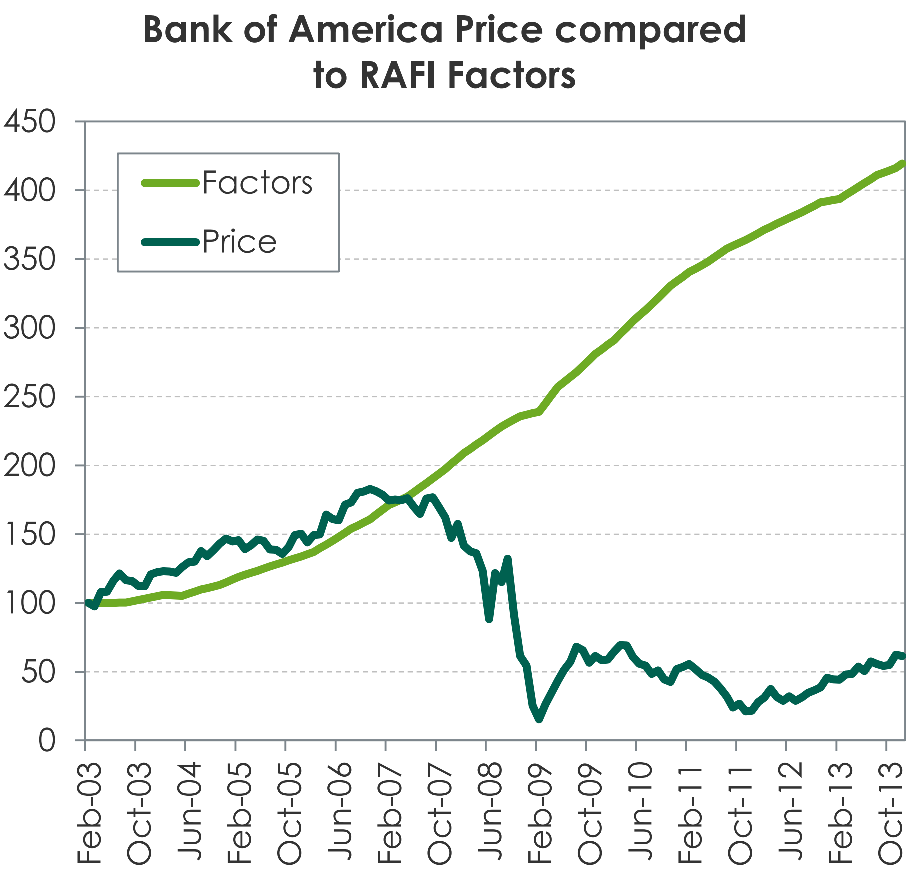
A SUPERIOR BLENDING: ADDING GLOBAL SMART BETA TO ACTIVE-ONLY STRATEGIES

CRAIG CHAMBERS

Managing Director
at Old Mutual Global
Index Trackers

BANK OF AMERICA (BOA): CLEANING HOUSE

- By ignoring the stampede for the exits (share price), our fund was able to take a contrarian overweight position in BOA
- The underlying business model was still very much intact with over 5000 branches servicing profitable main street customers



Source: Bloomberg

INTERNATIONAL BUSINESS, TEAM & AUM UPDATE

INTERNATIONAL BUSINESS UPDATE

- Our AUM has exceeded R60bn (Feb 2013), due to strong offshore flows
- In less than three years, our international AUM has gone from zero to 35% of total AUM
- We continue to pioneer smart-beta solutions with AUM in these funds of close to $1bn:
  - Our RAFI All World Fund has gone above R6bn in 24 months
  - We were the first player in the US to offer FTSE EDHEC Risk Efficient Indices. This process aims to maximize the return-to-risk ratio. Our AUM is now R3.3bn and our FTSE EDHEC Emerging Market Fund has significantly outperformed the MSCI EM Index (See return slides)
  - We now manage seven different local and international smart-beta strategies
- We launched our MSCI World (Developed-only) capability in May 2013 with AUM of $127m

OMGxT FRONT OFFICE TEAM

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CIO

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COO

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OMGxT MANAGES A BROAD REPRESENTATION OF GLOBAL & LOCAL PORTFOLIOS

OMGxT Benchmarks

FTSE Edhec Emerging Index
FTSE RAFI All World
JSE ALBI Index
JSE ALSI_SWIX
JSE CILI
JSE CPI+5%
JSE RAFI 40
JSE RAFI ALSI CAPPED
JSE SRI Index
JSE Top 40 Equally Weighted Index
JSE Top 40 SWIX
JSE Top 40
MSCI All Country Global Small Cap Index
MSCI All Country World Index
MSCI All Country World Index (MSCI Japan)
MSCI Emerging Index
MSCI Emerging Market Consumer Staples
MSCI Frontiers Index
Nedbank Green Index
S & P Africa Custom Index
S&P Africa Index
SA Property Index
China Dividend ex Financials

Mandate Type	Assets Under Management	No. of Benchmarks
ALL WORLD	R9 264 915 538	3
EMERGING MARKETS	R9 123 752 340	4
FRONTIER MARKETS	R3 676 387 101	1
SOUTH AFRICA	R36 733 673 773	12
AFRICA EX SOUTH AFRICA	R1 714 922 626	1
TOTAL	R60 513 651 378	21

