QC
Quarterly Commentary
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ALLAN GRAY

Currency dynamics and returns in emerging and frontier markets

CONTENTS

COMMENTS FROM THE CHIEF OPERATING OFFICER

Mahesh Cooper

Applying our investment philosophy and process to identify attractive stocks has always been fundamental to who we are and how we manage money for our clients.

As I mentioned last quarter, this year we celebrate our 50th anniversary. Milestones naturally provide an opportunity for both reflection and prospection: It is always insightful looking back on lessons learnt, considering what is currently happening in the world, and making sure that our portfolios account for multiple scenarios and possible outcomes. The various articles in this issue of our Quarterly Commentary reflect some of these themes.

Our Marketing team has spent time speaking to our past and present chief investment officers and chief operating officers to capture learnings and memories for current and future generations. A video of these interviews is available on our website, and provides some insights into our beginnings, our culture and our values. A key thread that emerges is how, over the generations of our leaders at Allan Gray, our philosophy has been consistently applied and we have always strived to act in our clients' best interests.

An area in which this is apparent is our approach to investing responsibly. Sustainability, which includes good governance, is embedded in how we invest on behalf of our clients, manage the business and interact with society at large. We have always considered environmental, social and governance (ESG) factors as part of our investment process and have a long history of responsible stewardship – as you can see from the quote below, which I have lifted from our latest Stewardship Report, but which first appeared in our Q4 2003 Quarterly Commentary.

"Allan Gray's relationship of trust with its clients and its investment ethics require not only that we make buy and sell decisions with our clients' best interests at heart, but also that we encourage our clients to exercise their rights as shareholders in favour of sound corporate governance. In our opinion, the key components to sound corporate governance are: effective disclosure, which enables investors to make informed decisions; accountability of those entrusted with running the business for their actions, both management to the board and the board to shareholders; and aligning the interests of managers and shareholders so that managers' incentives are designed to reward them for creating value for shareholders." – Stephen Mildenhall, chief investment officer, April 2001 - February 2008

We aim to be a great investment manager that integrates ESG well in our investment approach and decision-making, rather than an ESG-focused company that manages clients' assets. If you would like to learn more about our approach, and are interested in case studies and practical examples, please read our latest Stewardship Report, available via our website, which looks back on our efforts over 2022.

If this subject piques your interest, you may want to listen to our latest podcast. Nshalati Hlungwane, from our Institutional Clients team, is in conversation with ESG analyst Raine Adams and governance analyst Nicole Hamman about our approach to investing with ESG in mind.

Podcasts are a relatively new feature in our content arsenal, and we have delved into some interesting investment-related topics over the last few months. You can access these via our website or subscribe to *The Allan Gray Podcast* via your favourite podcasting platform.

The current investment context

The global economic outlook is not rosy. As Sandy McGregor discusses in his piece this quarter, there is a widely held view that developed economies are about to enter either a recession or, at the very least, a serious economic slowdown.

Sandy cautions that we should not expect the world to simply return to the relatively stable conditions that prevailed between 2010 and 2019. We face challenges that governments and central banks will find difficult to control. The turbulence of the past two years could be the new norm.

Opportunities emerge

Of course, it is important to remember that there are always countries that prosper despite global economic difficulties, and even within economies that are struggling, investment opportunities emerge. Japan is a great example: While it has been a depressing market overall for investors, it has been a tremendous hunting ground for active valuation-oriented stockpickers. The market's cyclicality feeds big swings in greed and fear, providing a great setup for contrarians to exploit. Brett Moshal, from our offshore partner, Orbis, illustrates this in his piece.

Sticking with the theme of finding opportunities in unusual places and embracing contrarian ideas, Rami Hajjar looks at some of the opportunities in emerging and frontier markets. He considers currency dynamics, focusing on how currency impacts returns, and how we think about this factor when investing in the emerging and frontier universe.

These themes all point to our focus on stockpicking: Applying our investment philosophy and process to identify attractive stocks has always been fundamental to who we are and how we manage money for our clients. As we celebrate our golden jubilee, Nick Curtin discusses one of the most significant events in our history – the launch of our first unit trust in 1998, the Allan Gray Equity Fund.

Several generations of investment professionals applying the same investment philosophy and repeating the same investment process over 50 years of market cycles has created an organisational DNA that is very difficult to replicate. The firm has been intentionally designed this way so that we can harness the power of compounding returns over long periods of time for our clients. Our track record is not just a number – it is a testament to repeatability. We protect our investment philosophy and investment process like the crown jewels that they are. Delivering on our promise to clients over the decades ahead depends on it.

Planning for the future

One of your longest-term investments is likely to be your retirement savings. Planning adequately for retirement is essential to ensure your long-term financial well-being. A key aspect of retirement planning is choosing the product, or combination of products, that will best enable you to meet your retirement goals. Earl Van Zyl and Tiaan van Wijk discuss the various investment products typically used to save for retirement, using examples to bring the insights to life.

As clients, you access our investment expertise through our unit trusts, and your investment success depends on our investment performance. However, client behaviour also plays a role. Of course, no client wants to lose money. In fact, as humans, we have a built-in aversion to loss. Unfortunately, by attempting to avoid short-term losses, many of us jeopardise our ability to achieve long-term real returns. In this quarter's Investing Tutorial, Nomi Bodlani discusses the importance of taking on enough risk, and staying the course, to ensure you reach your investment goals.

I hope the insights we share go some way towards helping you remain committed to your investment goals and time frames. Thank you for trusting us with your savings.

Kind regards

Mahesh Cooper

Mahesh Cooper

THE PROSPECTS FOR GLOBAL GROWTH

Sandy McGregor

There are strong arguments supporting the view that we are entering a new world … which will have aspects very different from what we have experienced over the past 40 years …

The post-pandemic bounceback of the global economy is losing momentum, and many fear that developed economies may slip into recession. Sandy McGregor discusses some of the important changes impacting the outlook.

A notable achievement of mathematicians in the second half of the 20th century was to establish theoretically that, in the long term, we cannot accurately predict either the weather or the economy, because both are complex systems in which a small, unpredictable random event can have profound consequences for the system as a whole. This insight is well expressed when it is said that a butterfly flapping its wings in the Himalayas can trigger a hurricane in the Caribbean. Perhaps the most dramatic example of this was the 1914 assassination of Archduke Franz Ferdinand in Sarajevo, which precipitated a succession of events leading to the First World War, the rise of communism, the Great Depression of the 1930s, the Second World War and the Cold War.

In our times, the COVID-19 pandemic may prove to be a similar game-changer. While hopefully we do not have a world war in our future, the pandemic may have set us on a very different path from the one we have followed since the early 1980s, when market liberalisation and globalisation became the key determinants of global growth.

An uncertain world

I have been involved in financial markets for more than 50 years and have never sensed such uncertainty among market participants as I do today. This is not just a South African phenomenon. It is everywhere. It is as if people have sensed things are changing but do not know where we are headed. While there are occasional outbreaks of old-style exuberance, such as we have recently witnessed when the prices of companies expected to benefit from artificial intelligence soared, generally the mood is not joyful. The days when US President Ronald Reagan could be triumphally re-elected on the slogan "It is morning in America" are long gone.

A widely anticipated recession

Currently, there is the widely held view that developed economies are about to enter either a recession or at the very least a serious economic slowdown. This is in itself unusual. Normally the market ignores prophets of doom until disaster is about to strike, often citing the adage “this time it is different”. Since 1980, economic expansions following a major recession have lasted between eight and 10 years. This time the consensus is that the recovery following the pandemic disaster of 2020 is already petering out. Consensus forecasts are that in 2023 the US, European and Japanese economies will all only grow by about 1%. The slowdown is already visible in Europe, but the US and Japan remain fairly buoyant. The Chinese growth outlook is also being questioned, as its bounceback after the ending of draconian COVID-19 restrictions seems less sustainable than expected.

The important question is whether this slowdown is simply a readjustment as the world recovers from the dislocations caused by the pandemic, after which more sustainable growth will resume, or the start of a very different economic order. There are strong arguments supporting the view that we are entering a new world, whose workings we shall only understand in time, but which will have aspects very different from what we have experienced over the past 40 years, a feature of which was declining inflation and interest rates (see **Graph 1** for the US experience).

The end of quantitative easing

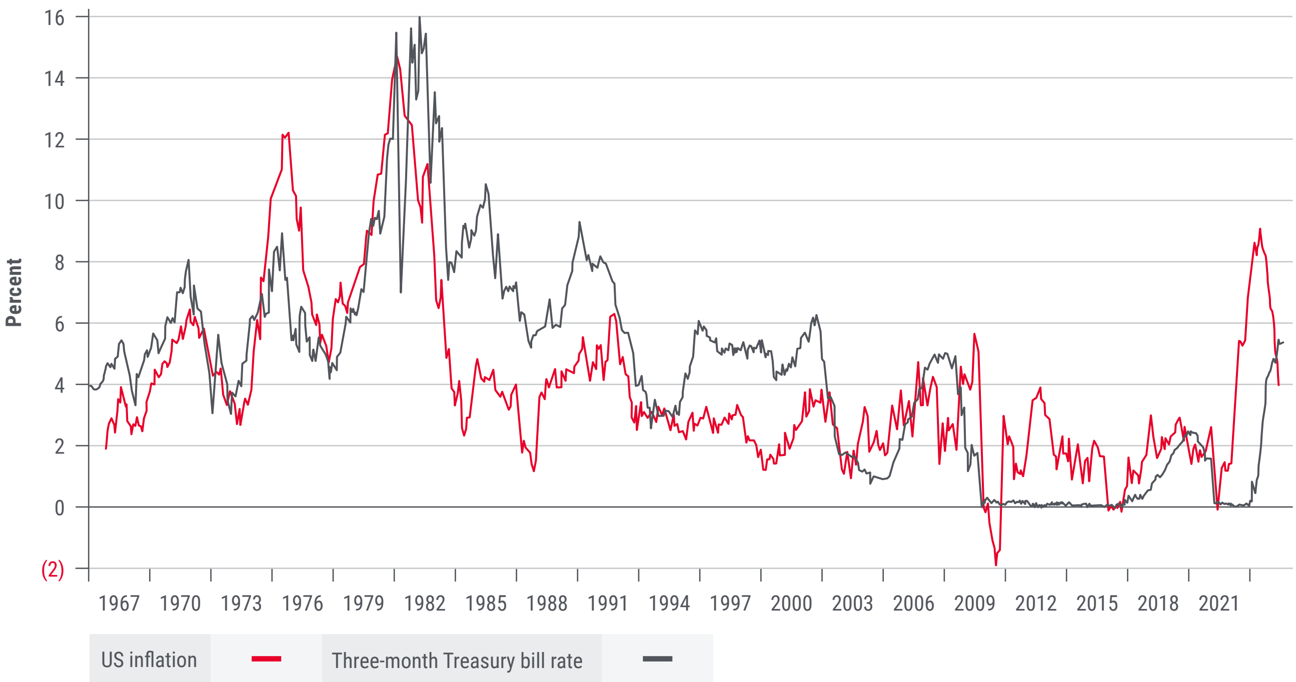
Central banks responded aggressively to the banking crisis of 2008/9 to protect financial stability. However, once the crisis had passed, within developed countries they responded to what were regarded as unacceptably low economic growth rates by slashing interest rates to zero and in some countries even below zero. They also embarked on programmes of quantitative easing (QE), which involved printing money to buy financial assets, mainly government debt.

QE failed to produce the growth central banks expected, and its proponents had to retreat to the common argument in support of failed policies that without QE, things would have been much worse. However, while QE failed to produce growth, it had a dramatic impact on asset prices. As real estate is financed by debt to a greater extent than other asset classes, it is the asset class whose prices have been the most inflated by low interest rates. More than a decade of zero rates has promoted a reckless overpricing of property. History suggests deflating these property bubbles could take another decade.

In response to the dislocation caused by the pandemic, governments and central banks expanded fiscal deficits and printed even more money. In the US, where the Federal Reserve

Graph 1: Four decades of declining inflation and interest rates (1982 – 2022)

US inflation vs. three-month Treasury bill rate



Source: IRESS

had started to raise interest rates, they were rapidly returned to zero. During the previous decade inflationary pressures had been benign, despite QE. Indeed, central banks were complaining that inflation was too low. Accordingly, there was widespread complacency about the possible inflationary consequences of the aggressive response to the pandemic.

While the initial financial actions in March 2020 were totally appropriate to preserve financial stability, governments operated under the illusion that ultra-low interest rates would be a sustainable feature of the financial system for many years to come. When inevitable inflationary pressures developed, central banks initially argued that these would be transitory and did not require tighter monetary conditions. They realised too late that they had triggered the biggest outbreak of inflation since the 1970s, which they are now struggling to control with ever-higher interest rates. Events have totally discredited the policies of QE and zero rates. We are returning to a world of higher interest rates such as prevailed in the 20 years that followed the 1982 recession, which crushed the inflation of the 1970s.

The path to a low-carbon world is going to be long, difficult, and acrimonious.

Unsustainable fiscal pressures

Almost all governments are facing ever-increasing obligations to provide healthcare and pensions. Generally, households' accumulated savings are inadequate to fund retirement, especially as people are living longer. The pandemic seems to have accelerated demographic changes, notably a decline in birth rates. A contracting cohort of those of working age who pay taxes and rising numbers of retirees who receive benefits is a fiscal time bomb, which will increasingly dominate the political discourse over the next decade. Politicians have made promises which are unaffordable, but to which the beneficiaries of this largess are deeply attached. Recently in France, President Macron faced huge opposition when he forced through a relatively small increase in retirement ages. This is a precursor of struggles to come.

When central banks were printing money seemingly without adverse consequences, it was argued that this offered a solution to the fiscal challenges facing governments. The sudden return of inflation has discredited this argument. Expenditures will be restricted to what is affordable. Difficult choices will have to be made as to where fiscal spending is to be directed. There will be no easy choices.

… there are not enough countries doing well to compensate for the impact of slower growth in China and the developed nations.

The decarbonisation project

The decarbonisation project is gaining momentum. Regardless of its merits, it is going to cost a lot of money. It requires huge investment in the generation and distribution of electricity and the introduction of new technologies, which often are less efficient than what is being replaced. It is inherently inflationary.

Already governments are paying substantial subsidies to kickstart the process. However, given other fiscal challenges, the scope to increase these subsidies is limited and the cost will have to be paid by consumers. This financial burden will reduce what is available for other expenditures, disrupting traditional spending patterns. In Europe, the surge in energy prices last year has angered voters, who could well turn against incumbent governments. For example, polls indicate that in the past year in Germany, support for the Green Party has declined from 24% to 16%. The path to a low-carbon world is going to be long, difficult, and acrimonious.

Slower growth in China

In the first two decades of this century, China has been the locomotive of global growth. Its gross domestic product (GDP) has grown from US$1.2tn in 2000 to an expected US$19.4tn this year. However, this era of rapid Chinese growth is drawing to an end. It is facing increasing economic challenges. Its population is no longer growing. Prior to the pandemic it was expected that China's population would peak in 2028. It now seems that its population already peaked in 2021. The country's one-child policy has left a demographic legacy, which has serious adverse consequences. China may get old before it gets rich. Its growth has largely been driven by investment; normally as an economy reaches maturity, growth is increasingly driven by consumption. In China, consumer spending has never grown large enough to replace investment as the main source of growth.

Investment in housing has been a key driver of the Chinese economy. Estimates of the contribution of housing to its GDP range between 20% and 30%. Houses account for more than 60% of household wealth. However, the Chinese property sector is now in deep trouble and the government is intervening to prevent a collapse of house prices. Housing is expensive relative to incomes and there is no longer the spending power to support ever-rising prices. Potential buyers are approaching the market with more caution. Housing can no longer contribute to Chinese growth as it has up to now.

China has disappointed expectations that, with the ending of pandemic lockdowns, it would bounce back strongly. While the People's Bank of China has cut interest rates, these are already too low for even lower rates to have a big impact. Aggregate debt is about 280% of GDP, the largest amount of which is owed by state-owned companies. It is no longer possible to drive the Chinese economy by perpetually increasing borrowings.

Japan reached a similar situation of overindebted companies in 1990 and it took 25 years of stagnation to fix the problem. Japan's response was to invent the modern policy of QE. China may have to do something similar, which, given its low rate of inflation and the protection to its exchange rate provided by capital controls, it can do. However, its contribution to global growth will be much reduced compared to the recent past.

Which countries are doing well?

It is important to remember that there are always some countries which are prospering despite global economic difficulties. India is now the country with the largest population. It has been transformed in recent years by more effective infrastructure investment and the pro-business policies of the Modi government. It looks set to grow more than 6% this year and its growth path seems sustainable. The Middle East is booming on the back of high energy prices. Indonesia, which has a population of 274 million, is also set on a path of longer-term growth. However, there are not enough countries doing well to compensate for the impact of slower growth in China and the developed nations.

A bipolar world

The increased integration of the global economy after 1982 accounted for much of the prosperity of the four decades prior to the pandemic. Communism collapsed in Eastern Europe and Russia, and China became a market economy and the world's biggest trading power. Sophisticated global supply chains reduced the costs of traded goods, increasing the well-being of consumers everywhere.

The pandemic caused supply disruptions, which have caused business and governments to question the robustness of these supply chains and manufacturing is moving back to be closer to key markets. This process has been accelerated by increasing tensions between China and the US and by Russia's invasion of Ukraine. The world is dividing into two blocs. One is made up of the democracies of North America, Europe, Japan, Korea and Australasia. The other is Russia and China. As tensions rise, more money is being spent on armaments. The global trading system still operates but not as efficiently as it did in the past.

... it looks as though the days of cheap money are over.

