PSG Asset Management

ANGLES & PERSPECTIVES

SECOND QUARTER 2016

Contents

We believe that diversification is key to reducing risk and is an integral part of our investment process.

Introduction

Anet Ahern

Anet has 30 years' experience in investment and business management. After starting her career at Allan Gray in 1986, where she fulfilled various roles in trading and investment management, she worked as a portfolio manager at Syfrets, and later BoE Asset Management, where she was CIO and CEO. She also spent six years at Sanlam, where she was the CEO of Sanlam Multi Manager International, with assets totalling R100 billion in local and global mandates. Anet joined PSG Asset Management as CEO in 2013.

> 'As I think back over the years, I have been guided by four principles for decision-making. First, the only certainty is that there is no certainty. Second, every decision, as a consequence, is a matter of weighing probabilities. Third, despite uncertainty we must decide and we must act. And lastly, we need to judge decisions not only on the results, but on how they were made.'
>
> Robert Rubin, former Secretary of the US Treasury

Uncertainty and volatility in the markets remain an ongoing theme

Investors around the world have had to face volatile and uncertain markets in an environment of significant political events, unexciting growth prospects and persistently low interest rates.

Here in South Africa we have seen our currency reach R17/$ earlier this year amidst our own political upheaval, a possible ratings downgrade and a large-scale emerging market sell-off. Since then the rand has strengthened all the way back to pre-Nenegate levels. Many investors have chosen either to sell riskier assets and sit on the sidelines, move as much as possible of their investments offshore, or to look for any form of 'safe haven'. Examples of these so-called 'safe havens' include a complex guaranteed product, a low-yielding offshore cash account, a portfolio of well-known dual-listed rand hedge shares, or an apparently cheap and 'safe' passive strategy.

Where others see doom and gloom, we at PSG Asset Management see opportunity

Greg Hopkins, our CIO, opens this edition with an important contribution to the active versus passive debate and emphasises the benefits of investing with a manager who takes an active position relative to the market. However, we recognise that passive strategies should and will play an increasing role in fund strategies. As you will read in Greg's article, our funds are an ideal complement to a passive fund, and a valuable addition to a diversified investment strategy.

Flexibility is an ally in navigating current markets. This can manifest itself through a specific investment approach, a flexible or multi asset mandate, a phased approach to investing into funds, and the application of cash holdings in the construction of a robust portfolio over time. Shaun le Roux, Manager of the PSG Flexible and PSG Equity Funds, explains how our clients benefit from the flexible investment approach we follow.

Paul Bosman, Manager of the PSG Balanced, PSG Stable, PSG Flexible and PSG Diversified Income Funds, follows the thread of this flexible investment approach through to the asset allocation in our funds. He illustrates how and where we are finding undervalued investments during this uncertain time, and how we work hard at making every aspect of our funds – including the cash portion – contribute to the funds' investment objectives.

This quarter's fund in focus is the PSG Diversified Income Fund, which relies on all aspects of our investment process and disciplines. This fund has recently surpassed the R1 billion mark.

We believe our flexible, independent, long-term approach will continue benefitting our clients

We hope that the thinking we share in this edition gives you the comfort that uncertainty does bring opportunities, and that we have the right process in place (which we consistently apply) to find these opportunities for our clients. Paul mentions in his piece that 'the magic ingredient is time'. A case in point is the December 2015 events in South Africa, which seem like a lifetime ago. Yet in the short space of six months remarkable opportunities presented themselves to those investors who were able to stay calm and take a longer-term approach.

Thinking independently and with the longer term in mind is what will continue to stand our clients in good stead.

We trust that you will enjoy this edition.

The active versus passive debate: PSG Asset Management's views

Greg Hopkins

Greg is the Chief Investment Officer at PSG Asset Management and is the Co-Fund Manager of the PSG Equity, PSG Balanced and PSG Global Equity funds.

A case for passive investing

In 2008, Warren Buffett made a now famous million-dollar bet against specialist asset management firm Protégé Partners. He set out to prove that a simple passive strategy – tracking the performance of the S&P 500 – could outperform actively traded, more complex hedge fund strategies designed to seek out untapped value. Buffett placed his money in the Vanguard 500 Index Fund Admiral Shares (which invests in the S&P 500). In response, Protégé Partners picked five funds of funds (each comprised of a selection of hedge funds) that the firm felt could do better.

Today, eight years into the ten-year bet, Buffett's investment has returned over 65%. In comparison, the Protégé Partners portfolio has returned just over 20%. While there is still some time to go, it is likely that passive pundits will soon have a strong case to support their standpoint. Buffett himself highlighted these results at the most recent Berkshire Hathaway annual general meeting, to rally behind passive investing and the benefits that this approach offers everyday investors.

Passive investment strategies will play an increasingly prominent role

A lot has been said and written on the debate between active and passive investing, so we are mindful not to flog the proverbial horse. However, we have little doubt that passive investment strategies will play a bigger role in our industry in future. A passive investment approach offers a good value proposition for investors who don't feel confident in choosing a manager that can deliver consistent outperformance over the long term. We also believe that it's a mathematical certainty that the average investor (including mutual fund managers, institutional investors and private investors) will underperform their relevant benchmarks over the long term, after investment fees.

We're a long way from Buffett's Omaha…

While Buffett's bet (and its likely outcome) has certainly given investors something to think about, the debate between active and passive investing becomes more interesting when placed in a local context. In fact, the South African market presents a compelling case for active management, especially when compared to global markets. This is because it has a high concentration of large index-weighted companies, which can become significantly mispriced at times. Active managers are therefore given greater scope to deviate from the underlying benchmark and seek out opportunities for long-term outperformance. (Shaun le Roux writes more about how this opportunity currently presents itself in his article on page 4.)

The differences in the composition of the S&P 500 and the South African FTSE/JSE All Share (ALSI) and FTSE/JSE Shareholder (SWIX) indices are illustrated to the right. This highlights a marked increase in the weightings of the top five and ten shares in our local indices.

As an example and can be seen in the graphs below, the top five stocks in the ALSI make up 41% of the index, compared to the top five stocks in the S&P 500 which make up just 11% of that index.

As a result, there are a number of South African asset managers that have consistently outperformed benchmarks after fees, over meaningful periods. In all instances, they have certain characteristics in common, which include:

- a consistent investment process
- a long-term orientation
- a value-based approach of trying to buy when expectations are low and sell when expectations are high

Deliberate, considered benchmark deviation contributes to outperformance

Asset managers may stick closely to their benchmarks when compiling their funds in the fear that they will underperform over shorter periods. However, they might have a tough time justifying their fees and longer-term performance when compared to passive strategies. To add meaningful outperformance as an active manager, the ability to deviate from the benchmark and identify high-quality, undervalued securities is key.

An increasingly popular way of measuring the extent to which a fund overlaps with its benchmark is by considering its 'active share'. Put simply, active share is calculated by adding up the differences in each fund holding's weighting in the fund and its weighting in the benchmark, and then dividing by two. The higher the active share, the larger the differentiation from the underlying benchmark.

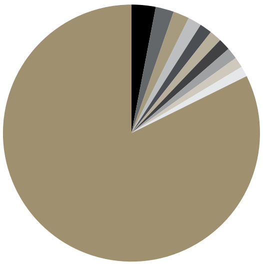
A study by Yale University[1] showed that funds with the highest active share (>80%) outperformed their benchmarks by a significant amount over a 23-year period. Interestingly, the study also showed that the number of funds with active share below 40% increased significantly over the measurement period, perhaps explaining why passive strategies have become more popular in global markets.

Our philosophy and process result in high active shares

An analysis of the PSG Equity Fund reveals a high active share of 88%, which differentiates the fund from both its benchmark and its peer group. We certainly don't believe in being contrarian for the sake of being contrarian. However, there are often opportunities to be found when you step away from the crowd. Over time, we have consistently followed a patient, long-term, risk-based approach, buying above-average quality assets at below-average prices (see *PSG Angles & Perspectives Q1 2014: 'How our philosophy helps us exploit market opportunities'* for some more detail in this regard). While this strategy is not guaranteed to work over the short term, it can create significant wealth for long-term investors.

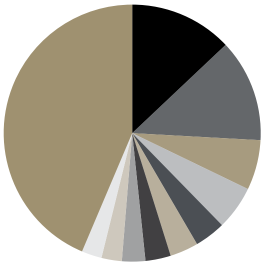
[1] 'How Active is Your Fund Manager? A New Measure That Predicts Performance' (M. Cremers, A. Petajisto), 31 March 2009

S&P 500 composition weighting %



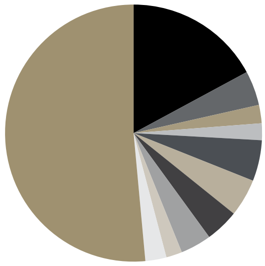
• Apple Inc	3%
• Microsoft Corp	2%
• Exxon Mobil Corp	2%
• Johnson & Johnson	2%
• General Electric Co	2%
• Amazon.com Inc	2%
• Facebook Inc A	2%
• Berkshire Hathaway Inc B	1%
• AT&T Inc	1%
• JP Morgan Chase & Co	1%
• Other	82%
Total	**100%**

ALSI composition weighting %



• Naspers - N	13%
• SABMiller plc	13%
• Compagnie Financiere Richemont	6%
• BHP Billiton plc	5%
• British American Tobacco	4%
• Sasol Limited	4%
• Steinhoff International HLDGS N.V.	3%
• MTN Group Ltd	3%
• Old Mutual plc	3%
• Anglo American plc	2%
• Other	44%
Total	**100%**