INTERNATIONAL INDEXATION RATIONALE

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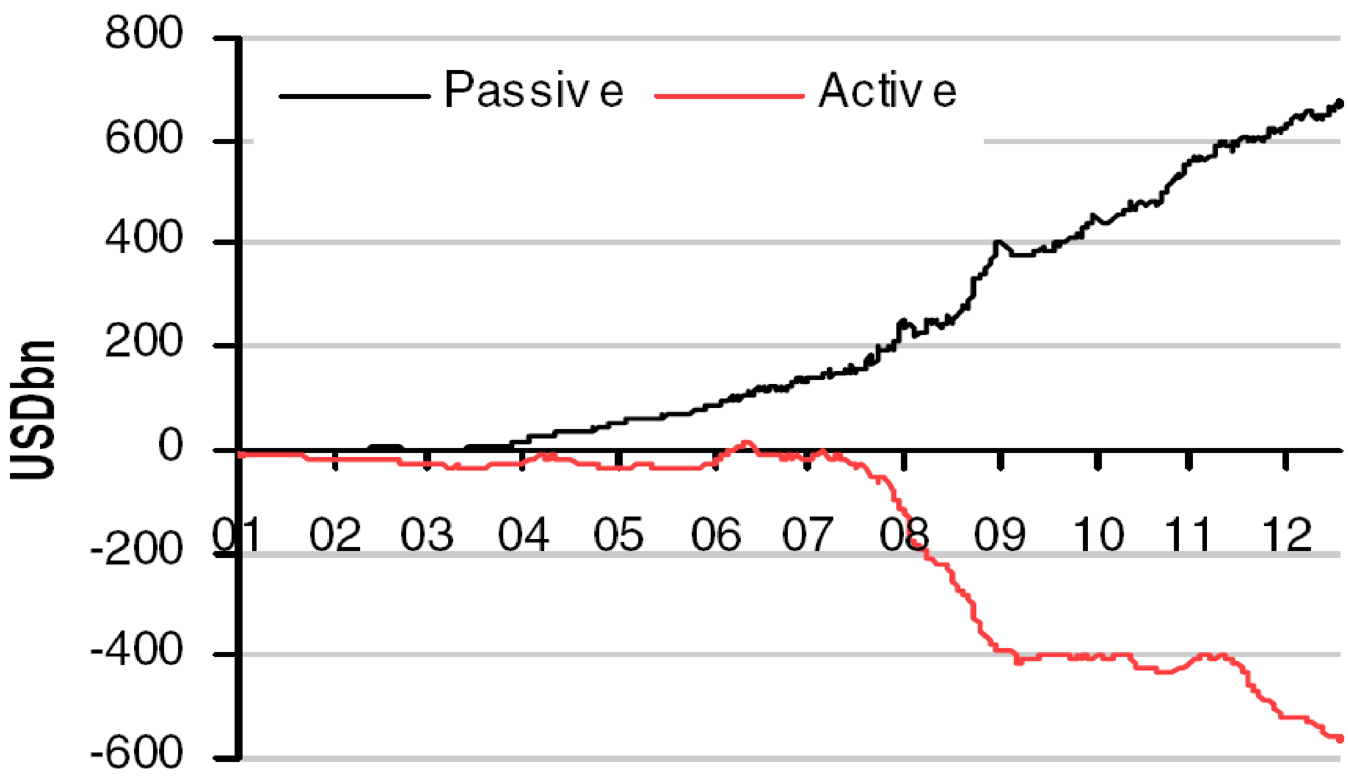
Beta is the cornerstone of international portfolio construction.	
1	The international component of SA investor's equity investments should now be a material contributor to their overall returns. Exchange controls will probably continue to be gradually relaxed over time, resulting in an ever increasing emphasis on a fund's international diversification strategy
2	Active/Passive blending within this international equity & bond component is a compelling proposition for the following reasons: • Only 10%-12% of global active equity managers outperform their benchmarks (FAJ) • Research shows that blending a high-risk active manager with a low-risk index fund yields better results than utilising a low-risk active manager only (MSCI) • Offshore active fees are high & selection risk is significant given huge active universe
3	The use of smart-beta indices within an overall international investment strategy, continues to gain traction. Funds utilising Research Affiliates' Fundamental Indices (FTSE RAFI) are now in excess of $143bn

SHIFT TO PASSIVE GLOBALLY

Passive equity funds worldwide have seen inflows of about $660bn over the past 10 years, and active funds outflows of $543bn (**One third** of their assets under management at the start of the period)



Source: EPFR

TAKE-UP OF GLOBAL SMART-BETA IS HAPPENING FAST…

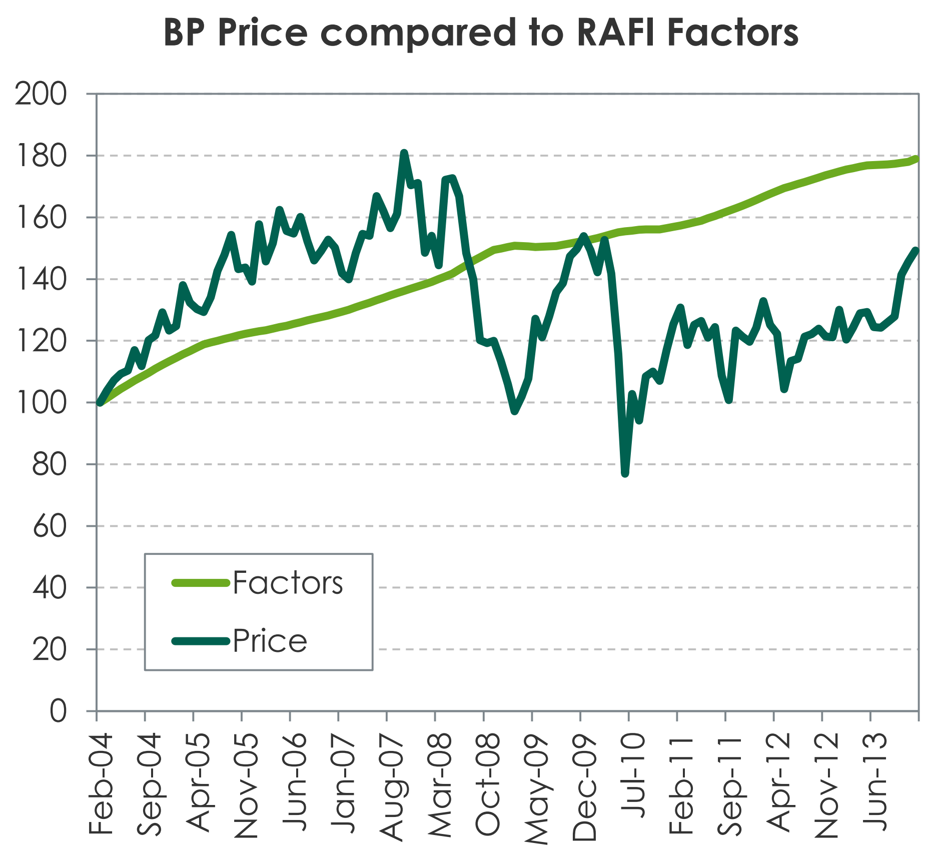
- Wiltshire County Council put 5% of £1.3bn into **RAFI AW 3000** Equity
- PNO Media pension fund, which holds €3.4bn, manage the **equal-weighted portfolios** itself, using the MSCI Pan-Euro index and Russell Top 200 index of US equities
- Danish Teachers' Pension Fund (Laerernes) has invested approximately €120m in fund tracking the **Russell fundamental emerging markets** large company index
- Dutch Metalworkers Pension Fund (PME) has invested in segregated mandates tracking the Russell defensive US and developed Europe indices
- Glasgow-based Strathclyde Pension Fund intends to hire **fundamental indexation managers** for £550m of its £11.4bn portfolio, while also increasing its passive equity investments on the back of disappointing performance from its active managers.
- Strathclyde may appoint up to eight managers to run "**non market-cap weighted**, rules-based" global equity index portfolios
- **According to Chris Ford from a very large consulting firm, rising demand for so-called "smart-beta" indices will become a dominant investment theme within the next five years**