The ending of the savings glut

From 2003 onwards there was an increasing glut of global savings. Certain countries had significant current account surpluses which were recycled mainly into the dollar, the world's reserve currency. In aggregate, savings exceeded the requirement for investment, which depressed interest rates. However, the major source of excess savings since 2008 has been the creation of money by central banks (QE, as explained earlier). In this period, the assets of the Federal Reserve System, the European Central Bank and the Bank of Japan have increased from US$4tn to US$22.2tn. Between them they have added US$18.2tn to the global savings pool. Most of this went to funding government deficits. Over the past year, as their primary policy objective has shifted from promoting growth to taming inflation, central banks, with the notable exception of the Bank of Japan, have reduced their funding of governments and are contracting their balance sheets.

The immediate impact of this important policy change has been reduced by the availability of excess savings accumulated during the pandemic. There are various estimates of the size of the pool of excess savings, but it seems probable it will be exhausted within six to 12 months. This would place the full brunt of funding government deficits on private sector savings and the market could experience significant liquidity problems. Central banks will respond to ensure that markets have the liquidity they require to operate efficiently, but they do not wish to create too much money for fear of reigniting inflationary pressures. We have yet to see the full consequences of the ending of QE, but it looks as though the days of cheap money are over.

The turbulence of the past two years could be the new norm.

A Minsky moment

Hyman Minsky was an economist, who would surely have won the Nobel Prize if he had lived slightly longer. His key insight was that long periods of stability create instability. Stability allows market participants to take on more risk, notably by taking on more debt. It allows people to do crazy things, paying inflated prices for assets. The longer the stability lasts, the greater the excesses. Then there is a sudden collapse, often for some trivial reason, and the whole edifice comes crashing down. The Minsky moment is the point when this implosion commences.

A good example was the US subprime crisis, which blew up the world's financial system in 2008. Years of increasingly irresponsible mortgage lending suddenly became unsustainable. That was a Minsky moment. Like most regulators and central bankers, Minsky thought stability was a good thing and that policy should promote it. He saw regulation as the solution to the problem he had identified. However, regulation is seldom effective because the regulators are always fighting the last war. The best solution is to allow a degree of instability, which eliminates excesses before they become threatening. That has not found favour among governments, which remain committed to maintaining stability.

Central banks used low interest rates and QE to maintain stability in the decade following the 2008 crisis. This was accompanied by an unsustainable absence of inflation. Our present Minsky moment was when inflation exploded out of control in 2022. This heralded the start of a new more turbulent time, characterised by higher inflation and interest rates and increasingly acrimonious political discourse, both between and within nations.

As the world emerges from the current economic slowdown, we should not expect that we shall return to the relatively stable conditions which prevailed between 2010 and 2019. We face challenges which governments and central banks will find difficult to control. The turbulence of the past two years could be the new norm.

Sandy joined Allan Gray as an investment analyst and economist in 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. Sandy was a director of Allan Gray Limited from 1997 to 2006.

CURRENCY DYNAMICS AND RETURNS IN EMERGING AND FRONTIER MARKETS

Rami Hajjar

Recurrent macroeconomic and currency shocks do pose a problem in that they often cause short-term value loss … but these generally correct over time …

Rami Hajjar considers currency dynamics in emerging and frontier markets, focusing on how currency impacts returns, and how we think about this factor when investing in those markets. He also looks at South Africa in the context of the analysis and discusses whether the rand faces similar risks.

Given that emerging and frontier market currencies have weakened considerably over the recent past, this seems to be an opportune time to discuss some concerns investors have about investing in these markets.

Emerging and frontier markets are developing countries typically characterised by less mature capital markets, infrastructure and governance. This means that they tend to have less stable macroeconomic pillars in place: In most cases the tax take is low, governments spend beyond their means and, more importantly, there is a lack of institutional independence. Monetary policy is often at the service of the government, and fiscal and monetary profligacy tends to be correlated. These factors drive high currency volatility.

Focusing on currency performance

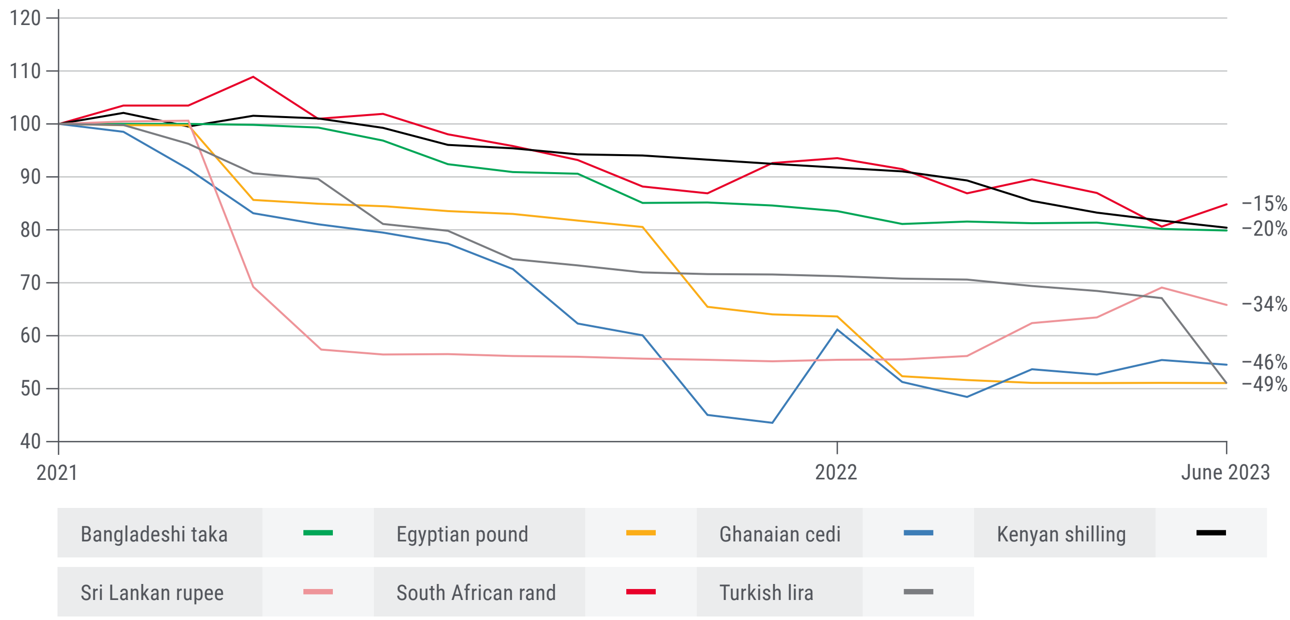
Since the end of 2021, several countries in emerging and frontier markets have experienced sizeable devaluations of their currencies, as shown in **Graph 1** on page 10. Large capital movements into and out of these markets are recurrent and generally track the developed markets' economic cycle. High inflation has pushed developed markets' central banks to increase interest rates, which, in turn, has reduced the relative attractiveness of returns in emerging and frontier markets. Some countries – many in the emerging and frontier universe – are more vulnerable, such as those with higher foreign currency debt levels and/or import needs, which exacerbate foreign exchange shortages and currency devaluation. It is not an easy task to predict the timing or the magnitude of these moves. But once they occur, investors become increasingly concerned and question the case for investing in emerging and frontier markets.

Why do emerging and frontier markets have volatile exchange rates?

Let's start by considering some basic concepts that will inform the ensuing analysis:

Graph 1: Currency performance in selected emerging and frontier markets

Spot exchange rate based at 100 as at end 2021



Note: The currency performances measure the US$ value of the local currency as opposed to the local currency value of a US dollar.
Sources: Bloomberg, Allan Gray research

Fundamentally, two factors drive monetary stability: In a closed economy, the money supply is a main determinant of monetary stability. The monetarist view holds that an increase in the money supply by more than real gross domestic product (GDP) is inflationary.

In an open economy, money supply also drives monetary stability, but the exchange rate is an additional factor. The quantity of foreign exchange that a country has to meet its foreign exchange needs is a main driver of the exchange rate, as is the quantity of foreign exchange held relative to the local money supply. All else being equal, both a shortage of foreign exchange in the country and an increase in money supply can lead to a large currency devaluation.

One important economic theory postulates that the relative prices of goods and services between two countries should not vary over time. High inflation in a given country necessitates an equivalent currency devaluation to keep relative prices broadly intact. This appears to hold over long periods of time: Inflation and the exchange rate are very highly correlated. In economic jargon, this is referred to as the relative Purchasing Power Parity (PPP) model.

Money supply impacts inflation

A common driver of large currency devaluations in emerging and frontier markets is very high inflation levels that are caused by large increases in the money supply. Let's look at the example of four currencies that have experienced very large devaluations since the end of 2019: The Turkish lira is down 70%, the Egyptian pound 52%, the Argentinian peso 75% and the Ghanaian cedi 52%.

An increase in money supply through reckless monetary policy – which in most cases is tied to reckless fiscal policy – has led to very high inflation levels, as shown in **Graph 2**. This, in turn, has been a major factor behind the large currency devaluations.

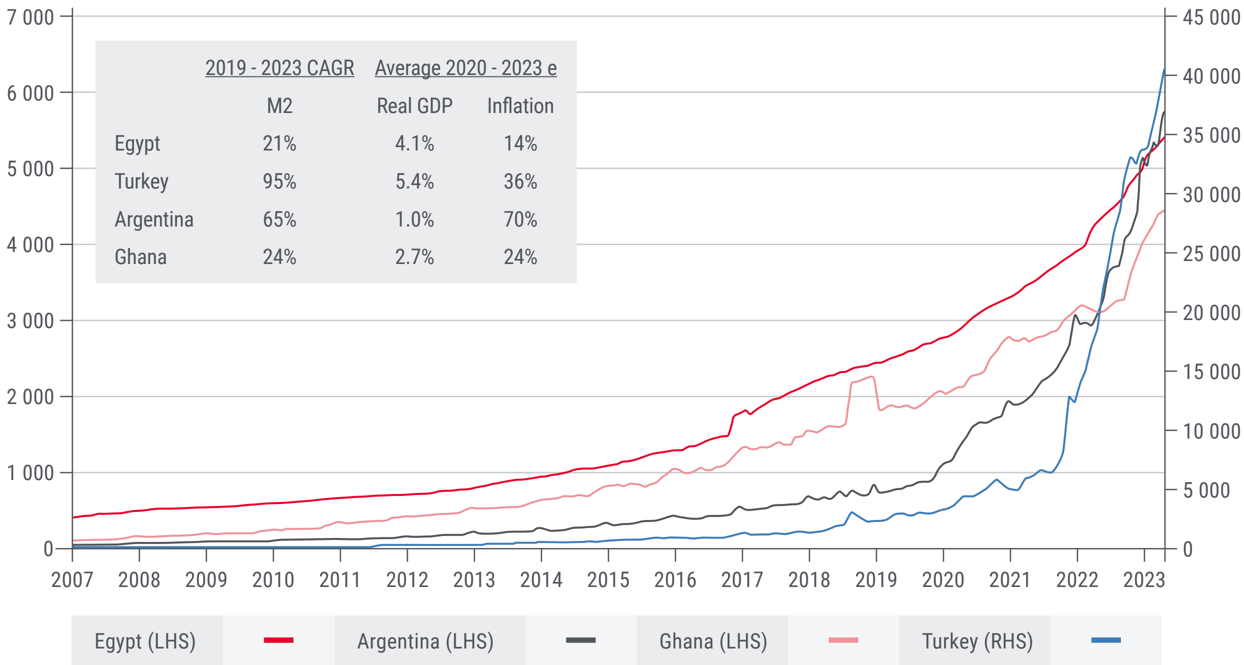
Increase in money supply → Inflation → Currency devaluation

Importantly, those inflation levels and the concomitant currency trajectories are the result of arbitrary changes in monetary policy and not something that could have been assessed beforehand. If one can no longer reliably forecast inflation in a country, it becomes futile to determine the fair value of that country's currency, or to be more specific, to anchor the US dollar value of a local currency today with the aim of establishing a trajectory that could be reliably forecast.

Foreign exchange reserves matter

Monetary policy is a large driver of a currency, but it is not the only factor at play. Irrespective of monetary policy,

Graph 2: M2* money supply



	2019 - 2023 CAGR	Average 2020 - 2023 e	
	M2	Real GDP	Inflation
Egypt	21%	4.1%	14%
Turkey	95%	5.4%	36%
Argentina	65%	1.0%	70%
Ghana	24%	2.7%	24%

*M2 is a measure of the money supply that includes cash, chequing deposits and other types of deposits that are readily convertible to cash.
Note: Turkey based at 100 in January 2007, Egypt based at 400 in January 2007, Argentina based at 50 in January 2007 and Ghana based at 100 in January 2007.
CAGR = compound annual growth rate. e = estimate.
Sources: Bloomberg, Allan Gray research

countries that lack a diversified export base (to earn foreign currency) or that have a strong reliance on the imports of goods (and have to pay foreign currency) are highly exposed to exogenous shocks. An unfavourable change in the terms of trade[1] can lead to large shortages in foreign currency at times. For countries that haven't built the appropriate foreign currency reserves (or are not fortunate enough to receive a large external bailout), the change in the exchange rate could become permanent: The inability to supply the necessary amount of foreign currency to meet local demand for foreign goods and services until circumstances normalise can lead to a currency devaluation/inflation spiral.

Currency devaluation → Inflation → Further devaluation

From a return perspective, do currency moves matter over long periods of time?

Currency moves in emerging and frontier markets impact returns for foreign investors.[2] Stocks and interest-bearing securities have local currency income streams, and the US dollar prices of those securities move in tandem with the US dollar value of those streams.

Interest-bearing securities

Interest-bearing securities include T-bills, bonds and any form of local currency debt. From a foreign investor's standpoint:

Returns = nominal yield + currency change over the investment period

Given the fixed nature of the income stream, large currency devaluations have a significant impact on returns.

As bond investors ... we ... gauge the likelihood of upcoming shocks and position our portfolios accordingly.

A metric often used to gauge the attractiveness of a local currency interest-bearing security is the real (after local

[1] Relative price of exports in terms of imports defined as the ratio of export prices to import prices.
[2] We use US dollar as a proxy for foreign currency in this discussion.

inflation) yield. The problem with this metric is that it uses local inflation as a deflator to determine the approximate real return. In countries with stable macroeconomics, inflation expectations are more predictable, and this metric can be relied on to some extent (the real rate should approximate the US dollar return). But this is not the case in countries with mismanaged macroeconomic policy or countries at high risk of exogenous shocks. **Table 1** provides good examples.

The disconnect between inflation at the date of investment and actual currency devaluation over three years meant that while real rates screened attractive at the end of 2019, the actual returns were very poor. In contrast, in June 2017, while real rates on Egyptian bonds were deep in the negative, an investor in those bonds would have generated 22% p.a. in US dollar over the next three years.

As bond investors in these markets, we proactively gauge the likelihood of upcoming shocks and position our portfolios accordingly. For instance, since the double whammy of COVID-19 and the Russia-Ukraine war, we have tilted the Allan Gray Africa Bond Fund substantially into Eurobonds[3] and kept a small exposure to locally denominated instruments in countries with much lower risk of currency shocks, such as Uganda.

Stocks

Over long periods of time, the value of a stock[4] is driven by the earnings that the company generates – and earnings are a function of the prices a company can charge for its goods and services. On aggregate, corporates price with inflation – which is nothing but the change in the aggregate price level of goods and services that corporates sell. Based on the relative PPP model and what history suggests, currency devaluation and inflation tend to move in tandem, which means that the real value of a corporate's revenue stream or profits should be protected over time.

However, reality over the short term is not as smooth as long-term trends. Firstly, currency devaluation has a direct translation impact on today's earnings. Given that the market is short-term-driven, this impacts short-term price performance. Secondly, adjustments take time, and short-term problems arise that can lead to longer-term ones. Some of the more common issues include a large deterioration in the purchasing power of consumers, which does not recover quickly, an inability to pass cost increases on to consumers for some time, currency mismatches on the balance sheet, and the inability to source foreign exchange.

> ... [quality] corporates tend to restore their earning power quickly, ... providing a natural hedge to currency devaluation.

