

dibanisa  
FUND MANAGERS

10 YEARS

Applied common sense.

**Investment Managers' Conference**

**Fundamental Indexation (RAFI®)  
The SA & Global Experience**

October 2011

# Introduction

- † DFM is a dedicated equity and bond tracker house established over 10 years ago
- † 66.6% owned by Old Mutual and 33.3% owned by One Stone Capital
- † BEE and social development are key components of our core values
- † R39bn assets under management.
- † OMGXT offers a range of solutions to UK, US and European investors
- † Successful track record of delivering tracking errors well below acceptable industry standard of 0.50%.
- † Retail Funds: Old Mutual RAFI® 40 Fund; Old Mutual Top 40 Fund; Old Mutual Global Index FoF's

# Investment Philosophy

## Objective

- ✦ We aim to construct portfolios that deliver the return of the underlying benchmark with low tracking error, and minimising cost.

## Philosophy

- ✦ Traditional beta is a valuable tool in portfolio construction.
  - Market Cap/ Sector/ Fundamental/ Size/ Fixed Interest or Tailor-made indices, etc.
- ✦ Successful tracker funds are best achieved by:
  - Committed, experienced people applying their trade with skill and diligence;
  - Application of tested optimisation models; and
  - Intelligent handling of required changes.

# Agenda



- ✦ Fundamental Tracking: The International Experience

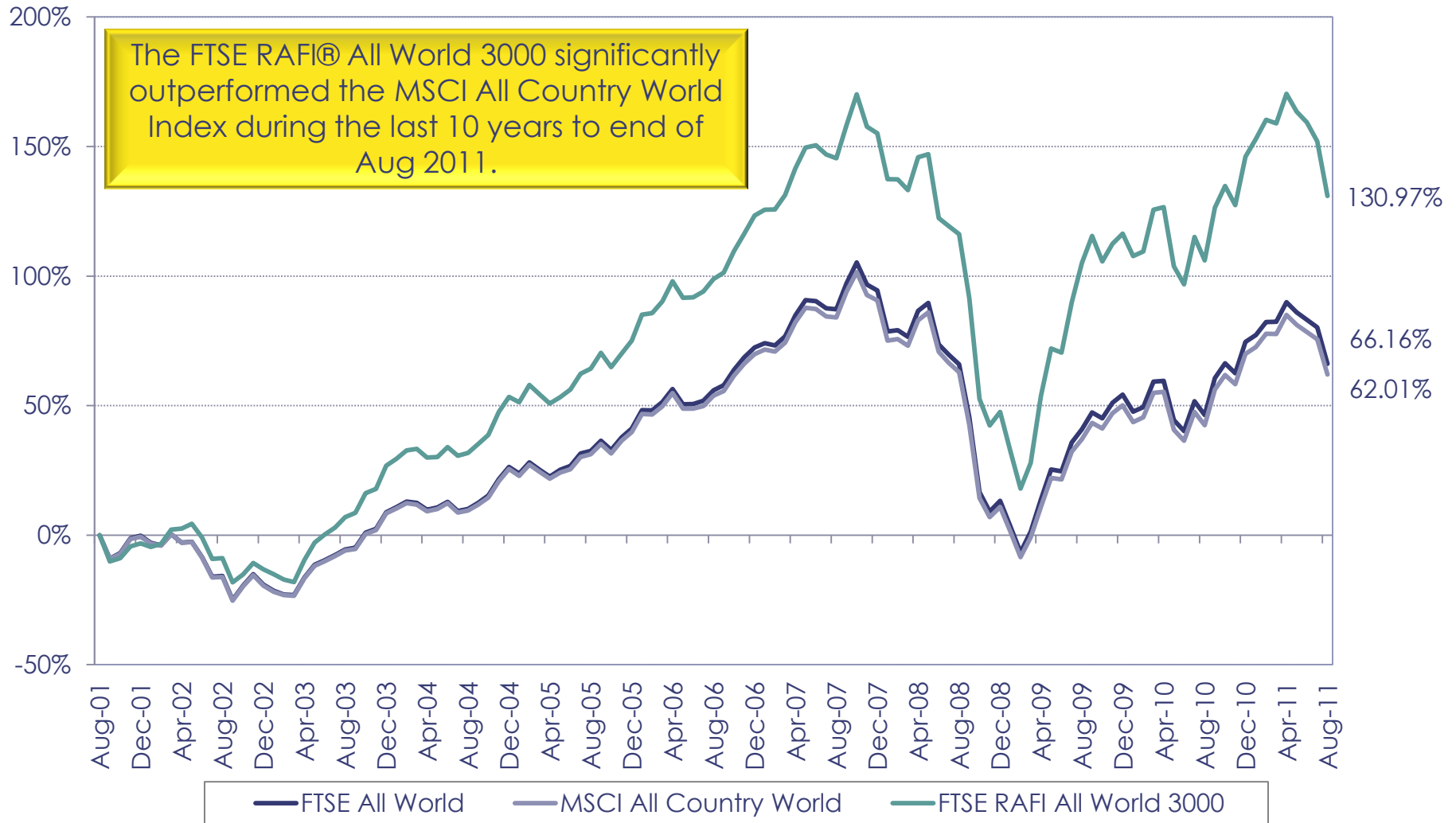
# RAFI® Global Indices: Strong performance relative to mkt cap

Total Return as of 8/31/11	Bloomberg Ticker	12 Month	Annualized 3 Year	Annualized 5 Year	Annualized 10 Year	Annualized 10 Year Volatility
<b>FTSE RAFI® All World 3000</b>	<b>TFRAW3</b>	<b>12.12%</b>	<b>2.23%</b>	<b>3.04%</b>	<b>8.73%</b>	<b>18.96%</b>
FTSE All World Series All World Index	FTS5ALWR	<b>14.05%</b>	<b>0.21%</b>	<b>1.38%</b>	<b>5.26%</b>	<b>17.27%</b>
MSCI All Country World	GDUEACWF	<b>14.28%</b>	<b>-0.01%</b>	<b>1.14%</b>	<b>5.00%</b>	<b>17.21%</b>
<b>FTSE RAFI® Developed 1000 Index</b>	<b>TFRDU</b>	<b>11.20%</b>	<b>0.42%</b>	<b>0.67%</b>	<b>5.81%</b>	<b>18.66%</b>
FTSE All World Developed Index	FTS5DEV	<b>14.86%</b>	<b>-0.50%</b>	<b>0.52%</b>	<b>4.46%</b>	<b>16.82%</b>
MSCI Daily Total Return Gross World	GDDUWI	<b>15.06%</b>	<b>-0.71%</b>	<b>0.35%</b>	<b>4.22%</b>	<b>16.76%</b>
<b>FTSE RAFI® Emerging Markets Index</b>	<b>TFREMU</b>	<b>9.00%</b>	<b>7.14%</b>	<b>11.98%</b>	<b>23.00%</b>	<b>24.62%</b>
FTSE All Emerging	FTS5ALEM	<b>8.56%</b>	<b>5.81%</b>	<b>9.23%</b>	<b>16.61%</b>	<b>24.19%</b>
MSCI Daily Total Return Gross Emerging Markets	GDUEEGF	<b>9.40%</b>	<b>5.36%</b>	<b>8.72%</b>	<b>16.29%</b>	<b>24.20%</b>

Source: Research Affiliates

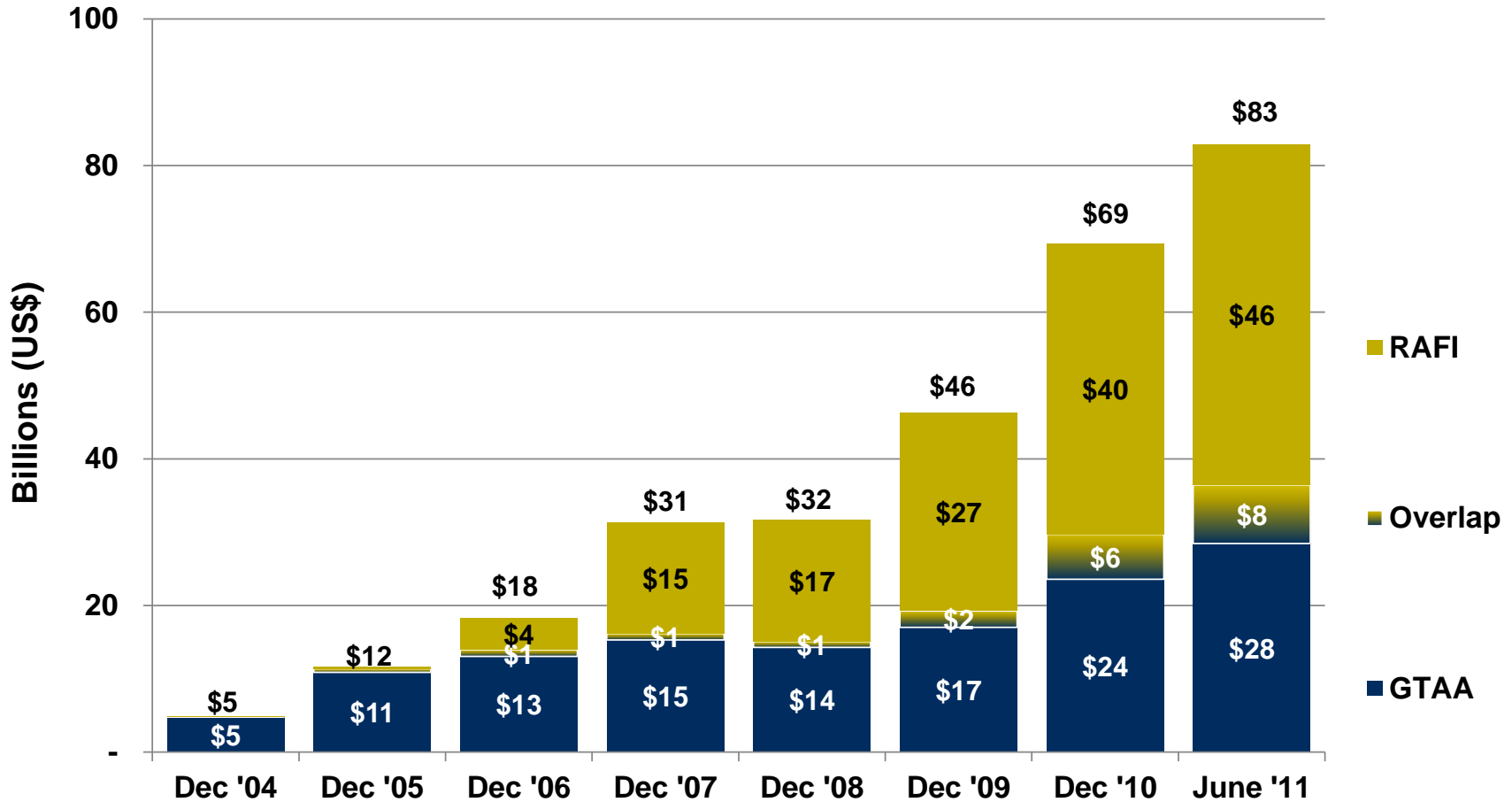
All rights in and to the FTSE RAFI Indices vest in FTSE and/or its relevant partners