FTSE RAFI ALL WORLD FUND:

- RETURNS
- METHODOLOGY
- COUNTRY, SECTOR, TOP 10

BRITISH PETROLEUM (BP): LIFE AFTER DEEPWATER HORIZON

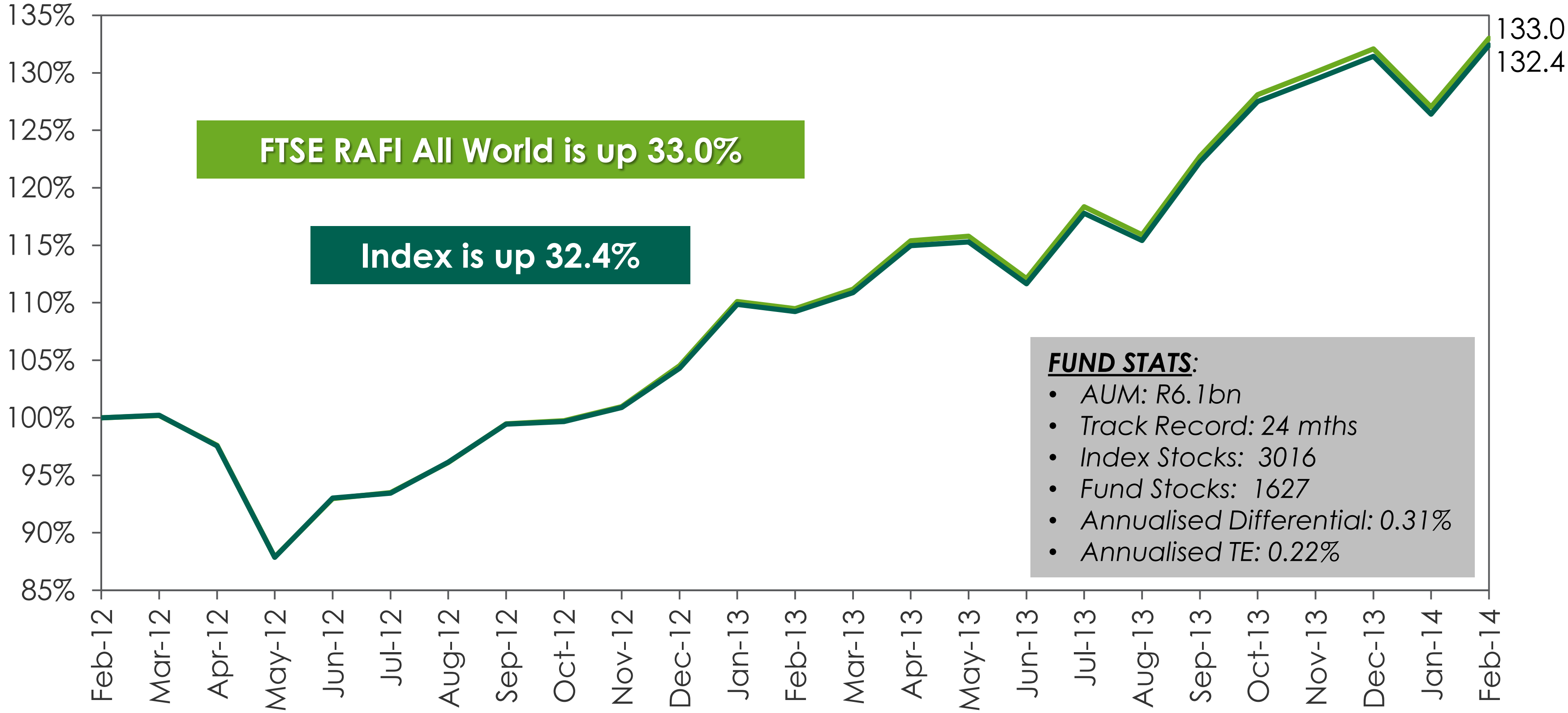
- Deepwater Horizon became the largest accidental marine oil spill in the history of the petroleum industry
- But, has the world's insatiable appetite for oil subsided?
- This demand assisted BP grow 2013 revenue to $379bn and declare an 11% increase in dividends
- The resultant dividend yield of 4.6% is very attractive
- The fund therefore remains overweight



Source: Bloomberg

FTSE RAFI ALL WORLD TRACKING PERFORMANCE ($)