Given the recurring nature of macroeconomic shocks, many of the quality corporates in those countries have developed resilient business models and are accustomed to those risks. These corporates tend to restore their earning power quickly, thereby providing a natural hedge

Table 1: Hypothetical returns on local currency three-year bonds

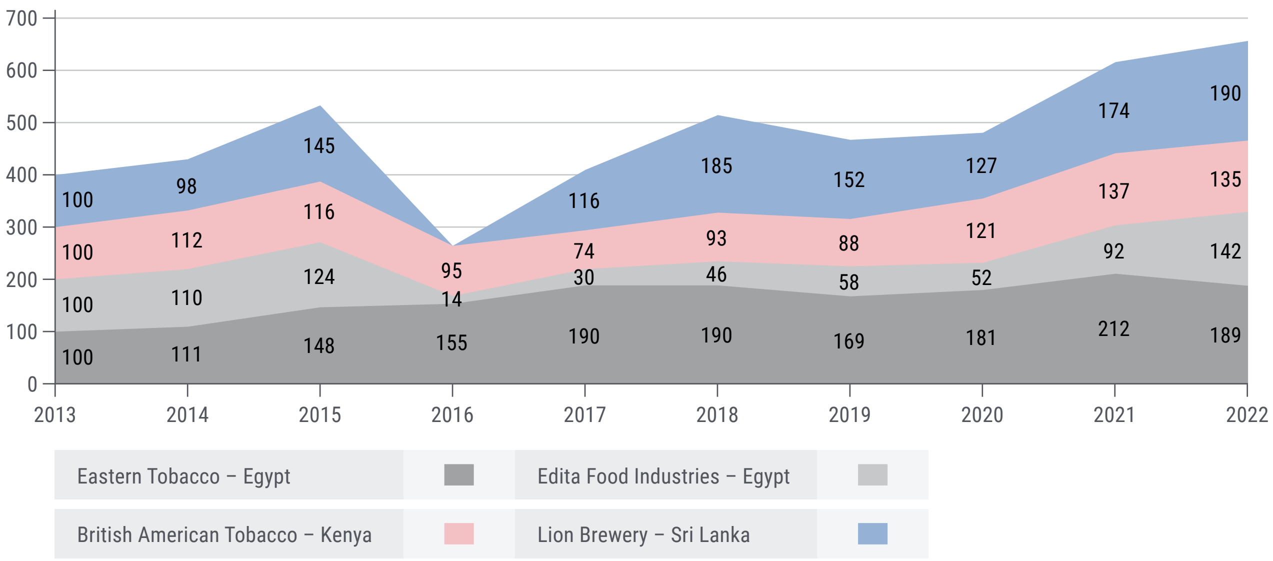
		At date of investment			
	Date of investment	3-year nominal bond yield	Inflation	"Real" rate	Actual US$ returns p.a. – held to maturity
Egypt	31/10/2019	14%	2%	**12%**	0%
Ghana	31/10/2019	18%	8%	**10%**	−9%
Turkey	31/10/2019	14%	9%	**6%**	−18%
Egypt	30/06/2017	18%	32%	−14%	**22%**

Sources: Bloomberg, Reuters, Allan Gray analysis

[3] Country bonds issued in a currency other than that of the issuer's country.
[4] In the context of this section, we are referring to corporates that generate their revenue predominantly in local currency, noting that the universe also includes corporates that generate the majority of their revenue in foreign currency, such as resource companies and exporters.

Graph 3: US$ earnings of key frontier market consumer names*

The equi-weighted US$ earnings of these four companies have gone up by 5.5% p.a. since 2013.



*Based at 100 in 2013.
Notes: Financial year-end for Lion Brewery is in March, which means for this company, 2022 on the graph refers to March 2023. Financial year-end for Eastern Tobacco is in June, which means for this company, 2022 on the graph refers to June 2022. Financial year-end for British American Tobacco and Edita Food Industries is in December, which means for these companies, 2022 on the graph refers to December 2022.
Sources: Bloomberg, Allan Gray analysis

to currency devaluation. As investment managers, we strive to pick those quality stocks. **Graph 3** depicts the earnings of four names we hold on behalf of our clients.

Despite large currency devaluation in their respective countries, these consumer names – whose earnings are predominantly in local currency – have seen decent US dollar profit growth since 2013. And it is US dollar earnings growth that drives share price performance over time.

How to think of value amid high currency volatility: The case of Zimbabwe

Zimbabwe provides an extreme example to explain how we think of value in markets with high currency volatility. I will not expand on Zimbabwe's economic case in this piece. Suffice to say that highly reckless fiscal and monetary policies have led to repeated episodes of monetary debasement since 2000 – reflected in multiple periods of hyperinflation and currency collapses.

Let's take the example of the dominant brewer in Zimbabwe, Delta Breweries. As **Graph 4a** on page 14 shows, there is a clear positive correlation between Delta's earnings in Zimbabwean dollar (ZWL), the stock price and the foreign exchange rate.

Local currency earnings at a given point in time do not tell us much and looking at local currency valuations is not appropriate in such circumstances. For instance, valuing Delta using 15 times end of March 2023 earnings per share would yield a fair price of ZWL1 110. Spot price on 30 June 2023 was ZWL3 147 (Graph 4a, bar chart, right-hand-side axis, depicts the large premium of the spot rate relative to a conventional approach to calculate fair value).

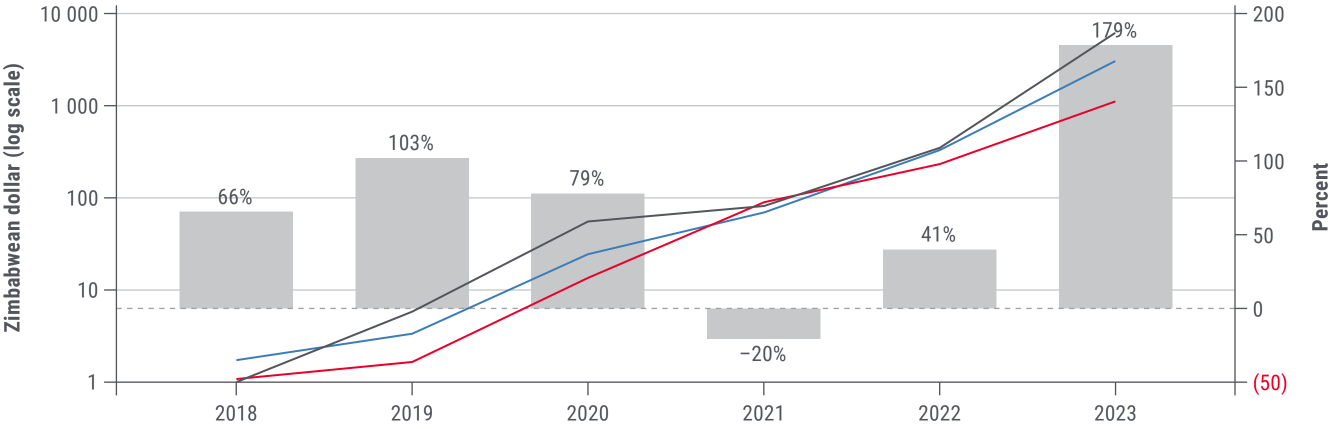
The aim is to anchor the net worth of a business to a stable value. Delta is a dominant brewer that owns state-of-the-art equipment (real assets), sells products that are in strong demand throughout the cycle, and proactively prices its products with inflation. As **Graph 4b** on page 14 shows, the US dollar price of a beer in Zimbabwe at any given point in time does not differ much relative to history and remains in a range that is comparable to prices in the region. One can therefore make assumptions about the US dollar earning power of the business – irrespective of whether the company is generating US dollar or Zimbabwean dollar revenues.[5]

Once conservative assumptions are made, one can estimate the net worth of the business by applying the right valuation multiple. In situations where value is not realisable, such as

[5] As a matter of fact, since Zimbabwe has become a mostly dollarised economy, the larger part of Delta's sales is made in US dollar, and volumes are currently at record highs.

Graph 4a: Delta Breweries stock price and the currency

Given the extent of the moves, the left-hand axis is shown in log scale. At each point the line charts cross a horizontal line, the data series is up tenfold.

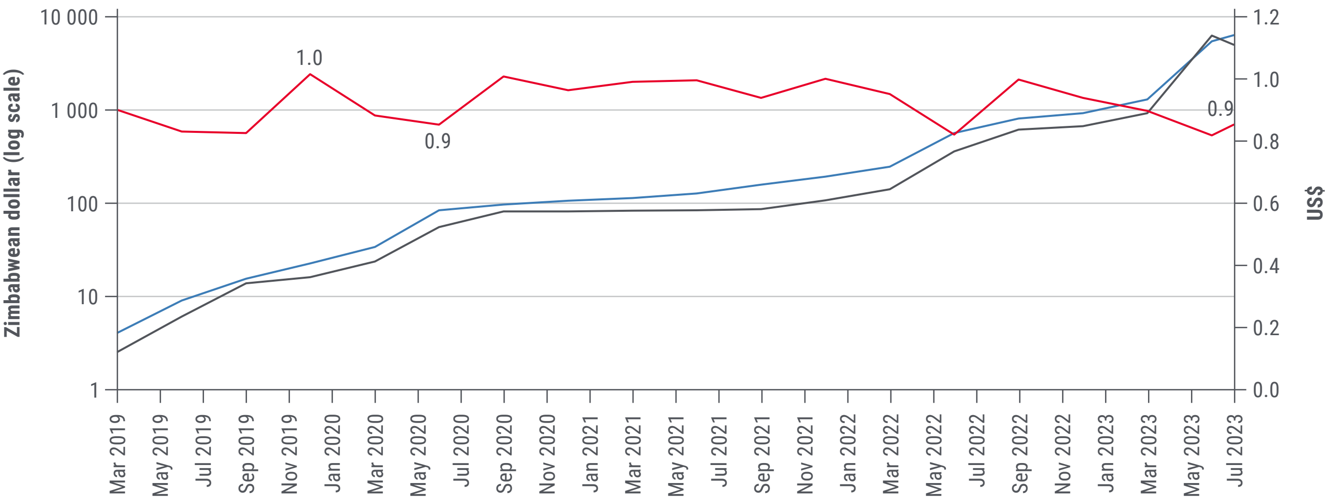


		2018	2019	2020	2021	2022	2023
(blue line)	Delta share price – mid-year (ZWL) (LHS)	2	3	25	72	335	3 100
(red line)	"Fair value": 15x Delta EPS* (LHS)	1	2	14	90	238	1 110
(grey bar)	Premium: (Delta share price)/(Delta "fair value") (RHS)	66%	103%	79%	−20%	41%	179%
(dark grey line)	US$/ZWL (official) (LHS)	1	6	56	85	366	6 326

*FYE March (ZWL)
Note: The values in the table are not in log scale, as opposed to the values of the line charts in the graph, which are in log scale.
Sources: Bloomberg, Reserve Bank of Zimbabwe, author calculations

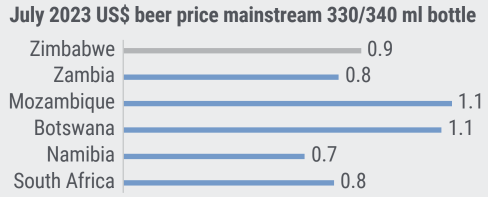
Graph 4b: Beer prices remain stable in real terms over the long term

Zambezi Lager – Mainstream 340 ml returnable bottle



Retail price of beer (ZWL)** – log scale (LHS)
US$/ZWL official – log scale (LHS)
Retail price of beer (US$) – using parallel rate** (RHS)

July 2023 US$ beer price mainstream 330/340 ml bottle



**Values are very approximate and based on unofficial sources including author estimates.
Sources: Bloomberg, various sources from the internet, author estimates

is the case with Zimbabwe today, we apply a further discount to the valuation multiple. In fact, our positions in Zimbabwe are valued at the lower of the market price, using the official exchange rate, or our conservative estimate of each stock's fair value.

Patient investors in emerging and frontier markets can earn real returns

We generally avoid making firm currency forecasts. On the one hand, this is not our speciality, and the track record of those who do it is mixed. On the other, we try to think of valuations irrespective of currency moves.

This doesn't mean that we do not consider the country's track record in macroeconomic governance and its history of monetary management. Recurrent macroeconomic and currency shocks do pose a problem in that they often cause short-term value loss (lower US dollar earnings and dividends), but these generally correct over time, and patient investors are able to generate decent real returns.

Is South Africa at risk of currency debasement?

One important takeaway from the countries we considered is that reckless fiscal and monetary policies have led to very high inflation levels, and these have been the main drivers of the currency collapses.

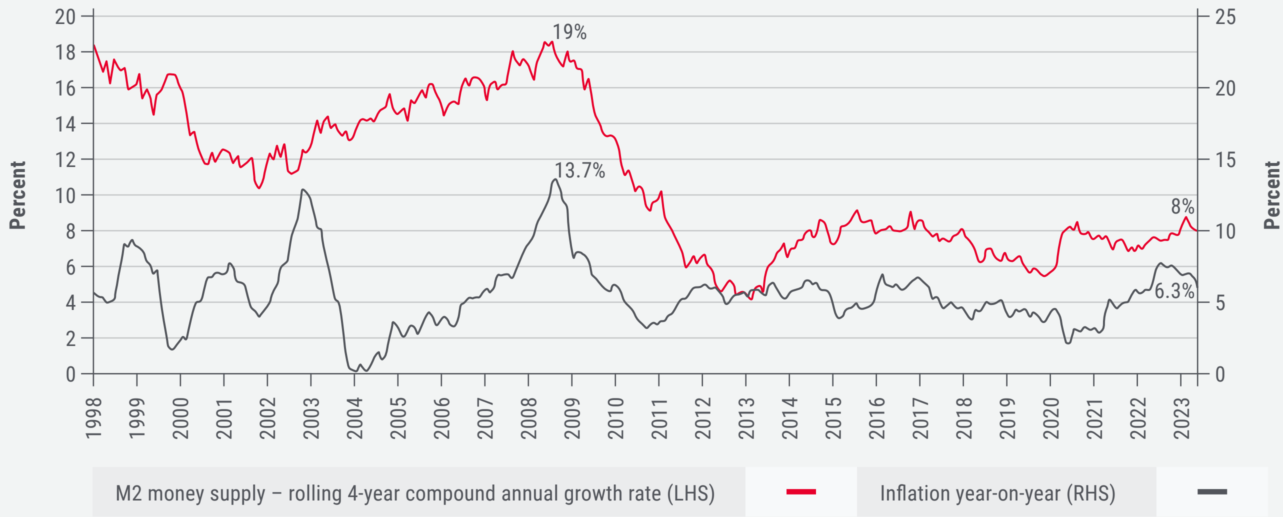
Graph 5a on page 16 shows that South Africa has a good track record of monetary discipline. This is one benefit of having an independent central bank that respects a mandate to control inflation. Continued monetary discipline and anchored inflation expectations will be important drivers of currency stability going forward – while recognising that monetary policy can lose its effectiveness with fiscal imprudence.

The other fundamental factor in currency stability is foreign exchange supply and demand. South Africa has a structural current account deficit, which means that normal economic activity results in more foreign exchange going out of the country than coming in, in any given year. But the deficit is not large, and the country fares well relative to other markets we consider, as it has an export base that is sensitive to rand weakness, and some import substitution can take place when the currency weakens a lot – a natural adjustment mechanism. The latter factor means that the pass-through effect from the weakened currency to inflation is not very large, compared to that in a country like Egypt, for instance, where the local manufacturing base is very weak.

There is an important third factor to consider: confidence. No matter how solid the fundamentals of a country are, investors losing confidence in a market can drive a run on the currency. In such a scenario, a dangerous feedback loop can kick in where negative sentiment drives currency drops, and large currency drops start to de-anchor inflation expectations, which causes further currency drops.

The probability of this happening in South Africa is low, and we are hopeful that the action plan currently in place to solve the crucial infrastructure issues, together with successful efforts to contain the fiscus, will prompt a re-evaluation of South Africa's investment case.

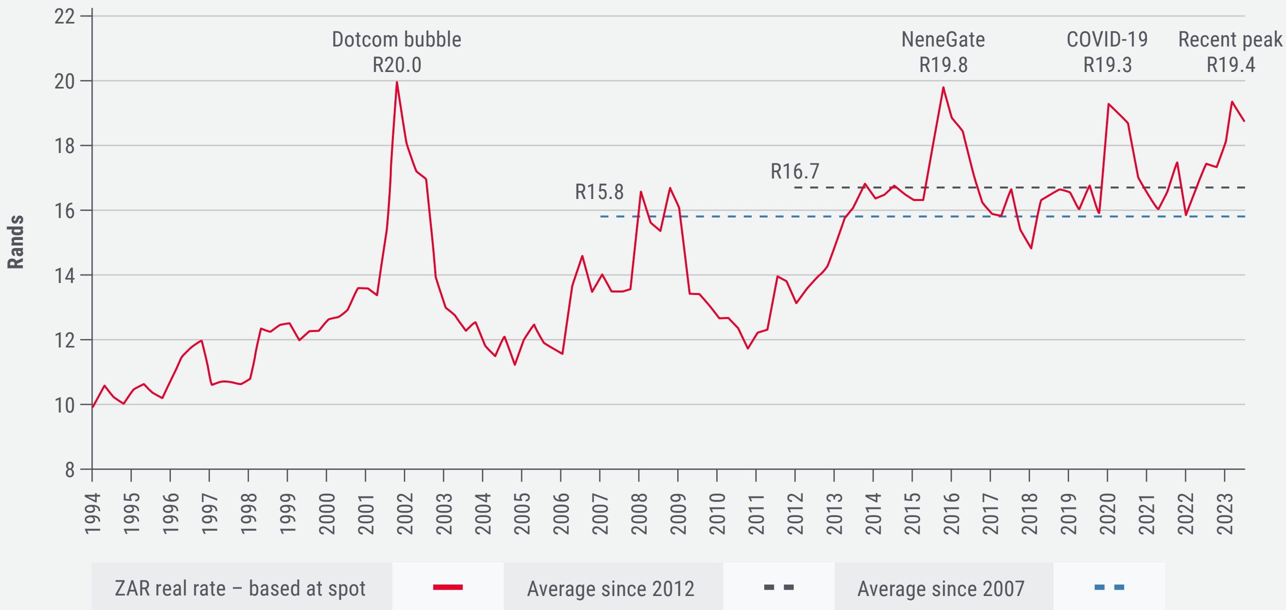
Graph 5a: SA money supply and inflation



Sources: Bloomberg, Allan Gray analysis

Graph 5b: ZAR/US$ real rate – based at spot (as at end June 2023)

The ZAR spot exchange rate is highly undervalued based on the CPI-based real effective exchange rate model.



Note: The ZAR real rate is the author's calculation based on the J.P. Morgan South Africa CPI-based real broad effective exchange rate.
Sources: Bloomberg, Allan Gray analysis

Rami joined Allan Gray as an equity analyst in 2015 after having worked in various investment roles in Beirut and Paris. He was appointed as a portfolio manager in 2020 and manages a portion of the African equity portfolio. Rami holds a Bachelor of Arts degree in Economics from the American University of Beirut and a Master of Science degree in Financial Economics from HEC Paris.

