Product Assessment

Report as at 25 Sep 2024

RECOMMENDED

Allan Gray Australia Balanced Fund

Rating issued on 25 Sep 2024 | APIR: ETL4654AU | mFund: AQY03

Investment objective

To outperform a customised benchmark, balancing capital growth, income generation, over rolling three-year periods. The benchmark is comprised of the following: 36% S&P/ASX 300 Accumulation Index; 24% Bloomberg AusBond Government Bond Index; 24% MSCI World Index (net dividends reinvested) expressed in AUD; and 16% JPMorgan Global Government Bond Index expressed in AUD.

Manager	Allan Gray Australia Pty Limited
Distributor	Allan Gray Australia Pty Limited
Sector	Multi-Asset \ Growth
Investment Style	Active
RI Classification	Integrated
Absolute Risk	High
Relative Risk	Active - Strategic AA Focussed
Investment Timeframe	5-6 Years
Benchmark	Diversified Market Growth Benchmark
Min Investment Amount	$10,000
Redemption Frequency	Daily
Income Distribution	Annually
Fund Size (30 Aug 2024)	$190.56M
Management Cost	0.76% p.a. Incl. GST
Performance Fee	The performance fee is 20% of the Fund's outperformance, net of the base fee, in comparison to the Benchmark
Buy / Sell Spread	0.20% / 0.20%
Inception Date	30 Apr 2017

Fund facts

- A moderate to high risk strategy with a SAA comprising 60%/40% exposure to growth/defensive assets
- Managed to broad asset allocation ranges
- Deep value investment approach with the portfolio built on a security-by-security basis

Viewpoint

The Fund, managed by Sydney-based, Allan Gray Australia (Allan Gray) invests in a mix of Equity, Fixed Income and commodity securities across Australian and Global markets. Employing a value-based investment process, the firm draws on the collective expertise of Allan Gray and its parent firm, Orbis Investment Management (Orbis), who is responsible for managing the global portion of the portfolio. Allan Gray's proven ability to generate excess returns from bottom-up security selection and holistic approach to portfolio construction underpins Zenith's conviction in the Fund. Further, we believe the Fund is well-positioned to meet its investment objectives through the cycle.

Portfolio Managers, Simon Mawhinney (Allan Gray) and Alec Cutler (Orbis) co-manage the Fund with each maintaining autonomy over their respective sleeve. Mawhinney is responsible for selecting all domestic securities (including equities and bonds) while Cutler is responsible for populating the Fund's global holdings. Zenith maintains a high opinion of Mawhinney noting his ability to detach his investment decision-making from consensus and apply the firm's value investment approach in a rigorous manner.

The Fund's Strategic Asset Allocation (SAA) is based on a 60%/40% allocation to equities and bonds and within each bucket, Allan Gray seeks to achieve a similar split between Australian and global securities i.e. 60% and 40%, respectively. Zenith notes that these allocations will vary through the investment cycle and are subject to relative valuations across the respective asset classes. The split between equities and bonds is largely an outworking of the bottom-up opportunities identified through the security selection phase.

Zenith highlights the simplicity of Allan Gray's SAA setting process, in particular its limited focus on adding value from revising the SAA or implementing active asset allocation strategies. In our opinion, while the approach has narrow breadth in terms of excess return drivers, the quality of Allan Gray's bottom-up research mitigates the one dimensional focus.

Allan Gray assesses each investment idea and the perceived risk/reward relationship, seeking to identify the best ideas whilst adhering to broad risk constraints. These are derived by ranking stocks by valuation discounts, with the highest discounts considered the most attractive. The stocks selected are then assessed relative to cash on a risk/reward basis, resulting in only the best risk-adjusted ideas being selected.

The final portfolio represents an amalgam of the domestic and global portfolios. The two portfolios are generally complementary in terms of positioning, however where there is duplication of holdings or unintended aggregations of risk, the portfolio managers will collaborate to ensure the portfolio reflects the collective views of the respective team. Where there are divergent views on the Fund's domestic/global split, Mawhinney retains the final veto on all portfolio decisions.

Zenith highlights the mismatch between the Fund's underlying investment strategy and the composition of its benchmark, as it pertains to the calculation of performance fees. The Fund invests in a mix of government and credit securities, while the benchmark only includes the JPMorgan Global Government Bond Index expressed in AUD i.e. sovereign only. Zenith would prefer the benchmark be aligned with the Fund's investment strategy via the inclusion of an aggregate benchmark i.e. Bloomberg Global Aggregate Index, and/or a high yield index.

This document has been prepared by Zenith. Zenith's Financial Services Guide is available at https://www.zenithpartners.com.au/important-information/financial-services-guide/ and full details regarding Zenith's contact details, research processes, ratings information and conflicts of interest are available at https://www.zenithpartners.com.au/our-solutions/investment-research/fund-research-regulatory-guidelines/

Fund analysis

Fund characteristics

Constraint	Value
Equities (incl. domestic and global)	40% to 90%
Fixed Income (incl. cash)	10% to 50%
Commodities	0% to 10%
Maximum exposure to single issuer	Up to 20%
Unlisted securities	Up to 10% of portfolio value

Investment objective and philosophy

The Fund seeks to outperform a customised benchmark, balancing capital growth, income generation, over rolling three-year periods. The benchmark is comprised of the following: 36% S&P/ASX 300 Accumulation Index; 24% Bloomberg AusBond Government Bond Index; 24% MSCI World Index (net dividends reinvested) expressed in AUD; and 16% JPMorgan Global Government Bond Index expressed in AUD.