# RAFI® All World 3000: 10 Year Cumulative Performance



Past performance is not an indicator of future results. Index performance is not representative of a specific fund or product. One cannot invest directly in an index.  
 Source: Bloomberg, MSCI

# Performance Translating into Huge Growth in AUM



\*June 2011 data based on estimates.

Includes GTAA, RAFI and eRAFI assets managed or sub-advised by Research Affiliates and RAFI licensees.

# But Let's Start With The Frame of Reference

## Two Views on the Markets

### Cap-Weight Market Centric View

- Markets are efficient—prices reflect true valuations
- Departures from cap weight are active bets, inherently a zero-sum game
- Invest in companies proportional to market valuation
- Seek equity risk premium not alpha

### Graham & Dodd Economy-Centric View

- Markets are constantly seeking fair value, but prices are rarely right
- Some companies can get overpriced, some underpriced
- The market itself makes active bets
- Create valuation model of the company and invest in ones which offer the best rate of return

Source: Research Affiliates. This slide has been reproduced from a Research Affiliate slide

# Based on Economy-Centric View: Four Factors Developed

- To date FTSE have launched over 50 FTSE RAFI® indices across the globe

## Book Value (25%)

- As at review date
- Intangibles and minority interests are included
- Differentiation is made for sectors

## Cashflows (25%)

- Averaged over the past five years
- Defined as Operating Income plus Depreciation
- Cashflow before dividends are used

## Dividends (25%)

- Averaged over the past five years
- Including both special and regular dividends paid in cash
- Excludes dividends paid to minority shareholders

## Sales (25%)

- Averaged over the past five years
- Differentiation is made for sectors (Mines, Retailers, Banks)

The eRAFI™ methodology weights shares based on fundamental valuation metrics - sales, cash flow, book price and dividends, as well as (the quality of earnings screen and the financial distress risk screen)

# The Dangers of a Cap-Weighted Approach: No Link to Economic Reality (Data From the Tech Bubble of 2000)

	As of March 31			
	1999	2000	2001	2002
<b>Cisco</b>				
Percent in Russell 1000	1.65%	4.09%	1.11%	1.25%
Percent of Economy*	0.14%	0.20%	0.28%	0.44%
P/E	81.76	181.91	25.09	21.96
<b>Nortel</b>				
Percent in FTSE Canada	10.89%	29.40%	10.28%	3.78%
Percent of Economy*	2.92%	3.90%	4.31%	6.27%
P/E	37.31	122.82	28.2	—
<b>Nokia</b>				
Percent in FTSE Finland	14.91%	82.56%	79.20%	41.61%
Percent of Economy*	16.23%	17.52%	20.71%	22.36%
P/E	43.91	86.03	31.56	37.1
<b>Ericsson</b>				
Percent in FTSE Sweden	19.25%	45.83%	23.78%	10.04%
Percent of Economy*	6.67%	8.44%	8.95%	9.69%
P/E	32.13	95.99	25.99	57.22

\*Percent of Economy represents the rebalance weight of each company in its respective RAFI Country Index.

Source: Research Affiliates, based on data from Wilshire Atlas and Bloomberg.

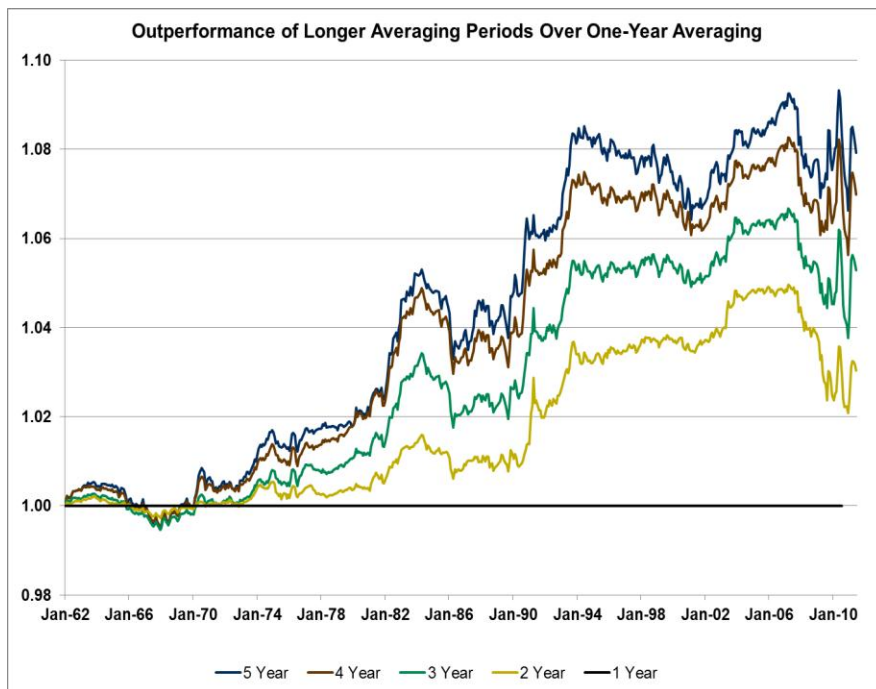
# RAFI Factor Weighting: Specific International Stock Examples

	5-Year Average						Current		RAFI Weight
	Sales		Cash Flow		Dividend		Book Value		
	Weight	Rank	Weight	Rank	Weight	Rank	Weight	Rank	
Exxon Mobil	1.4%	2	1.6%	2	1.2%	7	0.8%	15	1.4%
Bank of America	0.5%	18	0.9%	6	1.0%	11	1.5%	1	1.1%
ING	0.7%	9	2.2%	1	0.4%	51	0.4%	44	1.1%
General Electric	0.7%	11	0.7%	18	1.5%	1	0.8%	11	1.0%
Wal-Mart	1.5%	1	0.7%	17	0.5%	36	0.5%	28	0.7%

Source: Research Affiliates, LLC., based on data from Bloomberg back office.

# Using a Five Year Average Improves Performance...

1962–June 2011



- Helps smooth peaks and valleys in financial data
- Less susceptible to aggressive accounting
- Recent financial data more highly correlated with recent price moves
- Breaks the link with price

	5-Year	4-Year	3-Year	2-Year	1-Year	Cap 1000
Annual Return	11.66%	11.64%	11.60%	11.56%	11.50%	9.67%
Annual Volatility	15.43%	15.44%	15.45%	15.47%	15.44%	15.25%
Value Add	1.99%	1.97%	1.93%	1.89%	1.83%	
Tracking Error	4.52%	4.49%	4.43%	4.39%	4.32%	
Information Ratio	0.44	0.44	0.44	0.43	0.42	
Turnover	11.67%	11.81%	12.01%	12.32%	13.11%	

Source: Research Affiliates, LLC. Based on data from CRSP and Compustat. THE INDEX DATA PUBLISHED HEREIN IS SIMULATED, UNMANAGED AND CANNOT BE INVESTED IN DIRECTLY. PAST SIMULATED PERFORMANCE IS NO GUARANTEE OF FUTURE PERFORMANCE AND IS NOT INDICATIVE OF ANY SPECIFIC INVESTMENT. ACTUAL INVESTMENT RESULTS MAY DIFFER.