Our fund has generated a Tracking Error of 0.22% since launch…



FTSE RAFI® Index Performance as at 28 February 2014	QTD	1 year	3 year	5 year	Index Launch Date
FTSE RAFI® All World 3000	2.40%	21.89%	8.51%	23.04%	06/10/2008
MSCI All Country World Index	2.48%	18.77%	8.94%	20.21%	06/10/2008

research affiliates®

* Since first full month of tracking: March 2012

RAFI® METHODOLOGY RE-VISITED

Stocks are weighted in proportion to Economic size

Book Value (25%)
- **Intangibles and minority interests are included**

Cashflows (25%)
- **Defined as Operating Income plus Depreciation**
- **Cashflow before dividends are used**

Dividends (25%)
- **Including both special and regular dividends paid in cash**
- **Excludes dividends paid to minority shareholders**

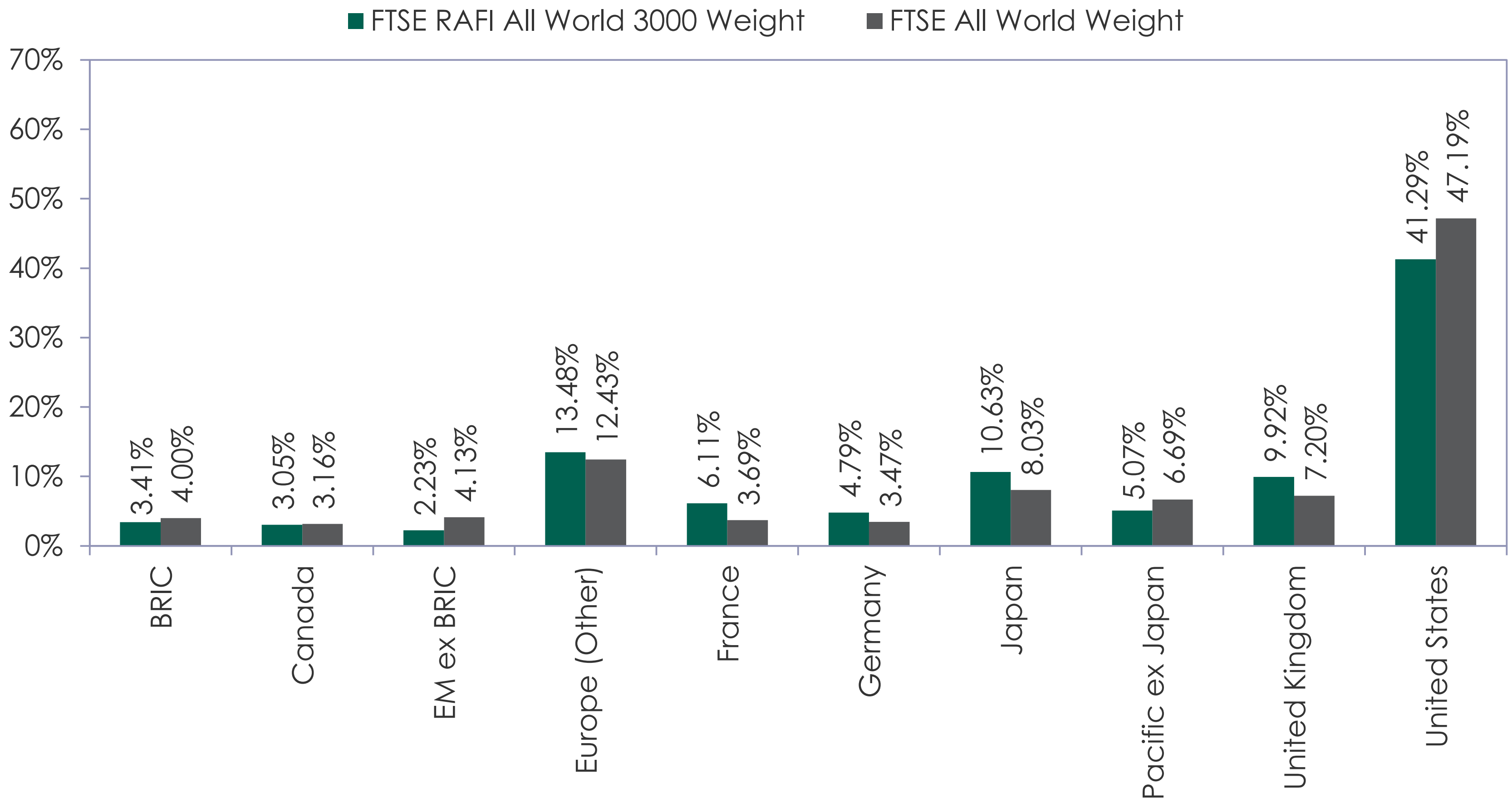
Sales (25%)
- **Differentiation is made for sectors (Mines, Retailers, Banks)**

Mitigates the excesses and peculiarities associated with each individual factor
- Book Value – overexposure to companies with aggressive accounting
- Cashflow – overexposure to cyclical stocks at cyclical peaks
- Dividends – overexposure to mature, stable companies to the exclusion of growth stocks
- Sales – overexposure to large companies with thin margins

Source: FTSE and Research Affiliates.