Zenith highlights that while the customised benchmark is for reference/reporting purposes only, there is an embedded mismatch with the underlying composition of the portfolio. For example, the Fund is permitted to hold sub-investment grade corporate securities, while sovereign bond indices are included in the Fund's benchmark. Zenith would prefer to see this aspect of the process tightened i.e. including an aggregate benchmark that includes credit securities, particularly as it applies to performance fee calculations.

Allan Gray's contrarian investment philosophy centres on the belief that equity markets are not always efficient or rational. Investors may be motivated by greed and fear, succumbing to herd instincts, often overlooking a company's fundamental worth. As a result, a company's share price may deviate substantially from its intrinsic value over the short to medium-term.

Allan Gray seeks to identify companies/securities that are misunderstood or out of favour, and trading significantly below their long-term intrinsic value. Applying in-depth bottom-up fundamental research, Allan Gray assesses the perceived risk and reward relationship of each investment idea. The Fund invests in these securities (equities or debt), believing that business fundamentals will prevail over market noise over the longer-term, thus, resulting in convergence between prevailing prices and intrinsic value.

The Fund's Strategic Asset Allocation (SAA) is based on a 60%/40% allocation to equities and bonds. Within each bucket, Allan Gray seeks to achieve a similar split between Australian and global securities i.e. 60% and 40%, respectively. Subject to relative valuations across respective asset classes, Zenith notes that this split can vary through the investment cycle, noting that the Fund is managed according to non-invasive asset allocation ranges.

In terms of the complementarity between the domestic and global components, the respective portfolio managers discuss the portfolio on a regular basis, with a particular emphasis on exploring the impact of overlapping or divergent views. In a practical context, this means understanding how the combination of their separate views and themes interact at a portfolio level and ensuring it is managed in accordance with its moderate risk mandate.

Zenith highlights the simplicity of Allan Gray's SAA setting process, in particular its limited focus on adding value from revising the SAA or implementing active asset allocation strategies. Instead, the Fund's asset allocation will change over time, reflecting the breadth and quality of ideas identified through the security selection process. In our opinion, while the approach has narrow breadth in terms of excess return drivers, the quality of Allan Gray's bottom-up research mitigates the one-dimensional focus.

Portfolio applications

The Fund is suitable for investors with a moderate to high risk tolerance, noting its flexible asset allocation ranges. The Fund is expected to provide sound capital growth over the medium to long-term. Zenith considers an appropriate investment horizon to be three or more years.

While Allan Gray's focus on selecting stocks with an acceptable 'margin of safety' or discount to fair value, should act to dampen volatility (as measured by Standard Deviation), Zenith highlights that there is a risk of capital variability, particularly in stressed equity environments.

Allan Gray has provided an indicative Standard Risk Measure (SRM) for the Fund of three to less than four negative annual returns over 20 years. This SRM was last calculated in July 2024 by Allan Gray based on the categories provided for in the SRM guidance issued jointly by AFSA and the FSC in July 2011.

Zenith considers the Fund to be suitable as a standalone investment, or as a complement to a broader portfolio that seeks to produce outcomes consistent with an investors risk/return preferences. The Fund is structured to pay distributions on an annual basis, and therefore may not be suitable for investors requiring more frequent income distributions.

Fund responsible investment attributes

Key Information	Description
Zenith RI classification*	Integrated
Has Responsible Investment Policy	Yes
PRI Status	
PRI Signatory	Yes

*Zenith RI Classification scale:

- Traditional
- Aware
- Integrated
- Thematic
- Impact

Absolute performance

Performance as at 31 Aug 2024

Monthly performance history (%, net of fees)

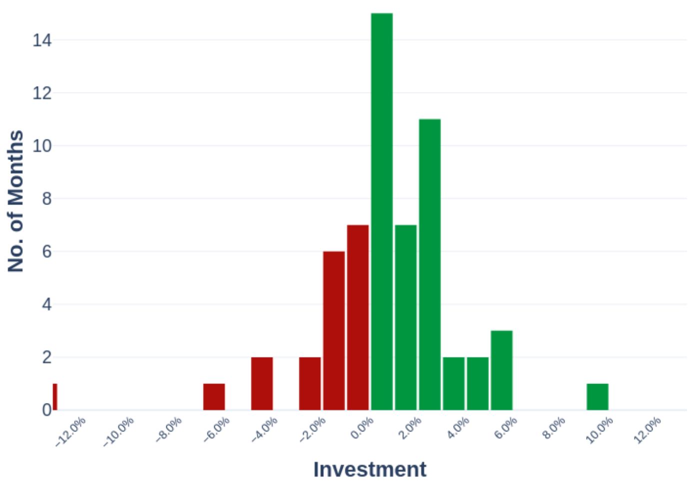
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	BM YTD*
2024	0.97%	0.74%	5.50%	-0.45%	0.55%	-0.52%	5.22%	0.38%					12.86%	9.34%
2023	2.56%	-0.23%	0.94%	2.04%	-1.81%	0.61%	2.64%	-1.15%	-1.91%	-2.43%	1.75%	3.75%	6.74%	12.61%
2022	1.57%	3.18%	2.08%	0.11%	-1.03%	-6.79%	2.32%	0.88%	-4.57%	5.56%	4.21%	0.24%	7.30%	-8.34%
2021	0.65%	2.21%	2.29%	0.30%	1.90%	0.06%	-0.12%	1.74%	0.80%	-0.52%	-1.46%	2.68%	10.96%	14.64%
2020	0.86%	-4.35%	-13.13%	4.90%	2.57%	-0.28%	-0.88%	2.38%	-2.90%	1.47%	9.42%	1.56%	-0.10%	4.54%

Diversified Market Growth Benchmark

Growth of $10,000

Risk / return

Monthly histogram



Minimum and maximum returns (% p.a.)