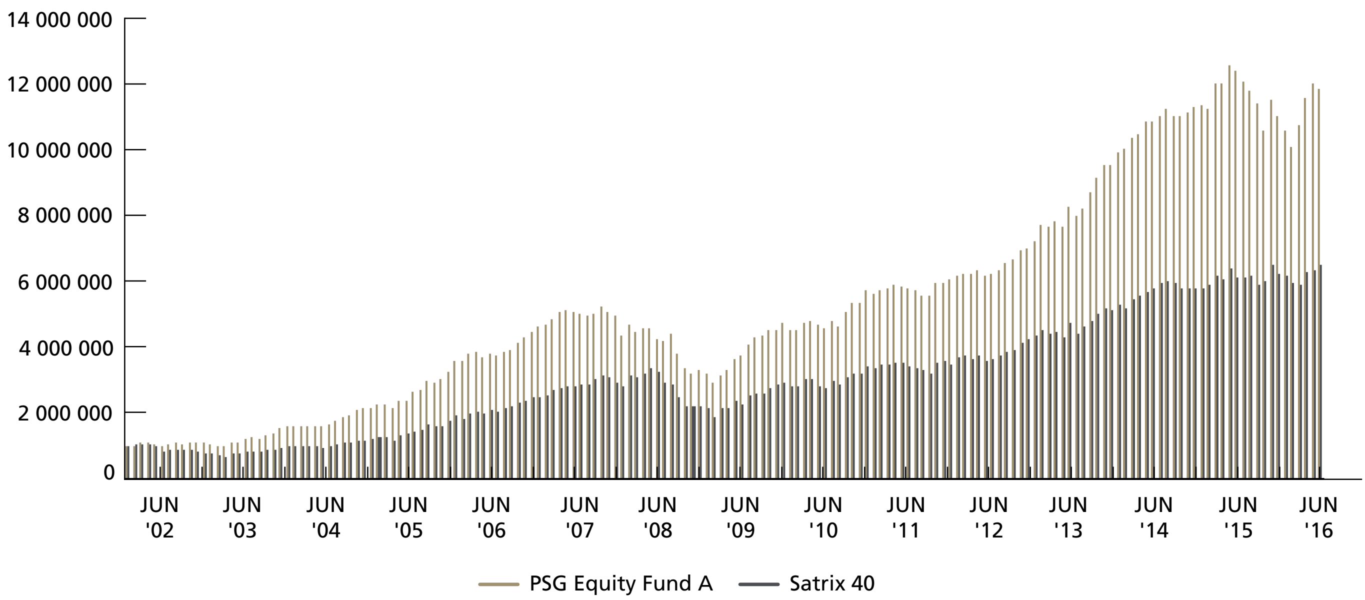
SWIX composition weighting %



• Naspers - N	17%
• SABMiller plc	4%
• FirstRand Ltd	2%
• Remgro Ltd	2%
• British American Tobacco	5%
• Sasol Limited	5%
• Steinhoff International HLDGS N.V.	4%
• MTN Group Ltd	4%
• Old Mutual plc	2%
• Standard Bank Group Ltd	3%
• Other	52%
Total	**100%**

Sources: Morningstar Direct, Statpro Revolution as at 31 May 2016

Graph 1: Total Return Index for R1 million – the PSG Equity Fund A versus Satrix 40 (2002 - 2016)



Source: Morningstar Direct

Shaun le Roux

How a flexible investment approach benefits our clients

Shaun is the Fund Manager of the PSG Flexible Fund and the PSG Equity Fund.

Following a disciplined investment process helps us avoid the interference of emotions

Emotions get in the way of good investment decision-making. The average investor will always feel more inclined to sell when tough times are casting a negative spell on stockmarkets and to buy when stocks are doing well. Asset managers such as ourselves fulfil an important role in both counter-balancing and exploiting these swings in investor sentiment.

We follow a disciplined process that sees us buying when others are panicking and selling when prices are rising. Cash levels in our funds will therefore be rising when stocks are getting more expensive and future returns are diminishing. We will employ that cash aggressively when panic sets in, even if it feels uncomfortable at the time.

We buy stocks that meet our investment requirements, irrespective of their popularity

We assess each stock idea on its merit. If we find the best long-term returns with low likelihood of permanent capital loss in more cyclical businesses, we actively exploit those opportunities, even if they are less popular or more volatile at the time.

Constantly assessing risk and return and being flexible are central to successful investing

A crucial part of an investment process is constantly assessing the risks and returns of individual investment opportunities and the ability to adapt portfolios to changing dynamics, especially a change in asset prices. Because asset prices reflect the swings in sentiment between optimism and pessimism, and in extreme cases between fear and greed, it is possible to improve the chance of strong future returns tremendously by buying when a stock is out of favour and the price is depressed. Similarly, as an asset becomes more popular and its price rises, future expected returns will diminish. Ironically, it is natural human behaviour to feel more comfortable about investments that have risen in price and to be more worried about those that have declined.

Consistent application of our investment process delivers optimal results over the long term

At PSG Asset Management we follow an equity process that we believe offers a high probability of placing the odds in our clients' favour if consistently applied. In equity markets we look for businesses where there is clear evidence that the business's inherent quality and management team will preserve and grow shareholder value. We also prefer to buy at a margin of safety that serves as a buffer against unpredictable outcomes, and don't like to own stocks that we consider overpriced. Experience has taught us that we tend to find the best opportunities for strong future returns at relatively low levels of risk when sentiment is poor, economic conditions are tough and hence prices are low – a case of buying when others are panicking.

Cash plays a key role in our portfolios, providing firepower when we need it

We have a track record of waiting patiently for good opportunities for our clients. We will not invest in overpriced or high-risk, low-return stocks – even if they are popular or large components of benchmarks. In times where higher-quality businesses are popular and prices are high, you can expect us to be sitting with large levels of cash in the funds that allow for this. This is the case at the moment. We think the value of cash is tremendously underappreciated. Cash may not yield much above inflation much of the time, but it is firepower that can be deployed just when you need it, in the inevitable moments of panic. We think of cash as the ammunition in a portfolio that allows you to invest in inherently risky assets such as equities.

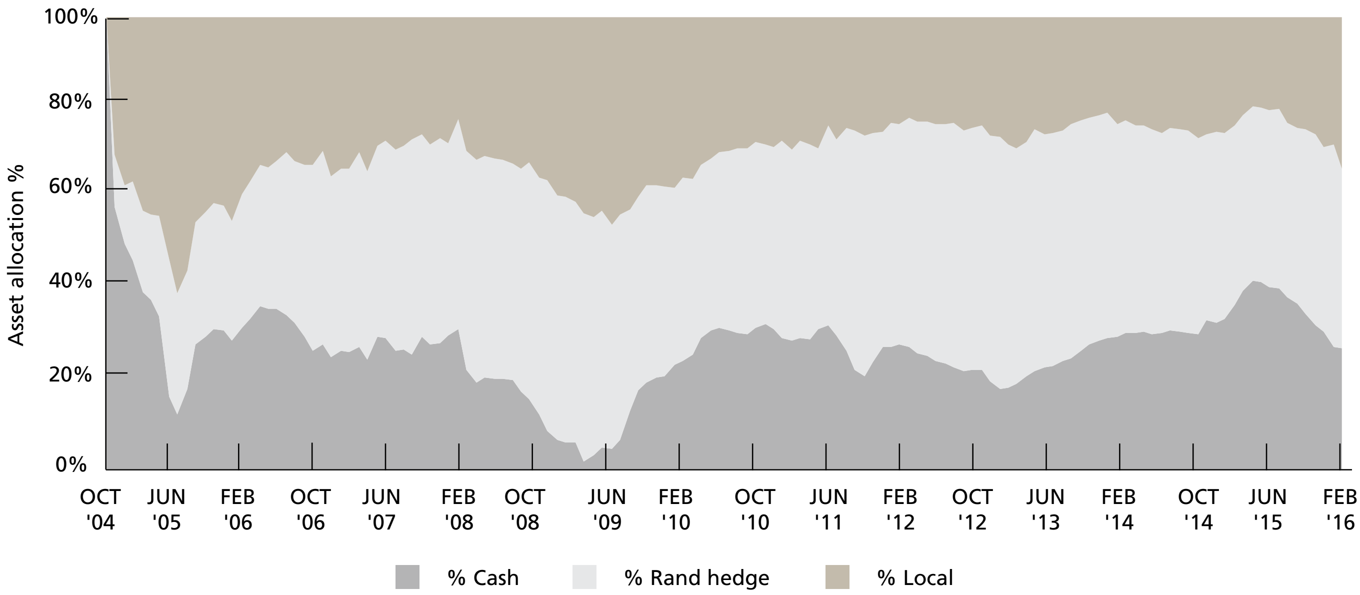
The size of our cash holdings reflects our assessment of the state of the market

At the start of 2008 our multi asset portfolios held a lot of cash – the PSG Flexible Fund had more than 30% of its fund value in cash (as shown in Graph 1). This reflected our assessment that valuations and risk were elevated for much of the stock market, which meant we could find fewer investable opportunities. The global financial crisis provided an opportunity to employ cash aggressively as good companies went on sale. By the end of 2008, the PSG Flexible Fund was 95% invested in equities. With the benefit of perfect hindsight, we could have been more patient in employing our cash. Nevertheless, the actions taken during those difficult times are indicative of how we manage money. When others were panicking we jumped at the opportunity to lock in fantastic long-term returns for our clients by investing in high-quality businesses at fantastic prices.

