

The image shows three white wind turbines standing on a grassy hill. The turbines are positioned in a line, with the one on the left being the largest and most prominent. The sky is a clear, bright blue, and the ground is covered in green grass. The overall scene is a clean, modern representation of renewable energy.

FUTUREGROWTH

/ ASSET MANAGEMENT

Monthly Review

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Market review

Economic and market review

Global stampede into emerging market bonds continues unabated

In terms of the global backdrop, not much changed over the past month or so – except that the US labour market is consolidating its regained strength, which is also reflected in growing evidence of a sustained increase in the general level of wages. To us, this remains one of the main reasons why the US Federal Reserve should resume the gradual normalisation of monetary policy. The market never fails to bemuse us with the amount of attention that is paid to events such as the recent Jackson Hole gathering where, as should be expected these days with so much regular central bank communication, absolutely nothing new was revealed. Meanwhile, the dusty stampede into markets offering higher-yielding emerging market assets remains relentless. While capital inflows are always welcomed, the fact is that the extreme (and largely ineffective) monetary policy measures are causing unprecedented distortions in the majority of developed bond markets.

Foreign buying of SA bonds reached over R90bn this year

As a direct result of this, non-resident net purchases of rand-denominated government bonds continued to rise sharply and are now at levels reminiscent of the large inflows of 2012 (at that point, sparked by an earlier global reach for yield and also technical factors such as the inclusion of South Africa into the Citi Group Global Bond Index). While this is all very well, it concerns us that foreign holdings of local currency RSA government debt is estimated to have reached a level close to 40% of total outstanding national government local currency debt. This equates to about R0.6 trillion. If history has taught us anything, it is that foreign portfolio flows are fickle at times and that an orderly exit is never guaranteed. So, to us this remains a risk. It should also be borne in mind that it potentially impacts the current account via net interest payments to foreign investors, assuming not all coupon payments are re-invested – an already significant drag on the external balance.

Political uncertainty once again cause market turmoil

The desperation of the global reach for yield is best demonstrated by the continued buying of local bonds despite the negative impact of renewed uncertainty involving the Minister of Finance (which contributed to both the rand and bond markets losing significant ground in August). The yield of the benchmark R186 (maturity 2026) gyrated between an intra-month low of 8.40% and its weakest level of 9.06%, before settling at 9.02% at month end. As a result, the JSE All Bond Index returned a disappointing -1.8%, significantly worse than the official inflation-linked index's return of -0.2% and cash's +0.6%. For the year ending 31 August, nominal bonds are still leading the trio with a total return of 11.7%, followed by inflation-linked bonds at 6.6% and a cash return of 4.4%.

Local data releases supportive of stable repo rate

The local data picture was pretty mixed, with the latest consumer inflation data print slightly lower than expected at a year-on-year rate of increase of 6.0%. However, inflation at the producer level for the same month was significantly higher than expected at 7.4%. While the external trade balance showed another, albeit smaller, surplus and in turn points to a significant improvement in the current account deficit, tax revenue collections have disappointed. All in all, the above points to stable monetary policy, but puts at risk the Ministry of Finance's plans to reduce the fiscal deficit as planned.

Key macroeconomic themes

Economic growth

A mild cyclical and uneven global economic recovery remains our base case, with a relatively stronger US economy leading the way. In contrast, euro zone growth remains challenged, and prospects for Japan look particularly poor. We believe that the global recovery will be structurally lower than in previous cycles, mainly due to low productivity growth, high leverage levels (albeit much improved from pre-crisis levels) and demographic factors (older populations tend to save more and spend less). BREXIT is simply another factor that is driving uncertainty about prospects for a more sustained recovery.

Most emerging market economies are caught between a mixed outlook for the developed world, concern about the implications of weaker Chinese growth on commodity demand and the impact of the Federal Reserve's well telegraphed intent to normalise monetary policy. Commodity producers with large external imbalances, such as SA, remain particularly vulnerable.