THE EQUITY CORE THAT POWERS OUR BUSINESS

Nick Curtin

… the last 50 years have taught us that the best investment opportunities often present themselves when sentiment is bleakest – and this time is no different.

As we celebrate our 50th anniversary this year, we naturally reflect on the history of the firm and the important milestones we reached along the way. Nick Curtin discusses one of the most significant events in our history – the launch of our first unit trust, the Allan Gray Equity Fund, and delves into the core that powers us, our key differentiators, and what it takes to be contrarian.

The year 1998 was eventful. A liquidity crisis roiled financial markets after Russia unexpectedly defaulted on its foreign debt. The European Central Bank was established ahead of the launch of the euro in 1999, and in-orbit construction of the International Space Station began in earnest. A small American search engine company called Google was founded in California, while on the other side of the planet, a little-known Chinese technology company called Tencent came into being.

In South Africa, Nelson Mandela was still president and South Africa won the ICC KnockOut Trophy. The average prime interest rate was 21.5% and one US dollar cost R5.50. It cost about R126 to fill a 50-litre tank of petrol, and the cost of electricity was around 12 c per kWh (about R2.34 today). The JSE All Share Index was at 5 820 (versus around 78 218 today) and government bond yields averaged over 15%.

Closer to home, 1998 was also the year that Allan Gray celebrated its 25th anniversary – halfway to where we are today – and the year that we launched our first unit trust, the Allan Gray Equity Fund. Although at that point the firm had been successfully managing South African equities for 25 years, this marked the first time that retail investors could directly access our investment expertise. Now, 25 years later, is therefore an opportune time to reflect on the lifetime of the Allan Gray Equity Fund.

The myth of normal[1]

As eventful as 1998 may have seemed, the reality is that it was not particularly different from any other year in the last 50. For most of us, our minds tend to anchor to some

[1] Acknowledgement to the title of Gabor Maté's latest book.

concept of "normal", probably as a way to psychologically survive the endless news flow in the belief that things will soon settle down and we can then relax. However, the world has always been largely unpredictable and its capital markets volatile. This is why our long-term, valuation-driven, contrarian investment philosophy has not changed in 50 years and likely never will. It is what allows us to stay focused on the facts and cut through the noise, so that we can see things as they are and not as we might want them to be.

It is an approach that has delivered on its long-term promise. Since inception in 1998, our Equity Fund has achieved a return of 19.3% per year, net of all fees and expenses, versus the benchmark's return of 14.1% and inflation of 5.4%. Over 25 years, the compounding effect is powerful: R1 000 invested in the Allan Gray Equity Fund on 1 October 1998 would be worth R79 573 today – more than three times the amount had you been invested in the benchmark (see **Graph 1**).

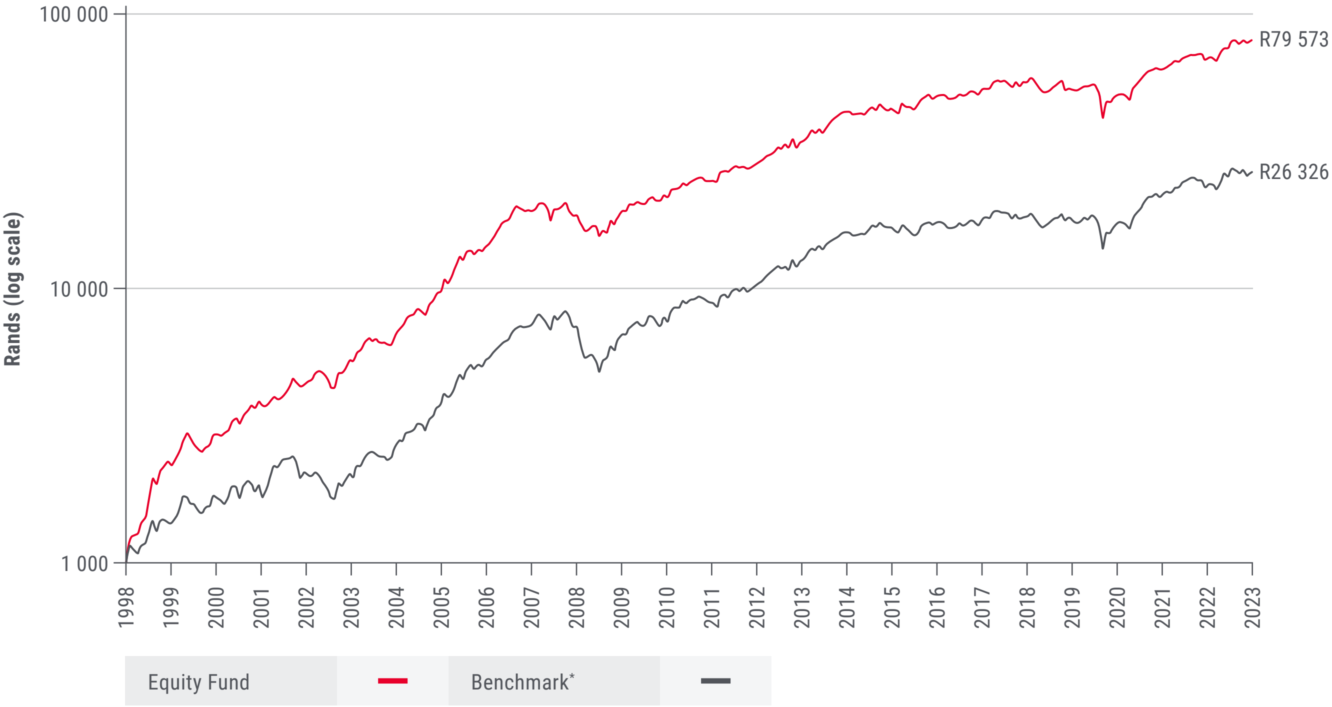
The stock selection core

Graph 1 only shows half the picture, though. Today, Allan Gray is well known for its security selection abilities across all major asset classes and geographies. Security selection is the beating heart of the firm, but it is important to remember that equity stock selection specifically is at its core. Managing equities has always been fundamental to our investment capabilities.

... we consider our stock selection ability to set us apart ...

Notwithstanding our strong fixed interest capabilities, South African equities still comprise approximately two-thirds of all assets that we manage in South Africa. **Graph 2** shows the return of the equity component of our balanced strategies (23.6% per year) against the FTSE/JSE All Share Index (ALSI) (16.9% per year) stretching back almost 50 years, i.e. well before the launch of our retail Allan Gray Balanced Fund. Although this is a carve-out from the multi-asset class strategy, the underlying equity core is fundamentally the same as that of the Allan Gray Equity Fund. Indeed, to a large extent, the asset allocation in our balanced strategies is the by-product of our bottom-up security selection process. That's where everything starts.

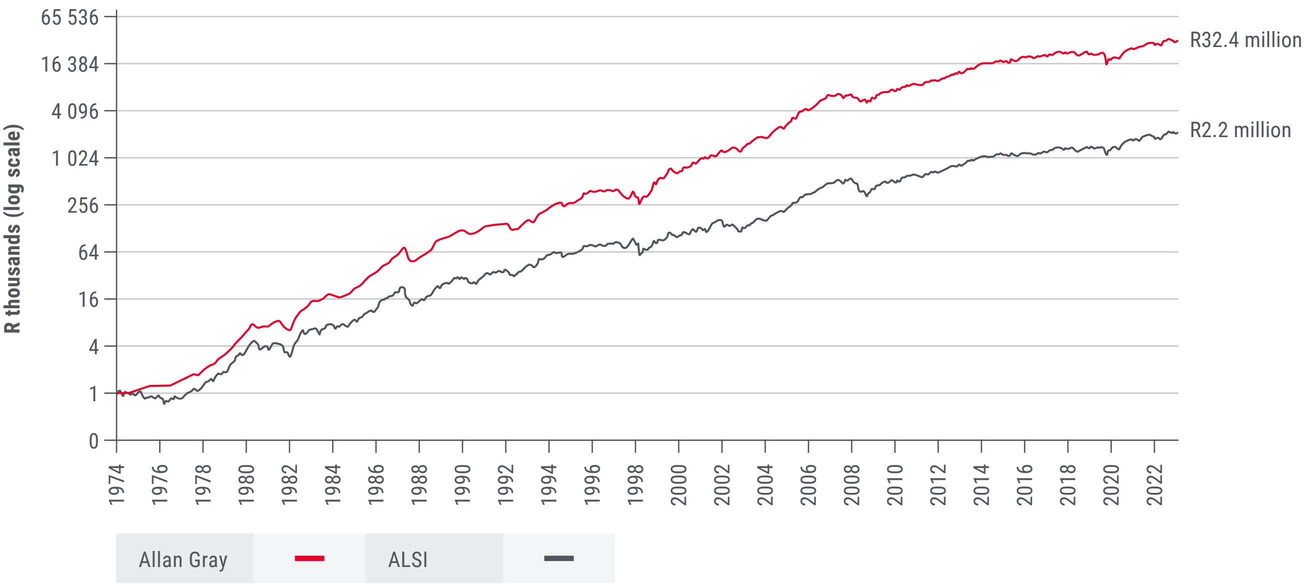
Graph 1: Allan Gray Equity Fund value of R1 000 invested in 1998



*The benchmark is the market value-weighted average return of funds in the South African - Equity - General category (excluding Allan Gray funds). From inception to 28 February 2015, the benchmark was the FTSE/JSE All Share Index including income.
Sources: Allan Gray research, Morningstar, IRESS

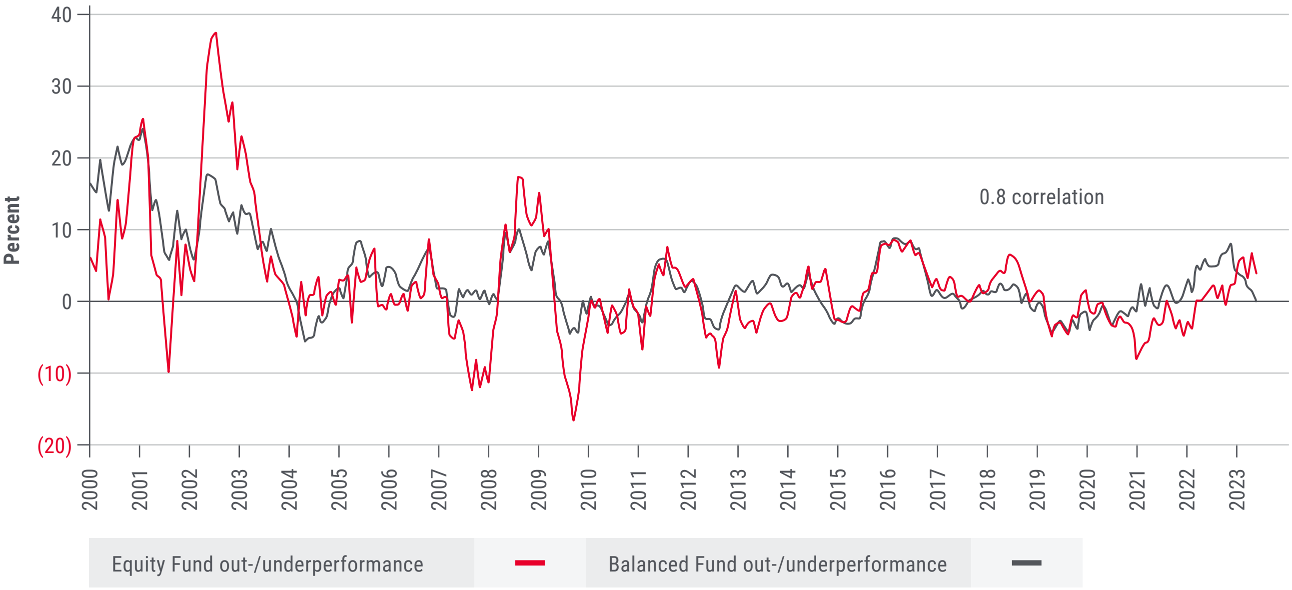
The Allan Gray balanced strategies and Allan Gray equity strategies tend to outperform or underperform at very similar points in time, as illustrated by **Graph 3**, which shows the rolling 12-month relative returns for the Allan Gray Equity Fund and Allan Gray Balanced Fund since 1998. This correlation of excess returns (i.e. performance relative to benchmarks) makes sense given the bottom-up share selection anchor to our investment philosophy, the relatively high-conviction positions we take and the average weight in the asset class. It is therefore very difficult for the bulk of Allan Gray's investment strategies to do well if the South African equity core is not doing well. The South African equity capability is fundamental to our entire investment process, and has been for 50 years.

Graph 2: Long-term global balanced strategy equity carve-out – value of R1 000 invested in 1974



Note: Clients cannot invest in a carve-out of a portfolio.
Sources: Allan Gray research, IRESS

Graph 3: Allan Gray Equity Fund and Allan Gray Balanced Fund rolling 12-month relative returns



Sources: Allan Gray research, Morningstar, IRESS

Key differentiators

While we consider our stock selection ability to set us apart, the key differentiator of our Equity Fund is the shape of returns over time. The combination of a long-term investment horizon and a genetic ability to take high-conviction, contrarian positions results in periods of outperformance when our investors need them most. We tend to deliver our strongest relative performance when markets and competitors are not performing very well.

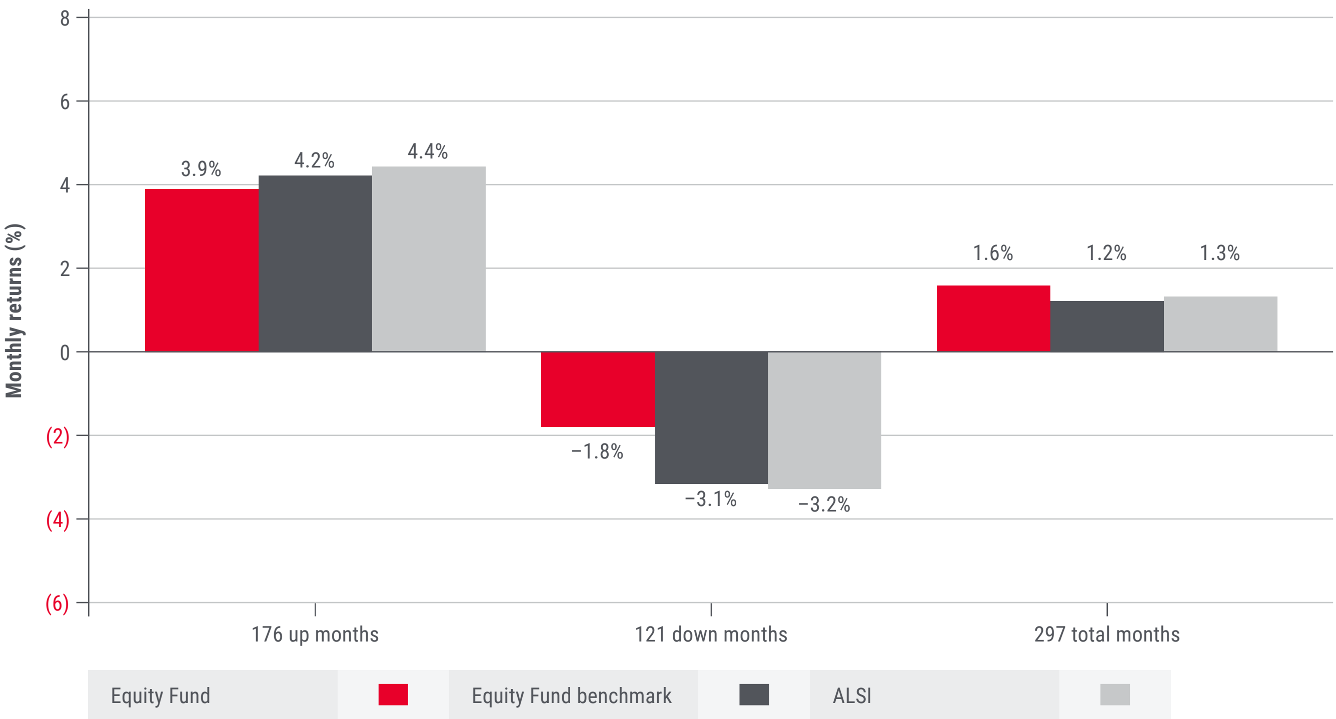
In all but one of the seven largest ALSI market falls since 1974, Allan Gray's equity strategy meaningfully outperformed the market and protected investor capital. Because our strategy fell by less than the market, it typically recovered much quicker and was then able to continue compounding positive returns while the market had not yet recovered to its starting point.

Prior to market falls, as the market rises to those extreme points, we often experience that our investment approach may not keep pace because one area is becoming very popular (see the 1997 example cited under "Dare to be different" on page 21). Although we typically still deliver a reasonable absolute return given generally rising markets, it is harder (and arguably less necessary) to differentiate ourselves from others when the proverbial rising tide is lifting all ships. We believe delivering strong relative performance when markets are weak and absolute returns are low, is far more useful. In these circumstances, we can make a meaningful difference to clients' outcomes by protecting their capital and growing it when the broader market lags. These performance patterns are fundamental to our equity strategy capabilities.

We protect our organisational structure like the crown jewel that it is.

Graph 4 shows the average monthly return of the Allan Gray Equity Fund compared to its benchmark and to the ALSI during up months, down months and overall. In relative terms, this performance pattern underpins our diversifying position – we tend to look different from the market. In absolute terms, protecting returns on the downside has immense compounding power over the long term, which is the most important component of the wealth creation formula.