In 2011/2012, global equities were deeply out of favour with South African investors. Elevated initial valuations and rand strength had resulted in very poor returns over the previous decade, while the FTSE/JSE All Share Index (ALSI) had performed very well over the same period. Sentiment toward global equity markets was therefore poor, with Europe a major source of concern. As a result, it was possible to invest in high-quality global franchises at good prices at a time when the rand was relatively strong. Accordingly, our funds bought direct global equities to the maximum extent permissible. As Graph 1 demonstrates, we deployed cash into rand hedges in 2011/2012, primarily into direct offshore equity opportunities.

Global equity markets enjoyed strong performance between 2012 and early 2015, with the S&P 500 appreciating by almost 70%. Many stockmarkets around the world, including the ALSI, re-rated substantially. As a result, future expected returns declined and opportunities diminished. We consider it appropriate to take profits in our portfolios under such circumstances and our cash levels increased over this period. The PSG Flexible Fund's cash levels exceeded 40% in mid-2015.

Graph 1: PSG Flexible Fund – asset allocation history (2004 - 2016)



Source: PSG Asset Management (31 March 2016)

Our flexible approach to portfolio management contributes to dynamic asset allocation

As described above, the last five years have seen material changes in our asset allocation. However, our flexible approach to portfolio management, which enables us to seek the best possible returns for our clients at acceptable levels of risk, has also led to significant changes in our portfolio composition within equities over the same period. As we wrote in our previous edition of this publication, recent times have been characterised by a discrepancy between growth and value in stockmarket valuations last seen in the tech bubble. Growth shares have been in high demand and we believe that most high-quality growth shares, both in South Africa and abroad, have become overpriced. At the same time, sentiment towards more cyclical value opportunities has become very poor and we have found more and more opportunities to buy unloved companies at a wide margin of safety. Examples of deeply out-of-favour sectors in recent times include resource stocks and domestic financial and industrial stocks. Resource stocks have enjoyed a strong recovery in 2016 but many SA Inc. shares continue to languish at very depressed levels. We have consequently grabbed the opportunity to buy high-quality domestic businesses such as FirstRand, Imperial and Old Mutual at prices that reflect the very poor sentiment towards the South African economy. As a result, our cash levels have reduced and our exposure to local equities has increased significantly, as shown in Graph 1.

As a protective measure, we always seek to diversify our portfolios

It is widely held that high-quality rand hedge stocks, particularly dual-listed companies, are defensive and provide portfolio protection because their revenues are more predictable and earned in hard currencies. We actively seek to diversify our portfolios and have been heavily invested in these businesses at times. We do not, however, share the view that investing in overpriced shares – even if they have more predictable earnings – is an appropriate way to preserve our clients' capital, particularly when the rand is so oversold. Conversely, we think that investing in overpriced and over-owned securities may be one of the biggest risks to many portfolios today.

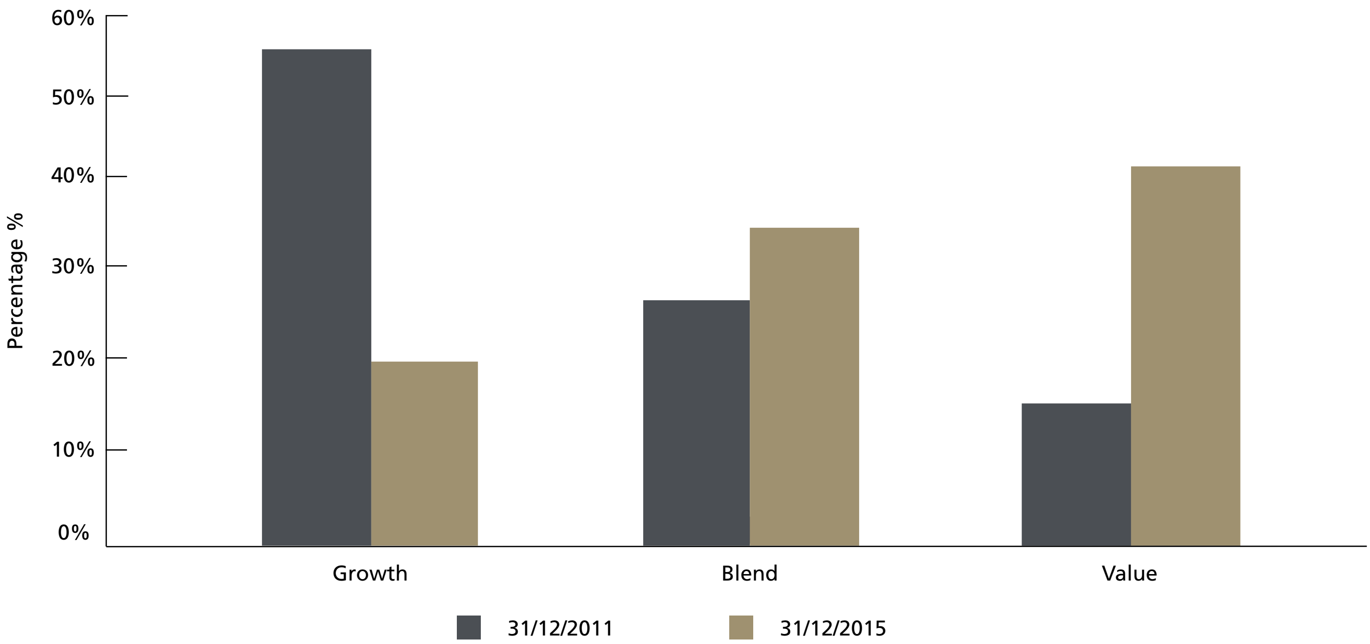
The rotation out of growth and into value assets provides evidence of our approach

Graph 2 demonstrates the steady migration of the equity component of our portfolios over the past four years. At the end of 2011, our portfolios were dominated by high-quality growth shares (56% of the fund value of the PSG Equity Fund was classified as 'Growth' according to Morningstar). Our assessment that such stocks have become increasingly overpriced and the opportunity to invest in unloved, more cyclical value shares at a wide margin of safety have necessitated a rotation within our portfolios. As at the end of 2015, more than 40% of the fund value was in shares classified as 'Value'.

Irrespective of the quality of a business, the price we pay is crucial

Our preference is to hold high-quality businesses, but we are not prepared to overlook the price at which a share is trading. Also, there is a difference between cyclicality and quality. We think that the market will often overlook the inherent quality of a business and its management team when profits are cyclically depressed. That gives rise to the opportunity to buy a good

Graph 2: PSG Equity Fund – steady migration in the equity composition (2011 - 2015)



Sources: Morningstar Direct, PSG Asset Management

business on low earnings and at low valuations. We think our portfolios contain numerous examples of above-average quality but cyclical businesses that should produce excellent long-term returns for our clients.

Recently, we have been buying government bonds in our multi asset funds. These bonds have been heavily sold off by foreign investors due to prevailing pessimism, which has presented an opportunity to lock in attractive long-term yields for our clients (read more in Paul Bosman's article on page 7).

At the end of the day, uncertainty and risk provide opportunities

We are made aware of the uncertain macroeconomic environment and elevated levels of political risk in South Africa daily. However, long-term investors should try to remember that it is this uncertainty and risk that provides the opportunity to invest in securities at levels that provide attractive long-term returns. It is possible that local economic or political conditions deteriorate further. In addition, Brexit has increased the range of outcomes for financial markets. This is why we consider it appropriate to keep relatively high levels of cash on hand to seize future opportunities.

Paul Bosman

Unpacking our asset allocation process

Paul is the Co-Fund Manager of the PSG Balanced, PSG Stable, PSG Flexible and PSG Diversified Income Funds. Paul joined the PSG Tanzanite team in 2004 as an Equity Analyst. He became a Fund Manager of the PSG Stable Fund in 2011.

Our investment philosophy and process guide all our decisions

For us at PSG Asset Management it is very important that our clients understand our investment philosophy and what it means for their investment. This significantly reduces the risk of clients taking their money and running for the hills at exactly the wrong time, which can result in long-term value destruction. On the flipside, it increases the probability of clients making additional investments when our funds are offering good value. The first part of this article is dedicated to our investment philosophy as it relates to equities and fixed income instruments. We then explain how this feeds into our asset allocation process with the help of a few examples of actual holdings in our portfolios.

Our equity philosophy – considering management, moat and margin of safety

When selecting equities, we consider three factors, both in isolation and collectively. These factors are whether the company has a moat, the ability of the management team, and whether the share price offers a margin of safety (our '3Ms'). A moat refers to some form of competitive advantage that will ensure that the company's profits won't be eroded by competitive forces. When considering the ability of a management team we especially focus on management's track record of growing profits and how free cash flow has been allocated. Margin of safety is just another way of saying that we want to pay less than what we estimate the company is worth. Buying at a margin of safety very often inflicts pain before gain as we will typically buy when the share price is under pressure. It could take time before the share price turns and therefore requires patience.