Locally, the biggest impediment to higher local growth remains structural, while the severity of the drought adds to the list of growth detractors. Encouragingly, overdue engagement between government and business raises the prospects of unbundling domestic growth potential – but prompt and practical follow through is still necessary to be impactful.

Inflation

Although recent data releases have quelled earlier excessive global deflation fears, expectations of rapid reflation are also misplaced. Global inflation trends are likely to remain subdued in our view.

Locally, a milder than previously envisioned food inflation forecast, crude oil depreciation and recent rand appreciation have anchored our 2016 and 2017 annual average inflation forecasts to 6.4% and 5.3% respectively. We shall be keeping one eye on the core measure of inflation for a more reliable indication of underlying inflationary pressure, which is still below 6%.

Balance of payments

The combination of years of rand weakness and a marginally improved terms of trade position in the first quarter (partly due to lower crude oil prices), lends relief to the fragile balance of payment situation. As a result, we expect a narrowing in the current account deficit from an annual average of 4.4% in 2015 to 3.7% in both 2016 and 2017. Although this improvement is welcomed, we note with a fair degree of concern that SA is still saddled with a relatively weak external trade position which in turn will remain a drag on the currency. It remains a significant challenge to fund the shortfall considering the un-supportive global backdrop, low domestic real rates and the relative unattractiveness of SA as a longer-term investment destination, both in an absolute sense and relative to peers.

Monetary policy

Having finally started the long awaited and well telegraphed monetary policy normalisation process, we agree with the Federal Reserve's intent to follow a slow and gradual process.

Key macroeconomic themes *continued*

Monetary policy *continue*

The current trend of global monetary policy divergence is expected to continue over the next year or so. With more policy tightening in the US on the cards, the European Central Bank and Bank of Japan will retain their quantitative easing and negative interest rate programmes. At the same time some of the smaller advanced and commodity-driven economies may be forced to ease policy, mainly due to low growth and a modest inflation backdrop. On the positive side, monetary policy divergence will act to soften the impact of higher US rates on global growth.

In the case of SA, we feel comfortable with the prospects of the South Africa Reserve Bank (SARB) being near the peak of the interest rate tightening process, especially considering that the repo rate has already been increased by a cumulative 2% in this cycle. A cautious approach is supported by the weak economic growth backdrop, low levels of credit extension growth and limited evidence of demand-led inflation. However, considering the size of the balance of payments deficit, the real repo rate remains accommodative - and this guides our caution to pricing in the probability of interest rate cuts as yet.

Fiscal policy

The minister of Finance delivered a realistic and balanced Budget in February, placing due emphasis on realism in light of a soft domestic growth outlook and questionable fiscal policy credibility. We now look for evidence of the planned consolidation path, cognisant of the elevated execution risk in the outer years of the Medium Term Expenditure Framework. Until now, government financing data for the first four months of the 2016/17 fiscal year looks promising, but the hefty year-on-year increase in revenue over this period was mostly on the back of revaluation profits on foreign exchange transactions and mineral/petroleum royalties. Actual tax revenue is up by only 7.0% against a target of 8.3%. Moreover, the financial state of some state-owned enterprises, and the implications for a finely balanced fiscal position, remain a significant concern. We are still awaiting firm action with regards to the troubled SOEs. Recent changes at SAA are not entirely convincing for two reasons: the retention of Chairperson Dudu Myeni and the unclear implication of the recent announcement that President Zuma will chair oversight of reform efforts across state-owned entities.

Investment view and strategy

The global growth recovery remains fragile and patchy, which sets the scene for a modest future inflation profile as well as significant monetary policy divergence. It also implies a steady and shallow tightening cycle for the few economies that are in a position to normalise monetary policy, especially the US. This should cap global bond yields. On the negative side, the continued uncertainty about the global, and particularly the Chinese, growth outlook remains a risk - especially for emerging market commodity producers with a weak external position in both absolute and relative terms, like South Africa. We also expect global risk appetite to remain volatile and do not regard market rallies boosted by expectations of more policy easing to be sustainable.

