

# Boutique

## market strategies

Market Dynamics  
October 2011



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# Absolute Return Investments

## Market Highlights

- ▲ Global equity markets were strongly up in October 2011 on the back of the European sovereign debt rescue package. Domestic markets also enjoyed a strong rally, with the FTSE/JSE Shareholder Weighted All Share Index (SWIX) delivering 7.7%. All major sectors contributed to the equity performance. The resources sector led with an 11.2% gain, followed by the industrials sector, which gained 9.5%. The financials sector lagged with a 5.8% gain.
- ▲ Implied volatility fell sharply over the course of the month, in line with the equity market rally.

## Premium Equity Fund

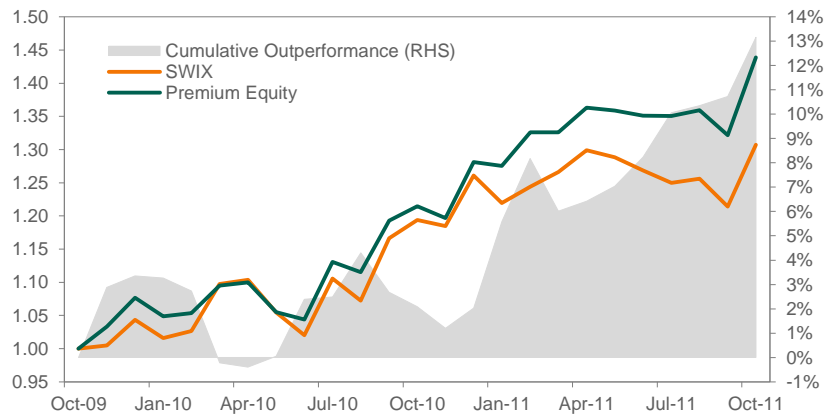
- ▲ The Premium Equity Fund is an actively managed institutional equity fund that targets 2% to 3% outperformance of the SWIX benchmark over the long term.
- ▲ Returns for the fund also tend to be less volatile than other equity portfolios.
- ▲ The Premium Equity Fund was up 8.9% for the month, outperforming the benchmark by 1.2%.
- ▲ Since inception, the fund has outperformed the SWIX by 5.7% per annum.

*“Our Premium Equity Fund has outperformed the market, with less volatility, since inception.”*

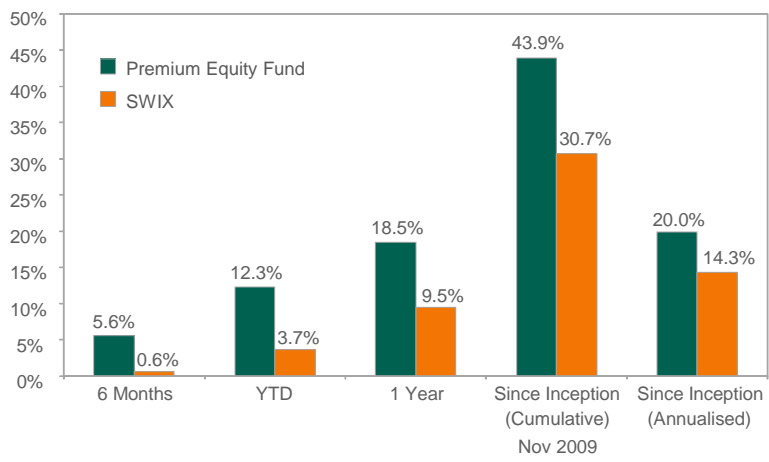


**Bryn Hatty** | Portfolio Manager

**Premium Equity Fund since inception**  
1 November 2009 – 31 October 2011



**Historical Returns**



Source: OMIGSA. Institutional returns only

# Dibanisa Fund Managers

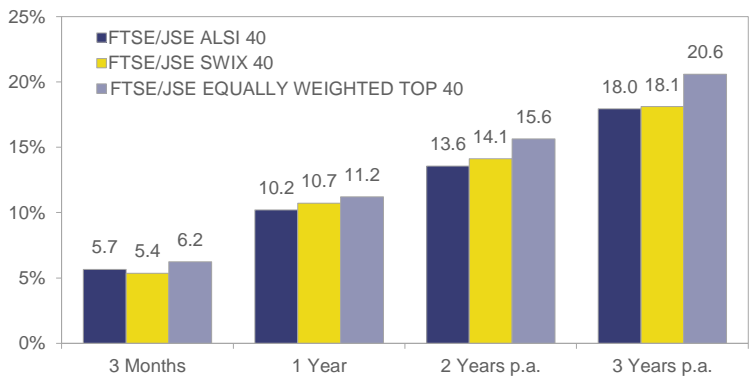
## Alternatively Weighted Indices for South Africa