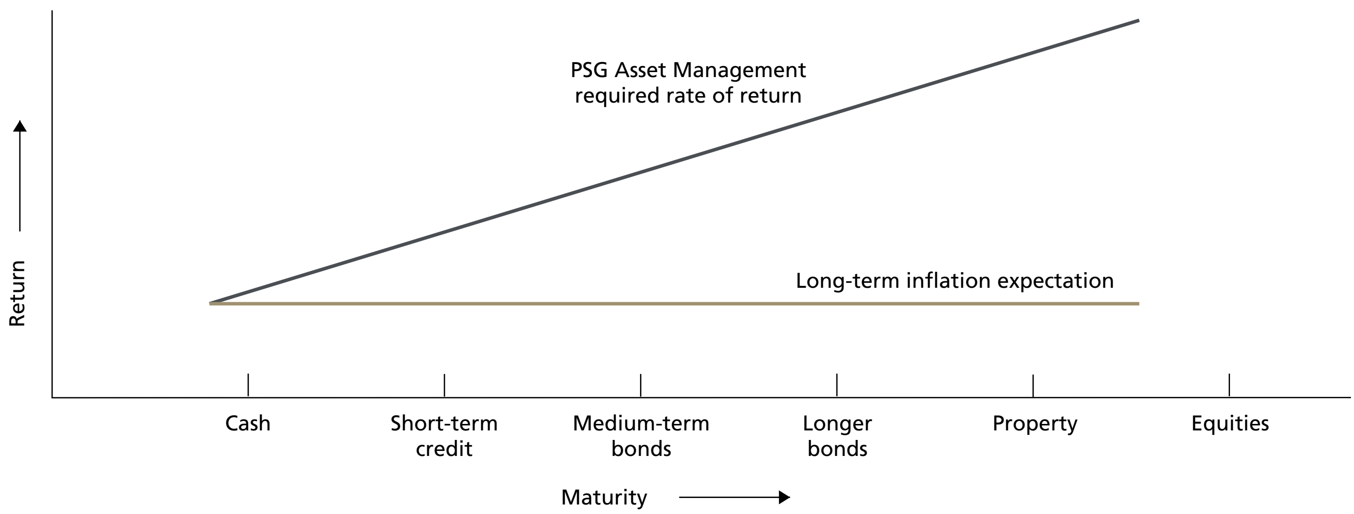
Our fixed income philosophy – looking for returns that exceed long-term inflation

In fixed income markets we hunt for instruments offering appropriate through-the-cycle real yields given credit and duration risk. An appropriate through-the-cycle real yield means a return that is higher than an average or realistic long-term inflation rate. This return must be high enough to compensate us for the risk of not being repaid the money we lent to the relevant entity. To assess this risk we consider the same factors as with equities – it is a company's moat and management that determines whether the company is firstly, able to generate sustainable cash flows and secondly, is trustworthy.

Asset allocation in our portfolios – the result of our philosophy

Consider Graph 1. Required rate of return is just another way of expressing required margin of safety. A lower security price implies a higher return or yield. We determine a required return for each individual security, based on the company's moat, management and balance sheet strength. Securities that offer a rate of return in excess of our required rate will be added to our portfolios. The more the return exceeds our required return, the greater the exposure to the security. The fewer opportunities there are, the greater the funds' allocation to cash.

Graph 1: Our required rate of return versus long-term inflation expectations



Source: PSG Asset Management

This process is therefore what determines the asset allocation of our funds, rather than a strategic (or 'top-down') view on a per-asset-class basis.

Asset allocation examples

To demonstrate how we go about this asset allocation process, let us look at three examples.

1. **Negotiable certificates of deposit (NCDs)**
   NCDs are tradeable bank deposits with investment terms of anywhere between one month and five years. We mostly use NCDs to park cash while we wait for equity or bond opportunities. However, we also apply our investment philosophy within the NCD market.

   Graph 2 shows the NCD curve (that is, the rates available across the maturity spectrum) at two specific points in time, at the end of May 2014 and at the end of June 2016. The dashed line indicates our estimate of average future inflation.

   The two dots indicate the yield on the PSG Balanced Fund's NCD portfolio as at these dates. It indicates that we allocated more of the portfolio further out on the curve (that is, to longer-term instruments) when the yields moved sufficiently above inflation to compensate us for the commensurate risk. This application of our philosophy resulted in a yield increase of more than 200 basis points.

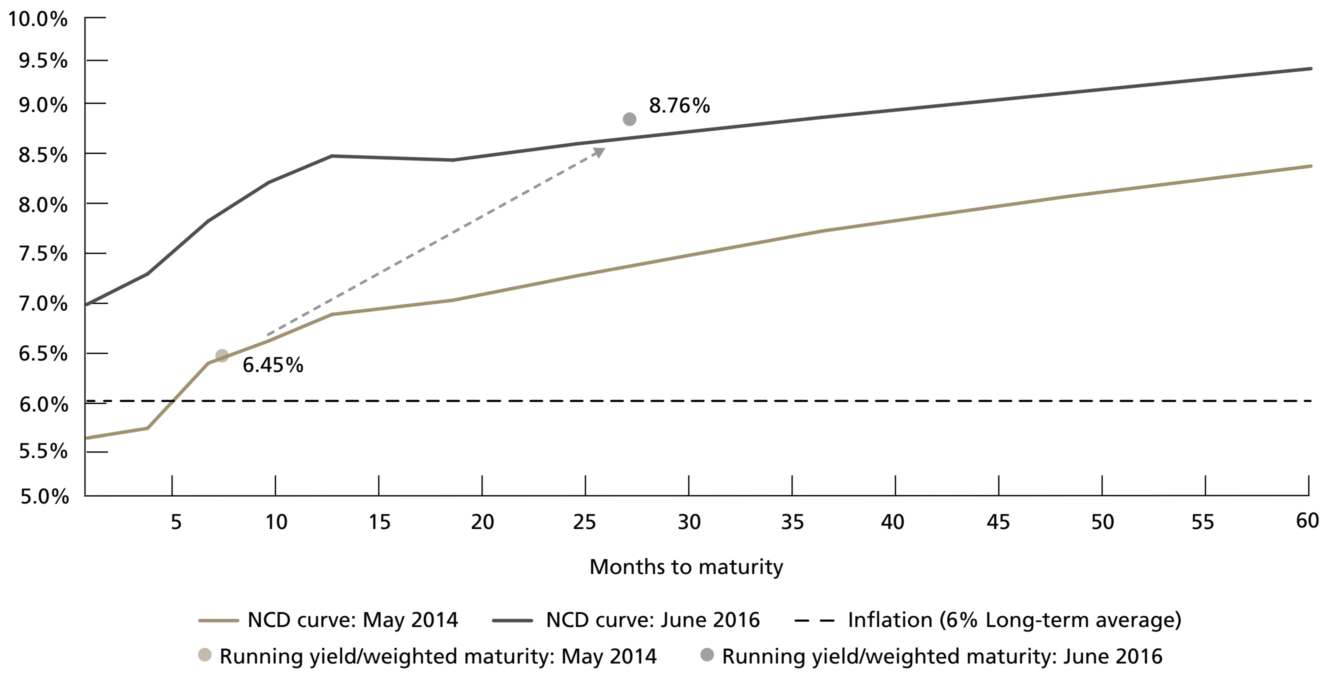
2. **South African government bonds**
   The next example deals with our allocation to South African government bonds over the last couple of months. Graph 3 shows the shift in the local government bond yields over the 2015 calendar year.

   The majority of the shift occurred towards the end of the year when a couple of events collided to create the perfect storm:
   - sovereign panic around the replacement of the finance minister
   - inflation fears arising from the weak rand and high soft commodity prices
   - a global emerging market sell-off

   We were prepared and ready to act. When the yields on offer shifted above our required rates for South African government bonds we started buying bonds with our cash reserves. We have continued to add local bonds to our portfolios as we see the real yields on offer to be very attractive. As at the end of June 2016, 9.7% of the PSG Balanced Fund is invested in government bonds, as opposed to 0% in December 2014, when the yields were below our required rates.

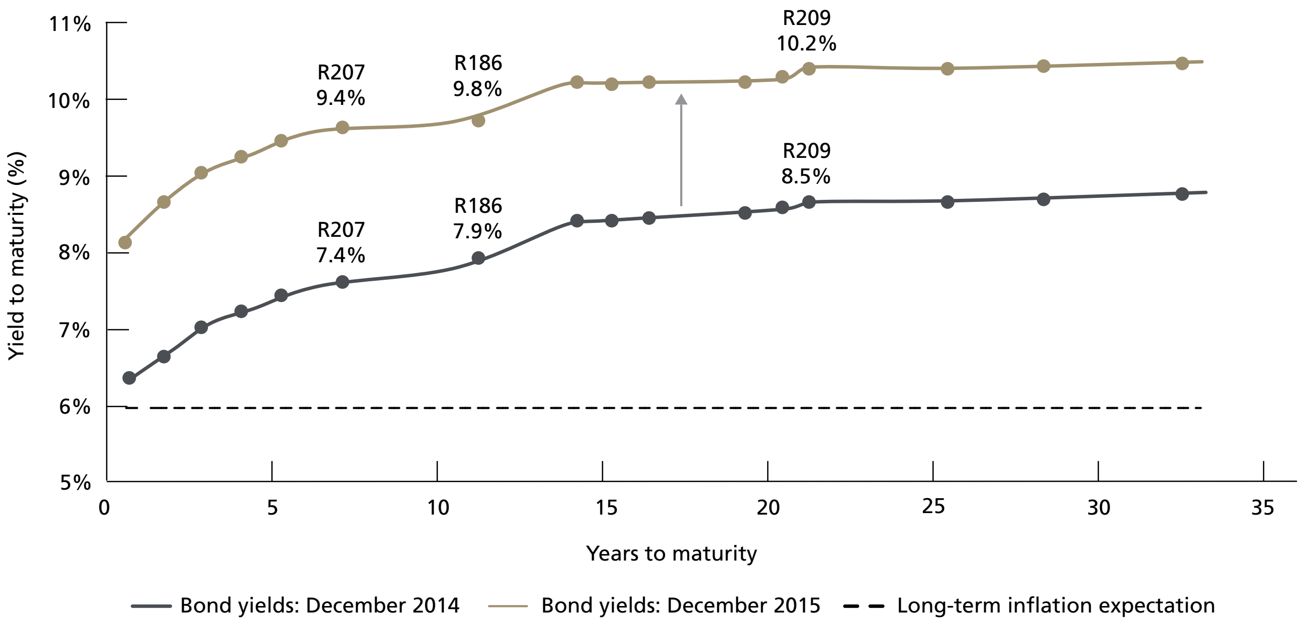
3. **South African banks**
   As a final example we discuss the gradual but steady increase in our portfolios' exposure to South African banks, as shown in Graph 4.