# Plus: Weighting by “Stale” Information is (Surprise!) Better than by Forward-Looking Information

The key to the Fundamental Index approach is breaking the link between price and weights

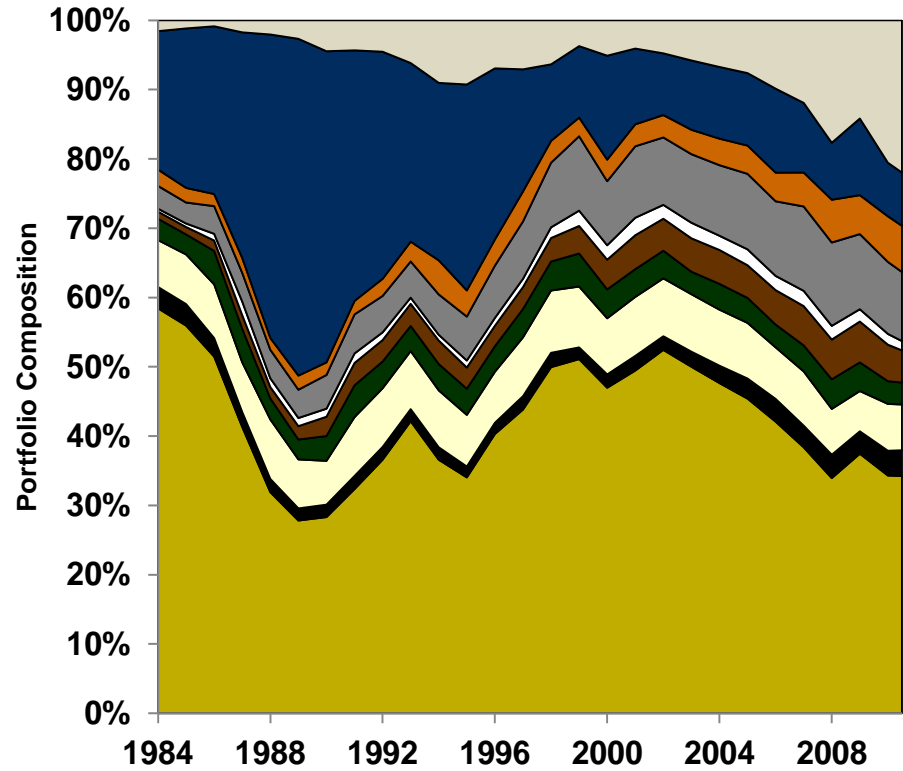
- Forward-looking expectations *are in the price!*
- Thus, forward-looking information reintroduces a link with price (it is still correlated with over- and underpricing)
- Thus, weighting by *forecasted* earnings removes *only part* of the return drag

Forward-looking information, such as stock prices or analyst forecasts, does not give investors any additional investment edge

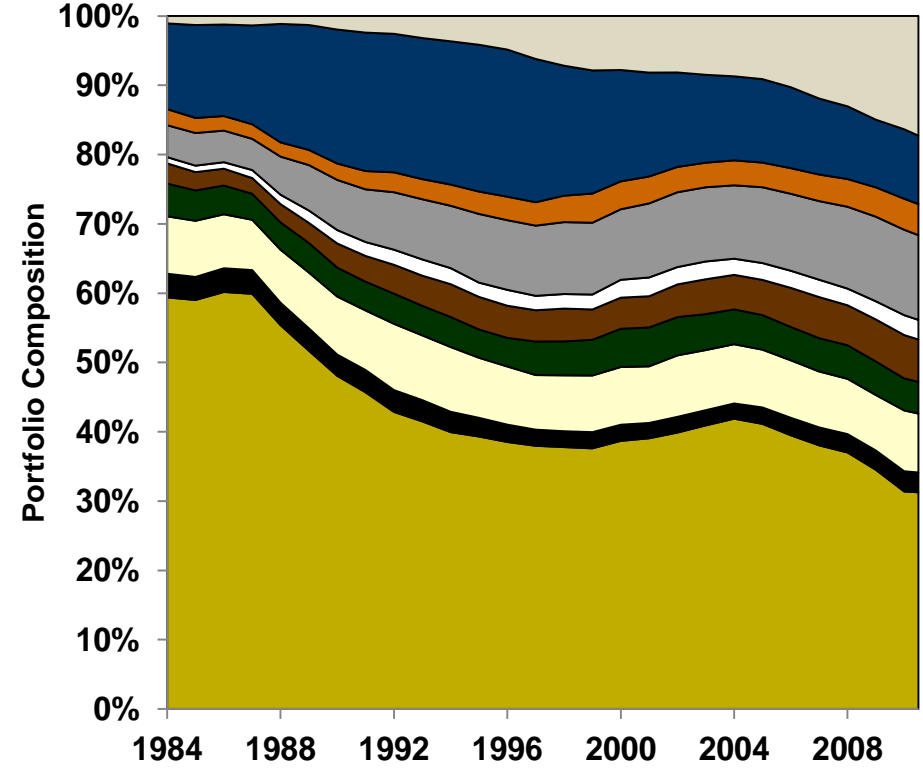
*Source: Research Affiliates. This slide has been reproduced from a Research Affiliate slide*

# Country Weights: Long-term Down Weighting of US & Japan

Rolling 12-Month Averages: 1984–June 2011



- United States
- Canada
- United Kingdom
- Germany
- France
- Italy
- Other Europe
- Dev. AP ex Japan
- Japan
- EM



- United States
- Canada
- United Kingdom
- Germany
- France
- Italy
- Other Europe
- Dev. AP ex Japan
- Japan
- EM

Source: Research Affiliates, LLC. Based on data from CRSP, Compustat, Datastream, and Worldscope. THE INDEX DATA PUBLISHED HEREIN IS SIMULATED, UNMANAGED AND CANNOT BE INVESTED IN DIRECTLY. PAST SIMULATED PERFORMANCE IS NO GUARANTEE OF FUTURE PERFORMANCE AND IS NOT INDICATIVE OF ANY SPECIFIC INVESTMENT. ACTUAL INVESTMENT RESULTS MAY DIFFER.




# RAFI Valuations More Attractive than Cap Weighted Indices

10 Year Analysis (31 Aug '01 to 31 Aug'11)

INDEX	Bloomberg Ticker
FTSE RAFI® All World 3000*	TFRAW3
MSCI All Country World (ACWI)	GDUEACWF
FTSE All World Series All World Index	FTS5ALWR

\*FTSE RAFI® All World 3000 was launch in September 2008.  
Data prior to launch date is back-dated data

FTSE RAFI® All World is currently showing better valuations than the FTSE All World Index.

	Number of Holdings	Positive Price/Earnings	Price/Book	Price/Sales	Price/Cash Flow	Dividend Yield (%)	Beta	Weighted Average Market Cap (\$M)
<b>GLOBAL/EMERGING</b>								
<b>FTSE RAFI® All World 3000</b>	<b>3025</b>	<b>11.30</b>	<b>1.23</b>	<b>0.60</b>	<b>3.71</b>	<b>3.32</b>	<b>1.03</b>	<b>53,051</b>
<i>FTSE All World Series All World Index</i>	2858	12.50	1.59	0.92	4.97	2.88	1.00	60,142
<b>FTSE RAFI® Developed 1000 Index</b>	<b>1023</b>	<b>11.10</b>	<b>1.20</b>	<b>0.60</b>	<b>3.59</b>	<b>3.47</b>	<b>1.03</b>	<b>63,615</b>
<i>FTSE All World Developed Index</i>	2059	12.60	1.56	0.93	4.99	2.86	1.01	64,052
<b>FTSE RAFI® Emerging Markets Index</b>	<b>357</b>	<b>10.60</b>	<b>1.39</b>	<b>0.60</b>	<b>3.83</b>	<b>3.58</b>	<b>0.98</b>	<b>35,330</b>
<i>FTSE All Emerging</i>	799	11.60	1.82	0.83	4.85	3.05	0.99	32,362

Source: FTSE, MSCI, Bloomberg and Research Affiliates  
All rights in and to the FTSE RAFI Indices vest in FTSE and/or its relevant partners