- + The FTSE/JSE Shareholder Weighted Index (SWIX) is widely used as the preferred benchmark for local equity portfolios. Dibanisa Fund Managers currently manages more than R30bn of SWIX tracker funds with a since-inception tracking error of 15 basis points (bps). Capitalisation-based strategies like SWIX are good momentum strategies, but are vulnerable to price movements driven by market sentiment and emotions.
- + During the last one, two and three year periods, equally weighted strategies have outperformed the FTSE/JSE Shareholder Weighted Top 40 Index (SWIX 40) by between 0.5% p.a. and 2.5% p.a. Dibanisa is the sub-advisor for the Nedbank BetaBeta Equally Weighted Top 40 Exchange Traded Fund (ETF) that has delivered great outperformance relative to the SWIX 40. The outperformance is mainly attributed to the strategy that breaks the link between the price and the weight of a security in an index.
- + Another strategy that offers this benefit of breaking the link between the price and the weight of a security, is a fundamentally weighted index, such as RAFI®. The FTSE/JSE RAFI®40 Index has outperformed the SWIX 40 by 2.1% p.a. over the last three years. The Old Mutual RAFI®40 Fund is currently a top-quartile performing fund over three years in the general equity unit trust category.

## Alternatively Weighted Indices for Global Markets

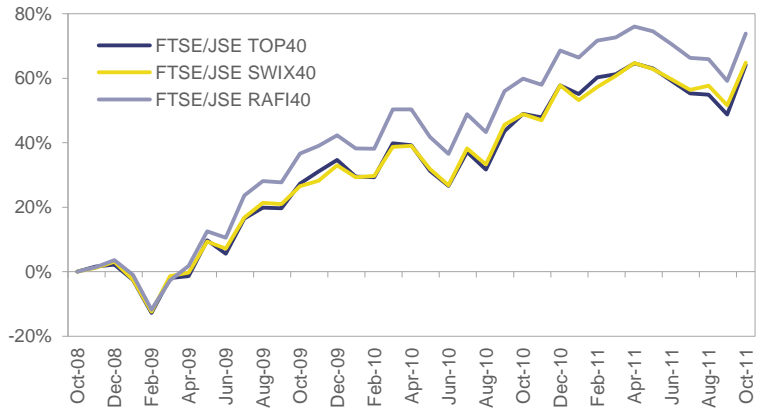
- + Dibanisa has recently been appointed to track the FTSE EDHEC-Risk Efficient Emerging Market Index and is in the process of launching a FTSE RAFI® All World Tracker Fund. As with the alternatively weighted indices in South Africa, the FTSE RAFI® All World 3000 Index has outperformed the MSCI All Country World Index by 2.1% p.a. since its inception in 30 September 2009.

## Equally Weighted Index outperforms SA market cap indices over all periods to 31 October 2011



Source: I-NET Bridge

## Three year cumulative performance of FTSE/JSE RAFI®40 Index



Source: I-NET Bridge

*“Cost-effective, technology-dominated tracker solutions can add significant value to a fund’s overall portfolio construction.”*



Craig Chambers | MD



## MARKET HIGHLIGHTS

- For the month ending 31 October 2011, the FTSE/JSE All Share Index (ALSI) rose 9.4%, while the FTSE/JSE Shareholder Weighted All Share Index (SWIX) rose 7.7%.
- Resource shares were the best performers, rising 11.2%, while industrials and financials rose 9.5% and 5.8%, respectively. Large caps rose 10.3%, mid-caps rose 4.8% and small caps rose 1.9%.

## PERFORMANCE PROFILE

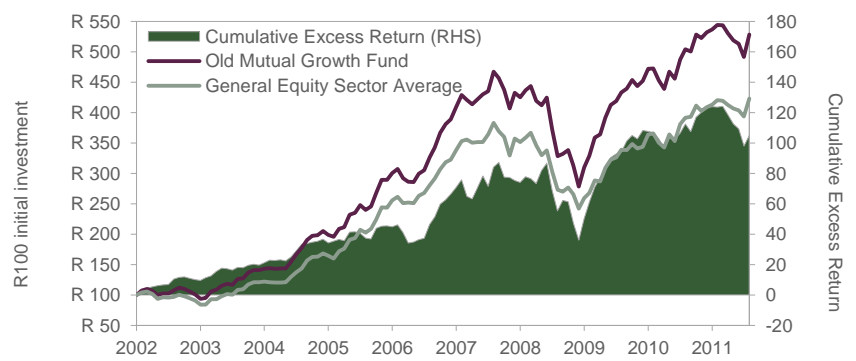
- As shown in the end-October charts, the funds have strongly outperformed their Domestic-Equity-General unit trust peer-group average over the medium- and the long term.
- Within the resources sector, we continue to have a bias towards the large diversified and high-quality mining companies, especially the undervalued Anglo American, as they are typically low-cost producers with diversified income streams across various commodities and geographies. We also hold selected and undervalued single-commodity shares in businesses which we believe have a competitive position in their respective industries.
- In the South African industrial sector, we have reduced exposure to a few of the domestic consumer industrials, as they have now reached full value. With the proceeds, we have slightly increased exposure to selected, high-quality and better value rand-hedge industrial shares.
- Within financials, we retain our preference for the banks, and Old Mutual in the life assurance sector, as we continue to believe it offers significant upside return potential.
- The funds have rolling price:earnings (p:e) ratios below the market, while they are expected to have above-average earnings growth.

