

New ACI categories from 1 January 2008 affect the Allan Gray Balanced and Stable Funds

Correctly classifying funds helps investors understand the various fund types to select the right one for their needs. It also helps investors, financial advisers and the industry compare funds both within and across the different categories. The Association of Collective Investment Schemes (ACI) continuously reviews fund classifications and from time to time updates its categories in line with changes in the market. Because of recent changes to the way the ACI classifies unit trusts the Allan Gray Balanced Fund has moved to a new ACI category.

How funds are classified by the Association of Collective Investments

The first level of classification divides funds into those that invest primarily in local markets (domestic), those that invest primarily in foreign markets (foreign), and those that invest in a mix of the two (worldwide). Then, funds are categorised according to the type of asset classes or combination of asset classes they hold – such as equities, bonds and other fixed interest instruments and property. The Allan Gray Balanced Fund falls into a broad group of funds called ‘asset allocation’ funds as it may invest in a mix of different asset classes.

How asset allocation funds are classified

The ACI firstly classifies asset allocation funds according to whether or not they adhere to legislation governing retirement funds – specifically Regulation 28 of the Pension Funds Act. Those that do comply with Regulation 28 are known as ‘prudential’ funds and are considered suitable investment vehicles for retirement funds. The ACI then divides asset allocation funds according to the amount of equities their portfolios may hold. According to the categories that were in place before the recent changes, the ACI allowed for low, medium and high levels of equity exposure. These have now been changed and the current categories’ equity exposure limits and the impact on Allan Gray funds is set out below:

1. Prudential Low Equity category: an actual equity exposure below 40% at all times

The Allan Gray Stable Fund remains in this category. The maximum net equity exposure for this Fund has now been limited to below 40% in terms of its investment mandate.

2. Prudential Medium Equity category: an actual equity exposure of between 40% and 65%

Prior to 1 January 2008 the Allan Gray Balanced Fund fell within this category as it permitted flexibility to, where warranted, have equity exposure higher than 65% or lower than 40%. As of 1 January 2008, the ACI requires that the funds classified as Prudential Medium Equity portfolios have “an actual equity exposure (including international equity) between 40% and 65% at all times.”

3. Prudential High Equity: an actual equity exposure above 60%

4. New Prudential Variable Equity category: an actual equity exposure of between 0% and 75%

The ACI has introduced a new category – the Prudential Variable Equity category – that allows for substantial flexibility in terms of the amount of actual equity exposure a fund may have. Its requirements state that portfolios classified in this category “would have an equity exposure (including international equity) between 0% and 75% at all times.” In order to ensure there is no change to the way we manage the Allan Gray Balanced Fund, we needed more investment freedom and a greater flexibility with regard to equity exposure than the new Prudential Medium Equity limits allow. To retain investment flexibility in respect of equity exposure limits from 1 January 2008, the Allan Gray Balanced Fund has now moved to the new category, along with a large number of other funds previously in the Prudential Medium Equity category.

Implications of the Allan Gray Balanced Fund category change:

1. Benchmarks provide investors with a yardstick against which they can evaluate their fund’s performance, therefore it is important to ensure that the benchmark selected for a particular fund is relevant and appropriate and is as consistent as possible regardless of ACI category changes. The Allan Gray Balanced Fund’s benchmark was previously the average of the funds in the category (excluding itself). With the new development in the ACI’s fund classifications, many other funds either already have or will soon be changing to the new variable classification. To ensure that the benchmark for the Allan Gray Balanced Fund remains as consistent and representative as possible the benchmark is now based on the average of all funds in both the Prudential Medium Equity category and the Prudential Variable Equity category (excluding the Allan Gray Balanced Fund).
2. The Allan Gray Balanced Fund’s past performance history is retained in the newly created category because the change was due to an ACI code change, and there has been no change to the investment mandate.
3. Due to the broad limits of the category (‘the underlying risk and return objectives of individual portfolios may vary as dictated by each portfolio mandate and stated investment objective and strategy’), ranking of funds within the Domestic Asset Allocation Prudential Variable category is not appropriate.

Allan Gray Balanced Fund Performance to 31 December 2007

	% Returns Balanced Fund	% Returns Benchmark*
Latest 5 years (annualised)	25.0	22.3
Latest 3 years (annualised)	26.1	22.3

*The market value-weighted average of the Domestic Medium Equity Prudential unit trust category excluding the Allan Gray Balanced Fund.

Source: Micropal, performance as calculated by Allan Gray 31 December 2007

Commentary by Johan de Lange, Director Allan Gray Investor Services

Collective Investment Schemes in Securities (unit trusts) are generally medium- to long-term investments. The value of participatory interests (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. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees and charges and maximum commissions is available on request from Allan Gray Unit Trust Management Limited. Commission and incentives may be paid and if so, would be included in the overall costs. Forward pricing is used. A prospectus is available from Allan Gray Unit Trust Management Limited - a member of the ACI. The portfolio is managed to comply with the limits of Annexure A to Regulation 28 of the Pension Funds Act. Exposures in excess of the limits will be corrected immediately except where due to market value fluctuations or capital withdrawals in which case they will be corrected within a reasonable time period. Allan Gray Unit Trust Management Limited does not monitor compliance by retirement funds with section 19(4) of the Pension Funds Act (item 9 of Annexure A to Regulation 28).