

The fund had a very strong final quarter, returning 12.2% against the benchmark return of 8.5%. For the 12 month period to 31 December 2006 it returned 30.5%, outperforming its benchmark by 0.6%. Over a rolling three year period, the fund has returned 32.5% per annum compared to 29.3% per annum from the benchmark. Bull markets are usually not kind to long-term, valuation-driven investors and we are greatly encouraged by the alpha we have achieved in an environment where a 'rising tide has lifted all boats'.

These pleasing calendar-year returns mask a year of abnormally high volatility. 2006 was a year of abnormally high volatility. Emerging markets, the rand and domestic interest rate-sensitive assets experienced a dramatic sell-off in the middle of the year. For long-term investors, periods of uncertainty often provide fantastic long term investment opportunities. This was the case in May/June, and our strong performance in the final quarter of the year was very much due to the asset allocation and stock selection decisions taken in that period.

The last few years have been a once-in-a-lifetime wealth creation opportunity for South Africans. In just under four years the market has increased 2.9 times in real terms. This compares favourably to the 2.9 times increase over 3 years in the late 1970s and the 4.5 times increase over 8 years in the 1960s. The returns in this cycle, however, are of a much higher quality than in previous bull markets. The bull market of the late 1960s was a global phenomenon and a large part of the returns came from rating expansion. In May 1969 the JSE peaked at 25 times earnings and over the subsequent two and a half years the market declined by 65%, giving up 80% of its gains. Investors had to wait till 1987 for the market to reach the same level as its 1969 peak (in real terms). The bull market of the late 1970s was driven by a commodity run, which saw the gold price peak at \$850 in January 1980. In the following two years the market declined by 50%, with investors in this cycle giving up 75% of their earlier gains.

History has clearly not dealt kindly with extended bull markets and periods of euphoria, and we are painfully aware of this in our asset allocation and stock selection process. Developed Market equities are our preferred asset class. Capital has poured into emerging markets leaving blue-chip shares in the US, Europe and Japan trading at ratings not seen since the early 1990s. Notwithstanding the extraordinary returns of the last few years, domestic equities remain our preferred domestic asset class. We do not believe that the market is overextended, as it clearly was in 1969 and 1980, for the following reasons:

- Ratings are still undemanding, with South African stocks trading at significant discounts to their emerging Market peers and the JSE trading at a historically undemanding 11.8 forward p:e and 3.5% dividend yield.
- While earnings are high, much of the re-basing of earnings has come from sound macro-management of the economy and the underpin of an emerging middle class.
- While we expect low returns from commodity stocks in general, there is select value in the sector (which represents 40% of the market compared to a hefty 69% in early 1980).

From a global perspective, we expect a benign economic environment, with the greatest risk probably being complacency and investors' appetite for risk. Growth continues to moderate in the US, as consumer spending slows in the face of a soft housing market. Although we expect at least another year of sub-trend growth, we are not overly bearish. The US economy is very efficient, it 'takes its medicine' early and we therefore expect it to achieve some kind of a soft landing. We expect slower growth in the US to be offset by continued strength in Asia and Europe – this is part of a much-needed global rebalancing process.

The domestic economy continues to surprise. We believe the economy is a lot more robust and internationally competitive than it was in the 1980s and 1990s and believe that it will continue to take the tightening cycle "in its stride". Inflation is showing signs of abating, but consumer spending has been strong and we expect a further rate hike to help cool the economy down.

Looking at the underlying sectors, Resources lagged the market materially for the second quarter in a row. The signs of a maturing commodity cycle, which we referred to in last quarter's commentary, became increasingly clear in the final quarter. We continue to find good value in Impala and Sasol. In both these commodities we expect the long term supply response to high prices to be more muted than in the bulks and base metals. Within Industrials we increased our position in Netcare. The acquisition of GHG, the largest private hospital group in the UK, is a very bold move not without risk. But we believe that significant value can be added to the business and that de-leveraging the balance sheet will create a lot of value for shareholders over the next 3 to 5 years. We took some profits in the interest rate sensitive industrial and financial shares we had acquired in the third quarter after very strong price recoveries.

Bonds had a strong final quarter, as the market became more comfortable with the tightening cycle and started to 'look through' the near-term increase in inflation. For the year however, bonds still underperformed both cash and inflation-linked bonds. After strong rallies, we took profits in the bonds and property stocks that we had bought in the mid-year sell-off.