Graph 4: Allan Gray Equity Fund monthly returns in bull and bear markets (October 1998 – June 2023)



Sources: Allan Gray research, Morningstar, IRESS

A crucial differentiating factor is therefore our focus on and understanding of the risk of capital loss. We are not simply trying to find shares whose prices will go up; rather, we look to invest in businesses where the share price is substantially below the intrinsic value of the company. The downside protection this valuation buffer provides is fundamental to our investment philosophy.

Dare to be different

It is easy to call oneself a contrarian, but much harder to actually be one. Our 50-year history serves up a smorgasbord of examples. In December 1997, Allan Gray did not hold a single share in the financial sector, while the index had an exposure of 28%. Instead, we were invested in much cheaper industrial and resource shares. It hurt performance in the prior years as the hot money continued to chase the expensive shares up, until the bubble finally burst in 1998, when Allan Gray investors were handsomely rewarded: Our equity strategy returned 67% for the period May 1998 to November 1999, while the ALSI delivered 5%.

Today, the same preference for high-conviction contrarian positions is evident at the security selection level in our Equity Fund. For example, we hold no Anglo American, which comprises approximately 10% of the ALSI, while our combined weighting in Naspers/Prosus is about half their combined index weight. Similarly, we hold significantly higher-than-index weights in shares such as British American Tobacco, Anheuser-Busch InBev, Glencore and Woolworths. In addition, the ability to invest a portion offshore (since 2015) has also increased our ability to differentiate. We are very comfortable with a portfolio that looks quite different from the index and peers.

The ability to execute on contrarian positions like these requires a lot more than just a high-conviction investment idea. An important factor that enables us to follow through on our approach is the structure of our firm. Several generations of people repeating the same process over 50 years of market cycles has created an organisational DNA that is very difficult to replicate. The firm has been intentionally designed this way so that we can harness the power of compounding returns over long periods of time for our investors. The track record is not just a number – it's a testament to repeatability. We protect our organisational structure like the crown jewel that it is. Delivering on our promise to investors over the decades ahead depends on it.

Back to the future

While our Equity Fund's 1998 birth year was an eventful one, we have had many trials and tribulations in the markets every year since. Twenty-five years later, most South Africans may be feeling shell-shocked. Having barely recovered from the pandemic-era trauma, we are deep in the throes of a national energy crisis and struggling with a stagnant economy. The world seems to be changing more rapidly than ever. But the last 50 years have taught us that the best investment opportunities often present themselves when sentiment is bleakest – and this time is no different.

> The Allan Gray equity investment core is hard at work.

While we are not totally immune to the distractions of sentiment, what may feel like a rollercoaster ride to investors is familiar territory for the Allan Gray team. While caution is appropriate, the prevailing market environment is very well suited to how we manage money. Risk is high, but there are good opportunities. The Allan Gray equity investment core is hard at work.

Nick joined Allan Gray in March 2023 and is a senior manager in the Institutional Clients team. He holds a Bachelor of Arts degree in Economics and International Politics from the University of South Africa as well as a Postgraduate Diploma in Financial Planning from the University of the Free State. Nick is a CFA® charterholder and a CFP® professional.

ORBIS GLOBAL EQUITY: VALUE IN A CHANGING JAPAN

Brett Moshal

While Japan has been a depressing market for passive investors, it has been a tremendous hunting ground for active stockpickers.

Optically, Japan has not been an attractive investment destination over the last 30 years. However, Brett Moshal, from our offshore partner, Orbis, illustrates that there have been pockets of opportunity for active, value-oriented, contrarian stockpickers.

Japan is a big overweight in the Orbis Global Equity Fund ("the Fund"). It's big in global markets, too. Japan is the world's second-largest developed stock market and home to over 600 companies with market values above US$1bn. That is as many sizeable stocks as there are in all the countries in Europe combined. But despite its size, Japan is often left hanging on the periphery of investor attention.

We can see why. If investors know a single thing about Japan's market, it's that Japan has been a singularly bad market for investors. Since its epic bubble burst in 1990, the Japanese benchmark has returned less than 1% per year in dollars, compared to 9% per year for other developed markets.

But dismissing Japan after a glance at its passive returns would be a mistake. While Japan has been a depressing market for passive investors, it has been a tremendous hunting ground for active stockpickers. For a start, a textbook value style has worked much better in Japan than it has elsewhere. In Japan, value has beaten growth by 4% per year since 1975, far beyond the 1% per year value has delivered in other global stock markets. The market's cyclicality feeds big swings in greed and fear, providing a great setup for contrarians to exploit.

Opportunity for contrarians

Indeed, contrarian stockpicking has worked much better than a simple value approach. Despite the poor returns of Japan's market, the Fund's Japan holdings have been competitive with world stock markets since we bought our first Japanese stock in 1992, as shown in **Graph 1**, and our Japan holdings have beaten world stock markets over the last 25 years.

Bottom-up stockpicking has worked better than a simple value style in part because doing our homework helps us avoid stocks that look cheap but remain cheap forever. There are plenty of such value traps in Japan. Unlike in the rest of the world, the proportion of companies in Japan that trade below their book value is enormous, and many of them have traded at those low valuations persistently.

… Japan is changing, and in a good way.

In recent years, the Japanese government has made efforts to "untrap" some of that value. These began in earnest after the election of the late Shinzo Abe, who in 2013 laid out the "structural reform" arrow of his namesake economic strategy. In 2014, the government published the Ito Review, which took a frank look at the low capital efficiency of Japanese corporates. Japan's Stewardship Code, which encourages engagement from investors, was also adopted in 2014, and we signed it the following year. In 2015, Japan introduced its Corporate Governance Code, which aims to encourage better behaviour from companies. It has since been revised twice, amid a smattering of smaller measures.

These policies have greatly improved the quality of Japan Inc.'s investor engagement – though from a low base, and at a glacial pace.

That pace changed this year, when the Tokyo Stock Exchange singled out companies whose shares trade at a price-to-book ratio of less than 1.0, obliging them to tell investors their plans to achieve a higher valuation. This has lit a fire under management teams and opened the door to greater shareholder activism.

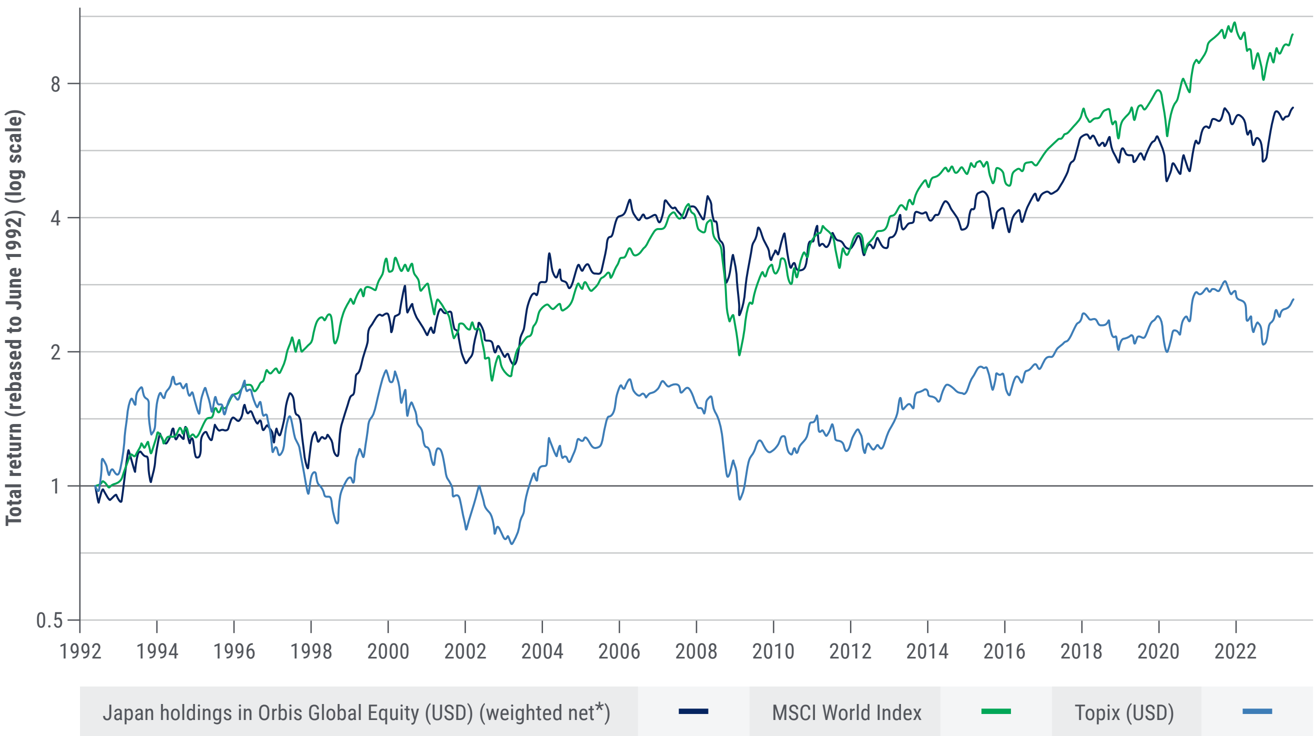
In short, Japan is changing, and in a good way. Helped by Warren Buffett's public enthusiasm for Japan's trading companies, investors and the press are beginning to take notice. Companies are demonstrating an increased commitment to dividend growth, minimum payouts and share buybacks. Dividend yields in Japan now rival those of major Western markets. See **Graph 2** on page 24.

Selective enthusiasm

We share the enthusiasm, but we believe it pays to be selective – passive investors are likely getting exposure

Graph 1: Japan – a tough market for passive investors, but a ripe market for stockpickers

Total return in USD of Orbis Global Equity's Japan holdings, the MSCI World Index and the Topix



*This is the asset-weighted net-of-fees return of all share classes in the Orbis Global Equity Strategy. This return may differ from the return of any individual share class.
Sources: Refinitiv, MSCI, Orbis. Past performance is not a reliable indicator of future results. Returns may decrease or increase as a result of currency fluctuations. The Orbis Global Equity Strategy bought its first Japanese share in June 1992. The fee experience of the Strategy has been applied to the Japan carve-out. Clients cannot invest in a carve-out of a portfolio.

to more expensive stocks that have less opportunity to improve.

Some of our holdings have already started to improve. Megabanks like Sumitomo Mitsui Financial Group and Mitsubishi UFJ Financial Group continue to reduce inefficient crossholdings of other companies' shares, have adopted progressive dividend policies, and have increased share buybacks. In this, they are following the model of the trading companies Sumitomo and Mitsubishi, which have improved their capital allocation and been rewarded with much higher valuations. We know those businesses well, having owned them well before Berkshire Hathaway, and we have sold down those positions into the Buffett-induced euphoria.

Yet other companies could benefit greatly from self-help measures within their own control. Inpex, for example, is a highly cash-generative oil and gas producer whose valuation has languished at 0.5 times book value. Part of the reason for that is its payouts. Although the company has bought back more than 10% of its shares over the past two years and pays out 40% of its earnings to shareholders, it can afford to do much more. Its free cash flow generation is prolific, but payouts are lower than those of international peers. Were Inpex to increase payouts in line with peers, it could be rewarded with a far higher valuation.

Self-help is not the only appeal of Japanese shares. In a global portfolio, currency matters too, and the setup there makes Japan look even more appealing. The policy interest rate in the US is at 5%, while the Bank of Japan has stubbornly kept rates at zero. Foreign investors looking to buy Japanese shares while hedging the currency essentially get this 5% difference, as they pay yen interest rates and receive dollar interest rates. If the exchange rate doesn't move, foreign investors can pocket this 5% in addition to the yen return of their shares.

Company fundamentals are improving, and a cheap currency provides additional upside potential. And above all, valuations are attractive.

However, in the view of our currency team, the exchange rate should move over the long term – in the yen's favour. With 144 yen per 1 dollar, our data suggests the dollar is more

Graph 2: Having lagged for decades, Japan's dividends are catching up

Dividend yield of Japan and world excluding Japan stock markets, 1990 to date

Sources: Refinitiv, Orbis. Indicated dividend yield for the Datastream Japan and World excluding Japan Market indices.

than 40% overvalued. When the team stacks up how buyers and sellers of the yen and dollar could change over time, it seems unlikely that the forces supporting the dollar will remain as strong as they've been in the recent past. If that analysis is right, the currency tailwind for foreign investors could exceed 5%.

But the biggest reason we find Japanese shares attractive is the simplest one: their valuations. Despite its improving fundamentals, the Japanese market remains inexpensive versus other world stock markets, particularly the US. As is the case elsewhere, valuation spreads remain exceptionally wide in Japan, with a wide gulf between the prices of cheap versus expensive stocks. See **Table 1**. When we look bottom up, we can find shares that are far cheaper than the Japanese market, while still picking up a higher dividend yield.

That is the case for Japan today. It's been a tough market for passive investors, but an outstanding stockpicker's market. Company fundamentals are improving, and a cheap currency provides additional upside potential. And above all, valuations are attractive. That sounds compelling to us and, accordingly, Japan now represents 13% of the Orbis Global Equity Fund.

Table 1: Japan is inexpensive, and there is deep value within it

Metrics for Orbis Global Equity holdings and the FTSE World Index

Valuation	Price/book value	Price/earnings*	Dividend yield
FTSE World Index	5.0	22	1.6%
Japan stocks in FTSE World Index	1.6	16	2.2%
Japan stocks in Orbis Global Equity	0.7	10	3.9%

*IBES forecast forward price-to-earnings for the next financial year.
Sources: Refinitiv, Orbis. Data is based on a representative account for the Orbis Global Equity Strategy. In each case, calculated first at the stock level and then aggregated using a weighted median. Statistics are compiled from an internal research database and are subject to subsequent revision due to changes in methodology or data cleaning.

Orbis
Invest Differently

Brett joined Orbis in 2003. He is based in London, co-leading the Japan Investment team, and is responsible for the Orbis Japan Equity Strategy. Brett holds a Bachelor of Commerce and Bachelor of Accounting Science degree, both from the University of the Witwatersrand, and is a Chartered Accountant and CFA® charterholder.

RETIREMENT ANNUITIES STILL WORK

Earl Van Zyl and Tiaan van Wijk

Planning well for retirement is essential to ensure your long-term financial well-being. One key aspect of retirement planning is choosing the product, or combination of products, that will best enable you to meet your retirement goals. Earl Van Zyl and Tiaan van Wijk discuss the various investment products that investors typically use to save for retirement and shed some light on the trade-offs that investors need to consider.

The process of choosing the most appropriate product, or products, to save for retirement can seem daunting. Among the available options, retirement annuities[1] (RAs) have long been touted as a suitable option for most long-term savers, given the favourable tax treatment of contributions. However, some argue that the investment limits under Regulation 28 of the Pension Funds Act ("Regulation 28"[2]), the limited access investors have to their accumulated savings in these products before retirement, and the requirement to purchase an annuity with your savings in an RA at the point of retirement outweigh the tax benefits.

We will illustrate that, when viewed through a lens of the income in retirement that various products provide, RAs remain a good option for most investors, even after accounting for the restrictions that apply. As always, it is important for every long-term investor, together with their independent financial adviser, if they have one, to understand how our simplified examples would apply to their personal situation so that they can assess how best to use our insights. Our analysis assumes that the product rules do not change in any material way in the future.

Comparing the different products

While RAs have traditionally been a popular choice to save for retirement, many investors also use basic unit trusts and tax-free investments (TFIs) for this purpose. **Table 1** outlines

[1] A retirement annuity is a retirement fund in terms of the Pension Funds Act. It is a retirement savings product that allows you to invest in unit trusts and gives you tax savings and a measure of protection, but it comes with some restrictions.

[2] Regulation 28 limits the exposure that you may have to various asset classes in a retirement fund. For your account to be compliant, your selection of unit trusts should have a maximum of 75% in equities, 25% in property and 45% in foreign assets.

the key features of these three products. We have assumed that there are no differences in product administration fees across the different options. While this is true for Allan Gray products, it may not be true at all product providers.

To fairly compare the products, it is essential to evaluate the impact of your options across the entire retirement life cycle. While it may seem intuitive to compare the total savings available *at* retirement of each product or combination of products, we believe a more complete analysis that includes comparing the income available *in* retirement, goes a step further. This is because the ultimate goal of saving for retirement is not simply to reach retirement with the largest possible retirement pot, but rather to secure the largest possible income that you can sustainably draw during retirement to maintain your lifestyle.

A comprehensive comparison therefore includes assessing the pre-retirement tax benefits of each option, the tax implications of lump sum withdrawals at retirement, and the tax implications of income withdrawals during retirement. The highest sustainable net income that can be drawn in retirement offers an objective measure of the benefits of each option, as it is derived by considering all tax implications throughout the retirement life cycle.

To assess the attractiveness of an RA relative to a basic unit trust investment and a TFI, we constructed four product options that investors might use to save for retirement:

Option 1: An RA only. To ensure that we compare products with the same take-home income, we assume that tax savings on contributions, or, in the case of an individual RA, tax refunds are invested in the RA.

Option 2: A combination of an RA and a TFI, assuming that the tax savings on RA contributions, or, in the case of an individual RA, tax refunds are invested in the RA.