**“We always strive to buy into high quality businesses at prices that are low compared to their long-term investment value.”**

**Richard Hasson & Neil Brown | Boutique Heads**

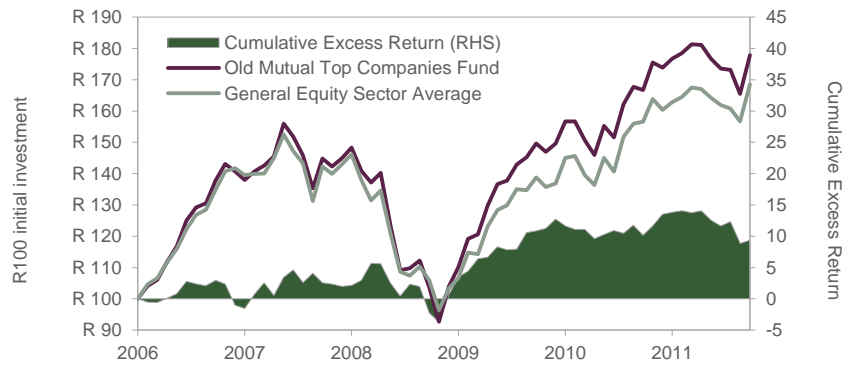


## OLD MUTUAL GROWTH FUND (TO END OF OCTOBER 2011) \*



\* Since managed by Richard Hasson  
Sources: OMIGSA and Morningstar

## OLD MUTUAL TOP COMPANIES FUND (TO END OF OCTOBER 2011) \*



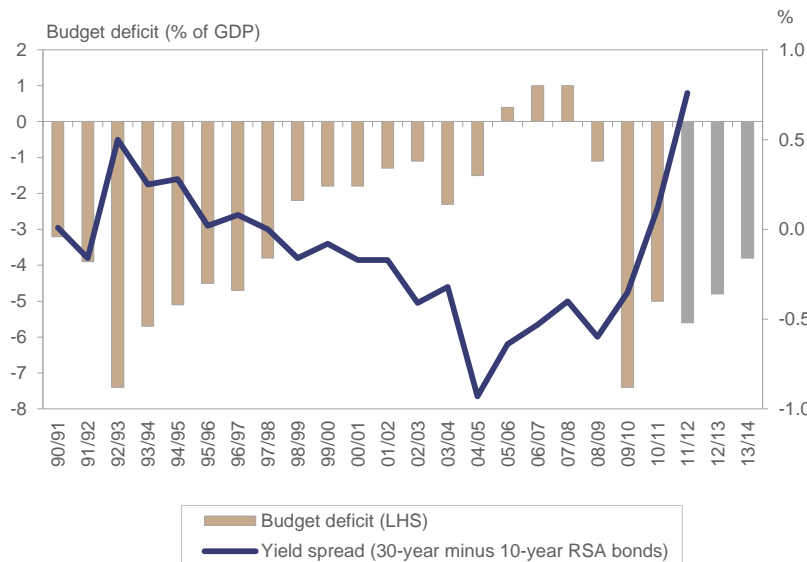
\* Since managed by Richard Hasson & Neil Brown  
Sources: OMIGSA and Morningstar

# Futuregrowth Asset Management

## Market Highlights

- Following the outcome of the latest Eurozone summit, the September bout of risk aversion made way for the so-called “risk-on” trade. For South Africa this meant net foreign bond purchases of just over R9.6bn in October, compared to a net outflow of R18bn the previous month. As a result, both the local currency and the bond markets have had a stronger month, although they failed to regain all the ground lost since the start of September. The yield of the 10-year RSA government bond rallied from 8.30% to close the month at 7.88%. In contrast, inflation-linked bond yields drifted higher, causing them to underperform cash and nominal bonds.
- Although comprehensive in terms of proposed actions, we believe that the latest Eurozone agreement still lacks important detail, contains some unrealistic macro assumptions and will, most likely, encounter obstacles on the long road to implementation.
- Locally, steadily rising inflation behaved in line with our expectations, but we were somewhat bemused by the positive market reaction to the outcome of the Medium-Term Budget. The fact is that budget-deficit revisions for the current and forthcoming fiscal years have gradually deteriorated since October last year.

## Yield curve slope is steepening sharply in reaction to rising inflation and the high net funding requirement



Sources: I-Net, National Treasury, Futuregrowth

## Investment Strategy

- Our money market funds are neutral duration and overweight in short- and medium-dated assets.
- We still express a strong preference for variable-rate bonds, as opposed to fixed-rate bonds, given the point in the interest rate cycle.
- In our bond mandates, we have reduced the underweight modified-duration tilt into recent market weakness, but remain cautious.
- Corporate debt spreads have tightened to the point where we conduct a very selective purchase strategy.
- Inflation-linked bond yields have also corrected upwards and now offer better value, especially considering upside risks to Headline CPI following the recent bout of rand weakness.