Investment view and strategy continue

Locally, we still expect a bout of upward pressure on inflation over the next few months, but are more focused on the downward trend expected for next year. While it has become difficult for the South African Reserve Bank to maintain a firm tightening bias, especially considering persistently weak growth, it is unlikely that they would consider interest rate cuts soon. The external imbalance is simply too big to allow for a lower real repo rate, while unpredictable currency swings continue to pose a risk to the more benign inflation outlook. Although the Minister of Finance is clearly determined to rectify the damage to fiscal policy credibility and, by implication, to avoid a sovereign credit downgrade to non-investment grade status, the jury is still out on actual delivery. Therefore, the risk of a credit rating downgrade over the next 12 months still hovers. In the short term, local political uncertainty remains a nagging risk. This is particularly worrying considering how much risk has been priced out of the market since the end of last year, mostly the result of the global reach for yield which tends to whitewash the economic and policy sins of South Africa.

Considering the above, we will continue to approach the market with caution. The emphasis remains on capital preservation. For this reason we have a large holding of variable rate bonds and longer-dated money market instruments that are offered at reasonable yields, but with significantly lower market risk. Although inflation-linked bonds may still benefit from the expected rise in inflation from current levels during the last quarter of this year, the focus has shifted to the more benign 12-month outlook. As a result, we have started reducing our inflation-linked bond holding. Apart from lower than expected inflation, the biggest risk to our cautious stance is sustained foreign inflows into the bond market.

Our broad interest rate investment strategy for a core bond fund benchmarked against the ALBI is as follows:

- Modified duration – (Reduced) underweight
- Cash – (Reduced) overweight
- Nominal bonds (1-12 years) - Overweight
- Nominal bonds (12+ year) - Underweight
- Inflation-linked bonds – (Reduced) overweight

Key economic indicators and forecasts (annual averages)

	2012	2013	2014	2015	2016	2017
Global GDP						
USA	2.2%	1.9%	2.4%	2.4%	1.4%	1.9%
Euro area	0.1%	-0.4%	0.9%	1.5%	1.6%	1.3%
Japan	2.1%	1.6%	-0.1%	0.5%	0.6%	1.1%
China	7.8%	7.7%	7.4%	6.9%	6.7%	6.4%
SA GDP	2.2%	2.2%	1.5%	1.3%	0.5%	1.3%
SA Headline CPI	5.6%	5.8%	6.1%	4.6%	6.4%	5.3%
SA Current Account (% of GDP)	-5.2%	-5.8%	-5.4%	-4.4%	-3.7%	-3.7%

Source: Old Mutual Investment Group

Produced by



Wikus Furstenberg
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Product information and performance