Absolute performance analysis

Instrument	1 Yr	3 Yrs	5 Yrs	7 Yrs	Inception
Investment	**14.03%**	**9.46%**	**8.29%**	**7.68%**	**7.75%**
Income	4.77%	6.24%	4.52%	4.19%	4.03%
Growth	9.26%	3.22%	3.77%	3.48%	3.72%
Benchmark	**13.61%**	**4.52%**	**6.83%**	**7.64%**	**7.39%**
Median	**12.93%**	**4.18%**	**5.93%**	**6.44%**	**6.28%**
Cash	**4.35%**	**2.68%**	**1.74%**	**1.77%**	**1.77%**

Ranking within sector (p.a.)

Ranking within Sector	1 Yr	3 Yrs	5 Yrs	Inception
Fund Ranking	9 / 57	2 / 53	2 / 49	6 / 44
Quartile	1st	1st	1st	1st

Absolute risk

Instrument	1 Yr	3 Yrs	5 Yrs	7 Yrs	Inception
Standard Deviation (% p.a.)					
Investment	8.45%	8.90%	10.87%	9.95%	9.69%
Benchmark	8.60%	9.93%	11.11%	9.98%	9.72%
Median	8.06%	8.78%	9.65%	8.70%	8.47%
Downside Deviation (% p.a.)					
Investment	3.17%	5.33%	7.57%	6.88%	6.69%
Benchmark	4.59%	6.50%	7.92%	6.96%	6.77%
Median	4.26%	5.72%	6.95%	6.12%	5.95%

Absolute risk/return ratios

Instrument	1 Yr	3 Yrs	5 Yrs	7 Yrs	Inception
Sharpe Ratio (p.a.)					
Investment	1.15	0.76	0.60	0.59	0.62
Benchmark	1.08	0.19	0.46	0.59	0.58
Median	1.06	0.17	0.43	0.54	0.53
Sortino Ratio (p.a.)					
Investment	3.06	1.27	0.86	0.86	0.89
Benchmark	2.02	0.28	0.64	0.84	0.83
Median	2.02	0.26	0.60	0.76	0.76

Zenith benchmarks funds in the 'Multi-Asset - Growth' peer group against the Zenith Diversified Growth Benchmark. While this benchmark may not be consistent with the one adhered to by all rated participants, it has been adopted to provide investors with a common reference point against which similarly structured strategies may be assessed.

The Fund seeks to outperform a customised benchmark, balancing capital growth, income generation, over rolling three-year periods. The benchmark is comprised of the following: 36% S&P/ASX 300 Accumulation Index; 24% Bloomberg AusBond Government Bond Index; 24% MSCI World Index (net dividends reinvested) expressed in AUD; and 16% JPMorgan Global Government Bond Index expressed in AUD.

All commentary below is effective as at 31 August 2024.

The Fund has outperformed its customised benchmark on a since inception basis and has outperformed the median manager over all periods of assessment. In addition, the Fund has featured in the upper quartiles of its peer group over all periods of assessment.

The Fund's volatility (in terms of Standard Deviation) has been higher than the median manager when assessed over a range of time frames.

Relative performance

Excess returns

Statistic	1 Yr	3 Yrs	5 Yrs	7 Yrs	Inception
Excess Return	0.42%	4.94%	1.46%	0.03%	0.36%
Monthly Excess (All Mkts)	33.33%	52.78%	48.33%	47.62%	48.31%
Monthly Excess (Up Mkts)	22.22%	38.10%	35.90%	36.36%	37.93%
Monthly Excess (Down Mkts)	66.67%	73.33%	71.43%	68.97%	67.74%

Capture ratios (% p.a.)

Statistic	1 Yr	3 Yrs	5 Yrs	7 Yrs	Inception
Downside Capture	60.56%	37.91%	56.84%	64.19%	62.52%
Upside Capture	86.28%	81.04%	79.34%	79.28%	80.31%

Tracking error (% p.a.)

Instrument	1 Yr	3 Yrs	5 Yrs	7 Yrs	Inception
Investment	5.87%	6.62%	5.95%	5.66%	5.54%
Median	0.97%	1.61%	1.86%	1.65%	1.61%

Information ratio

Instrument	1 Yr	3 Yrs	5 Yrs	7 Yrs	Inception
Investment	0.07	0.75	0.24	0.01	0.06
Median	-0.71	-0.21	-0.49	-0.73	-0.69

Beta statistics

Statistic	1 Yr	3 Yrs	5 Yrs	7 Yrs	Inception
Beta	0.75	0.68	0.84	0.84	0.84
R-Squared	0.58	0.57	0.73	0.70	0.70
Correlation	0.76	0.76	0.85	0.84	0.84

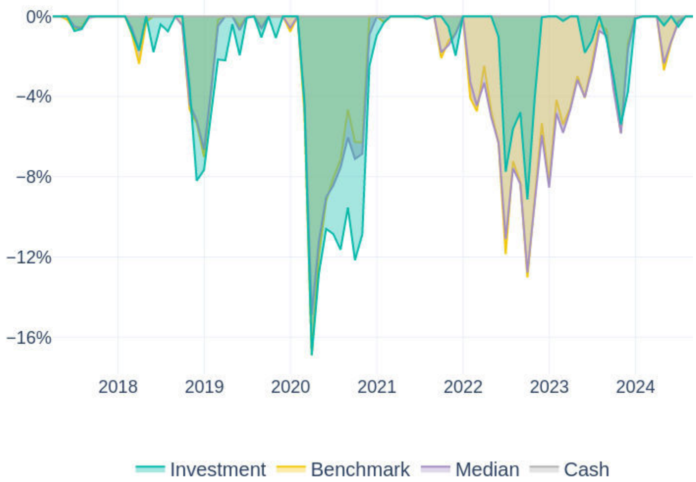
All commentary below is effective as at 31 August 2024.