*“Our investment view remains defensive, with focus on short-term capital preservation while carefully considering potential investment opportunities into market weakness, especially with regards to inflation-linked bonds.”*



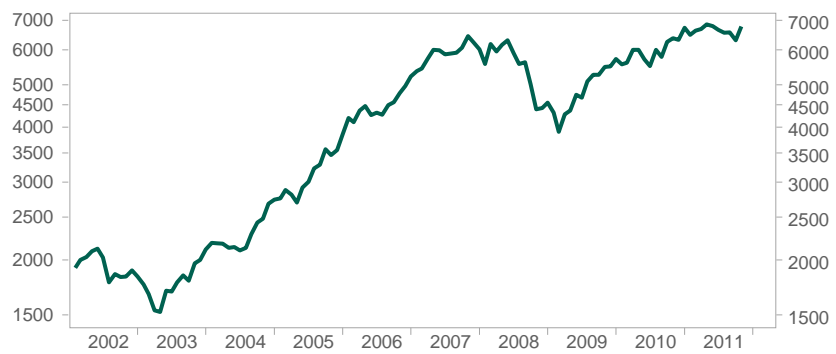
**Wikus Furstenberg** | Portfolio Manager

# Macro Strategy Investments

## Monthly market comments

- ▲ Global equity markets rebounded strongly in October. This was on the back of better-than-expected US economic data, and relief that the Eurozone countries had agreed to a plan of action to recapitalise their banks and to write-down 50% of Greek debt.
- ▲ The MSCI World Index gained 10.4% on a total return basis in US dollars.
- ▲ Locally, the FTSE/JSE Shareholder Weighted All Share Index (SWIX) gained 7.7%, the All Bond Index (ALBI) gained 2.8%, the listed property sector was up 2.6%, the Inflation-linked Bond Index declined by 0.1%, and cash returned 0.5%.
- ▲ Commodity prices also recovered from the sell-off in the previous quarter, as the US dollar gave back some gains in October.
- ▲ Gains in equity markets were pared towards the close of the month, as doubts resurfaced about the effectiveness of the announced plans.

**FTSE/JSE Shareholder Weighted All Share Index (SWIX)  
- at an all-time high**



Source: I-Net

*“Asset allocation is simply much easier than adding alpha to a fund, since there is more to sink your teeth into. Counter-intuitively, asset classes are more inefficiently priced than stocks.”*  
Jeremy Grantham, CIO and co-founder: GMO



**Peter Brooke** | Boutique Head

## Boutique performance relative to performance target to end October 2011

AGGRESSIVE		1 Year	3 Years	5 Years
Profile Funds	Profile Pinnacle	9.8%	14.2%	10.0%
	Performance Target: CPI + 7%	13.0%	11.9%	13.8%
Life Wrapped	Optimised Aggressive	8.4%	13.2%	8.5%
	Performance Target: CPI + 8%	14.0%	12.9%	14.8%
Unit Trusts	Old Mutual Flexible Fund	6.8%	14.7%	9.1%
	Performance Target: CPI + 8%	14.0%	12.9%	14.8%

MODERATE		1 Year	3 Years	5 Years
Profile Funds	Profile Balanced	10.2%	13.1%	9.0%
	Performance Target: CPI + 5%	11.0%	9.9%	11.8%
Life Wrapped	Optimised Balanced	8.4%	11.9%	7.8%
	Performance Target: CPI + 6%	12.0%	10.9%	12.8%
Unit Trusts	Old Mutual Balanced Fund	9.6%	12.6%	8.3%
	Performance Target: CPI + 6%	12.0%	10.9%	12.8%

CONSERVATIVE		1 Year	3 Years	5 Years
Profile Funds	Profile Stable Growth	10.2%	11.7%	9.3%
	Performance Target: CPI + 4%	10.0%	8.9%	10.8%
Life Wrapped	Optimised Defensive	8.5%	10.1%	8.6%
	Performance Target: CPI + 4%	10.0%	8.9%	10.8%
Unit Trusts	Old Mutual Stable Growth Fund	8.1%	10.2%	-
	Performance Target: CPI + 4%	10.0%	8.9%	10.8%

VERY CONSERVATIVE		1 Year	3 Years	5 Years
Profile Funds	Profile Capital	10.2%	11.0%	9.7%
	Performance Target: CPI + 3%	9.0%	7.9%	9.8%
Unit Trusts	Old Mutual Real Income Fund	7.7%	12.0%	9.5%
	Performance Target: CPI + 3%	9.0%	7.9%	9.8%

Below performance target      On or above performance target

Note: A performance target is not necessarily the same as a benchmark. It is the average level of performance that the fund manager aims to achieve over the long term.

Note: These fund returns are shown net of management fees (does not include initial charge for unit trusts), except for Profile funds, which are gross of fees.