Graph 2: Negotiable certificates of deposit (NCD) rates



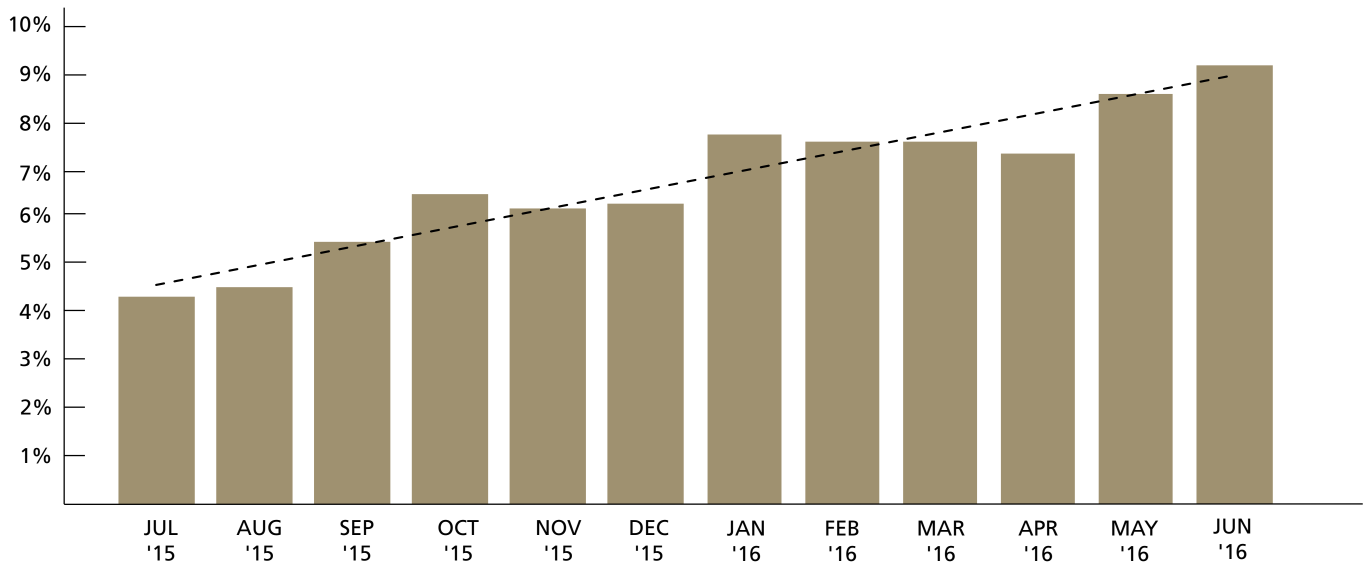
Sources: PSG Asset Management, Bloomberg

Graph 3: South African government bond yields in 2015



Sources: PSG Asset Management, Bloomberg

Graph 4: PSG Balanced Fund exposure to South African banks (31 July 2015 - 30 June 2016)



Source: PSG Asset Management

Let's first take a look at the dividend yield and price-earnings ratio of the South African Financials Index over the last six years (Graph 5). Optically this sector is showing compelling value. What is even more encouraging is that this industry enjoys the benefit of a couple of barriers to entry, i.e. a moat. One of the most significant barriers is the time it takes to earn sufficient trust for the public to entrust their savings to a bank.

In addition, most of the local banks are run by excellent management teams who in some cases have a large personal equity stake in the business. The South African banking sector is therefore a very fertile hunting ground for us.

It is therefore no surprise that FirstRand is now one of the largest holdings in our portfolios. The CEO and chairman both have large personal stakes in the business and the business has a track record of executing well for clients and creating value for shareholders. Best of all, the dividend yield on offer is comfortably above the 5% level for the first time since the financial crisis.

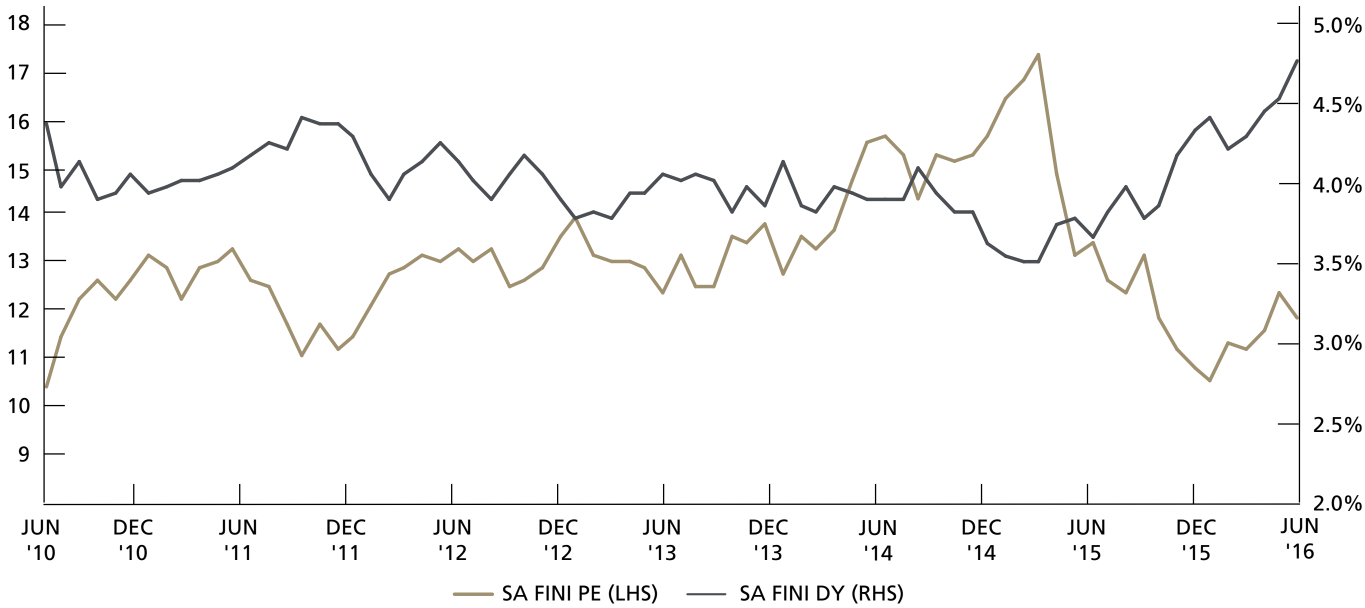
Graph 6 shows the dividend yield of FirstRand going back as far as July 2006.

Although FirstRand is the largest local bank holding in our funds as it scores best on our 3Ms metrics, we also have holdings in some of the other South African banks.

Our asset allocation process reduces risk and improves long-term return prospects

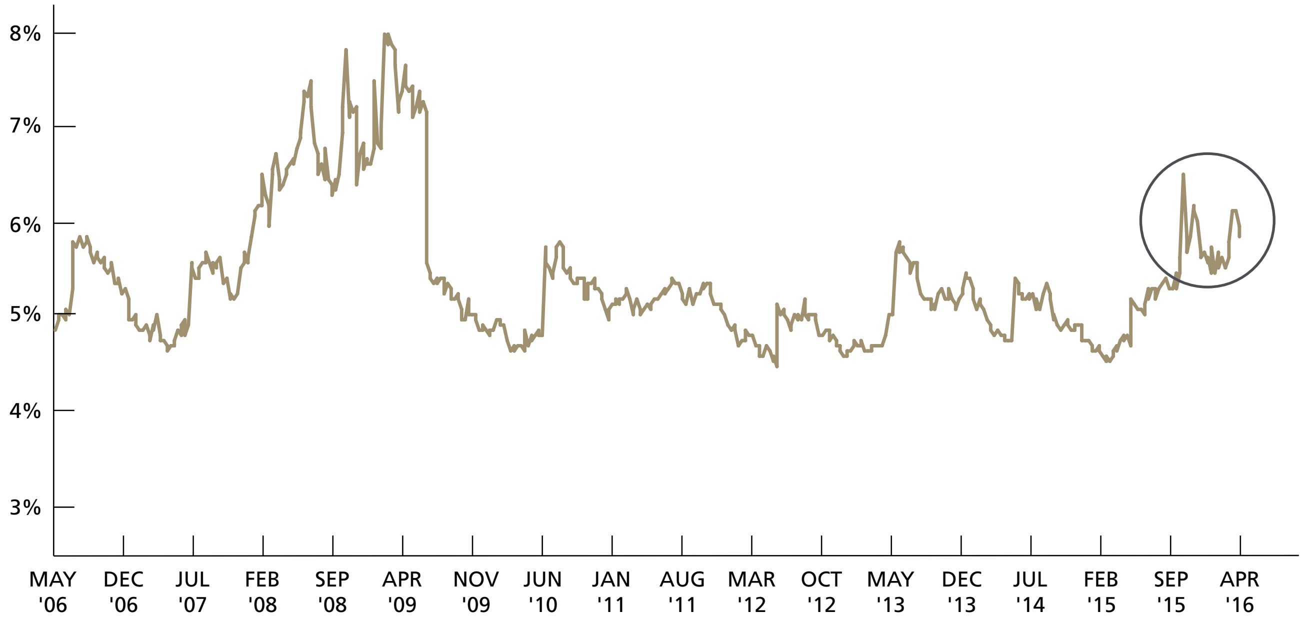
Asset allocation in our funds is the result of the consistent application of our 3M process across the total asset opportunity set. This results in portfolios that have larger exposure to more undervalued securities that firstly, reduces the risk of capital loss and secondly, increases the total expected real returns from our portfolios. The magic ingredient is time.