COUNTRY & REGION ATTRIBUTION

Overweight positions in Japan, France & Germany have assisted performance. Although the fund is under-weight USA, the bets within this market have been good



Source: Research Affiliates, Bloomberg as at February 28, 2014

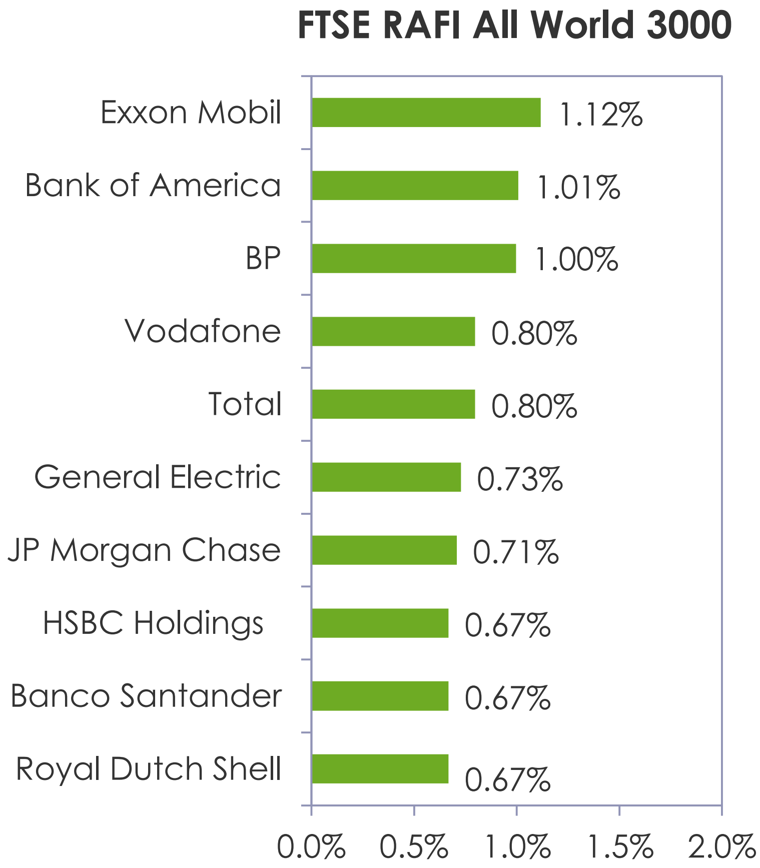
SECTOR ATTRIBUTION

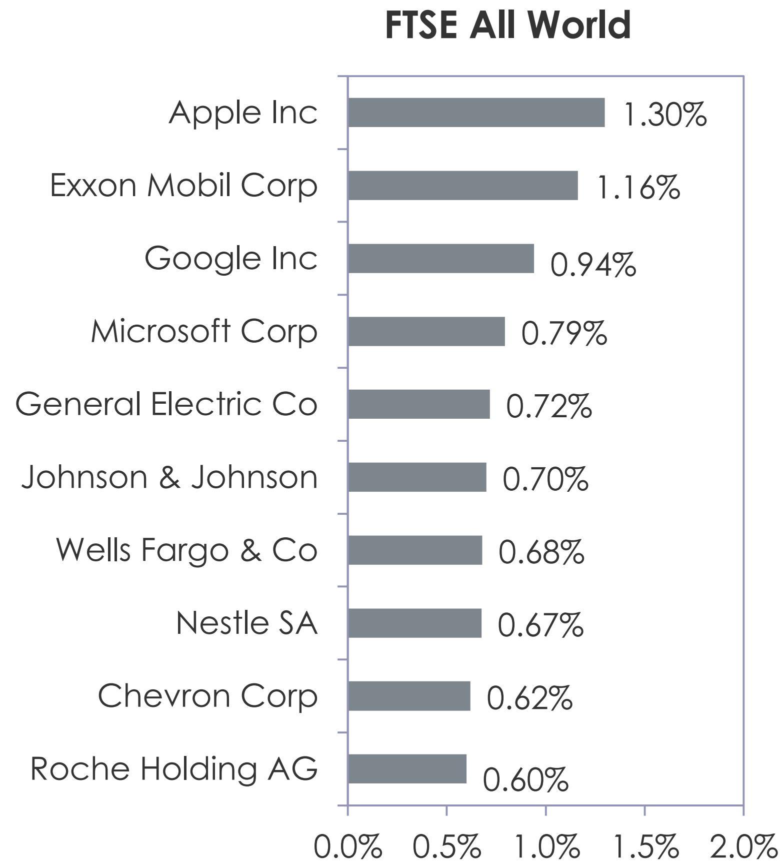
An overweight position in global banks (US & Europe) has assisted performance.
An under-weight to Healthcare & Tech has hampered performance.

Source: Research Affiliates, Bloomberg as at February 28, 2014

TOP TEN HOLDINGS

The RAFI AW's top ten is well diversified between Global Energy, Global Banks & Global Telco's