Zenith seeks to identify funds that can outperform in over 50% of months in 'all' market conditions, as we believe this represents consistency of manager skill.

The Fund has mixed success in achieving this consistency ratio across all markets over most periods of assessment with more success outperforming in 'down' markets than 'up' markets.

Drawdown analysis (since inception)

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.



All commentary below is effective as at 31 August 2024.

In recent years, the Fund has exhibited a more constrained drawdown profile relative to both the Zenith assigned benchmark and peer median manager.

Fund commentary

Fund risks

Zenith has identified the following key risks of the Fund. Although Zenith believes the risks noted are all significant, we have listed them in order of importance. In addition, we have not intended to highlight all possible risks.

Key person risk: Key person risk exists with Mawhinney and Cutler, with the departure of either warranting a reassessment of Zenith's rating. However, this risk is largely mitigated noting both maintain an ownership stake in Allan Gray and Orbis.

Portfolio manager focus risk: Mawhinney maintains a broad range of management and investment responsibilities, including leading the firm's Australian equity capability. As such, there is a risk that Mawhinney's focus on the Fund is diluted, potentially to the detriment of performance. Despite this, Zenith highlights the overlap between the holdings of this Fund and Allan Gray's flagship Australian equity strategy, which partly mitigates this risk.

Investment style risk: The Fund's equity exposure follows a value-based benchmark unaware investment approach, which may result in the performance of the equity exposure diverging substantially from the benchmark.

Hybrid security risk: Investors should be aware that hybrids may at times exhibit risk/return characteristics similar to that of listed equities, and this may in turn contribute to the overall volatility of the Fund.

Sub-investment grade risk: By its nature and as reflected by its rating, sub-investment grade debt has a higher potential of default. Although investors have historically been compensated, in the form of excess returns, for defaults in the broader asset class, there is potential for the strategy to experience more defaults than the broader market. Additionally, defaults tend to cluster in certain years and therefore investors should expect periodic episodes of higher defaults.

Security/asset selection

The security selection process is a joint responsibility between Mawhinney, who oversees the domestic portion of the portfolio, and Cutler, who manages the global component.

Equity selection

In terms of equity selection, Allan Gray and Orbis employ a similar security selection process, with each approach tailored to the respective nuances of each market.

Initially, ideas are generated through the use of a variety of qualitative and quantitative tools, which are supported by Allan Gray's proprietary company database, tracking prices and fundamental company data for more than 9,000 companies globally. Metrics employed in the screen includes:

- Long-term return on equity
- Long-term total net asset value (TNAV) growth
- Long-term revenue and earnings growth
- Debt/TNAV
- Cash/TNAV

Analysts are afforded the discretion to use parameters which are deemed to be relevant to a particular company or situation. The output of the screen creates a short-list of investment ideas for further evaluation. An important qualitative overlay is applied to the process where the analyst seeks to understand the reasons the company looks undervalued, and whether the concerns are legitimate.

For any company that passes the initial analysis, the analyst conducts in-depth bottom-up, fundamental research to determine whether there is an attractive investment opportunity. One of the key objectives of the research process is to thoroughly understand the underlying drivers of the company, with factors such as competitive position, management quality and return on capital considered paramount. Zenith believes the research reports are of a high quality and a competitive advantage of the Fund.

Contact with company management is a key focus, particularly in the later stages of research and ongoing reviews. The aim of the research process is to produce an internally generated assessment of the company's long-term intrinsic value. This assessment is compared against current market price to determine a stock's level of attractiveness.

A key difference between the stock selection for this strategy and Allan Gray/Orbis' flagship equity strategies, is the additional hurdle, defined as an increased discount to valuation, required for a stock’s inclusion into this Fund. Furthermore, to manage the portfolio’s downside volatility, companies with lower gearing levels and less cyclical earnings streams are typically prioritised.

An important component of the research process is peer review. Analysts present their investment ideas to the broader team for rigorous debate, with the team actively attempting to find flaws in every investment thesis. The peer review provides an additional layer of robustness to the investment process, as well as further insight into a stock's downside risk. Zenith believes the research process is sound and displays a high degree of independent thought.

The process concludes with the analyst presenting the investment idea at a Policy Group Meeting (PGM), which is held on an ad-hoc basis, as ideas are brought forward. The PGM structure provides a forum for portfolio managers to consider new ideas and challenge the underlying investment thesis supporting each recommendation. If the idea is approved, the portfolio manager will determine the appropriate position sizing.

Stocks selected for inclusion within the portfolio are often considered 'contrarian investments', with Allan Gray generally preferring companies that are out of favour with brokers and the general industry. This contrarian approach can lead to short-term volatility and Tracking Error from the Fund's equity portion of the benchmark; however, Zenith believes that the analytical depth and rigour of Allan Gray's process generally prevails over the long-term.

