

The South African bond market had a lacklustre period over the quarter. Although the All Bond Index (ALBI) showed a positive return of 1.1%, this lagged returns achieved on not only equities (which outperformed bonds exceptionally, with the All Share Index (ALSI) returning 20.3%, but even cash (+1.8%). For the year to date, the ALBI has returned 5.5%, slightly lagging cash (+5.6%) and well behind the ALSI's 36.7%.

However, the star performer in the fixed interest universe (both this quarter and all year) has been inflation-linked bonds (which are not included in the ALBI). The Barclays SA Inflation-Linked Bond Index returned 14.1% in the year to end September and 4.0% in the third quarter (both comfortably ahead of the comparable period ALBI returns). The fund's holding of 6.3% in inflation-linked bonds during the quarter contributed to the fund's performance.

The generally sideways movement overall in the ALBI during the quarter masks some significant movement that occurred in the quarter. Indeed, in August there was enough momentum for bond yields to reach record lows, surpassing the previous low in February, helped along by Fitch and Standard & Poor's both upgrading SA's credit rating by one notch to BBB+ during that month. However, the positive sentiment did not last, as the market began revising inflation forecasts higher in light of rising oil prices, and started taking note of some more hawkish rhetoric coming out of the Reserve Bank. Whereas earlier in the quarter there was still some talk of the possibility of a further interest rate cut, by quarter end such expectations had all but disappeared and some market participants had begun to talk about the timing of an interest rate hike.

The benchmark 1 - 3 year sector produced a return of 1.23% for the quarter, while the fund managed a handsome outperformance of its benchmark with a 1.90% return. The reason for the outperformance can mainly be ascribed to the low risk strategy employed with respect to the bond market, where we maintain an underweight fund modified duration position in relation to the benchmark. We remain of the view that the current yield being offered in longer dated bonds do not provide sufficient compensation for the capital risk taken.

Although the corporate credit market continued to perform well, the phenomenal demand for these instruments seems to be slowing. The credit spread compression, where the additional yield received over and above that available for an equivalent duration RSA bond, has been slower than the previous quarter, resulting in lower capital gains. The corporate bonds continued to perform well returning 2.44% for the quarter. The fund took the opportunity to reduce its exposure to corporate bonds, to 9.3%.

We continue to believe that credit spreads in general are now too tight and do not provide adequate compensation for the risk being taken in many cases. During the quarter we took the opportunity to exit our investment in the Denel bond in light of the deteriorating credit fundamentals, and purchased the Liberty bond. Subsequent to its inclusion, the Liberty bond has had capital gain with a 10 basis point credit spread compression. We continue to monitor the credit quality of the portfolio and adjust our exposures accordingly.

We have, for some time, held the view that official interest rates are likely to rise in 2006. CPIX (inflation excluding mortgage interest rates) is beginning to pick up, from a low of 3.1% in February 2005 to 4.8% in August, as the weakness in the rand this year and higher petrol prices start taking effect. Food price inflation has remained very low, and this has helped offset the effect of rising petrol prices (CPIX excluding food was at 5.5% in August). We see inflation rising further next year, likely sailing close to the top of the Reserve Bank's 3% to 6% target range for CPIX. There is a chance that it will breach the top of the target range. Factors (other than the petrol price) that may see this happen include a less benign food price environment (maize futures prices have risen sharply in recent months), rising global inflation (affecting imported inflation) and a potentially weaker rand. There will be further pressure on input prices from above-inflation wage increases this year. With consumer spending so strong, there seems little incentive for retailers to try absorb a rising cost base into their margins. We thus still expect that cyclical pressures on inflation will probably see interest rates rise next year, but that this (especially compared to historic standards) will be contained, probably at between 1.5% to 2%.

We reiterate that our bearish view on inflation is a short-term, cyclical view, and that the structural improvement remains in place. But we emphasise that while we believe SA has in general moved into a structurally lower inflation environment, we cannot ignore the fact that inflation will still exhibit cyclical movements.