Graph 5: Dividend yield and price-earnings ratio of the South African Financials Index (2010 - 2016)



Source: I-Net

Graph 6: FirstRand's dividend yield (2006 - 2016)



Source: Bloomberg

The PSG Diversified Income Fund: income and some capital growth

Ian Scott

Paul Bosman

Basic fund information:

Fund name:	PSG Diversified Income Fund
Fund size:	R998 million
ASISA sector:	South African – Multi Asset – Income
Benchmark:	Inflation plus 1%
Managers:	Ian Scott and Paul Bosman

The fund aims to provide investors with both income and capital growth at low levels of risk

The PSG Diversified Income Fund aims to provide investors with a real income as well as inflation-beating growth over time. To do this, the fund invests predominantly in fixed income assets, but also in instruments that have a small degree of volatility, such as equities and property. Investors who choose this fund should therefore have at least a two-year investment horizon.

One of the significant advantages of investing in a unit trust that has fixed income assets is that it provides investors with access to interest rate markets and the credit market, enabling them to share in exposures that are traditionally only available to institutional investors. Due to the large sums involved, individuals generally do not have the means to invest directly in government and corporate bonds, negotiable certificates of deposit (NCDs) and certain large-cap equity or property stocks. By investing in a fund that is able to buy these instruments, investors can enjoy the benefits of investing in them at a fraction of the capital that would be required for a direct investment.

Investors in this fund are therefore able to enjoy positive inflation-beating yields (and income distributions) while achieving diversified exposure to some growth assets. To put these prospects in perspective: although the fund has the lowest real return benchmark of the funds we currently manage, the total return of this fund (income and capital) over time has exceeded both the benchmark and expectations significantly, with promising real yields locked in over the next 12 to 24 months.

Our fixed income philosophy is the cornerstone on which we build the portfolio

Our philosophy centres on the fact that fixed income markets are inherently inefficiently priced, which allows us to add significant risk-adjusted value by investing in quality assets that offer a sufficient level of pricing asymmetry. However, for us, risk comes first. We will only invest in an instrument if we believe that there is an adequate margin of safety that will not put our investors at risk of a permanent capital loss.

Our Fixed Income Investment Committee helps the fund managers to decide in which instruments to invest

The committee tries to identify where the opportunities are on the yield curve, given the interest rate risk. The fixed income assets that we can choose from include various cash instruments, medium- and longer-dated government bonds, and listed property. For each of these assets our fixed income team determines what we believe the appropriate yield should be via fundamental, bottom-up research and taking into account the macroeconomic environment.

The team looks for mispricings where we believe the value of the instrument is greater than its prevailing market price. If we can acquire and hold these instruments at an appropriate margin of safety to what we determine as fair value, we will place them on our fixed income buy list. From there, the fund managers will populate their funds.

Our Credit Investment Committee helps the fund managers decide to whom we will lend money

The committee is tasked with evaluating credit assets, that is, instruments where a bank, corporate or state-owned enterprise (SOE) aims to raise a sum of money over a particular period of time. The primary role of the Credit Investment Committee is to determine the creditworthiness or quality of the lender to establish the probability of getting back the capital loaned to the entity – this is our first measure of the margin of safety. We will not invest in instruments where we believe the risks of not getting capital back is too great for our investors to bear. Secondly – as with fixed income instruments – we make an evaluation of whether the yield the instrument is offering is below what we see as fair value. This is our second measure of the margin of safety. The most attractive opportunities are where we are satisfied with the quality of a company and are able to buy it at a price below fair value.

Asset allocation is done by considering each instrument's risk/return prospects

When populating the funds that we manage, the fund managers consider the instruments on a risk/return basis relative to our long-term inflation expectation and our required rate of return for each instrument.

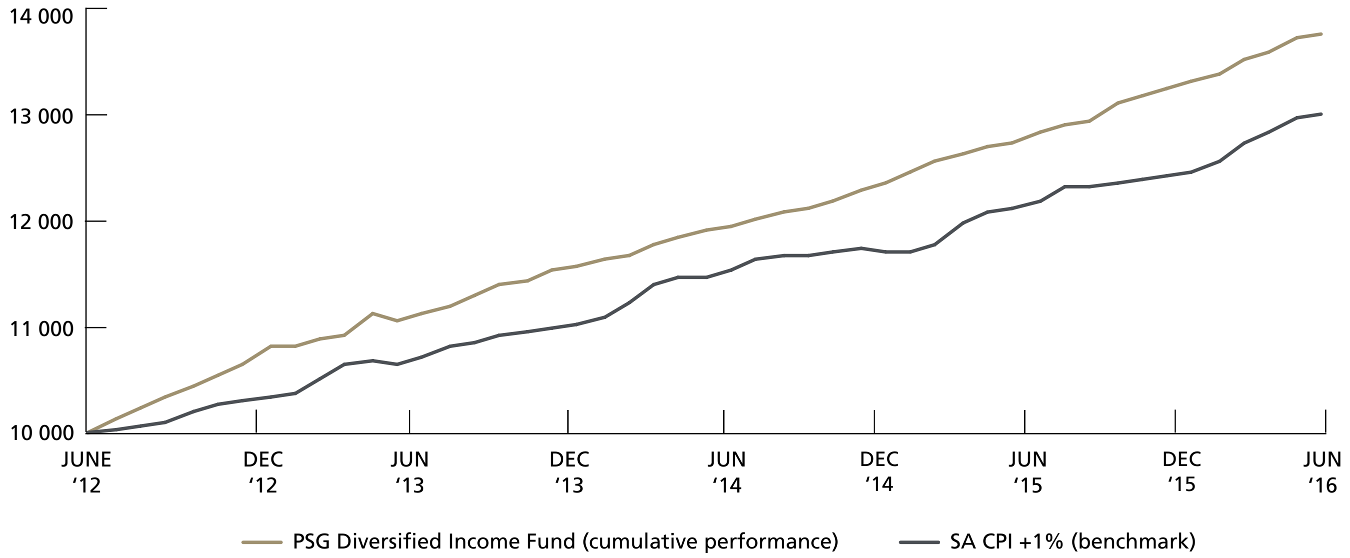
The PSG Diversified Income Fund is able to invest in all the asset classes shown in Graph 1. Choosing from the respective buy lists, the fund managers blend those assets that will provide the appropriate amount of income and growth at the lowest achievable levels of risk, according to their calculations.

The fund should continue to provide income and growth to investors going forward

Since 1 July 2012 the fund has had a total return of 8.3% per year. Over this period inflation averaged 6.7% per year, which has seen the fund nicely outperform its benchmark of CPI plus 1%, while providing investors with significant regular income distributions.

Going forward, we believe that the consistent application of our investment philosophy and processes should continue to deliver investors in this fund with reasonable income and above-inflation capital appreciation over time.

Graph 1: Performance of the PSG Diversified Income Fund (2012 - 2016)



Source: Morningstar Direct

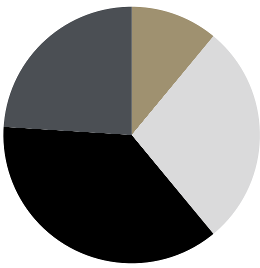
Portfolio holdings as at 30 June 2016

PSG Equity Fund

Top 10 equities

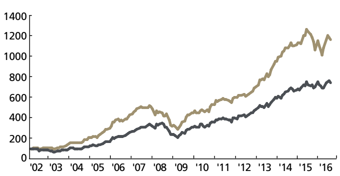
Imperial Holdings Ltd
Glencore plc
FirstRand Ltd
Old Mutual plc
Discovery Holdings Ltd
Softbank Corp
Hudaco Industries Ltd
Nedbank Group Ltd
Grindrod Ltd
Tongaat-Hulett Ltd

Asset allocation



Domestic resources	11%
Domestic financials	28%
Domestic industrials	37%
Foreign equity	24%
Total	**100%**

Performance

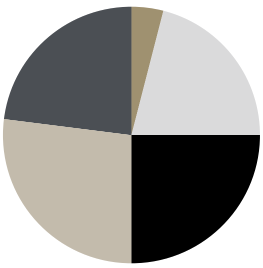


PSG Flexible Fund

Top 10 equities

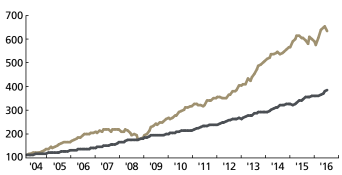
Berkshire Hathaway Inc
FirstRand Ltd
Imperial Holdings Ltd
J Sainsbury plc
Old Mutual plc
Discovery Holdings Ltd
Glencore plc
Super Group Ltd
Reunert Ltd
PSG Group Ltd

Asset allocation



Domestic resources	4%
Domestic financials	21%
Domestic industrials	25%
Domestic cash	27%
Foreign equity	23%
Total	**100%**