Overall, Zenith has confidence in the analytical depth and rigour of the Allan Gray/Orbis stock selection process. In addition, we believe the research process provides analysts with considerable freedom and the robust peer review process ensures investment discipline is maintained across all investment ideas.

Government bond/credit selection

Similar to the above-mentioned equity selection process, the Fund's underlying fixed interest securities are selected by Mawhinney and Cutler, who are responsible for populating the domestic and global fixed interest sleeves, respectively.

The domestic fixed interest universe includes Cash, Hybrids and Government Bonds. A key feature of the Fund's asset allocation approach is a meaningful exposure to government bonds which are principally held to balance portfolio risk, provide liquidity and as an additional source of return.

In terms of key interest rate and curve decisions, Allan Gray assesses the level of prevailing long-term bond yields relative to history, purchasing physical bonds based on its assessment of the level of undervaluation.

Zenith notes that the Fund's government bond holdings are typically held in the context of balancing risk at the portfolio level, as opposed to identifying the most attractive bonds based on a specific view on monetary policy and the direction of interest rates.

In our opinion, we believe there is scope to enhance this aspect of the process, including introducing a more structured view of domestic and global interest rate policies and deeper analysis of the shape and slope of the yield curve (to highlight roll down opportunities).

Cutler is responsible for selecting government, inflation-linked and corporate securities within the global component of the portfolio. The process is supported by a range of screening tools which rank the investable universe by a range of yield/spread metrics i.e. yield-to-worst, yield to maturity etc. The screening process can be tailored to focus on those segments of the market that are out-of-favour.

The government bond process is managed in parallel with Orbis' active currency approach, where country analysts are responsible for assessing interest rate, inflation, sovereign and political risk. This is synthesised into a view on the attractiveness of local cash rates and break-even inflation rates, with a requirement that any duration risk is compensated with a commensurate pick-up in yield.

The corporate bond research effort leverages Orbis' company research capabilities, with a focus on bottom-up fundamental analysis. If a bond trades below its intrinsic value i.e. comparing the current yield to Orbis' assessment of fair value, then the security is considered for the portfolio. Where a corporate bond has a high default risk, but with tangible underlying assets, it is willing to accept an equity swap or receive assets from the business. All securities are purchased with the intention of holding to maturity or redemption.

Zenith notes that Orbis' approach to corporate credit selection is highly targeted and akin to a 'distressed credit' investing philosophy. That is, seeking to identify deeply mispriced securities with high underlying intrinsic value but with a commensurate level of default risk. While this style of approach has the potential to generate attractive risk-adjusted returns, it also introduces additional default risk and spread volatility. In Zenith's opinion, the quality and depth of Orbis' bottom-up research supports this approach, particularly with respect to decomposing the value of a business in the case of an equity swap or asset sale.

Commodities

Allan Gray has the flexibility to invest up to 10% of the portfolio in commodities where the asset class is deemed to be more attractive relative to the fixed income and equity sectors. The decision to invest is principally a relative value decision between investing in the physical commodity (via futures or exchange traded funds) versus an underlying stock or bond, which provides a similar economic exposure i.e. a company whose primary source of revenue is mining a particular commodity (e.g. gold, silver etc). Further, the inclusion of commodities can also be based on the diversification requirements of the portfolio, such as diversifying equity risk.

Where Allan Gray's bottom-up research of basic materials companies identifies a strong thematic supporting a particular commodity, it will seek to express this view by identifying high quality companies in the sector, that are well managed with low costs of production. If Allan Gray's bottom-up research cannot identify these companies, the portfolio managers have the flexibility to invest directly in the commodity, thus capturing the thematic while at the same time, removing the operational and execution risk of a poorly managed miner.

Zenith is supportive of Allan Gray's approach noting that over the longer-term mining companies have tended to underperform the price inflation of their respective underlying commodities. Historically, the Fund's commodity exposure has generally been limited to holding 'risk-off' positions such as precious metals i.e. gold, which protect the portfolio during periods of equity market stress.

Responsible investment approach

Allan Gray has been a signatory to the Principles for Responsible Investment (PRI) since 2018 and has an established Statement of Responsible Investing that is publicly available for viewing, which was last updated in May 2023.

The Fund is not explicitly limited from investing in any individual company based on environmental, social and governance (ESG) considerations and as such may hold exposures to those considered unethical (i.e. tobacco manufacturers).

However, relevant ESG factors are evaluated as part of each analyst's fundamental analysis, which are those they consider to be potentially material to their intrinsic value assessment and could impact the sustainability of profits. These are outlined in the research reports submitted on each company. The same approach is also applied to fixed income securities.

Allan Gray has appointed Stephanie Derrington as a dedicated ESG analyst. Notwithstanding this, analysis of ESG issues remains the responsibility of each analyst and is subject to peer review.

Portfolio construction

The final portfolio represents an blend of the domestic and global portfolios, with Mawhinney and Cutler responsible for each sleeve, respectively. The two portfolios are generally complementary in terms of positioning, however where there is duplication of holdings or unintended aggregations of risk, the portfolio managers will collaborate to ensure the portfolio reflects the collective views of the respective team. Where there are divergent views on the Fund's domestic/global split, Mawhinney retains the final veto on all portfolio decisions.