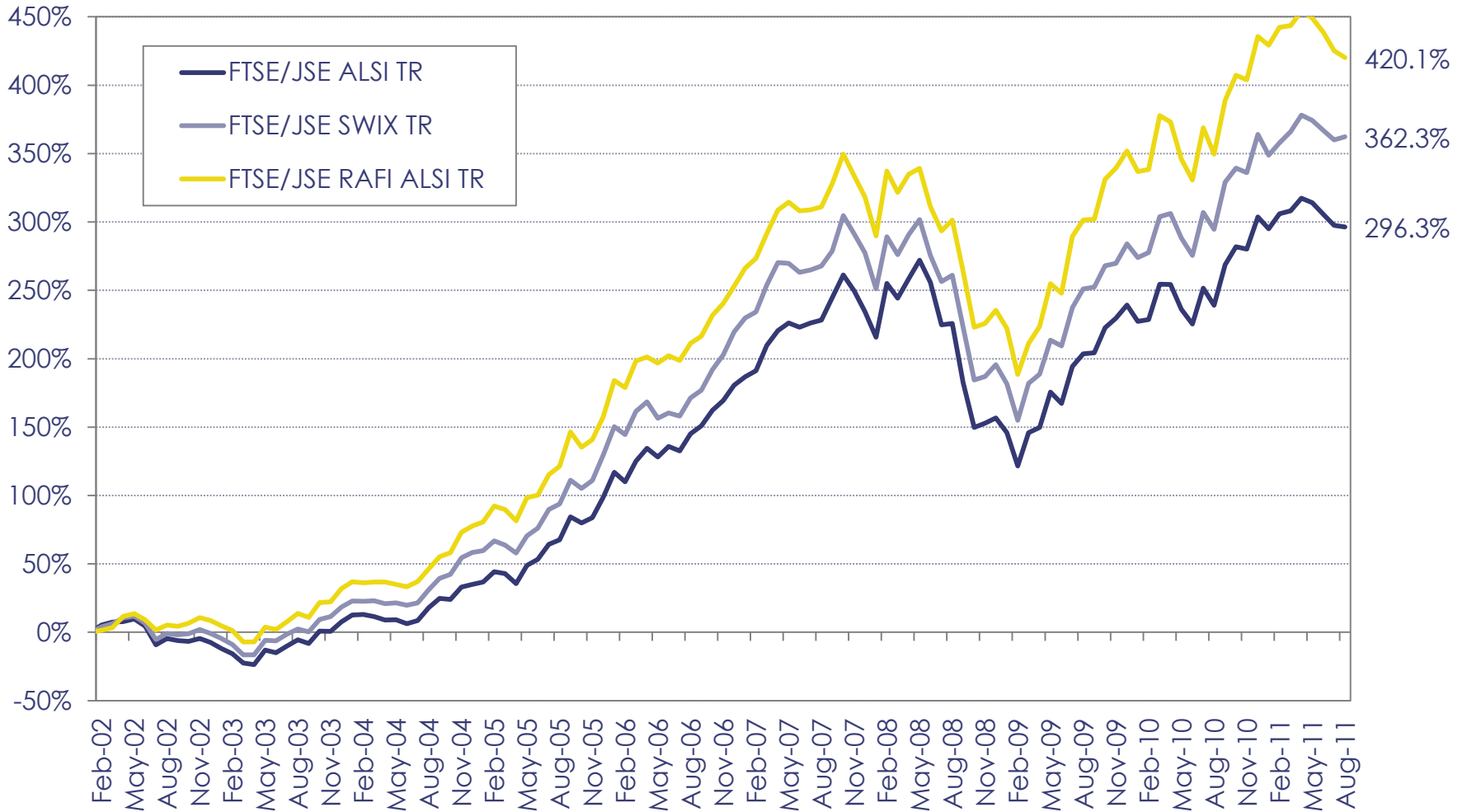
# Agenda



- ✦ Fundamental Tracking: The South African Experience

# Strong FTSE/JSE RAFI® Out-performance

## Cumulative Returns 31 January 2002 to 31 August 2011



Source: I-Net Bridge

FTSE/JSE RAFI® ALSI was launched on May 2008. Data prior to this was back-tested

# Average Outperformance or Underperformance of RAFI ALSI

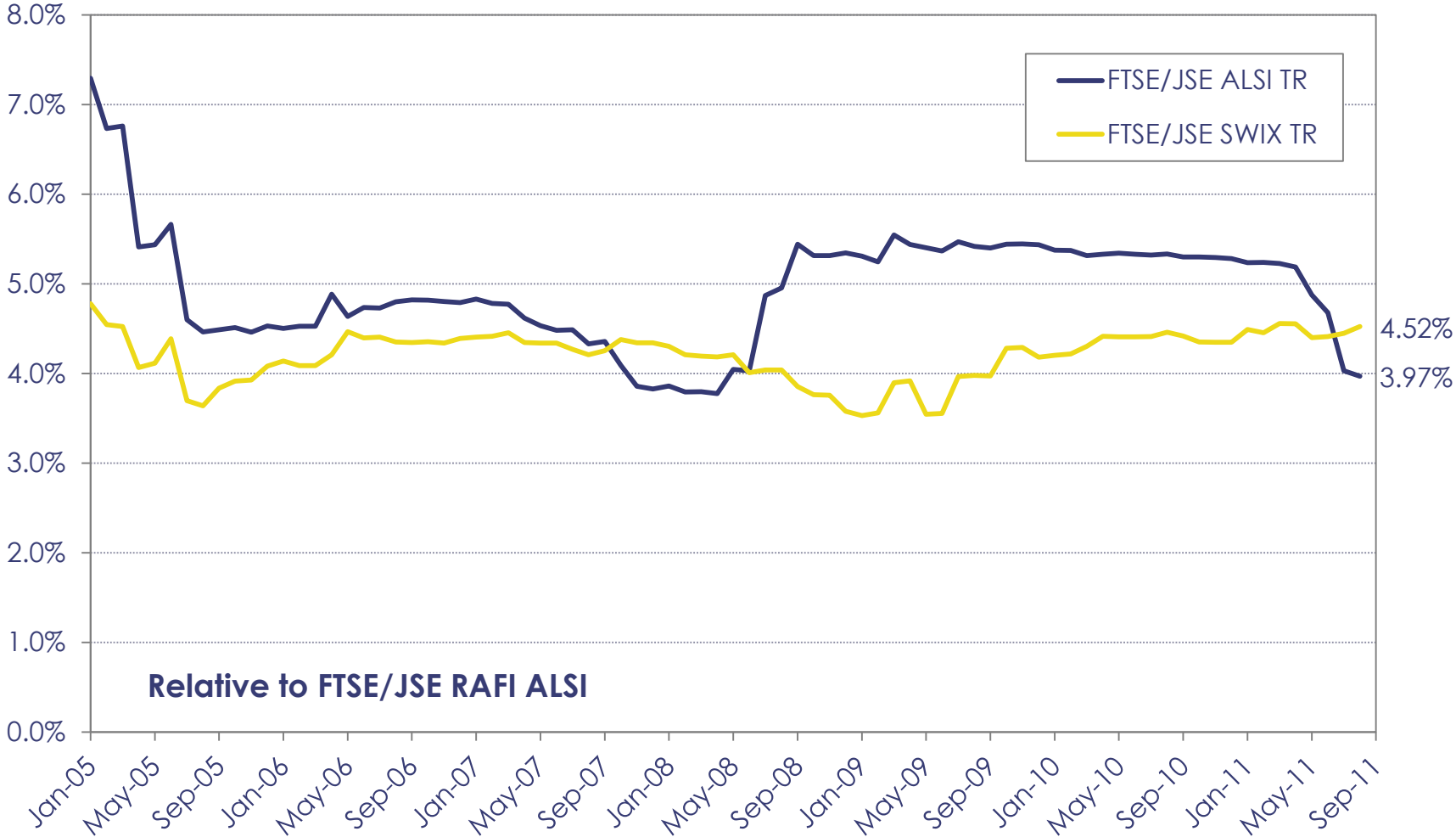
31 Jan 2002 to 31 August 2011

The FTSE/JSE RAFI® indices **especially outperform** the FTSE/JSE ALSI and FTSE/JSE SWIX indices **during negative markets**, but also performed much better during the financial crisis recovery

	Negative Markets		Positive Markets		All Markets	
	ALSI	SWIX	ALSI	SWIX	ALSI	SWIX
Rolling 1 Month	0.66%	0.13%	-0.06%	0.09%	0.22%	0.10%
Rolling 3 Month	2.32%	0.85%	0.13%	0.19%	0.77%	0.39%
Rolling 6 Month	4.80%	2.15%	0.33%	0.32%	1.42%	0.77%
Rolling 12 Month	7.35%	3.54%	1.09%	0.69%	2.47%	1.32%
Rolling 36 Month	N/A	N/A	2.07%	1.02%	2.07%	1.02%
Rolling 60 Month	N/A	N/A	1.39%	0.67%	1.39%	0.67%

Source: I-Net Bridge  
 FTSE/JSE RAFI® ALSI was launched on May 2008. Data prior to this was back-tested

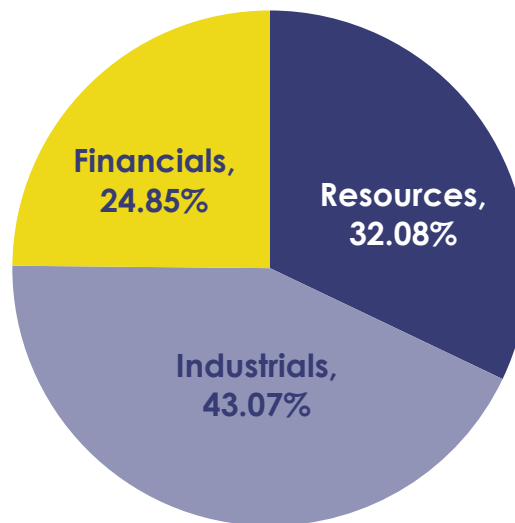
# 3 Year Rolling Tracking Errors



Source: I-Net Bridge  
 FTSE/JSE RAFI® ALSI was launched on May 2008. Data prior to this was back-tested