Performance

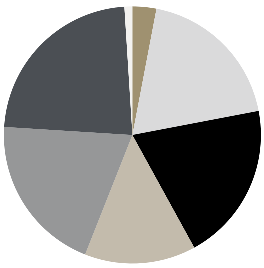


PSG Balanced Fund

Top 10 equities

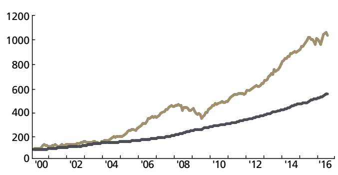
FirstRand Ltd
Berkshire Hathaway Inc
Old Mutual plc
Imperial Holdings Ltd
Brookfield Asset Management Inc
J Sainsbury plc
Super Group Ltd
Discovery Holdings Ltd
Reunert Ltd
Colfax Corp

Asset allocation



Domestic resources	3%
Domestic financials	19%
Domestic industrials	20%
Domestic cash	14%
Domestic bonds	20%
Foreign equity	23%
Foreign cash	1%
Total	**100%**

Performance



PSG Stable Fund

Top 5 equities

FirstRand Ltd
Berkshire Hathaway Inc
Brookfield Asset Management Inc
Old Mutual plc
J Sainsbury plc

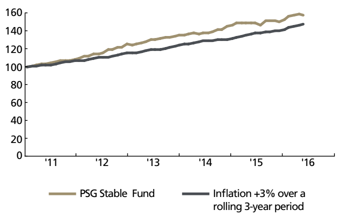
Top 5 issuer exposures

Absa Bank Ltd
Republic of South Africa
FirstRand Bank Ltd
Standard Bank of SA Ltd
Capitec Bank Ltd

Asset allocation

Domestic financials	9%
Domestic industrials	10%
Domestic cash	41%
Domestic bonds	24%
Foreign equity	15%
Foreign cash	1%
Total	**100%**

Performance



PSG Diversified Income Fund

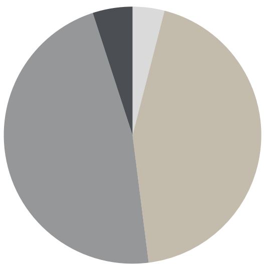
Top 5 equities

Berkshire Hathaway Inc
FirstRand Ltd
Old Mutual plc
J Sainsbury plc
Discovery Holdings Ltd

Top 5 issuer exposures

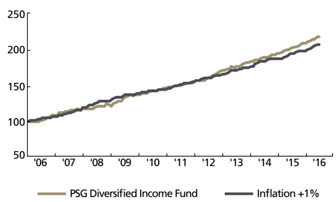
Republic of South Africa
Standard Bank of SA Ltd
Absa Bank Ltd
Nedbank Ltd
FirstRand Bank Ltd

Asset allocation



Domestic equity	4%
Domestic cash	44%
Domestic bonds	47%
Foreign equity	5%
Total	**100%**

Performance

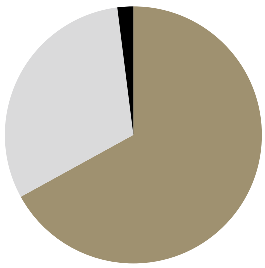


PSG Income Fund

Top 10 bond exposures

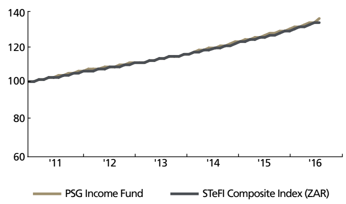
Absa Bank Ltd
FirstRand Bank Ltd
Republic of South Africa
Nedbank Ltd
Standard Bank of SA Ltd
Capitec Bank Ltd
Imperial Holdings Ltd
The Thekwini Fund (RF) Ltd
MMI Group Ltd
Barloworld Ltd

Asset allocation



Fixed rate notes	67%
Floating rate notes	31%
Cash	2%
Total	**100%**

Performance

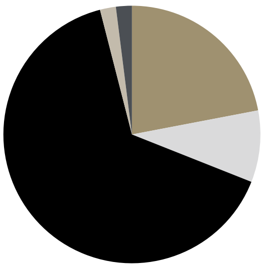


PSG Money Market Fund

Top 10 issuer exposures

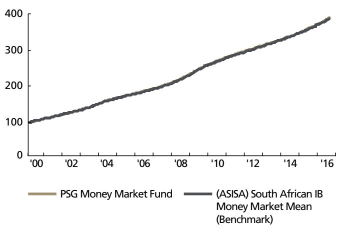
Absa Bank Ltd
FirstRand Bank Ltd
Nedbank Ltd
Standard Bank of SA Ltd
Investec Bank Ltd
Republic of South Africa
Transnet Soc Ltd
Capitec Bank Ltd
Land and Agricultural Development Bank of SA
Steinhoff Services (Pty) Ltd

Asset allocation



Linked NCDs/Floating rate notes	22%
Step rate notes	9%
NCDs	65%
Corporate paper	2%
Bill	2%
Total	**100%**

Performance

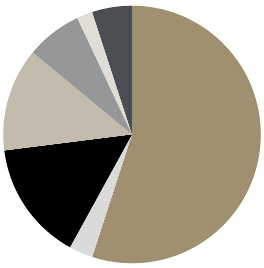


PSG Global Equity Sub-Fund

Top 10 equities

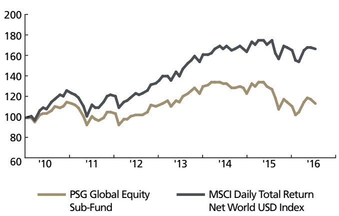
Berkshire Hathaway Inc
Brookfield Asset Management Inc
Softbank Corp
J Sainsbury plc
Capital One Financial Corp
Cisco Systems Inc
Colfax Corp
JP Morgan Chase & Co
Union Pacific Corp
Glencore plc

Regional allocation



US	55%
Europe	3%
UK	15%
Asia	13%
Canada	7%
Singapore	2%
Cash	5%
Total	**100%**

Performance

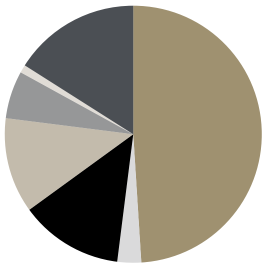


PSG Global Flexible Sub-Fund

Top 10 equities

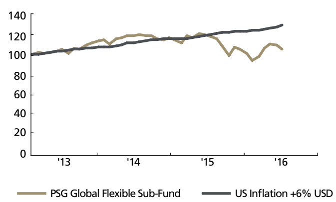
Berkshire Hathaway Inc
Capital One Financial Corp
Brookfield Asset Management Inc
Softbank Corp
J Sainsbury plc
JP Morgan Chase & Co
Cisco Systems Inc
Colfax Corp
Union Pacific Corp
Glencore plc

Regional allocation



US	49%
Europe	3%
UK	13%
Asia	12%
Canada	6%
Singapore	1%
Cash	16%
Total	**100%**

Performance



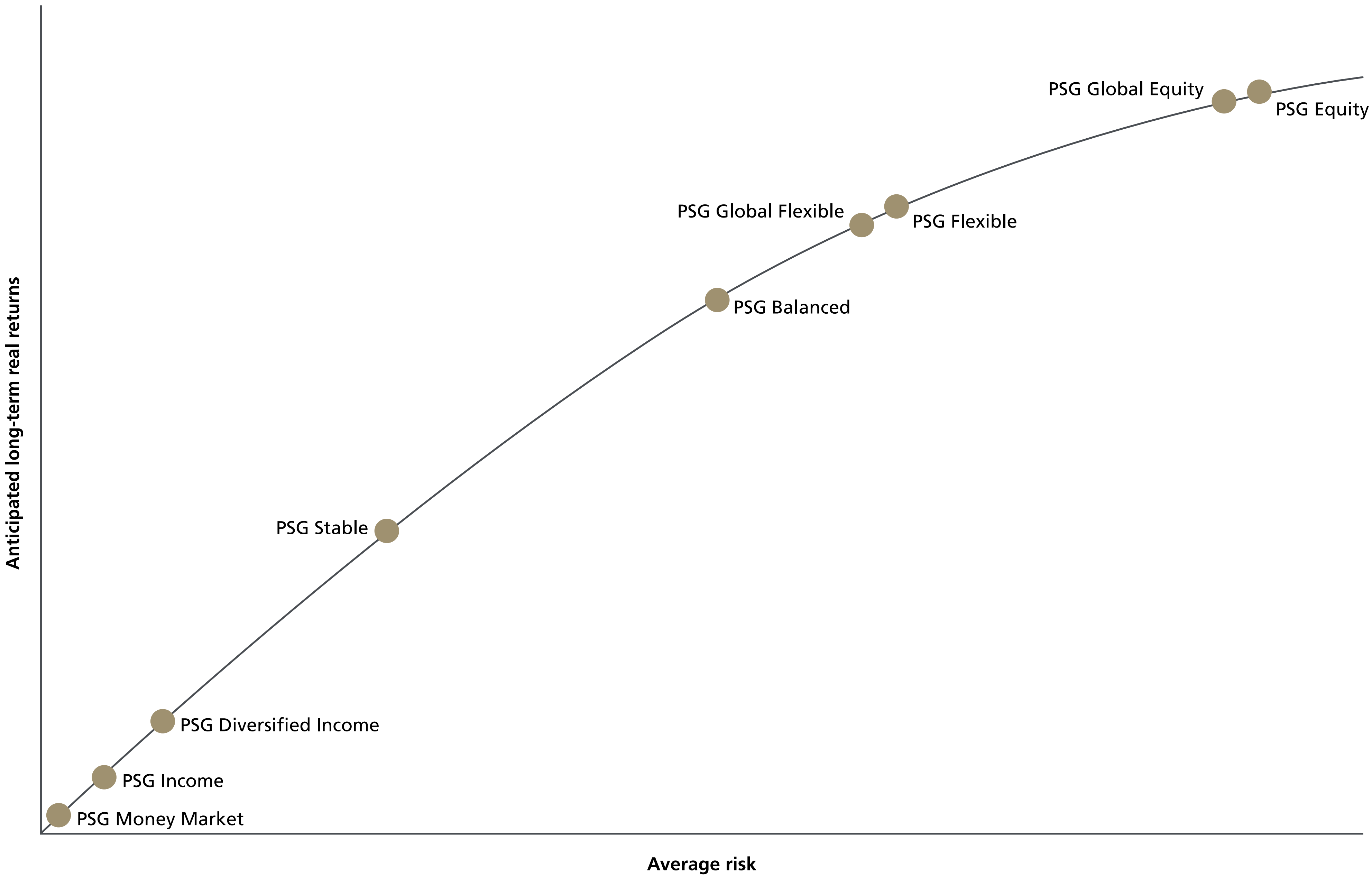
Percentage annualised performance to 30 June 2016 (net of fees)