Source: OMIGSA

## Market Highlights October 2011

- **Inflation:** South African (SA) inflation increased to 5.7% year-on-year (y/y) in September, from 5.3% y/y in August. Although we have seen inflation steadily ticking up through 2011, it has, to some extent, been masked by the strength of the rand which has kept imported inflation at bay, particularly rising food and fuel prices. Almost one third of our gross domestic expenditure (GDE) consists of imports, thus the rand's recent depreciation against the US dollar will exert significant upward pressure on inflation in the months ahead.
- **Currency:** The rand is currently trading at approximately R7.9/ US dollar.
- **Local markets:** The FTSE/JSE All Share Index (ALSI) increased in value by around 9% for the month of October. Despite the recent increase in investor optimism, we remain of the view that the majority of sectors making up the ALSI are expensive, as reflected by low dividend yields without the prospects of above-average dividend growth. Sectors that are showing good value are the telecommunication and insurance sectors. The forward yields of Vodacom, MTN, Altech and Liberty Holdings compare favourably to current cash interest rates. On an after-tax basis, the yields of these securities are even more attractive. These companies also have the potential to grow their income in line with inflation over the next five years.
- **Offshore markets:** The global economy is showing slower growth which generally manifests in less growth in corporate dividends and thus less capital growth. Seeking out reliable dividend streams and high dividend yields will therefore be a better way of ensuring reasonable returns. With the dividend yields of some of the biggest companies in the world well above bond yields, equity valuations in these markets present investors with a significant opportunity to generate inflation-beating returns over time.

*"Marriott – The Income Specialists"*

**Simon Pearce | CEO**



## Dividends as an inflation hedge

- We consider inflation to be the most important economic variable as it influences the income yield and income growth prospects of all asset classes. It also has a profound impact on the lifestyle of income-dependent investors, as well as being the benchmark for real returns.
- Consumer inflation has continued its upward trend this year, due to rising global food and energy prices. With limited prospects for further rand appreciation to mask the impact of rising food and energy prices, along with a number of other structural inefficiencies within the SA economy, we anticipate inflation to rise throughout 2011, and to average at least 7% over the next five years. For retirees, high inflation means a reduction in the purchasing power of their investment income, if that income does not grow in line with rising consumer prices.
- Reliable income production is a vital consideration for retired investors as they need a consistent income stream. Companies operating within the banking, pharmaceutical, food, and telecommunication industries typically produce the most reliable dividends. These companies produce consumer necessities which enable them to retain and grow their customer base, protect margins, and increase their dividend payments at least in line with inflation, regardless of the prevailing economic circumstances.
- The Marriott Dividend Growth Fund is an equity fund that aims to provide investors with a high level of dividend income that will grow faster than inflation over time. By investing in fundamentally sound JSE-listed companies with the ability to pay consistent dividends, the fund has delivered a reliable, inflation-beating income stream over the past decade. Investors in the Marriott Dividend Growth Fund have experienced an average distribution growth of 13% each year, which has exceeded inflation by approximately 7% p.a. This growth in income has translated into a 78% real increase in income (over and above inflation) for those investors who are dependent on the income produced by the fund to fund their lifestyles.

**MARRIOTT**

# Property

## Market Highlights

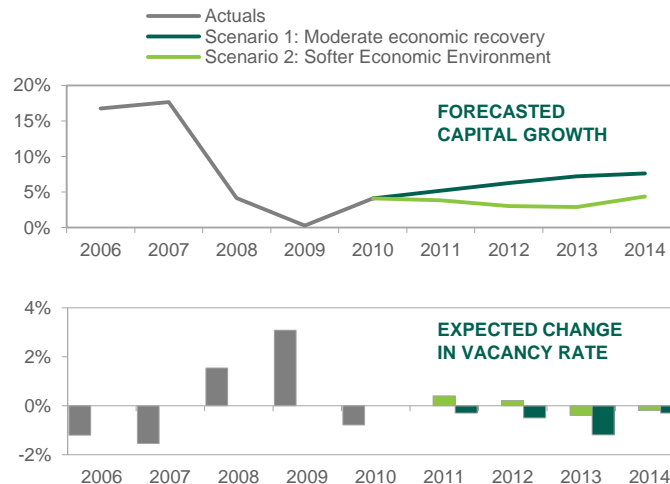
- ▲ Given the uncertainty surrounding the global economic environment, there is increased downside risk to commercial property growth.
- ▲ Because of this, nodal and asset selection will be even more critical to risk mitigation and sustainable performance over the medium term.
- ▲ Should we see further declines in the economic growth rate, we would expect a consequent slowdown in the rate of space absorption – placing further pressure on rentals and property costs, which will ultimately lead to lower values, given adjusted discount rates.
- ▲ As with the international experience, we are seeing a clear preference for primary (less risky assets) over secondary assets.
- ▲ In terms of asset allocation, our preference remains for dominant retail centres – given their limited substitutability relative to other property segments. This segment is reporting positive rental reversions, which in combination with national retailer expansion programmes, should support medium-term growth.

## Performance Profile

### SA Corporate Real Estate Fund (Listed Real Estate)

- ▲ As at the end of September 2011, SA Corporate’s total return was 12.0% compared to 11.8% over the same period last year. The fund outperformed the FTSE/JSE SA Listed Property Index (SAPY)’s 5.0% over the month, maintaining a top-half ranking in the listed sector.
- ▲ The fund has strategically initiated processes to improve efficiency in its working capital management, which will result in improved interest income and expense management.
- ▲ Vacancies continue to be a challenge throughout the industry and a clear distinction can now be drawn between the absorption of primary and of secondary properties. The fund’s general view is to aggressively manage the renewal pipeline, while retaining tenants has become key within the second-tier properties.
- ▲ Initiatives to improve the level of unsigned leases and the portfolio’s cost-to-income ratios are yielding the desired results, with the fund currently being ahead of targets set in these areas.