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
MONEY MARKET											
Call Money Market	Average Call rate of four largest SA banks	Aims to provide maximum return on overnight cash investments.	Nazley Bardien	January 2000	Product Benchmark Outperformance	6.71% 6.35% 0.36%	5.92% 5.50% 0.42%	5.60% 5.15% 0.45%	5.77% 5.29% 0.48%		7.07% 6.58% 0.49%
Core Money Market	STeFI 3-month Index	Targets high cash returns through a carefully balanced and actively managed mix of short-term interest-bearing investments. The weighted average duration for the Composite may not exceed 120 days.	Michael van Rensburg	July 2004	Product Benchmark Outperformance	7.77% 6.70% 1.07%	6.84% 6.01% 0.83%	6.41% 5.71% 0.70%	6.59% 5.88% 0.71%	7.87% 7.11% 0.76%	7.82% 7.12% 0.70%
180 day Enhanced Money Market	STeFI Composite Index	Targets high cash returns through a carefully balanced and actively managed mix of short- and medium-term interest-bearing investments with maturities ranging from 180 days to 2 years.	Michael van Rensburg	July 2004	Product Benchmark Outperformance	8.04% 7.03% 1.01%	7.05% 6.31% 0.74%	6.62% 5.95% 0.67%	6.81% 6.05% 0.76%	8.05% 7.23% 0.82%	8.04% 7.22% 0.82%
STeFI PLUS											
Yield Enhanced A STeFI+ Short Term	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of A-. Weighted average term to maturity less than 365 days.	Daphne Botha	October 2002	Product Benchmark Outperformance	8.20% 7.03% 1.17%	7.62% 6.31% 1.31%	7.61% 5.96% 1.65%	7.64% 6.16% 1.48%	8.69% 7.32% 1.37%	8.96% 7.80% 1.16%
Yield Enhanced A STeFI+	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of A based on official ratings. Weighted average term to maturity less than five years.	Daphne Botha	January 2010	Product Benchmark Outperformance	9.60% 7.03% 2.57%	8.49% 6.31% 2.18%	8.43% 5.96% 2.47%			8.47% 6.08% 2.39%
Yield Enhanced BBB STeFI+	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of BBB.	Daphne Botha	February 2010	Product Benchmark Outperformance	11.74% 7.03% 4.71%	10.54% 6.31% 4.23%	10.32% 5.96% 4.36%			10.07% 6.06% 4.01%

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
STEFI PLUS CONT.											
Yield Enhanced BB SteFI+	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of BB.	Daphne Botha	January 2012	Product Benchmark Outperformance	11.88% 7.03% 4.85%	13.18% 6.31% 6.87%				12.30% 5.98% 6.32%
Yield Enhanced Geared BB SteFI+	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement, as well as equity risk. The Composite's weighted average rated credit quality must be a minimum of BB-.	Daphne Botha	January 2008	Product Benchmark Outperformance	11.91% 7.03% 4.88%	12.88% 6.31% 6.57%	12.04% 5.96% 6.08%	11.88% 6.16% 5.72%		12.07% 7.07% 5.00%
Power Debt***	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of BBB. Investments in this product are limited to listed and unlisted assets in the power sector and supporting industries.	Paul Semple	May 2014	Product Benchmark Outperformance	11.62% 7.03% 4.59%	11.58% 6.31% 5.27%				10.16% 6.07% 4.09%
INCOME											
Core Income	50% STeFI Call Deposit Index; 50% 3-7 Years All Bond Index	Aims to deliver excess return by investing in money market and bond assets with a focus on yield enhancement while limiting interest rate risk to a maximum average duration of two years.	Wikus Furstenberg	November 2002	Product Benchmark Outperformance	7.21% 7.23% -0.02%	7.12% 6.97% 0.15%	6.54% 5.97% 0.57%	7.03% 6.44% 0.59%	8.08% 7.37% 0.71%	8.54% 7.91% 0.63%
Flexible Income	110% SteFI Call Index	Aims to deliver excess return by investing in money market, bonds, preference shares and listed property and taking advantage of yield enhancement and capital growth opportunities. The composite is not limited by duration constraints.	Wikus Furstenberg	July 2006	Product Benchmark Outperformance	7.16% 7.03% 0.13%	6.84% 6.21% 0.63%	7.33% 5.92% 1.41%	7.86% 6.38% 1.48%		8.88% 7.21% 1.67%
Yield Enhanced Income	20% All Bond Index; 80% SteFI Composite Index	Aims to deliver excess returns through a combination of active interest rate risk management and yield enhancement by investing in listed and unlisted assets. Interest rate risk is constrained.	Wikus Furstenberg	May 2012	Product Benchmark Outperformance	8.45% 6.60% 1.85%	8.38% 6.54% 1.84%				8.37% 6.20% 2.17%