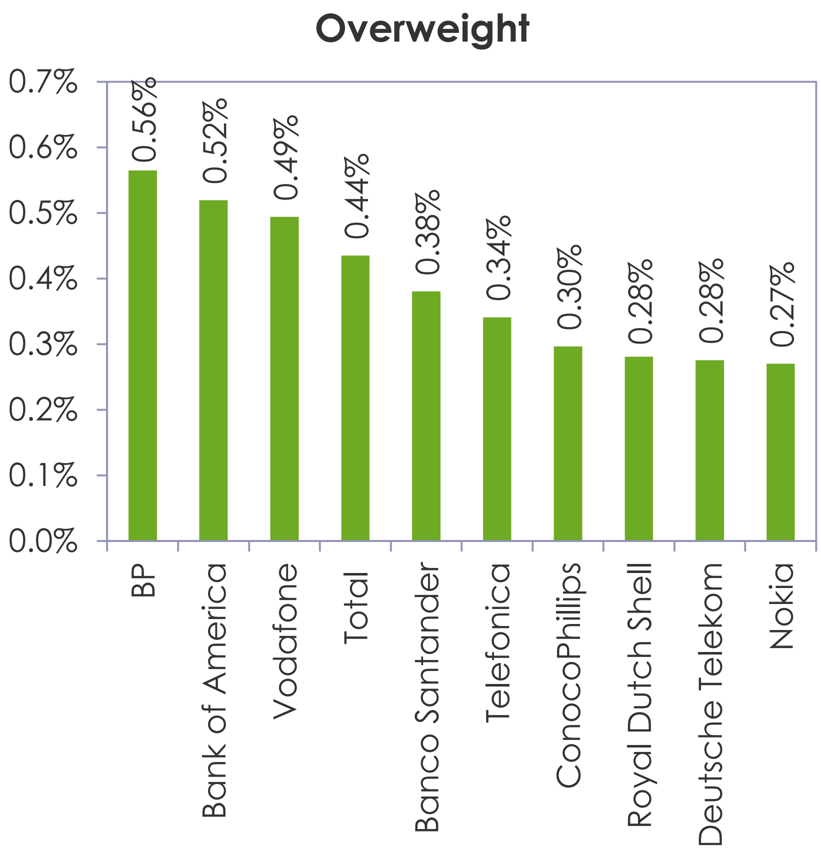


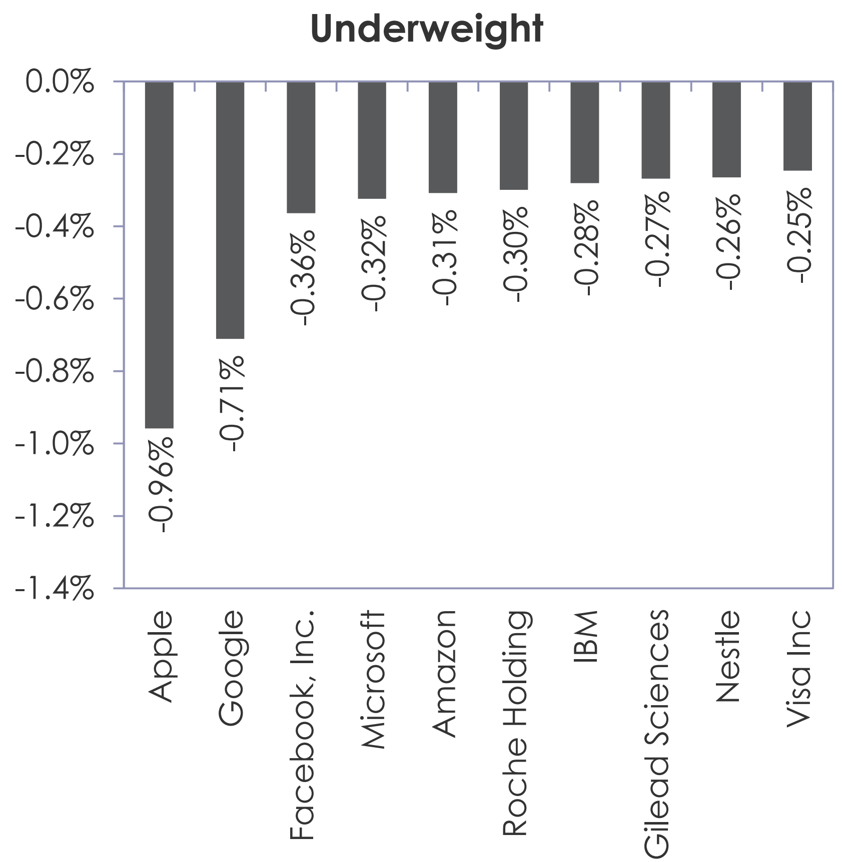


Source: Research Affiliates, Bloomberg as at February 28, 2014

TOP TEN OVER/UNDERWEIGHT SHARES

RAFI AW's major O/W bets are in Global Energy and Global Telco's given their high dividend yields. Major U/W's are in US Tech stocks …





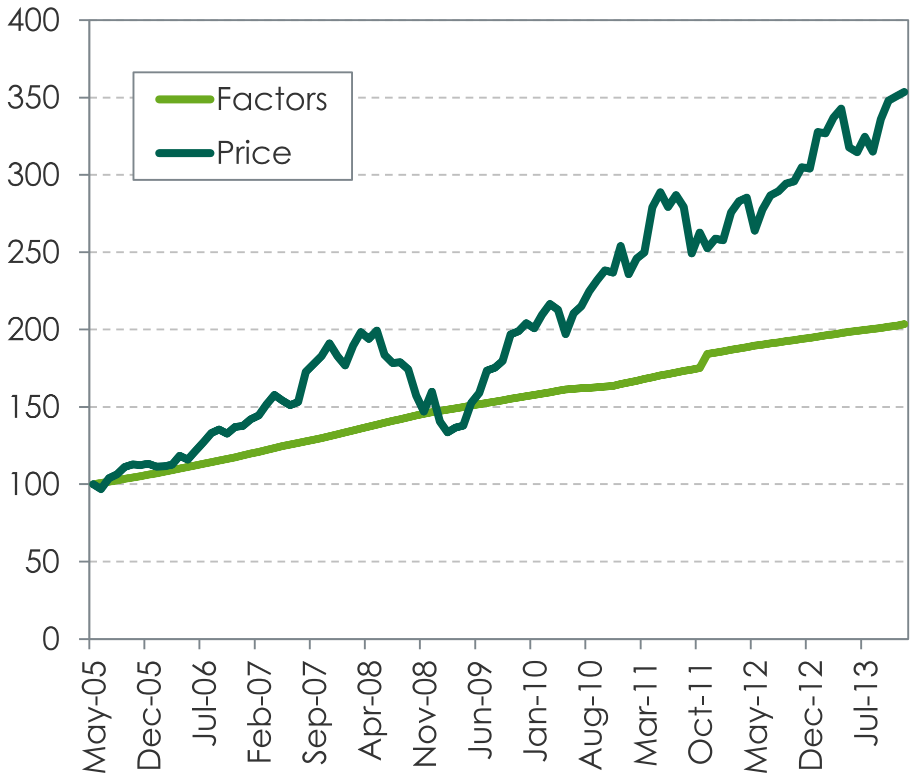
Source: Research Affiliates, Bloomberg as at February 28, 2014

