

Investing offshore allows you to gain exposure to sectors that are underrepresented in South Africa, and also reduces the overall riskiness of your portfolio. At Allan Gray we aim to ensure that the selection of funds available on our Offshore Platform allows investors adequate geographic choice while at the same time appealing to a spread of risk tolerances. With South African investors displaying a keen interest in Australia, we have now added the Allan Gray Australia Opportunity Fund to our offshore offering, alongside the Allan Gray Australia Equity Fund. For further information on the Australia Equity Fund and Allan Gray Australia please read GrayIssue 132.

Investors would do well to remember that like South Africa, the Australian market is relatively small, making up only 2-3% of the World Index. But if you have family in Australia, or plan to relocate eventually, there are several benefits of investing in this economy. Of course, diversification is only one of many elements you need to consider when making your investment choices.

The aim of most investors should be to achieve a real return

Even at retirement, the average person today has a life expectancy of more than 20 years. Over such timescales even modest levels of inflation play a significant role in the ultimate purchasing power of your investments. The aim of most investors should therefore be to achieve a real return. This is not always easy. In most countries of the world (Australia is a big exception) putting your money in the bank or bonds is very unlikely to even match inflation. Historically the lowest risk approach to maximise your chances of a real return has been to invest in the stock market (see **Graph 1**). The same picture is true over this period for all countries where data exists since 1900.

However, the stock market is prone to violent corrections, often dropping 50% or more with little prior warning, as shown in **Graph 2**. While it is clear that stocks are the best place to invest over long time periods, there is one significant class of stock market investor that achieves disappointing returns. Many smaller investors lose their nerve when their precious retirement funds fall significantly and are panicked into selling their shares often near the bottom of the market. This happened to many people in the recent Global Financial Crisis.

It is easy to be rational about such matters when it is a theoretical exercise, but many investors cannot withstand the pressure of big losses on money they rely on, further potential downside, very negative news reports and panic among fellow investors.

Launch of the Allan Gray Australia Opportunity Fund

It was to help such investors that Allan Gray Australia launched the Allan Gray Australia Opportunity Fund. The Fund invests in top-rated Australian bank deposits. In addition, analysts look out for investment opportunities in the Australian stock market where they have high confidence that a specific share will yield returns better than cash with limited downside. The focus is not on returns relative to the stock market and often this analysis is much easier than the traditional analysis done for the Australia Equity Fund.

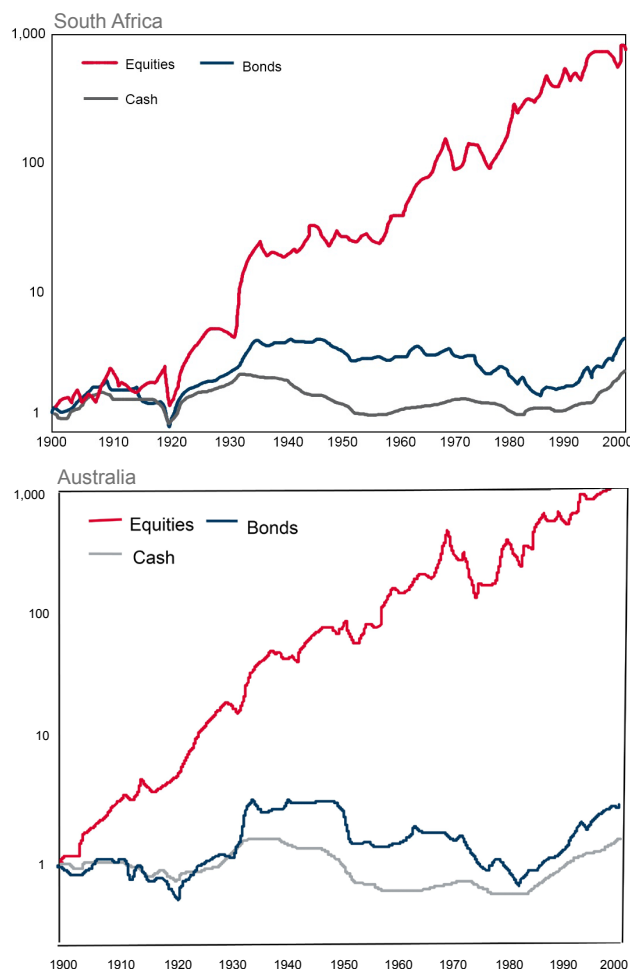
The Fund does not gear or use derivatives and will never have a share exposure of more than 50%. At some stages of market valuation, it will have no share exposure at all with all money invested in cash deposits. Over time, the aim is to have higher share exposure when the market is low (and thus yields many investment opportunities that give good absolute returns) and to help investors avoid the market when it is expensive (when we are unlikely to find much that is attractive).

Over the long term the Fund aims to add a little to the returns of cash. Early indications are encouraging, with the Fund returning 9.3% per year in Australian dollars after 21 months.

By Simon Marais, Managing Director and Portfolio Manager, Allan Gray Australia

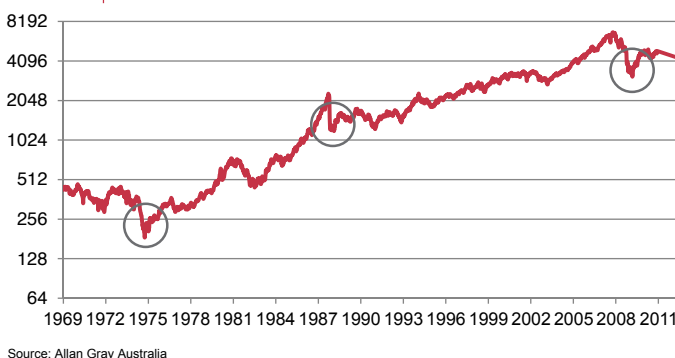
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Graph 1 | Twentieth Century history of real returns in South Africa and Australia



Source: Triumph of the Optimists; 101 Years of Global Investment Returns, Dimson, Marsh, Staunton

Graph 2 | Australian All Share Index since 1965



Source: Allan Gray Australia

For investors looking for Australian exposure, but who are unsure as to how they will react to a large drop in the value of their investments through the more volatile Australia Equity Fund, the Opportunity Fund may well be a superior solution. These investors will miss out on some of the upside the stock market provides over time, but will sleep much better at night and ultimately may achieve a better outcome in the volatile markets that are likely over the next few decades.