# Sector Exposure

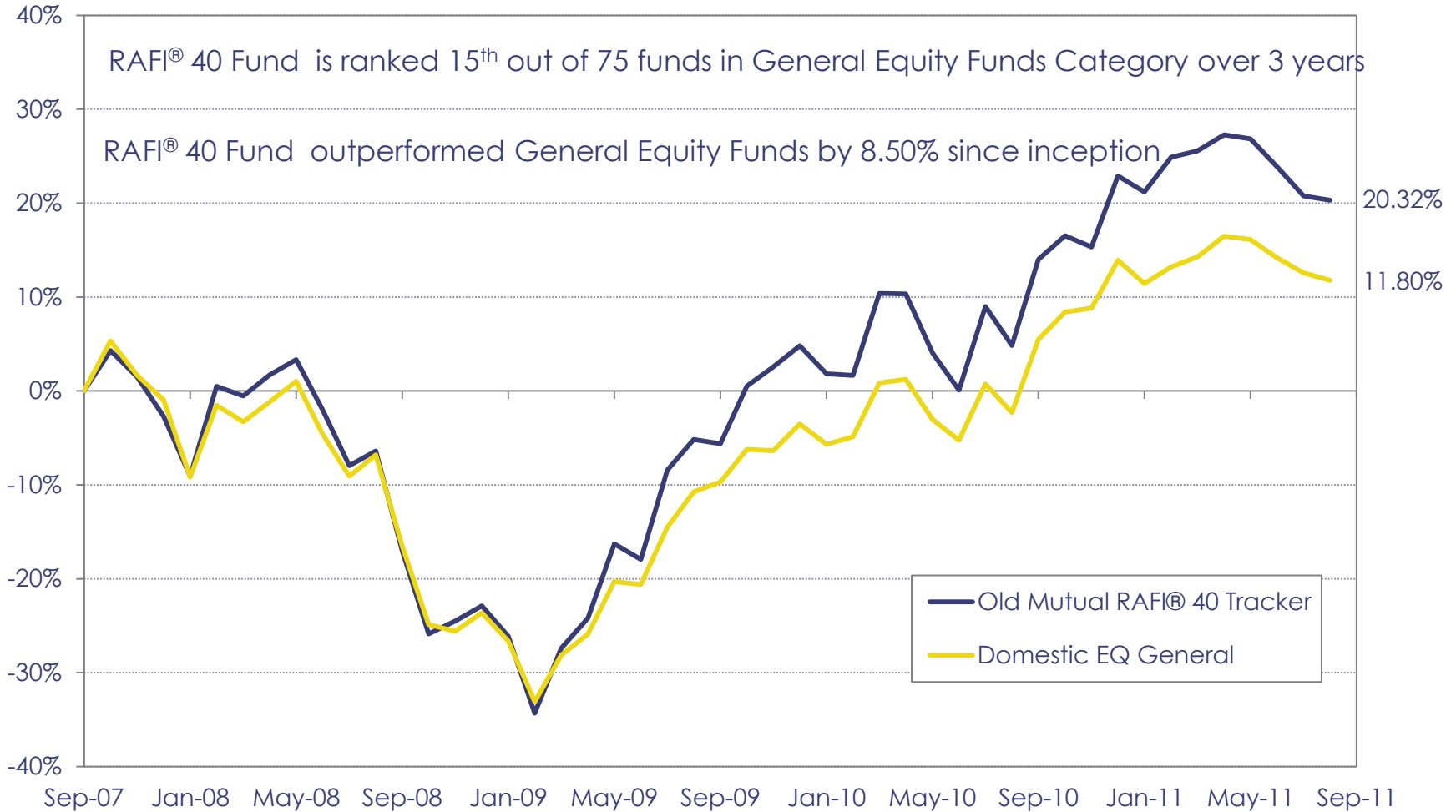
- The average sector breakdown of the RAFI Capped Index over the last 2 years



31 August 2011

SECTOR	ALSI SWIX	RAFI ALSI CAPPED	ACTIVE WEIGHT
RESOURCES	25.00%	31.62%	6.62%
INDUSTRIALS	49.72%	42.20%	-7.52%
FINANCIALS	25.28%	26.18%	0.90%

# RAFI® 40 Fund relative to Domestic Equity General Unit Trust



Old Mutual RAFI® 40 Inception: Oct 2007  
 Source: Morningstar

# RAFI® 40 Fund relative to Domestic Equity General Unit Trust

Average rolling out/underperformance during different markets  
(30 September 2007 to 31 August 2011)

Market	1 Month	3 Months	6 Months	1 Year	3 Years
Positive	0.86%	1.71%	2.44%	4.00%	2.49%
Negative	-0.54%	-1.08%	-0.73%	1.02%	N/A*
All Markets	0.20%	0.66%	1.53%	3.01%	2.49%

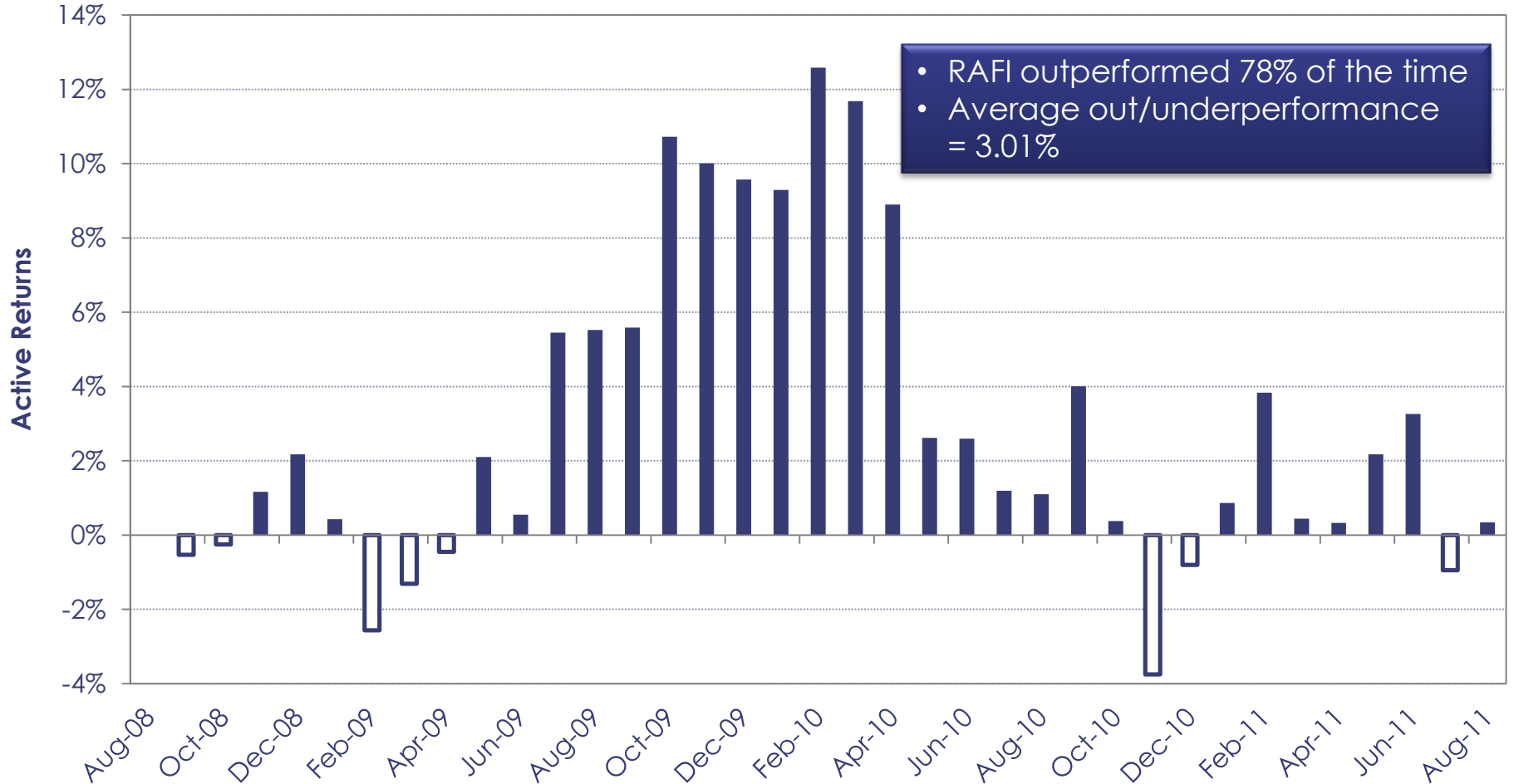
- Net Returns

Old Mutual RAFI® 40 outperform the Domestic Equity General Unit Trust on average by 2.49% during rolling 3 year positive markets.

Old Mutual RAFI® 40 Inception: 30 Sep 2007  
Source: Morningstar

# RAFI® 40 Fund relative to Domestic Equity General Unit Trust

Rolling 12 month active net returns



Old Mutual RAFI® 40 Inception: 30 Sep 2007  
 Source: Morningstar

# RAFI Conclusion

- ✦ RAFI® indices constructed with **fundamental factors are superior** to market capitalisation based indexing strategies – both locally & internationally.
- ✦ The **FTSE/JSE RAFI® 40 index has outperformed 85% of General Equity funds over the last three years.**
- ✦ The **FTSE/JSE RAFI® 40 index has outperformed FTSE/JSE ALSI 40** and FTSE/JSE SWIX 40 since inception.
- ✦ The FTSE/JSE RAFI® indices **especially outperform** the FTSE/JSE ALSI and FTSE/JSE SWIX indices **during negative markets**, but also performed much better during the financial crisis recovery.
- ✦ **The Old Mutual RAFI 40 unit trust has an expense ratio of 0.90%. This is almost 50% lower than the average general equity fund's TER.**
- ✦ ***Institutional Class B fee of 0.63% is available for assets above R10Mn.***
- ✦ **Dibanisa Fund Managers has closely tracked** both the FTSE/JSE RAFI® ALSI and FTSE/JSE RAFI® 40 indices since launching these funds.