Local funds							
	1 Year	2 Years	3 Years	5 Years	10 Years	Inception	Inception date
PSG Equity Fund A	-3.45	2.80	13.25	15.08	11.87	18.64	01/03/2002
FTSE/JSE All Share Total Return Index	3.82	4.30	13.03	13.80	12.62	14.99	
PSG Flexible Fund A	4.83	8.55	14.84	14.86	14.92	17.10	01/11/2004
Inflation +6%	12.12	11.37	11.80	11.72	12.30	12.04	
PSG Balanced Fund A	3.48	7.50	11.97	13.27	10.92	14.68	01/06/1999
Inflation +5%	11.10	10.34	10.77	10.70	11.33	10.65	
PSG Stable Fund A	6.26	7.46	8.50			10.22	13/09/2011
Inflation +3% over a rolling 3-year period	9.10	8.34	8.77			8.69	
PSG Diversified Income Fund A	8.01	7.52	7.59	7.80	8.07	7.85	07/04/2006
Inflation +1%	7.11	6.34	6.77	6.69	7.33	7.35	
PSG Income Fund A	7.58	7.09	6.63			6.18	01/09/2011
STeFI Composite Index	6.83	6.55	6.18			5.90	
PSG Money Market Fund A	6.84	6.58	6.15	5.78	7.27	8.61	19/10/1998
South African Interest Bearing Money Market Mean	6.90	6.53	6.14	5.81	7.28	8.60	
PSG Global Equity Feeder Fund A	-0.91	5.78	12.30	15.44		13.95	03/05/2011
MSCI Daily Total Return Net World USD Index (in ZAR)	17.26	16.50	21.74	24.37		23.41	
PSG Global Flexible Feeder Fund A	3.47	9.21	13.35			16.17	10/04/2013
US Inflation +6% (in ZAR)	29.07	24.93	21.84			25.00	

International funds							
	1 Year	2 Years	3 Years	5 Years	10 Years	Inception	Inception date
PSG Global Equity Sub-Fund A	-13.19	-8.28	0.69	0.35		2.19	23/07/2010
MSCI Daily Total Return Net World USD Index	-2.77	-0.70	6.95	6.62		9.08	
PSG Global Flexible Sub-Fund A	-9.82	-5.79	1.24			1.54	02/01/2013
US Inflation +6% (USD)	7.01	6.49	7.04			7.25	

Source: 2016 Morningstar Inc. All rights reserved as at end of June 2016.
Annualised performances show longer term performance rescaled over a 12-month period.
Annualised performance is the average return per year over the period.
Past performance is not necessarily a guide to future performance.

Risk/return profile



Unit trust summary

	South African portfolios							Rand-denominated offshore	
	PSG Equity Fund	PSG Flexible Fund	PSG Balanced Fund	PSG Stable Fund	PSG Diversified Income Fund	PSG Income Fund	PSG Money Market Fund	PSG Global Equity Feeder Fund	PSG Global Flexible Feeder Fund
Fund category (ASISA classification)	South African - Equity - General	South African - Multi Asset - Flexible	South African - Multi Asset - High Equity	South African - Multi Asset - Low Equity	South African - Multi Asset- Income	South African - Interest Bearing - Short-term	South African - Interest Bearing - Money Market	Global - Equity - General	Global - Multi Asset - Flexible
Investment objective	Provide long-term capital growth and deliver a higher rate of return than that of the South African equity market within an acceptable risk profile.	Achieve superior medium- to long-term capital growth through exposure to selected sectors of the equity, bond and money markets.	Provide long-term capital growth and a reasonable level of income.	Seek to generate a performance return of CPI+3% over a rolling 3-year period, while aiming to achieve capital appreciation with low volatility and low correlation to equity markets through all market cycles.	Preserve capital and maximise income returns for investors. The fund conforms to legislation governing retirement funds.	Maximise income and preserve capital while achieving long-term capital appreciation as interest rate cycles allow.	Provide capital security, a steady income yield and high liquidity.	Outperform the average of the world's equity markets, as represented by the MSCI Daily Total Return Net World USD Index (in ZAR).	Achieve superior medium- to long-term capital growth through exposure to selected sectors of the global equity, bond and money markets.
Benchmark	FTSE/JSE All Share Total Return Index	Inflation +6%	Inflation +5%	Inflation +3% over rolling 3-year period	Inflation +1%	STeFI Composite Index	South African - Interest Bearing - Money Market mean	MSCI Daily Total Return Net World USD Index (in ZAR)	US Inflation +6% (in ZAR)
Risk rating	High	Moderate - High	Moderate - High	Moderate	Low - Moderate	Low - Moderate	Low	High	Moderate - High
Time horizon	5 year +	3 year +	3 year +	2 year +	24 months	1 year +	1 month +	4 year +	4 year +
The Fund is suitable for investors who:	• seek an equity-focused portfolio that has outstanding growth potential • aim to maximise potential returns within an acceptable risk profile • focus on a long-term investment horizon	• seek exposure to the equity market but with managed risk levels • aim to build wealth • focus on a medium- to long-term investment horizon	• would prefer the fund manager to make the asset allocation decisions • aim to build wealth within a moderate risk investment • have a time horizon of at least 3 years and can withstand short-term market fluctuations • want a balanced portfolio that diversifies the risk over the various asset classes • want long-term retirement savings	• have a low risk appetite but require capital growth in real terms • focus on a short- to medium-term investment horizon	• have a low risk appetite and an income requirement • want to earn an income, but need to try and beat inflation • focus on a short- to medium-term investment horizon	• have a low risk appetite with an income requirement • focus on a short- to medium-term investment horizon	• seek capital stability, interest income and high liquidity through a low- risk investment • need an interim investment vehicle or 'parking bay' for surplus funds • focus on a short- to medium-term investment horizon	• seek an equity-focused portfolio that has outstanding growth potential • aim to maximise potential returns within a moderate risk investment • focus on a long-term investment horizon	• want a managed solution in offshore markets • want to diversify their holdings across the world • focus on a medium- to long-term investment horizon
Net equity exposure	100%	0% - 100%	0% - 75%	0% - 40%	0% - 10%	0%	0%	100%	40% - 75%
Income distribution	Bi-annually	Bi-annually	Bi-annually	Bi-annually	Quarterly	Quarterly	Monthly	Annually	Annually
Minimum investment	R2 000 lump sum, or R250 monthly debit order	R2 000 lump sum, or R250 monthly debit order	R2 000 lump sum, or R250 monthly debit order	R2 000 lump sum, or R250 monthly debit order	R2 000 lump sum, or R250 monthly debit order	R2 000 lump sum, or R250 monthly debit order	R25 000 lump sum	R2 000 lump sum	R2 000 lump sum
Fees (incl. VAT)	Annual management fee: Class A: 1.71% Class B: 1.14% + 22.8% of outperformance of benchmark	Annual management fee: Class A: 1.14% + 7.98% of outperformance of high watermark	Annual management fee: Class A: 1.71% Class B: 1.14% + 7.98% of outperformance of high watermark	Annual management fee: Class A: 1.71%	Annual management fee: Class A: 1.14%	Annual management fee: Class A: 0.74%	Annual management fee: Class A: 0.57% Class B: 0.17%	Annual management fee: Class A: 0.86%	Annual management fee: Class A: 0.86% Class B: 0.29%
Compliance with Prudential Investment Guidelines (Regulation 28)	No	No	Yes	Yes	Yes	No	Yes	No	No

For full disclosure on all costs and fees refer to the Minimum Disclosure Documents on our website.

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Trustee: The Standard Bank of South Africa Limited, Main Tower, Standard Bank Centre, 2 Hertzog Boulevard, Cape Town, 8001. Tel: +27 (21) 401 2443. Email: compliance-PSG@standardbank.co.za. **Conflict of Interest Disclosure:** The Fund may from time to time invest in a portfolio managed by a related party. PSG Collective Investments (RF) Limited or the Fund Manager may negotiate a discount in fees charged by the underlying portfolio. All discounts negotiated are re-invested in the Fund for the benefit of the investor. Neither PSG Collective Investments (RF) Limited nor PSG Asset Management (Pty) Ltd retains any portion of such discount for their own accounts. The Fund Manager may use the brokerage services of a related party, PSG Securities Ltd.

PSG Collective Investments (RF) Limited does not provide any guarantee either with respect to the capital or the return of the portfolio and can be contacted on 0800 600 168 or on e-mail at assetmanagement@psg.co.za.

Date issued: 29 July 2016

PSG Asset Management