Table 1: Key features of retirement annuities, basic unit trusts and tax-free investments

	Retirement annuities (RAs)	Basic unit trusts	Tax-free investments (TFIs)
Investment restrictions	Limited by Regulation 28 at a pre-retirement stage, but no restriction on asset allocation once you have retired from an RA.	None	None
Contributions	Contributions are tax-deductible. The deduction is limited to 27.5% of the greater of your taxable income or remuneration, capped at R350 000 per tax year.	No tax savings or contribution limits.	No tax savings. Contributions are limited to R36 000 per tax year, with a lifetime contribution limit of R500 000.
Tax on dividends and interest	Dividends and interest are tax-free.	Dividends and interest are taxable according to the investor's tax residency.	Dividends and interest are tax-free.
Access before and at retirement	Currently, you cannot access your money before age 55, except under specific circumstances. (There will be limited access to the so-called "savings pot" once the two-pot retirement system comes into effect.) At retirement, a maximum of one-third can be taken as cash. The balance must be invested in either a living annuity or a guaranteed annuity. In a living annuity, your retirement income is limited to between 2.5% and 17.5% of your investment value.	You have full access to your money at any time.	You have full access to your money at any time, although the full impact of the tax benefits of the product is realised over the long term.
Tax on lump sums and retirement income	At retirement, the first R550 000 cash portion is tax-free, and the balance is taxed according to the retirement tax table. Retirement income withdrawals are taxed according to the income tax table.	Any withdrawal is subject to capital gains tax.	There is no income or capital gains tax.

Source: Allan Gray

Option 3: A basic unit trust investment only.

Option 4: A combination of a basic unit trust investment and a TFI. Contributions and withdrawals are assigned to the TFI first.

We then applied these product options to two investor personas with the same contributions and after-tax cash needs relative to their income, which are set out in **Table 2**.

… a retirement annuity provides a higher sustainable income after tax than basic unit trust investments.

The results of our analysis

To make the comparison easier, we illustrate the maximum sustainable net income in retirement for each of the three alternative options relative to the total income delivered in Option 1 for both investor personas – see **Graph 1**. Assuming the same investment strategy across all options, the graph illustrates that an RA provides a higher sustainable income after tax than basic unit trust investments.

This analysis highlights some key truths regarding retirement savings product options, assuming that the investment strategy across the options is the same:

- Higher marginal tax rates result in greater tax savings on RA contributions before retirement. Consequently, the difference in sustainable net income earned between an RA and a basic unit trust investment is higher for individuals with a higher marginal tax rate than for individuals with a lower marginal tax rate.
- Pairing a basic unit trust investment with a TFI offers a superior outcome to investing in a unit trust alone, as it capitalises on the tax benefits of a TFI while being able to maintain the same investment strategy. In this combination, it is essential to prioritise contributions to the TFI to maximise the long-term benefits.
- The impact of combining an RA with a TFI is influenced by several factors, including your level of contribution, marginal tax rate and cash portion taken at retirement. Each investor needs to trade off their liquidity needs before retirement and their intended use of their TFI, bearing in mind that TFIs have annual and lifetime contribution limits that do not "reset" if withdrawals are made.

For investors with a risk appetite that does not require exceeding Regulation 28 limits, an RA therefore remains

Table 2: Investor personas

	Investor 1	Investor 2
Starting age	25	35
Retirement savings accumulation period	40 years	30 years
Gross salary	R350 000 per year	R1 200 000 per year
Marginal tax rate	26%	41%
Contribution rate	15% of gross salary. Contributions prioritised to TFI, where applicable.	15% of gross salary. Contributions prioritised to TFI, where applicable.
Withdrawal at retirement (age 65)	The maximum RA tax-free cash portion of R550 000. Withdrawals prioritised from RA, where applicable.	The maximum RA tax-free cash portion of R550 000. Withdrawals prioritised from RA, where applicable.
Post-retirement income (for 30 years)	The maximum sustainable income that can be drawn without breaching a 17.5% drawdown rate over 30 years. Withdrawals prioritised from TFI, where applicable.	The maximum sustainable income that can be drawn without breaching a 17.5% drawdown rate over 30 years. Withdrawals prioritised from TFI, where applicable.
Inflation	6% per year	6% per year
Real return*	5.8%	5.8%

*Real return is the return achieved above inflation. We have used the median 30-year real return per year for a portfolio invested 60% in equities and 45% offshore over a 120-year period.

an effective retirement savings product, particularly when tax savings are invested. However, investors should be aware that if tax savings on RA contributions are not invested in the RA, the attractiveness of an RA compared to a unit trust diminishes due to potentially higher taxes at and after retirement compared to those applicable to a basic unit trust investment.

> ... historically, there has been minimal benefit to having more than 45% of your retirement portfolio invested offshore.

Assessing the impact of Regulation 28 investment restrictions

A significant advantage of basic unit trusts and TFIs compared to RAs is the absence of Regulation 28 investment restrictions. Regulation 28 is relevant when an investor's risk appetite exceeds an equity allocation of 75% or an offshore allocation of 45% – the two investment restrictions on which most critics of Regulation 28 focus their attention.

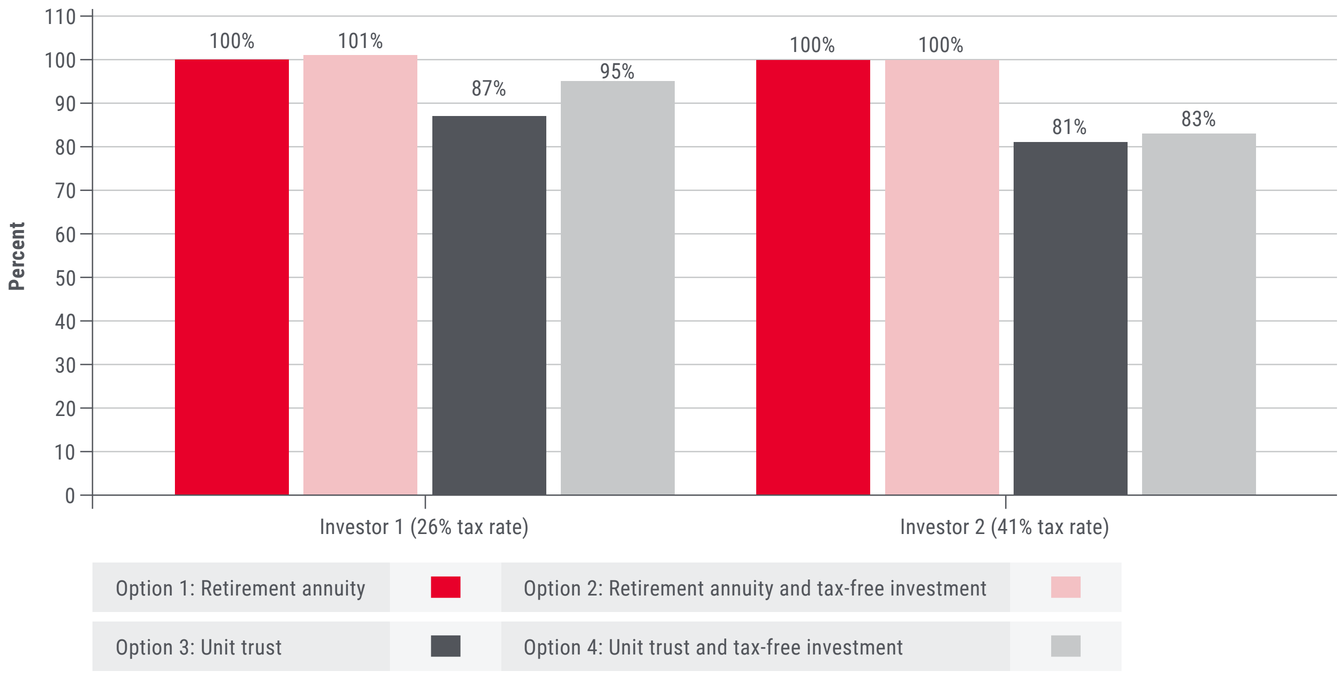
However, the restrictions set by Regulation 28 have the often-overlooked advantage of protecting investors from themselves: These limits serve as a safeguard against asset allocations that may create very volatile portfolio performance, which may lead to suboptimal decisions from investors, such as switching in and out of funds when performance disappoints.

While we acknowledge that a risk appetite beyond the limits of Regulation 28 is not typical for most South African retirement savers, it is important to assess the potential impact of being able to invest without the restrictions imposed by Regulation 28. Our research shows that, historically, there has been minimal benefit to having more than 45% of your retirement portfolio invested offshore. **Graph 2** on page 30 demonstrates that, over 30-year rolling periods since 1900, increasing offshore exposure beyond 45% did not lead to higher risk-adjusted returns. We therefore believe that the current Regulation 28 offshore limit of 45% provides sufficient opportunity for retirement investors to diversify their portfolio offshore.

While there is potential for generating additional returns by increasing your equity allocation beyond 75% of your portfolio, it is important to be aware of the additional volatility that would be expected from this decision. To illustrate the point,

Graph 1: Maximum sustainable net income achievable in retirement

(Relative to a retirement annuity)



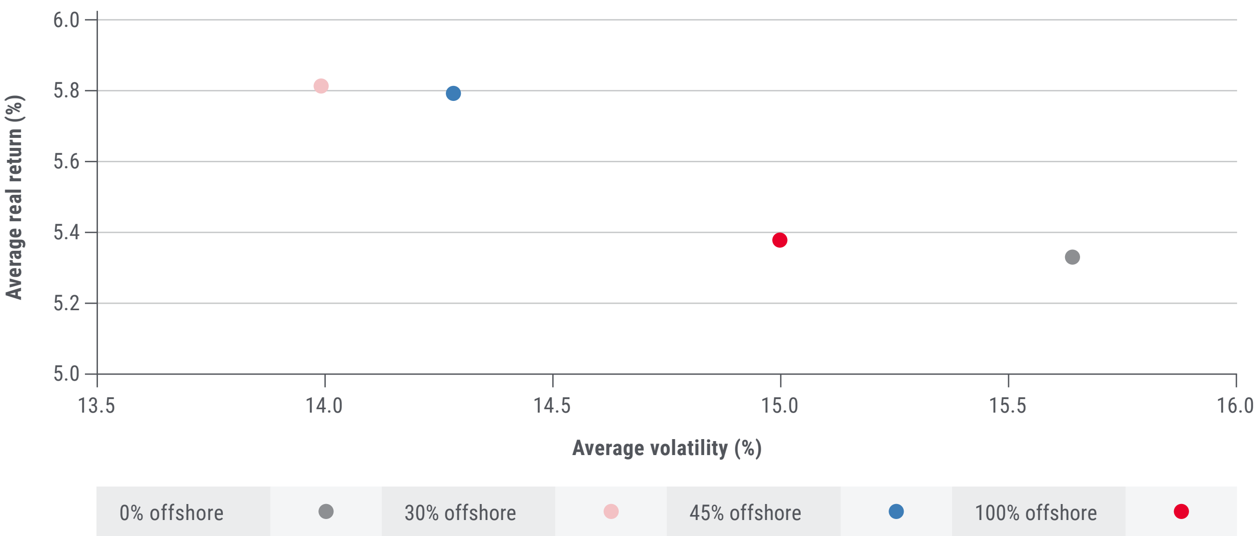
Source: Allan Gray research. DMS Global Returns Data 1900 - 2012 and Morningstar data from 2013. Non-equities portion invested in bonds.

we can again consider 30-year rolling returns since 1900 of a portfolio with 45% in offshore assets. Increasing portfolio equity allocation from 60% to 100% would have achieved an additional 1.9% real return per year, but at the cost of an additional 4.3% in average annual volatility. For many investors, such increases in risk can make it more challenging to maintain discipline by sticking to their investment plan and avoiding switching in and out of funds during volatile markets. Investors often experience lower returns than those delivered by the funds in which they are invested due to their behaviour, as we discussed in our [Q1 2023 Quarterly Commentary](). It is therefore not clear that a limit on equity allocation of 75% within RAs is a negative constraint for the average retirement saver if the reduction in risk compared to investing 100% in equities helps you to stick to your investment plan.

RAs are still a great option – but there are trade-offs

Our analysis demonstrates that for a typical investor, an RA is a highly effective vehicle to save for retirement. In most scenarios, an RA will also play an important role in enabling investors to build a retirement pot from which to earn an income in retirement – the ultimate goal of saving for retirement. However, it is crucial for each investor to engage in a thoughtful decision-making process to understand the trade-offs on RAs and other products that are most relevant to their long-term goals and personal circumstances.

Graph 2: Average real return and volatility for 30-year rolling periods for a portfolio invested 60% in equities (1900 – 2022)



Note: Volatility – or variability – is a risk measure that indicates how much the value of an investment has fluctuated over time and is often used to suggest how volatile returns may be in the future.
Source: Allan Gray research. DMS Global Returns Data 1900 - 2012 and Morningstar data from 2013. Non-equities portion invested in bonds.

Earl joined Allan Gray in 2015 as a manager in Product Development, spent two years leading our Digital teams and currently heads up the Product Development team. He holds a Master of Business Administration from the University of Chicago Booth School of Business and a Bachelor of Science degree in Aeronautical Engineering from the University of the Witwatersrand.

Tiaan joined Allan Gray in 2014 as a consultant in Retail Client Services and is currently a senior business analyst in Product Development. He holds a Bachelor of Commerce degree in Investment Management and an Honours degree in Financial Analysis, both from Stellenbosch University.

RISK: AN ESSENTIAL INGREDIENT FOR REAL LONG-TERM RETURNS

Nomi Bodlani

… for optimal long-term outcomes, investors should make sure they take on enough risk … as this improves their chances of … achieving their investment objectives.

When it comes to investing, no investor wants to lose money. In fact, as humans, we have a built-in aversion to loss. Unfortunately, by overly focusing on avoiding short-term losses, many investors jeopardise their ability to achieve real returns over long periods of time. Nomi Bodlani discusses the importance of taking on enough risk to ensure you reach your investment goals.

In recent years, global inflation has been spurred on by significant world events, including the COVID-19 pandemic and the ongoing Russia-Ukraine conflict. Many experts believe that the higher levels of inflation we are currently experiencing are likely to persist for some time. In South Africa, we are no strangers to living with high inflation. However, even though most of us factor it into our lives from year to year as we account for our expenses, many investors are guilty of overlooking the impact of inflation over the long term and on their investments.

The impact of inflation can feel abstract and hard to visualise over long periods. To gain a clearer understanding of this, consider the following example: The basket of goods that cost you R1 000 in 1999 would set you back R3 650 today. Put another way, in today's terms, R1 000 would buy less than one-third of what it could at the turn of the century. If you are planning for long-term goals such as retiring in 30 years, you therefore need to plan for that same basket of goods that costs R3 650 today to cost you over R20 000 in 30 years' time (assuming 6% inflation per year over the next 30 years). As a result, when it comes to long-term wealth creation and preservation, the very least you should be asking your money to do is to grow by inflation – ideally meaningfully more. This is critical to achieving many long-term investment objectives, such as saving for retirement and drawing an income that maintains its purchasing power in retirement.

Because of this, in investing, we often refer to the "real return", which is the excess return generated by your investment after taking inflation into account. The Allan Gray Balanced Fund has delivered a real return of 9.4% per year since its inception, i.e. the Fund has delivered a 15% annual return, while inflation over that period averaged 5.6% per year. Compounded over 23.75 years, the Fund's return would have grown an investment of R1 000 in October 1999 to R27 900 today. That is meaningfully more than the minimum of R3 650 to which the investment would have been required to grow to maintain its purchasing power.

Why is our Balanced Fund able to deliver these real returns? The Allan Gray Investment team carefully considers a number of principles to achieve the Fund's objectives. Following are three principles that can be applied to your own investments if your intention is to benefit from real returns over a long period of time.

… the very least you should be asking your money to do is to grow by more than inflation – ideally meaningfully more.

Principle 1: Ensure sufficient exposure to carefully selected equities over the long term

If you compare the performance of various asset classes over various periods, equities have significantly outperformed inflation, and more consistently so than bonds and cash. Globally, equities have generated a real return of 5.1% per year since 1900 and 6.6% over the last decade. Locally, equities have fared even better, generating real returns of 9.1% per year since 1900 and 5% over the last 10 calendar years.

Does this imply that simply investing in the FTSE/JSE All Share Index will allow you to reap the long-term rewards of being invested in local equities? Not necessarily. Firstly, when you invest in equities, you are investing in individual businesses, and not all businesses will succeed or prove to be good investments. Secondly, equity returns do not come in a straight line: Share prices can fluctuate meaningfully in the short term, which we refer to as volatility. The most recent major drawdown is fresh in our minds: The local market declined by more than 30% (top to bottom) in March 2020, but has since recovered to a further 31% above pre-COVID-19 levels.

The above two points demonstrate the importance of active equity selection and taking a long-term view. As an active manager, we focus our efforts on selecting those businesses that we believe will deliver long-term real returns for investors, and we assess the performance of these businesses over long periods to ensure that we take advantage of the opportunities that short-term price volatility can create, rather than be whipsawed by it.

Over the last three issues of our Quarterly Commentary, including the current one, we have provided greater insight into our flagship unit trusts and how you can use them for your various investment objectives. In order to achieve their respective objectives, these unit trusts can invest up to different maximum levels of equities: the Allan Gray Equity Fund: 100%, the Allan Gray Balanced Fund: up to 75%, and the Allan Gray Stable Fund: up to 40%.