### Uncertain economy sees growth risks to downside



Sources: IPD, Old Mutual Property Research

### Triangle Funds (Direct Real Estate)

Development projects and activities underway with the fund:

- ▲ Riverside – the former Game space is being converted into a new entrance, line shops and restaurants.
- ▲ Knysna Mall – a new retail development adjoining existing Knysna Mall.
- ▲ Gateway – the mall has expanded into the parking area to create a new Zara footprint. In addition, the ex-Imax premises are being converted into a single-level retail store for Mr Price Sport.
- ▲ Gateway – the rezoning of the existing precinct now incorporates additional bulk of 200 000m<sup>2</sup>, made up of a mixed-use development, including retail, hotel, residential and commercial offices.
- ▲ Menlyn Park Shopping Centre – the existing shopping centre has been rezoned to incorporate additional bulk of 86 700m<sup>2</sup>, comprising retail, hospitality and commercial offices.
- ▲ Menlyn Office Park – the rezoning of the existing office park has increase the bulk by 10 731m<sup>2</sup>.

*“With increasing pressure on vacancy rates, our preference is for dominant retail centres.”*



**Peter Levett | Boutique Head**

# Toros Equity

## Market Highlights

- The FTSE/JSE All Share Index (ALSI) gained 9.4% on a total return basis in October 2011. This was driven by consumer goods stocks contributing 15.6%, mainly due to the strong performance in Richemont. General retailers were also strong, increasing by 14.1% as expectations of a further interest rate cut grew.
- The rand's appreciation against the US dollar in October has boosted the performance of the ALSI by 11.3% in US dollar terms, thus benefiting the foreigners' outlook.

## Portfolio Overview

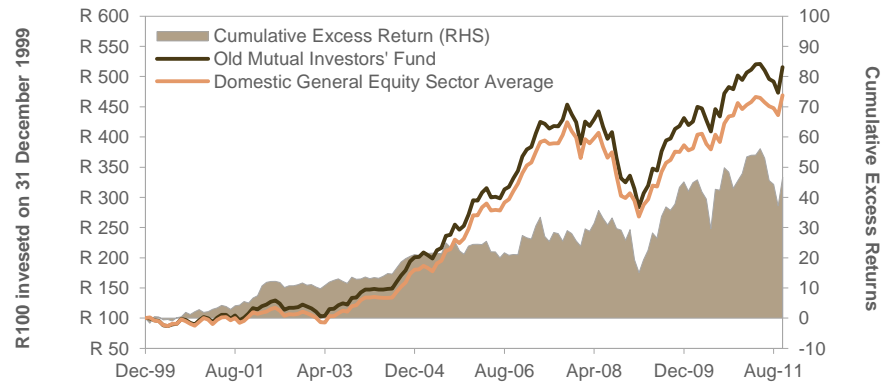
- Our view expressed in previous comments that the world economy was not moving into a recession was recognised by the markets as prices rose from depressed levels, and the ALSI was up by 9.4% for the month.
- We continue to seek out high-quality, undervalued companies with appealing growth as we recognise the huge challenges facing the global economy. Volatility is likely to continue as long as the high levels of uncertainty exist. Stabilising the Eurozone is essential to bringing some stability to markets, but the timing of that is uncertain.

*"While nervousness may affect markets in the short term, I expect conditions to remain supportive of equities over the medium term."*



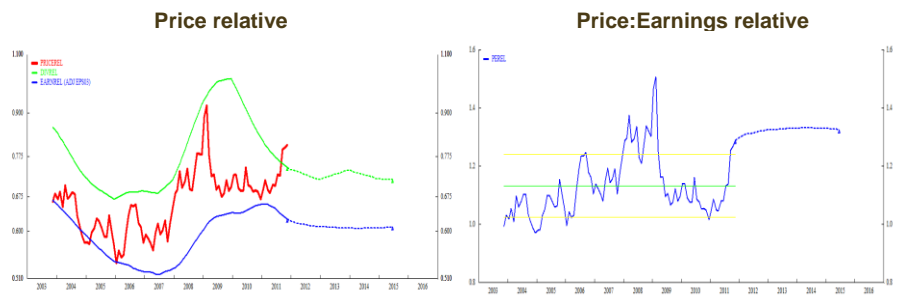
**Peter Linley | Boutique Head**

### Old Mutual Investors' Fund performance to 31 October 2011



Sources: Morningstar & OMIGSA

### Defensives vs Cyclical



Defensive shares (safer, less volatile) continued to outperform cyclical shares (more affected by the economic cycle) last month, as fears soared over European debt issues and global growth concerns.

Sources: OMIGSA

Defensive shares trading at a 30% premium on a p:e relative basis to cyclicals compared to the long-term average of 10%. As long as investors remain risk-averse, this premium is likely to remain.



