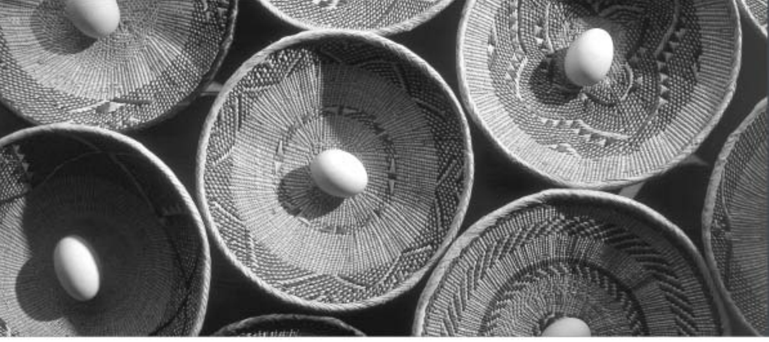
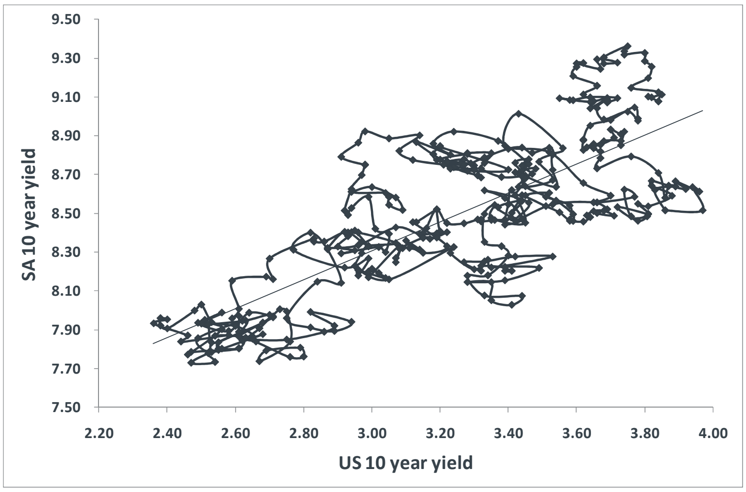


Orthogonal Investments Bond fund commentary for the quarter ended 30 June 2011

Bonds had a good quarter, with the ALBI returning 3.89%. Once again, the Orthogonal GIPS composite fared quite a bit better. It has beaten the All Bond Index by an annualised 1.76% since inception in August 2007, at lower volatility (6.09% versus 7.70%), with a lower maximum drawdown (3.42% versus 7.34%) and with a beta of just 0.78. Further, it has beaten the ALBI in 74% of all single months, 94% of all rolling 12 months and 100% of all rolling 24 and 36 month periods.

Market review

From time to time, the South African bond market latches onto an apparently important (but inevitably temporary) short term indicator. Over the past 21 years, this has varied from the dollar price of gold to the Kruger rand premium over gold (which itself closely tracked the discount between the finrand and the rand), to developments in South East Asia to the Zimbabwean political situation. For the past while, it has quite closely tracked US ten year Treasury yields, as shown in the chart below. We have long held the view that trying to predict US Treasury yields is a very poor way to seek alpha, as this is an extremely liquid and mostly very efficient market. Over the quarter, these yields *fell* about 30 basis points, apparently to the considerable surprise of the manager of the world's biggest bond fund, Bill Gross of PIMCO. Taking a short duration position on macro themes such as America's QEII would have hurt bond investors in both South Africa and America; the latter more so due to the steepness of the price to yield graph at low yields.



Strategy

We have not changed our view since last quarter, namely that our inferred bond risk premium suggests that at current levels, ten year bonds can withstand an average inflation rate, over the next ten years, of up to 6%. That does not provide a great margin of safety, but it is somewhat above the prevailing level of 4.6% and is coincidentally precisely the level before which the monetary authorities are supposed to have taken pre-emptive action. We have positioned the funds' modified durations 0.28 lower than the ALBI, and even with half the holdings in RSA and AAA bonds, we are able to earn a weighted average yield to maturity of almost 80bp's in excess of the ALBI. The reason for not implementing an even shorter duration is the extreme steepness of the yield curve. That, combined with holdings in credit, gives the funds a yield of about 380 basis points higher than what is available in the money market. We remain on the outlook for good quality, yield enhancing bonds.

Rowan Williams-Short

Orthogonal Investments

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