Zenith highlights that with Mawhinney based in Sydney and Cutler in Bermuda, the interaction between the portfolio managers is less frequent and constrained by time zone differences. In our opinion, while this has the potential to dilute the quality and frequency of interaction, we believe the philosophical alignment between the portfolio managers moderates this risk.

The split between equities and bonds is largely an outworking of the bottom-up opportunities identified through the security selection phase. As such, the growth/defensive split can vary though the cycle, based on the relative attractiveness of equities and bonds. The Fund's equity exposure can range between 40% and 90% (on a gross basis), while the fixed income portion will account for between 10% and 50% of the portfolio's net asset value (NAV).

In Zenith's opinion, we believe the approach is fluid and closely aligned to valuations across equity markets. We believe the approach could be enhanced with a stronger top-down component, including more granular, forward-looking asset class research i.e. understanding the valuation of long bond yields, credit cycles etc. Further, we believe that tighter asset allocation ranges could provide more clarity to prospective investors with respect to the level of equity and drawdown risk.

Allan Gray/Orbis assess each investment idea and the perceived risk/reward relationship, seeking to identify the best ideas whilst adhering to broad risk constraints. These are derived by ranking stocks by valuation discounts, with the highest discounts considered the most attractive. The stocks selected are then assessed relative to cash on a risk/reward basis, resulting in only the best risk-adjusted ideas being selected.

The Fund typically holds approximately 50 to 100 positions in its highest conviction ideas with average position sizes ranging from 1% to 5%. Portfolio turnover for the equity portion is expected to be approximately 20% p.a. to 50% p.a., which is consistent with the long-term investment philosophy adhered to by the firm.

The Fund can invest in commodity-linked instruments (typically ETFs, exchange traded futures etc) for either hedging purposes (i.e. investing in gold) or if the actual commodity is assessed as more attractive relative to companies operating in the same sector.

Proprietary analytical software is used to assess the impact on weightings changes on the overall portfolio. Correlations between stocks are also analysed to gain an understanding of and manage the exposure to underlying variables, which acts to increase diversification and reduce risks.

Securities are sold when they reach the targeted intrinsic value, or when they are displaced by more attractive investment opportunities. Where a stock experiences a significant price deterioration post initial investment, provided the investment thesis remains unchanged, Allan Gray/Orbis would continue to purchase the stock to ensure that the position is maintained at the desired weight in the Fund.

Ultimately, Zenith considers the portfolio construction approach to be highly qualitative, relying on the skill and experience of the portfolio managers. While we believe there is scope to introduce more science and rigour to the process, we believe the quality of bottom-up research largely offsets this weakness.

Risk management

In addition to the broad risk constraints, risk management is embedded into the research process in both the security selection and portfolio construction processes.

In terms of Equity selection, investment themes are identified through rigorous and detailed research. As Allan Gray's investment process is contrarian in nature, the assessment of the downside risks to individual stocks takes on even greater significance.

In assessing a company, one of the key objectives of the bottom-up research process is to understand why a company is out of favour with the market and whether the view is justified. Zenith believes the discipline embedded in this approach ensures that downside risk is properly considered at both a security selection level and in a portfolio management context.

At the portfolio construction level, Allan Gray uses a proprietary risk management system to identify and monitor any unintended biases within the Fund. Zenith notes that Allan Gray's risk management systems are equity centric and may not fully capture the inherent risks within fixed income and hybrid securities. In addition to this, the ability to invest in small cap equities can increase liquidity risks in comparison to large cap equities. Allan Gray is aware of the potential liquidity risks that arise from its investment process. To this end, Allan Gray monitors portfolio liquidity on an ongoing basis to ensure liquidity risks are managed appropriately.

Zenith is satisfied that the firm's risk management processes are applied at multiple stages of the investment process and that the liquidity of holdings are adequately monitored. In addition, the flexible portfolio constraints ensure that Allan Gray is not restricted in its ability to deliver outperformance. However, investors should be aware that there is significant reliance on management judgement and skill.

Investment fees

	Fund	Sector Average
Total Fees and Costs (RG 97)	0.80% p.a.	0.86% p.a.
Management Fees and Costs	0.76% p.a.	0.76% p.a.
Transaction Costs	0.04% p.a.	0.08% p.a.
Performance fees as at 30 Jun 2023	0.00%	0.03%
Performance fees description	The performance fee is 20% of the Fund's outperformance, net of the base fee, in comparison to the Benchmark	
Management Cost	0.76% p.a.	0.74% p.a.
Buy / Sell spread	0.20% / 0.20%	0.14% / 0.14%

All fees and costs are inclusive of GST unless indicated otherwise. The Performance Fee shown is the performance fee disclosed in the PDS. It is calculated by taking the average performance fees charged over the last five financial years (or less if the investment or performance fee mechanism has not been in place for five financial years).

The sector average management cost is based on the average management cost of all flagship Multi-Asset - Growth funds surveyed by Zenith.

Zenith highlights the mismatch between the Fund's underlying investment strategy and the composition of its benchmark, as it pertains to the calculation of performance fees. The Fund invests in a mix of government and credit securities, while the benchmark only includes the JPMorgan Global Government Bond Index expressed in AUD i.e. sovereign only. The performance fee is payable monthly in arrears and subject to a high watermark.

Zenith would prefer the benchmark aligned with the Fund's investment strategy via the inclusion of an aggregate benchmark i.e. Bloomberg Global Aggregate Index, and/or a high yield index. Further, for any fund that charges a performance fee, Zenith would prefer to see in place an additional excess return hurdle (i.e. a target return above the index other than the management cost) and considers this best practice.