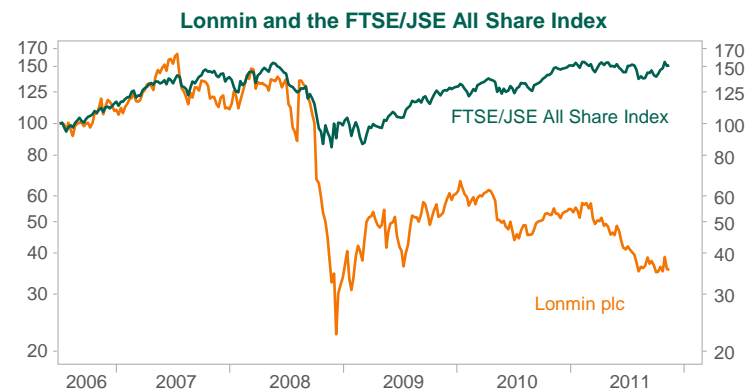
# Value Equity Investments

## Market Highlights

- ▲ The FTSE/JSE All Share Index (ALSI) posted a gain of 9.4% on a total return basis for the month of October, the best monthly return so far in 2011.
- ▲ The euphoria in the market was driven by slightly better-than-expected global economic data, but the big catalyst for the re-rating was the announcement of the Eurozone's progress on a series of agreements designed to backstop Greece, European banks and sovereigns. The market reacted positively to the news, although the sustainability of rally is questionable given the lack of detail provided.

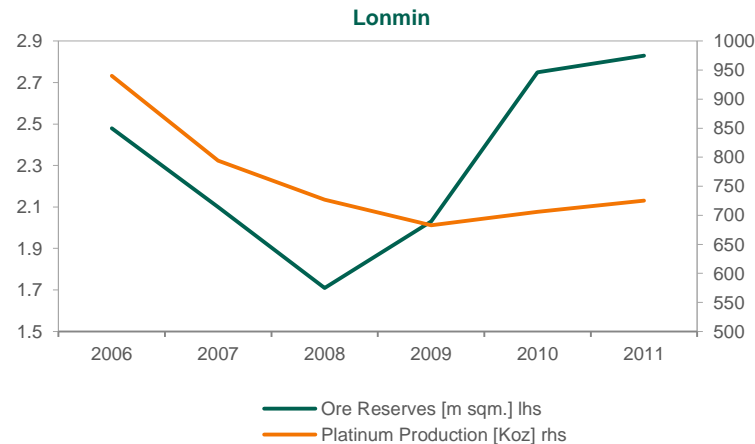
## We believe LONMIN will be a hot stock in 2012

- ▲ While platinum shares have had a rough time in 2011, we still like the longer-term fundamentals of the platinum group metals. Ever-tightening emissions standards around the world will lead to increasing demand for these metals for years to come.
- ▲ Lonmin has been under particular pressure. It is a share that we are very happy to accumulate at current levels. Only three years ago, just before the global financial crisis, Xstrata tried to take the company out at R480/share. When that attempt failed, Lonmin's share price never recovered - it is now trading on a fraction of that.
- ▲ We believe that the share's severe underperformance is overdone. The company has come to the end of several years of production problems, which had come about by an ill-advised decision made in 2005 to mechanise the operations. This caused platinum output to drop from 950 Koz/a to a level of only 700 Koz/a.
- ▲ We see production from Lonmin's mines rising back to that level fairly quickly. Three new shafts are ramping up and all operations have focused on opening up fresh ore reserves. The success of these efforts is bearing fruit, indicating that output will rise substantially from here onwards.



Source: I-NET Bridge

## Production lags ore reserves development by 12-18 months



Source: Lonmin

*"We believe Lonmin will become a hot stock in 2012"*

Feroz Basa | Joint Boutique Head



**OLD MUTUAL**  
Investment Group

Value Equity  
Investments

## For more information, please contact:

### Western Cape:

Old Mutual Investment Group South Africa (OMIGSA), West Campus: Entrance 2, 3<sup>rd</sup> Floor, Jan Smuts Drive, Pinelands 7405

Mike van Heerden – Senior Executive: Distribution

Tel: +27 21 509 5082

Cell: +27 82 450 4483

E-mail: [mvheerden@omigsa.com](mailto:mvheerden@omigsa.com)

Paul Glendining – Investment Sales and Marketing Executive: Retail

Tel: +27 21 504 7690

Cell: +27 82 414 3412

E-mail: [pglendining@omigsa.com](mailto:pglendining@omigsa.com)

Nirdev Desai – Investment Sales and Marketing Executive: Retail

Tel: +27 21 504 6305

Cell: +27 82 419 4770

E-mail: [ndesai@omigsa.com](mailto:ndesai@omigsa.com)

Sue Brooks – Business Development Consultant

Tel: +27 21 509 3936

Cell: +27 82 728 8732

E-mail: [sbrooks@omigsa.com](mailto:sbrooks@omigsa.com)

### Gauteng:

Old Mutual Square, Umnotho Building, 3<sup>rd</sup> Floor, OMIGSA office, 93 Grayston Drive, Sandton 2196