It also seems apparent that short rates are likely to remain flat in the near term, but the risk is for a rate hike into the second quarter of next year. On that basis, the portfolio remains conservatively positioned with capital preservation and yield enhancement paramount. However, the surprise element that could negate that view remains a strong rally in the rand which could force the Reserve Bank into a further round of easing.

Mark le Roux & Tania Miglietta
Portfolio Managers

Fund category	Domestic Fixed Interest Varied Specialist
Launch date	2 July 2001
Portfolio manager	Mark le Roux & Tania Miglietta
Fund size	R1.9 billion
NAV	1233.94 cents
Annual management fee	1.00% (ex VAT)

Benchmark	BEASSA ALBI (1 - 3 year) TR Index
Fund description	A widely diversified, actively managed fund that aims to provide a higher level of income than a pure income fund.

ASSET ALLOCATION

Sector	30 Sep 2005	30 Jun 2005
Domestic Assets	100.0%	100.0%
Cash/Money Market	49.4%	71.2%
Bonds	34.0%	19.8%
Listed Property	8.6%	5.5%
Preference Shares	2.9%	1.8%
Other investments*	5.1%	1.7%
International Assets	0.0%	0.0%

* Makalani Holdings Ltd: High yielding, listed, mezzanine debt and BidBEE

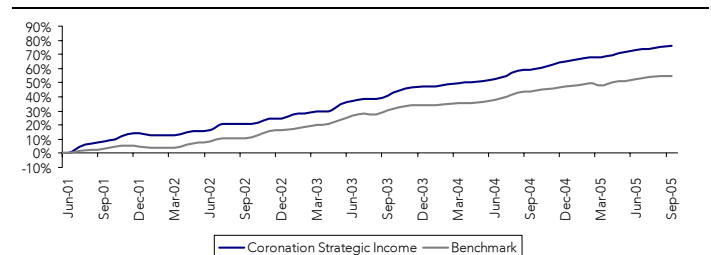
PERFORMANCE & RISK STATISTICS

	Fund	Benchmark
Latest 12 months	10.61%	7.57%
Latest 36 months (annualised)	13.36%	11.89%
Since inception (annualised)	14.25%	10.80%
Annual deviation since inception	3.85%	2.97%
Sharpe ratio	1.08	0.22
Maximum gain	21.97%	15.89%
Maximum drawdown	-1.05%	-1.54%
Positive months	92.16%	84.31%

ANNUAL RETURNS SINCE INCEPTION

	Fund	Benchmark	Active Return
2004	11.88%	10.17%	1.71%
2003	18.09%	15.02%	3.07%
2002	9.58%	11.50%	-1.92%
2001	13.98%	4.34%	9.64%

CUMULATIVE PERFORMANCE SINCE INCEPTION



INCOME DISTRIBUTIONS

Declaration	Payment	Amount	Dividend	Interest
30/09/2005	01/10/2005	15.04	0.04	15.00
30/06/2005	01/07/2005	20.23	0.30	19.93
31/03/2005	01/04/2005	21.11	0.00	21.11
31/12/2004	01/01/2005	19.97	0.00	19.97

PERFORMANCE RETURNS

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	YTD
Fund 2005	0.70%	0.92%	0.26%	0.88%	1.16%	0.76%	0.48%	0.73%	0.68%				6.76%
B'mark 2005	0.34%	0.96%	-1.05%	1.69%	0.41%	1.25%	0.75%	0.31%	0.18%				4.91%
Fund 2004	-0.28%	0.97%	0.71%	0.51%	0.68%	0.65%	1.54%	2.18%	0.78%	0.77%	1.52%	1.27%	11.88%
B'mark 2004	0.17%	0.70%	0.48%	0.18%	0.59%	0.93%	1.52%	2.02%	0.62%	0.77%	0.85%	0.89%	10.17%