

Sanlam/Allan Gray Relative Equity Fund

The Sanlam/Allan Gray Relative Equity Fund is a segregated portfolio managed on Sanlam's behalf by Allan Gray Limited offered only through the Stratus platform. The product is often confused with our unit trust fund, the Allan Gray Equity Fund even though the two are completely different products.

The launch of the Fund arose from client demand for a portfolio based on our long-term ability to select stocks which represent fundamental value but which would have a tracking error lower than our normal portfolios and no greater than our investment manager peer group. Our challenge then was to retain as much of our historic outperformance whilst reducing our tracking error to the required levels.

The portfolio management process employed to manage the Sanlam portfolio is designed to limit the portfolio's relative risk, i.e. the risk of performing differently from the benchmark (the FTSE/JSE All Share Index with resources down weighted to 75%). The aim is to capture some of the excess returns (alpha) delivered by Allan Gray's research, but to limit the risk of underperformance. This approach is different from the usual Allan Gray approach as used in our own Equity Fund, which focuses on absolute risk, i.e. the risk of losing money. As a result, we would expect the Sanlam portfolio to deliver returns that are different from our Equity Fund. The Sanlam portfolio's returns are likely to be lower than those of the Equity Fund during periods of strong outperformance by the Equity Fund, while its returns are likely to be higher during periods of underperformance by the Equity Fund. Over the long-term, we would expect the Equity Fund to outperform, with lower levels of absolute risk but higher levels of relative risk.

The investment process

Whilst both the Allan Gray Equity Fund and the Relative Equity Fund employ our value-orientated approach, there is a fundamental difference in the portfolio construction and risk management process.

In the construction of the Equity Fund, the managers select shares and construct the portfolio with a "clean sheet" approach. They do not start with the benchmark and adjust undervalued stocks or weightings according to their investment views. Instead they only invest in shares that they find attractive. Shares that we are neutral about or find unattractive will be avoided irrespective of their weighting or importance in the benchmark. For example, on 24 June 2003, the Equity Fund had no exposure to Billiton whilst it had a 7.5% weighting in the benchmark.

In contrast to this, the Relative Equity Fund manager will start with the benchmark, we will use our research inputs and we will only deviate from the benchmark in line with strict constraints as agreed with Sanlam. In the Relative Equity Fund, Billiton had a 5.5% weighting versus the 7.5% of the benchmark. The underweight position confirms our research that we regarded Billiton as over-valued at the time.

Returns

The performance table below (performance gross of fees) shows that we have managed to retain a significant portion of our outperformance (alpha) while reducing our tracking error versus the FTSE/JSE All Share Index to that of our investment manager peer group.

	Sanlam Value Institutional Fund	Benchmark	Allan Gray Domestic Equity Average
Annualised since inception	11.6	2.7	19.8
Year to date	-5.5	-5.8	-1.9
Inception for calculation of performance - 1 November 2001			

Commentary by Johan de Lange, Director of Allan Gray Unit Trust Management Limited

Unit trusts are medium- to long-term investments. The value of units may go down as well as up and past performance is not necessarily a guide to the future. Unit trust prices are calculated on a net asset value basis, which is the total value of all assets in the portfolio including any income accrual and less any permissible deductions from the portfolio. A schedule of fees and charges and maximum commissions is available from the management company/scheme. Commission and incentives may be paid and if so, would be included in the overall costs. Forward pricing is used. Member of the ACI. The FTSE/JSE Africa Index Series is calculated by FTSE International Limited ("FTSE") in conjunction with the JSE Securities Exchange South Africa ("JSE") in accordance with standard criteria. The FTSE/JSE Africa Index Series is the proprietary information of FTSE and the JSE. All copyright subsisting in the FTSE/JSE Africa Index Series index values and constituent lists in FTSE and the JSE jointly. All their rights are reserved.