Taz Victor – Investment Executive: Retail Institutional

Tel: +27 11 217 1002

Cell: +27 82 460 1495

E-mail: [tvictor@omigsa.com](mailto:tvictor@omigsa.com)

Eudrè Craven – Investment Executive: Retail Institutional

Tel: +27 11 217 1411

Cell: +27 82 447 2378

E-mail: [ecraven@omigsa.com](mailto:ecraven@omigsa.com)

Mokgadi Skwambane – Investment Sales and Marketing Executive: Retail

Tel: +27 11 217 1021

Cell: +27 71 681 0622

E-mail: [mskwambane@omigsa.com](mailto:mskwambane@omigsa.com)

Wynand Gouws – Head: Retail Sales

Tel: +27 11 217 1664

Cell: +27 82 450 7386

E-mail: [wgouws@omigsa.com](mailto:wgouws@omigsa.com)

Sean du Buisson – Investment Sales and Marketing Executive: Retail

Tel: +27 11 217 1003

Cell: +27 82 926 6955

E-mail: [sdubuisson@omigsa.com](mailto:sdubuisson@omigsa.com)

Naleni Govender – Investment Sales and Marketing Executive: Retail

Tel: +27 11 217 1869

Cell: +27 83 472 0539

E-mail: [ngovender@omigsa.com](mailto:ngovender@omigsa.com)

### Durban:

Viewz @ Westway, Office 3B, 11 The Boulevard, Westway Park 3611

Imtiaz Shaik – Investment Sales and Marketing Executive: Retail

Tel: +27 31 275 8305

Cell: +27 83 292 7860

E-mail: [ishaik@oldmutual.com](mailto:ishaik@oldmutual.com)

Nondumiso Zulu – Investment Sales and Marketing Executive: Retail

Tel: +27 31 275 8305

Cell: +27 76 704 0282

E-mail: [nzulu@oldmutual.com](mailto:nzulu@oldmutual.com)

### Bloemfontein:

The Courtyard, 196 Nelson Mandela Drive, Bloemfontein 9300

Brian Vermeulen – Investment Sales and Marketing Executive: Retail

Tel: +27 51 505 2950

Cell: +27 83 408 0528

E-mail: [bvermeulen@omigsa.com](mailto:bvermeulen@omigsa.com)

### Pretoria:

1<sup>st</sup> Floor, Glen Manor Office Park, Frikkie de Beer Street, Menlyn 0042

Hennie van Rensburg – Investment Sales and Marketing Executive: Retail

Tel: +27 12 369 7220

Cell: +27 83 286 2405

E-mail: [hjansevanrensburg@omigsa.com](mailto:hjansevanrensburg@omigsa.com)

### Eastern Cape:

3<sup>rd</sup> Floor, Mutual Plaza, Cnr Cape Rd & Langenhoven Dr, Greenacres, PE 6000

Brendan Capstick – Investment Sales and Marketing Executive: Retail

Tel: +27 41 502 4906

Cell: +27 74 762 8724

E-mail: [bcapstick@omigsa.com](mailto:bcapstick@omigsa.com)

# Regulatory Information

## Old Mutual Investment Group

Old Mutual Investment Group (South Africa) (Pty) Limited  
Physical address: Mutualpark, Jan Smuts Drive, Pinelands 7405  
Telephone number: +27 21 509 5022

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In respect of these products, no fees or charges will be deducted if the policy is terminated within the first 30 days. Returns on these products depend on the performance of the underlying assets. Old Mutual Investment Group (South Africa) (Pty) Limited has comprehensive crime and professional indemnity insurance, as part of the Old Mutual Group cover. For more detail, as well as for information on how to contact us and on how to access information, please visit [www.omigsa.com](http://www.omigsa.com).

Unit trusts are generally medium to long term investments. Past performance is no indication of future growth. Shorter term fluctuations can occur as your investment moves in line with the markets. Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. Unit trusts can engage in borrowing and scrip lending. The fund's TER reflects the percentage of the average Net Asset Value of the portfolio that was incurred as charges, levies and fees related to the management of the portfolio. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs. A schedule of fees, charges and maximum commissions is available from the company. You may sell your investment at the ruling price of the day (calculated at 15h00 on a forward pricing basis (and 17h00 at month-end for Old Mutual Umbono RAFI® 40 Tracker Fund and Old Mutual Umbono Top 40 Fund). Certain funds may be capped to be managed in accordance with their mandates. Different classes of units apply to these portfolios and are subject to different fees and charges. Old Mutual Unit Trusts is a member of the Association of Savings and Investments, SA. The portfolio performance is calculated on a NAV-NAV basis and does not take any initial fees into account. Income is reinvested on the ex-dividend date. Actual investment performance will differ based on the initial fees applicable, the actual investment date and the date of reinvestment of income. Past performance is not necessarily an indication of future performance.

A schedule of fees and charges and maximum commissions is available from the management company/intermediary. Source for unit trust fund returns: Morningstar (unless otherwise stated) for periods ended 31 October 2011.