Zenith believes the Fund's overall fee structure is consistent with the peer group, providing Allan Gray with a strong alignment of interest with unitholders. However, Zenith notes that the application of the performance fee has the potential to materially affect the net return delivered to investors if the Fund achieves its investment objectives.

(The fees mentioned above are reflective of the flagship version only, fees may differ when the product is accessed through an alternate investment vehicle such as a platform).

About the fund manager

Organisation

Allan Gray Australia (Allan Gray) was established in 2004 as a joint venture between Orbis Holdings Australia (Orbis) and the Simon Marais' family trust. Allan Gray is majority-owned by Orbis, which has a controlling interest, with Allan Gray's employees owning the remaining 17% of equity.

The heritage of the firm links back to Allan Gray Limited (South Africa), which was founded in South Africa in 1973. As at 31 July 2024, Allan Gray Limited (South Africa) managed approximately $US 52.6 billion.

Under the same umbrella, the Orbis Group was formed in 1989 as a global fund manager, specialising in investment services to wholesale and retail investors. As at 31 July 2024, Orbis Group managed approximately $US 60.8 billion.

Allan Gray maintains close operating links with both Allan Gray Limited and the Orbis Group, outsourcing functions such as trade execution to the group's principal operating company, which is based in Bermuda.

Zenith is supportive of the business structure of the organisation. In addition, we view the outsourcing of non-investment functions positively, allowing investment personnel to focus purely on investment management.

As at 31 July 2024, Allan Gray managed approximately $A 11.5 billion across a range of Australian Equity and diversified strategies. Of this, $A 189 million was managed in this strategy/Fund.

Investment personnel

Name	Title	Industry Experience (yrs)	Tenure (yrs)	Location
Simon Mawhinney	Portfolio Manager	23	18	Sydney, Australia
Alec Cutler	Portfolio Manager	30	19	Hamilton, Bermuda

The Fund is managed by key investment personnel from Sydney-based Allan Gray and the Orbis Multi-Asset team, principally based in Bermuda.

Portfolio Managers, Mawhinney and Cutler co-manage the Fund with each maintaining autonomy over their respective sleeve. Mawhinney is responsible for selecting all domestic securities (including equities and bonds) while Cutler is responsible for populating the Fund's global holdings.

The Allan Gray team is led by Mawhinney and comprises nine investment professionals. Mawhinney joined Allan Gray in 2006 from Alliance Bernstein, having previously worked within the Equity Markets Group at Macquarie Bank, in addition to Deloitte and Touche. Zenith maintains a high opinion of Mawhinney noting his ability to detach his investment decision-making from consensus and apply the firm's value investment approach in a rigorous manner.

Zenith highlights that the majority of Mawhinney's focus is on the firm's Equity strategies, with government bonds and credit/hybrid securities representing a secondary consideration. While Zenith would prefer to see more specialisation in this aspect of the process, we recognise that generating outperformance in equities is likely to yield more portfolio benefit relative to achieving the same outperformance in bonds.

Consistent with their contrarian philosophy and independent thought process, Allan Gray seeks to employ people from contrasting backgrounds, believing this provides a higher degree of diversity in thought and unique investment ideas. Zenith believes the cognitive and cultural diversity within the team mitigates the risk of ‘group think’, allowing for a broader cross-section of investment ideas.

The Orbis Multi-Asset team is led by Cutler and comprises eight investment professionals, who are responsible for identifying and selecting the most attractive securities (Equities and Fixed Interest) for the Fund. Cutler joined Orbis in 2004 and is a Director of Orbis Holdings Limited. Prior to joining Orbis, he was employed at Brandywine Asset Management, holding a number of senior investment management roles. In Zenith's opinion, Cutler is a well-credentialed and experienced portfolio manager with a strong equity orientation.

Mark Dunley-Owen joined Orbis in September 2020. Dunley-Owen joins the team following a 11-year tenure at Allan Gray, where he was largely responsible for managing fixed interest portfolios, having also had prior equities experience. Zenith notes that Dunley-Owen became a named Portfolio Manager on the Orbis Global Real Return Fund in May 2022. We view favourably the additional perspective he provides having come from a Fixed Income background, albeit note that to date his involvement has been more on the Equity side.

Cutler is further supported by Ashley Lynn in the Multi-Asset team. Lynn joined Orbis in 2013 and is responsible for investment research and the development of high-impact ideas. Lynn has a strong legal background having previously worked as an attorney at Boyden Gray & Associates and in a policy role at the Office of the Secretary of Defence. Zenith highlights that while Lynn has limited fixed income experience from prior roles, her legal background is highly complementary to the Orbis investment process. In particular, the firm focuses on companies undergoing restructures, recapitalisations, where interpreting complex legal documentation can be highly accretive.

The remainder of the team is comprised of Timo Smuts, Head of Fixed Income and Analysts, Londa Nxumalo, Junichi (Jeffrey) Miyamoto, Romari Tucker and Robyn Carroll. The Orbis Multi-Asset team is augmented by the broader resources of the Orbis global equity team, which is comprised of 52 investment professionals (as at 31 July 2024), The core of the team is the investment research team consisting of 36 equity analysts, who are organised along both regional and global sector lines.

While the majority of equity ideas are sourced from the Orbis global equity team, Zenith highlights that the Multi-Asset team has the remit to conduct bottom-up equity analysis, outside of the research undertaken by the broader team. This typically occurs when the assessed upside of a security is below the return expectations for the global equity portfolios or where a security introduces particular diversification benefits to the Fund.