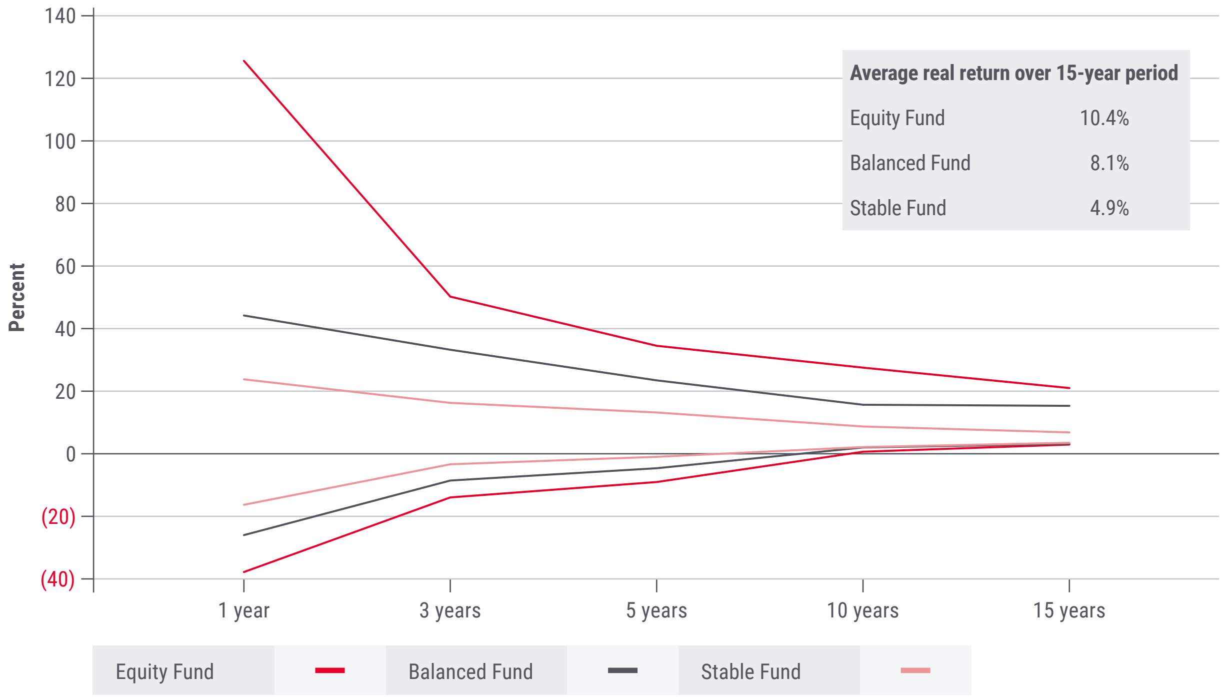
However, the right level of equity exposure is determined as a result of a bottom-up, actively managed asset allocation process: The equity exposure in the Allan Gray Balanced Fund and Stable Fund will, at any time, be a function of how attractive our favourite equities are – locally and offshore – relative to other opportunities like selected bonds, listed property and cash. For reference, at 30 June 2023, the equity exposure in our Balanced Fund is 65.9%. We aim to position the portfolios to do well under a range of possible outcomes, while focusing on protecting downside risk and avoiding extreme events.

Graph 1 demonstrates the range of real returns for each of these unit trusts over different periods of time. Over any 15-year period (measured daily), the average real return for these unit trusts has been 10.4%, 8.1% and 4.9% respectively. Graph 1 also demonstrates the risk-return trade-off that results from varying levels of equity exposure.

Taking on higher equity exposure increases the return potential, but also the potential volatility in the portfolio. While our Equity Fund has a significantly wide range of returns, and therefore higher volatility over the short term than our Stable Fund, over longer periods, the higher equity exposure should offer higher expected returns: Our Equity Fund achieved an average real return of 10.4% over any 15-year period, compared to our Stable Fund's 4.9%.

A well-diversified multi-asset unit trust, like the Allan Gray Balanced Fund, can provide meaningful levels of equity exposure while reducing the shorter-term volatility risk. You can see this by the narrower range of real returns experienced in our Balanced Fund compared to our Equity Fund in Graph 1. Additionally, even though our Balanced Fund has lower exposure to equities, it has still achieved an average real return of 8.1% compared to our Equity Fund's 10.4% over any 15-year period.

Graph 1: Range of real returns for the Allan Gray Equity, Balanced and Stable funds



Source: Allan Gray analysis. Range of returns is the annualised real returns for all available one-, three-, five-, 10- and 15-year periods (measured daily).

To determine the most appropriate level of equity exposure for your portfolio, you should consider your investment objective, your return expectations, your investment horizon and the level of risk you are willing to take on. You can then use these considerations to select a unit trust that matches those needs. Bear in mind that when investing in a retirement product, such as the Allan Gray Retirement Annuity, your portfolio will need to align to the requirements of Regulation 28 of the Pension Funds Act and can invest a maximum of 75% in equities.

Of course, it is not just where you invest your capital – it is also how much, and for how long you invest that makes a meaningful difference over the long term. This leads us to the second principle.

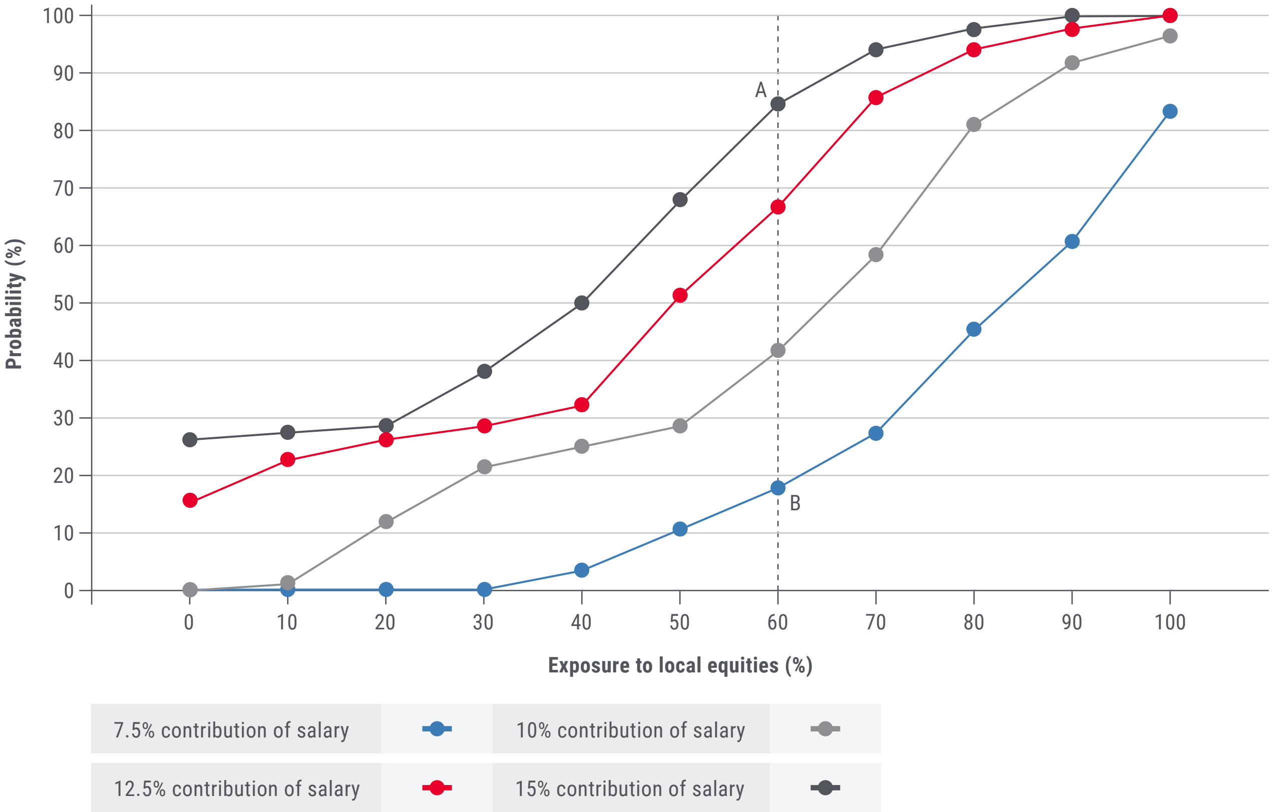
Principle 2: Pay attention to the level at which you contribute and draw down

Even if you maximised equity exposure, no amount of equities is going to make up for not starting early enough or investing sufficiently for your investment objective or drawing down too fast. **Graphs 2** and **3** on page 34 illustrate the impact of varying levels of contribution and drawdowns on the chances of achieving two investment objectives: 1) being able to save enough to replace 70% of your final income at retirement (i.e. achieve a 70% replacement ratio), and 2) being able to increase your income in retirement by inflation each year (i.e. maintain the purchasing power of your income).

… staying invested over the course of your investment horizon will help you maximise your investment outcomes.

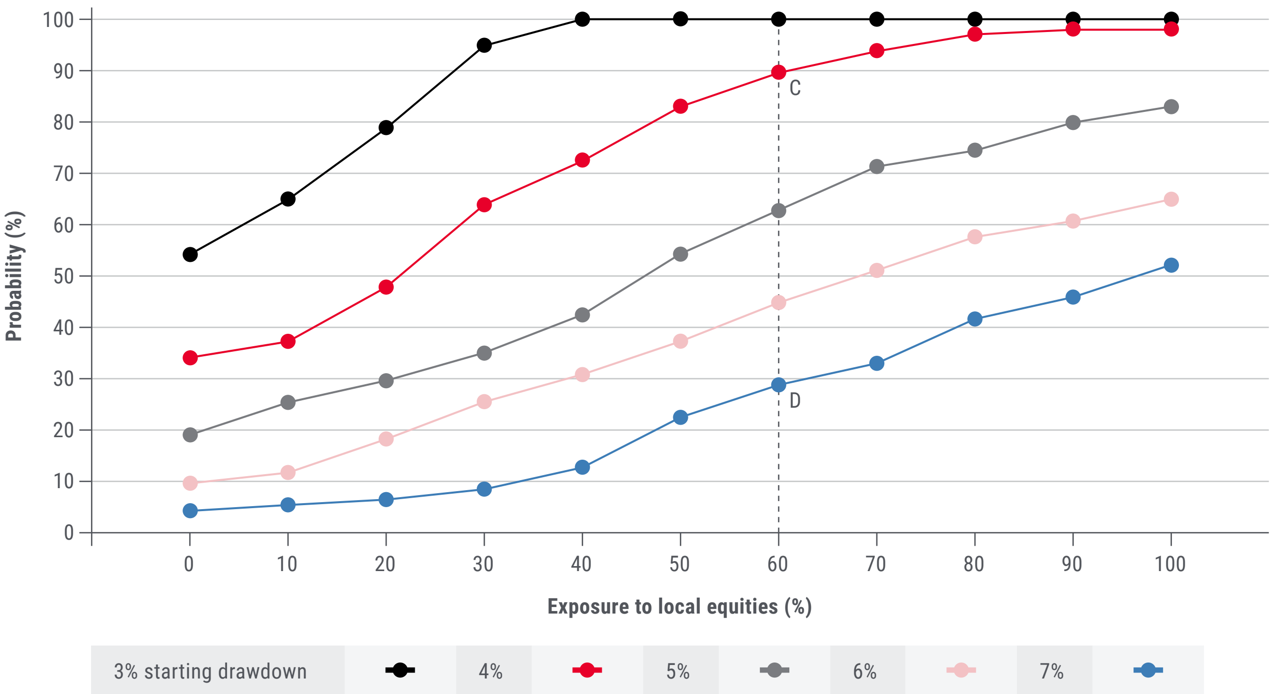
If you start working at 25, you will have roughly 40 working years to save for retirement. In Graph 2, point A demonstrates that historically, when contributing 15% of your salary towards retirement over 40 years, an equity exposure of above 60% corresponds to a more than 80% probability of saving enough for retirement (i.e. a 70% replacement ratio). As the contribution level declines, it becomes increasingly challenging to achieve this objective. Point B illustrates that, at the same equity exposure of 60% and a contribution level of 7.5%, the probability of saving enough for retirement declines to less than 20%. Graph 2 demonstrates historical outcomes for investors saving over a 40-year period.

Graph 2: The probability of achieving a 70% replacement ratio at retirement after saving for 40 years



Source: Allan Gray research. DMS Global Returns Data 1900 - 2012 and Morningstar data from 2013. Non-equities portion is invested in local bonds.

Graph 3: The probability of maintaining the purchasing power of your income for 30 years



Source: Allan Gray research. DMS Global Returns Data 1900 - 2012 and Morningstar data from 2013. Non-equities portion is invested in local bonds.

While a 15% salary contribution over 40 years can help you achieve your objective, the required contribution level will increase significantly beyond 15% as you give yourself less and less time to save for retirement.

If you retire at age 65, you should plan for your income to last you 30 years. During that time, you want to draw an income at a rate that still allows you to increase your income by inflation each year, maintaining its purchasing power. Point C in Graph 3 illustrates that, at 60% equity exposure and an income drawdown of 4%, you can have a 90% chance of achieving your objective. If you increase your drawdown to 7% (point D), at the same equity exposure of 60%, it drastically reduces the chances of maintaining your income's purchasing power to less than 30%.

Once you have selected a unit trust with the right level of equity exposure for your return expectations, investment objective and risk appetite, and are contributing (or drawing down) at a level that gives you the best chance of achieving your objective, the final critical step is to stay invested.

Principle 3: Stay invested

To truly benefit from long-term equity exposure, investors need to stay the course. This can be particularly hard when times are uncertain and market volatility seems constant. It is often during the toughest times, when short-term performance is materially down, that investors are tempted to abandon their choice of unit trust. When performance is negative, investors disinvest, and when performance is positive, investors return. The effect of this over time is that investors miss the periods of recovery that typically follow a downturn. Compounded over time, this behaviour erodes investment outcomes.

If you invested R100 000 in the Allan Gray Balanced Fund 20 years ago and missed just the top five months of performance recovery, you would have achieved an outcome of R784 735. If you stayed invested throughout the period, you would have accumulated R1 185 830, equivalent to an annualised return of 13.2%, versus 10.9%. Poor investor behaviour would therefore have cost you a third of your potential return in rands.

Given the global economic uncertainty and accompanying market volatility in recent years, there has been renewed and growing interest in low-equity investment solutions. However, for optimal long-term outcomes, investors should make sure they take on enough risk and not shy away from ensuring their portfolios have appropriate levels of equity exposure, as this improves their chances of earning real returns and achieving their investment objectives.

Our core unit trusts offer varying levels of equity exposure to suit various investment objectives, time horizons and risk appetites. Once you have selected the unit trust that aligns with your goals, and are contributing or drawing down appropriately, staying invested over the course of your investment horizon will help you maximise your investment outcomes.

Nomi joined Allan Gray in 2015 and is currently the head of Direct Clients. Previously, she occupied manager roles in Retail Client Services and was head of Strategic Markets. Nomi holds an Engineering degree from the University of Cape Town and a Master of Philosophy in Engineering for Sustainable Development from the University of Cambridge.

Allan Gray Balanced and Stable Fund asset allocation as at 30 June 2023

	Balanced Fund % of portfolio			Stable Fund % of portfolio		
	Total	SA	Foreign*	Total	SA	Foreign*
Net equities	65.9	41.1	24.8	25.5	13.9	11.5
Hedged equities	10.4	3.9	6.5	20.7	10.0	10.7
Property	1.0	0.8	0.2	0.9	0.8	0.1
Commodity-linked	3.3	2.6	0.7	2.6	2.1	0.5
Bonds	11.9	7.4	4.5	30.9	23.5	7.4
Money market and bank deposits	7.5	7.3	0.2	19.3	21.1	−1.7
Total	**100.0**	**63.1**	**36.9**	**100.0**	**71.5**	**28.5**

Note: There may be slight discrepancies in the totals due to rounding. *This includes African ex-SA assets.

Allan Gray Equity Fund net assets as at 30 June 2023

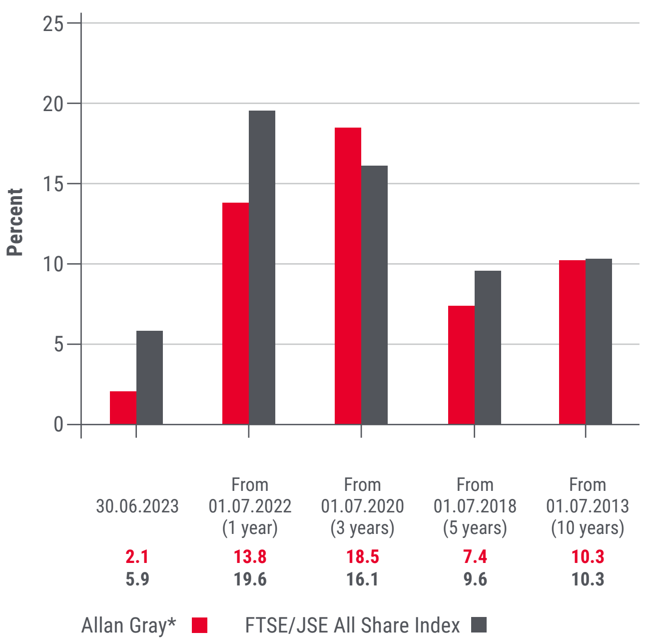
Security (Ranked by sector)	Market value (R million)	% of Fund	FTSE/JSE ALSI weight (%)
South Africa	**25 188**	**59.8**	
South African equities	**24 529**	**58.3**	
Resources	**5 780**	**13.7**	**29.2**
Glencore	1 823	4.3	
Sasol	903	2.1	
Sibanye-Stillwater	626	1.5	
Gold Fields	570	1.4	
AngloGold Ashanti	486	1.2	
Sappi	468	1.1	
Positions individually less than 1% of the Fund	904	2.1	
Financials	**7 133**	**16.9**	**27.8**
Standard Bank	1 308	3.1	
Nedbank	1 186	2.8	
Remgro	1 012	2.4	
FirstRand	669	1.6	
Positions individually less than 1% of the Fund	2 958	7.0	
Industrials	**11 615**	**27.6**	**43.0**
British American Tobacco	2 128	5.1	
Naspers & Prosus	1 768	4.2	
AB InBev	1 591	3.8	
Woolworths	1 372	3.3	
Mondi	1 111	2.6	
Positions individually less than 1% of the Fund	3 645	8.7	
Commodity-linked securities	**252**	**0.6**	
Positions individually less than 1% of the Fund	252	0.6	
Bonds	**12**	**0.0**	
Positions individually less than 1% of the Fund	12	0.0	
Cash	**395**	**0.9**	
Foreign investments	**16 897**	**40.1**	
Equities	**1 462**	**3.5**	
Walt Disney Company	679	1.6	
Booking Holdings Inc	674	1.6	
Positions individually less than 1% of the Fund	110	0.3	
Equity funds	**15 217**	**36.2**	
Orbis Global Equity Fund	6 603	15.7	
Orbis SICAV International Equity Fund	4 298	10.2	
Allan Gray Frontier Markets Equity Fund	2 250	5.3	
Allan Gray Africa ex-SA Equity Fund	1 005	2.4	
Orbis SICAV Japan Equity (Yen) Fund	676	1.6	
Orbis SICAV Emerging Markets Equity Fund	384	0.9	
Cash	**218**	**0.5**	
Totals	**42 085**	**100.0**	

Note: There may be slight discrepancies in the totals due to rounding. For other fund-specific information, please refer to the monthly factsheets.

