

After recording losses in Q2, bonds rebounded somewhat to show a positive performance in Q3. The 1 – 3 year bond index returned 1.6%, just underperforming cash of 1.9%. The All Bond Index returned 2.1% for the month, aided by longer-dated bonds which produced better returns than shorter-dated ones.

Bond market performance was perhaps surprising, given that we entered the quarter just following the first interest rate hike for the cycle in June, and ended it amid a volatile and much weaker rand. Even as expectations cemented around further rate rises – and despite a poor performance by the rand – longer dated bond yields generally moved in a sideways range over the quarter.

It was unusual for the longer-dated bond yields to not have responded more negatively, especially with notable rand depreciation. However, a possible explanation may be that in late June after the first repo rate hike, bond yields broke a lot higher and stayed there – pointedly ignoring the currency appreciation seen in July and August. It thus seems feasible that the reason that longer-dated bonds largely ignored the weakening in the rand during September was that they had effectively already discounted it.

It also appears that central bank credibility was established through the 50 basis point rate hikes in June and September. The bond market appears to have confidence that the SARB will respond appropriately to ensure that any inflationary impact of the rand's weakness will be short-lived. With the depreciation in the rand so far this year (it is currently down around 25% on a trade-weighted basis) together with the interest rate rises that we have seen so far with more to come, it is a matter of time before the worrying current account deficit starts to correct.

The international backdrop remains of critical importance too. The rand's reaction to the news of the current account deficit should be seen in the context of jitters in emerging market currencies – especially those of countries with high current account deficits. Furthermore, the restraint in local bond yields, would probably not have been possible had both US Treasury yields and emerging market bond spreads (as measured by the EMBI) not have remained at relatively low levels during the quarter.

Money market rates on the other hand rose to levels of around 9.5% this quarter, which offers good value versus other asset classes permissible in the Strategic Income Fund. Hence we continue to invest in the 1 to 2 year area of the curve, largely using tradeable fixed rate NCD's which pay regular interest and are issued by the top four banks.

The Strategic Income Fund asset allocation has remained largely unchanged for the quarter due to most market movement having taken place during June. That follows through too to the property stocks which were bought after the sector sold off dramatically. We continue to hold these, expecting better returns than cash over the next 3 years.

**Mark le Roux and Tania Miglietta**  
Portfolio Managers

Fund category	Domestic Fixed Interest Varied Specialist
Launch date	2 July 2001
Portfolio manager	Mark le Roux and Tania Miglietta
Fund size	R3.3 billion
NAV	1271.72 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 2006
<b>Domestic Assets</b>	<b>100.0%</b>
Cash/Money Market	48.2%
Bonds	36.9%
Listed Property	8.7%
Preference Shares	2.3%
Other investments*	3.9%
<b>International Assets</b>	<b>0.0%</b>

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

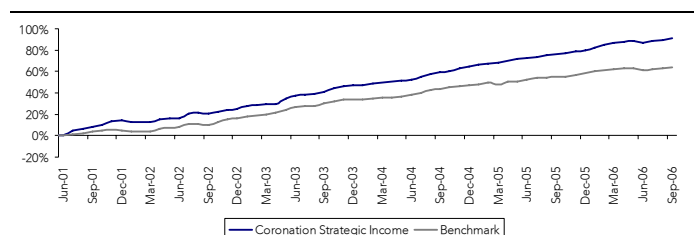
## PERFORMANCE AND RISK STATISTICS

	Fund	Benchmark
Year to date	6.02%	3.23%
Latest 12 months	9.10%	5.97%
Latest 36 months (annualised)	10.88%	7.86%
Latest 60 months (annualised)	12.16%	9.63%
Since inception (annualised)	13.25%	9.87%
Annual deviation since inception	3.63%	2.86%
Sharpe ratio	0.99	0.07
Maximum gain	29.19%	15.89%
Maximum drawdown	-1.05%	-1.54%
Positive months	92.06%	85.71%

## ANNUAL RETURNS SINCE INCEPTION

	Fund	Benchmark	Active Return
2005	9.85%	7.70%	2.16%
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
30/09/2006	01/10/2006	20.18	-	20.18
30/06/2006	01/07/2006	16.06	0.21	15.85
31/03/2006	01/04/2006	21.54	2.57	18.97
31/12/2005	01/01/2006	18.44	0.50	17.94

## MONTHLY PERFORMANCE RETURNS

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
Fund 2006	1.17%	1.61%	0.87%	0.66%	0.42%	-1.05%	0.73%	0.78%	0.70%			
B'mark 2006	0.74%	0.74%	0.35%	0.73%	0.09%	-1.09%	0.60%	0.38%	0.66%			
Fund 2005	0.70%	0.92%	0.26%	0.88%	1.16%	0.76%	0.48%	0.73%	0.68%	0.65%	0.87%	1.35%
B'mark 2005	0.34%	0.96%	-1.05%	1.69%	0.41%	1.25%	0.75%	0.31%	0.18%	0.24%	1.40%	0.99%