# Agenda

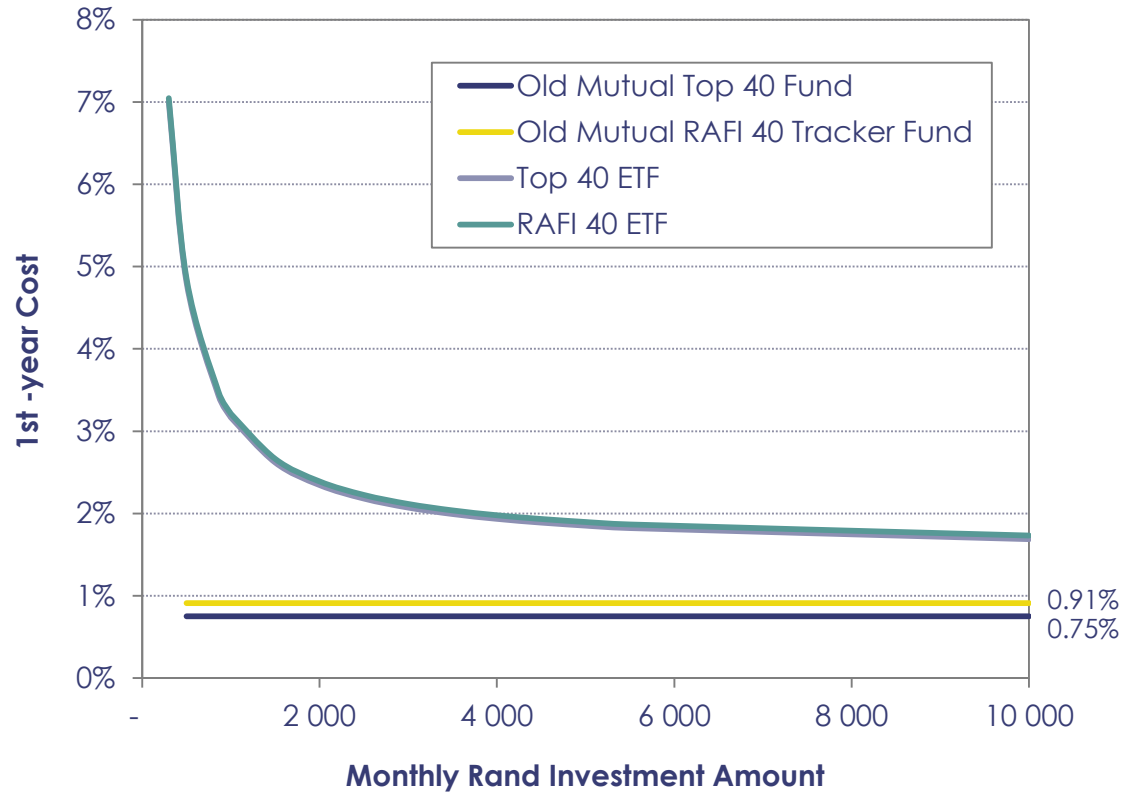


- + ETF Costs versus Unit Trust Tracker Costs

# Exchange Traded Fund vs. Unit Trust Analysis: Total Costs

## Investment plan monthly debit order costs

Recurring Monthly Investment



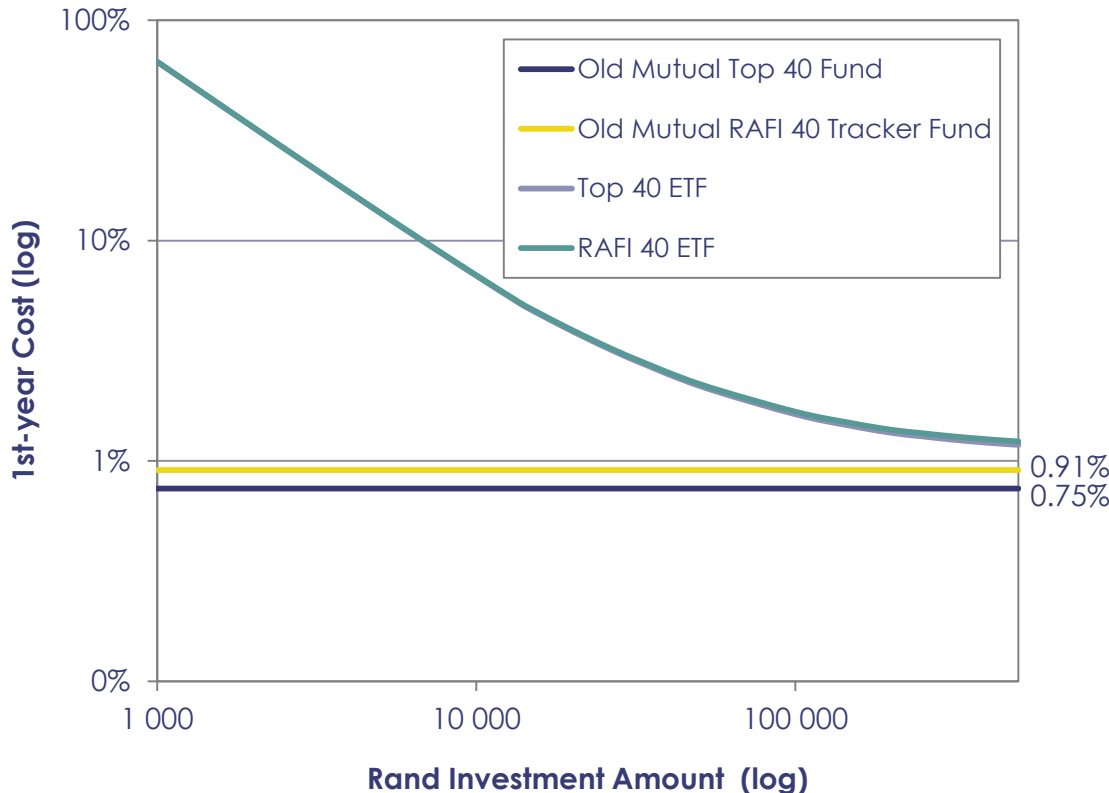
Top 40 ETF Investment Plan Costs	Annual Costs
Annual Administration	0.91%
Debit Order (/month)	R3.99
Stock Brokerage	0.11%
Strete Contract Note (/month)	R12.45
Investor Protection Levy	0.0002%
Total Expense Ratio	0.4968%

RAFI 40 ETF Investment Plan Costs	Annual Costs
Annual Administration	0.91%
Debit Order (/month)	R3.99
Stock Brokerage	0.11%
Strete Contract Note (/month)	R12.45
Investor Protection Levy	0.0002%
Total Expense Ratio	0.5408%

# Exchange Traded Fund vs. Unit Trust Analysis: Total Costs

- Single ad-hoc retail investment
  - ETF purchased and held via personal brokerage account

Single Ad-hoc Investment



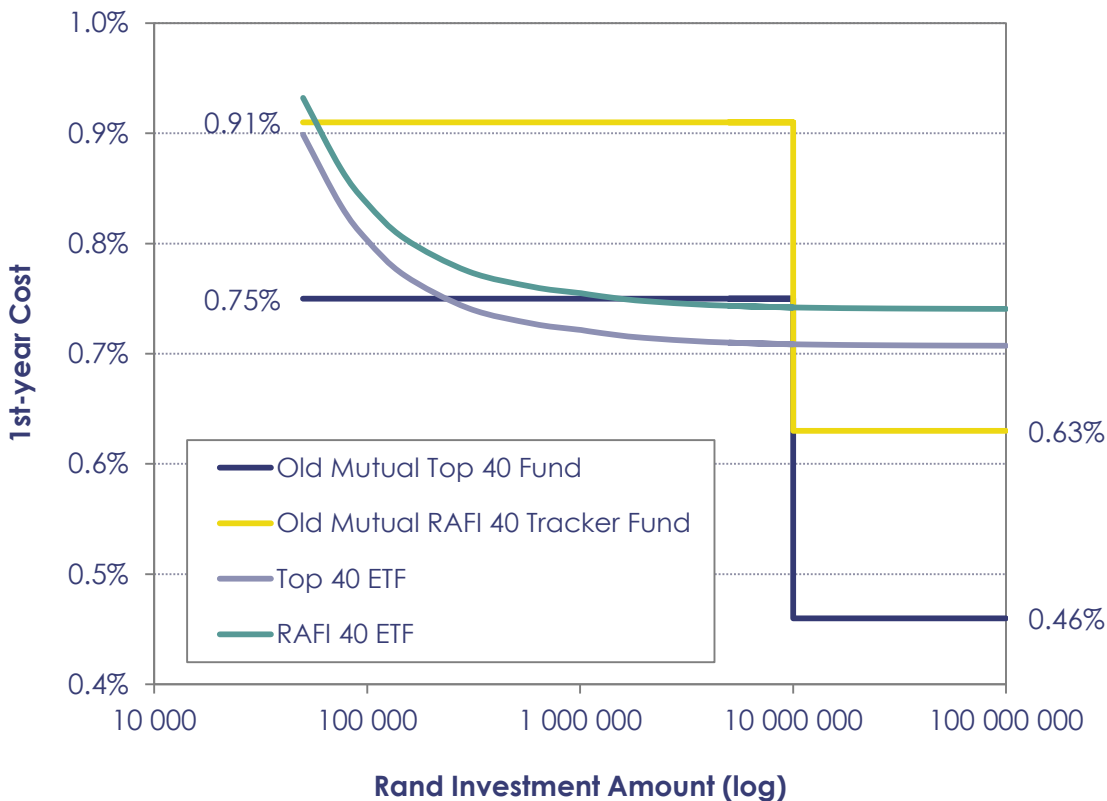
Top 40 ETF Retail Brokerage Costs	Annual Costs
Brokerage (R50 minimum)	0.57%
Strate Contract Note (min: R12.45 – max: R62.23)	0.006223%
Investor Protection Levy	0.0002%
Brokerage Account (/month)	R50.00
Total Expense Ratio	0.4968%