Investment track record – share returns

Allan Gray Proprietary Limited global mandate share returns vs. FTSE/JSE All Share Index			
Period	Allan Gray*	FTSE/JSE All Share Index	Out-/Under-performance
1974 (from 15.6)	−0.8	−0.8	0.0
1975	23.7	−18.9	42.6
1976	2.7	−10.9	13.6
1977	38.2	20.6	17.6
1978	36.9	37.2	−0.3
1979	86.9	94.4	−7.5
1980	53.7	40.9	12.8
1981	23.2	0.8	22.4
1982	34.0	38.4	−4.4
1983	41.0	14.4	26.6
1984	10.9	9.4	1.5
1985	59.2	42.0	17.2
1986	59.5	55.9	3.6
1987	9.1	−4.3	13.4
1988	36.2	14.8	21.4
1989	58.1	55.7	2.4
1990	4.5	−5.1	9.6
1991	30.0	31.1	−1.1
1992	−13.0	−2.0	−11.0
1993	57.5	54.7	2.8
1994	40.8	22.7	18.1
1995	16.2	8.8	7.4
1996	18.1	9.4	8.7
1997	−17.4	−4.5	−12.9
1998	1.5	−10.0	11.5
1999	122.4	61.4	61.0
2000	13.2	0.0	13.2
2001	38.1	29.3	8.8
2002	25.6	−8.1	33.7
2003	29.4	16.1	13.3
2004	31.8	25.4	6.4
2005	56.5	47.3	9.2
2006	49.7	41.2	8.5
2007	17.6	19.2	−1.6
2008	−13.7	−23.2	9.5
2009	27.0	32.1	−5.1
2010	20.3	19.0	1.3
2011	9.9	2.6	7.3
2012	20.6	26.7	−6.1
2013	24.3	21.4	2.9
2014	16.2	10.9	5.3
2015	7.8	5.1	2.7
2016	12.2	2.6	9.6
2017	15.6	21.0	−5.4
2018	−8.0	−8.5	0.5
2019	6.2	12.0	−5.8
2020	−3.5	7.0	−10.5
2021	28.9	29.2	−0.3
2022	13.1	3.6	9.5
2023 (to 30.06)	**2.1**	**5.9**	**−3.8**

Returns annualised to 30.06.2023



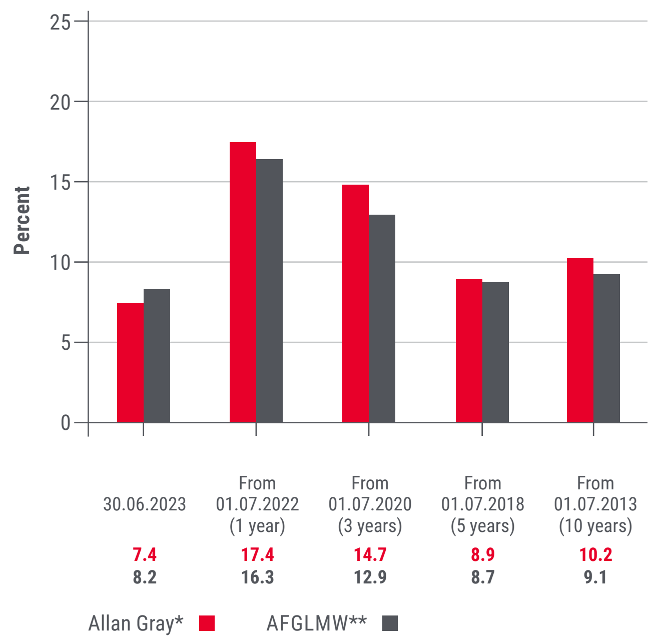
An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown to R324 108 803 by 30 June 2023. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to R15 074 772. Returns are before fees.

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

Investment track record – balanced returns

Allan Gray Proprietary Limited global mandate total returns vs. Alexander Forbes Global Large Manager Watch			
Period	Allan Gray*	AFGLMW**	Out-/Under-performance
1974	–	–	–
1975	–	–	–
1976	–	–	–
1977	–	–	–
1978	34.5	28.0	6.5
1979	40.4	35.7	4.7
1980	36.2	15.4	20.8
1981	15.7	9.5	6.2
1982	25.3	26.2	−0.9
1983	24.1	10.6	13.5
1984	9.9	6.3	3.6
1985	38.2	28.4	9.8
1986	40.3	39.9	0.4
1987	11.9	6.6	5.3
1988	22.7	19.4	3.3
1989	39.2	38.2	1.0
1990	11.6	8.0	3.6
1991	22.8	28.3	−5.5
1992	1.2	7.6	−6.4
1993	41.9	34.3	7.6
1994	27.5	18.8	8.7
1995	18.2	16.9	1.3
1996	13.5	10.3	3.2
1997	−1.8	9.5	−11.3
1998	6.9	−1.0	7.9
1999	80.0	46.8	33.1
2000	21.7	7.6	14.1
2001	44.0	23.5	20.5
2002	13.4	−3.6	17.1
2003	21.5	17.8	3.7
2004	21.8	28.1	−6.3
2005	40.0	31.9	8.1
2006	35.6	31.7	3.9
2007	14.5	15.1	−0.6
2008	−1.1	−12.3	11.2
2009	15.6	20.3	−4.7
2010	11.7	14.5	−2.8
2011	12.6	8.8	3.8
2012	15.1	20.0	−4.9
2013	25.0	23.3	1.7
2014	10.3	10.3	0.0
2015	12.8	6.9	5.9
2016	7.5	3.7	3.8
2017	11.9	11.5	0.4
2018	−1.4	−2.1	0.7
2019	6.5	10.9	−4.4
2020	5.3	6.3	−1.0
2021	20.4	21.9	−1.5
2022	9.9	1.2	8.7
2023 (to 30.06)	**7.4**	**8.2**	**−0.8**

Returns annualised to 30.06.2023



An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown to R37 330 889 by 30 June 2023. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to R7 920 659. 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 2023 is an estimate. The return from 1 April 2010 is the average of the non-investable Alexander Forbes Global Large Manager Watch.
Note: Listed property included from 1 July 2002. Inward listed included from November 2008 to November 2011.

Allan Gray South African unit trusts annualised performance (rand) in percentage per annum to 30 June 2023 (net of fees)

	Assets under management (R billion)	Inception date	Since inception	10 years	5 years	3 years	1 year	Highest annual return[6]	Lowest annual return[6]
High net equity exposure (100%)									
Allan Gray Equity Fund (AGEF)	**42.1**	**01.10.1998**	**19.3**	**9.4**	**7.2**	**17.0**	**17.7**	**125.8**	**−24.3**
Average of South African - Equity - General category (excl. Allan Gray funds)[1]			14.1	8.3	7.8	16.2	13.7	73.0	−37.6
Allan Gray SA Equity Fund (AGDE)	**3.5**	**13.03.2015**	**6.3**	**–**	**6.2**	**17.9**	**12.0**	**57.3**	**−32.0**
FTSE/JSE All Share Index, including income			8.2	–	9.6	16.1	19.6	54.0	−18.4
Allan Gray-Orbis Global Equity Feeder Fund (AGOE)	**27.5**	**01.04.2005**	**14.2**	**13.8**	**11.0**	**12.8**	**33.8**	**78.2**	**−29.7**
MSCI World Index, including income, after withholding taxes[2]			14.7	16.9	16.3	15.6	36.2	54.2	−32.7
Medium net equity exposure (40% - 75%)									
Allan Gray Balanced Fund (AGBF)	**175.0**	**01.10.1999**	**15.0**	**9.2**	**7.8**	**13.9**	**16.5**	**46.1**	**−14.2**
Allan Gray Tax-Free Balanced Fund (AGTB)	**2.5**	**01.02.2016**	**8.1**	**–**	**7.8**	**13.6**	**16.9**	**31.7**	**−13.4**
Average of South African - Multi Asset - High Equity category (excl. Allan Gray funds)[3]			11.4/7.3	8.1	7.8	12.0	16.6	41.9/30.7	−16.7/−10.3
Allan Gray-Orbis Global Balanced Feeder Fund (AGGF)[4]	**17.5**	**03.02.2004**	**11.2**	**11.7**	**10.5**	**14.3**	**29.2**	**55.6**	**−13.7**
60% MSCI World Index with net dividends reinvested and 40% J.P. Morgan GBI Global Index[4]			11.4	12.8	11.8	7.6	25.8	38.8	−17.0
Low net equity exposure (0% - 40%)									
Allan Gray Stable Fund (AGSF)	**51.0**	**01.07.2000**	**11.2**	**8.1**	**7.0**	**10.5**	**12.5**	**23.3**	**−7.4**
Daily interest rate of FirstRand Bank Limited plus 2%			8.5	7.0	6.5	5.9	8.1	14.6	4.6
Very low net equity exposure (0% - 20%)									
Allan Gray Optimal Fund (AGOF)	**0.9**	**01.10.2002**	**6.7**	**5.2**	**2.9**	**3.9**	**−0.5**	**18.1**	**−8.2**
Daily interest rate of FirstRand Bank Limited			6.0	4.9	4.4	3.8	5.9	11.9	2.5
Allan Gray-Orbis Global Optimal Fund of Funds (AGOO)	**1.8**	**02.03.2010**	**8.0**	**7.1**	**6.1**	**10.7**	**22.6**	**39.6**	**−12.4**
Average of US$ bank deposits and euro bank deposits			6.7	6.2	6.7	3.2	20.9	35.6	−19.1
No equity exposure									
Allan Gray Bond Fund (AGBD)	**6.5**	**01.10.2004**	**8.6**	**7.7**	**7.2**	**7.0**	**8.8**	**18.0**	**−2.6**
FTSE/JSE All Bond Index (Total return)			8.3	7.4	7.4	7.6	8.2	21.2	−5.6
Allan Gray Money Market Fund (AGMF)	**26.7**	**03.07.2001**	**7.6**	**6.6**	**6.3**	**5.4**	**7.1**	**12.8**	**4.3**
Alexander Forbes Short-Term Fixed Interest (STeFI) Composite Index[5]			7.4	6.3	5.8	5.0	6.8	13.3	3.8

[1] From inception to 28 February 2015, the benchmark was the FTSE/JSE All Share Index including income (source: IRESS).
[2] From inception to 15 May 2023, the benchmark was the FTSE World Index, including income.
[3] 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.
[4] 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.
[5] 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.
[6] 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 2023

	Fee for benchmark performance	Performance fees	Other costs excluding transaction costs	VAT	Total expense ratio	Transaction costs (incl. VAT)	Total investment charge
Allan Gray Equity Fund	1.10%	−0.02%	0.04%	0.11%	1.23%	0.09%	1.32%
Allan Gray SA Equity Fund	1.00%	−0.47%	0.01%	0.08%	0.62%	0.11%	0.73%
Allan Gray Balanced Fund	1.02%	0.09%	0.03%	0.11%	1.25%	0.07%	1.32%
Allan Gray Tax-Free Balanced Fund	1.31%	N/A	0.04%	0.15%	1.50%	0.09%	1.59%
Allan Gray Stable Fund	1.01%	0.24%	0.03%	0.15%	1.43%	0.05%	1.48%
Allan Gray Optimal Fund	1.00%	0.00%	0.02%	0.15%	1.17%	0.11%	1.28%
Allan Gray Bond Fund	0.38%	0.00%	0.01%	0.06%	0.45%	0.00%	0.45%
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	1.47%	−0.51%	0.05%	0.00%	1.01%	0.11%	1.12%
Allan Gray-Orbis Global Balanced Feeder Fund	1.38%	0.14%	0.06%	0.00%	1.58%	0.09%	1.67%
Allan Gray-Orbis Global Optimal Fund of Funds	0.98%	0.00%	0.08%	0.00%	1.06%	0.13%	1.19%

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 2023 (net of fees)

	Inception date	Since inception	10 years	5 years	3 years	1 year	Highest annual return[6]	Lowest annual return[6]
High net equity exposure								
Orbis Global Equity Fund	**01.01.1990**	**17.6**	**14.1**	**11.5**	**13.3**	**34.3**	**87.6**	**−47.5**
MSCI World Index, including income, after withholding taxes[7]		14.1	17.0	16.5	15.7	37.0	54.2	−46.2
Orbis SICAV Japan Equity (Yen) Fund	**01.01.1998**	**14.2**	**12.8**	**9.7**	**11.0**	**38.4**	**94.9**	**−40.1**
Tokyo Stock Price Index		9.6	12.6	9.3	8.2	35.7	91.0	−46.4
Orbis SICAV Emerging Markets Equity Fund (US$)[8]	**01.01.2006**	**13.2**	**10.8**	**8.9**	**7.6**	**38.3**	**58.6**	**−34.2**
MSCI Emerging Markets (Net) (US$) Index[8]		12.4	10.9	7.6	5.2	17.3	60.1	−39.7
Allan Gray Africa ex-SA Equity Fund (C class)	**01.01.2012**	**11.6**	**7.3**	**5.6**	**15.0**	**4.9**	**65.6**	**−24.3**
Standard Bank Africa Total Return Index		7.4	6.2	9.7	9.9	18.9	41.4	−29.4
Allan Gray Australia Equity Fund	**04.05.2006**	**14.6**	**14.2**	**11.3**	**18.2**	**30.7**	**99.5**	**−55.4**
S&P/ASX 300 Accumulation Index		12.7	12.2	11.8	13.0	27.7	55.6	−45.1
Allan Gray Frontier Markets Equity Fund (C class)	**03.04.2017**	**11.6**	**–**	**11.9**	**18.5**	**44.8**	**45.2**	**−11.0**
MSCI Frontier Emerging Markets Index		5.6	–	5.2	6.0	20.0	20.0	−12.8
Medium net equity exposure								
Orbis SICAV Global Balanced Fund	**01.01.2013**	**14.9**	**12.7**	**11.1**	**15.1**	**30.0**	**54.4**	**−9.8**
60% MSCI World Index with net dividends reinvested and 40% J.P. Morgan GBI Global Index		14.1	12.7	11.9	7.6	26.5	40.2	−12.1
Allan Gray Australia Balanced Fund	**01.03.2017**	**11.0**	**–**	**10.5**	**13.2**	**26.2**	**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%).		10.4	–	10.4	7.0	23.6	25.1	−8.3
Low net equity exposure								
Allan Gray Australia Stable Fund	**01.07.2011**	**10.9**	**9.2**	**8.5**	**7.5**	**19.2**	**32.7**	**−8.9**
Reserve Bank of Australia cash rate		6.7	4.9	5.6	2.8	15.0	28.8	−15.5
Very low net equity exposure								
Orbis Optimal SA Fund (US$)	**01.01.2005**	**10.0**	**8.6**	**8.2**	**12.5**	**23.5**	**48.6**	**−15.7**
US$ Bank deposits		8.5	7.9	8.5	4.4	20.0	57.9	−25.6
Orbis Optimal SA Fund (Euro)	**01.01.2005**	**7.7**	**5.4**	**4.8**	**9.9**	**25.5**	**44.1**	**−19.3**
Euro Bank deposits		6.3	4.7	5.2	2.1	22.4	40.2	−20.9
No equity exposure								
Allan Gray Africa Bond Fund (C class)[9]	**27.03.2013**	**12.8**	**12.6**	**10.1**	**4.2**	**25.2**	**28.9**	**−7.4**
FTSE 3-Month US T Bill + 4% Index[9]		8.8	9.0	13.0	11.2	24.3	36.5	−12.3

Performance as calculated by Allan Gray

6 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.

7 From inception to 15 May 2023, the benchmark was the FTSE World Index, including income.

8 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.

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

IMPORTANT INFORMATION FOR INVESTORS

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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.

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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.

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

The Allan Gray Money Market Fund is not a bank deposit account. The Fund aims to maintain a constant price of 100 cents per unit. The total return an investor receives is made up of interest received and any gain or loss made on instruments held by the Fund. While capital losses are unlikely, they can occur if, for example, one of the issuers of an instrument defaults. In this event, investors may lose some of their capital. To maintain a constant price of 100 cents per unit, investors' unit holdings will be reduced to the extent of such losses. The yield is calculated according to applicable ASISA standards. Excessive withdrawals from the Fund may place it under liquidity pressure; if this happens, withdrawals may be ring-fenced and managed over a period of time.

Additional information for retirement fund members and investors in the tax-free investment account, living annuity and endowment

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

Life Limited, an insurer licensed to conduct investment-linked life insurance business as defined in the Insurance Act 18 of 2017. The underlying investment options of the Allan Gray individual life and retirement products are portfolios of collective investment schemes in securities (unit trusts or funds) and life-pooled investments.

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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