OLD MUTUAL MULTI-MANAGERS
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Dear Clients, Consultants and Administrators

INFLATION LINKED BOND MANDATE – CHANGES

In actively managing the investment strategies, our objective at Old Mutual Multi-Managers is to ensure that each strategy has the highest probability of achieving its targeted return at an appropriate level of risk. We continue as always, to closely monitor the strategies and make the necessary changes to ensure that we achieve each strategy's objective. This note details the changes we have made to our inflation linked bond (ILB) mandate. Implemented changes are effective 1 March 2019.

Our approach to managing fixed income

Old Mutual Multi-Managers' approach to managing fixed income has been to give asset managers flexibility in managing interest rate risk (duration risk) across the yield curve. The higher the duration the more sensitive bond prices are to movements in interest rates. We expect our managers to use their expertise to manage this risk. For our flexible fixed income mandate our managers (Coronation and Prudential) are expected to buy bonds when they are cheap and to move into cash when bonds are expensive. This is clearly a difficult mandate to 'beat' and we thus give our managers a longer-term horizon in which to achieve this dual target, measuring their performance over rolling three-year periods.

The ILB mandate is similar in that it aims to achieve a return, which is higher than that of inflation linked bonds and cash over rolling three-year periods. The mandate has a bias toward capital protection with a long-term real return expectation of between 1% and 1.5% per annum. At Old Mutual Multi-Managers, we constantly interrogate our assumptions, so that the mandated objectives set for managers are achievable over reasonable periods.

The two ILB mandates have been managed by Prudential Investment Managers and Prescient Investment Managers. While the current ILB mandate allows the manager to move between cash and ILBs, lack of liquidity in trading ILBs has meant that this has not been practical or possible. The flexibility to manage such a mandate has therefore been limited, thereby constraining our managers' ability to take advantage of valuation changes in ILBs and to fully express conviction in this asset class versus cash.

Change to be made

Given the constraints of illiquidity and interest rate risk in trying to achieve the mandate objective, we have decided to terminate the ILB mandates and merge these into the flexible fixed income (FFI) mandate described earlier. This mandate is broad allowing investment in a wide array of fixed income instruments such as ILBs, credit, various short dated instruments and nominal bonds. The objective of the FFI mandate is to outperform the 'better of bonds or cash' over rolling three-year periods with a long-term real return expectation of approximately 2% per annum. Liquidity in the nominal[1] bond market is considerably higher than that of the ILB market (on average 16 times higher

[1] Predominantly government bonds which make up a large allocation in the FFI mandate

based on monthly trading volumes). More importantly, given the flexibility of the FFI mandate, our managers have been able to achieve the mandate objectives with less risk than the All Bond Index.

Prescient Investment Managers has been introduced as a third manager to our flexible fixed income building block. They will manage the assets that were previously in the ILB mandates managed by Prescient and Prudential and that have now been converted into the FFI mandate. We detail reasons for our allocation to Prescient later in this note.

Implications for lower return strategies

We have given considerable thought to our fixed income allocation in the lower return targeted strategies. For these funds, which had a material exposure to ILBs, we have re-allocated a portion of this investment to our Enhanced Income fund. The objectives of the Enhanced Income fund is to maximise income with due consideration to capital preservation and to outperform the benchmark (STeFI 3 month). Current real money market and short-dated bonds currently offer similar (and generally higher) real returns relative to what we expected from ILBs over the long term. We are therefore getting a return from the Enhanced Income building blocks, which is similar to that of ILBs *albeit* at much lower volatility. On a risk-adjusted basis, this is in the best interests of clients and aligns to the real return targets on strategies such as the Old Mutual Multi-Managers Inflation Plus 1-3% Strategy and SIS Inflation Plus 1-3% Strategies.

Prescient Investment Management

Effective March 2019, we have introduced Prescient Investment Management ('Prescient') as a third FFI manager in the strategies. We have had a long relationship with Prescient who manage a money market mandate for Old Mutual Multi-Managers and until this change in mandate, managed the inflation linked bond mandate discussed above. Our selection of fixed income managers is premised on their ability to add value through asset allocation, manage interest rate risk and liquidity risk, while also focusing on capital protection. This should be underpinned by an experienced and well-resourced team with a demonstrable track record and an entrenched credit process and philosophy.

We are confident that Prescient comfortably meet our requirements above. Prescient have a valuation investment philosophy with the primary objective to maximise real returns and minimise downside risk. Their philosophy and process aims to position portfolios for optimal upside in positive markets while minimizing loss in negative markets. Prescient have over the years demonstrated their relentless focus on downside risk management and capital protection. They are innovative in their use of derivatives, swaps and futures to manage the fund more efficiently with a conservative bias.

Fee impact

There is no fee impact resulting from this change.

Summary of changes made

- Prudential and Prescient ILB mandates have been terminated.
- Proceeds of this termination have moved into the flexible fixed income mandate and some into the enhanced income mandate.
- Prescient have been appointed as third manager within our flexible fixed income mandate.

We are confident that the combination of our fixed income managers, Coronation, Prudential and Prescient allows for diversification and that their robust investment processes and respective philosophies are consistent with that of the Old Mutual Multi-Managers.

As always, should you have any questions in this regard, please do not hesitate to contact us.

Kind Regards

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