Louis Stassen and Karl Leinberger
Portfolio Managers

Fund category	Domestic Asset Allocation Prudential Medium Equity
Launch date	15 April 1996
Portfolio manager	Louis Stassen and Karl Leinberger
Fund size	R1.7 billion
NAV	4216.45 cents
Annual management fee	1.25% (ex VAT)

Benchmark	Composite benchmark (63% equity, 22% bonds, 10% international, 5% cash)
Fund description	A fully managed investment solution diversified across the various asset classes and sectors. Its asset allocation is compliant with Regulation 28 of the Pension Funds Act.

EFFECTIVE ASSET ALLOCATION EXPOSURE

Sector	31 Dec 2006
Domestic Assets	85.67%
Equity	63.15%
Oil & Gas	4.30%
Basic Materials	14.07%
Industrials	2.62%
Consumer Goods	5.86%
Healthcare	2.07%
Consumer Services	17.13%
Telecommunications	3.96%
Financials	11.64%
Technology	0.09%
Derivatives	1.41%
Real Estate	4.14%
Fixed Interest	7.91%
Cash	10.47%
International Assets	14.33%
Equity	11.13%
Fixed Interest	0.73%
Cash	2.47%

TOP 10 HOLDINGS

As at 31 December 2006	% of Fund
Coronation Global Equity Fund of Funds	9.18%
Standard Bank Group	5.57%
Naspers Ltd – N ordinary shares	5.43%
Impala Platinum Holdings Ltd	4.84%
Sasol Ltd	4.30%
Woolworths Ltd	3.32%
MTN Group Ltd	2.97%
ABSA Group Ltd	2.81%
BHP Billiton Plc	2.80%
Liberty International Plc	2.27%
Total	43.49%

INCOME DISTRIBUTIONS

Declaration	Payment	Amount	Dividend	Interest
30/09/2006	01/10/2006	52.00	36.21	15.79
31/03/2006	01/04/2006	43.76	32.20	11.56
30/09/2005	01/10/2005	47.16	35.29	11.87
31/03/2005	01/04/2005	25.23	10.35	14.88

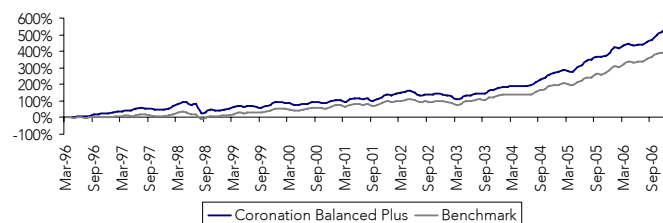
MONTHLY PERFORMANCE RETURNS

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Fund 2006	6.22%	-1.10%	4.06%	2.13%	-2.12%	1.13%	-1.02%	3.61%	2.60%	4.83%	2.98%	3.93%
B'mark 2006	6.13%	-1.74%	4.68%	2.99%	-0.95%	1.79%	-0.83%	3.96%	2.61%	3.38%	2.00%	2.89%
Fund 2005	1.24%	2.58%	-0.24%	-2.07%	7.22%	2.58%	6.69%	1.94%	3.79%	-0.60%	2.09%	5.61%
B'mark 2005	0.93%	3.32%	-1.66%	-3.10%	7.40%	2.48%	4.97%	1.21%	6.38%	-1.04%	1.86%	5.61%

PERFORMANCE AND RISK STATISTICS

	Fund	Benchmark
Year to date	30.48%	29.90%
Latest 12 months	30.48%	29.90%
Latest 36 months (annualised)	32.55%	29.28%
Latest 60 months (annualised)	22.41%	20.53%
Since inception (annualised)	19.14%	16.38%
Annual deviation since inception	16.39%	14.71%
Sharpe ratio	0.41	0.28
Maximum gain	57.74%	29.32%
Maximum drawdown	-29.84%	-23.24%
Positive months	68.22%	64.34%

CUMULATIVE PERFORMANCE SINCE INCEPTION



ANNUAL RETURNS SINCE INCEPTION

	Fund	Benchmark	Active Return
2005	35.00%	31.59%	3.41%
2004	32.01%	26.41%	5.61%
2003	17.68%	18.15%	-0.47%
2002	0.26%	-0.37%	0.63%
2001	20.28%	21.48%	-1.20%
2000	1.15%	5.30%	-4.15%
1999	36.68%	46.67%	-9.99%
1998	-1.51%	-3.15%	1.64%
1997	17.85%	7.21%	10.64%