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The Stable Fund at Five

Allan Gray has a suite of risk-profiled portfolios designed to suit different investor needs. The Equity Fund only invests in shares and while offering the prospect of superior long-term returns has higher volatility of returns given its full exposure to equity markets. The Balanced Fund is managed the way we would manage our average pension fund client with a reasonable weighting in domestic shares and the rest in foreign assets, bonds, cash and property. While not necessarily providing the same returns as the Equity Fund over the long-term, it has a lower volatility of returns and has a risk profile suitable for the average member of a pension fund.

While the Equity Fund and Balanced Fund meet the needs of most investors, there was a need for a portfolio that was suitable for people at or near retirement age who needed a high level of capital stability and yet that provided returns that over time beat inflation. The Allan Gray Stable Fund was launched five years ago with the aim of providing a high level of capital stability while still aiming to produce superior after-tax returns when compared to bank deposits. The Fund sought to achieve these objectives by investing in various asset classes chosen for their high income yielding potential. While the Fund does have some exposure to shares, the weighting is relatively small (substantially less than our Balanced Fund) and focused on shares that offer attractive prospective dividend yields.

The Fund's benchmark is the after tax return of call deposits plus two percentage points. The management fee is directly related to the rolling two-year return of the Fund compared with that of its benchmark. Should the Fund produce a return of 0% or worse over a two-year period the firm will forego all fees.

With the Stable Fund achieving a five-year track record last month it is worthwhile reviewing how it has performed relative to its objectives of **returns** and **capital stability**.

% Returns *

	Stable Fund	**Benchmark**	**Annualized Outperformance**
5 years (annualized)	15.4	8.2	7.2
3 years (annualized)	14.3	8.0	6.3
1 year	18.4	6.0	12.4

* = Applying a 25% tax charge

It is pleasing that the Fund's returns since inception, and over shorter periods, have comfortably exceeded its benchmark. As important though is that this outperformance has been achieved with low levels of risk. Two commonly used measures of risk are **maximum drawdown** and **volatility**. Maximum drawdown is the maximum percentage decline over any period from peak to trough. Volatility is the annualized monthly volatility of the fund. The table below illustrates the return and risk characteristics of three of our equity based risk-profiled funds for the last five years till end June 2005 (the Allan Gray Optimal Fund was only launched on 1 October 2002; discussed in GrayIssue 38).

	% Return	**Maximum Drawdown %**	**Annualised Monthly Volatility**
AGEF	27.8	-17.0	14.6
FTSE/JSE All Share Index	16.6	-34.4	19.8
AGBF	24.9	-10.7	10.2
Average Prudential Fund	14.9	-14.0	10.9
AGSF	15.4 *	-2.3	4.0
Benchmark **	8.2 *	n/a	0.5

* = Applying a 25% tax charge
** = After tax return on call deposits plus two percentage points

The Equity Fund and the Balanced Fund have also both delivered substantially superior returns to their benchmarks with lower absolute risk than that of their benchmarks. As one would expect the Stable Fund has had lower risk than the Balanced Fund, which in turn has had lower risk than the Equity Fund. What is particularly pleasing is that the Stable Fund has significantly outperformed its benchmark and inflation with very low levels of absolute risk. While the returns have clearly been assisted by the strength in the South African equity market in the last couple of years, we continue to believe that the Stable Fund is a very attractive alternative to other low risk investment options.

Commentary by Stephen Mildenhall, Chief Investment Officer, Allan Gray Limited