GRAY ISSUE
LONG TERM COMMENTARY

26 October 2001
Issue no. 4

Allan Gray Equity Fund – Does Size Matter?

New unit trusts often produce stellar returns that attract a large amount of new money. However as the fund grows, performance starts to lag. While a small pool of initial investors may do well, the bulk of the fund's clients find their returns mediocre at best. This is true for almost all the top performing funds of three years ago.

The Allan Gray Equity Fund has done very well for the past three years since its launch. While that has been very gratifying for our investors to date, it is fair to ask whether these returns can be expected to continue into the future. We are convinced that the size of our fund has nothing to do with our performance. To see this, one has to look at the crucial differences between our equity fund and that of most other industry players.

The performance of our equity fund has been little different from that of the total equity asset pool over its first three years.

<u>Returns for the three years to 30 September 2001 (annualised)</u>

Allan Gray Equity Fund (Buy to Sell)	52.3%
Combined equity return of Allan Gray's total client base	51.1%
All Share Index return	20.1%
Average general equity unit trust return	11.4%

The Equity Fund has had almost exactly the same performance as the equities of our total client base; this is to be expected since we treat all of our clients the same. No unit trust or any other client gets preference over any other. The total equities under our management are in excess of R18 billion so our R1.2 billion unit trust is still small relative to the total equity pool.

We only have one equity fund and this is likely to remain the situation in future.

Marketing orientated fund management companies need to have something to sell. It is thus vitally important to have a best performing fund even if your overall performance is poor. There is thus a constant need for new funds to which you allocate your best ideas first. As the fund grows this becomes more difficult, since these best ideas are usually limited in size. As the next new fund is formed the best ideas migrate to this fund, often at the expense of the established fund.

At Allan Gray, we have to make our one and only equity fund perform. We do not envisage a competitor fund and investors can be confident that this fund will continue to have access to all our best ideas.

So can prospective investors expect the same returns from our fund in the future as has been experienced over the past three years? The answer is simple: Certainly not! The last three years has been exceptional for Allan Gray, even in the light of its extraordinary 27-year track record displaying 21 years of out-performance.

From the table above, one can see we outperformed by 32% p.a. since September 1998. This is very much above our long-term mean. Since 1974 we averaged a return of about 11% p.a. better than the All Share Index. We would see this as a realistic (if ambitious) long-term expectation for our clients. The reason for the last three years' extraordinary results has been the very skewed stock market in 1998 with crazily high prices for certain "growth" stocks, but bargain basement prices for good quality companies such as Richemont, De Beers and Sappi. We do not see the same levels of divergence in the current market.

Added value of 11% p.a. may not sound that impressive, especially in the light of the past three years experience. But we are not aware of a better 25-year track record for a general equity fund anywhere in the world. Over the period, the extra performance would have increased your wealth tenfold!

Commentary by Simon Marais, Chairman