RAFI 40 ETF Retail Brokerage Costs	Annual Costs
Brokerage (R50 minimum)	0.57%
Strate Contract Note (min: R12.45 – max: R62.23)	0.006223%
Investor Protection Levy	0.0002%
Brokerage Account (/month)	R50.00
Total Expense Ratio	0.5408%

# Exchange Traded Fund vs. Unit Trust Analysis: Total Costs

- ✦ Single ad-hoc institutional investment
  - Unit Trust institutional B1 fee class above R10m
  - ETF purchased at execution-only brokerage rates and held in a separate custody account

**Institutional Investment**



Top 40 ETF Institutional Costs	Annual Costs
Brokerage	0.11%
Stare Contract Note (min: R12.45 – max: R62.23)	0.006223%
Investor Protection Levy	0.0002%
Custody Transaction Settlement	R68.40
Custody Holding	0.09%
Stare On-market Transaction	R14.94
Total Expense Ratio	0.4968%

RAFI 40 ETF Institutional Costs	Annual Costs
Brokerage	0.11%
Stare Contract Note (min: R12.45 – max: R62.23)	0.006223%
Investor Protection Levy	0.0002%
Custody Transaction Settlement	R68.40
Custody Holding	0.09%
Stare On-market Transaction	R14.94
Total Expense Ratio	0.5408%

# Appendix

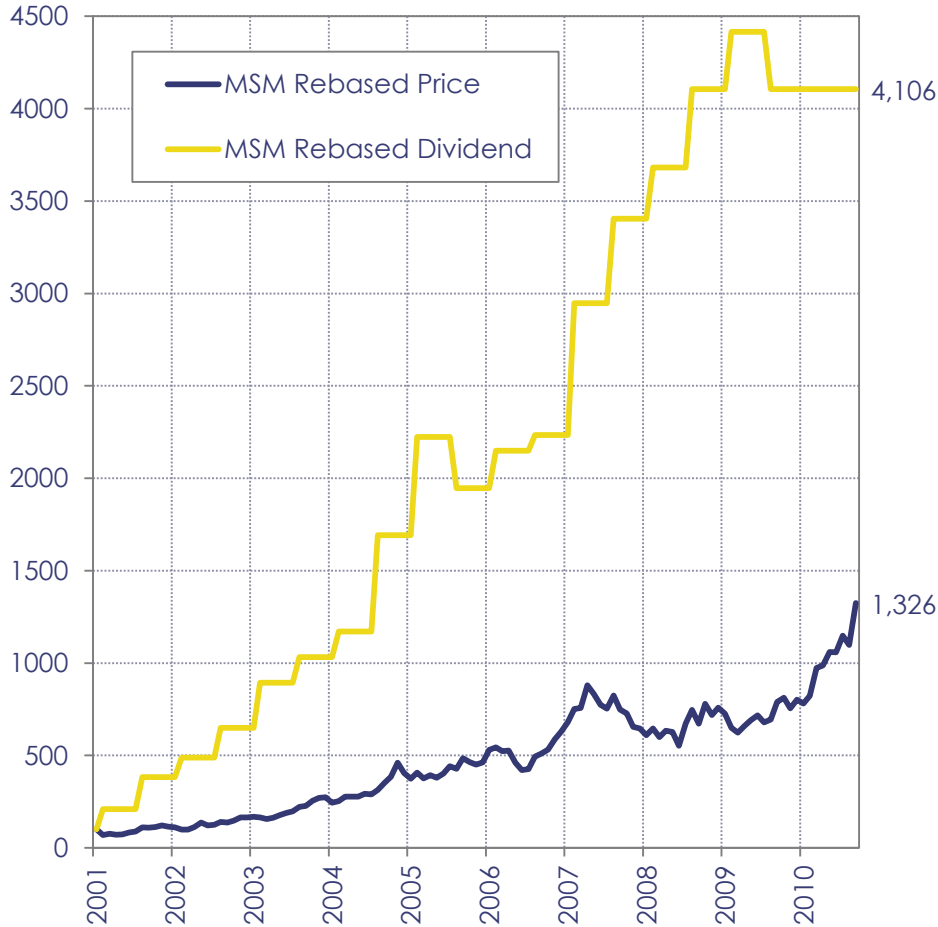


+ Why RAFI works (SA Stock Bets)

# Current & Historical Positioning

## Massmart: overweight vs. index

### Massmart Price versus Dividend Growth



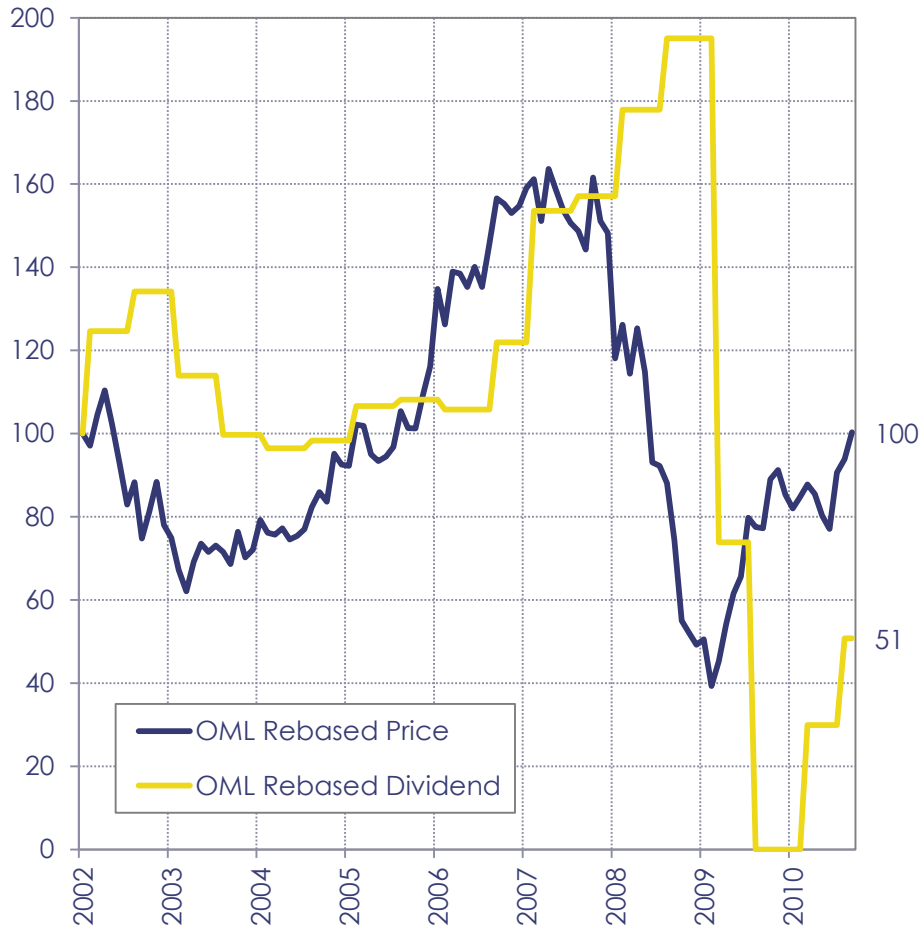
Source: I-Net Bridge

- RAFI® seeks to invest in companies that are increasing their **economic footprint**, which is gauged by looking at real-world measures such as sales and dividends, rather than abstract accounting ratios
- In MSM's case, dividends have grown at a much faster rate than its share price, resulting in an overweight position relative to the market
- Walmart has recognised Massmart's attractiveness, which has been beneficial to the overweight position RAFI® investors have taken in MSM

# Current & Historical Positioning

## Old Mutual: overweight vs. index

### Old Mutual Price versus Dividend Growth



Source: I-Net Bridge

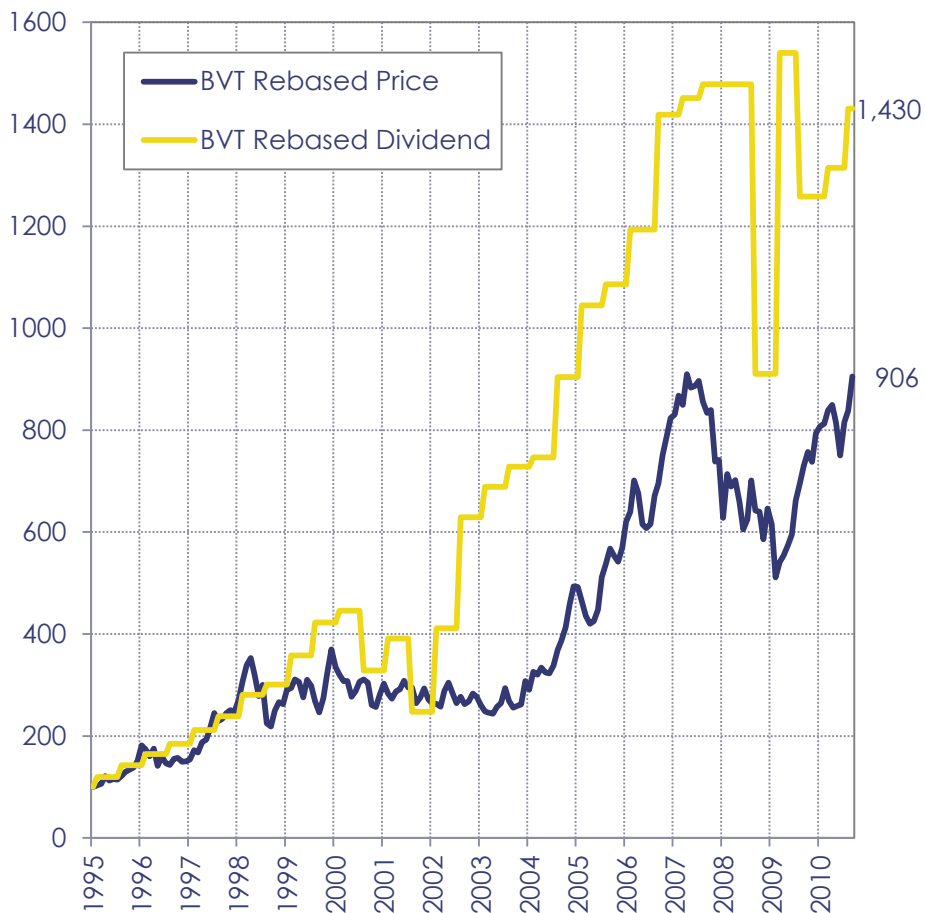
✦ The systematic and unemotional approach RAFI<sup>®</sup> has to investing, allowed it to take a big overweight position in OML, right at the time the market had just about written it off