BLENDING RAFI ALL WORLD WITH ACTIVE-ONLY STRATEGIES

NESTLE: BABY FORMULA & CHINA'S ONE-CHILD POLICY

- Exposure to emerging markets has contributed to Nestle's impressive growth
- But the fund has taken an underweight position in the company
- This de-coupling began post the financial crisis as investors piled into defensive stocks
- Defensive stock can become far more risky as the share price moves further away from the fundamentals

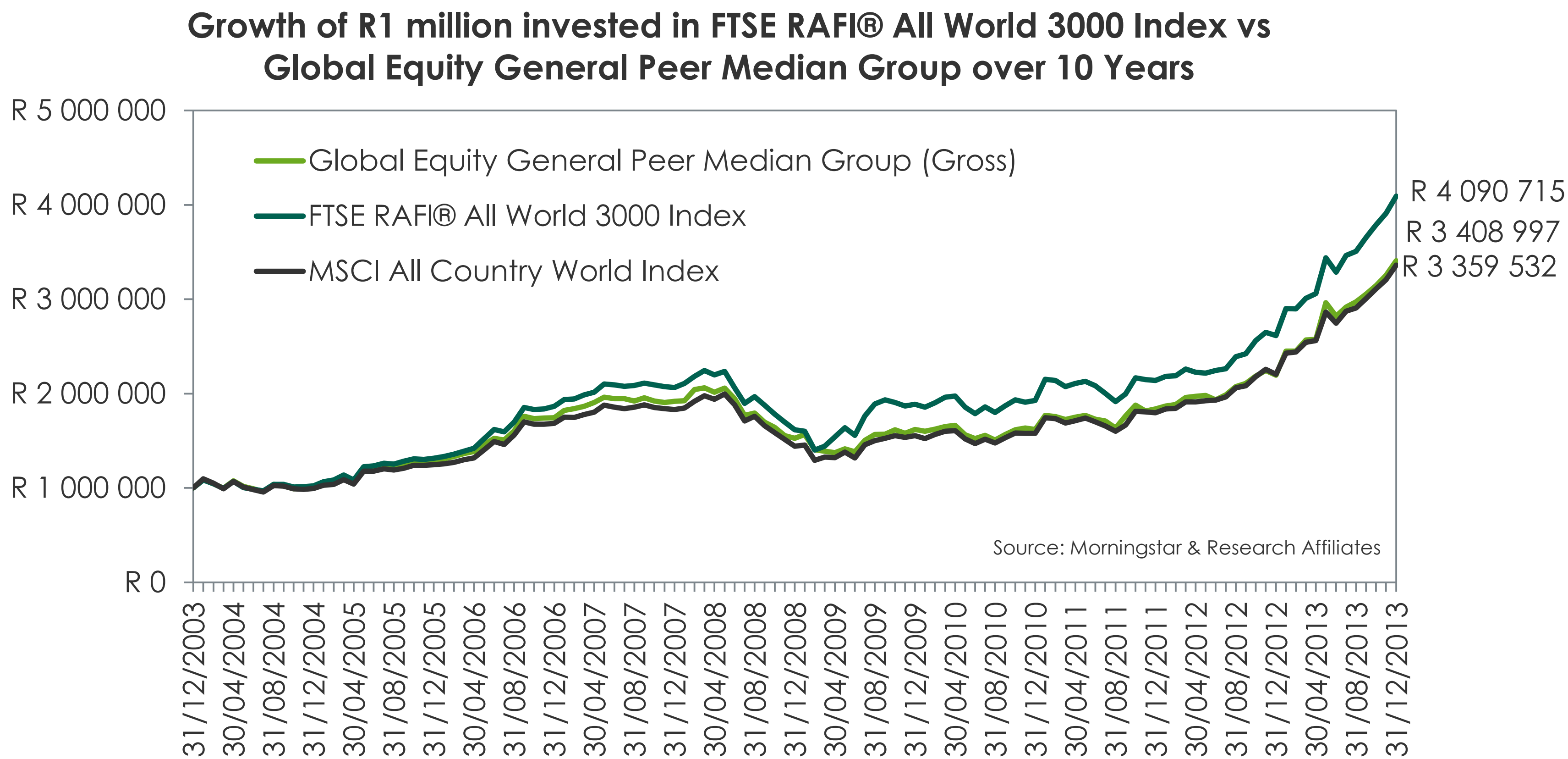
Nestle Price compared to RAFI Factors



Source: Bloomberg

PERFORMANCE RELATIVE TO (ASISA) GLOBAL EQUITY GENERAL FUNDS

Over the 10 year period the FTSE RAFI® All World 3000 was able to outperform the Global Equity General Peer Median Group by R681 718 on a cumulative basis or 2.28% p.a.



FTSE RAFI® ALL WORLD VS PEER GROUP VS MSCI ACWI :

Table 1 shows the annualised performance of the FTSE RAFI® All World 3000 Index relative to the Global Equity General Peer Median Group over multiple periods ending 31 December 2013.

Funds	1 Year	3 Years	5 Years	10 Years
FTSE RAFI® All World 3000 Index	56.40%	28.50%	20.40%	15.10%
Global Equity General Peer Median Group	55.28%	28.15%	17.45%	13.05%
MSCI All World Country	52.38%	28.58%	18.45%	12.88%

Table 2 shows relative performance relative to the fund managers. Over the last five years, ended 31 December 2013, the FTSE RAFI® All World 3000 Index ranked 3rd out of 21 funds.