In our opinion, we would prefer to see the portfolio's investable universe limited to those securities that are recommended by the equity team i.e. via inclusion in the flagship fund or as part of each analysts' paper portfolios.

Remuneration is predominantly performance based. Detailed performance attribution analysis is undertaken and decisions in investment research, portfolio construction and trade execution are thoroughly analysed. Senior executives are shareholders in the business and cannot fully divest their equity interest until 10 years after their departure of the firm. Zenith believes the current alignment structure is strong, ensuring investor interests are prudently managed.

In Zenith's opinion, the investment team is of a high calibre. While the time zone difference between the respective portfolio managers has the potential to dilute the quality of decision-making, we believe the common 'value anchor' across the firms ensures alignment of portfolio management.

About the sector

Sector characteristics

The Multi-Asset sector comprises funds that are permitted to invest across multiple asset classes and investment strategies. Traditionally, asset class exposures have included equities, fixed interest, property and cash. However, in more recent times, Zenith has observed a greater preparedness by sector participants to incorporate alternative assets and strategies within their targeted asset mix. Included amongst these are real assets (i.e. direct property and infrastructure), commodities and private market exposures (i.e. private equity and private credit). Innovation has also been observed in terms of sector structuring and tail risk hedging strategies, with the goal of building more resilient, all-weather portfolios.

Zenith categorises funds in the 'Multi-Asset – Growth' peer group (greater than 60% exposure to growth assets and up to 80%) based on our collective assessment of their targeted asset mix and actual portfolio holdings. Funds within this peer group are benchmarked against the Zenith Composite Growth Benchmark, which has a defensive/growth split of 20%/80%. The exact composition of this benchmark is provided below:

Cash: Bloomberg AusBond Bank Bill Index (2%)

Australian fixed interest: Bloomberg AusBond Composite 0+ Yr Index (7.25%)

International fixed interest: Bloomberg Global Aggregate Index Hedged $A (7.25%)

Alternatives (defensive): HFRX Global Hedge Fund Index $A (3.5%)

Australian equities: S&P/ASX 300 Index (40%)

International equities (unhedged): MSCI World ex-Australia Unhedged Index (16%)

International equities (hedged): MSCI World ex-Australia Hedged Index (16%)

Australian listed property: S&P/ASX 300 A-REIT Index (2.25%)

Global listed property: FTSE EPRA Nareit Developed Rental Index TR Hedged $A (2.25%)

Alternatives (growth): HFRX Global Hedge Fund Index $A (3.5%)

To provide greater insight into a Fund's risk/return profile, Zenith decomposes targeted exposures between two broad categories – growth and defensive. While we are cognisant that our designation of asset class exposures between these categories may vary from that defined by the manager, we have sought to adopt a common methodology to ensure consistency in the assessment of like strategies across Zenith's universe of rated funds. Further detail on the Fund's targeted asset mix is provided in the 'Fund characteristics' section.

Sector risks

There exist a number of risks that are generally common amongst all Multi-Asset funds. These include:

Market risk: In periods of heightened risk aversion, it is feasible that asset class correlations merge. Should this occur, the diversification benefits brought through the construction of a portfolio comprising multiple lowly correlated asset classes may be lost, potentially exposing investors to a broader deterioration in market conditions.

Currency risk: Sector participants may be permitted to gain international exposures on an unhedged basis. The decision whether or not to hedge is often deemed active in nature and can expose investors to fluctuations in cross currency rates. This may be either to the benefit or cost of Fund volatility and performance.

Emerging market risk: Many sector participants gain exposure to emerging and frontier markets which bring with them additional risks. These may include reduced liquidity, a more opaque pricing mechanism, increased sovereign risk and political tensions.

Alternatives risk: A growing number of funds have investment mandates that permit a meaningful exposure to alternative assets and strategies. Investors should be aware that the use of alternatives can bring with them additional risks.

Illiquidity risk: While most sector participants will seek to retain high levels of liquidity, it is feasible that a fund may retain exposure in assets that are deemed illiquid or subject to irregular pricing policies. It may be difficult for an investment manager to subsequently liquidate such portfolio positions without incurring meaningful transaction or other performance related costs.

Administration and operations

Responsible Entity	Equity Trustees Limited

Zenith rating

Report certification

Date of issue: 25 Sep 2024

Role	Analyst	Title
Analyst	Bonnie Corbett	Senior Investment Analyst
Sector Lead	Andrew Yap	Head of Multi Asset & Austn. Fixed Income

Association & relationship

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Rating history

As At	Rating
25 Sep 2024	Recommended
28 Sep 2023	Recommended
29 Sep 2022	Recommended
30 Sep 2021	Recommended
30 Sep 2020	Recommended
01 Oct 2019	Recommended

Last 5 years only displayed. Longer histories available on request.

In March 2021, Zenith implemented a new ratings methodology for products classified as Traditional Index. Any rating issued from this date forward for Traditional Index products only reflect this change in methodology, with the relevant Traditional Index ratings being Index Approved, Index Recommended and Index Highly Recommended. Ratings issued for Traditional Index products prior to March 2021 are retained for historical purposes in line with our regulatory requirements and were issued in line with Zenith's Fund Research Methodology. Further information in relation to Zenith's Traditional Index Research Methodology and Traditional Index Ratings can be found on the Zenith website.

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This report refers to the Australian unit trust for the fund, and the fund and benchmark returns are all in AUD.

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