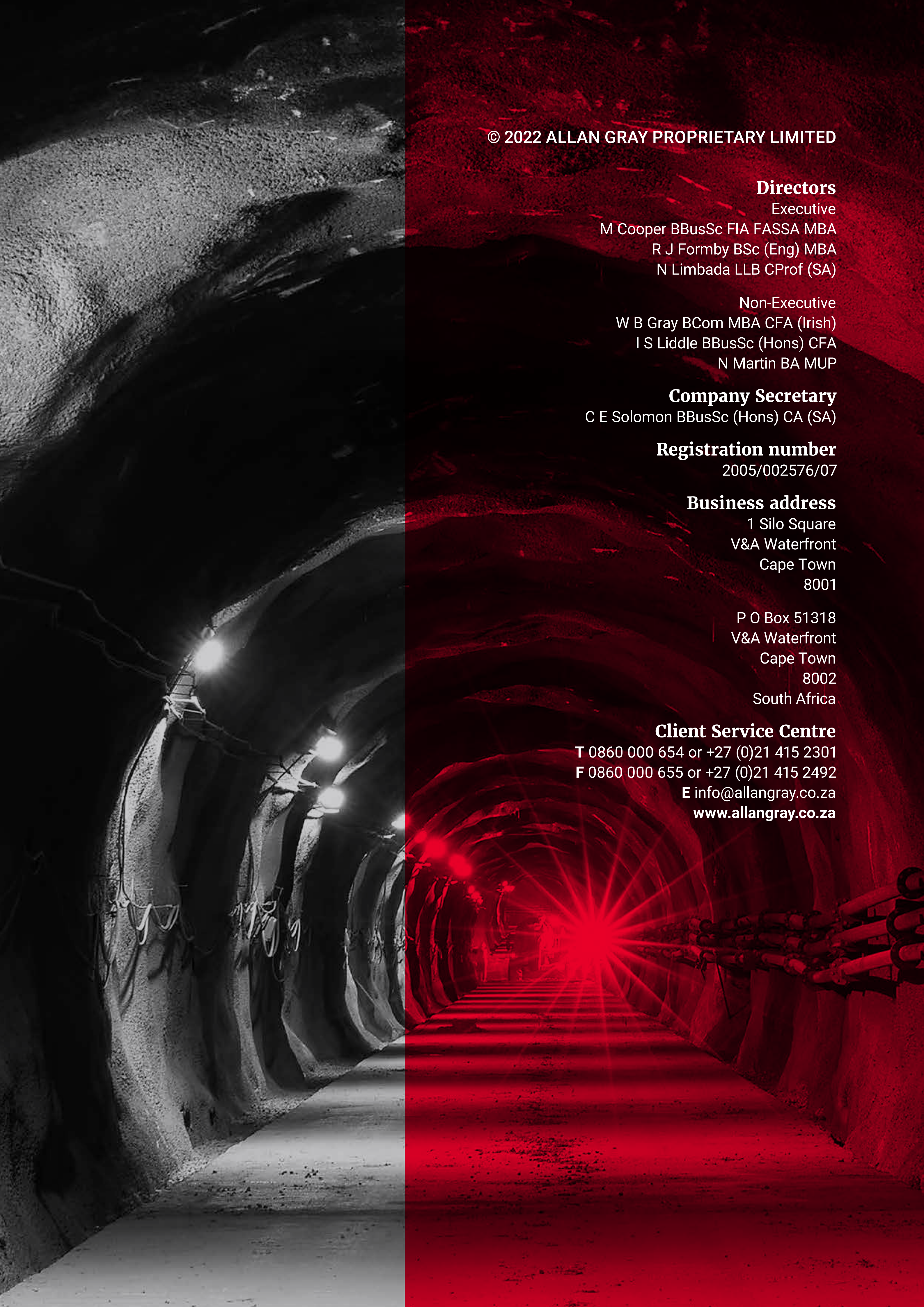



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