- RAFI<sup>®</sup> is not subject to the vagaries of investor emotions, and will weight stocks according to their long-term economic footprint
- The performance of OML since the RAFI<sup>®</sup> rebalance in March 2009, has been handsomely rewarded
- RAFI has taken its profits by steadily reducing its overweight position in OML in response to its reduced RELATIVE economic footprint
- This is classic value investing – buying low & selling high!

# Historical Positioning

## Bidvest: overweight vs. index

### Bidvest Price versus Dividend Growth



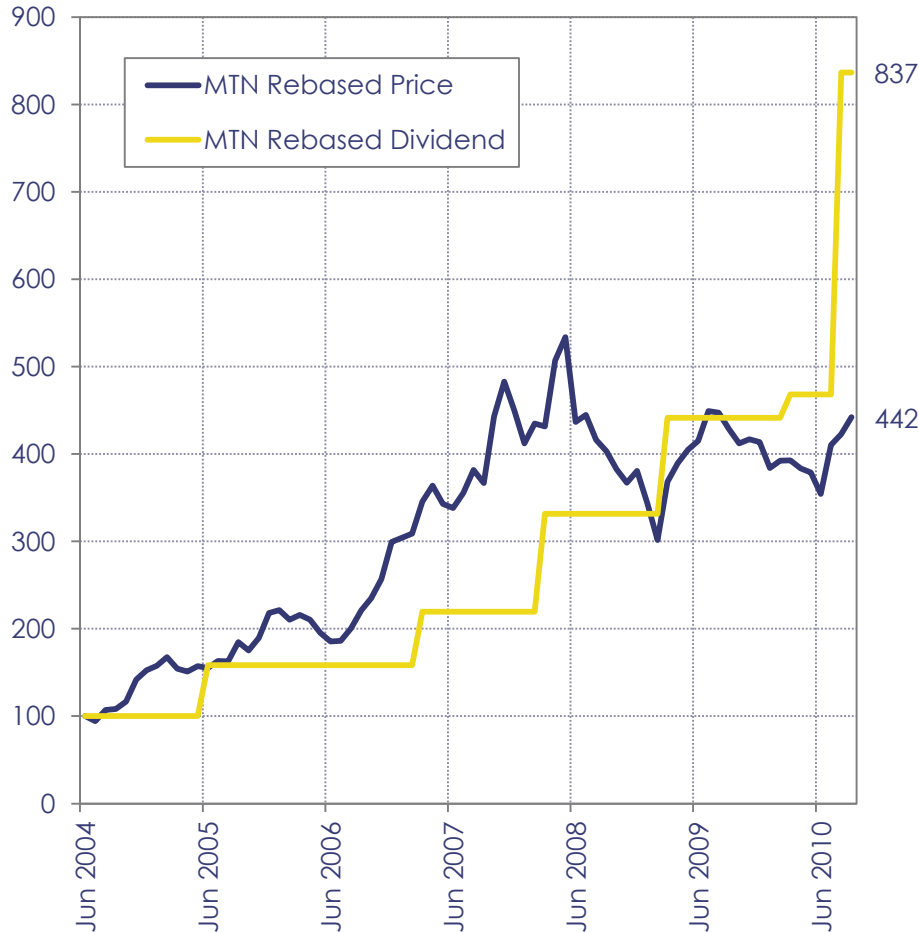
Source: I-Net Bridge

- ✦ Since 2002, the growth in BVT's dividend has outstripped that of its share price
  - **RAFI® therefore had an overweight position in BVT relative to the active managers**
- ✦ RAFI® ignored the big drop in dividends in 2008, as it uses longer term averages, whereas a market capitalisation weighted index, would have down-weighted BVT due to the drop in its share price
  - **RAFI® was therefore perfectly positioned for BVT's phenomenal performance from 2009 onwards**
  - **Ignoring short-term news and following long-term fundamentals is a tried and tested method to successful investing**

# Current & Historical Positioning

## MTN: underweight vs. index

### MTN Price versus Dividend Growth



Source: I-Net Bridge

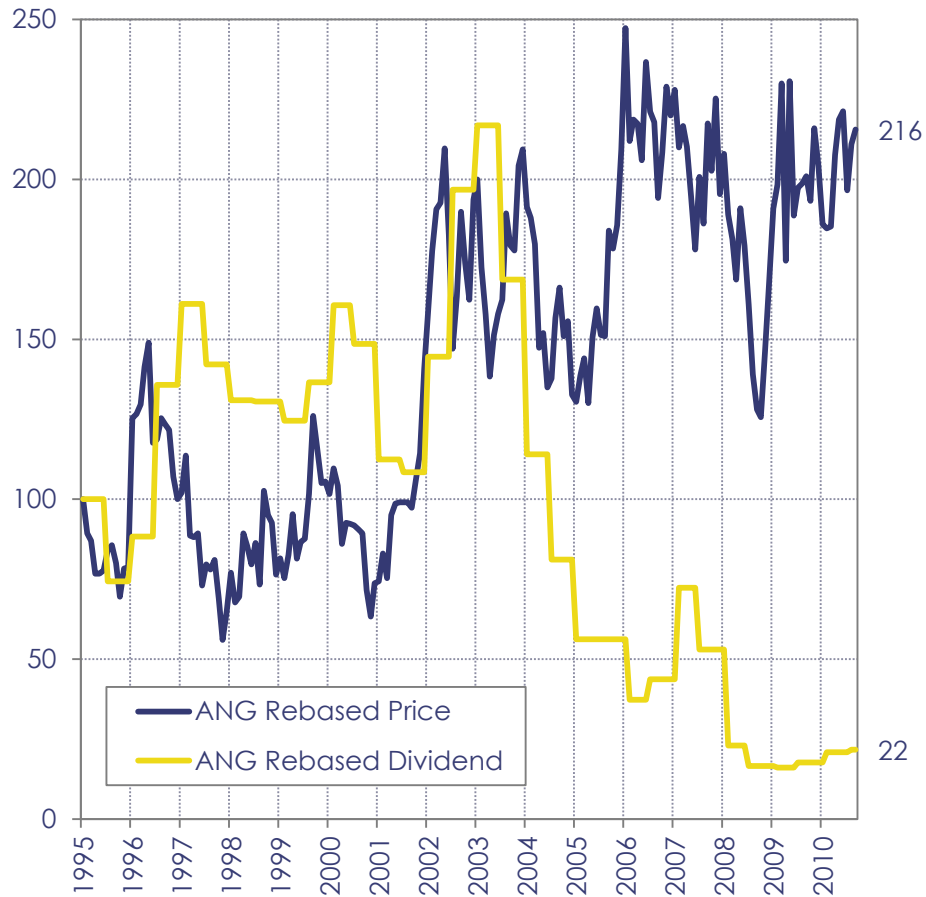
- ✦ RAFI® will invest less in a company whose valuation (price) has run ahead of its economic footprint
- ✦ In MTN's case (a classic growth story), RAFI® was underweight MTN because its share price was factoring in as yet unrealised growth in its fundamentals

- Investing in growth stocks can be more risky, as that future growth is never guaranteed
- RAFI® therefore follows more of a value approach to investing
- The underweight position in MTN limited MTN's drag on performance over the last 3 years
- RAFI has steadily increased its weight in MTN in response to its improved 'value' fundamentals

# Current Positioning

## Anglogold Ashanti: underweight vs. index

Anglogold Ashanti  
Price versus Dividend Growth



Source: I-Net Bridge

✦ The defensive nature of RAFI® can clearly be seen in the way it has underweighted ANG

- Instead of trying to time the highly volatile short-term movements in ANG's share price, it has instead tracked ANG's long-term economic footprint, as expressed through the real-world factors that RAFI® considers, namely:
  - Sales
  - Cash Flow
  - Dividends
  - Book Value
- This reduces portfolio turnover and minimises costs for investors

# Regulatory Information

Old Mutual Global Index Trackers (Pty) Limited trading as Dibanisa Fund Managers

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Personal trading by staff is restricted to ensure that there is no conflict of interest. All directors and those staff who are likely to have access to price sensitive and unpublished information in relation to the Old Mutual Group are further restricted in their dealings in Old Mutual shares.

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