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
INTEREST RATE ASSET ALLOCATION											
Interest Rate Asset Allocation	ALBI (62.5%); JSE ILB IGOV Index (30%); STe-FI Call Deposit Index (7.5%)	Aims to deliver excess return mainly through a combination of aggressive asset allocation within the various interest-bearing asset classes.	Wikus Furstenberg	July 2010	Product Benchmark Outperformance	5.70% 5.54% 0.16%	8.54% 7.70% 0.84%	8.87% 7.45% 1.42%			9.63% 8.55% 1.08%
INFLATION-LINKED BONDS											
Passive ILB Index	Barclays Capital/ Absa SAGILB	Aims to match the returns of the benchmark through passive interest rate and yield curve management.	Nazley Bardien	September 2005	Product Benchmark Outperformance	7.21% 7.06% 0.15%	9.08% 9.07% 0.01%	8.73% 8.77% -0.04%	9.27% 9.32% -0.05%	9.82% 9.87% -0.05%	9.96% 10.02% -0.06%
Core ILB	JSE ILB IGOV Index	Aims to deliver excess return through active interest rate risk management and limited yield enhancement.	Wikus Furstenberg	November 2005	Product Benchmark Outperformance	7.29% 7.20% 0.09%	9.17% 9.12% 0.05%	9.07% 8.80% 0.27%	9.78% 9.35% 0.43%	10.15% 9.89% 0.26%	10.15% 9.89% 0.26%
Yield Enhanced Inflation-linked	RSA Inflation Linked Government Bond R202 Total Return Index	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted assets.	Mei-Chi Liou	June 2011	Product Benchmark Outperformance	9.14% 6.71% 2.43%	12.83% 10.48% 2.35%	11.53% 8.92% 2.61%			11.97% 9.83% 2.14%
Power Inflation-linked***	RSA Inflation Linked Government Bond I2038 Total Return Index	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted assets in the power sector and supporting industries.	Mei-Chi Liou	January 2014	Product Benchmark Outperformance	12.94% 8.90% 4.04%	15.17% 12.06% 3.11%				10.19% 7.54% 2.65%
Infrastructure & Development Inflation-linked	Barclays BESA SAGILB 15+	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted socially responsible and developmental assets.	Mei-Chi Liou	Pending	Product Benchmark Outperformance	N/A					
NOMINAL BONDS											
Passive All Bond	All Bond Index	Aims to match the returns of the benchmark through passive interest rate and yield curve management.	Nazley Bardien	June 2000	Product Benchmark Outperformance	4.49% 4.46% 0.03%	7.14% 7.14% 0.00%	6.94% 6.94% 0.00%	8.27% 8.29% -0.02%	8.35% 8.35% 0.00%	10.80% 10.78% 0.02%
Core Bond	All Bond Index	Aims to deliver excess return through a combination of interest-bearing asset allocation, active duration management and yield enhancement.	Daphne Botha/ Wikus Furstenberg	January 2000	Product Benchmark Outperformance	4.57% 4.46% 0.11%	7.41% 7.14% 0.27%	7.69% 6.94% 0.75%	9.12% 8.29% 0.83%	9.04% 8.35% 0.69%	11.25% 10.66% 0.59%