Performance	Quartile Performance			
	1 Year	3 Years	5 Years	10 Years
FTSE RAFI® All World 3000 Index	**Second** (12/28)	**Second** (11/24)	**First** (3/21)	**First** (1/13)

Source: Morningstar & Research Affiliates

BLENDING FUNDAMENTAL INDEXATION WITH AN EXISTING GLOBAL EQUITY STRATEGY

If an investor allocated 50% to the Fundamental Index over the period, the results would be as follows:

- The overall blended portfolio return would have increased by 1.1% each year whilst the risk or portfolio volatility would have only marginally increased by 0.2%.
- The investor would also have enjoyed an 18% reduction in annual fees. This might not seem that significant but over a 10 year period, this will compound into a material saving

RAFI® Weighting	Peer Median Weighting	Return	Risk	% Fee Saving By Adding RAFI®
0%	100%	13.0%	14.2%	0
10%	90%	13.3%	14.2%	4%
20%	80%	13.5%	14.2%	7%
30%	70%	13.7%	14.3%	11%
40%	60%	13.9%	14.3%	15%
50%	**50%**	**14.1%**	**14.4%**	**18%**
60%	40%	14.3%	14.5%	22%
70%	30%	14.5%	14.6%	26%
80%	20%	14.7%	14.8%	30%
90%	10%	14.9%	15.0%	33%
100%	0%	15.1%	15.2%	37%

Source: Morningstar & Research Affiliates
[1] Global Equity General Peer Median Group is used as a proxy for International Manager Performance

CONCLUSION

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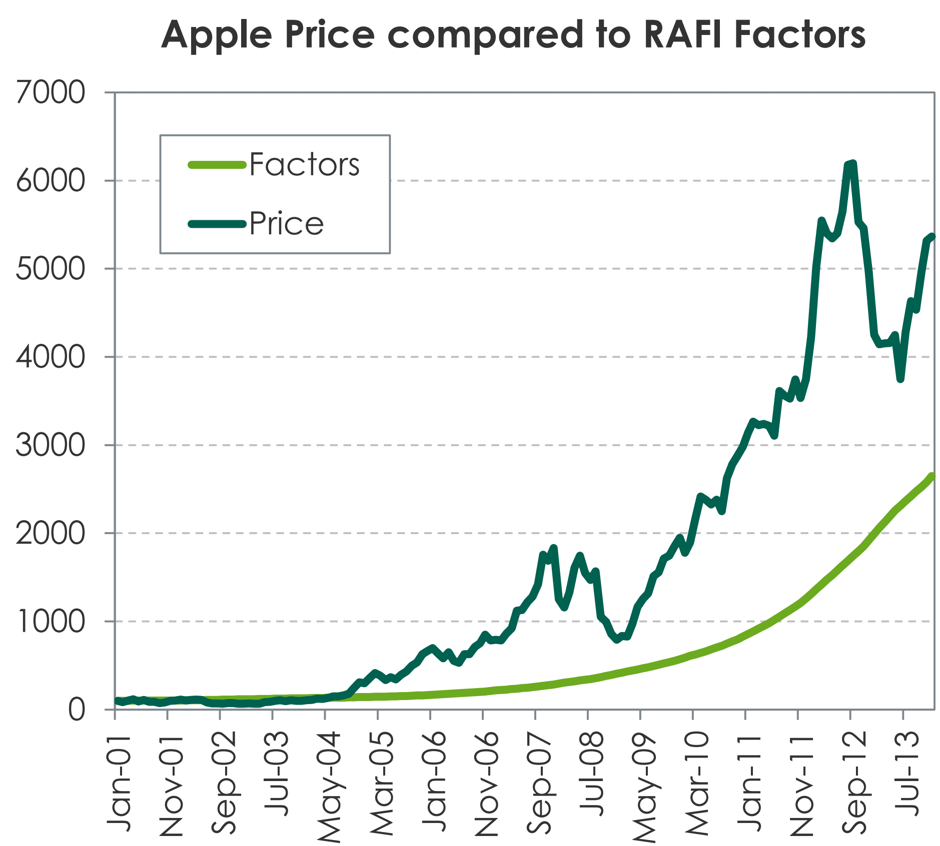
- Fundamental Indexation led by Research Affiliates LLC continues to gain credibility:
  - A very large global consultant has predicted that smart-beta indices will become a dominant investment theme over the next five years
  - For example: Invesco's PowerShares FTSE RAFI US 1000 ETF has generated actual outperformance of 1.56% pa since launch, eight years ago (No back-testing!) Source: PowerShares Fact Sheet
- We believe that our international value proposition is compelling:
  - Our ZAR based feeder fund has a TER that is 37% lower than the median TER
  - Actual five year RAFI AW index returns are almost 3% pa ahead of the Global Equity Median Peer Group
  - A 50/50 RAFI AW and active blend is superior

APPLE INC: SAM SUNG WHO?

- In 2004 the market began to suspect that Steve Job's multiple disruptive businesses were going to make a huge global impact
- Over the last eighteen months, however, the stock performance has started to look decidedly soggy, as Samsung continues to take global market share – especially in the east



Source: Bloomberg

APPENDIX

ADDRESSING SOME UNFOUNDED CRITICISMS OF FUNDAMENTAL INDEXATION:

- A market cap weighted index best reflects the overall investment universe available to an investor. This means that large, liquid companies are allocated the largest weights
  - Rebuttal: Given that RAFI® ignores share price and therefore market capitalisation, it does tend to invest in less liquid stocks but this is at the margin when a highly diversified 3000 stock universe is being used
- If Fundamental Indexation flows become too large, the alpha possibilities will start to disappear
  - Rebuttal: RAFI® flows are indeed growing exponentially but to put this into perspective, the $100bn currently invested in these strategies is still a negligible percentage relative to the $24 trillion US stock market. (Source: Mckinsey)

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For hypothetical return calculations from December 31, 2008 through April 30, 2011, the historical index constituents and weightings of the S&P Africa ex SA Custom Index were imported into the BBU Bloomberg function for index rebalance dates starting Dec. 31, 2008. The index results include actual historical pricing and volume for each of the constituents. The index results do not represent actual trading.

In Slide 10 “Implementation Costs in Some of the World’s Most Illiquid Markets are Prohibitive” and Slide 11 “Emerging Markets – Not that Easy to Outperform”, the actual historical volume and volatility are applied to the securities in the basket. Expected Impact cost is based on the mean of the historical volume and volatility values. Favorable and unfavorable markets are one standard deviation away from the mean. A favorable/unfavorable market will depend on the direction of the market in relation to the direction of the trade.

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