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
NOMINAL BONDS cont.											
Long Duration Bond	All Bond Index 12+ Years	Aims to deliver excess return through active allocation between long-dated fixed rate and inflation-linked bonds, limited yield curve selection, duration management and yield enhancement.	Wikus Furstenberg	December 2006	Product Benchmark Outperformance	2.10% 3.25% -1.15%	7.20% 7.61% -0.41%	6.84% 6.97% -0.13%	8.31% 8.20% 0.11%		7.55% 7.22% 0.33%
Yield Enhanced Bond	All Bond Index	Targets high cash returns through a combination of active interest rate risk management and yield enhancement by investing in listed and unlisted assets.	Jason Lightfoot	December 2001	Product Benchmark Outperformance	6.77% 4.46% 2.31%	9.59% 7.14% 2.45%	9.75% 6.94% 2.81%	11.14% 8.29% 2.85%	10.76% 8.35% 2.41%	11.14% 9.17% 1.97%
Infrastructure & Development Bond	All Bond Index	Targets high cash returns through a combination of active interest rate risk management and yield enhancement by investing in listed and unlisted socially responsible and developmental assets.	Jason Lightfoot	January 1995	Product Benchmark Outperformance	6.60% 4.46% 2.14%	9.65% 7.14% 2.51%	9.91% 6.94% 2.97%	11.19% 8.29% 2.90%	11.04% 8.35% 2.69%	12.66% 10.66% 2.00%
SOCIALLY RESPONSIBLE INVESTMENTS											
Infrastructure & Development Bond	All Bond Index	Targets high cash returns through a combination of active interest rate risk management and yield enhancement by investing in listed and unlisted socially responsible and developmental assets.	Jason Lightfoot	January 1995	Product Benchmark Outperformance	6.60% 4.46% 2.14%	9.65% 7.14% 2.51%	9.91% 6.94% 2.97%	11.19% 8.29% 2.90%	11.04% 8.35% 2.69%	12.66% 10.66% 2.00%
Development Equity	Consumer Price Index (CPI) + 10%	Targeting high returns by investing in equity and related assets that are socially responsible or developmental.	James Howard	September 2006	Product Benchmark	17.10% 16.04% 1.06%	17.41% 15.79% 1.62%	14.34% 15.73% -1.39%	13.68% 15.37% -1.69%		18.29% 16.36% 1.93%
Community Property	Consumer Price Index (CPI) + 4%	A portfolio specialising in the finance and development of retail shopping centres catering to the needs of under-served communities throughout South Africa.	Smital Rambhai (Product Manager)	June 1996	Product Benchmark	17.43% 10.03% 7.40%	12.14% 9.79% 2.35%	10.88% 9.73% 1.15%	10.65% 9.37% 1.28%	11.93% 10.36% 1.57%	13.15% 9.94% 3.21%
Agri	Consumer Price Index (CPI) + 10%	A portfolio specialising in equity investments in agricultural land, agribusinesses and farming infrastructure.	Smital Rambhai (Product Manager)	March 2010	Product Benchmark	N/A					

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
SOCIALLY RESPONSIBLE INVESTMENTS cont.											
Development Balanced**	A composite weighting of the underlying funds' benchmarks.	A balanced portfolio providing investors with social impact from a targeted and development perspective and exposure to listed equities that track the JSE's SRI Index.	James Howard	November 2004	Product Benchmark Outperformance	8.41% 6.39% 2.02%	9.36% 7.79% 1.57%	11.36% 9.53% 1.83%	11.28% 10.06% 1.22%	10.65% 9.74% 0.91%	13.21% 12.36% 0.85%
Power Debt***	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of BBB. Investments in this product are limited to listed and unlisted assets in the power sector and supporting industries.	Paul Semple	May 2014	Product Benchmark Outperformance	11.62% 7.03% 4.59%	11.58% 6.31% 5.27%				10.16% 6.07% 4.09%
Power Inflation-linked***	RSA Inflation Linked Government Bond I2038 Total Return Index	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted assets in the power sector and supporting industries.	Mei-Chi Liou	January 2014	Product Benchmark Outperformance	12.94% 8.90% 4.04%	15.17% 12.06% 3.11%				10.19% 7.54% 2.65%
Infrastructure & Development Inflation-linked bond	Barclays BESA SAGILB 15+	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted socially responsible and developmental assets.	Mei-Chi Liou	Pending	Product Benchmark Outperformance	N/A					

Currency: ZAR/Gross of fees

* Annualised

** Currently investors are Futuregrowth staff who may elect to invest through their retirement funds.

*** Portfolio returns. Supplemental information.

FUTUREGROWTH

/ ASSET MANAGEMENT

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